

CB(1)2276/09-10(01)



中華人民共和國香港特別行政區

Hong Kong Special Administrative Region of the People's Republic of China



立法會 LEGISLATIVE COUNCIL

葉劉淑儀 議員 GBS, 太平紳士 Hon Mrs Regina IP LAU Suk-ye GBS, JP

Our Ref: LA2/EDEV/09-10

15 June 2010

Hon Jeffrey LAM Kin-fung, SBS, JP
 Chairman, Panel on Economic Development
 Legislative Council
 8 Jackson Road
 Hong Kong

Competition Law

Further to our discussion at the informal meeting of the Panel on Economic Development yesterday, I attach a copy of an article entitled "Competition Law - Why Hong Kong is Different" which appears in *Best Practice - A Public Policy Journal for Hong Kong* in Autumn 2009 (Vol.1 No. 3).

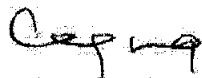
This article is very useful in that it explains that competition law (or antitrust as it is called in the US) generally seeks to address three types of market behavior - monopolies, collusion amongst competitors, and mergers and acquisitions. The situation is different in Hong Kong in that there are some monopolies (notably in the area of energy, transport and telecoms) which fall within the area of natural monopolies. As for areas such as property, construction, supermarket and retail sectors, market concentration has arisen because of the government's massive interference in the land system. The government intervenes heavily by providing public housing for 3.3 million people and by controlling the land supply and keeping prices high. The high land price prices potential competitors and new entrants out of the market in many sectors. Until and unless the government fixes this land system, there is little a competition law could do to stimulate competition in trade in services and the property sector.

The article concludes that "while Hong Kong has competition problems, they are not of the sort that can be remedied by the introduction of a cross-sector competition law. Instead, the roots of the problems lie with poorly regulated natural monopolies and with the land system".

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While not every member of the Panel might agree with the conclusions, the arguments are well laid out and well worth our consideration.

Yours sincerely,



Mrs. Regina IP

MOVING HONG KONG FORWARD

Competition Law – Why Hong Kong is Different

Hans Mahncke *uncovers the roots of Hong Kong's competition problems and explains why they will not be remedied by a cross-sector competition law*

Joe Graz



An interesting feature of competition law is that it is usually enforced administratively through a special agency, rather than judicially through the courts.

A year and a half has passed since the Hong Kong government put forward its proposals for a cross-sector competition law regime. Although draft legislation was to be tabled in the Legislative Council during the 2008/9 legislative session, the government decided to put the plan on hold. According to a spokesman for the Commerce and Economic Development Bureau, the delay is due to “technical, legal and policy issues.” Meanwhile, Donald Tsang, the Chief Executive, who had earlier promised to enact competition

legislation during the 2008/9 legislative session, now states that “people’s main concerns are the economy and livelihood issues.”

While the government’s explanations for the bill’s delayed introduction are not particularly tangible, the policy debate which led up to the postponement offers good clues as to the material reasons for the delay. This article aims to look at those reasons by reviewing the case against the government’s competition law proposals. By doing so, the present study will explain not only why, specifically, the government’s legislative proposals are ineffectual

but also, more broadly, why standard competition law models are not suitable for Hong Kong.

A NEW DIRECTION

The competition law narrative in Hong Kong has a long history. The Consumer Council first called for the introduction of competition legislation in 1996. In 1998 the government issued a statement on competition policy stating that “competition is best nurtured and sustained by allowing the free play of market forces and keeping intervention to the minimum.”

Throughout Tung Chee-hwa’s tenure as Chief Executive the government maintained this approach. The first sign of a change in attitude became visible in 2005 when the current Chief Executive used his first policy address to state that the government would “promote fair competition and adopt appropriate measures according to the circumstances.” By the time of his 2007 policy address, aptly entitled “A New Direction for Hong Kong,” Donald Tsang had decided to introduce competition legislation.

COMPETITION LAW BASICS

Before exploring the situation in Hong Kong and delving into the detail of the government’s plans for competition legislation,

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it is instructive to first consider competition law from a broader perspective. Generally, competition law (or antitrust as it is called in the United States) seeks to address three types of market behaviour, namely monopolies, collusion amongst competitors, and mergers and acquisitions. The commonality amongst these three types of conduct is that they are indicative of potentially concentrated market power. Thus, the aim of regulating such conduct is to ensure that such concentration does not occur or that market power is not abused either by overcharging consumers or by denying other suppliers the opportunity to do business. Yet, beyond these basic commonalities, national competition laws are largely idiosyncratic. What is a monopoly? When is collusion detrimental to consumers and when is it beneficial? When should mergers be allowed? Different countries' systems provide different answers to these questions.

Indeed, the answers change over time, even within the same country, depending oftentimes on the individuals in charge. Thus, the vigour of European Union competition law enforcement has been closely tied to the respective commissioner in charge. Similarly, the extent of application of antitrust law in the United States tends to depend on which party controls the executive branch. Another feature of competition law is that it is usually enforced administratively through a special agency, rather than judicially through the courts.

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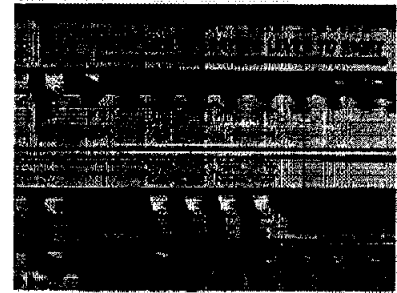
COMPETITION LAW AND HONG KONG

Moving to the specific situation of Hong Kong, there are some peculiarities which may affect the applicability of competition law. First, Hong Kong has developed into its current levels without having employed an across-the-board competition law regime. Instead, it has adopted sectoral regimes in the areas of telecoms and broadcasting. These will be revisited below. Second, unlike all other countries and customs territories in the world (save for Macau), Hong Kong is a free port. This means that no customs duties are levied on imports or transshipments.

In theory this should ensure that market power concentration is not possible as new players can freely enter the market. However, this only applies to trade in goods. As far as other sectors are concerned, most notably natural monopolies, trade in services, and the property market, the situation may not be as straightforward. Third, the Hong Kong government had, until recently, observed a policy of "positive non-interventionism" which was built on the belief that the economy tends to do better without government interference. The policy was adopted in 1971, modelled from the Financial Secretary John Cowperthwaite, but ostensibly abandoned in 2006 by the current Chief Executive, whose preference is a model he has coined "big market, small government."

COMPETITION DEFICITS

There are those who feel that Hong Kong has fared well without a



John C. Ah-Ji

Since competition law is enforced administratively, it is vitally important to have a democratically legitimated administration.

comprehensive competition law and that, therefore, the status quo should be maintained. Indeed, the government, as explained below, could also be counted in this group. However, the various individuals, organisations, and policy makers who have been calling for competition regulation in Hong Kong cannot be ignored. At the very least, irrespective of whether competition law is needed, there seems to be a strong perception within the community that there are competition deficits in Hong Kong.

The most common grievances relate to concentrated market power in the energy, transport, property, construction, and supermarket retail sectors. Concerns have also been raised in the area of telecoms. However, as mentioned above and discussed below, there is already a competition regime in place for this sector. The areas complained about can roughly be grouped into two categories.

First, energy, transport, and telecoms all fall within the area of natural monopolies. That is to say, these are sectors which inherently do not lend themselves to free market philosophy. For instance, it is neither feasible nor desirable to build multiple or duplicate rail networks, highways or electricity grids. Instead,

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There is no balance between private and public housing.

the market is naturally limited to a low number of participants. Thus, to protect consumers and businesses, government regulation is desirable in order to ensure the best service at the lowest price. But while these sectors ought to be regulated and it can be argued that the Hong Kong government has not done particularly well in doing so, the existence of natural monopolies does not justify a cross-sector competition law.

Second, this leaves the property, construction, and supermarket retail sectors. While it may not be immediately apparent, there is a commonality between these sectors: the land system in Hong Kong. While the nexus between the land system and the property sector is clear, supermarkets are also affected as the restrictive land system prices potential competitors and new entrants out of the market. Similarly, the close connection between property development and construction in many cases means that these sectors operate in symbiosis. Most importantly, these sectors are dominated by a few players who have used the land

system as a platform for building their respective business empires.

THE LAND SYSTEM

While it may be debated how far the current government has strayed from the "positive non-interventionism" policy, there is no mistaking the fact that the government has for decades interfered with the system of land distribution and allocation, often with catastrophic consequences for competition in Hong Kong. This interference manifests itself two-fold. First, the government provides heavily subsidised public housing to 3.3 million people, roughly half of the population. Second, all land in Hong Kong is owned by the government which, from time to time, auctions off leases to certain plots of land. Both these factors represent massive interferences in the operation of the free market and can be said to be the true source of Hong Kong's competition troubles.

With regard to the public housing system, eligibility for tenancy is strictly means tested, whereby the income limit for a couple is set at HK\$ 11,600. As a result of this

low threshold, rents paid by public housing tenants are very low, usually a fraction of those paid on the private market. While one may argue about the social desirability of Hong Kong's public housing policy, the undeniable consequence of it is that the rental housing market is starkly divided between cheap and expensive housing with very little in between.

Further – and perhaps even more serious – is the size of the public housing sector means that the size of the private market for property is kept artificially small. In turn this keeps private market prices high. This leads to the second issue, the role of the government in making land available for private development. Instead of having a predictable policy for auctioning land leases, the government chooses to supply land depending on prevailing prices, almost always with the aim of keeping prices high. For instance, when the economy finds itself in a downturn, auctions are put on hold. The situation can similarly be influenced by electing not to sell certain plots of land.

One example is the massive old airport site in Kowloon City which, more than eleven years after the last plane took off, remains in disuse. A related problem is the land premium system whereby property owners can negotiate with the government to amend the covenants on land use. Re-classification can be used to increase land prices, for instance, by re-designating agricultural land for residential use. Land premium negotiations take place behind closed doors and afford the government wide discretion in decision making.

One may ask why the government would be interested in maintaining high property prices. The reason is that a large portion of the government's income is generated

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through property sales, land premiums, and stamp duty. Thus, undersupplying the market helps the government as much as it helps property developers.

The operation of this system has had three effects. First, it has created an indirect tax on consumers and businesses, be it through higher rents or higher retail prices. Second, artificially high property prices stifle economic activity. Third, the land system has facilitated the rise of a few family-owned property conglomerates that control large swathes of the economy, ranging from electricity to transport to supermarket to telecoms. Li Ka-shing and his family are probably the best exponents of this situation, owning amongst others, Hong Kong Electric, the former Hong Kong Telecom (PCCW) and Hutchison Whampoa, with its port facilities and major supermarket retailer Park n'Shop.

There are others too, such as the Kwok family who control Sun Hung Kai, which operates Kowloon Motor Bus (KMB), one of the world's largest private bus companies, various construction and engineering enterprises, as well as Smartone, a leading telecoms firm. Another example is Lee Shau-kee who owns major property developer Henderson Land, Hong Kong and China Gas, Hong Kong Ferry, and a number of department stores.

THE 2008 PROPOSALS

Given the situation described above, the pivotal question which arose from the government's release of its 2008 competition law proposals was whether the same government that maintains and profits from a distorted land system would introduce a competition regime that had the effect of undermining

that land system. Not surprisingly, as betrayed by the details of the government's feeble competition law proposals, the government's mindset was more occupied with maintaining the land system than with fixing Hong Kong's competition deficit.

Thus, the government's overall goal seems to have been to cursorily appease those who have called for competition law while preserving the status quo. Although a detailed discussion of the government's 2008 proposals seems futile at a time when they are being reconsidered, the proposals do yield some information on what may be changed if and when the government releases its new proposals.

The four most glaring defects in the 2008 proposals were the lack of adequate penalties, the exclusion of mergers and acquisitions, administrative enforcement and the fact that the government was attempting to exempt itself from the effect of the legislation. While it cannot be expected – for the reasons mentioned above in relation to the land system – that the government will remedy all defects, there will inevitably be some changes.

Penalties

First, with respect to adequate penalties, the 2008 proposals had

set a limit of HK\$ 10 million as a penalty for breaching competition provisions. Alternatively, a penalty amounting to up to 10% of turnover was to be levied in some circumstances. Compared to other jurisdictions these are small amounts and there have been no indications that the government intends to alter these thresholds.

Mergers and Acquisitions

Similarly on the second issue, the fact that an area as important as mergers and acquisitions was left out of the original proposals must have been carefully considered at the time and, therefore, it is not expected that this item will be amended. Even if relevant provisions are introduced, the example of the Telecommunications Ordinance (discussed below) suggests that they will not be effective.

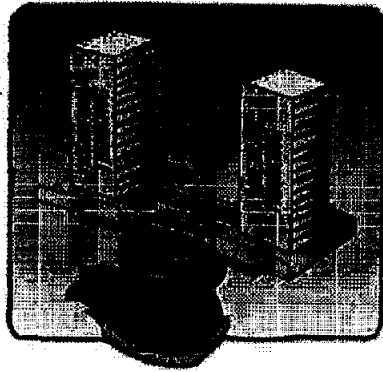
Administrative Enforcement

Third, there are, however, indications that the issue of administrative enforcement may be revisited. This is a problematic aspect to competition law in most jurisdictions, but would be especially so in Hong Kong where there is a lack of democracy and, therefore, lack of legitimacy of the executive. Comments made by Secretary for Commerce and

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MOVING HONG KONG FORWARD

Billy Alexander



We should change our traditional approach – if the government did not intervene in the distribution and pricing of land, there probably would not be as many competition problems.

Economic Development Rita Lau Ng Wai-lan in March 2009, as well as by other government sources reported in the local media, suggest that the government may try to transfer competition law enforcement from an administrative body to the courts.

Although this would overcome some of the difficulties created by Hong Kong's democratic deficit, it would still pose serious questions with respect to the courts' capacity to handle competition law related cases. One of the reasons competition law cases in other countries are often handled by specialised administrative bodies is that they are said to have the expertise necessary to deal with complex economic questions. It would also pose the risk of courts being asked to act as policy makers. The conclusion one might draw is that without a democratically legitimised executive, competition law is unfeasible.

Government Exempt from Legislation

Fourth, there are indications that the government is willing to back away from its earlier desire to exempt itself from being covered by any competition law. However, the extent of this retreat is likely to be

limited, perhaps covering a number of selected statutory bodies. Thus, it is not expected that the modifications the government might introduce to its competition law proposals will change the fact that the law will remain ineffective.

Indeed, the competition regime already in place for the telecoms sector is a good indicator of what can be expected. Since 1999 the Telecommunications Authority has been charged with enforcing rules on anti-competitive conduct, abuse of dominance and mergers and acquisitions in the telecoms sector. It is also charged with investigating misleading and deceptive conduct. However, these last two types of conduct fall outside the scope of what is usually regarded as competition law and also outside the scope of the 2008 proposals for a general competition law.

A look at the competition law related cases investigated by the Authority reveals a disturbing picture. Out of a total of 39 cases of suspected abuse of dominance or anti-competitive conduct which were examined by the Authority, only one case led to issuance of a warning. In all 38 remaining cases, the complaint was said not to have been established. Indeed, given this trend it is not surprising that there has been a very sharp drop in cases being brought. In fact, 23 of the 39 cases in total were brought in 1999, the year the Authority started its work. Similarly, there have been eight investigations relating to

mergers and acquisitions, whereby the Authority saw no problems in any of the eight cases.

CONCLUSION

Thus, while Hong Kong has competition problems, they are not of the sort which can be remedied by the introduction of a cross-sector competition law. Instead, the roots of the problems lie with poorly regulated natural monopolies and with the land system. Unless and until these issues are addressed, there is no point in adopting an across-the-board competition law. In particular, unless the land system is fixed, both in respect of revamping the market segmentation created by public housing, as well as reducing land prices by overhauling the current system of allocating and designating land, nothing will change.

If the government did not constantly intervene in the distribution and pricing of land, there would probably be no need for it to intervene elsewhere. But just as the government has shown itself unwilling to properly regulate natural monopolies, it will in all likelihood not change the way the land system operates. And thus, Hong Kong's competition ills will remain, with or without a competition law regime. **HP**

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