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## **Global Forum on Competition**

### **THE IMPACT OF DISRUPTIVE INNOVATIONS ON COMPETITION LAW ENFORCEMENT**

#### **Contribution from Brazil**

-- Session III --

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## **DISRUPTIVE INNOVATION: IMPLICATIONS FOR THE ENFORCEMENT OF COMPETITION LAW**

**-- Brazil --**

### **1. Disruptive innovation: challenges for competition authorities**

1. By profoundly changing existing markets and creating new ones, disruptive innovations impose challenges for governments, especially for regulators and competition authorities.

2. Challenges faced by competition authorities vary from the assessment of the relevant markets to the tension between regulation and competition policy. Technical staff has to understand how markets have been changed by innovations and decide on the appropriate tools to handle these new realities. Conversely, there needs to be a balance between regulation and competition enforcement, especially in jurisdictions where regulatory and competition agencies work separately and have political and legal autonomy.

3. Market definition is central to antitrust analysis. When markets are altered or created by disruptive innovators, competition authorities are confronted with the need for either segmenting existing markets or defining new ones. As innovations are fast-paced processes, authorities also face a time pressure, often in sectors that involve much legal and political controversy.

### **2. The necessary balance between regulation and competition**

4. Regulation stems from the necessity to fix market failures, such as monopolies, asymmetry of information and mismatch between supply and demand. Market failures have a direct impact in consumer welfare by causing reduction of consumer surplus and dead weight. In sectors in which markets are not able to auto regulate, the government intervenes through regulatory agencies in order to fix these failures. Notwithstanding, regulation can also cause loss of surplus and competition concerns.

5. Disruptive innovations have the potential to fix market failures and address regulatory concerns in several markets. When a disruptive innovator enters the market, it can break monopolies, provide more even information and match supply and demand more efficiently.

6. Whenever disruptive innovations properly fix regulatory concerns, regulation of such markets is no longer necessary and its continuation may cause loss of consumer welfare.

7. Out of that situation, competition concerns may arise. Regulators can be captured by the sector due to political pressure and lobbies, in which regulation may constitute a barrier to entry more than a remedy for market problems.

8. The role of competition authorities in this case is that of advocacy before the government branches, in order to address the problems of undue regulation that could harm competition. Antitrust

authorities therefore have to promote awareness about the changes in market caused by disruptive innovations and the benefits of competition and consumer welfare they may create.

9. In the case complaints are filed against disruptive innovators, competition authorities may use the enforcement tools they have at their disposal, but market definition and time pressure could be important issues to consider.

### **3. The Brazilian experience**

#### ***3.1. The current debate on Uber***

10. Even though many disruptive innovations have come to Brazil, such as Uber, Airbnb and Booking.com, CADE has not seen many antitrust cases involving disruptive innovators throughout the past years. Nevertheless, there has been a lively debate in Brazil about the new online platforms of sharing economy and their implications to competition and consumer welfare. The current hot topic is the rideshare online platform “Uber”, which has seen opposition from taxi drivers all over the country.

11. In 2015, the Legislative branch of the state of São Paulo passed a bill prohibiting the use of rideshare applications in the state. The Federal District also passed a bill restricting the use of Uber to licensed taxi drivers, which in practice has the same prohibitive effect. The Federal District bill was since vetoed by the Governor of the Federal District.

12. In 2015, CADE received two complaints regarding the rideshare online platform Uber. Both cases are currently under analysis by CADE’s General Superintendence. Considering the relevance of the case of Uber in Brazil, we shall focus on the market of public and private individual transportation in Brazil, which comprises taxi and Uber services, as well as the debate over the case and the role of the competition authority.

#### ***3.2. Why is the debate so important in Brazil?***

13. Much of the debate on Uber in Brazil is centered in the argument of taxi drivers that the online platform causes unfair competition by opening the market to unlicensed drivers. Taxi drivers argue that if they have to observe regulations and pay taxes, then drivers rideshare platforms also would have to comply with the same regulations and pay the same taxes. Uber counterargues that its drivers are not required to be licensed because of the different nature of the service provided.

14. Taxi drivers also argue that safety is a concern for consumers. Regulators usually share this same concern and seem to be convinced by systems of reputational feedback provided by applications such as Uber. As a counterargument, people can dismiss rides if they believe the driver is not well rated by other passengers, and once the ride has started, due to GPS services, the car’s itinerary is monitored by Uber.

15. The issues involved are not only practical, but also political. In Brazil, taxis are considered “rental cars” and drivers must be licensed by the state government to offer the service. The amount of licenses available is defined by the government and granted licenses are tradable. Licensed drivers can also buy cars with tax benefits. The discussion therefore encompasses professional class interests, which represents another challenge for regulators and policymakers.

16. Taxi licenses are considered an asset because of the limited number of licenses granted by the government and the fact that those licenses are tradable. With new technologies that allow drivers to enter the market without licenses, the value of the licenses will fall, which may be a concern for associations of taxi drivers.

#### **4. CADE's advocacy efforts**

17. As part of the agency's work on this issue, CADE is making efforts to further understand the market and the changes these rideshare apps bring to it.

##### ***4.1. DEE's Working Paper***

18. In September 2015, CADE's Department of Economic Studies (DEE) published a working paper assessing the main implications of rideshare platforms for both the market of individual transportation and urban planning in Brazil. The main findings of the study show that rideshare online platforms can offer a viable solution not only to market failures in the transportation sector, such as asymmetry of information, but also to urban problems, such as traffic jams and high house rent prices in the core areas of big cities.

19. The purpose of the working paper is to shed light on the market of both public and private individual passenger transportation, which includes both taxis (considered as public individual transportation in Brazil) and rideshare apps (considered as private individual transportation).

20. The taxi market in Brazil, like in many other countries is an example of market in which regulation was imposed by the government in order to fix observed market failures. Common market failures of this market are asymmetry of information, monopolist practices, abusive prices and mismatch between supply and demand.

##### ***4.2. Market segmentation***

21. The taxi market is divided into three segments: rank, hailing and booking. Taxi rank is the service provided from fixed taxi stations. Hailing comprises the taxis that keep circulating on the street to get passengers. Booking is the provision of the service in a pre-arranged time and place, usually by phone.

22. Market failures are more common in the rank and hailing segments, mainly due to concerns related to public safety, consumer protection, traffic jams and mismatch between supply and demand. According to the DEE paper, rideshare applications disrupt the market segment of taxi booking.

23. The new applications allow consumers to know beforehand the reputation of the driver, the estimated price of the ride, the route options and payment directly through credit card.

24. There are possibilities of regulations of these segments that encompass entry in the market and prices, with different combinations. The market solution would be no regulation at all. The opposite scenario would be regulation of both market entry and prices.

25. The DEE working paper points out to sound arguments either in favor or against entry and prices regulation in the market.

26. In regards to entry, the regulation would address important issues such as excess of cars in circulation, with lower occupation rates and possible price increase. On the other hand, this kind of regulation is expensive and can confer protection over licensed taxi drivers.

27. Concerning prices, regulation would grant economic protection for consumers against abusive prices and prevent that a few areas become more attractive to taxi drivers, thereby granting that the services are provided more widely. On the contrary, price regulation by the government can generate distortions in the definition of optimal price levels. In the bargaining process for price readjustments, the regulatory body can be captured by class interests and lobbies.

#### **4.3. *How does this can affect urban planning?***

28. The DEE working paper recognizes that taxis are important for public transportation in large cities. Good taxi systems that are complementary to bus and subway transportation are essential to the functioning of the transportation system. The main concerns in this case are traffic jams and the fluidity of circulation of people.

29. The cost of transportation can have indirect impacts over spatial concentration, once it influences location decisions of firms and the occupation of urban areas. It has impact on urban planning policies, with potential effects even on the price of rent in central areas of large cities.

#### **4.4. *Main findings***

30. The DEE shows that rideshare platforms can provide a superior substitute for private cars for a group of consumers, and a superior substitute for taxis for another group of consumers, with a potential reduction of the prices charged by taxis. The new market would also provide an alternative for licensed taxi drivers and for licensed drivers who would like to change business model.

31. The working paper concludes that rideshare applications would result in several benefits for consumers, and that there have been no economic arguments to prohibit those technologies.

### **5. Conclusion**

#### **5.1. *Do disruptive innovations fix all market failures?***

32. The DEE working paper indicates that rideshare online platforms only addresses the problems of the booking segment of the taxi market, namely mismatch between supply and demand, the possibility to decline the ride and see the estimated fares in advance, with credit card payment. The possibility to give feedback on the driver in a rating system is also attractive.

33. In this sense, in the rank and hailing segments the regulations would remain necessary, since the market failures in these segments are not fully addressed by disruptive innovations. In regards to the booking segment, it would be possible to question whether more regulation would be necessary and desirable from a competition point of view.

34. If rideshare applications can avoid some problems of the individual transportation market, it can also generate others. Car insurance would be an example. Since Uber requires cars with specific characteristics (black sedan cars with leather seats, for instance), insurance companies would be prone to increase the prices of insurance of these car models, since they could be used for rideshare apps. The price increases would apply to every car with the same characteristics, regardless of their personal or rideshare use.

#### **5.2. *What can the competition authority do?***

35. In the field of disruptive innovations, competition authorities face many challenges. Antitrust authorities are usually in favor of innovation, which allows for more competition and consumer welfare.

36. The Brazilian Competition Act (Law No. 12.529/2011) foresees that the Brazilian Competition Policy should be centered on consumer welfare. Concerning the market of individual transportation, rideshare online platforms foster more competition in the market and provide more options for consumers.

37. In this situation, the role of the competition authority is that of advocacy with both civil society, government and legislators in order to promote awareness about the benefits of competition in the sector. Additionally, the competition authority may engage in advocacy efforts with regulatory agencies in order to assess the need for regulation in the market.

38. In this sense, it is possible to envision regulation for some segments (rank and hailing) and for the booking segment, in which Uber and other rideshare apps are inserted, clearer rules for their operation and coexistence with taxis in a pro-competitive environment.

39. The efforts of competition authorities in promoting the establishment of transparent and legitimate ground rules for the market jointly with regulatory bodies is a relevant institutional role CADE is ready to play.

## REFERENCE

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