Programme of Dialogue and Co-operation with China

CHINA GOVERNANCE PROJECT

COMPETITION LAW AND POLICY AS TOOLS FOR CHINA TO PREVENT ANTICOMPETITIVE CONDUCT AND TO ENSURE THAT GOVERNMENT POLICIES REALISE THEIR OBJECTIVES AS EFFICIENTLY AS POSSIBLE

Paris, 3 February, 2005

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COMPETITION LAW AND POLICY AS TOOLS FOR CHINA TO PREVENT ANTICOMPETITIVE CONDUCT AND TO ENSURE THAT GOVERNMENT POLICIES REALISE THEIR OBJECTIVES AS EFFICIENTLY AS POSSIBLE

A Introduction

1. A leading theme of the 2002 China Study and its Competition Chapter is that having made great strides towards the opening of its borders, China should focus greater attention on governing market activities within its borders. The 2002 Competition Chapter recommended a number of specific laws and policies.

   - First, it recommended enactment of a general competition law that would provide a coherent basis for combating regional protectionism and other ‘monopolistic’ conduct by enterprises and local governments. Such conduct was and is obstructing the economic integration and efficiency that China desires in order to promote growth and improve its citizens’ standard of living.
   
   - Second, it recommended a competition policy approach to regulating infrastructure monopolies, explaining how this approach could introduce efficient market competition where feasible and improve government regulation where necessary. Based on the experiences of both OECD Members and developing economies, the Chapter offered specific comments concerning China’s policies concerning electricity, natural gas, telecommunications, and railways.
   
   - Third, it recommended adoption of a “national competition policy” calling upon all parts and levels of government to incorporate competition policy into all consideration of all proposed and existing laws and policies that affect market conduct. Without interfering in any way with governments’ ability to restrict market activity in ways that are considered necessary, such a policy would help ensure that China’s social, economic, and other laws and policies realize their goals without imposing unnecessary costs.

2. This Chapter endorses all of the 2002 recommendations, but its focus is different. The 2002 Chapter contained an extensive discussion of using competition principles to regulate infrastructure monopolies – the second of the above-listed recommendations. Given that discussion, and because this Study’s Regulatory Reform Chapter addresses China’s progress in reforming its infrastructure markets, this Chapter focuses on the first and third of the previous recommendations, and it discusses those recommendations from a governance perspective. In other words, it focuses on how competition law and policy can assist China in “perfect[ing] a modern, integrated, and competitive market economic system under its national conditions and circumstances.”1 After a general discussion of core principles, the Chapter turns to how the systematic application of competition policy principles would benefit policy-making in China, and why and how China should establish a competition law enforcement system.

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B. General considerations

1. The operation and benefits of market competition

3. To understand competitive markets’ benefits and how they are created, it is useful to view competition as the process by which enterprises seek to discover and satisfy consumer demand. Competitive markets, then, may be seen as those in which enterprises have incentives and freedom to develop, produce, market, and sell goods and services as efficiently as possible.

4. In such markets, buyers and sellers are in a dynamic and constantly evolving relationship, with sellers’ innovations shifting consumer demand, while changing buyer preferences suggest new directions for sellers to explore. Moreover, markets produce much of the information that market participants need to operate efficiently. If price for one good goes up, buyers are signalled to consider existing alternatives, and both current and potential sellers are signalled that they may have a business opportunity. If buyers’ demand shifts away from a product, increasing inventories and falling prices warn sellers to reduce production and either improve or replace the product.

5. By rewarding enterprises that efficiently respond to consumer demand and punishing those that fail to do so, the competitive process creates economic efficiency. In this regard, it is important to note that ‘economic efficiency’ does not only refer to efficient use of enterprises’ resources (i.e., ‘productive’ or ‘technical’ efficiency). It also includes the optimal development of new processes and products – ‘dynamic’ efficiency – and the best use of society’s overall resources – i.e., ‘allocative’ efficiency. Thus, economically efficient markets tend to produce products and services that reflect the quality, quantity, and cost and price levels that make the best use of society’s resources. Stated differently, the economic efficiency that results from competition maximises the overall welfare of society.

6. This welfare-enhancing process is distorted by restrictions on both entry and exit. Restrictions on entry, it should be emphasised, include not only barriers to initial “entry” but also restrictions on efficient methods of production, marketing, distribution, and other activities. Although government restrictions of this sort can be appropriate in some markets to deal with market failure or to pursue governments’ social or other legitimate goals, unnecessarily broad restrictions on entry clearly reduce the overall welfare of society.

7. Barriers to exit interfere with the efficient operation of markets both by creating entry barriers (since investors are more reluctant to enter markets from which exit is difficult) and by distorting the market in other ways. For example, the exit of unsuccessful enterprises may be a signal that new entry into a particular market may not be warranted. When exit barriers are combined with soft budget constraints, as is often the case with enterprises owned by local governments in China, the distortion is greatly increased. The result (as in some of China’s consumer electronics markets) can be ‘destructive competition’ in which all producers price below marginal cost.

8. In addition to economic efficiency, competitive markets promote economic opportunity and macroeconomic stability. Halting cartels and eliminating special treatment of protected businesses gives more citizens a chance to contribute to, and benefit from, the resulting economic growth. In addition, competition provides firms incentives to adjust to internal and external shocks, thereby reducing the macroeconomic cost of adjustment to shocks.

2. The roles of competition law and competition policy

9. There are two main threats to competitive markets: anticompetitive conduct by enterprises, and government regulation that imposes undue restrictions on enterprises’ ability to enter, exit, or otherwise respond efficiently to consumer demand. Both anticompetitive conduct and unduly restrictive government
regulation harm efficiency, create economic waste, and generally reduce the overall welfare of society by restricting output (thereby creating artificial shortages), raising price, and reducing enterprises’ incentive and ability to discover what consumers want and find innovative ways to supply it. The principal goal of competition law and policy is to promote economic efficiency by addressing these two threats.

10. In general, competition law bans anticompetitive conduct by enterprises. Especially in developing and transition economies, it sometimes also prohibits anticompetitive conduct by government officials and government regulations or policies that place unwarranted and unauthorized restrictions on enterprises.

11. As used in this Chapter, the term competition policy refers to a general approach to government regulation – an alternative to central planning, laissez-faire, and command-and-control – whose essence is that laws and regulations should not contain restrictions on competition and consumer choice that are not necessary to achieve their goals.\(^2\) Competition policy in this sense is distinct from competition law, but complements it by addressing the costs to society of government policies and laws that impose unduly restrictive rules on market activity. Thus, competition policy is closely related to the regulatory impact analysis that is recommended in the OECD Regulatory Reform Programme. In governance terms, competition policy provides an organising principle for all policy making that affects market activities.\(^3\)

12. The basic principle of competition policy is that governments should not restrict market activity any more than is necessary to achieve their social and other goals. Systematic application of this principle can assist all governments to meet their regulatory goals as efficiently as possible, thereby maximising the overall welfare of society.

13. It is important to stress that competition policy promotes economic efficiency in order to maximise aggregate welfare; it does not seek to maximise competition or economic efficiency regardless of the consequences. Thus, competition policy seeks the elimination of unjustified restrictions on competition, but does not oppose restrictions that legislatures or duly authorised government agencies find necessary to meet social or other goals such as helping needy citizens, providing for the public’s health and safety, or protecting the environment. Competition law does not apply at all to such restrictions; competition policy actually provides a tool for policy-makers to use in pursuing their various policy goals as efficiently as possible.

14. The principle that competition policy opposes only those government laws and policies that unnecessarily restrict competition requires emphasis because in many developing economies, especially in Asia and including China, policymakers sometimes express concern that adopting a competition policy approach would mean deciding that competition should be raised above other social goals – that markets should be deregulated (and competition maximised) without regard to other policy considerations. This concern is misplaced. Unlike laissez-faire economics, a competition policy approach to regulation recognizes that both market failure and social or other goals can justify laws and policies that restrict market activity. As set forth in the OECD’s 1997 Policy Recommendations on Regulatory Reform\(^4\) and the

\(^2\) The term is sometimes used as a synonym for competition law, and sometimes to refer to a set of policies of which competition law is a part.

\(^3\) See, e.g., Crampton, Paul, Competition Policy and Efficiency as Organising Principles for All Economic and Regulatory Policymaking, IADB Working Paper, Series No. 2 (January 2004), prepared for the first meeting of the OADB/OECD Latin American Competition Forum. The report is available at www.oecd.org/dataoecd/43/26/2490195.pdf.

\(^4\) See The OECD Report on Regulatory Reform, Summary (June 1997).
1999 APEC Principles to Enhance Competition and Regulatory Reform, competition policy has a central role to play in the assessment of such laws and policies, and indeed in all regulatory analysis.

15. Examples may help illustrate how competition policy contributes to analysing laws and policies that implement social and other policies. A simplified example involves the manner in which governments regulate products that present safety hazards. The possible approaches include banning the manufacture of products that do not meet certain standards, restricting the sale of products to buyers that are deemed qualified to use them safely, and permitting products to be sold only if they have warning labels. Each of these approaches has different market effects that can and should be considered in policy-making. Some products may be so dangerous that bans or elaborate restrictions are necessary, but for products that are safe unless used in a particular way, the use of mandatory warning labels may be a “less restrictive alternative” that maximises the overall welfare of society.

16. In addition, competition policy principles can help governments choose the most efficient mechanism to assist citizens who are too poor to buy products or services they need. For example, price controls can benefit the needy, but they are costly because they also benefit those who are not needy. Moreover, the existence of price controls distorts markets in undesirable ways, reducing the incentive of firms to make needed investments. Competition policy principles show that direct subsidies to the needy can often provide assistance that is more targeted and does not distort the market in ways that waste societies' resources.

C. How systematic use of competition principles in policy-making can contribute to China's economic reform

17. A 2002 DRC paper on governance issues in China identified two key reasons for China to improve governance. First, China should “restructure the government organisation and transfer its function” – a transfer reflecting the fact that market participants will make many decisions previously made by government. Second, China wants its government to reflect "the principles of the modern market economy as well as Chinese practice.” From this perspective, the central questions facing China include the following:

- To what extent should governments own enterprises, and how should ownership rights be structured?
- What sectors or activities should be specifically regulated by the state, and how should they be regulated?
- What sectors or activities should be left to the market subject to general regulatory provisions such as bans on fraud, anticompetitive activity, etc.?

18. As noted above, both OECD and APEC reports suggest that competition policy should be incorporated into all policy-making that may affect market activities. This section first discusses how competition policy addresses these questions in China and elsewhere, and then turns to issues that have been raised concerning the application of competition policy in China in light of its history and current conditions.

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6 The previous Competition Chapter provided a more extensive description of situations in which OECD countries have used competition policy principles in deciding what policies to pursue in infrastructure monopolies and in other kinds of policy analysis.
7 Governance Research in DRC (2002).
I. The applicability of competition policy to governance issues in China today

19. Government ownership. In China and elsewhere, government ownership of enterprises has a tendency to distort markets because it results in opportunities and incentives to confer preferential treatment and soft budget constraints. Competition policy helps identify and analyse these problems, and seeks to deal with them by either reducing government ownership or taking intermediate steps to remove particular distortions. In the case of China, with its position that extensive government ownership is desirable for its “socialist market economy,” competition policy necessarily focuses on how to minimise the resulting distortions. Many chapters of this Report analyse how particular market distortions might be minimised, and that analysis is fully consistent with – and could be said to reflect – a competition policy approach.

20. Market framework regulation. Competition policy supports generally applicable laws or policies that are necessary to permit markets to operate efficiently, such as those providing for the rule of law, the clear definition of property rights, the enforceability of contracts, the prevention of fraud and corruption, and the prevention of anticompetitive activity. Such laws and policies may be viewed as preventing market failure, but are perhaps better seen as necessary to provide a “framework” for market activities. They may restrict market activity to some extent, but if not overbroad they are procompetitive.

21. The relationship of competition law to anti-corruption activities is particularly notable. Much government corruption consists of acts that illegally favour one business over another or are otherwise anticompetitive (e.g., the sale of an exclusive license). There are two ways in which competition law enforcement complements anti-corruption enforcement.

- In Russia and many other transition countries, competition law has successfully been used to void government acts that illegally favour one firm or group of firms; this can be done even if there is no evidence of a bribe, so long as the preponderance of the evidence shows that the action was discriminatory. Thus, competition law can deprive the bribing entity of its illegal gains even in cases when the evidence would not support a criminal conviction.

- Bid rigging (collusive tenders) is a specific area in which competition law complements anti-corruption laws. In many bid-rigging cases, the participating enterprises not only agree among themselves concerning the bids they will submit, but also involve a government official in their illegal conspiracy in order to be more secure that the conspiracy will succeed.

22. Industry-specific regulation to address market failure. Competition policy affirmatively supports industry-specific government regulation that is necessary to deal with market failure. The clearest example of such failure, perhaps, is the case of ‘natural monopoly’ – where the cost structure in some element of an industry is such that efficiency requires having only one provider. In that situation, it is generally accepted that the provider should regulated to prevent it from abusing its monopoly. China has already moved towards taking a competition policy approach to regulation of some infrastructure monopolies. Given the importance of infrastructure sectors to China’s citizens and its overall economy, the cost savings realizable by promoting competition in infrastructure sectors could be substantial.

23. Markets in which participants’ activities impose significant cost on parties outside the market are another example of market failure. Such ‘market externalities’ are the market failure on which environmental regulation is generally based. Competition policy has played an important role in the development of environmental policies in OECD countries, and can be equally useful in China.

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8 For a time, New Zealand sought to deal with natural monopoly sectors merely through its general competition law and the possibility of direct regulatory intervention, but in recent years it has increasingly taken a more regulatory approach.
24. In areas such as health care, where consumers cannot be expected to have enough knowledge to prevent exploitation, ‘information asymmetries’ produce market failure. In general, this form of market failure leads to the licensing health care providers and to establishing safety standards for medication.

25. Where market failure exists, competition policy seeks to limit government intervention to that which is necessary to deal with the market failure. Thus, as discussed in the 2002 Competition Chapter, the existence of a natural monopoly element previously led to government regulation or ownership of entire industries, but the focus now is on seeking to permit competition where possible and to regulate only the natural monopoly element.

26. *Other industry-specific regulation.* Except where market failures exist, competition policy generally prefers that specific sectors and activities be left to the market, subject to generally applicable laws and policies. Although competition policy recognises that some sectors and activities may be regulated for social or other reasons that do not amount to market failure, it advocates that such regulations interfere with market forces no more than necessary to achieve their goals.

2. *The applicability of competition policy to policy-making in China today*

27. In many ways, China’s overall reform programme in recent decades has reflected an implicit competition policy approach, in that China has taken dramatic steps to reduce formal entry barriers and other unnecessary restrictions on market activity. However, there has been no call for the national government, its ministries and other agencies, or local government to include competition policy principles in their policy-making and regulatory activity. Given the extensive market reform that China has been pursuing, and the unfamiliarity of most Chinese officials with competition policy principles, China could realize substantial benefits by requiring systematic consideration of whether proposed and existing laws and policies contain restrictions on enterprise activity that are not needed to deal with market failure or to achieve some other specific policy goal.

28. As noted above, competition policy analysis is very closely related to the kind of regulatory impact analysis that the OECD has recommended in its Regulatory Reform programme. Some have argued these approaches are not appropriate for China today because of (a) China’s heavy reliance on the exercise of administrative discretion by line ministries, and (b) its relative lack of independent agencies that engage in *ex ante*, rules-based regulation of enterprise conduct. This argument misconceives the role of competition policy as merely a discipline for regulatory decision-making by independent agencies, rather than a general approach to all policy-making, legislation, and regulation that affects market activities. China’s National Peoples’ Congress, State Council (and its Office for Legislation), and Ministries can and should use competition policy in making policy judgments and exercising discretion, and it is recommended that China also require local government entities to apply this approach.

29. China’s relative unfamiliarity with competition policy principles is not a reason to refrain from requiring systematic use of competition policy as a tool to policy-making. Competition policy analysis of some issues can be very complex, but it begins with the simple but important step of asking whether a policy, law, regulation, or other action is designed to achieve its desired goals (health, safety, environmental protection, or whatever) without interfering with market mechanisms more than necessary. By adopting a national competition policy or otherwise requiring government entities to consider this question in making policies or decisions that affect market activity, China could reduce the likelihood of unwarranted restrictions while at the same time increasing awareness of competition considerations without interfering with governments’ ability to adopt the policies they consider necessary.
3. **Competition policy and China’s infrastructure monopolies**

30. Although competition policy provides a guide to all policy-making that restricts market conduct, it is useful to note specifically its application to infrastructure industries. In this respect, competition policy begins by taking a sceptical approach to claims that a market has natural monopoly elements. Moreover, bearing in mind that natural monopoly markets can and do become potentially competitive over time, competition policy advocates regular reviews to determine whether markets stop being natural monopolies because of new technologies, new sources of supply, etc.

31. Competition policy also provides guidance on how to regulate markets that are natural monopolies. In this regard, much of competition policy consists of an analysis of how alternative rules are likely to affect the behaviour of the regulated firm and of the firms with which it deals. This process was addressed at length in the 2002 Competition Chapter, and that discussion is not repeated here except to note, in Box 1, the key reform steps that face China. Since then, the OECD’s Competition Division has pursued these issues by holding a seminar with China’s Development Research Centre on promoting competition as part of railway reform in China, and participating in relevant OECD and other conferences in China. China has made some progress in reforming some of its infrastructure sectors, but, as is further discussed in this report’s Regulatory Reform Chapter, much remains to be done.

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<th>Box 1 - Steps in Procompetitive Infrastructure Reform</th>
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<td>(a) 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.</td>
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<td>(b) Establish state regulatory institutions that have the powers and the resources necessary to regulate the 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.</td>
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<tr>
<td>(c) Put into place corporate governance systems to ensure adequate control and incentives for the commercial infrastructure enterprises.</td>
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<tr>
<td>(d) 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.</td>
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D. **China’s need for a general competition law**

32. Whereas competition policy provides guidance for government entities to use in analysing policies, laws, and regulations that affect market activity, competition law sets forth binding prohibitions.


10 The 5th Forum of Infrastructure Sectors and Public Utilities in China, organized by the China Institute for Reform and Development and the German Agency for Technical Assistance, held in Hainan, China on 17-18 October 2003; China-OECD International Conference on Building Regulatory Frameworks for Network Industries, Beijing, December 2003.
of anticompetitive conduct. In most OECD countries, the competition law applies to enterprises, including SOEs, but the competition laws enacted by many transition and developing countries include binding prohibitions on unauthorised, anticompetitive actions by government officials or agencies.

33. Like laws banning corruption and regulating natural monopolies, competition law is increasingly understood to be a necessary part of the framework for governing a market economy. Competition laws have been adopted by virtually all transition and many developing countries, and the record is clear that competition law enforcement can play an important part in the market reforms of such countries.

34. The 2002 Competition Chapter pointed how the absence of a general competition law has left China vulnerable to anticompetitive enterprise conduct and to such problems as regional protectionism by local government officials and entities. It therefore recommended that China move quickly to finalise and adopt a competition law. This recommendation was based on close co-operation between the OECD and China’s “drafting group” during the 1997-2001 period, when the OECD co-sponsored seminars to discuss draft laws and the Secretariat submitted detailed comments and suggestions on several occasions.

35. Since 2002, China/OECD co-operation in competition law and policy has continued but has not focused on China’s draft competition while internal deliberations continue. In 2004, a draft was submitted to the State Council for its consideration. Since then, a number of drafts have surfaced, but neither their origin nor their status has been apparent. Without a specific “official” draft, the Secretariat is not in a position to make specific comments, but the drafts it has seen do contain provisions that could pose problems for competition law enforcement in China. The Secretariat continues to recommend the quick adoption of a competition law, but first it recommends further consultations with international experts to discuss the relevant issues. The Secretariat is prepared to work closely and quickly with China in this process in close co-operation with the Asian Development Bank.

36. The discussion below addresses the following major topics: China’s vulnerability to anticompetitive enterprise conduct and to unauthorised anticompetitive actions by local government officials and agencies, misconceptions that may have delayed China’s adoption of a competition law, the substance of China’s competition law, and the structure of China’s competition law enforcement system.

I. China’s vulnerability to anticompetitive conduct by enterprises

37. Because the 2002 OECD China Study focused on the domestic policy challenges to China’s trade and investment liberalisation, its Competition Chapter focused on the fact that none of China’s competition-related laws provided a means to halt exclusionary conduct that obstructs the new entry that trade and investment reforms were intended to produce. China’s vulnerability to such conduct continues today and remains the most important reason for prompt enactment of a competition law.

38. Two points merit re-emphasis. First, some policy-makers and scholars in China consider competition law a relatively low priority in China, arguing since that China’s industrial concentration (the percentage of production, sales, or some other measure accounted by the leading enterprises) is relatively low, monopoly or market power is not a current problem in China. This argument is flawed, because concentration is not a meaningful indicator of competitiveness unless it reflects conditions in economically defined ‘product markets’ and ‘geographic markets.’ Available reports of concentration in China, however, are generally based on statistical product categories and administrative boundaries; such reports are not reliable and are often very misleading. Given China’s size, transportation problems, and regional protectionism, national concentration ratios clearly understate actual market concentration in China.

39. Second, some policy-makers and scholars have suggested that competition law is less important in China than in some other countries because China has a problem of ‘administrative monopoly,’ rather
than ‘enterprise monopoly.’ This argument is also flawed. It is true that governments’ preferential
treatment is often the source of enterprises’ power, and it important to seek to eliminate the laws and
policies that create or protect this power. However, government policies are a major source of enterprises’
market power in all countries, and there is no policy reason for permitting abuses by enterprises that derive
their power in this way.

40. A recent report by China’s State Administration for Industry and Commerce (SAIC) focused on
China’s need for a competition law from a somewhat different perspective – China’s vulnerability to
anticompetitive conduct by foreign enterprises. The report’s allegations against particular firms were not
documented and remain unconfirmed, and some of the report’s analysis was unclear or questionable. For
example, the report appeared in some places to suggest that multinational firms have a dominant position
merely because they have greater assets or experience than domestic competitors, whereas mainstream
competition analysis finds dominance only when a firm has the power behave substantially independently
of its competitors in a relevant market. Nonetheless, the report is certainly correct that China’s lack of a
competition law exposes it to anticompetitive conduct by foreign enterprises, as well as domestic ones.

41. As implied by the SAIC report, the competition-related measures China has taken since 2002 do
not protect it against exclusionary or other anticompetitive conduct. In 2003, the State Development and
Planning Commission (now the National Development and Reform Commission) issued Provisional
Regulations on Prohibiting Price Monopolistic Conduct. The rules were a step forward, but they merely
implemented the existing prohibitions and did not reduce China’s vulnerability to anticompetitive conduct.

42. Also in 2003, China’s Ministry of Foreign Trade and Economic Cooperation (now the Ministry
of Foreign Trade and Commerce [MOFCOM]) issued Provisional Regulations on the Merger and
Acquisition of Domestic Enterprises by Foreign Investors. These regulations may provide China some
protection against anticompetitive acquisitions, but they also could be improved. The regulations establish
separate premerger notification thresholds for foreign investors’ onshore and offshore acquisitions of
equity or assets of domestic enterprises. (Mergers involving foreign firms are not covered by these
regulations, but rather by a different regulation that has no premerger notifications system.) Improvements
to the regulations could include (a) consistency concerning whether “foreign-invested enterprises” are
“domestic enterprises,” (b) definitions of “onshore” and “offshore” transactions, (c) clarification of the
standards for the disapproval of proposed transactions, (e) clarification of the respective roles of the two
“relevant antitrust authorities” (the SAIC and MOFCOM), (f) the creation of a clear deadline for the
antitrust authorities to make a decision, (g) the application of “national treatment,” and (h) revision of a
provision empowering a domestic competitor or trade association to request a premerger notification not
otherwise required by the law.

43. At least some of the issues with the proposed “Merger and Acquisition” regulations have
apparently been acknowledged by Chinese officials. The existence of these issues, all of which relate to
only one of the many topics that should be covered by China’s competition law, illustrate the benefits that
could come from further consultations with international experts to discuss the draft and any concerns
Chinese officials have with incorporating international “best practice” standards into its competition law.

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11 Moreover, the report’s list of abuses discussed various forms of conduct as abuses without discussing
whether the conduct had efficiency justifications that rendered it procompetitive on balance. It discussed
exclusive dealing, for example, as if were always anticompetitive when engaged in by a dominant firm.

60-63.
2. China’s vulnerability to anticompetitive actions by local government officials and agencies

China’s desire to create a more integrated economy is well known. Some of the obstacles to such integration are simply a reflection of its size, but the task of integration is made much more difficult by regional protectionism by China’s local governments. Such governments are generally authorised to regulate commerce in various ways in order to protect the health and welfare of their citizens, but in many cases local governments in China have taken unauthorised, anticompetitive actions to prevent entry by new firms or products, thus protecting local enterprises at the expense of their citizens. Examples of such conduct were discussed in the 2002 Competition Chapter and are presented in various other chapters of both the 2002 China Study and this Report on Governance in China.

China’s Unfair Competition Law prohibits “administrative monopoly,” which includes but is not limited to the unauthorised use of governmental power to impose protectionist policies. This law is enforced by the SAIC, and its enforcement has had some success in challenging regional protectionism. However, the SAIC’s success in challenging local government restraints than has been significantly less than that achieved in the comparable activities of, for example, the competition agencies of the European Union, Russia, and Peru. There appear to be two reasons for China’s relative lack of success. First, the local AICs are part of the local governments they are charged with policing, whereas the successful programmes use a central competition authority. Second, unlike most competition laws applicable to local government conduct, the Unfair Competition Law does not authorise the SAIC either to rescind illegal decisions or agreements, or to impose fines or other sanctions.

In order to deal more effectively with regional protectionism and other unauthorised, anticompetitive actions by local governments, China should include a ban on administrative monopoly in its competition law. Moreover, the law should authorise the competition authority to rescind illegal decisions or agreements and impose sanctions for violations. Finally, as discussed further below, the extent to which local governments are responsible for anticompetitive activity in China means that the competition law should be enforced by a central competition authority whose local offices are not dependent on local governments.

3. Misconceptions that may have delayed China’s adoption of a competition law

In the past, some policy-makers and scholars have opposed China’s adoption of a competition law on the grounds that competition law enforcement would (a) prevent Chinese firms from merging to achieve minimum efficient scale, or (b) interfere with China’s “industrial policy” initiatives, including in particular the creation of “national champions. Neither of these objections is sound. Competition law does not prevent mergers to achieve minimum efficient scale or in any way reduce a country’s ability to create national champions or pursue other forms of industrial policy.

4. The substance of China’s competition law

The substance of China’s competition law can and should reflect both China’s current conditions and international best practice. China’s legal, cultural, and other conditions will undoubtedly affect the enforcement structure it chooses, but they should not influence the core substantive provisions of the law. As in other countries, the law should ban abuse of dominance, anticompetitive agreements, and mergers and acquisitions that substantially lessen competition or create or maintain a dominant position. Moreover, the law should make it clear that except perhaps for cases involving hard core cartels or other conduct that is clearly anticompetitive and lacking any efficiency justification, all competition cases require (a) the definition of relevant product and geographic markets, and (b) the assessment of market power.
49. Recent drafts of China’s competition law suggest that some in China are considering competition law provisions that depart from mainstream international best practice. Some such provisions may ban conduct that is not considered anticompetitive in other countries, and others may create unnecessary bureaucratic obstacles to efficient enforcement. Given the lack of any official draft and the existence of translation problems with drafts that are being circulated, it is impossible to address these concerns in detail. However, despite much good work by the drafting group, there are issues concerning how the law will treat market definition and the assessment of market power, what kind of evidence will be necessary to condemn particular practices as abuses of dominance, how allegedly anticompetitive horizontal and vertical agreements will be assessed, and how the merger review process will operate. As discussed above, consultations with international experts could help clarify such issues and improve the draft law.

50. In addition to assuring that its competition law provides an efficient way of addressing anticompetitive conduct, China should – for “good governance” reasons – eliminate overlaps between the competition law and other laws. For example, China’s Price Law bans monopolistic pricing, and its Provisional Regulations explain that this ban extends to output restrictions. At the same time, China’s draft competition laws have consistently included “monopolistic pricing” and “output restrictions” as abuses of dominance. Such conduct is a harmful exploitation of market power, but at least in developed economies, it is increasingly believed that it is counterproductive to try to halt the conduct since (a) assessing whether pricing (or reduced output) is monopolistic is very difficult and (b) halting such conduct is likely to prolong the monopoly, whereas permitting it encourages entry that can eliminate the monopoly. Assuming that China wants to continue to ban such conduct, it would be sensible to remove the bans from the draft competition law and keep them in the Price Law, which is enforced by an agency whose price regulation responsibilities give it skills and tools that China’s competition authority is unlikely to have.

51. On the other hand, some provisions of the Price Law – Articles 14.1 (collusion), 14.2 (predatory pricing), and 14.5 (price discrimination) – relate to conduct whose assessment requires the core skills and tools of a competition authority. Since it would be inefficient and very confusing to have two different agencies enforcing similar but non-identical provisions using different procedures and applying different sanctions, it is recommended that the competition law explicitly repeal these provisions of the Price Law. For the same reason, it is recommended that the competition law explicitly repeal Articles 6 (tying by statutory monopolists) and 11 (predatory pricing), and the first sentence in Article 15 (collusive tenders) of the Unfair Competition Law.

5. The structure of China’s competition law enforcement system

52. How China will structure its competition law enforcement system is a vitally important one that was not addressed in the 2002 OECD China Study. Therefore, the discussion below provides a comparatively extensive discussion of the considerations China might take into account in deciding the kind of competition authority it wants.

53. Some countries have competition policy departments in a number of ministries and agencies, and some give competition policy responsibility to a particular ministry, but it is generally accepted that an effective competition law enforcement system requires that the competition authority be free from undue influence by ministries, other government entities, and other stakeholders. The importance this independence was affirmed at the February 2003 meeting of the OECD Global Forum on Competition, which devoted considerable attention to the optimal design of competition authorities. Those discussions

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13 See OECD, Global Forum on Competition: Preventing Market Abuses and Promoting Economic Efficiency, Opportunity, and Growth, 2004, which contains a summary of those discussions (and other matters considered during the first three meetings of the GFC. Both this summary and the background materials for the discussions are available at www.oecd.org/competition.
noted that independence is not simply a matter of the formal organisational status of the authority or its place in the government administrative structure, though institutional and budgetary independence are clearly useful in protecting competition law enforcement decisions from being subordinated to other government objectives.

54. Despite the need to go beyond formal measures of dependence or independence, it may be useful to note that of the competition authorities that responded to a Secretariat questionnaire in connection with the 2003 GFC meeting, about 35 percent considered themselves as independent of Government. Another 20 percent or so were independent of ministries but considered themselves in some way as responsible to Government. Approximately 45 percent were part of a ministry.

55. Of course, no competition authority can be completely independent from the government structure of which it is a part. The authority’s leadership is nominated or appointed by a government officer – often the President or Prime Minister – though many countries provide a check on the appointment power by setting forth the necessary qualifications and/or requiring that nominees be reviewed by the legislature or some other independent body. Some countries also legislate that appointees may be removed only for cause. Competition authorities’ need for government funding generally provides another opportunity for Government to influence their actions. This opportunity is sometimes abused, but it is partially protected from abuse if restrictions imposed by the budget process are a matter of public record.

56. On the other hand, even competition agencies that are part of a ministry can be given substantial independence, at least with respect to their law enforcement decisions. In countries with long traditions of competition law enforcement, the independence may be a matter of custom rather than law, but legal protections of independence are also common. For example, Germany’s competition authority is organisationally part of the Ministry of Economics and Labour, but the independence of its decision-making process is subject to numerous legal protections. The Ministry may become involved in competition cases only after the authority has completed a proceeding and prohibited a merger or cartel, at which point it can issue a public ministerial authorisation. Even this limited ministerial “override” could undermine competition enforcement, but it has not done so in Germany because the override has very rarely been used.

57. Although it is possible to provide the necessary independence for a competition authority that is part of a ministry, many countries prefer to create their competition authorities as independent agencies, often multi-member commissions whose members are appointed for fixed terms and are removable only for cause. Other countries prevent their competition authorities from being subordinated to any particular ministry by making the authority directly responsible to Council of Ministers or the Prime Minister.

58. Thus, another alternative that China could consider is the creation of a new, national competition authority that is independent from China’s ministries and whose local offices are independent from local governments. China does not have many independent agencies, and its national agencies tend to operate in local areas through the local governments. Nevertheless, China has taken some steps in this direction, and it could consider this alternative with respect to competition law enforcement because this is a field in which the need for independence is widely recognised.
E. Conclusion

59. China’s national government has implicitly applied competition policy principles in much of its recent policy-making, and by requiring a more systematic application of those principles by all national and local government entities, China could reduce the extent to which laws and policies waste resources by imposing unnecessary restrictions on legitimate market activity. A competition law is one of the key frameworks of a market economy, and China’s lack of such a law reduces its ability to halt ongoing anticompetitive activity by enterprises and local governments.