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## **Global Forum on Competition**

### **COMPETITION AND COMMODITY PRICE VOLATILITY**

#### **Contribution from Mexico**

-- Session I --

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## COMPETITION AND COMMODITY PRICE VOLATILITY

-- Mexico --

### 1. Background

*1.1 In recent years has there been significant volatility in the prices of commodities that are important to general population in your country? Please briefly provide details (e.g., among others, on the product(s), market(s) and adjacent market(s) concerned and the magnitude and duration of this volatility, be it prices going up or down).*

1. In recent years, international corn (or maize) prices have been subject to a sharp upward trend as a result of several factors. In particular, the growing demand from the biofuel sector, adverse climatic conditions, and even fluctuations in the foreign exchange markets that have made international prices of this commodity to rise sharply. The corn price index for the period from December 2006 to December 2011 rose in 60.9%.

2. Price volatility of corn is particularly harmful for Mexican consumers since maize is a basic ingredient for a wide range of food products, mainly corn tortillas. The maize dough and maize tortillas are an integral part of the Mexican households' food consumption. In fact, in 1998, according to the ENIGH<sup>1</sup> 2008, households in the poorest decile spent 9% of their food expenditure in tortillas, compared with 6% spent by the average household. Therefore as maize, and hence tortilla's prices, increase the impact on poorest households' food security is significant.

3. Maize tortilla dough is made from maize dough (nixtamal), maize flour, or a mixture of both. The tortilla market is served by almost 65 thousand tortilla shops (tortillerías).

4. To meet the annual domestic demand of maize dough and maize tortilla, 8.7 million tons of corn grains are required.

5. Within this context, the Mexican Federal Competition Commission's (CFC or Commission) main concern is not directly related with price volatility or price increases but rather with the competition conditions in the markets of maize dough and maize tortilla. And the reason for this is simple: the absence of competition in these markets not only is likely to increase the aforementioned problems but also is likely to amplify their effects.

6. In the maize dough and tortilla markets, therefore, Commission has made use of its advocacy powers to promote policies that protect and encourage competition, without undermining its actions to investigate and sanction practices that violate the Federal Law of Economic Competition (FLEC).

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<sup>1</sup> National Survey of Households' Income/Spending (ENIGH for its acronym in Spanish).

1.2 *Are the price volatility in these commodities, and causes of that volatility, global, regional or domestic?*

7. The pass-through from international prices to México's domestic prices, to a great extent, is caused by the degree of substitution among varieties of maize. Thus, internal shocks in the prices of white maize are caused by external shocks in the prices of yellow maize. Furthermore, the domestic crop losses because of frost, drought and other adverse weather conditions intensify the upward trend in prices of white maize.

8. According to SAGARPA estimates, in the period from June 2010 to June 2011, the wholesale price of white maize increased 65%, affecting the price of tortillas, which increased 25%.

1.3 *Does your agency have any ongoing /pre-emptive monitoring activities in relation to these sensitive commodities? For example do you routinely monitor prices, quantities of behaviors in these markets?*

9. No. FLEC does not empower the CFC to perform such activities. PROFECO is responsible for carrying out surveillance activities related to industrial and maize tortilla dough and constantly monitor the prices of their products. PROFECO prevents abusive practices against consumers through the National Monitoring and Verification of Commodities Prices Program, designed on the basis of the National Information System and Market Integration of the Ministry of Economy.

## **2. Competition law enforcement and formal investigations**

2.1 *Please provide a brief overview of significant law enforcement matters that your agency has undertaken in relation to commodities including: i) Merger assessments , ii) Cartel and horizontal agreements, iii) Vertical restrictions, iv) Abuse of dominance, v) Any price control or other actions to regulate prices. Please explain how the matter came to the attention of the agency, the substance of allegation and the remedies imposed.*

10. As mentioned above, the Commission foremost concern is to prevent or eliminate competition problems in the maize and tortilla markets that may amplify the effects of exogenous factors (such as price volatility or increases in the international markets) that, to a great extent, are beyond their control.

11. Until the mid-1990s the maize dough and maize tortilla markets were subject to a wide range of instruments to promote supply and development of national distribution networks and control of prices for final consumers. During the second half of the 1990s price controls were eliminated to enable competition and reduce distortions that arose from price controls. In addition, trade barriers were reduced and several public companies dedicated to storage and distribution of maize were privatized.

12. Since markets liberalized, the Commission has been particularly active in the identification of anti-competitive practices to ensure that benefits of competition are delivered to consumers. The remaining part of this section describes the Commission's enforcement actions related to merger assessments, cartel and horizontal agreements, and abuse of dominance.

### *2.1.1 Merger assessments*

13. The FLEC prohibits mergers which objective or effect is to reduce, distort or hinder competition. The FLEC requires that the CFC, in assessing mergers, consider whether the merging parties would be allowed to unilaterally fix prices, substantially restrict competitors' access to the market, or enable them

conduct anti-competitive practices. From 1996 to 2010, the most relevant cases reviewed by the Commission in the markets of maize and tortilla were as follows.

14. In 1996, the Mexican company Gruma and the American company Archer-Daniels Midland Co. (ADM) proposed a strategic alliance in the business areas of maize and wheat flour. Gruma is a Mexican company dedicated to the production and marketing of maize flour, tortillas and related activities. The CFC approved the merger subject to the condition that the merging parties provided a review of the exclusivity clauses. In response to this provision, aspects of non-intervention, directly or indirectly of ADM in the manufacturing, distribution and sale of machinery to produce wheat and corn tortillas were eliminated. This prevented the potential barriers to the entry of new competitors.<sup>2</sup>

15. In 1999 the companies Asgrow Mexicana and Cargill de México notified its intention to merge. The companies coincided in the hybrid seed markets for maize and sorghum. The risks to competition in horizontal aspects were the potential high level of market concentration derived from the transaction and the existence of entry barriers in the form of R&D. Under this scenario the Commission approved the merger subject to the divestiture of certain brands and assets and the transfer to public research institutes of the inputs required for the development of hybrid seed maize and sorghum.<sup>3</sup>

16. In 2006, the Commission rejected a merger between Gruma and Agroinsa, two Mexican companies engaged in the production and marketing of maize meal on the grounds that the transaction had the potential to result in a firm with substantial power that could displace competitors or prevent access to relevant markets of maize flour in the Northeast region and in the West / Midwest of the country. Also, the Commission had evidence that Gruma had entered into agreements for the purpose of conditioning the sale of maize flour and machinery and spare parts to small competitors.<sup>4</sup>

### 2.1.2 *Cartel and horizontal agreements*

17. In the case of maize tortilla, the Commission has been particularly active in preventing price agreements established by trade associations which, as they did for decades, have sought to become price regulators to the detriment of consumers.

18. In 1997, the Union of Maize Tortilla of the Mayan Zone and other independent producers promoted concerted practices to distribute the market for these products. The agreement was supported by the municipal authority and intended to maintain exclusivity for certain producers in geographic areas in the municipality of Carrillo Puerto in Quintana Roo. The firms tried to stop the distribution of tortillas in the municipality by the owners of two stores. The Commission decided that the concerted action of the firms and the performance of the Municipal Authority constituted violations to the FLEC. In this case, the Commission sanctioned individuals and advised the government of Quintana Roo to abstain from participating and supporting actions that would harm competition in the tortilla market.<sup>5</sup>

19. In 1999, the Commission carried out in Baja California and the region of the Comarca Lagunera two investigations against tortilla producers for agreeing to fix prices. The agreements were facilitated by regional business organizations. The Commission determined that the maintenance of these mechanisms

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<sup>2</sup> File: CNT-076-1995.

<sup>3</sup> File: CNT-114-98.

<sup>4</sup> The case was challenged in the judiciary and the courts did not uphold the Commission's decision.

<sup>5</sup> File: IO-041-1996.

eliminated price competition. Both investigations were concluded after the associations involved agreed to, to inform their members about their freedom to set prices for their products.<sup>6</sup>

20. In 2001, the company Club Cadena Maíz Tortilla, SA de CV (Camato), which gathers producers, millers and manufacturers of maize tortilla, suggested its affiliates to fix the price of maize tortillas in the Federal District and metropolitan area. At that time, Camato represented 17 thousand producers and millers of maize, which supplied 10% of the domestic market and 5.8% of 12 thousand tortillerías of Mexico City. The Commission determined that Camato members could not be regarded as a single economic agent and therefore, instructions or suggestions on the price of the tortilla issued by that Organization constituted an infringement to the FLEC. The Commission ordered the suspension of the practice and imposed a fine.<sup>7</sup>

21. In 2002, the government of the state of Yucatan filed a complaint before the Commission against leaders of the Trade Association of Tortilla Manufacturing in Yucatan for publishing in the local media a new price for maize tortillas in the region. The FLEC provides that recommendations of trade associations to its members intended to fix, raise, agree or manipulate the price of goods or services, or exchange information with the same purpose are evidence of an infringement to the FLEC. During the investigation, the leaders recognized that the trade association had no power to fix or establish official prices of maize tortillas, and reported not knowing the accuracy of newspaper's reports. However, the Commission got access to several transcripts of the trade association meetings proving that its members had gathered to exchange information on the sales and price of maize tortillas and as a result of such meetings had agreed on the sale price of the good. Also, from information published by the Bank of Mexico and price monitoring conducted by the Federal Attorney's Office of Consumer Protection, it could be established that the price of maize tortillas in several municipalities of Yucatan had increased after the trade association published the new price for maize tortillas. This provided the evidence that the producers had agreed increases in the price of tortilla. The investigation ended with the commitment by the leaders of the trade association to cease the anti-competitive agreements, and report to its members that the association had no authority to regulate prices of maize tortilla and that that agreements among competitors to fix prices constituted a violation of the FLEC. Finally, the group pledged to monitor the behavior of its members in order to prevent agreements among competitors. Also, the trade association agreed to send to the Commission a copy of the meetings minutes.<sup>8</sup>

### 2.1.3 *Abuse of dominance*

22. In 2001, the Commission found that the company Harinera Yucatan, a subsidiary of Grupo Industrial Maseca (Gimsa), and the associations of mills and tortilla of two municipalities in the state of Yucatan held agreements that stipulated the distance among tortillerías. In these agreements, the Harinera Yucatán committed not to sell machinery and flour tortilla to those tortillerías that did not follow the aforementioned agreements. From the analysis of the relevant market, the CFC concluded that Harinera Yucatán had substantial market power in Yucatán, and it was responsible for establishing exclusive distribution of goods or services. In establishing the amount of the fine, the Commission took into account that Harinera Yucatan committed to suspend the practice.<sup>9</sup>

<sup>6</sup> Files: IO-001-1999 and IO-002-1999.

<sup>7</sup> Files: IO-02-2000 and RA-40-2001.

<sup>8</sup> File: DE-07-2002.

<sup>9</sup> File: IO-11-2000.

2.2 *Has your agency undertaken a market study into any commodity or commodities? Please explain what triggered the market study, the substance of the allegation, the analysis undertaken and the remedies imposed (if any)*

23. In 2008 the Commission conducted a market study to assess the distributive and spatial effects of monopoly power in the Mexican economy. Such study was supported by the Organization for Economic Cooperation and Development (OECD) and by the participation of a local expert supervised by the CFC.

24. The study estimated the loss of welfare for different social groups, both in rural and urban areas, that stemmed from the exercise of market power in seven markets of basic consumer goods: i) maize tortillas, ii) processed meats, iii) egg and chicken, iv) milk, v) soft drinks, bottled water and juice, vi) beer and vii) pharmaceuticals. It was concluded that, as a consequence of inadequate regulation and inefficient institutional design that maintain market structures that hinder competition and deteriorate the competitiveness of the Mexican economy, more than 30% of household spending in Mexico is destined to markets with competition problems. It also found that Mexican consumers spend in these products and services about 40% more than they would spend if competition existed in these markets. Additionally, it was shown that the situation is worse for low income groups and the southeast region of the country, which happens to be the poorest. For example, households in Chiapas State have an average welfare loss 277% times bigger than households of Baja California State, which in that moment was the least affected entity by the lack of competition.

2.3 *Has your agency received requests from governments or other parts of society to formally investigate commodities markets or requests for the competition authority to put downward pressure on prices where there has not been information or evidence suggesting anti-competitive behavior? What was the nature and circumstances of the request and how did your agency respond?*

25. Given the importance of the maize dough and maize tortilla markets for Mexican consumers, the Commission often receives requests to investigate competition concerns in these markets. Probably because the lack of familiarity with competition law, in most of these cases the Commission has been asked to regulate prices. Faced with these pressures, the Commission has made clear that it does not have the power to regulate prices and that such a measure is likely to introduce market distortions that could harm consumers in these markets.

### **3. Advocacy opportunities and challenges**

3.1 *Has your agency had the opportunity to improve the efficiency and effectiveness in commodities markets through advocacy? For example, have you had the opportunity to recommend or advice on commodity price deregulation? Have you had the opportunity to advise on the reform of government or private sector monopolies for the purchase or sale of particular commodities for domestic consumption or export? Have you had the opportunity to advise on the reform of regulations that fix or control prices or quantities? What was the commodity, the nature of the reform and the outcome?*

26. The CFC is empowered to issue opinions on regulation, issued by different government bodies, which could affect market access and competition conditions. In the exercise of this power, the Commission has identified municipal regulations that have or may have the effect of unreasonably restricting new participants' access to the markets and the growth of established ones.

27. As a consequence, the Commission has issued several non-binding opinions on several local regulations that unduly restrict competition in the production and commercialization of wheat and/or maize tortillas.

28. In addition, in 2010 the CFC issued guidelines aimed at ensuring that the regulatory framework promotes vigorous competition in the production, commercialization, and distribution of tortillas. This guideline was addressed to all municipal and state governments, and to federal entities involved in the regulation of the tortilla markets.

29. The guidelines included four specific recommendations for municipal governments, aimed at avoiding the most common regulatory barriers that hinder competition in the markets of maize dough and corn tortilla:

- Eliminate minimum distances and other restrictions to the number of competitors. It is frequent that local regulations forbid the establishment of a new tortilla business close to another vending location, thus limiting the total number of tortilla businesses in a locality. Also, home delivery businesses are often prohibited. The Commission stated in the guidelines that these types of regulation reduce consumer options and leave buyers at the mercy of a small number of suppliers who use their market power to charge artificial high prices.
- Eliminate provisions that allow established businesses to have a say on the entrance of new participants and market prices. Some local regulations oblige the authority to consult tortilla associations on the entrance of a new competitor to the market. In other cases, the regulations provide for consultations with trade associations on prices and business hours, etc. that all tortilla business must abide to. The Commission stated in the guidelines that this type of regulation hinders the entry of new suppliers (who require the authorization from other suppliers to operate), facilitate collusion among tortilla businesses, and limit competition among them.
- Local authorities should respond to market access requests based on transparent and public criteria that favor market access. Some local regulations do not clarify the requirements or time needed for a tortilla business to obtain an authorization to operate. The discretion with which market access requests are handled –probably because of pressure from other tortilla business– has led to requests that have never been solved, or requests hindered with additional paperwork. The Commission stated in the guidelines that the effect of the lack of a prompt and transparent mechanism to grant business licenses in this market is to limit artificially the number of tortilla businesses and consumer's choice.
- Eliminate minimum quota requirements of local production inputs. Some municipal regulations require the use of specified proportions of local production inputs (e.g. maize), and therefore restrict the tortilla business capacities to obtain them at better quality and prices. The Commission stated in the guidelines that by raising the cost to tortilla business these regulations also harm consumers.

3.2 *Has your agency been confronted by a government proposal to address pressing concerns about commodity prices that did impede competition (or would have impeded competition if it had been introduced)? What was the nature of the problem that the government was seeking to address? What was the timing and political constraints upon your opportunity to provide advocacy? What advice did the agency provide and what was the result?*

30. The Mexican Federal Government has tried several times to prevent the rises in tortilla prices and to mitigate the effects of the volatility in the international prices of maize. For example, in 2007 “The

Agreement to Stabilize Tortilla Prices” - which was signed, among others, between the Ministries of Economy, Agriculture, and Social Development - increased import quotas to tariff-free maize; assisted the industrial maize-tortilla production chain to increase its competitiveness and, most importantly, set maximum retail prices for tortillas. From the outset, the Commission fiercely lobbied against this agreement arguing that it introduced distortions in the markets reducing the competitive pressures between rivals and maintaining a fragmented market structure. Unfortunately, the Commission could not persuade the government from adopting the agreement. Nevertheless, it was in place for a very short time and tortilla prices were again liberalized.

31. Although not directly related with the maize dough and tortilla market, recently the Government of Mexico City issued a regulation that prohibits the establishment of convenience stores and supermarkets in areas nearby street markets. In the light of this, the Commission issued a non-binding opinion that pointed out the negative effects the measure could have on competition and consumer welfare in those areas. More precisely, the opinion highlighted that the regulation could result in the creation of barriers to entry for new competitors that could offer their products at more competitive prices.

3.3 *Please describe any pre-emptive steps available to your agency to: - Reduce risks that commodity price volatility becoming a problem in your country? - Reduce risk that governments or public societies seek policy to problematic commodity price volatility that would impede competition*

32. The FLEC does not include provisions directly aimed at preventing price volatility of commodities. However, as mentioned above, it does empower the Commission to prevent market distortions that may amplify this problem.

33. In addition to the enforcement powers mentioned in the preceding section, the FLEC provides the Commission with the power to significantly influence markets. In particular, the law gives the Commission two key attributions. On the one hand, enables it to prevent the creation and implementation of Federal or State regulations that restrain competition in the markets. In this sense, the FLEC empowers the CFC to issue opinions where recommendations are provided to prevent market distortion. On the other hand, includes provisions related to prices that are aimed at preventing market distortions from price regulation. Thus, Article 7 of the FLEC allows the Federal Executive to control prices of products and services deemed necessary for the popular consumption, only after the CFC has declared that such controls are necessary and will correct and do not create market distortions.