Competition policies in Hong Kong: review and prospects

The following is a summary of a presentation given to the ACCC on 18 September 2001 by Professor Tsang Shu-ki, Professor of Economics, Hong Kong Baptist University and the Chairperson, Competition Policy Committee, Hong Kong Consumer Council.

Professor Tsang Shu-ki's talk covered milestones in Hong Kong's competition policy, the current sector-specific approach, and the question of whether Hong Kong needs a comprehensive competition regime — that is, a general competition law plus a competition authority. He then speculated, in light of international experience, on the prospects for Hong Kong.

Franchise vs scheme of control

During Hong Kong's long history as a colony it has operated under various franchises and schemes of control. The difference between a franchise and a scheme of control is that a franchise renders an exclusive right. But a scheme of control is, in effect, a regulatory scheme under which other market players can enter the market to compete with the incumbent.

Such a scheme of control exists in the power industry. We have two power companies in Hong Kong — one is operating on the Hong Kong Island, called the Hong Kong Electric. The other operates on the Kowloon Peninsula and the New Territories, the China Light and Power. They operate in two different geographic regions and within each they have a monopoly.

The scheme of control gives them a rate of return on assets of 13.5 per cent if they are acquired on borrowed funds and 15 per cent if on shareholders funds. So theoretically anyone could enter into competition with either company. But nobody dared to enter the market because they were rich and powerful companies.

The milestones

Hong Kong Consumer Council

In 1974 the Hong Kong Consumer Council was established as a result of the oil crisis and high prices; the council was initially given the duty of prices surveillance. But it has no investigative or sanctioning power; there is no s. 155 and we cannot take anybody to court.

But there is one very important clause in the ordinance governing the council — our functions include 'collecting, receiving and disseminating information concerning goods, services and irremovable property'. And we have used those functions to very good effect. So we will talk to a corporation if there is some complaint and then ask for information.

Usually the corporation will cooperate. If not, we could mention it in our report — so it is a kind of moral suasion that enables the council to investigate many cases. In fact, companies are sometimes so cooperative that they want to give us commercially sensitive data on the condition that we do not publish it. But as a matter of principle we refuse to accept the deal. Whatever they give us, we must have the right to publish at our discretion. We decline commercially sensitive data because we don't have the legal power that a competition authority possesses. Our operation has to be transparent.

Industry-specific authorities

In 1987 the Broadcasting Authority was set up. This was the first sector-specific authority, in essence monitoring the broadcasting industry. And it has power to oversee anti-competitive behaviour.

In the 1990s some of Hong Kong's enterprises became world-class — you would have heard about Hutchison or the Hong Kong and Shanghai Banking Corporation or the Li Ka-sing family — and they are really huge operations of global size.

Then in 1992 the Hong Kong government asked the Consumer Council to begin competition analyses of various sectors; a responsibility given to us by the last colonial governor, Chris Patton. We did not quite understand why we were given the duty to do competition analyses, being a consumer organisation. I guess the governor looked around, found no other suitable agency to perform the duties and chose the council.

In 1993 a second industry authority was set up, the Telecommunications Authority.

Advocating a competition authority

In 1996, after the Consumer Council had produced several industry reports covering, for example, gas, telecommunications and the property market, it published a summary document called *Fair competition: the key to Hong Kong's prosperity*, advocating the establishment of a competition law and a competition authority.

When the government responded formally, instead of establishing a competition authority and a competition law, it established an organisation called COMPAG — the Competition Policy Advisory Group. This is an in-house group within the government bureaucracy, consisting of various bureau chiefs and chaired by the Financial Secretary, who is responsible for economic policy and is the third most powerful person in Hong Kong.

In May 1998 the government put out a Statement on Competition Policy — a statement not a law. It describes various anti-competitive behaviour that should attract attention and scrutiny. But there is no legal provision for investigation or sanction.

In November 1999 the IMF (International Monetary Fund) conducted its annual Article IV consultation exercise. It is supposed to be concerned with monetary or fiscal policies. But, somewhat unexpectedly, the main topic of discussion was domestic competition. And in its concluding statement, the IMF for the first time expressed concern about domestic competition in Hong Kong and praised the work of the Consumer Council. This was repeated in 2000 and, in fact, a similar concern was echoed by the European Parliament in the same year.

Also in 2000 the power of the Broadcasting Authority and Telecommunications Authority to monitor and sanction against anti-competitive behaviour and abuse of dominance was enhanced by amending the respective ordinances.

So a debate emerged in Hong Kong, concentrating on the merits and demerits of two approaches: one sector-specific and the other comprehensive. A small collection of articles can be found on my website at <http://www.hkbu.edu.hk/~sktsang>.

Hong Kong's sector-specific approach

The government started out with regulation, and then from the 1980s onwards it paid more attention to competition. Regulation is based largely on control of rates of returns, as is the case for electricity and transport. And there was a price-capping regime for telecommunications but the tariff regulation system has been much modified because the telecommunications industry has been opened up for competition.

Competition policy is largely sector-specific, and focuses essentially on two sectors: telecommunications and broadcasting. Telecommunications is quite interesting because Hong Kong Telecom had a 25-year franchise for its international arm, Hong Kong Telecom International, which would have run until 2006. But, in 1998 the government decided to buy back the exclusive licence and open up the market, costing the government HK$6.7 billion.

There is no comprehensive, cross-sector competition law or a competition authority to implement it. The argument is that there is no need for excessive interference in the market. But to be fair, the Telecommunications Authority and the Broadcasting Authority, particularly with the amendments to the ordinances in 2000, are almost like mini-competition authorities in their own right, for those industries.

Does Hong Kong need a comprehensive competition regime?

The usual argument is that in an open economy there is always competition. Well, that is true for the tradeable sectors. But there are many non-tradeable ones, for example, real estate, energy, transport, legal and medical services, supermarket chains and banks.

Traditionally, Hong Kong, as a small open economy, depends on regulation to guarantee reliable, reasonable supply at reasonable prices for non-tradables. But the trouble is that because we and the markets are small, it would be relatively easy for corporations to gain economies of scale in the domestic market. The thresholds are relatively low. If a company is successful, it can continue to be very successful. Pretty soon it may reach the point of having market power, no matter how fairly the power was achieved in the first place — then, we have to wait and see if the power is abused or not.

On the question of regulation versus competition, we have to consider technological development, market dynamics and changes in the market boundaries. In technologically advanced industries there is a often a divorce between natural monopoly and economies of scale. For example, in power generation, mini-generators are now common. I have heard that the new airport in Hong Kong could have built its own mini-generator (but it did not for various reasons) instead of acquiring its electricity from China Light

and Power. The natural monopoly argument is not very popular now. So, would it be better to have more competition than better informed regulations?

The second consideration, market dynamics, depends largely on mergers and acquisitions that transcend industrial and even national boundaries. A sector-specific approach may not be able to monitor the behaviour of cross-industry conglomerates.

The third looks at the boundaries of sectors — both technological developments and market dynamics are re-writing the definitions of markets. Therefore, sticking to the sector-specific approach runs the risk of being outdated.

Of course we still need the regulators in more complicated sectors, for example, telecommunications or power generation, to set technical standards, codes of practices and guidelines. But as far as competition is concerned, their rulings have to be consistent with a comprehensive competition law, subject to waivers or specific regulations.

The arguments against competition policy

The counter argument in Hong Kong concentrates first on competition policy as excessive intervention. We explain that competition opens up the market and is not intervention. We use the analogy that competition policy is like a referee in a football match — the referee sanctions against misbehaviour but does not tell both teams how to play football.

The second argument is that the problems are not serious. But without proper complaint and redressing mechanisms, one never knows how serious the problem is. The Council receives all sorts of extraordinary complaints which have absolutely nothing to do with consumer welfare but we think it is because there is no better channel. For example, we have had complaints about business-to-business conflict with the shipping companies claiming that the container terminals are over-charging.

The third argument is that competition law and competition authority are expensive. We have compared the ACCC's and Consumer Council's budgets. The Consumer Council's works out to be HK$10 per capita and the ACCC's HK$9 per capita. So you are more cost effective and you have to do more work than the whole Consumer Council. However, we do have to pay higher wages, rentals and other costs in Hong Kong.

The problems of the sector-specific approach are, first, lagged responses. You have to wait until a serious problem emerges in a sector before you go in and legislate and sanction. And there is injustice across sectors. Why is price fixing an offence in telecommunications and broadcasting but not in other business sectors such as supermarkets, property and many other fields?

We also have the problem of regulatory capture. I don't want to name names but some former regulators have become high-ranking executives of the companies within regulated sectors.

Based on these considerations, the Hong Kong Consumer Council regards a comprehensive approach to building a competition regime as preferable to the sector-specific approach, because it is inter-sectoral, forward looking and less susceptible to 'regulatory capture'. And its greater synergy makes it more cost-effective.

After all, why do we emphasise domestic competition? Because we have tremendous competition in the international marketplace, the thing that will help enhance the efficiency in Hong Kong's non-tradeable sectors is a comprehensive competition regime. In the long run it will benefit the whole economy.

We have had the first full year recession in our history and now we are struggling with vigorous competition from cities in China and a fixed exchange rate against the US dollar. So a competition law helps enhance our internal efficiency and would therefore increase our international competitiveness.

The international experience

The Council has compiled a survey and found that more than 50 countries and territories have comprehensive competition laws and together they constitute 80 per cent of world trade. The list is as follows.

Americas	Canada, Mexico, Argentina, Brazil, Chile, Peru and Venezuela
Asian region	Japan, Korea, Taiwan, China, Thailand, Indonesia, India and Philippines; Australia, New Zealand and Fiji
Europe	all the members of the EU and most of Eastern Europe countries including Russia
Middle East	Israel, Turkey
Africa	South Africa, Zimbabwe and Algeria

We talk about the Asian tigers — that is, South Korea, Taiwan, Hong Kong and Singapore. Hong Kong is the only one without a comprehensive competition law. Korea and Taiwan have competition laws and Singapore is, as far as I know, drafting one. Even the Philippines and India have competition laws. Some argue that many countries may have the laws but do not implement them. In some developing countries that might well be the case, but not all.

What does competition law cover?

The coverage of the law includes structure (mergers and acquisitions), conduct (vertical and horizontal restraints) and performance (abnormal profits).

The major targets are: monopolies and cartels; mergers and acquisitions; horizontal constraints such as price fixing, bid rigging, output collusion and division of markets; vertical restraints such as resale price maintenance, tie-in sales and discriminatory supplies; and unfair trade practices such as predatory pricing and deceptive marketing.

On the basis of public interests, some structures, conduct or performance can be exempted from the competition law, such as R&D cartels, as was suggested in a World Bank report.

However, the process of granting exemptions should be transparent and the exemptions reviewed regularly.

Internationally, the tendency when implementing competition policy is to:

- focus on anti-competitive conduct — the OECD has defined hardcore cartels as price fixing, bid rigging, collusive restrictions on output and divisions of markets (that is, horizontal restraints);
- see that the implementation of the law is transparent;
- emphasise advocacy and education work; and
- promote cooperation with other agencies to deal with the increase in multinational cartels.

Prospects for Hong Kong

There is increasing international pressure on monitoring domestic competition in Hong Kong, as testified by the recent gestures of the IMF, EU and WTO. I am sure that there is anxiety because, before the 1997 transition, Hong Kong was under British jurisdiction. International investors had more faith or trust in British law and order. After 1997 they feared there may be collusion between government officials and the business circles, as well as increasing Chinese influence.

China is now the biggest investor in Hong Kong and many of its shares are listed in Hong Kong and can be traded. There are many companies called red chips rather than blue chips because they have communist backing. China Mobile, for example, is the largest and takes about 12–15 per cent of the total stock market capitalisation in Hong Kong.

People outside Hong Kong are afraid, rightly or wrongly, that there may be collusion and corruption here; so they press for competition oversights. But it is strongly opposed by local vested interests and the government because the business circle is very much against a comprehensive law.

The models to choose from

There are three major models that Hong Kong would consider in establishing a competition authority: the US's court approach, Australia's hybrid court and agency approach, and Taiwan's agency approach.

In the US, the Department of Justice acts according to anti-trust laws to put cases through the courts. Civil and criminal penalties co-exist.

In Australia, the ACCC has partial autonomy. Implementation of the competition law is generally through the courts with only civil but no criminal penalties, at this stage.

In Taiwan, the Fair Trade Commission executes the Fair Trade Law and has the autonomy to deliver civil sanctions but criminal penalties must now be through the courts.

For all three there are appeal channels, as well as regulators in some sectors. For Hong Kong, the US approach seems to over-rely on the court process and is comparatively expensive.

We believe that, for Hong Kong's unique situation, a prototype mixture of the Australian and Taiwan models may be the most appropriate. It should also first concentrate on what the OECD calls hardcore cartels.

Recent statements by top government officials in Hong Kong, including the former Financial Secretary, the present Finance Secretary and the Secretary for Economic Services are all discouraging about instituting a competition law and authority. Despite the debate heating up, they insist on the sector-specific approach. However, a good sign is that the government is adding more competition elements into its sector-specific approach. For

example, the government has appointed a telecommunications (competition provisions) appeal panel. As described in the press release when it was set up, it is:

> ... the first ever sector-specific appeal board on competition matters in Hong Kong. It provides an independent avenue for aggrieved parties to review the decisions of the Telecommunications Authority on competition matters which may involve wider competition issues, in addition to telecommunications policy.

Recently the Telecommunications Authority has also published a consultation paper on specifying the merger and acquisition regulation in the industry, first starting with carrier licensees (network operators). It may consider extending the regulation to non-carrier licensees (mainly service providers) later if there is serious concern.

A compromise is not to have a comprehensive competition law, but one against price fixing and bid rigging. That is, a non-comprehensive but also non-sector-specific law against the most notorious forms of anti-competitive behaviour. Even that may not receive sympathy from the Government in the present economic climate. It will be a long haul.

Competition aspects of e-commerce

The following is an edited version of a presentation given by Commissioner Dr David Cousins to the 30th Annual Conference of Economists held on 23–26 September 2001 in Perth.

Introduction[1]

As e-commerce develops it is increasing competitive opportunities for business and it is likely that it will eventually, and markedly, affect how businesses operate. This is despite its not yet delivering the returns that investors once hoped for.

It is estimated that widespread adoption of e-commerce in Australia could increase national output by 2.7 per cent and enhance consumption by about $10 billion within the next decade.[2] Studies also indicate that as well as increasing competition from international or domestic online sources, e-commerce will enable businesses to become more efficient in day-to-day operations.

But the development of e-commerce is not without its difficulties. These include consumer confidence, domain naming rights, recognition of digital signatures, treatment of intellectual property rights, development of financial payment systems, and application of competition laws. The Internet knows no borders so global and domestic solutions must be simultaneously applied.

From a competition regulator's perspective, the new economy raises exactly the same issues as the offline world, but in new contexts. Nevertheless, in dealing with online commerce regulators will be increasingly confronted with some of the more controversial issues in competition law.

Competitive analysis of network effects is a notable example. As usual, regulators will need to decide if competitors' responses — both online and offline — to the threat of competition are anti-competitive. As network effects or externalities may be a key characteristic of many e-commerce activities, the positive and negative competitive aspects of network effects and how they may be taken into account within the framework of the Trade Practices Act need to be addressed.

A regulator's ability to assess competitive conduct issues in relation to an activity characterised by network effects, particularly in new economy markets, has attracted considerable debate.

I want to address the arguments that:

- competition regulators over exaggerate the potential market power issues arising in relation to network effects. Some commentators think this may harm and stifle pro-competitive ventures.[3]

---

[1] I would like to acknowledge Ms Vanessa Holliday's major contribution to this paper. Vanessa is an assistant director in the ACCC's E-commerce Unit, Compliance Branch.

[2] NOIE, *E-commerce Beyond 2000*, Final Report p. xi.

[3] Dr Cento Veljanovski, 'EC Antitrust & the New Economy, Is the EC Commission's View of the Network Economy Right?' *European Competition Law Review*, 2001, vol. 9 writes: 'The application of network effects theory to new economy mergers is overblown and lacks supporting evidence.'