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Response on Competition Policy in Hong Kong

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Foreword

Hong Kong is regarded as the freest economy by Heritage Foundation (傳統基金會) for thirteen consecutive years since 1993. We shocked the world by our annual trading volume and we are supported by best-in-class law system. We enjoy the fruitful result with the increase of per capita annual income from USD 20,268 to USD 25,577 from 1993 to 2005[1]. With our strong financial support, we can further utilize our medical and social benefits in our city. Thus, not only does a healthy competitive environment enhance our international reputation, but it is also a foundation stone for our social and economic success. The result is touchable and taste-able.

The government launched the review of competition policy in Hong Kong and planned to enact the competition law in 2005.

"How to maintain our economic drive? How to promote competition? Is establishing the competition law an effective way to promote competition in Hong Kong?" Those are important questions to the future development of Hong Kong. ***In this paper, we would like to show that it is not the right time to enact a cross industry competition law in Hong Kong.***

[1] Annual income data from Census and Statistics Department

Reasons for not enacting a cross industry competition law at this stage

First and foremost, we all admit that promoting free competition is positive to our economy, and thus the society. We do expect our government to be proactive in promoting competition. It is appreciated that our government can evaluate different ways and methods on promoting competition.

Nevertheless, we do believe it is NOT THE RIGHT TIME to establish a cross industry competition law under current situation. Yet, we are open to set up guidelines which are not legally binding for individual industry according to individual need. We oppose the enactment of a cross industry competition law based on four main reasons:

1. Competition law can only promote competition under certain circumstances

A law has a gate keeping nature. It creates a standard and ensures we will be identified if we fall below the standard. There is a clear cut on either right or wrong. Competition law is a competition standard. If a company violates the law, the company is below the standard. Law will bring it up to standard by certain penalty. In an economy, if competitions are above the standard, there should be no need to establish the competition law to maintain the standard.

We believe that Hong Kong competition environment is above the standard. According to the Statement on Competition Policy ("the policy statement") released by the Competition Policy Advisory Group(COMPAG) in 1999, there are several factors to assess Hong Kong's overall competition environment. These factors are:

(a) a stable and effective political environment;
(b) a regime based on the rule of law;
(c) a free and open macroeconomic environment;
(d) abundant market opportunities;
(e) positive policy towards private enterprise and competition;
(f) positive policy towards foreign investment;
(g) no foreign trade and exchange controls;
(h) a transparent investment and tax regime;
(i) easy access to financing;
(j) a sophisticated labour market;
(k) transparent and fair labour and immigration policies;
(l) a strong physical infrastructure; and
(m) free flow of information

Hong Kong has a free and open macroeconomic environment as well as stable and effective political environment. It is also a regime based on the rule of law which has successfully developed many years ago. Moreover, Hong Kong allows free flow of information and the government has positive policy towards private enterprise and competition. Based on the Hong Kong Country Risk Report conducted by Political & Economic Risk Consultancy Limited in December, 2006, Hong Kong ranked the forth in least political and economic risk among twelve countries and districts. The result affirms that Hong Kong's political and economic environment is stable as well as efficient.

Furthermore, there are more than 300,000 small-to-medium enterprises (SMEs) in Hong Kong. SMEs represent 98% of Hong Kong enterprises and employ two-third of Hong Kong's labor force. Therefore, SMEs are very influential in the market and make the market very competitive. It is really hard for enterprises to act together to have restrictive agreements.

All these factors suggest that Hong Kong's overall environment is competitive and there should be no need to establish the competition law in Hong Kong at current stage.

Besides evaluating the overall environment, we also need to assess whether anti-competitive conducts exist in Hong Kong and their consequences. A three-step broad economic test is provided under the policy statement as the means to determine whether the government will take action against anti-competitive conduct:

(a) Step 1 – whether such market conduct limits market accessibility;
(b) Step 2 – whether it impairs economic efficiency or free trade; and
(c) Step 3 – whether the conduct is to the detriment of the overall interest of Hong Kong.

The test certainly provides guidelines for departments or related parties when they deal with any related issues. In past few years, Consumer Council has investigated lots of cases related to monopolies or anti-competitive business conducts, including telecommunication market, supermarkets, green minibus, etc. In order to provide a true and fair view, Consumer Council has employed consultants from other countries to investigate the above suspected cases. The result shows that there is no evidence to show that any anti-competitive element is involved in those conducts. Base on past experiences, the market is so efficient that no special entry barrier exists and it runs smoothly under the principle of supply and demand.

So, we conclude the market in Hong Kong is competitive at this stage and able to run efficiently under the free market power. Hong Kong is certainly above the standard in competition.

2. Potential competition failure industries can be handled by existing legislation

Not all industries have competition failure crisis. Competition law is not able to demonstrate the power in industries that keen competition already exists. We would like to focus more on industries that have potentially lost competition. One of the suggested methods is Porter Model. By using Porter Model's five criteria, we are able to identify those potential competition failure industries. The five criteria leading to competition failure are: (1) low bargaining power of buyer; (2) low rivalry exists among suppliers; (3) low threat of new entrants; (4) low threat of substitute and (5) high power over feedstock supplier.

The five criteria of competition failure industries do not fit into most industries in Hong Kong. The government sets guidelines and regulations to promote competition. There is no entry barrier for most industries. Only the utility markets, like electricity and water supply, may have potential competition failure. Electricity fee is always a controversial issue as there are only two electricity suppliers in Hong Kong. In order to increase market efficiency, like other developed countries, Hong Kong government has lots of guidelines, regulations and statues binding these suppliers to ensure that they provide qualified services at reasonable prices. For example, both local electricity companies are subject to a Scheme of Control (管制計劃協議) agreed with the HKSAR Government. Besides, their performances are under close supervision of the mass media and citizens can learn any anti-competitive conducts through the media. We can see that these utilities run smoothly and without affecting customers' benefits. We conclude that for some "inborn" monopoly markets, Hong Kong has well established regulations to enhance competition in such markets. ***Therefore, competition failure is rarely found in Hong Kong and thus there is no need to establish the competition law.***

3. Efficiency of competition law establishment and execution

Although promoting competition is important to economic success, we need to do it in an effective way. The establishment and execution of competition law consumes our public resources. ***Because of the following reasons, we do think it is misallocation of public resources to set up the competition law in Hong Kong at this moment.***

A. Few cases of complaints

As recorded in the annual reports of COMPAG, there are 67 reports on anti-competitive practices between 2000/01 and 2004/05. Among the 67 cases, only 2 cases are found to be substantiated, 49 cases are unsubstantiated and the remaining 16 being under investigation. This reveals that anti-competitive conducts are not very common in Hong Kong. Competition law is not necessary in Hong Kong at this moment.

Also, although there are provisions governing anti-competitive activities for the broadcasting industry, the Office of the Telecommunications Authority only received three complaints regarding price fixing and predatory pricing between 1999 and 2001. During the same period, OFTA received 75 complaints. Most were related to misleading and deceptive advertising. It shows that even there are provisions governing anti-competitive behaviour, the number of complaints are still very low. Therefore, we doubt if we should set up a regulatory authority to govern anti-competitive activities when such activities are rare in Hong Kong.

It would be worth to note that anti-competitive activities exist between the Hong Kong government and the private sector rather than between companies in different industry. As seen from the three annual reports issued by the COMPAG between 2003 and 2006, about one-third of the cases relate to tender arrangements by various governmental departments and the provision of Government Electronic Trading Services. Thus, the government should take precautions to prevent anti-competitive conduct, especially, in dealing with tender instead of introducing the costly competition law.

B. High cost

	Independent Police Complaints Council	Privacy Commissioner's Office	Equal Opportunities Commission	**Regulatory authority governing anti-competitive practices**
Expenditure	$13,000,000	$36,000,000	$72,000,000	**Tens of millions**
Complaints received	4,695	972	932	**15**
Cost per complaint	$2800	$37000	$77000	**Up to one million**

In 2005, the Independent Police Complaints Council, the Privacy Commissioner's Office and the Equal Opportunities Commission had expenditure of 13 million, 36 million and 72 million respectively[2]. Therefore, we can expect that running a regulatory authority governing anti-competitive activities will also require tens of millions dollars.

Also, in 2005, the Independent Police Complaints Council, the Privacy Commissioner's Office and the Equal Opportunities Commission received 4695 complaints[3], 972 complaints[4] and 932 complaints[5] respectively. That means one complaint can cost from $2800 to $77000. However, in 2005, COMPAG only received 15 complaints[6]. Such few number of complaints means that after we spend tens of millions dollars to set up a regulatory authority to govern anti-competitive activities, we may have to spend up to one million dollars to investigate one complaint. We think that enacting competition law and setting up a regulatory authority at this moment is just wasting the public resources.

[2] Report of the Director of Audit on the Accounts of the Government of the HKSAR for the year ended 31 March 2006

[3] http://www.ipcc.gov.hk/tc/statistics.htm

[4] http://www.pcpd.org.hk/chinese/publications/annualreport2006_5.html

[5] http://www.eoc.org.hk/eoc/graphicsfolder/inforcenter/papers/statisticcontent.aspx?itemid=6819

[6] COMPAG Annual Report 2005

4. Possible Issues on cross-industry competition law

A. Contradict with freedom of contract principle

A giant firm should not be penalized when it uses its cost advantages to compete as long as it earns performance and cost advantages legitimately. It is so even if a huge company tries to preserve its own competitiveness by asking the wholesaler not to supply to other firms because freedom of contract has to be respected. So long as freedom of contract and private property rights are enshrined, a firm can do whatever is legal to compete and earns benefit. Where a government helps to keep competitors out of an industry is different because other competitors cannot enter into the industry at all. The wholesaler mentioned above is still free to choose and other competitors are still free to compete despite the fact that it may face a tougher situation.

B. Limiting free market innovative solution

The competition law, would hinder, rather than encourage competition. Firms may fear of being sued if it wants to acquire market share by lowering its price. Modern market becomes increasingly complicated and cannot be analyzed by a single approach. For example, $1 chicken may be argued to have distorted the chicken market or restaurant market. The very first arise of free tabloid (like Metro) may be complained to have distorted the "traditional newspaper market" if there is competition law. Innovative marketing solutions may then be discouraged.

Based on the above four reasons, we do believe it is NOT THE RIGHT TIME to establish a cross industry competition law under current situation.

Lessons learned from different jurisdiction with competition law

For the last part of our paper, we will seek to show that competition law is itself undesirable and inefficient in promoting a fairer and more competitive market by using various reports and statistics in regard to the situation in different jurisdictions. We will also use some competitiveness statistics to support our proposition.

United Kingdom

Inefficiency of the competition law is shown by the low success rate in the UK. The success rate in the UK is as low as about 0.34% and in 2004/2005 and 2005/2006. This means that among more that 1,100 cases received in both years, only four formal infringement decisions were issued by the Office of Fair Trading (the "CFT").[7] Among those 1,100 cases, only very few cases were considered by the CFT to have reasonable grounds to suspect an infringement had occurred and investigation was rarely launched.[8] Since merely 2% to 3% of cases are worth to be investigated and the success rate is extremely low, a floodgate of complaint is opened by the law which has no substantive application.

Also, we believe that implementing such law is not an effective way to avert customer detriment because of the long investigation period. It often takes two to five years to investigate a case and reach an infringement decision.[9] During such a long period, it is reasonable to reckon that the power of free market can bring things back to the right track. Alan Greenspan, the former Chairman of the Board of Governors of the Federal Reserve in the US, argues that as long as a monopoly is not securely insulated from potential competition under governmental protection, the firm must keep prices low in order to prevent competition from arising because of increase in profit.[10]

If an industry takes this specific course of development, legal action is unnecessary and would wrongly interfere with the free market operation. If an industry potentially fails to have competition as analyzed above by the Porter Model, it is reiterated that we are open to certain degree of regulation to individual industries.

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[7] p83, *Annual Report and Resource Accounts 2005-06*, Office of Fair Trading.
p44, Annual Report and Resource Accounts 2004-05, Office of Fair Trading

[8] *supra* In 2005-06, 23 out of 1195 cases investigated in UK (see p41), while in 2004-05, 17 out of 1173 cases were investigated. (see p46)

[9] p83, *Annual Report and Resource Accounts 2005-06*, Office of Fair Trading.

[10] Memo, 6-12-98; *Antitrust* by Alan Greenspan. Retrieved on 26th Jan 2007 from http://www.polyconomics.com/searchbase/06-12-98.html

Singapore

Since the prohibition on anti-competitive agreements and abuse of a dominant position under ss34 and 47 of the Competition Act only came into force in 1st Jan 2006, statistic is not available at the moment. Singapore, as mentioned above, is an economy which is comparable to that of Hong Kong. Thus, it is suggested that Hong Kong should not introduce competition law before considering the outcome of it in a similar economy.

Although the Competition Act was enacted in Singapore in 2004, the law itself was not without controversies. There is worry that the regulatory authority would fail to disclose the legal analysis, citing the reason of "commercial sensitivity".[11] We have potential worry that if civil cases regarding anti-competitive behaviour are brought into courts, confidential business secret has to be disclosed to both parties for the sake of administration of justice. Litigation may be used as a means to obtain information from rivals and thus not satisfactory.

It should also be noted that the Competition Act is vague and the scope of the law is very narrow in Singapore. The Hong Kong government should, therefore, be very cautious if it wants to refer to the legislation in Singapore. For example, in regard to regulation of abuse of dominant position, "dominant position" is not well defined where would create a "grey area" in law.[12] Moreover, concerning anti-competitive agreements, vertical agreement is not included.[13] More importantly, the law enables the authority to exempt anti-competitive behaviour when it considered that there are "exceptional and compelling reasons of public policy"[14]. In our opinion, the law would result in more government intervention as it may have the discretion to exempt on a case by case basis.

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[11] The Straits Times, *MDA should give fuller picture*, by Burton Ong (a member of the law faculty at the National University of Singapore), filed 25 May 2006

Although the article only refers to a case decided by the Media Development Authority (MDA), it is relevant as it is also about anti-competitive behaviour.

[12] In s47(3), Competition Act 2004 (Singapore). "Dominant position" means a dominant position within Singapore or elsewhere.

[13] Section 8, Third Schedule, Competition Act 2004 (Singapore)

[14] Section 4, Third Schedule, Competition Act 2004 (Singapore)

Statistics from IMD World Competitiveness Centre[15]

We would seek to show that Hong Kong is not in need of competition law by referring to the data retrieved from IMD World Competitiveness Centre. In regard to the competition legislation which prevents unfair competition, although Hong Kong does not have competition law, it receives similar mark with Taiwan, Japan and Korea. For Singapore, the introduction of Competition Act in 2004 did not help her to score higher mark. Her score even dropped drastically in 2005 after the enactment of Competition Act.

Regarding to the business legislation, Hong Kong performed the best among all the countries in both 2005 and 2006. We also look closer into the score about legal and regulatory framework which encourages the competitiveness of enterprises. Hong Kong received the highest mark for its legal and regulatory framework in 2006 among all the countries which have GDP per capita greater than $10,000. All the above statistics show that it is not necessary to introduce competition law to curb unfair competition or to enhance business competitiveness.

[15] All data retrieved on 1 Feb 2006 from http://www.worldcompetitiveness.com

Conclusion

To conclude, although we do not deny that promoting free competition is crucial to Hong Kong's future development, competition law should not be introduced at current stage.

The cross-industry competition law is ineffective to promote free competition under current situation because (i) the market is already very competitive, (ii) market failure in individual industry has been regulated, (iii) the law is economically inefficient, and (iv) it would possibly derogate from the fundamental ideology of free market economy and principle of freedom of contract. Competition law would, therefore, be a step backward, rather than one forward as it would restrict current normal competition activities. The examples in the UK and Singapore also show that the effectiveness of promoting competition through competition law is doubted.

We really hope that our government can examine other ways to promote free competition instead of enacting a cross-industry competition law.