RESTRICTED

WORLD TRADE ORGANIZATION

WT/WGTCP/W/36

7 November 1997

(97-4872)

Working Group on the Interaction between Trade and Competition Policy

Original: Spanish

COMMUNICATION FROM PERU

The following communication has been received from the Permanent Mission of Peru with the request that it be circulated to Members.

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THE NEW COMPETITION AND TRADE FRAMEWORK IN PERU

Introduction

1. Background to the competition and trade regime

    1.1 The process of economic stabilization from 1990
    1.2 The process of structural reform
    1.3 Trade reform
    1.4 The new competition framework

2. Interrelationship between trade and competition policies

    2.1 Negative effects of discrepancies between competition policies and multilateral trade rules
    2.2 Anti-competitive practices involving enterprises in two or more countries

3. The general framework of competition and trade policies

    3.1 The new competition framework

        3.1.1 The framework of Legislative Decree No. 701

            A. Abuse of dominant position
            B. Practices restricting free competition

        3.1.2 Economic concentration

    3.2 The new trade policy framework

4. Implications for discussion of the issue of competition within the World Trade Organization

    4.1 Need for an integrated approach to the treatment of trade and competition issues in the case of developing countries

Introduction

The purpose of this paper is to present the new Peruvian regulatory framework in the field of competition and trade and, at the same time, to put forward some important ideas for the analysis of competition and its relationship with trade policies. The first section provides background on the main features of the competition policy implemented in Peru in recent years. The second section explains the interrelationship between trade policies and competition, while the third section describes the current competition and trade environment in Peru. Finally, reference is made to some of the implications of this issue for discussions within the World Trade Organization (WTO).

1. Background information on the competition and external trade regime

1.1 The stabilization process from 1990

At the beginning of this decade, the Peruvian Government undertook a strict programme of economic stabilization directed at reducing inflation, recovering control of the money supply and restore fiscal balance. On the basis of a conservative fiscal and monetary policy, the Government has succeeded over the last six years in reducing inflation from 7,600 per cent to 9 per cent in 1996. The budget deficit dropped from 6.5 per cent of GDP in 1990 to 1.1 per cent in 1996, thanks to a significant improvement in tax collection and a disciplined expenditure policy. It is important to point out that, in this area, the criteria laid down in the framework of the programme with the International Monetary Fund (IMF), between 1991 and 1996, have been fully complied with.

1.2 The process of structural reform

Side by side with the stabilization programme, the Government initiated a broad programme of structural reform, with the aim of laying the foundations of a market economy. Thus, the early 1990s, saw a radical transformation of the regulatory and institutional framework for economic activity in Peru, with a redefinition of the relationship between the public and private sectors, and a revaluation of the market and competition as essential elements for the efficient allocation of resources within the economy.

In the context of the reform process, changes were made to the overall framework of economic activity. In particular, a new law on private investment was adopted, changes were made in the regulatory framework for foreign investment and rules for protecting the market were introduced. At the same time, the State's role in the economy was redefined, and a far-reaching programme of privatization of public enterprises was initiated, providing private sector access to the provision of public services which until then had been the preserve of the State.

Lastly, the reform process covered a series of specific areas, such as foreign trade, the financial market, the labour market, productive sectors (agriculture, fisheries, mining and hydrocarbons) and public services and infrastructure. As regards trade[1], tariff and para-tariff reforms were carried out,

[1]The reform process is analysed in greater detail in the following section.

simultaneously with an overhaul of the customs regime. As far as the financial market is concerned, the regime governing the operations of financial and insurance institutions was liberalized, interest rate controls were scrapped, the State development banks were wound up and the law on the stock market was overhauled. With regard to the labour market, the rules on labour stability and participation were made more flexible, a compensation system based on time in service was introduced, and the social security system was reformed. With respect to the provisions governing production sectors and specific services, ownership rules were made more flexible, affording access and equality of treatment for private and foreign investors, and a range of bureaucratic regulations and red tape which had limited their efficiency were eliminated.

1.3 Trade reform

Trade reform is one of the pillars of the structural reform process on which Peru bases its model of economic growth and development. The aim was to put an end to protectionist policies implemented during past decades, while at the same time introducing a development model based on a market economy and the exploitation of the country's competitive advantages.

The reform was divided into three parts: tariff reform, non-tariff trade deregulation and reform of the customs regime.

(i) Tariff reform

Up to July 1990, the tariff regime was made up of 39 *ad valorem* rates (between 15 and 84 per cent) and 14 surcharges (between zero and 24 per cent), resulting in a total of 56 rates (between 15 and 108 per cent). In October 1990, the Government established three *ad valorem* tariff rates: 15, 25 and 50 per cent, together with a temporary surcharge of 10 per cent on imports subject to the two highest rates. Subsequently, in March 1991, the tariff regime was amended and the number of *ad valorem* rates was reduced to two: 15 and 25 per cent. The higher rate is applied mainly to consumer goods, the lower one to inputs and capital equipment, accounting for 97 per cent of imports.

In 1997, the tariff average was lowered to 13.6 per cent, maintaining a structure of two rates: 12 per cent and 20 per cent. A few agricultural products (roughly 20) are subject to a 5 per cent surcharge.

It is important to mention that, side by side with this process of unilateral tariff liberalization, Peru has undertaken a series of tariff commitments within the framework of the bilateral and regional agreements to which it is a party. These aspects will be discussed below.

(ii) Non-tariff trade deregulation

Numerous restrictions created obstacles to foreign trade during past decades. A range of certificates, authorizations and other forms of control served in practice to impede or restrict access to the Peruvian market for certain products. Some of these barriers were lifted during the second half of 1990, when all quantitative barriers were eliminated. The process culminated in March 1991, when successive rules discontinued or eased specific restrictions which had remained in force.

The Law on Foreign Trade (DL 668), which provides for a set of guarantees and general principles to guide economic activity towards an open market economy, consolidated

the elimination of all non-tariff measures and established a mechanism to control the issuance of new regulations which impair freedom of trade.

(iii) Reorganization of the customs regime

Within the process of trade reform, a new customs law was adopted, a reorganization of the customs was initiated, with the establishment of the National Customs Administration (Aduanas), and the import inspection system was introduced (DL 659).

(iv) Anti-dumping and countervailing duty rules

With the aim of protecting domestic producers from unfair practices which distort competition in international trade, the Government established protection mechanisms against dumping and export subsidies by setting up the Dumping and Subsidies Commission. It should be pointed out that the national rules aimed at preventing or forestalling dumping or export subsidies on the Peruvian market are in keeping with WTO requirements.

1.4 The new competition framework

The new conception of the State's role in respect of the economy and markets has called for the creation of institutions and mechanisms to promote their efficient operation. For example, a set of bodies has been established for the purpose of promoting market efficiency and protecting consumer rights, including the following in particular:

(i) The National Institute for the Defence of Competition and the Protection of Intellectual Property (INDECOPI), a body set up in 1992 for the purpose of establishing competition regulations and protecting intellectual property rights.

(ii) The Private Concessions Commission (Promcepri). There have been two distinct stages in the process of redefinition of the State's role in the economy. During the first stage, as mentioned above, a wide-ranging programme of privatization was initiated. In the second stage, priority has been given to promoting private investment in the construction and operation of public infrastructure works and public services. It was for this purpose that Promcepri was established, a body entrusted with promoting private sector concessions for public infrastructure works and public services that are financially viable, thus enabling the State to concentrate its resources on the implementation of public works and infrastructure projects which produce a lower financial return but are socially necessary and have a greater impact on the low-income sectors. On the basis of the system of concessions, Promcepri, through a set of special committees, promotes private sector participation in the implementation and/or administration of these projects.

(iii) Other. The need for bodies capable of guaranteeing the efficient allocation of resources in sectors having the characteristics of a natural monopoly or requiring highly specialized regulation justified the establishment of a number of sectoral regulatory entities in addition to INDECOPI. This was the case for Osinerg (Supervisory Body for Investment in Energy), Sunass (National Sanitation Services Administration) and Osiptel (Supervisory Body for Investment in Telecommunications).

2. The interrelationship between competition policies and multilateral trade rules

The world trade agenda includes measures to lower tariff and non-tariff trade barriers, together with measures to liberalize investment flows among countries. The main risk in this process is that the distortions caused by government policies may be replaced by distortions due to the behaviour of private firms with a dominant market position. In this connection, it is important to consider the degree of complementarity that is required between trade and competition policies in the processes of trade liberalization and integration.

2.1 Negative effects of discrepancies between competition policies and multilateral trade rules

The current divergence or lack of national competition policies among countries, or the lack of a multilateral agreement on the subject, combined with the prevalence of multilateral rules on international trade, gives rise to a range of contradictory situations, especially as regards the treatment of competition issues in the tradeable sectors of the economy. Table 1 shows how companies may be subject to different types of regulation in respect of competition policies (CPs) and multilateral trade rules (MTRs), depending on the nature of their inputs and end products. Differences in the treatment of competition issues at the level of international trade and in domestic markets (for both tradeable and non-tradeable goods) may have distorting effects, inasmuch as MTRs remain substantially incompatible with CPs. For example, in countries where the competition framework is weak or non-existent but MTRs are observed, predatory or discriminatory practices by domestic companies will not be penalized, while those of companies exporting to that market will be. Similarly, the decision by a firm to source inputs from the domestic or the world market may be influenced by discrepancies between national CPs and MTRs. Such contradictions not only entail discriminatory treatment between companies competing in the same market, but also provide incentives for firms to take decisions or adopt forms of conduct that are undesirable from the social welfare standpoint.

As is shown by Table 1, this type of problem arises when part of a company's output or some of its inputs are tradeable goods. The relevant market for such goods is by definition the world market, although the way in which the competition issue is handled differs according to whether the companies concerned import or export end products or inputs.

The advantage of placing greater emphasis on the analytical components of competition in this context is that it provides a more complete overview of the market in which the practices under investigation are carried out. Concepts such as the relevant market, in terms of the product and geographical factors, make it easier to define the elements of supply and demand and the consumer interests at stake in the market, thereby complementing the analysis of MTRs. Accordingly, the type of transaction involved (foreign or domestic trade) or the geographic location of the producer or applicant company is less reliable than competition analysis as a means of studying the behaviour concerned, in accordance with the particular characteristics of the markets for goods or products.

Attention should be drawn to the fact that, from the consumer's point of view, the existing discrepancies have serious repercussions. Indeed, the greater those discrepancies, the higher the risk of anti-competitive practices, losses in terms of social efficiency and reduction of consumer surplus. Divergencies between CPs and MTRs raise prices and lower the levels of production.

2.2 Anti-competitive practices involving enterprises in two or more countries

As the flow of trade among countries increases, the question arises as to how to deal with the development of anti-competitive practices involving enterprises from two or more countries. In this connection, competition policies normally relate to national spheres of activity and do not affect private anti-competitive practices, such as mergers or export cartels, which have an impact on other trading

partners. In such cases, it is advisable to look into the possibility of cooperation schemes among countries in respect of information exchange or coordination mechanisms, in order to facilitate the efficient application of CPs and MTRs when business practices taking place in more than two countries become an issue. Other possible alternatives to be considered, according to the type of commercial integration scheme concerned, are dispute settlement mechanisms, harmonization of rules or procedures, or definitions of judicial responsibilities.

3. The general framework of competition and trade policies in Peru

This section will set out the main features of Peru's competition and foreign trade policies.

3.1 The new competition framework

The National Institute for the Defence of Competition and the Protection of Intellectual Property (Indecopi) was set up in November 1992 under Decree Law 25868. This entity was granted a wide range of powers, albeit for a common purpose, namely that of supervising competition in the various markets. The main tasks of Indecopi are the following:

- To promote and foster free competition;
- to promote adequate participation by the economic agents in the market place;
- to encourage fair and honest competition between suppliers of goods and services;
- to ensure respect for freedom of competition in international trade;
- to lower the costs of entering and exiting the market;
- to approve technical and metrological standards;
- to protect and register all forms of intellectual property: distinctive signs (marks), copyright and patents.

3.1.1 The framework of Legislative Decree No. 701

The Law on the Elimination of Monopolistic, Regulatory and Restrictive Practices in respect of Free Competition (DL 701) is designed to eliminate monopolistic practices, controls and restrictions on free competition in the production and marketing of goods and the provision of services, enabling free private enterprise to develop for the greater benefit of users and consumers. Its scope extends to all transactions relating to goods and services within the national territory, regardless of whether the source of anti-competitive conduct is within or outside the country. It also extends to all public or private-law natural or legal persons who engage in economic activity, including persons responsible for representing and managing firms, to the extent that they participate in the decision to engage in prohibited acts.

Legislative Decree No. 701 prohibits all practices which limit, restrict or distort free competition or which involve abuse of market dominance. At the same time, the Political Constitution of 1993 calls for the State to combat any practice which restricts freedom of competition or involves abuse of a dominant position.

A. Abuse of dominant position

"Dominant position" means a situation where one or more firms may act independently, disregarding their competitors, buyers, clients or suppliers, owing to factors such as significant market share, supply and demand characteristics, the technological development or services involved, access of competitors to finance, etc. (Article 4 of Legislative Decree No. 701).

The forms of abuse expressly envisaged are the following:

(a) Unjustified refusal to satisfy requests to buy or acquire, or offers to sell or provide products or services;

(b) the application of unequal conditions for equivalent commercial services, placing some competitors at a disadvantage *vis-à-vis* others;

(c) making the conclusion of contracts conditional upon acceptance of supplementary services which, by their nature or by virtue of trade custom, bear no relation to the purpose of such contracts;

(d) measures of equivalent effect.

There is no provision for specific exceptions at the present time. It is, however, acknowledged that cases of abuse of dominant position should be considered in the light of the "rule of reason" as well as certain forms of restrictive practices.

B. Practices restricting free competition

Practices restricting free competition, the modalities of which are set out in Article 6 of Legislative Decree No. 701, take the form of agreements, decisions, recommendations, parallel actions or concerted practices among firms which produce or might produce the effect of restricting, hampering or distorting free trade.

The express criteria are the following:

(a) Concerted fixing of prices or other conditions of trade or service between direct or indirect competitors;

(b) market sharing or sharing of sources of supply;

(c) sharing of production quotas;

(d) coordination of product quality, where the latter does not satisfy national or international technical standards and has a negative impact on the consumer;

(e) the application of unequal conditions for equivalent commercial services, which place some competitors at a disadvantage in relation to others;

(f) making the conclusion of contracts conditional upon acceptance of supplementary services which, by their nature or by virtue of trade custom, bear no relation to the purpose of such contracts;

(g) The concerted and unjustified refusal to satisfy requests to buy or acquire, or offers to sell or provide, products or services;

(h) the concerted limitation or control of production, technical development or investment;

(i) the establishment, harmonization or coordination of offers or refusal to present offers in public tendering procedures, competitions or public auctions;

(j) actions of equivalent effect.

See Annex I on procedures, penalty systems and remedies.

3.1.2 Economic concentration

As is clear from a reading of Legislative Decree No. 701, it is not dominance in itself that is punishable in Peru but the abuse of a dominant position. This entails, among other things, the *ex post facto* regulation and penalization of practices involving abuse of a dominant position or restricting free competition. In this sense, the competition policy applicable in Peru regulates and penalizes certain market practices and not market structures.

This approach is based on the following main considerations:

(i) *Contestability of markets*. The idea that the configuration of a market depends to a crucial extent on barriers to entry and exit. In particular, the elimination of "sunk costs" and of barriers to access may promote competition more efficiently than the control of mergers.

(ii) *Smaller economies of scale in small markets*. In the case of non-tradeable products intended for relatively small markets, the control of mergers may inhibit the best use of more far-reaching economies of scale and limit possible efficiency gains from such mergers.

Consequently, economic concentrations are not regulated in Peru, except in the electric power sector. Moreover, as was mentioned earlier, the public service and telecommunication sectors have specialized regulatory bodies.

3.2 The new trade policy framework

Up to the end of the 1980s, trade policy objectives formed part of the framework of an inward-looking growth model. As from 1990, the Government undertook a sweeping reform of trade policy, liberalizing trade through the simplification, reduction and elimination of internal measures which hampered the efficient allocation of resources. Within this new context, national trade policy is geared to international economic reintegration and making the best use of the advantages of specialization in a competitive environment.

In order to ensure the achievement of these objectives, it was proposed to eliminate the anti-export bias of tariff policy while applying measures to promote the mobility of factors of production and encourage foreign investment.

Peruvian trade policy aims to achieve the highest possible degree of neutrality with regard to the different sectors, leaving market forces to determine how economic activities develop. Apart from the extra protection given to certain agricultural products, there are no incentives to production in specific sectors.

The Peruvian Government considers its policy of commercial and financial integration to be a key part of the process of international reintegration of the Peruvian economy. Accordingly, Peru has been taking an active part in the work of multilateral and regional trade bodies.

Multilateral trading system

Peru acceded to the GATT in 1951 and has been an active participant in that forum ever since. During the Uruguay Round negotiations it submitted various specific proposals in the different negotiating groups, either individually or jointly with other Latin American and developing countries. Peru's offer in the sphere of market access includes the binding of its entire tariff at a maximum level of 30 per cent, except in the case of certain agricultural products which have been bound at a higher level.

Peru is a founder Member of the WTO and fully applies the commitments and provisions adopted within this multilateral trading system.

Other trade agreements

Peru is also a party to various regional trade agreements. In the first place, Peru is a member of the Latin American Integration Association (LAIA), established in 1980 by the Treaty of Montevideo, and since then has signed a series of bilateral partial-scope and economic complementarity agreements within the framework of that Treaty. Secondly, Peru is a signatory to the Cartagena Agreement, under which the Andean Group - now known as the Andean Community - was set up. At the present time, Peru is actively participating in the trade liberalization programme and complies with the rules in force under the above-mentioned Agreement. Finally, Peru is involved in the trade negotiations being pursued within the framework of the Free Trade Area for the Americas (FTAA) and is participating in the negotiations within each of the latter's respective working groups.

4. Implications for discussion of the competition issue within the WTO

A preliminary review of Peru's experience of the harmonization of trade and competition policy objectives brings out a number of aspects that clearly need to be taken into account in the discussion of competition within the WTO. These issues relate to the need for a comprehensive approach to the treatment of both trade and competition, the particular experience of developing countries and the need to review integration experiences which have already covered this ground. These considerations should be based on any discussion of the possibility of coordinating trade and competition policies in a global framework, which aims at promoting a more competitive global environment.

4.1 Need for an integrated approach to the treatment of trade and competition issues in the case of developing countries

The progress of liberalization in the developing countries has sharpened competition in their economies but has also made them more vulnerable to unfair or anti-competitive practices in the field of international trade in goods and services.

In these circumstances, focusing on the implementation of competition policies may be the most efficient line of approach, serving to reduce the costs of access to the means of protection provided by law. The market-based approach of competition policies makes it possible to take account of different issues relating to trade practices (dumping or predatory pricing on an international scale, establishment of para-tariff barriers, sanitary or phytosanitary regulations, etc.), and to seek a solution which protects the interests of consumers and the validity of market principles.

Hence the importance of furthering discussion of these topics and seeking to identify ways to reduce the costs of access to protection from international anti-competitive practices and to protect conditions of market competition in the developing economies.

4.2 The particular experience of developing countries in the areas of trade and competition

The new competition patterns that are emerging in developing countries follow the Peruvian model in most cases. An effort is being made in these countries to entrust the new institutions with responsibilities which in more developed economies are handled by a variety of institutions applying different approaches and methodologies, which are not necessarily compatible with the overall aim of promoting conditions of competition in the market-place. In this connection, it is sufficient to compare the tradition of institutions for consumer protection or standards and quality certification systems with the more flexible and less costly schemes that are being put in place in less developed countries.

It is therefore not enough to review the approaches proposed in the more developed economies. The experience of developing countries may be more instructive in this regard and provide new perspectives on topics that have been the subject of wide-ranging discussion in more developed economies.

4.3 Review of integration experiences in the discussion of these issues

The complexity of the debate on the issues of multilateral trade and competition may hamper the search for lines of approach to future negotiations, particularly with regard to the results obtained during the Uruguay Round, which are in the process of implementation. An interesting perspective on this subject can be obtained by considering the regional integration programmes which have taken these issues into account and proposed solutions based on consensus between countries. In this connection, the experience of the European Community should be compared with regional integration programmes like that of MERCOSUR, the Andean Community and the Group of Three, and with hemispheric proposals like the one relating to the Free Trade Area for the Americas (FTAA). Hence the importance of considering regional experiences in the discussion of trade and competition at the multilateral level.

12 September 1997

ANNEX 1

Proceedings, Penalty System and Means of Appeal Under the Peruvian Competition Regime

1. Proceedings

Proceedings may be initiated ex officio by the Technical Secretariat or at the request of a party. Actions concerning infringements of Legislative Decree No. 701 shall be subject to prescription five (5) years after such infringements have been committed.

The Secretariat shall notify the alleged offender of the conduct under investigation, setting out the acts of which he is accused, if it considers that reasonable evidence exists of a violation of Legislative Decree No. 701. The time-limit for disputing the charges is 15 working days, and whatever evidence is considered necessary may be put forward; during this period, other parties with a legitimate interest may appear in the proceedings.

Within the time-limit for presenting a challenge, the party or parties complained against may offer an undertaking for the cessation or modification of the actions under investigation. This proposal shall be evaluated by the Secretariat and, if it deems appropriate, presented to the Commission with suggestions as to appropriate measures to ensure fulfilment of the undertaking. The Commission on Free Competition shall approve or reject the proposal.

The period for the presentation of evidence shall start to run, for a period of 30 working days, following expiry of the time-limit for challenging the complaint. Upon completion of the period for the presentation of evidence, the Technical Secretariat shall issue a report on all points of the complaint, with suggestions as to measures and penalties to be adopted, if appropriate.

The Commission on Free Competition shall have five working days to give a decision once it has received the report from the Secretariat. Commission decisions shall be appealable to the Competition Protection Division of the Court for the Defence of Competition and Intellectual Property.

Rulings issued by the above court may be challenged by judicial process (administrative proceedings) in the Civil Division of the Supreme Court of Justice. Decisions by this Division shall in turn be appealable to the Constitutional and Social Law Division of the Supreme Court.

2. System of penalties

Legislative Decree No. 701 expressly regulates only the financial penalties that may be imposed by the Commission on Free Competition, but this does not mean that these are the only penalties possible.

The amount of fines is determined in the light of:

- The pattern and scope of the prohibited conduct;
- the size of the market affected;
- the market share of the penalized enterprise;
- the effect of the prohibited conduct on actual or potential competitors, on other parties in the economic process, and on consumers or users;

- the duration of the restriction on competition;

- repetition of the prohibited conduct.

Supreme Decree No. 13-94-ITINCI (19 July 1994) lays down the scale of fines for violations of Legislative Decree No. 701, which are divided into two categories: serious and very serious. The maximum fine was equivalent to 50 fiscal tax units (Unidades Impositivas Tributarias - UIT).[2]

Legislative Decree No. 807 adjusted the scale of fines, introducing a higher maximum level equivalent to 1,000 UIT, provided that it does not exceed 10 per cent of the sales or gross income of the offender during the previous financial year, in the case of minor or serious offences. If the offence is very serious, the fine imposed may be higher than 1,000 UIT, provided that it does not exceed 10 per cent of the sales or gross income received by the offender in the previous financial year. Fines for repeat offences may be doubled by the Commission on Free Competition and increased on successive occasions without limit.

The Commission may also impose a fine of no less than ten and no more than 100 UIT in the event of failure to comply with the prudential measures ordered in the proceedings. In the event of persistent non-compliance, the Commission may impose a new fine which may be doubled successively and without limit until compliance with the prudential measure ordered is secured.

The Commission may also impose a fine of no less than one and no more than 50 UIT on anyone who provides false information, conceals, destroys or alters any book, register or document that has been required, or anyone who without justification fails to provide required information, refuses to appear or uses violent means or threats to impede or obstruct the performance of the Commission's duties. The fine may be doubled successively in the event of repetition.

The Commission on Free Competition may sentence anyone who has requested an investigation wilfully or on no valid grounds to pay personal costs generated by the proceedings.

Moreover, anyone who has been injured by the agreements, contracts or practices prohibited by Legislative Decree No. 701 may sue for damages in civil proceedings. The same action may be taken by anyone who has been falsely accused.

3. Remedies

The remedies available against decisions of the Commission on Free Competition are those set out in the single amended text of the Law on General Rules Governing Administrative Procedures, namely the following:

(a) An application for reconsideration, which shall be submitted to the Commission on Free Competition for the latter to reconsider its own decision. The cost of submitting such application shall be the equivalent of 0.05 UIT.

(b) An appeal, which shall be submitted to the Commission on Free Competition for referral to the Competition Protection Division of the Court for the Defence of Competition and Intellectual Property, which may modify all or part of the Commission's decision. The cost of submitting such appeal shall be the equivalent of 0.1 UIT.

[2]The fiscal tax unit (Unidad Impositiva Tributaria - UIT) is a reference amount fixed by the Ministry of the Economy and Finance to standardize and facilitate the application of tax rates and fines. It is currently also used by the administration as a reference amount. The current rate is set at S/.2,200 (two thousand two hundred nuevos soles). Selling exchange rate at 13 June 1996: S/.2.455 = US$1.00.

TABLE 1

Rules Governing Markets in Tradeable and Non-Tradeable Products

			Product		
			Tradeable		
			Products traded internationally	Products not traded internationally which are substitutes for those that are	Non-tradeable
Inputs	Tradeable	Products traded internationally	MTR	MTR/CP	MTR/CP
		Products not traded internationally which are substitutes for those that are	CP/MTR	CP	CP
	Non-tradeable		CP/MTR	CP	CP

CP: Competition Policies

MTR: Multilateral Trade Rules