The Case for a Competition Institution in Hong Kong*

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I. Tradable sectors versus non-tradable sectors

Hong Kong is one of the freest economies in the world, if we are talking about the tradable sectors. Everyone has to face worldwide competition. As far as the non-tradable sectors are concerned, I am not so sure. What I mean is products and services that are not easily exported or imported, e.g. energy supply, property, transport, legal and healthcare services, supermarkets, banking services etc. I have seen freer systems in other parts of the world.

Concerns have been expressed by international organisations such as the WTO, the EU, and the IMF. In its statement issued after its Article IV consultation mission to Hong Kong in November 1999, the IMF stated that "In recent years, a number of observers have raised questions about the extent of domestic competition in Hong Kong SAR, including the extent to which activity in certain sectors is dominated by a relatively small number of participants. A degree of market concentration is inevitable in a small market such as Hong Kong SAR, especially in sectors which have increasing returns to scale; the question is whether in practice this leads to abuses. Domestic competition issues continue to merit close attention, especially since - except in sectors which are subject to specific regulations or ordinances - there are no substantive penalties if firms engage in anti-competitive behaviour."[1]

In any case, for our own benefit, more vigourous competition in non-tradables will reduce costs in upstream sectors and of critical inputs such as communications, land, transport and services. This will help to raise external competitiveness and attractiveness for foreign capital for a small open economy like Hong Kong.

II. Regulation versus competition policy in a small economy

Hong Kong is a small place. This has produced two problems for the non-tradable sector. On the one hand, to guarantee adequate, reliable and agreeable supplies, the government has to rely on regulation, e.g. electricity, telecommunication, broadcasting, local transport, through using franchising or schemes of control. In other cases, self-regulation in specific sectors is depended upon, e.g. legal and medical services.

On the other hand, it is easy for a small place to produce a small number of market players after a process of competition, because of various considerations like economies of scale, limited demands, or simply superb entrepreneurship of some parties. Dominant players with market power would emerge, rather naturally. Let me stress that small number is not a problem in itself: even two firms could compete very

heatedly in a certain field. Economists call it a "contestable market". The key concern is whether any dominant player misuses or abuses its market power, which may have been gained fairly in the first place. In other words, market conduct is the focus of attention.

Given a long history of competition studies, legislation and implementation of competition laws all over the world, various forms of anti-competitive behaviour and restrictive practices have been identified. They include horizontal restraints (e.g. bid rigging, price fixing, market sharing, cartels etc.) and vertical restraints (e.g. exclusive dealings, resale price maintenance for goods or services with no substitutes etc.). These are actually acknowledged by the Hong Kong Government in its Statement on Competition Policy issued in 1998, and the establishment of Competition Policy Study Group (COMPAG) to co-ordinate the activities of the various Government bureaux and agencies on competition related matters.

III. Regulation and competition: complements or substitutes?

The answer is both. In Hong Kong, there are various regulation regimes and a kind of "competition policy". In the telecommunication sector, one may say both are actually operating. When natural monopolies are inevitable, regulation seems the only choice; where abuse of market power appears prevalent, competition policy is needed.

In any case, the world trend now seems to shift from rigid regulation rules by the government towards promoting competition through defining and sanctioning against anti-competitive behaviour. Usually there is a law plus an authority that implements it. Together they constitute a competition institution.

A survey by the Consumer Council on major trading economies reviews that competition laws are actually very widespread in the world. They now exist in

- The Americas: USA, Canada, Mexico, Argentina, Brazil and Chile;
- Asia: Japan, Korea, Taiwan, China, Thailand, Indonesia;
- Pacific: Australia, New Zealand, Fiji;
- Europe: all members of EU, and most of eastern Europe including Russia;
- Middle East: Israel;
- Africa: South Africa.

The headcount is over 50. There are other surveys with wider coverage quoting higher figures: one putting it more than 80. Nevertheless, just on the basis of our survey result of 50 plus, these existing competition regimes already represent about 80% of world trade. And many of their competition laws were enacted after 1990. More relevantly for Hong Kong, our competitors South Korea and Taiwan have had their fair trade laws; and even Singapore is said to be considering one.

There are various factors that have contributed to such a trend. Firstly, technological breakthrough means that what was regarded in many cases as a natural monopoly is no longer true, e.g. in the fields of electricity supplies and telecommunications, economies of scale can now be achieved at much lower capacities. I was told, rightly or wrongly, that the new airport could actually generate its own electricity instead of purchasing it from CLP. So monopolies can be broken

up, not just horizontally into smaller companies, but vertically by separating the generating, distributing and retailing functions. The end result is the introduction of more competition.

Secondly, market dynamics in more mature economies has been such that dominant players with increasing power are rapidly emerging, some through mergers and acquisitions, in formerly un-regulated sectors or across sectors, regulated or otherwise. It becomes necessary in many cases to prevent or to stop them from misusing or abusing its power, which may have been gained fairly in the past.

Thirdly, technology and market dynamics have combined to render the traditional definition of sectors increasingly suspect, e.g. broadcasting and telecommunications, banking and non-bank financial services, conglomerate retailing. So the shift now is from sectors to conduct. Price fixing is wrong in telecommunications, it should also be wrong in other sectors whose boundaries may be ever changing. In other words, restrictive practices may exist in markets that are not clearly defined by economic boundaries that mimic bureaucratic divisions of responsibility. The various government agencies may therefore be unable to respond quickly to convergence or divergence that takes place between different industries.

IV. The need for a fair rule of the game

Competition policy is sometimes misinterpreted as a form of government intervention worse than regulation. I cannot agree with that. If there is intervention, the basic objective of a competition law is for the government to intervene in the market place by setting some rules against unacceptable conduct, so as to introduce more competition or to ensure fair competition. The end result is that its intervention in the market would be reduced. Regulatory regimes, on the other hand, often spell out in detail what the company has to do and to specify a "maximum" rate of returns that often turns out to be a guarantee. Various distortions of such a form of intervention are well analysed by economists and lawyers. Anyway I should stress again that regulation is sometimes inevitable despite the theoretical and practical problems, particularly in situations where effective markets cannot be formed.

A competition law is more like a set of rules for a sport, say for football matches. On the basis of the principle of fair play, it specifies what sorts of conduct are not allowed, e.g. handling the ball with your hand, except the goalkeeper of course, being offside, tackling from behind etc. The referee (read the Competition Authority) just carries out those rules and penalizes misconduct. He does not tell both teams how to play the match! In fact, the footballers are free to use whatever techniques and tactics they like. Moreover, those rules are not team-specific (read sector-specific). They should be applied equally in an international match between Brazil and Wales; or a domestic match between Manchester United and Bolton. No teams should be favoured or discriminated against.

A competition regime will be more successful if the participants are in support of its broad principles: fair, efficient and welfare enhancing competition. Hence, in so far as it improves the quality of corporate governance, self-regulation by various sectors, maybe in the form of codes of practice, is a good supplement to, but not a substitute for a general competition framework and institution. If every player

behaves like a bad boy in the field, even the best referee implementing a well designed set of rules would not produce an entertaining and high-quality football match.

The football analogy would have to stop here, because so far we have not mentioned an important party: the consumers and various interest groups that represent them. As they are often the victims of unfair trade practices, there is a need to make them more informed of their rights and the redressing mechanisms that are available. In other words, it is necessary to "empower" the consumers, so that they can become more effective and conscientious "whistle blowers". A modern dynamic economy would depend on a healthy tripartite relationship among the state, the market, and the populace. [2] Scott Jacobs also argues that "second-generation regulatory reforms can contribute to a longer-term, comprehensive alignment of state, market and civil society". The solutions "include strong competition principles, more attention to market transparency and openness, high quality public sectors, and vibrant civil societies" and the direction is "to keep working on market-led growth supported and tempered by civic values and good governance". [3]

V. Sector-specific approach compared with comprehensive approach

The sector-specific approach has actually been the traditional approach in many countries. Its merit is that it has a clear focus. However, as the economy matures, complicated problems would emerge. I have already covered some of the problems about the approach concerning the interplay of technology and market dynamics that renders sectoral definitions suspect. Other problems are (i) lagged responses; (ii) unfairness across sectors; and (iii) regulatory capture: the sector-specific regulators being "captured" by the firms they are supposed to regulate.[4] The comprehensive approach, being forward looking and conduct-based avoids both problems. To be fair, it may also carry inflexibility by being too general. That is why the coverage of the competition law is important and experience and expertise needs to be built up. More crucially, exemption procedures are important. Apparently anti-competitive behaviour, if it has beneficial effects on public interest, should be exempted; and there is a long list of them if you go over the records of the competition authorities over the world.

Of course, even with a comprehensive competition law and a competition authority, regulatory bodies may still function in certain important sectors. But in many cases, they would be concerned with technical standards, safety measures and planning etc., rather than competitive oversight. In some situations, oversight that requires very technical knowledge may rest with the regulators or be shared between them and the competition authority.[5]

The first competition law in the US, the Sherman Act, was passed in 1890; more than a hundred years ago, and the US competition regime has changed significantly since then. Back to the football analogy, tackling from behind was OK in the past, now it warrants a yellow or even red card. The goalkeeper was not allowed to move more than four steps with the ball in his hands. Now he is free to move around, without deliberately wasting time, of course.

VI. Cost and benefit considerations

In the United States, the medium-term consequences of a proactive competition policy are clear: in every major sector, the results for consumers in terms of prices, quality, and choice are solidly positive. Pro-competition reforms in several sectors involved in intercity transportation (airlines, railways and motor carriers) were estimated to have been providing annual benefits to US consumers $50 billion in 1996 dollars. Prices declined primarily because real operating costs fell in most sectors by 25 to 75 percent. Gains were seen in all types of productivity.[6]

In Japan, efficiency gains from deregulation were estimated to boost consumer income by about 0.3 percent per year, or $36 billion annually. The hidden cost of weak competition in many sectors can be seen in the fact that Japanese price levels in 1993 were the highest in the OECD, 56 percent above the OECD average, particularly in prices for non-traded goods in cartelised and highly regulated sectors. Regulatory reform has begun to reduce prices: prices for national long-distance and international telecommunication services fell by 77 percent through 1996 and reforms in distribution lowered prices by one percent annually since 1990.[7]

A competition law is a prevention as well as a redressing mechanism: a general competition law is little different from any other law that acts as a deterrent to forms of behaviour that are considered at odds with accepted community standards. It would therefore contribute to reducing the cost of enforcement.

A competition law obviously needs a competition body to administer and implement it. The law and the body together would constitute a competition institution. Most competition regimes have set up a competition authority/agency, although various models, with different reliance on the court-based approach or the agency approach, and with provisions for judicial or administrative reviews, can be found.[8]

In any case, the cost of setting up a competition authority should also not be exaggerated. Information available on the Internet shows that Australia's watchdog, the Australian Competition and Consumer Commission (ACCC) recently was recently having an annual budget of slightly more than 40 million Australian dollars, which works out to be about 2.3 Australian dollars (roughly 9.0 HK dollars) per resident. This compares with about HK$10 per resident in the case of Hong Kong's Consumer Council. And Australia is a big country with a number of regional offices. Of course, the ACCC is court-based system, hence, legal costs would be incurred, but then the Commission includes the competition monitoring functions of all sector-specific bodies covering industries like energy and telecommunication.[9]

The cost of not having a comprehensive authority may actually be high. Leaving aside the possibility that Government agencies might not have the skills necessary to undertake antitrust analysis, the fragmented sector-specific approach may replicate resources required to investigate, research and analyse allegations of anti-competitive conduct across the broad spectrum of government. It may also fail to take advantage of synergy in a comprehensive institution.

If I may quote Scott Jacobs again, "The risk of costly institutional rigidities increases as regulators proliferate…… The risk is that regulators, whether independent or ministerial, will regulate too much for too long, and so hamper rather than aid the development of competition…….. Sector-specific regulators can slow the larger adjustment of the sector, and lose potential gains to economic growth and consumer welfare. Traditional sectors are changing and merging with other sectors or new sectors as technologies change, yet regulators are often designed around obsolete ideas of the sector. In these cases, regulators can inhibit sectoral convergence, and consumers lose potentially huge benefits. A hidden cost of a proliferation of regulators is the difficulty of taking coordinated reforms to exploit synergies. Hence, the benefits of comprehensive and multi-sectoral reforms can be lost."[10]

VII. An independent commission to study Hong Kong's choice?

By international standard, Hong Kong is lagging behind. Ironically, it means that Hong Kong is in a fortunate position to have the benefit of seeing how various competition institutions in other countries have operated. There are also many Hong Kong enterprises that have experience with competition jurisdictions through their parent companies, or through experience in attempting to enter markets in those jurisdictions. Their experience, and contributions in dealing with those competition laws would help Hong Kong to make a suitable choice on its own competition regime.

My own opinion is that Hong Kong can start with something that is not too controversial, say a law against "hard core cartels". According to an OECD report, they are "anticompetitive agreements by competitors to fix prices, restrict output, submit collusive tenders, or divide and share markets". Even for them, OECD suggested that they could be exempted for sanctions on efficiency grounds or in accordance with a country's law. "However, all exclusions and authorizations of what would have been hard core cartels should be transparent and should be reviewed periodically to assess whether they are necessary and no broader than necessary to achieve their overriding policy objectives".[11]

As to the institutional mechanism, Hong Kong may set up a Fair Competition Council (FCC) that administers and enforces the law, restricting itself to administrative and civil sanctions (ordering to desist and stop, imposing fines). I suspect that the competition law would not specific criminal sanctions unless the evolving situation warrants them. There should be an appeal mechanism in the form of an Appeal Board, which should be led by a judge and consist of a few independent and reputable persons. Of course, we may also consider when formal judicial process should be allowed.

These are just some preliminary thoughts, which anyhow are quite in line with what the Consumer Council proposed in its 1996 Competition Policy Report.[12] In any case, I remain open minded on the details.

I suppose a complicated issue like this and given Hong Kong's lack of experience regarding competition jurisdiction, an independent commission may be set up with representatives from the government, the business sector, academics, consumer organizations and professionals. Its task is to investigate whether and what

kind of competition institution Hong Kong should adopt to enhance its efficiency and competitiveness in the new era of the 21st century.

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Notes

[1] The statement is available from the Hong Kong SAR Government website www.info.gov.hk/gia/general/199911/30/1130170.htm.

[2] For a discussion of "tripartism", see Ian Ayres and John Braithwaite, ***Responsive Regulation: Transcending the Deregulation Debate***, Oxford University Press, 1992.

[3] See "The Second Generation of Regulatory Reforms", Scott H. Jacobs, Head of Program on Regulatory Reform, Public Management Service, OECD, presented at the ***IMF Conference on Second Generation Reforms***, November 8-9, 1999.

[4] See Ayres and Braithwaite (1992), chapter three, for a game-theoretic model of regulatory capture.

[5] See "Relationship between Regulators and Competition Authorities", ***OECD Report***, 1999, available from the website www.oecd.org/daf/clp/Roundtables/relat00.htm.

[6] See Clifford Winston "U.S. Industry Adjustment to Economic Deregulation", ***Journal of Economic Perspectives***, vol.12, no.3, summer 1998.

[7] See Scott H. Jacobs, "The Second Generation of Regulatory Reforms", op.cit.

[8] See Roger Alan Boner and Reinald Krueger, "The Basics of Antitrust Policy: A Review of Ten Nations and the European Communities", ***World Bank Technical Paper*** no.160, 1991.

[9] The comparison only serves as an indicative example that a competition institution may not be a hugely expensive bureaucratic monster, as some opponents imagine. The 40 plus million Australian dollars were roughly divided between competition and consumer protection tasks. There are also consumer protection agencies in each state, but the ACCC has oversight of consumer protection issues that cross state boundaries.

[10] See "Hard Core Cartel", ***OECD Report***, 2000; downloadable from the OECD website www.oecd.org/daf/clp/CLP_reports/hcc-e.pdf.

[11] "Hard Core Cartel", ibid.

[12] Consumer Council, ***Competition Policy: The Key to Hong Kong's Future Economic Success***, November 1996.