"Constitutional" public policy making in context

"Constitutional" public policy making in context: the peruvian experience

La formulación de políticas públicas "constitucionales" en el contexto: la experiencia peruana

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ABSTRACT: In this article the authors will identify how the reform of the "new" Peruvian Constitution policy was implemented, with particular emphasis on the influence of the Constitutional Court of Peru. At last, using the theory of public choice, we will present three cases that allow them to conclude that the Peruvian Constitution does not reflect a particular ideology but rather a mix of values that can be opportunistically used by interest groups. The first example deals with the regulation of the education, health and social security sectors. In this case, the authors conclude that the regulation is mercantilist. The second example deals with the "stabilization acts" for foreign investment contracts. In practice, this provision was used to concede a legal monopoly to Telefonica, a telecommunications company. Finally, our third case refers to the treatment of natural resources. In accordance to the Constitution, natural resources are property of the State, not the owner of the land. This anti-market provision has caused economic losses and social conflicts.

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KEYWORDS: Public policy making, public choice, institutional framework, interest groups.

RESUMEN: En este artículo los autores identificarán cómo se implementó la reforma de la "nueva" política de la Constitución peruana, con especial énfasis en la influencia del Tribunal Constitucional del Perú. Por último, utilizando la teoría de la elección pública, presentaremos tres casos que les permiten concluir que la Constitución peruana no refleja una ideología particular, sino más bien una mezcla de valores que puede ser utilizada de manera oportunista por los grupos de interés. El primer ejemplo se refiere a la regulación de los sectores de la educación, la salud y la seguridad social. En este caso, los autores concluyen que la regulación es mercantilista. El segundo ejemplo trata de las "leyes de estabilización" de los contratos de inversión extranjera. En la práctica, esta disposición se utilizó para conceder un monopolio legal a Telefónica, una empresa de telecomunicaciones. Por último, nuestro tercer caso se refiere al tratamiento de los recursos naturales. De acuerdo con la Constitución, los recursos naturales son propiedad del Estado, no del propietario de la tierra. Esta disposición anti-mercado ha causado pérdidas económicas y conflictos sociales.

PALABRAS CLAVE: Elaboración de políticas públicas, elección pública, marco institucional, grupos de interés.

INTRODUCTION

The idea that the Peruvian Constitution is "neoliberal" is pervasive within constitutional scholars and, consequently, among the population. In this article, we have tried to prove that this is a myth. The Peruvian Constitution is a child of the Washington Consensus, but the Consensus itself is not "neoliberal". Also, constitutional practice, especially in a country with interventionist tendencies, will ultimately conspire against any constitutional efforts to institutionalize a free market economy. In this article, we will go down to reality and prove how the Peruvian Constitution was far from the neoliberal ideal in two senses: i) it was enforced by authorities that did not share the values or interests of the Fujimori's regime; ii) it was habitually used to advance private interests. For this, in the first part of the article, we will show how these constitutional provisions were used in reality and were changed through constitutional practice, especially by the decisions of the Constitutional Court of Peru. We will characterize the provisions as "not neoliberal" and, ultimately, show that even when the provisions post Consensus are -at least on paperless interventionist than the former ones, they are not "neoliberal".

In the second and last part, we will present three cases to demonstrate that the Peruvian Constitution could be more easily explained in public choice theory terms than as an ideological pursuit of a neoliberal economy. The first example deals with the regulation of the education, health and social security sectors. In this case, we conclude that the regulation, rather than "neoliberal", is mercantilist. The second example deals with the "stabilization acts" for foreign investment contracts. In practice, this provision was used to concede a legal monopoly to Telefonica, a telecommunications company, when it entered the Peruvian market to replace the stateowned company. Finally, our third case refers to the treatment of natural resources. According to the Constitution, natural resources are property of the State, not the landowner. This anti-market provision has caused economic losses and social conflicts. Also, these cases had in common that they have an anti-market orientation. Indeed, the Peruvian Constitution does not mandate this outcome, but the institutions that it creates are perfectible compatible with it.

1. REAL IMPACT OF THE CONSTITUTIONAL REFORM

1.1. Private but Regulated

Before 1993, telecommunication, electricity, and mineral exploitation were –primarily– state-owned businesses in Peru. After the enactment of the 1993 Constitution, most formerly public utilities were privatized. The first one was Telefonica del Peru, in 1994. For that end, institutions like *PROINVERSION*¹ were created.

It is to be noted that the Privatization Act was passed in 1991, even before the enactment of the Constitution. However, no privatization was initiated before the Constitution, so – apparently– the Constitution played a role in changing the equilibrium of power, giving leverage to the government to undertake their reforms (Ortiz de Zevallos et al., 1999).

In the case of monetary stability, the Constitution also played a significant role, since the Constitution created an independent central bank, capable of structuring the Peruvian economy. It is also true in the case of opening the Peruvian economy to free trade. Norms like 'stabilization contracts' are unique to the Peruvian Constitution and are used continuously by corporations to secure their investments, along with other provisions.

In other aspects, like regulation, it is more difficult to see the influence of the Constitution. Before the 1993 Constitution, the Peruvian economy was small and mainly state-owned. In such a scenario, there is no need for economic regulation.

Conversely, a traditional state-owned economy would face difficulties when changing radically to a system of free enterprise. Therefore, when the Peruvian economy was privatized and opened to the world, a need for regulation emerged. Because of this, the Peruvian economy went from 'state-owned' to 'mostly privately owned but regulated.' Then, it

¹ Spanish acronym for Investment Promotion Agency.

is not easy to see how the Constitution has helped to deregulate the economy.

In general, though, the balance in diminishing the degree of government intervention is positive. On the one hand, the Constitution has procedural and substantive mechanisms that help deregulate or stop regulations. On the other hand, a privately owned but regulated economy is freer than a State-owned one.

1.2. The Role of the Constitutional Court

As stated by Elster (1994), the impact of a Constitution on economic performance is not simply a matter of the text itself' because of three reasons. First, constitutional arrangements are not always explicitly stated in a constitution. Some countries do not even have a constitution in the formal sense (the United Kingdom, for example). Second, constitutions can be useful or ineffective. Some of the more repressive regimes in the world have a long list of fundamental rights. As we say in Peru, some norms are 'dead words.' Talk is cheap, and so is writing a bill of rights. The same applies to other constitutional commitments. Third, the text of the Constitution is alive in some sense, moreover when constitutional courts are in place, which is currently the case in Peru.

In Peru, the "meaning" of the Constitution is decided to a great extent by the decisions of the Constitutional Court. In this context, for example, the Peruvian Court has stated that 'stabilization contracts' have constitutional limits: *i.e.*, the government needs a justification to enter these agreements, and the content of the agreements is subject to constitutional scrutiny (Decision STC 0003-2001-AI, 2001).

The influence of the Constitutional Court in developing the 'second wave' of the Washington Consensus agenda can be seen in at least three areas: a) The recognition of social rights beyond the scope of the Constitution

b) A pro-state-intervention interpretation of (neo) liberal constitutional provisions; and,

c) In general, sn indulgent treatment of economic regulation.

1.3. The Recognition of Social Rights Beyond the Scope of the Constitution

Similarly, as in the case of Colombia, even when the 1993 Peruvian Constitution has some provisions that can be interpreted as neoliberal, the Constitutional Court has had a more notable role in protecting social rights than other areas. The Court has even recognized some rights that are not explicitly considered in the Constitution, like the right to water. (Decision 06534-2006-PA/TC, 2006)

About the Colombian case, it has been said that:

Since its creation in 1991, the CCC (Constitutional Court) has actively and progressively defended the protection of social rights in areas such as health, labour social security, education, and housing. Its endeavours have constituted active resistance to the neoliberal policies that have been implemented in Colombia. These policies have developed the neoliberal economic clauses present in the Colombian Constitution, which clash with the social promises of the constitutional text. Indeed, through a strategy of economic liberalization and with the support of international agencies, the Colombian government has privileged the neoliberal orientation of specific constitutional clauses over the rights-based general orientation of the Constitution. In contrast, the CCC has emphasized the importance of protecting constitutional rights, human dignity, social inclusion, and equality, and has, therefore, imposed specific, considerable limitations on neoliberal policies. (Decision 06534-2006-PA/TC, 2006; Saffon, 2007, n. 25) (The added text is mine)

The Peruvian case is similar in that the Court has a progressive approach to economic issues, always remarking the fact that the Peruvian Constitution does not privilege economic aspects over the dignity of people.

For example, even when the Constitution does not recognize a right to have water, the Peruvian Constitutional Court has declared water as a human right.

> 19. Water, as a natural resource, does not only contribute directly to the consolidation of the fundamental rights mentioned but from another personal perspective impacts the social and economic development of the country through the policies that the State undertakes in a series of sectors. That is the case of agriculture, mining, transport, industry, and others. It can be said, therefore, that thanks to its existence and employment it becomes possible the sustained development and the warranty that society as a whole does not get prejudiced, in the short, medium and long term.

> 20. Thus, even when it is not part of the controverted matter, it is clear that the consideration of the essential role that water has for the individual and society as a whole allows for situating its status not only at the level of a fundamental right but also as an objective value that the Constitutional State has to privilege.

The context in which these declarations were made was a case of a person living in an apartment building with a contract with SEDAPAL (the state-owned Peruvian company of water supplier). The contract provided for separate invoices (one for each apartment owner) of water service, but if 25 per cent of owners in the building fail to pay, SEDAPAL will cut service to all. (Case file 06534-2006-PA/TC, 2006)

The Court considered this contract 'unreasonable' and declared it void. Thus, for this individual, the problem was solved and –for the entire society– a new right emerged. Nevertheless, the issue of access to water remains the same since that decision. More than 50 per cent of people in Peru do not have access to water.

Furthermore, the National Congress of Peru is trying to pass an amendment to convert water into a constitutional right within the text of the Constitution. It can be interpreted as a sign of the lack of impact of the Court decision since the recognition of the right by the Court theoretically should suffice to consider it a proper constitutional right.

Today in Peru, there exists a relevant discussion about whether or not water service should be privatized. The Court's decision in matters related to water does not solve any problems but are populist measures that confirm people's previous beliefs about the legal nature of water.

1.4. A-Pro State-Intervention Interpretation of Pro-Market Constitutional Provisions

As will be illustrated subsequently in a case, the 1993 Constitution has a prohibition on legal monopolies. Nevertheless, the Court stated that a previously state-owned firm could be granted a legal monopoly.

In the case against Congress for granting telecommunications company Telefonica del Peru SAA a legal monopoly, the Court noted that:

Article 61 of the Constitution prohibits the legislature from creating or establishing new monopolies by law: "No law or constitutional provision or arrangement may authorize or establish monopolies." However, the ban on creating legal monopolies cannot extend similarly to regulating mechanisms and the process of eliminating monopolies that existed before the Constitution of 1993. As previously noted, the second section of the Eighth Final Transitional Provision of the Constitution has established a mandate to regulate monopolies, with emphasis on the process and mechanisms to eliminate the monopolies that existed before the enactment of the Constitution. (STC 0005-2003-AI, 2003, paragraph 27)

In other words, the Court does good legal gymnastics to conclude that not all norms that impose legal monopolies are prohibited, although in other cases, have said that all monopolies, including those achieved through market competition, are forbidden.

In another case, however, the Court was much harsher against an act imposing an even natural monopoly, but that had only the effect of restricting competition is such a way that helped to create a monopoly:

> Although a dominant position in the market is not prohibited—because that would prevent entrepreneurial success that is so provided that such dominance is acquired legitimately and not on legal norms granting privilege without reasonable justification, violating the principle of equality before the law—it is not acceptable that the Supreme Decree No. 158-99-EF set an arbitrary classification, which gives preferential treatment to a category of cigarettes, favouring some producers or traders, concerning the other. (STC 01311-2000-AA, 2000, paragraph 4)

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It is not difficult to see that the Court has an ambiguous position regarding legal monopolies. Besides, the Court does not have a record of using this constitutional principle extensively, even when many markets have entry regulations that could be perceived as legal monopolies.

1.5. The Subsidiary State-Intervention Principle

The subsidiary principle is one of the most pro-market principles in the Peruvian Constitution. This principle, when interpreted correctly, imposes two restrictions upon the State. First, since the market is the rule, the State can only regulate when necessary. That is, only when regulation is the most reasonable way if compared with the market. Second, the State can only own a firm if the market is not capable of delivering the goods by itself (Quintana, 2011, p. 15).

Concerning the first use of the principle, the Court has never used this principle to take down a regulation. The Court has used a similar principle (the 'necessity' test, as part of the balancing test), but the 'necessity' principle is used to compare alternative methods of regulation, not regulation against the market.

Concerning the second use, the Court has never questioned the fact that the government acts as an entrepreneur in areas like water provision, education, and health. The only time that a State-owned firm was called out was in a case before Indecopi, an administrative agency (Decision 3134-2010/ SC1-INDECOPI, 2010), not by the Constitutional Court, and the case was utterly irrelevant: The discussion was if the State could own a chicken restaurant inside a public university. The decision has never been applied to other cases.

1.6. An Indulgent Treatment of Economic Regulation in General

In general, the Court has an indulgent treatment of economic regulation. It is evidenced in cases in which the Court is very flexible in interpreting the goals of acts like the '*Ley Universitaria*' (Universities Act)² In which 'having a constitutional goal' (Decision 0014-2014-P1/TC, 0016-2014-PI/TC, 0019-2014-P1/TC, and 0007-2015-PI/TC) was enough justification for a policy.

Examining over 400 hundred decisions in the period between 2000-2010, the Court used the 'balancing test' in order to analyze the validity of hundreds of acts of Congress. The test consists of three parts, with the third, the 'cost and benefit analysis' is arguably the more complicated and technical one. It is notorious that, in those 400 cases, the third part of the test was never used, even when the act passed the first two sub-tests (Sumar, 2012).

Also, the relationship between the Court and the other branches of government does not always guarantee an optimal resolution of cases involving economic regulation. In some cases, the Court has helped the government to enforce economic regulations, like in the case of casinos, where the Court helped the government to overcome decisions of independents judges opposing their regulation in particular cases (Decision 006-2006-PC/TC). Even in cases where the Court has opposed economic regulations, the Congress and the Executive Branch have insisted on passing the laws regardless, making the ruling of the Court irrelevant.³

² This is a statutory law that makes accreditation mandatory for all universities in Peru and creates standards to be met by them.

³ Here it is interesting to note that even when the Court declared, in a first case, that a decree (Supreme Decree 017-2005-MTC, 2005) was unconstitutional and therefore should not be applied (Decision 04197-2010-PA/TC, 2010), the Executive Branch enacted a very similar decree (Supreme Decree 003-2008-MTC, 2008) that passed another unconstitutional process (Decision 00863-2011-PA/TC, 2011).

From this, we can argue that, in general, the Court relies on the ability of the other two branches of government inadequately justifying economic regulations and does not have enough power to oppose the government when they do not.

2. THREE CASES OF OPPORTUNISM AND REFORM

Now, we will attempt an explanation of why the 1993 Constitution does not promote neoliberal values, as is regularly asserted. The explanation lies in the general theory of public choice. The Constitution, like every other norm, was not created with a genuine interest in achieving any social goal, but rather to primarily promote personal aims, reflecting interests that were already prevailing in that context and anticipating a favourable scenario to act opportunistically in the future.

As previously stated, constitutional reform in Peru was not primarily informed by a genuine desire to promote libertarian values. As in any regulatory process, the relevant factor is the pursuit of personal gains by interest groups. The reformers in Peru used the Constitution in three ways to obtain benefits, all predicted by Stigler (1971): (1) the restriction of rivals' entry and substitute products in the market; (2) direct subsidies; and (3) the weakening of buyers and suppliers.

All of this was achieved through direct modification of the Constitution (Case 1) or by creating institutions suited to subverting constitutional choices in the future (Cases 2 and 3).

2.1. Case 1: Education, Health and Social Security

According to the 1979 Constitution, health and social security must be run by public agencies. In the case of education, schools must be not-for-profit, even when administrated by private firms. The 1993 Constitution changed

As can be seen, if the Executive Branch would have considered the Court ruling in the subject, the second decree would have never been enacted, following the criteria of the Court in terms of economic regulation.

this. Today, private enterprises may create and run hospitals, private financial institutions may administer public trusts, and schools may be operated as for-profit institutions.

Until this point, one may say that this is an example of de-regulation; but, apart from that, the 1993 Constitution also encouraged the creation of more private universities, exonerating them from taxes. In the case of social security, an act established mandatory trusts for the public, and the designated private institutions in charge of their administration receive about 13 per cent of worker income every month.

Besides, the 1993 Constitution stated that these sectors would be closely supervised by the State. For each of the three, there exists a specialized regulatory agency in charge of supervising the quality of the services provided and imposing standards, which act as barriers to entry.

Therefore, far from a case of de-regulation, in Peru's case, public institutions have been replaced by highly regulated private ones, which are also beneficiaries of subsidies and rents.

It is to be observed, following Ortiz de Zeballos (1999, p. 9), That one of the foremost proponents of the reform, Carlos Boloña, Secretary of Economy under the Fujimori government, was later appointed director of a social security administration fund and was also the founder of a –now well established– for-profit private university.

In recent years, the education sector has entered a state of reform, based on the perceived lack of high-quality education due to the liberalization (including the spread of for-profit universities) that Fujimori's reform started. Keeping with this reform, in 2013, Congress passed the '*Ley Universitaria*' ('Universities Act'), which established hundreds of standards for universities, varying from campus extension requirements to the licensing of new programs. Now that

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nearly 200 universities, including that of Boloña, have already been established, one can perceive this as an attempt to prevent further competition in the sector.

In the case of social security, an inverse path has taken place. In this industry, the emergence of more beneficiaries and pensions has led the government to liberalize part of these savings. Nevertheless, the aggregate impact of this on the total amount of saving currently in the hands of private funds is minimal, which explains the possibility of the reforms in the first place. If the impact were significant, the opposition of private funds would have probably prevented the reform.

These cases illustrate how constitutional reform was used not as a means to advance libertarian ideals (like privatization), but rather in an opportunistic manner. Peru's privatization, rather than reflecting genuine liberalization, includes massive subsidies and economic regulation. The link between the actors of the reform and the beneficiaries of it are also evident in the person of Boloña.

2.2. Case 2: Stabilization Contracts and Legal Monopolies

One way an interest group can benefit from stricter rules –in this case, rules imposing a free market– is when they are better suited to subvert that rule, and everyone else must comply.

Peru is the only country in the world with a 'stabilization contract'⁴ At the constitutional level: These contracts are intended to provide investors with a guarantee of continuity of a given regulatory regime. At the same time, Peru has a rule prohibiting the creation of legal monopolies. Nevertheless, when the public telephone company was privatized, Telefonica del Peru (the Spanish buyer of the public company) used this

⁴ A type of contract that –at least in some countries- has the same formal value and its enacted by the same procedure as statutory law and has the effect of freezing the regulations for one person. *I.e.*, if we enter a stabilization contract today, tomorrow's regulatory changes do not apply to us.

same set of rules to create a legal monopoly.

Indeed, thanks to a provision in a contract –then formalized as an act using the stabilization contract provision– Telefonica gained a five years' monopoly. This monopoly was justified in the economic theory of 'natural monopoly.' According to the government and the Constitutional Court, the investment needed for telephonic infrastructure was high, then any potential investor would needes a monopoly to made profits.

> Article 61 of the Constitution prohibits the legislature from creating or establishing new monopolies by law: "No law or constitutional provision or arrangement may authorize or establish monopolies."

> Nevertheless, the ban on creating legal monopolies cannot extend similarly to regulating mechanisms and the process of eliminating pre-existing ones, before the Constitution of 1993. As previously noted, through the second section of the Eighth Final Transitional Provision Transitional of Constitution there has been established a mandate to regulate monopolies, with emphasis placed on the process and mechanisms to eliminate the monopolies that existed before the enactment of the Constitution. (decision STC 0005-2003-AI, 2003, paragraph 27)⁵

⁵ Free translation of: ...' el artículo 61° de la Constitución prohíbe al legislador crear o establecer nuevos monopolios mediante ley: "Ninguna ley –refiere dicho precepto constitucional- ni concertación puede autorizar ni establecer monopolios."

Pero esa prohibición de crear monopolios legales no puede extenderse análogamente, a la regulación de los mecanismos y el proceso de eliminación de los monopolios preexistentes a la Constitución de 1993. Como antes se ha señalado, a través de la segunda fracción de la VIII Disposición Final y Transitoria de la Constitución se ha establecido un mandato de legislar, con carácter prioritario, sobre el proceso y los mecanismos para eliminar los monopolios que existan con anterioridad a su entrada en vigencia' (STC 0005-2003-AI, 2003, par 27)

It is now clear that (1) the telephone market was not a natural monopoly, and (2) Telefonica made extraordinary profits from the concession.

It is to be noted that all three branches of government, acting one after another, granted Telefonica a monopoly even when there was a supposedly explicit constitutional provision prohibiting them. The rationale then was: The Constitution prohibits new legal monopolies, but not the granting of a monopoly in a previously state-owned industry.

Even when this rationale may sound somehow credible, it is unlikely that it would be used if this were not a 2 billion USD deal.

It raises questions about the use of political and economic power to subvert constitutional rules (Glaeser and Scheifel, 2003).

2.3. Case 3: The Ownership of Natural Resources

The 1993 Constitution states that natural resources (like water, gas, or electricity) are property of 'the Nation,' which is an elusive concept somehow similar to 'state-owned.' The consequence is that if petroleum is found in the land underfoot, the petroleum is not private property but of 'the Nation.' It is a rule contrary to the one in –for example– California, where if individuals find petroleum in their yard, it is their property.

Why is this norm a possible case of rent-seeking behaviour? If we are referring to a mining or petroleum corporation, then, these companies will probably prefer to pay a tariff to a government dependency rather than the price of the land to its actual private owner. This way, individuals have a 'less interested' seller, due to agency problems, accomplishing the 'weakening of the seller' as predicted by Stigler. This kind of norm also generates many social conflicts, since the owners of the land feel displaced in the intrusion. It has led the government to pass an act recognizing the right of indigenous peoples to being consulted about projects to be performed in their territories. Nevertheless, these concessions of the government can be understood as strategic acts to calm them, rather than a real vocation to alleviate the problem.

CONCLUSIONS

As we showed, the Peruvian Constitution is far from being a "neoliberal" one. It indeed followed most of the Washington Consensus provisions. However, most of the provisions are far from "neoliberal". For instance, some replaced state-ownership with intensive regulation. Others privatized public utilities or public services but incorporated legal monopolies at the private sector.

At the same time, it also recognizes even more social rights that the former Peruvian Constitution. Even more important, the constitutional provisions were interpreted and applied by authorities that are far from followers of the "Consensus" ideas. In particular, the Peruvian Constitutional Court is a "progressive" court, that interpreted the provisions in a way alien to "neoliberal" thinking. For example, the "principle of subsidiarity" was interpreted very narrowly and leaving much space for public intervention, in disregard of the fact that it is a principle supposed to lead us to a freer economy.

Apart from public institutions and the cultural disregard for a free market economy, one can tell that the Peruvian economy is also plagued with mercantilism. Using public choice concepts, we can understand that the shape of regulations -including the Constitution- is not a by-product of neoliberal influences (mostly right with the Washington Consensus which is not even liberal itself), but the result of the competition between interest groups, in which firm conglomerates with political ties are winning the battle. Sumar, O; Zuñiga, T. "Constitutional" public policy making in context

Thus, the Peruvian Constitution is best explained as a result of interventionist and mercantilist interest that converge in transforming an -otherwise ideologically neutral and technical constitution- in a constitution that serves to protect special interest couple with an always growing intervention of the State.

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