Unclassified **DAF/COMP/GF(2008)2/REV1**

Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development **27-Jan-2009**

English - Or. English

DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE

DAF/COMP/GF(2008)2/REV1
Unclassified

Cancels & replaces the same document of 27 January 2009

Global Forum on Competition

THE CHALLENGES OF TRANSITION FOR COMPETITION LAW AND POLICY IN CHINA

Note by the Secretariat

Session II

This note by the Secretariat is submitted FOR DISCUSSION under Session II of the Global Forum on Competition to be held on 21 and 22 February 2008. Session II is open only to country representatives and intergovernmental organisations.

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English - Or. English

JT03258744

THE CHALLENGES OF TRANSITION FOR COMPETITION LAW AND POLICY IN CHINA

Box 1. Summary

Conditions supporting vigorous market competition in China were revived after the interruption of a generation-long experiment in central planning. Transition reforms began in the 1970s by acknowledging and encouraging initiative in local markets, which led to vigorous competition among township and village enterprises and regions. Opening to outside markets destabilised monopolies. As competition became established by the 1990s, reform attention turned to create the laws and institutions needed to support enterprise markets on a national scale. These included laws about unfair competition, abusive pricing (including price fixing, predatory pricing and discrimination) and bid rigging. These laws and regulations about mergers involving foreign investors have been applied by three institutions that represent three elements of competition policy: correction of abuses and unfair practices, control of monopoly pricing and review of corporate combinations.

China adopted a general competition law in August, 2007, after more than a decade of debate and extensive consultations and exchanges of views with experts from around the world. China's Antimonopoly Law follows familiar international practices about horizontal and vertical restrictive agreements, abuse of dominance and mergers. A separate chapter addresses the important problem of administrative monopoly. Like competition laws in many jurisdictions, the Antimonopoly Law pursues several policy goals. Many details, such as merger notification thresholds, remain to be determined by regulations and guidelines and by experience in applying it. The law became effective in August 2008.

China is now completing the restructuring of the heavy-industry heritage of its once-planned economy. The challenges of transition to a market economy are being succeeded by challenges of development, along with the familiar problems of regulatory reform, of providing infrastructure and public services in a market setting. Curbing government intrusion that tries to protect special interests by dampening competition and favouring particular competitors is complicated by the complexity of the relationships between national and local levels of government authority.

1. Competition policy foundations

1. Competition and market exchange are now well-established features of China's economy. Institutional structures for mediating marketplace disputes while protecting public interests have evolved as China has re-established an enterprise economy over the past 30 years. China's new competition policy system adopts many familiar elements of modern competition laws and institutions, while the generality of the norms in the basic legislation and the system of institutions for applying them are characteristic features of China's governing traditions.

1.1 Context and history

2. Long experience with market institutions underpins China's current growth record. China's traditionally agricultural economy supported a thick network of markets. Sophisticated institutions within this traditional economy included formal commercial procedures and contracts, large organisations and associations, banks that transferred funds nation-wide and legal and customary-law processes for resolving commercial disputes. There were competitive markets for land and labour, as well as for most products.

Traditional production was fragmented, though, and capital accumulation was inefficient. The government had sometimes intervened in markets to prevent monopoly exploitation, but it also funded its own operations with revenues from monopolies. Modern industrial development began in the generation after the collapse of the Qing dynasty in 1911, much of it in the northeast and in the treaty port areas where foreign trade had concentrated. Despite the slowdown during the turmoil of the 1930s and 1940s, the economy grew over the first half of the 20th century, building on the foundation of traditional commercial and entrepreneurial networks and behaviours.

3. Equally long-standing traditions about the nature and role of government help explain the shape of China's reforms since the 1990s. The model of government in China for over 2000 years has been supervision of policy by experts operating from the centre of a unified state, motivated by a social theory emphasising harmony, with implementation delegated to local-level officials. In this model of government and society, control has been founded on respect and reciprocity, as much as on authority and sanction. Negotiation and relationship are more important than assignments and separations of powers. Case-by-case arrangements tend to be preferred over formal uniformity. *Ad hoc* adjustment also characterises the evolving relationships between central authorities and regional leaders and governments. Precise definition of legal categories and jurisdictional boundaries appear to be less important than indication of general policy direction and flexibility in applying it to particular circumstances.

4. Before the era of central planning that began in the 1950s, China was developing a substantial modern market economy – but there was also substantial government direction of that economy. Government intervention increased during the civil war, so that the government already controlled 90% of iron and steel output and most of the banking, transport and power systems when the Communist party took over in 1949. Much of the staff from the previous planning agencies stayed on to work on the Communists' central plan.

5. Central planning controlled the economy for 22 years. Phasing the command-economy system into full operation took seven years, beginning in 1949 and culminating in 1956 when shops became co-operatives and remaining private ownership nearly disappeared. In the planning era, services such as retail trade dropped, since production of consumer goods was discouraged. The legacy of planning was shortage, because the agricultural sector could not, or would not, produce enough. Needs were going unmet because of underdevelopment and diversion of resources to promoting industry. The seed of change was planted in the agricultural sector, in a pilot project for contracting out production to individuals that began in Anhui province in the early 1960s. By 1973, some more steps had been taken to return to a market system. In 1978, the Central Committee decided to shift in earnest back to a market economy. Nearly all of the institutional vestiges of the command economy, of dictated artificial prices, mandatory allocations of inputs and products and funding of the government from the revenues of state industries, have been dismantled since 1979.

6. Reform began in the rural, agricultural economy, with a return to the traditional market-based organisation of small-scale household and township businesses. These reforms aimed to create markets, diversify ownership and stimulate competition. Individuals were given more room for economic opportunity and entrepreneurial activity. Contract arrangements for farm production had become nearly universal by 1983. Individual operations proved to be highly productive, ending food shortages yet requiring less labour input than collective farming had. These first reforms did not eliminate state entities or market distortions, but loosening controls permitted resources to shift to respond to new opportunities.

7. Rural industrialisation catalysed the creation of a market economy. Entry of collectively-owned township and village enterprises (TVEs) provided the competition and the market context that forced state-run enterprises to learn how to improve their efficiency. The TVEs, although collectively owned, began outside the plan, where they faced factor prices that better reflected China's true, non-subsidised

endowments of labour and capital. Yet they could share in monopoly rents under the state-industry umbrella of inefficiency and protection, as well as move into promising empty niches, principally for consumer products. Local government institutions promoted these local firms with low taxes and financial guarantees and credits. Organisational forms, such as the extent of private ownership, varied across regions, so experimentation in that dimension accommodated growth and provided some demonstration effects for others. Regions and their enterprises were in competition, facing hard budget constraints and thus required to become efficient. Ownership patterns shifted as the TVEs became private enterprises after the mid-1990s, when credit got tighter and competition intensified. Firms in this smaller-scale industrial sector have often linked together into industrial clusters, in market structures similar to those that have longed characterised Chinese industry.

8. In the first phase of reform, from 1978 through 1996, the plan and the market co-existed as mechanisms for co-ordination. There was no single “big bang”, but a process of institutional evolution. Freezing the extent of the plan enabled the market economy to grow out of it. To encourage enterprise initiative, the commands of the plan were changed into performance contracts. To encourage competition, entry by new collectively owned firms or by other state firms was permitted. Flexible, market-driven prices were introduced at the industry level, while most consumer prices were gradually decontrolled. Profitability was promoted by reforming management, more than by privatisation as such. Changes were focused at first on activities outside the core of the plan, such as export trade. Macroeconomic stability was preserved by application of the remaining planning tools, rather than by market-based monetary and fiscal instruments, while private saving was encouraged to support investment. Reducing the scope of state monopoly encouraged new entry, new entry and market pricing increased competitive pressure and competitive pressure eroded high profit margins and forced state-sector managers to respond to the marketplace.

9. With the planning structure largely dissolved, attention shifted in the mid-1990s to improving the rules and institutions supporting the market economy, concerning banking, taxation, corporate governance and international trade. In the first phase of reform, decentralisation had permitted market-building experimentation, but in the second phase stronger central authority was needed to impose non-discriminatory regulation to support a larger, freer market, as well as to collect the taxes that replaced state-enterprise receipts. To help ensure accountability in the administration of government, an Administrative Litigation Law was adopted in 1990. A Company Law was adopted in 1993, and a securities regulator was set up in 1999. Foreign trade reforms culminated in WTO membership in 2001. The extent of state ownership declined, as did the profits of state-owned enterprises, and thus rescue and reorganisation of state-owned enterprises occupied government attention.

10. Institutions evolved with the shift from the plan to the market. In the first five-year period, from 1993-1998, the State Planning Commission (SPC) continued to apply the dual pricing system, while the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and State Economic and Trade Commission (SETC) were established to promote international commerce and develop the institutional foundation for domestic markets, and the Bureau of Industrial and Commercial Administration was established to oversee the conduct of enterprises. Ministry-level industry organisations began to be transformed into industrial associations. In the next five-year period, from 1998-2003, the SPC became the State Development and Planning Commission (SDPC), concerned more with macro-economic policy-making and long-term development than with oversight of markets and investment. The SETC was expanded and charged with industrial and short-term development policies. The Office of Rectification and Standardisation of Market Economic Order was responsible for constructing a credit system, supervision of food and pharmaceutical industries, protection of intellectual property, regulation of commercial fraud and breaking regional blockages of domestic trade. In the latest five-year period, from 2003-2007, SETC has been dissolved and its responsibilities assigned to other bodies, including the Ministry of Commerce

(MOFCOM), which has succeeded MOFTEC, and SDPC has become the National Development and Reform Commission (NDRC), which is now the main economic and social development policy-maker.

11. The State Asset Supervision and Administration Commission (SASAC) was created in 2003 to hold and manage the shares of enterprises in which the national government retains ownership stakes. Many state-owned enterprises are linked to local governments, and some have set up local versions of SASAC. SASAC holds few firms, but they include large and important ones in petroleum, metallurgy, electric power, military production and telecoms.

12. A functioning market economy had replaced the command economy by the mid-1990s, if not before. In the 1990s, hundreds of thousands of enterprises reorganised under the new Company Law, into limited liability companies or companies limited by shares. China opened to foreign capital in the early 1990s, recognising it as a source of technology (and inviting competing technologies, rather than granting monopolies). By 2000, there were over 350,000 foreign-invested enterprises, representing over USD 350 billion in foreign direct investment. The flood of investment by multi-national firms in medium- and high-technology sectors has contributed to knitting China tightly into global production networks of high-tech products. WTO access sealed and codified promises of protecting property rights underlying these technology transfers. Price control was lifted in stages, beginning with processed goods and agriculture products and production outside the plan. By 2002, over 90% of consumer retail transactions were at market-determined prices, and markets determined prices for over 90% of purchases of agricultural products and nearly 90% of capital equipment.

13. The extent of competition in China's domestic economy is mixed. Rivalry in many sectors appears vigorous, and by some standard indicators China's product markets appear to be reasonably competitive. Industry concentration at the national level is relatively low, and there has been substantial entry of new firms. National-level concentration measures may be deceptive, though. Limited transport infrastructure, local protection and other barriers to geographic integration create openings for market power that would not be apparent in national concentration data.

14. Government policies about competition have also been mixed. Some regional governments have protected local business interests, while some ministries have promoted national champions. Anti-competitive measures taken by sub-national governments and enterprises connected with them, to prevent competition from other parts of the country and to favour providers with connections to local government interests, have presented problems since early in the transition. The complexity of local government structures magnifies the problem and makes it harder to address. Below the level of the national government are 23 provinces, five autonomous regions, four municipalities that are directly under the central government plus the two special administrative regions of Hong Kong and Macau. These units further subdivide into three more levels of authority. Some local governments have conferred competitive advantages on enterprises affiliated with local bureaus or ministries or set up entities that combine administrative functions with market operation. They have tried to prevent competition by banning or discouraging foreign products – that is, products from other parts of China – from entering the local market or by preventing local products from being shipped elsewhere. Measures have ranged from imposing discriminatory fees to fining offending sellers or refusing licenses to them, in some cases even setting up checkpoints to enforce compliance and to intercept and confiscate offending shipments. Local governments have tried to protect local businesses by devices such as mandatory contributions to a "beer adjustment fund" or rules requiring use only of locally produced inputs such as fertiliser.

15. Ministries have ordered or encouraged combinations, to bring small, local firms together into a national-scale entities. The motivation for encouraging consolidation is typically to improve efficiency and international competitiveness. The government's work plan for 2006 called for encouraging combinations and rationalisations in sectors with surplus capacity. Sectors considered particularly in need of

rationalisation, because of inferior technology, surplus capacity or out-of-date management, include steel, cement, chemicals, coal, electric power, motor vehicles and textiles. The State Council has called for creating several large steel corporations during the current five year plan, each with a capacity over 30 million tons, to be done in large part through market-driven mergers and acquisitions. Other opinions from the State Council about restructuring, vowing to support successful firms and close down unsuccessful ones, also emphasise the importance of market-driven combinations. SASAC promotes continued government ownership as appropriate for four sectors: national security, natural monopoly, "important public goods or services" and natural resources, as well as major firms in a few priority industries. This position is in tension with SASAC's goal of improving governance to maximise asset value. NDRC, in line with SASAC, supports national champions and guides the structural adjustment of key industries such as automobiles and steel via industrial policies to improve the competitiveness of the dominant SOEs. For example, NDRC has been promoting rationalisation of the cement sector, aiming to reduce the number of firms from over 5000 to about 3500, among them 10 national champions capable of competing globally and identifying 30 to be supported by local governments. Regional agencies are encouraging consolidation in other sectors, such as steel.

Box 2. Competition Policy's Roles in Regulatory Reform

In addition to the threshold, general issue, which is whether regulatory policy is **consistent** with the conception and purpose of competition policy, there are four particular ways in which competition policy and regulatory problems interact:

- Regulation can **contradict** competition policy. Regulations may have encouraged, or even required, conduct or conditions that would otherwise be in violation of the competition law. For example, regulations may have permitted price co-ordination, prevented advertising or other avenues of competition, or required territorial market division. Other examples include laws banning sales below costs, which purport to promote competition but are often interpreted in anti-competitive ways, and the very broad category of regulations that restrict competition more than is necessary to achieve the regulatory goals. When such regulations are changed or removed, firms affected must change their habits and expectations.
- Regulation can **replace** competition policy. Especially where monopoly has appeared inevitable, regulation may try to control market power directly, by setting prices and controlling entry and access. Changes in technology and other institutions may lead to reconsideration of the basic premise that had supported regulation, namely that competition policy and institutions would be inadequate to the task of preventing monopoly and the exercise of market power.
- Regulation can **reproduce** competition policy. Regulators may have tried to prevent co-ordination or abuse in an industry, just as competition policy does. For example, regulations may set standards of fair competition or tendering rules to ensure competitive bidding. Different regulators may apply different standards, though, and changes in regulatory institutions may reveal that policies which had appeared similar may have led to different outcomes.
- Regulation can **use** competition policy methods. Instruments to achieve regulatory objectives can be designed to take advantage of market incentives and competitive dynamics. Co-ordination may be necessary, to ensure that these instruments work as intended in the context of competition law requirements.

1.2 Development of competition laws

16. China's first regulation about competition, issued by the State Council in 1980, was the Interim Provisions for the Promotion and Protection of Competition in the Socialist Economy, known more concisely as the Ten Articles on Competition. At that early stage of transition back to a market-based economy, the Ten Articles already explicitly pointed out the key problems. The Ten Articles ruled out official monopolies and exclusive privileges unless authorised by the state. They called on departments in

charge of industry, transportation, finance and trade to delete regulations that obstruct competition. And they stressed the importance of breaking down regional blockades and departmental divisions, ordering that no region or department may blockade the market or prohibit the sale of commodities originating in other regions or departments; however, they relied on the regions and departments themselves to implement these principles. A 1984 Decision of the Party Central Committee and State Council, addressing concerns about unfair competitive advantage and corruption due to official action and insider dealing, prohibited the leading organs of the Party and the government from "abusing their power to engage in business, set up enterprises, seek personal gains, and harm the interests of the people in violation of the regulations of the Party and of the State". The State Commission for Economic Restructuring and the State Planning Commission issued opinions in 1987 and 1989 dealing with risks to competition due to industry consolidation, instructing that monopoly enterprise groups should not be set up within an industry, that competition between enterprise groups within the same industry should be encouraged to promote technological progress and economic efficiency and that mergers should achieve economies of scale without harming competition. Another circular trying to prevent regional market blockades was issued in November 1990.

17. Formal legislation about competition began to take shape in the late 1980s. In August 1987, the State Council set up an anti-monopoly law drafting group. Draft Interim Regulations Against Monopoly and Unfair Competition appeared in 1988. In September, 1993 the Standing Committee of the Eighth National People's Congress enacted the Anti-Unfair Competition Law (AUCL). But the draft interim regulations about monopoly were not incorporated into law at that time. Experts and legislators expressed some doubt that a law to address monopolisation was needed at that stage in China's development, because firms were still relatively small compared to relevant economies of scale and to major multi-national corporations, while horizontal combinations were thought to be either uncommon in China or even desirable as means of achieving efficiency. Debate continued about a broader law about competition. In May 1994, the government formed a group to draft an antimonopoly law. The group was drawn principally from the State Economic and Trade Commission (SETC) and State Administration of Industry and Commerce (SAIC). In developing the draft, the group consulted Chinese experts and experts from international organisations, including the OECD, and several national competition agencies. An anti-monopoly law was included in the legislative plans for the sessions of the Standing Committee of the National People's Congress in 1994 and again in 1998, but none was adopted. A complete draft of a law appeared in November 1999, with eight chapters and fifty-six articles. This draft includes most of the features of the competition law that was adopted in 2007.

18. During the years of debate over a general competition law, other laws and regulations were enacted to deal with competition issues. The Price Law, which took effect in 1998, prohibits collusion to control market prices. It also prohibits some abusive pricing and provides for price controls on some products. The Bidding Law, enacted in 1999, prohibits bid rigging and provides for stronger sanctions against it than the AUCL. Interim provisions providing more detail and guidance about collusive and predatory pricing were issued in 2003. These regulations, and similar interim provisions for review of mergers and acquisitions involving foreign investors, were precursors to the comprehensive competition law.

19. In 2004, the State Council put the draft competition law on the legislative agenda. The draft was debated at sessions of the Standing Committee of the National People's Congress (SCNPC) in 2006 and 2007. One focus of the debate was the treatment of industries dominated by state-owned firms, such as banking, insurance, energy, telecommunications, tobacco, petroleum and railways. During the final round of consideration in 2007, the draft was revised to adjust the relative power of the competition enforcement authority and sector regulators, clarify that the market share presumption for establishing a dominant position is rebuttable, increase the fines against restrictive agreements and abuse of dominance and give the competition enforcer a clearer role in pursuing anti-competitive abuses of administrative power. At the

last minute, the SCNPC added a provision specifically targeting abuses by industry associations. The SCNPC adopted the AML on August 30, 2007, by a near-unanimous vote (150 out of 153). It took effect in August, 2008.

1.3 Policy goals

20. Four policy goals motivate the Antimonopoly Law: "safeguarding fair market competition, improving economic efficiency, protecting the interests of consumers and public interests, and promoting the healthy development of the socialist market economy." (Art. 1) [1] Rules about competition are to be suitable to the socialist market economy, and the state is to improve macroeconomic measures to support a unified, open, competitive and orderly market system. (Art. 4) The policy goals of the precursor laws are similar. The goals of the Price Law are to strengthen the role of prices in the allocation of resources, stabilise price levels, protect the interests of consumers and enterprises and promote healthy development of the socialist market economy; in addition, it declares that the state promotes fair, open and lawful market competition. (Price Law, Art. 1, 4) The purpose of the 1993 Anti-Unfair Competition Law (AUCL) is "to safeguard the healthy development of the socialist market economy, encourage and protect fair competition, prohibit acts of unfair competition, and defend the legitimate rights and interests of operators and consumers". (AUCL, Art. 1) In the latest legislation, the goal of healthy development of the socialist market economy is listed last, not first. And for the first time, the AML includes the policy goal of improving efficiency, implying that the application of the AML could follow modern economics-based conceptions of competition policy. China's law now incorporates all of the elements of the long-running debate about the priority and consistency of policy goals of fairness, efficiency, consumer and public interests and development.

21. When China embarked on the road to a socialist market economy, the leadership described it in terms that clearly support the importance of allocative and dynamic efficiency. The head of the Communist Party, Jiang Zemin, explained the principles to guide a socialist market economy in a speech in October 1992 (Wang, 2006):

> The purpose of the socialist market economic system, which China is going to establish, is, under the macro-control of the socialist state, to give full play to the basic role of the market in the allocation of resources; to ensure that economic activities are carried out in accordance with the law of value and adapted to the changes in relations between supply and demand; to use the lever of price and the competition mechanism to allocate resources to the places where they can produce the best economic results; to implement the system of selecting the superior and eliminating the inferior so as to give pressure and impetus to enterprises; and to promote the timely adjustment of production and demand by taking advantage of the sensitivity of the market to various economic signals.

2. Substantive issues: content of the competition law

22. China's new anti-monopoly law is a comprehensive general competition law. It collects and revises rules from several existing laws and regulations, while introducing new, generally applicable rules about important topics such as merger review. Monopoly agreements are covered in Chapter II (which treats horizontal and vertical agreements separately), abuse of dominance in chapter III, mergers in chapter IV, administrative monopoly in chapter V, investigative powers and processes in chapter VI and sanctions and remedies in chapter VII. Other laws and rules already address several of these topics, and many of those laws and rules will evidently remain in force.

1. Unless otherwise indicated, citations to legislation are to the AML, in an unofficial translation that was prepared for the OECD Secretariat.

Box 3. The Competition Policy Toolkit

General competition laws usually address the problems of monopoly power in three formal settings: relationships and agreements among otherwise independent firms, actions by a single firm, and structural combinations of independent firms. The first category, **agreements**, is often subdivided for analytic purposes into two groups: "horizontal" agreements among firms that do the same things, and "vertical" agreements among firms at different stages of production or distribution. The second category is termed "**monopolisation**" in some laws, and "**abuse of dominant position**" in others; the legal systems that use different labels have developed somewhat different approaches to the problem of single-firm economic power. The third category, often called "**mergers**" or "**concentrations**," usually includes other kinds of structural combination, such as share or asset acquisitions, joint ventures, cross-shareholdings and interlocking directorates.

Agreements may permit the group of firms acting together to achieve some of the attributes of monopoly, of raising prices, limiting output and preventing entry or innovation. The most troublesome **horizontal** agreements are those that prevent rivalry about the fundamental dynamics of market competition, price and output. Most contemporary competition laws deal very harshly with naked agreements to fix prices, limit output, rig bids or divide markets. To enforce anti-competitive agreements, competitors may also agree on tactics to prevent new competition or to discipline firms that do not go along; thus, the laws also try to prevent and punish boycotts. Horizontal co-operation on other issues, such as product standards, research and quality, may also affect competition, but whether the effect is positive or negative can depend on market conditions. Thus, most laws deal with these other kinds of agreement by assessing a larger range of possible benefits and harms, or by trying to design more detailed rules to identify and exempt beneficial conduct.

Vertical agreements try to control aspects of distribution. The reasons for concern are the same – that the agreements might lead to increased prices, lower quantity (or poorer quality) or prevention of entry and innovation. Because the competitive effects of vertical agreements can be more complex than those of horizontal agreements, the legal treatment of different kinds of vertical agreements varies even more than for horizontal agreements. One basic type of agreement is resale price maintenance: vertical agreements can control minimum, or maximum, prices. In some settings, the result can be to curb market abuses by distributors. In others, though, it can be to duplicate or enforce a horizontal cartel. Agreements granting exclusive dealing rights or territories can encourage greater effort to sell the supplier's product, or they can protect distributors from competition or prevent entry by other suppliers. Depending on the circumstances, agreements about product combinations, such as requiring distributors to carry full lines or tying different products together, can either facilitate or discourage introduction of new products. Franchising often involves a complex of vertical agreements with potential competitive significance: a franchise agreement may contain provisions about competition within geographic territories, about exclusive dealing for supplies and about rights to intellectual property such as trademarks.

Abuse of dominance or **monopolisation** are categories that are concerned principally with the conduct and circumstances of individual firms. A true monopoly, which faces no competition or threat of competition, will charge higher prices and produce less or lower quality output; it may also be less likely to introduce more efficient methods or innovative products. Laws against monopolisation are typically aimed at exclusionary tactics through which firms might try to obtain or protect monopoly positions. Laws against abuse of dominance address the same issues, and may also try to address the actual exercise of market power. For example under some laws about abuse of dominance, charging unreasonably high prices can be a violation of the law.

Merger control tries to prevent the creation, through acquisitions or other structural combinations, of undertakings that will have the incentive and ability to exercise market power. In some cases, the test of legality is derived from the laws about dominance or restraints; in others, there is a separate test phrased in terms of likely effect on competition generally. The analytic process applied typically calls for characterising the products that compete, the firms that might offer competition and the relative shares and strategic importance of those firms with respect to the product markets. An important factor is the likelihood of new entry and the existence of effective barriers to new entry. Most systems apply some form of market share test, either to guide further investigation or as a presumption about legality. Mergers in unusually concentrated markets, or that create firms with unusually high market shares, are thought more likely to affect competition. And most systems specify procedures for pre-notification to enforcement authorities in advance of larger, more important transactions, and special processes for expedited investigation, so problems can be identified and resolved before the restructuring is actually undertaken.

2.1 Horizontal agreements

23. The AML dedicates a separate section to controlling agreements among competitors. (Art. 13) Five types of horizontal agreements are specifically prohibited: to fix or change prices, restrict output or sales, allocate markets or materials, restrict new technology, equipment or products, and refuse to deal (that is, collective boycott). Other kinds of agreements may also be prohibited, upon a determination by the enforcement authority. The general definition of the "monopoly agreements" that the AML prohibits is broad enough to include group decisions and concerted actions. Sanctions against horizontal agreements that the AML prohibits include orders to cease the prohibited conduct, fines of from 1% to 10% of annual turnover, forfeiture of gains from the violation and criminal penalties. If the agreement was not actually implemented, the parties may still be liable for a fine up to CNY 500,000. Sanctions may be reduced or even eliminated for a party to a prohibited agreement that reports it to the enforcement authority and provides important evidence about it. (Art. 46) Thus, the AML's rules about sanctions support the adoption of a leniency program to facilitate enforcement against horizontal cartels.

24. The AML provides for exemptions from the prohibition against monopoly agreements, either horizontal or vertical. Six criteria could support exemption: improving technology, research and development of new products; improving product quality, reducing cost, enhancing efficiency, unifying specifications or standards or specialisation; improving efficiency and enhancing competitiveness of small and medium-sized firms; achieving public interests such as energy saving, environmental protection and disaster relief; moderating oversupply during economic depression; and ensuring legitimate interests in foreign trade and economic cooperation. In addition, to qualify for exemption the agreement must not substantially restrict competition in the relevant market and the benefits must be shared with consumers. (Art. 15) These last two provisos do not apply, however, to exemptions based on foreign trade and economic co-operation. The parties bear the burden of showing that their agreement meets the criteria for exemption. The process for deciding about exemptions is not specified. Particularly with respect to claims to exempt "depression" cartels, it will be important for guidelines or regulations to make clear that the exemption would be conferred only for limited periods and in limited circumstances.

25. Whether the AML prohibition against horizontal agreements is a *per se* rule, one that does not require a specific showing of effect as a condition of liability, is not yet clear. Coverage of the AML prohibition could depend on the definition of what is prohibited. The definition of "monopolistic agreements" describes them as agreements that eliminate or restrict competition. This phrase about competitive effects might be construed as another prerequisite for finding liability. Or, it might be treated as a characterisation of the likely effects of the kinds of agreements that are banned, and thus as guidance for identifying other horizontal agreements that should be prohibited. The definition is not qualified by a condition such as "substantiality". A conception of reasonableness or proportionality, reflected in enforcement practice or incorporated into guidelines if not into the text of the legislation, would help avoid mechanical and inefficient prohibition of all agreements that limit rivalry in any way. But enforcement against what is the most serious competition problem in developed economies, hard-core horizontal price fixing agreements, would be more efficient if they were prohibited *per se*.

26. Other laws already prohibit horizontal cartels and bid rigging. The 1997 Price Law prohibits collusion to control market price. (Price Law, Art. 14(1)) Sanctions include seizure of illegal gains, a fine up to five times of the illegal gains, warning or order to correct behaviour and even cancelling business licenses. (Price Law, Art. 40) Regulations implementing the Price Law, originally adopted in 2003 as the NDRC's *Interim Provisions on Prohibiting Monopolistic Pricing Behaviour* and recently issued as regulations of the State Council, describe in more detail what the law prohibits: entering agreements, decisions or concerted practices that fix or change price or that limit output to control price. The Price Law also prohibits collusion to control price in bidding or auctioning, and it includes a general term to deal with other kinds of price-controlling behaviour. In addition to banning price control through private agreement,

the Price Law also provides for official price control for key commodities and services. (Price Law, Art. 18)

27. The AUCL prohibits collusive bids. Such bids are void, and the colluding bidders are subject to a fine of from CNY 10,000 to CNY 200,000. (AUCL, Art. 15, 27) (This is the only kind of horizontal agreement covered in the AUCL.) The Bidding Law also prohibits bid rigging, and it authorises more serious sanctions than the AUCL, including seizure of illegal gains, a fine of from 5% to 10% of the project, disqualification from future bidding, cancelling business licenses, criminal penalties and compensation to other, injured parties. (Bidding Law, Art. 32, 53) And bid rigging can be prosecuted under the Criminal Law, where conviction could lead to fine and up to three years imprisonment. (Criminal Law, Art. 223) Enforcement against bid rigging has resulted in particularly strong sanctions. Two officials convicted of bid rigging and bribery in 2004, in connection with re-organising state enterprises, were sentenced to prison for 13 years.

28. Enforcement against other kinds of price fixing agreements has not been as vigorous so far. Price fixing has been reported about products ranging from rice noodles to airline service. Frequently-cited examples from the 1990s include an agreement to end a price war over air conditioners between state-owned department stores in Nanjing, an agreement on service fees between providers of pager services and two agreements about washing machines, one between producers over the prices and terms for sales to retailers and one between department stores about prices for sale to the public. Enactment of the Price Law prohibition did not stop reports of similar agreements, such as an agreement in 1999 to restrict output and keep prices up for video cameras and another agreement in Nanjing about air conditioners, this time between manufacturers.

29. The fate of a short-lived “price alliance” among nine TV manufacturers shows the beginning of stronger policy response. After six price wars in five years, the manufacturers held a summit meeting to agree on standards and research and also to agree on minimum prices and a production cutback. The participants evidently had no idea that this would violate the Price Law. One industry executive claimed that the agreed price only covered production costs, so any price below that should be treated as unfair competition. An official in the Ministry of Information Industry greeted the summit as a sign of industry maturity, healthy development and self-discipline. But the State Development and Planning Commission (the predecessor of the NDRC, which now enforces the Price Law) promised to investigate, saying it looked like a monopoly in disguise. A few weeks later, the Ministry joined with the SDPC in admonishing the industry that its agreement on price violated the law. No formal enforcement action was taken, because the agreement collapsed quickly: one of the parties had begun undercutting the minimum price the day after the summit meeting.

30. In the past, official calls for “self-discipline” in pricing sometimes led to market results that were the equivalent of collusion. The State Economic and Trade Commission issued *Opinions On Self-Discipline Pricing For Certain Industrial Products* in 1998 contending that this self-discipline was necessary to end price wars and disorderly competition. Producers of 20 categories of products, such as plate glass, cement, cars, agricultural vehicles and electricity generators, were required to observe minimum prices. Trade associations set the minimum prices, and the trade associations could enforce compliance by fining their members. In one case, a firm paid a fine of CNY 800,000 (plus an “inspection fee” of CNY 153,000) for cutting prices below the minimum; that fine for violating a price-fixing agreement is greater than the fine that SAIC could impose for bid rigging.

31. Trade associations are now subject to a special provision of the AML, added in the final reading. Associations “shall not organise” their members to engage in anti-competitive conduct that is prohibited by the chapter on “monopoly agreements.” (Art. 16) This new article underscores the importance of the topic. It was not needed to close a loophole in the proposed law, though (unless some special treatment is implied

by the admonition in Art. 11, that associations should strengthen their members' self-discipline to compete in accordance with the law). The general definition of the monopoly agreements that are prohibited by Article 13 should be broad enough to cover anti-competitive agreements reached through a decision by a trade association.

Box 4. Classic collusion

Several price-fixing arrangements surfaced in the summer of 2007, when the Standing Committee of the National People's Congress was finalising the AML. Publicity about these cases probably prompted the addition of an article specifically targeting trade association price-fixing agreements.

Noodles: Between the end of 2006 and July 2007, the China Instant Noodle Association called three meetings to discuss price increases. The association reached agreement on the extent and timing of price increases for three ranges of products, and the plan was published in the industry's trade journal. The July 2007 price increase announcement led to long queues of shoppers trying to buy before the price went up. Consumers complained to the NDRC, which opened an investigation. At first, the association did not provide complete documentation about its meetings, and it issued a media statement denying that the increases were collusive. But the NDRC determined that the meetings leading to the increases violated the Price Law and implementing regulations, by seriously impeding the market pricing system, restricting normal competition and harming consumer interests. As a remedy, the NDRC ordered the association to revoke the price increase plan and issue a public explanation of its conduct. The NDRC also called on all industry associations and firms to learn from the case and to stop price collusion. The NDRC invited the media and the public to pay attention to prices and to complain about suspicious pricing behaviour, using the NDRC's price-regulation hot-line, "12385".

Car washing: In August 2007, a local price supervision department in Hubei province received complaints about price increases at car-washing shops. Two shop-owners had suggested a price increase to nine others. The next day, there were two meetings to discuss it, the last one a general meeting among 16 shops that produced an agreed schedule of increases and a means to enforce compliance. Each shop deposited an amount equal to the price of 50 car washes (or 100 motorbike washes), which would be forfeited if the shop cheated on the cartel price. The local price supervision office investigated immediately on receiving the complaints. Just three days after the agreement and the price hike, it convened its own meeting with the cartel members and instructed them that their deal was illegal. The cartel agreed to roll back the increase and not to collude about prices in the future. The office agreed that prices could vary depending on the service, and that they could be changed to meet the prices for similar services in nearby counties.

Restaurants: Another local price supervision office, in Zhejiang province, followed up on newspaper reports that the local restaurant association was planning a 20% price increase. This association evidently had not reduced its agreement to writing. The investigation resulted in a warning. The association promised to comply with the law in the future, while taking measures to cope with increased costs and maintaining "stability" of prices in the industry.

Source: NDRC

32. Open, formal agreements to fix prices should become rarer as enforcement becomes stronger, backed by the new AML. It is not yet clear whether the AML will lead to stronger sanctions, though. In theory, the fine for violating the Price Law could be higher than the fine for violating the AML, since the Price Law sets no upper limit and authorises a fine of up to five times the gain from the violation. The Price Law sanctions even include revoking the violator's business licence. But reports of recent Price Law enforcement show that cases typically result in warnings or corrective orders, not fines. The AML provides for one sanction, criminal penalties, that is stronger than the Price Law. Regulations for implementing the AML might provide more guidance for setting fines high enough to deter violations.

2.2 Vertical agreements

33. Another separate section of the AML covers vertical agreements, that is, those "among counter-parties." (Art. 14) Only two types of agreement are specifically prohibited: to fix prices for sale to third parties and to restrict minimum resale prices to third parties. The enforcement authority can also determine that other kinds of agreement constitute "monopoly agreements" under the law. How the AML applies to price recommendations, ceilings on resale prices, exclusive distribution and supply, franchising and other distribution arrangements will be determined by the course of enforcement practice. Enforcement practice may also determine whether the ban on resale price maintenance is considered a *per* se rule, or whether its treatment will follow the trend in other jurisdictions to consider its net effects on competition in the relevant market. Exemption from the prohibition against vertical "monopoly agreements" is determined by the same part of the law that specifies exemptions for horizontal agreements, so the same standards and presumptions would apply.

34. Regulations already in place have anticipated the AML's treatment of vertical agreements. The *Administrative Measures for Fair Transactions between Retailers and Suppliers* prohibit agreements requiring resale price maintenance, tie-in sales or exclusive dealing. These regulations were issued in 2006 jointly by MOFCOM, SAIC, NDRC and two other agencies at ministerial level. They also cover other common topics of dispute in distribution relationships, such as timely payment, returns and promotional support. They are enforced by local-level departments corresponding to the national-level bodies that issued them. Sanctions for violation include corrective orders and fines of up to three times the illegal gain or loss, subject to a ceiling of CNY 30,000. To avoid violation, the regulations encourage parties to use sample contracts, which are recommended by the departments of industry and commerce. (Art. 5) The regulations contain no "competitive effects" test or provision for exemption or rule-of-reason balancing.

2.3 Abuse of dominance

35. The AML prohibits abuse of a dominant market position. One of the AML's opening general provisions states that firms with a dominant position shall not use that position to eliminate or restrict competition. (Art. 6) Chapter III about abuse of dominance begins by listing six types of abuse that are specifically prohibited: exploitation by charging customers unfairly high prices or by unfairly under-paying suppliers, selling below cost, refusal to deal, requiring exclusive dealing, imposing tying and other unreasonable terms and discriminating in price or terms. (Art. 17) The prohibitions are subject to the proviso that the conduct be "without justification," except that this proviso does not apply to exploitation. The enforcement authority may determine that other conduct also constitutes prohibited abuse.

36. A dominant position is defined as one that enables the holder to control price, output and conditions in a relevant market or to control entry into it. (Art. 17) Identifying a dominant position thus presupposes definition of a relevant market. Factors to be considered in determining whether a firm is dominant include its market share, its financial and technical capacity, the extent that other firms depend on it and the difficulty of entering the relevant market. (Art. 18) A finding of dominance can be based on market share and structure. For a single firm, dominance may be presumed from a market share over 50%. In a relevant market where two-firm concentration exceeds 67% or three-firm concentration exceeds 75%, any firm with a market share greater than 10% may be presumed to have a dominant position. These thresholds are rebuttable presumptions, so a firm could avoid liability by showing that it does not have the power to control price, output, entry or market conditions. In joint-dominance situations, the 10% threshold is a "safe harbour"; otherwise, the AML permits the enforcement authority to find that a firm is dominant, based on the defining criteria, despite having a market share below the level of the presumption. Enforcement guidelines explaining factors that will be relevant in applying the presumption could help ensure that the statutory criteria will not be treated too mechanically.

37. The Price Law also deals with exploitative and predatory pricing and with discrimination. It prohibits selling at prices below cost with an intention to eliminate competitors and monopolise the market. It also prohibits discriminatory pricing and excessive pricing, regardless of whether there is an intent to eliminate competition. Sanctions include orders to cease and correct the violation, seizure of illegal gains, a fine of up to five times the gains or cancellation of the offender's business licenses. (Price Law, Art. 14, 40) The NDRC, which enforces the Price Law, issued *Interim Provisions on Preventing Price Monopoly* in 2003 to elaborate its prohibitions and move toward putting them into a competition policy framework, by introducing the element of dominance. These regulations provide that a firm may not rely on its "market predominance" to engage in exploitative, predatory or discriminatory conduct. A position of market predominance is determined by share of the relevant market and the ease of substitution of other products or of entry by new suppliers. The *Guiding Principles on Below Cost Sales*, issued in 1999 by the NDRC's predecessor, provide further detail about what is considered to be a sale "below cost" under the Price Law. The cost reference is the cost of production and operation (Price Law, Art. 8), which implies a test based on variable cost, although average cost and the scope of the price cut may be used to establish the reference point if variable cost is difficult to determine. Violation depends on a purpose to squeeze out competitors or monopolise the market, and pricing below cost is permitted for normal clearance sales, that is, to dispose of overstock, seasonal and perishable goods or in case of insolvency, transfer or termination of a business.

38. The AUCL also prohibits sales below cost and tying. (AUCL, Art 11, 12) These prohibitions do not depend on showing that the firm has a dominant position. The AUCL prohibition on sale below cost is not a *per se* rule, though. It contains an element of intent, to put competitors out of business, and it provides exceptions, such as for disposing of perishable commodities, overstocks and seasonal goods and for liquidation of a business. (AUCL, Art. 11) These terms of the AUCL, which is enforced by SAIC, are analogous to the 1999 *Guiding Principles on Below-Cost Sales* under the Price Law, which is enforced by NDRC.

39. Abuse of intellectual property rights to eliminate or restrict competition could violate the AML. (Art. 55) Private lawsuits about technology licensing and compatibility have raised claims about monopolisation, which have been framed in terms of unfair competition or infringement of the Contract Law in the absence of a general law about abuse of a dominant position. A contract that monopolises technology or impedes technological progress or that infringes technological achievement by others is null and void. (Contract Law, Art. 329) A technology transfer contract may control the scope of use, if it does not restrict technological competition and development. (Contract Law, Art. 343)

40. No provision for exemption from the prohibition against abuse of dominance is provided in the AML. The proviso, that the conduct be "without justification," would encourage enforcers to assess net effect on competition, rather than apply the prohibitions literally and formalistically. But it might also envision balancing of anti-competitive effects against other goals or policies. Enforcement guidelines might clarify what would be considered adequate justification for otherwise prohibited conduct.

41. The application of the AML to network industries and public services remains to be worked out in practice. Where exclusive rights or monopolies have been authorised by law, the state is to protect the legitimate rights of the firms in those industries and also safeguard the legitimate interests of consumers and promote technological progress. These firms are not to use their exclusive or monopoly positions to harm consumers. (Art. 7) It does not appear that this section of the AML would confer an exemption from the general prohibition against abuse of dominance, because it also provides that the firms subject to it are to conduct their business in accordance with law.

42. The AUCL controls some aspects of monopoly abuse by utilities. It prohibits public utilities and statutory monopolies from forcing transactions on their customers. (AUCL, Art. 6) This prohibition responds to a pattern of abuses, of telecoms, electric power, water and gas suppliers refusing service unless

customers bought designated telephones, distribution boxes, meters or heaters – ones that were typically supplied by affiliates and were more expensive than others available on the market. The regulations that SAIC issued in 1993 elaborating this part of the AUCL, the *Provisions Prohibiting Public Utilities to Restrict Competition*, incorporate the concept of dominance. Firms in the sectors of water, electric power, gas, postal service, telecommunications and transport are prohibited from "using dominant position to impede fair competition of other business operators and to harm legitimate rights of consumers". The non-exhaustive list of prohibited behaviours includes forced transactions, tying, refusal to deal and excessive pricing. Sanctions for violation include orders to cease the practice and fines of up to 3 times the illegal gain. Customers and consumers can claim compensation for these violations by utilities; by contrast, suits for damage from most violations of the AUCL can only be brought by other firms.

43. Sectors that are the usual objects of regulatory reform, in which long-standing monopolies and public firms face new competition, could provide occasions to test the application of the AML. In telecoms, restructuring has created seven operators, but the two mobile phone companies, China Mobile and China Unicom, are state-owned and controlled substantially by the Ministry of Information Industry and its local agencies. There have been complaints about excessive pricing, tying and exclusive dealing. In health care, state-owned hospital pharmacies sell most prescription pharmaceuticals, and there have been complaints that exclusive dealing, tying and bid rigging prevent competition from retail pharmacies. China may need special rules to address anti-competitive strategies by publicly owned firms, because their capital structure and connection with government give them incentives and opportunities to distort competition with privately-held competitors.

2.4 Mergers

44. The AML establishes a general framework for applying competition policy to mergers and acquisitions. It covers mergers, acquisitions of shares or assets that lead to change in control and acquisitions of control or "decisive influence" through contract or other means. A transaction may be prohibited if it may eliminate or restrict competition; thus, the general substantive standard is not tied to the concept of dominance. Factors to be considered include the parties' market power and share, concentration in the relevant market, effects on entry and technological development, effects on consumers and other enterprises and effects on national economic development. A transaction may be approved if the parties show that it will lead to improvements in conditions of competition that outweigh adverse effects on competition or that it is otherwise in the public interest. (Art. 28) The opening provisions of the AML also make reference to mergers, in declaring that firms may agree to mergers to achieve economies of scale and improve competitiveness (Art. 5) By repeating this point in the context of the law's policy goals and general principles, the AML underscores that merger control will consider claims of improved efficiency.

45. The merger rules that are now in effect apply only to transactions by foreign investors taking over firms in China. The *Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* were issued jointly in 2006 by six ministries and bodies responsible for foreign exchange, securities regulation, taxation, state shareholding and competition policy and enforcement. These follow interim rules adopted in 2003. One policy goal is to maintain fair competition, and one of the substantive principles is that a foreign firm takeover should not cause excessive concentration or exclude or limit competition. Thus chapter 5 of these *Provisions* provides for antitrust review, to determine whether the takeover may lead to excessive concentration, hamper fair competition or impair consumer interests. Other goals and purposes include promoting foreign investment and introduction of advanced technology and management and protection of employment and national economic security. Approval by MOFCOM is therefore required for any acquisition transferring control of a domestic company relating to key industries with an actual or potential effect on national economic security, or of a company with a famous trademark or venerable company registration. A transaction may be exempted from review if it would improve competition in the market, the target of the takeover is losing money and the takeover would preserve jobs, the takeover

would improve international competitiveness through transfer of technology and management or the transaction would improve environmental conditions. MOFCOM issued guidelines for notification in 2007 to clarify procedural issues such as the timing and content of notification. Parties are encouraged to contact MOFCOM before making a formal notification, to discuss whether notification will be necessary and to begin clarifying issues such as the relevant markets.

46. Pre-notification will be required under the AML. Details of the notification obligation will be set by the State Council. Earlier drafts of the law would have set specific notification thresholds, of aggregate turnover of CNY 12 billion of all parties worldwide and turnover of CNY 800 million of any single party in China. These specific thresholds were dropped from the AML as finally adopted, and provisions in early drafts that would have based notification on market share were also not included in the final law. Setting notification thresholds and terms through regulations issued by the government rather than in the basic legislation will increase flexibility.

47. Notification under the current rules about takeovers by a foreign party can be required under several different criteria. If the transaction is in China, notification is required if any party to the transaction has annual turnover in China over CNY 1.5 billion, if the foreign party has acquired more than 10 domestic enterprises, if any party has a market share in China over 20% or if the post-takeover party will have a market share in China over 25%. For a transaction outside China, notification is required if the foreign party has CNY 3 billion in assets in China, annual turnover in China over CNY 1.5 billion, a market share (together with affiliates) in China over 20% or a post-takeover market share in China over 25%. In addition, notification of an overseas takeover is required if, as a result, there will be more than 15 foreign-funded enterprises in the Chinese industry. A transaction that does not meet any of these thresholds might still have to be notified, if MOFCOM or SAIC decides, after receiving a request from a domestic competitor, department or association, that the takeover involves a very large market share or presents major factors that would seriously impact market competition. Notification can be made to either MOFCOM or SAIC, and either may be involved in the competition review.

48. The two-stage review process under the AML will be subject to clear deadlines. The enforcement authority has 30 days from the original notification to decide whether to undertake a further review. If it does not, the transaction is deemed to be approved. This 30-day period cannot be extended. If a further review is undertaken, it must be completed within 90 days. That period can be extended up to 60 days if the parties agree, if the parties' documents are insufficient or if conditions have changed significantly since the notification. At the end of the review period, the transaction is deemed to be approved unless the enforcement authority has reached a decision to prohibit it or to impose conditions on it. Prohibition decisions will be published. Remedies for transactions that violate the AML's requirements include a fine of up to CNY 500,000 and orders to divest and other measures to restore the previous market situation. (Art. 47) Review also involves two stages under the current rules for foreign transactions. The initial waiting period is 30 working days, at the end of which the transaction is automatically cleared unless there is a notice of extension for a second review. That second-stage review is to be completed in another 90 working days. If MOFCOM and SAIC determine that the substantive standards for rejection might be met, and the transaction is taking place in China, they will convene a hearing.

49. Acquisitions of domestic enterprises by foreign investors, and other forms of concentration involving foreign investors that concern national security, must go through both a competition review and a national security review. (Art. 31) The rules about foreign takeovers now require an application to MOFCOM if a foreign firm intends to take control of an enterprise that is in a key industry or that has famous or historic Chinese brands, or if the transaction may have an impact on national economic security.

50. Sector regulators may also have merger review responsibilities. Acquisitions in financial industries may require approval from financial or insurance regulators, for example. In civil aviation, rules

about mergers and restructuring require approvals by the regulator or its local bureau. These rules, issued in 2005, call for promoting fair and orderly competition and preventing monopoly, but they contain no substantive competition standard, other than the invocation of competition among their purposes. They provide for a short review process, of 20 working days with a possible extension of 10 more working days.

51. Even without a formal program for control over domestic mergers, major combinations may receive official attention. Two top appliance and electronics retailers announced a merger in 2006, creating a national chain with 800 outlets. Some manufacturers expressed concern that this new enterprise would wield too much bargaining power over prices and promotions. Producer and consumer representatives presented their views to MOFCOM at a hearing, which was closed to the merging parties. The transaction was allowed to proceed, though.

2.5 Administrative monopoly

52. The AML deals extensively with abuse of administrative powers. One of the general principles set out in the first part of the AML is that administrative agencies and other organisations that are empowered by law or regulation with responsibilities for public administration shall not abuse their powers to eliminate or restrict competition. (Art. 8) Chapter V specifies in more detail the kinds of actions that these bodies may not do. They may not mandate exclusive arrangements, by directly or indirectly requiring dealing only with specified suppliers. (Art. 32) They may not impede trade among regions, by setting higher prices or standards for products coming from other regions, imposing different technical or inspection standards and costs on them, subjecting them to special license requirements or hindering trade through checkpoints. (Art. 33) They may not prevent or discourage firms from outside the region from participating in bids. (Art. 34) They may not discourage investment by firms from other regions, through discrimination in such functions as approving branch operations. (Art. 35) They may not abuse their power by ordering firms to take action that would be prohibited by the AML. (Art. 36) And they may not adopt regulations that eliminate or restrict competition. (Art. 37) The AUCL also prohibits two aspects of administrative monopoly, namely requiring dealing with designated firms and restricting imports from other regions or exports of local products. (AUCL, Art. 7) The longer list of prohibited practices in the AML expands the prohibition. To deal with anti-competitive administrative abuses that are not specifically listed, there is no “catch-all” provision in Chapter V itself, but the general prohibition against administrative abuse in Article 8 might be a sufficient basis for action.

53. The remedy against these abuses is administrative. If an administrative or public organisation abuses administrative power to restrict competition, its hierarchical superior body is to correct that problem and discipline the managers responsible for it. The antimonopoly enforcement authority may call these situations to the attention of the superior body and propose action. (Art. 51) To be effective, it will be important that this recommendation come from an antimonopoly enforcement authority at a higher level of government than the one where the abuse is occurring, and that it be directed to a higher-level hierarchical superior. Where a local government agency or official is the source of the problem, it would be unrealistic to expect that an antimonopoly enforcer at the same level of the same government could intervene effectively against it there. In earlier drafts of the law, the enforcement authority would have had power to order the agencies to correct their behaviour and even to refer the problem for criminal prosecution, which could be appropriate where the abuse is connected to bid rigging, bribery or other corruption. The administrative correction called for the AML is similar to what is already provided in the AUCL, except that the AUCL does not authorise the enforcement authority to recommend action by the offender’s superior body. (AUCL, Art. 30) The AUCL authorises an enforcement role, against the operator that benefits from improper official action if not against the administrative agency itself. The control and inspection authority can confiscate the illegal income a “designated operator” that charges excessive prices, and it can also impose a fine of from two to three times the illegal gain.

2.6 Unfair competition and consumer protection

54. The Anti-Unfair Competition Law, adopted in 1993, was China's first general legislation about competition. In addition to provisions about bid-rigging, predation, discrimination and tying, it deals with controversies about unfair practices between businesses. It prohibits passing-off of trademarks, trade names, packaging or other certifications of origin and quality, false advertising, commercial bribery, misappropriation of trade secrets, disparagement of competitors and lottery-based promotions (unless the reward is less than CNY 5000). Injured competitors can sue each other for damages. Lawsuits have been fought recently over practices such as imitation of the trademark for Starbucks and demotion to the bottom of the stack on a website search engine. In the trademark case, the court awarded damages and ordered the offender to apologise publicly; in the website case, the court could not find a legal authority governing search engine results and rejected the complaint.

55. Public enforcement by SAIC and regional administrations is important, particularly in cases about passing off, misleading advertising and commercial bribery. In the first nine months of 2007, SAIC and the local administrations investigated over 5000 cases of commercial bribery. Sanctions vary for different practices. For most unfair competition infringements, the maximum sanction is a fine of CNY 200,000, except for lottery sales, for which it is CNY 100,000. For counterfeiting products and other trademark violations, the offender may be fined up to three times the gain from the violation, and its business license may be revoked. Criminal penalties may also apply. For commercial bribery, the offender may be fined up to CNY 200,000, and its business license may be revoked; here too, criminal law may also apply.

56. The Law for the Protection of Consumers Rights and Interests was also adopted in 1993. It provides for strict liability for defective goods and services, regulates unfair contract terms and provides for punitive damages. Individual complaints may be resolved through administrative investigations by SAIC, mediation by consumers' associations, arbitration or civil lawsuits. SAIC has set up special direct-dial phone lines for complaints. This system has tapped a torrent: in 2006, the "12315" network handled nearly 50 million enquiries.

3. Institutional issues: enforcement structures and practices

57. Three bodies, the State Administration of Industry and Commerce (SAIC), the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM), have been principally responsible for enforcing the laws and regulations about competition. The AML authorises the State Council to establish an Anti-Monopoly Commission and to empower an Anti-Monopoly Enforcement Authority under the State Council, before the effective date of the AMP in August 2008. The three bodies continue to perform the same roles in enforceing the AML that they performed in applying the previous laws and regulations about competition.

58. SAIC is responsible for many aspects of market supervision, such as business registration, competition, consumer protection, marketing practices, advertising and trademarks. In the government organisation, SAIC is directly under the State Council, which appoints its Minister and four Vice Ministers. SAIC was promoted from vice-ministerial to ministerial status in 2001. The Fair Trade Bureau of SAIC is responsible for developing and enforcing rules, regulations and practice directions for preventing monopoly and unfair competition. It also initiates investigations of monopolisation, unfair competition, smuggling, and selling of smuggled goods. The Anti-Unfair Competition Office is responsible for the rules about unfair trading practices, and the Anti-Monopoly Office is responsible for the rules about practices that restrict competition. These policy offices at the headquarters of SAIC are small, because enforcement is entrusted to officials at the local level. Fair trade departments in governments at the province, prefect and county levels are responsible for monitoring and investigating conduct covered by

the AUCL. The staff at these levels who are involved in performing SAIC's many responsibilities numbers in the hundreds of thousands, and over 60,000 of them deal with matters that arise under the AUCL.

59. MOFCOM oversees domestic market development and international trade. Its responsibilities include supervising industrial associations, creating and developing markets in rural areas and standardising commodity markets in urban areas, reforming particular sectors such as distribution and dealing with international trade co-operation and dispute resolution. Some of its responsibilities were performed by the former Ministry of Foreign Trade and Economic Cooperation (MOFTEC) and State Economic and Trade Commission (SETC), and some were done by the former State Planning Commission. Competition policy matters are handled by MOFCOM's Department of Treaty and Law, which set up an Anti-Monopoly Investigation Office in November 2004. MOFCOM's principal competition enforcement function has been merger review.

60. NDRC is the principal economic and social development policy agency under the State Council. NDRC has 26 departments and about 900 staff. NDRC's predecessor was the State Planning Commission, which was created in 1952, renamed as the State Development Planning Commission in 1998, merged with the State Council Office for Restructuring the Economic System and part of SETC in 2003 and then restructured into what is now the NDRC. NDRC's Department of Price Supervision administers the Price Law and the *Monopolistic Pricing Provisions*. It investigates and takes action about violations, which include failure to observe prices that are set by regulation as well as price fixing, exploitation and predation. NDRC's Department of Price is responsible for forecasting and policy planning, investigating costs of major agricultural products and setting prices of important commodities and prices and fees that are administered by the central government. There are also price administration agencies at provincial, city and county levels.

61. The institutional structure for enforcing the AML is determined by the State Council. The 1999 and 2002 drafts of the AML envisaged an Anti-Monopoly Administration Body under the State Council. The 2004 substituted establishment of a "competent commercial authority" under MOFCOM. The April and July 2005 drafts returned to the 1999 and 2002 model and suggested a ministry-level Anti-Monopoly Authority with substantial investigating and decision-making powers. But the November 2005 draft did not include the model of a single ministry-level or independent enforcement body. The AML refers to "the authority empowered by the State Council to have functions for anti-monopoly law enforcement" and the "Anti-Monopoly Enforcement Authority under the State Council," which will be responsible for enforcement. (Art. 10) These terms support maintaining the division of responsibilities, with MOFCOM, SAIC and NDRC empowered with enforcement authority with respect to particular aspects of the AML. That is what the State Council has done. MOFCOM continues to deal with mergers, NDRC continues to deal with cartels and SAIC continues to deal with antitrust matters involving distribution and abuse of dominance and with some merger review. The anti-monopoly enforcement authority, in whatever form, is a body under the State Council, that is, the central government.

62. An Anti-Monopoly Commission of the State Council will be responsible for organising, coordinating and guiding anti-monopoly work. (Art. 9) Its authorities and responsibilities will include research, formulating policy, investigating and evaluating overall competition conditions, drafting and promulgating guidelines and co-ordinating enforcement. Creation of an Antimonopoly Commission to co-ordinate enforcement foreshadows a tri-partite division of enforcement authority, since a supervisory Commission would have little function if there was only one enforcement body to supervise. The Commission will also be in a position to oversee relations between the enforcement authority applying the AML and the sector regulators whose functions and responsibilities affect competition.

63. Enforcement at the local level will also be important. Early drafts of the AML would have provided for provincial branches of the national enforcement authority. As adopted, the AML provides that

the enforcement authority, in whatever form it takes, can authorise enforcement by corresponding organs of governments at the next level below the national government.

3.1 Competition law enforcement

64. Chapter VI of the AML establishes enforcement powers and procedures. Investigation of a monopoly agreement or abuse of dominance can begin on the initiative of the enforcement authority or in response to a complaint. The undertaking involved has rights to state its case and to defend itself. If the undertaking makes a commitment to eliminate effects of the conduct, the enforcement body may suspend the investigation pending fulfilment of the conditions. The enforcement authority will supervise performance of the commitments. It may decide to terminate the investigation (without a formal decision), and it may reduce or cancel the penalties upon satisfactory performance. The enforcement authority may reopen a proceeding if the parties fail to perform the commitments, if the facts supporting the suspension the investigation change substantially or if the parties presented incomplete or misleading information.

65. Investigative powers are backed by financial sanctions. Failing to submit information or documents in investigations or destroying evidence or otherwise obstructing investigations can be punished by fines. The maximum fine is CNY 200,000 for a firm and CNY 20,000 for an individual, although in serious cases the fine against the firm can be as high as CNY 1 million, and individuals could face fines up to CNY 100,000 and firms and individuals may also be subject to criminal liability. (Art. 52)

66. Sanctions for infringing the substantive prohibitions of the AML include orders, fines and confiscation of gains from the violation. The maximum fine is 10% of turnover in the affected market in the most recent year, and the minimum is 1%. (Art. 46, 47) Factors to be considered in setting the fine include the nature, extent and duration of the infringement. (Art. 49) If a restrictive agreement is not actually implemented, the maximum fine is CNY 500,000. (Art. 46) If a party to a restrictive agreement reports the agreement to the enforcement body and provides important evidence, its fine may be reduced or even eliminated. (Art. 46) This flexibility will support a leniency program to improve enforcement against cartels.

67. The People's Courts have power to review enforcement actions, as well as to adjudicate claims for compensation by injured parties. The Administrative Litigation Law provides more context about judicial oversight. Ordinarily, administrative litigation over legal and factual issues in matters such as competition enforcement would begin in one of the nearly 400 intermediate People's Courts at the municipal level, and there would be an appeal to the next higher court. Before appealing to court about a decision to approve or block a merger, a request for administrative review appears to be a necessary prerequisite. A request for administrative review can also be made about other matters, but it is evidently not a prerequisite for an appeal to the court. (Art. 53)

68. Parties who are injured by a monopoly agreement or abuse of dominance may recover damages through civil lawsuits. The AML does not indicate whether a prior finding of infringement by the enforcement authority is necessary before a private suit can be filed. The AUCL similarly authorises enterprises that are damaged by acts of unfair competition to recover their damages through civil suits. If it is difficult to show the actual damages from the unfair practice, the plaintiff can recover the defendant's profits from the infringement. (AUCL, Art. 20) Provisions about effects on competition in the Contract Law have been invoked in private litigation about intellectual property licensing.

69. Local and regional laws sometimes cover the same topics as national laws about competition. The local government in Beijing adopted its own law on unfair competition in 1994, shortly after the national law, and over 20 other local governments, in Shanghai, Wuhan and elsewhere, have also adopted similar laws and regulations. Price fixing was specifically prohibited first in the regulations of Guangdong

province implementing the AUCL. The Regulations of the Hainan Special Economic Zone Against Unfair Competition prohibit market division, boycotting in purchase or sales, fixing prices, limiting output and bid rigging, in terms that are more stringent than the AUCL.

3.2 International issues

70. The international "effects test" is incorporated into the AML. Its prohibitions apply to conduct outside China that eliminates or has restrictive effects on competition in China's domestic market. (Art. 2) Most provisions of the law apply equally to domestic and foreign firms. The exception is the requirement of an additional national security review for acquisitions of domestic firms by foreign investors and for other circumstances involving concentration of foreign capital that raise national security concerns. (Art. 31) A report issued by SAIC in 2004 called for a stronger competition law to protect against anti-competitive strategies of large foreign firms. This viewpoint might have been encouraged by advice such as that offered by (OECD, 2002), that in the absence of a general competition law China's economy was vulnerable to anticompetitive abuses by foreign firms. If the anti-monopoly enforcement authority takes the position that foreign firms present particularly serious threats to competition, then foreign firms may face closer enforcement scrutiny.

71. Cooperation agreements were entered with Russia in 1996 and Kazakhstan in 1999. These call for exchange of information where possible about investigations of monopoly, unfair competition and consumer rights violations. These agreements designate SAIC as the body responsible for co-operation in the Chinese government.

3.3 Resources, actions, and implied priorities

72. At SAIC, most enforcement matters arising under the AUCL are about trademarks and deceptive marketing practices. Among SAIC's competition cases, most have been about restrictions by public utilities. From 1995 to 2002, SAIC handled about 3400 of cases of public utility abuses, along with about 900 dealing with bid rigging, about 650 with tying, about 350 with administrative monopoly and about 250 with sales below cost. NDRC emphasises the consumer impact of its price enforcement, most of which is about misrepresentation, unfair charges and failure to observe regulated prices rather than price fixing or predation. A hotline for consumer complaints has been in place for five years. In 2006, the price monitors received over 500,000 complaints and investigated about 10% of them. Enforcement actions led to consumer refunds totalling CNY 190 million (and to collecting CNY 110 million for the State Treasury). The largest number of complaints, accounting for two-thirds of the total in 2006, have been about prices for education, transport, medical care, real estate and property management and telecoms. For merger review, SAIC and MOFCOM have each assigned about a half dozen staff at their headquarters offices. The number of transactions reviewed has been modest, but the rate is accelerating. There were only nine notifications in 2004, but there were 61 in the first eight months of 2006.

4. Limits of competition policy and enforcement

4.1 Exclusions

73. The AML does not contain a broad exclusion for conduct that is subject to supervision by other regulators. The AUCL, by contrast, defers to other laws and regulations in the event of a conflict. That is, for acts for which laws or administrative rules and regulations provide that other departments are to exercise supervision, those other provisions apply rather than the AUCL. (AUCL, Art. 3) In early drafts of the AML, there was a provision like the one in the AUCL excluding conduct that was subject to control under other law or regulation, but that was dropped from the final legislation. The 1999 draft of the AML proposed another way to deal with sectors where conflicts are likely to arise, by setting a five-year

transition period during which the general competition law would not have applied to natural monopolies or public utilities such as postal services, railroads, electricity, gas and water, as long as the conduct at issue was authorised by the relevant regulatory authorities reporting to the State Council. The idea of a transition period did not reappear in the 2002 draft, and it is not included in the AML as finally adopted.

74. Instead, accommodation between the AML's general prohibitions and the demands of other regulatory programs and public policies is covered by Article 7 of the AML. Different unofficial translations of this Article vary in potentially significant details. It provides that the state will protect the legitimate business operations of firms in industries in the state-owned economy, which are important to the national economy or national security, and those with legally-granted rights of exclusive operation or sales. In addition, though, it says that the state will supervise and control their operations and prices to protect the interests of consumers and to promote technological progress, and that these firms are to operate in good faith and in accordance with the law, accepting public supervision and not using their exclusive or controlling positions to harm consumers. This inclusive language, protecting "legitimate business activities" of these firms yet also requiring that they comply with laws and not harm consumers, is obviously a compromise between industrial policies and competition policy. It does not appear that the Article creates an exclusion from the AML; rather, it seems to announce authoritative guidance about how the AML will be applied or instructs state-owned enterprises about proper behaviour. Its actual effect remains to be determined in application.

75. As a general matter, claims of inconsistency between different legal norms might be resolved by reference to their hierarchy. The AML and the AUCL, as laws adopted by the National People's Congress, would normally be more authoritative than administrative regulations issued by the State Council, rules adopted by ministries, committees or commissions or notices issued by local governments. The concept of a "state action" defence is implicitly rejected, because the AML prohibits an administrative body from requiring parties to engage in conduct that would violate it. (Art. 36)

76. The only sectoral exclusion from the AML involves agriculture. The AML is not applicable to alliances or concerted actions among farmers and farmers' economic organisations in connection with production, processing, sales, transportation and storage of agricultural products. (Art. 56) This is a commonly encountered exclusion, to support co-operation among small-scale producers. Whether it impairs competition depends on how large the co-operative organisations become, whether they engage in extensive end-product processing and achieve large market shares there and how they treat would-be entrants and former members.

4.2 Sectoral regulation and competition policy

77. In the telecommunications sector, the rules recognise the importance of competition. Adopted in 2000, they call for separating governmental functions from enterprise management, prohibiting monopoly, encouraging competition and facilitating development, openness, equity and fairness. (Telecommunications Rules, Art. 4) Several specific requirements promote and protect competition. Major telecommunications enterprises may not refuse requests to connect to the network. Predatory pricing and unjustified cross-subsidies are prohibited. Customers can choose their service suppliers, and forced transactions are prohibited. The rules are administered by the Ministry of Information Industry and departments of information industry at provincial levels. Legislation for this sector is still being drafted.

78. In electric power, market reforms began in the mid-1980s, by permitting parties other than the central government to invest in generation. The Electric Power Law, adopted in December 1995, regulates entry, operation and pricing. The State Power Corporation took over most of the assets of the Ministry of Power in 1997, and in 2002 they were split into two transmission companies and five power generation groups. This separation of generation from transmission and distribution established an important

precondition for wholesale and retail competition. Important aspects of regulating grid operation and pricing remain to be worked out, though. For example, local control over dispatch often means that preference goes to locally owned plants, which may be smaller and less efficient, while newer plants that are more efficient and have better pollution control may be left idle. The State Electricity Regulatory Commission, established in 2002, and electricity departments above the county level supervise and administer the industry. NDRC has policy, regulatory and administrative functions, such as making development plans and issuing project approvals. Competitive power pricing has been tested in Shanghai and five other provinces, but that pilot programme covered less than 10% of the electricity generated in those areas. Until now, power sector investors have had the security of sales contracts based on a cost-plus pricing regime. Planned retail pricing reforms include a mechanism to adjust end-use prices to reflect fuel cost increases. In the long run, the pricing system is expected to be further reformed to make electricity prices fully cost-reflective and to give timely and adequate signals to consumers and investors. The price reform policy seeks to allow the wholesale market to determine tariffs on the generation side, while the government will regulate transmission and distribution prices as well as the relative prices to end users.

79. Postal services are a public monopoly, governed by the Postal Law adopted in 1986. Mail delivery and related services with the characteristics of mail delivery are monopolies of the public postal enterprises, unless the State Council makes exceptions. The State Post Bureau and SAIC supervise and administer the postal law and postal service. Postal services have been the object of several complaints about anti-competitive forced sales. Objectionable practices range from specifications that, in effect, required using packing materials sold by China Post and envelopes produced by its affiliates to requiring patrons to open postal savings accounts or to use debit card services from a particular bank.

4.3 Administrative monopoly and competition advocacy

80. The principal administrative monopoly problem has been regional protectionism. In the first phase of reform in the 1980s, the rapid creation and expansion of town and village enterprises led to excess capacity. Many of these firms were below minimum efficient scale or needed sales to other regions in order to make a profit. Regions and their firms found themselves in rivalry. To protect struggling local enterprises and preserve jobs, many local governments set up trade barriers such as local customs posts and supported exclusionary tactics ranging from price predation to slashing tires. Overt barriers and exclusive dealing rules have been prohibited by the AUCL since 1993, and SAIC has had some success in correcting these “regional blockades”.

81. But anticompetitive regional protectionism can take more subtle forms. Measures such as discrimination in taxes, standards, inspections and licensing also create significant barriers to commerce and competition. Local governments have sometimes blocked mergers that would eliminate the separate identity of local firms or prevented firms from exiting unproductive businesses through bankruptcy or merger. By interfering with restructuring in order to protect local business interests, local governments undermine the efficiency-promoting goals of reducing excess capacity and realising economies of scale. The general prohibition in the AML and the detailed listing of prohibited practices will extend enforcement oversight to indirect, complex abuses and barriers. Article 34, prohibiting discrimination about discrimination, may provide a basis for the antimonopoly enforcement authority to correct protectionist local decisions about mergers. If not, it may be useful to create another means for ensuring that national antimonopoly authorities have the opportunity and authority to review and approve, or reject, mergers that fall below the thresholds for notification and approval under Chapter IV.

82. Observers, including the OECD, have identified the weakness of remedies under the AUCL as a reason for the persistence of regional barriers. A more significant problem may be the delegation of enforcement to local levels. Local enforcers are employees of the government that is engaging in the abuse. If the local enforcer of the AUCL finds a violation, its only power is to inform a higher level of the

offending body. In this circumstance, enterprises have little incentive to make a complaint and the law enforcer has little incentive to act on complaints it does receive. Some transition competition law regimes provide for direct competition law enforcement to control administrative abuse. The power is used infrequently, due to the obvious practical and political challenges it presents, but it can be valuable even if held in reserve. Correction and discipline by the administrative superior body, as provided by the AUCL and the AML, may be the strongest power that would be clearly consistent with current organising principles of China's government bodies. Authorising the antimonopoly enforcement authorities to initiate the inquiry and recommend action gives them a positive role. The power to make the recommendation public could be important to making the process effective.

83. The role of the antimonopoly enforcement authorities under Chapter V verges on advocacy, seeking correction of rules and decisions that impair competition. Article 37 prohibits regulations that eliminate or restrict competition, and thus it explicitly authorises the antimonopoly enforcement authority to raise concerns about regulations that interfere with competition more than is necessary to achieve their other, presumably legitimate purposes.

5. Competition law and policy in the transition to a developed market economy

84. China's transition began by re-energising traditional market patterns in the countryside. Small-scale industry was encouraged to evolve out of the plan, and private and foreign-invested firms emerged to challenge state-owned enterprises that remained from the era of central planning. New entry, creating an intensely competitive product market, has been the most important external factor driving change in Chinese industry. State-owned enterprises were turned into corporations to improve their efficiency; however, this step just shifted their financial problems from the state budget to the state-owned banks, and another round of financial sector restructuring was needed to clear out zombie firms. While they were struggling under the new competitive conditions, the government encouraged "self-discipline pricing", evidently as a form of depression cartel. Despite these hesitations along the way, reform succeeded in replacing the command economy with a vigorous, competitive market without a "big bang" rejection of state enterprise and all of the other institutions of the planned economy.

85. In the first phase of reform, re-establishing confidence in the integrity of market transactions was more important than maximising efficiency by preventing monopoly and collusion. Thus the first law about competition was the AUCL. This was followed by laws to deal with obvious abuses involving prices and bidding. Similarly, after government institutions have managed the economy for a generation, problems of administrative monopoly were considered more serious and more destructive than those of business monopoly. The second round of reforms since the early 1990s has set up the key financial, legal and regulatory institutions needed to support a developed enterprise economy. The capacities and qualities of many of these new laws and supervisory institutions remain to be established. With corporate governance and regulatory oversight both still embryonic, the principal constraint and discipline on corporate management has come from product market competition (according to a survey of Chinese company CEOs). Ensuring that competition can continue to discipline enterprises requires a strong legal and institutional foundation for competition policy.

86. China has now adopted a general competition law, as its economy has reached the point where all of its tools are needed, to correct and deter exclusionary abuse, exploitation and collusion and to control the creation of market power through structural combinations. The AML's most significant addition to the laws and rules that were already in place is a comprehensive program of merger control and notification. That addition marks a turning point in the transition process. There is still room in many sectors for consolidation to improve efficiency and achieve scale economies. But merger review under the AML will recognise the pro-competitive importance of improving efficiency, and thus it should permit consolidation while preventing and disciplining abuses that would deny the public the benefits. To be sure, some

commentators in China called for a competition law in order to protect Chinese business against foreign competitors. This apprehension may explain why the AML provides for national security review of acquisitions by foreign investors. The OECD has noted, in commenting on the similar requirement in the current merger regulations, that an extra hurdle like this could substantially impede the stability of cross-border merger and acquisition transactions. (OECD, 2006) The case is still being made to the public that stronger competition law enforcement would benefit the economy. In the debate over the AML, some warned against going too far in prohibiting horizontal agreements, and defended price fixing as sometimes necessary to avoid cut-throat competition among Chinese firms, to protect safety and health and to resist being taken advantage of by other countries. The extended debate about the AML itself shows how stronger competition policy marks an important stage in the transition process. The transparency of the process, in which drafters and legislators have welcomed comments from the public and from experts in China and elsewhere, has educated the world about the evolution of China's system of governance, as well as the development of its market economy.

87. Challenges of development – investment, institutions and social security – are replacing those of the transition from plan to market, now that the market has been re-established as the foundation of the economy. China faces the same challenge now as many other countries, to encourage more competition in sectors such as infrastructure, finance and primary materials: that is, the challenges typical of regulatory reform. Vigorous competition policy can help China achieve its development goals by channelling rivalry away from claims for rents and privileges into contests over efficiency and innovation.

88. OECD reports on China's economy and regulatory process have emphasised the importance of strengthening competition policy. (OECD, 2002; OECD, 2005) These reports analysed conditions in China's markets to show why some indicators about the state of competition could mask problems. Where the structure of the economy still reflects the one-time goal of local self-sufficiency or local barriers have prevented national markets from developing, national concentration ratios would understate concentration in relevant markets. Some national markets show structural problems. In many areas once dominated by the state economy, excessive vertical integration, due in part to the high cost of enforcing contracts, undermines efficiency and discourages entry. Some important industrial sectors – including petroleum processing, ferrous metallurgy, non-ferrous metallurgy, transport, and basic chemicals – have been relatively closed to competition. The reports noted that a market structure featuring low national concentration and many regional enterprises operating below minimum efficient scale has important implications for competition policy. Market distortions such as soft budget constraints, regional protectionism and exit barriers that undermine the efficiency goals of competition can nonetheless spark intense rivalry, even "destructive competition" driving prices below marginal cost. Collusion to end these price wars typically breaks down quickly. As reforms make budget constraints harder and exit easier, consolidation to improve efficiency will reduce excess capacity but also raise industry concentration. Those conditions would facilitate oligopoly co-ordination and even more durable, non-public collusion, making it more important for China to have an effective general competition law.

89. The OECD reports pointed out three important steps that China should take to make its competition policy more effective. By enacting a general competition law, China has taken the first of these steps. The AML incorporates concepts that are common to modern competition laws around the world. Priorities and means for applying these common principles often vary, though, responding to difference in legal and political traditions and in economic and development conditions. Thus (OECD, 2002) noted that for developed, competitive economies the top enforcement priorities are cartels and anti-competitive mergers, while many transition countries concentrate on demonopolisation; in China's situation in 2002, the top priority was preventing exclusionary practices. Implementation of common principles can vary too, as different economic conditions explain difference choices about "rules of thumb" such as *per se* rules and market share tests.

90. The structure and evolution of enforcement institutions depend on differences in political traditions and legal systems, which can reflect difference about values other than economic efficiency. In most jurisdictions, in the OECD and elsewhere, core competition provisions are enforced by a single agency. In China, three bodies applied the previous laws, and the antimonopoly enforcement authority established under the AML has the same three component bodies too, as SAIC, NDRC and MOFCOM are designated as the enforcement authority with respect to their particular functions. In principle, unifying authority encourages policy coherence, while dividing authority creates inefficiencies. For example, expertise about a market gained while dealing with price fixing there would not readily be available to a different body dealing with a merger in the same markets. Experience in other countries with multiple enforcement bodies shows that the inefficiencies, though real, are not insuperable. Exchange of expertise can be encouraged by detailing or rotating the staff experts. Similarly, policy coherence may develop through interchanges of senior officials. In any event, institutional structures often embody policy choices that have emerged from extended political debate, and thus they can be particularly resistant to change.

91. Independence and transparency are more important than institutional integration to effective enforcement. None of the three bodies that enforce aspects of competition law is structurally independent from the government. Complete independence would be difficult to design in China's system of government, though. Thus transparency about processes and decisions will be important to show that they are based on sound, general principles rather than on bargains among interests. Government ownership of enterprises remains important in China, so competition policy must minimise the marketplace distortions that typically accompany government ownership, such as soft budget constraints and opportunities and incentives to confer preferential treatment. The best assurance of competitive neutrality in the treatment of state-owned enterprises is to keep antimonopoly enforcement independent of the missions of industrial policy and promotion. Providing several institutional means for enforcement, with different constituencies and priorities, might also reduce the risk that enforcement would pursue unrelated goals.

92. The second step to more effective competition policy recommended in (OECD, 2002) was to apply a competition policy approach to regulating infrastructure monopolies, in order to introduce efficient market competition where that is feasible and to improve government regulation where that remains necessary. Principles for pro-competitive regulation were drawn from experiences of OECD member countries and developing economies. That report and others have also made analytical comments and recommendations about China's policies for electricity, natural gas, telecommunications and railways. China is in the process of applying this approach in several infrastructure sectors, notably electric power and telecommunications.

Box 5. Steps in pro-competitive infrastructure reform

- Define the boundaries between commerce and the state, and the respective roles of commercial enterprises to operate and the state to regulate. Competition is hampered where the division between state and commerce is unclear, because potential competitors to state-owned enterprise fear a "tilted playing field" and will hesitate to enter. Further, the separation means that government policy decisions must be made explicit in order for the commercial operator to carry them out.
- Establish state regulatory institutions that have the powers and the resources necessary to regulate commercial infrastructure enterprises so as to ensure that they achieve efficiency and other regulatory goals. These institutions will use regulations to create incentives for commercial entities by, for example, reducing regulatory barriers, ensuring fair and efficient access to essential facilities, and ensuring that regulation is predictable. Thus, a market environment requires regulatory institutions that make decisions that are neutral, transparent and not subject to day-to-day political pressures or capture.
- Put into place corporate governance systems to ensure adequate control and incentives for commercial infrastructure enterprises.
- Use competition principles to specify the structures of the sectors and the regulations that will be applied to ensure that they are efficient and will meet universal service objectives.

Source : OECD (2002)

93. The third step represents the challenge for the future: to adopt and implement a comprehensive national competition policy. Underlying China's reform programme to establish a socialist market economy is a strong, implicit competition policy, to reduce entry barriers and promote markets. Now that the transition to an enterprise economy has matured and the important institutional structures are in place, China could benefit from a more explicit competition policy. A central element of a national competition policy would be a system to review laws and policies that affect market conduct, to locate and correct constraints on enterprise activity that are more stringent than necessary to correct market failure or to achieve other policy goals. An analytical framework for such a program has been developed at the OECD. The OECD "toolkit" for competition assessment provides a general methodology, beginning with a checklist to screen for laws and regulations that could restrain competition enough to require more thorough analysis. A comprehensive competition policy should be applied to proposed laws and regulations as they are being developed, and also to existing laws and regulations. The central government should take the lead in developing and implementing this approach at the national level. Regulation at the regional and local level is also important, though, and indeed may be a more serious source of market distortions. The approach should also be applied to those levels of government, following guidance from the central government. The aim of a national competition policy is not to elevate competition above all other social and economic priorities. In asking whether laws and regulations interfere with enterprise and initiative more than is necessary to achieve their policy goals, a national competition policy would detect and correct rules that constrain competition and growth.

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