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August 5, 2008

By E-mail

Dear Sir/Madam,

Re: Response to Hong Kong Government's Detailed Proposal for a Competition Law

Executive Summary

The Lion Rock Institute strongly opposes plans to introduce a cross-sector competition law regulator in Hong Kong as outlined in the Commerce and Economic Development Bureau May 2008 document entitled “*Detailed Proposals for a Competition Law – A Public Consultation Paper*” (the “Detailed Proposal”).

The key reasons for this can be summarized as follows:

1. The Detailed Proposal is based on flawed economic theory that proves largely unworkable in practice and produces undesirable unintended consequences.
2. The Detailed Proposal would result in vague, arbitrary law, do damage to the rule of law in Hong Kong, and be contrary to the best of the territory's Common Law legal tradition.
3. The Detailed Proposal goes beyond the constrained approach that was recommended in earlier consultation, lacks sufficient economic input and results from a flawed process.
4. The Detailed Proposal fails any honest cost-benefit analysis - the costs of adopting the law are greater than any possible benefit the new regulator would bring.
5. The Detailed Proposal would represent the biggest expansion of the state in the Hong Kong economy in the last 50 years and be contrary to Hong Kong's traditional “positive non-intervention” approach on which the territory's economic success has been built.

In this submission we will expand further on the points above. We will also outline some potential ways in which the harmful effect of regulator could be mitigated – although we continue to believe the best solution over all would be not to introduce this new regulator at all.



1 Based on Flawed Economics

Competition laws only make sense if the economics behind them make sense. There is no other rationale for them. If the economics behind the proposed competition law do not make sense, then the competition law proposal does not make sense.

1.1 Why Competition Laws Do Not Make Sense in a Market as Open as Hong Kong

The Detailed Proposal fails to promote competition and public benefit on two grounds. Firstly, recent economic analysis has undermined the fundamentals of conventional antitrust law approaches and has shown that it undermines efficient outcomes. Secondly, even conventional approach to competition policy is not easy to apply in a very open market in a single city like Hong Kong that is highly integrated with a hinterland in a different jurisdiction.

It is now well established that competition depends not on the number of participants in a particular market but on the potential for a new player to enter the market and challenge an existing incumbent. The idea of contestability undermines the traditional analysis on market structure that looks at the number of firms as important in defining the amount of competitive rivalry in the market.

In an open market competition is not reduced if a new competitor decides to challenge an incumbent and fails. It is also not reduced if two or existing competitors decide to cooperate or merge their operations in a market.

The only way competition can be reduced – that is, where the contestability of a market is reduced – is where there are government-imposed barriers to entry which restrict the ability of new competitors to emerge to challenge existing incumbents.

1.1.1 *Competition Law Regulators Have Static View of the Market*

It is important to understand that competition law regulators - no matter how sophisticated - can never predict accurately what new potential competitor will emerge to threaten an existing incumbent or what new products will be launched which reshape the market itself. Competition laws instead rely on a static view of the market in which no new potential competitors can emerge and no new products can be launched.

A classic example of the inability of competition law regulator to anticipate the potential contestability of a market is the high-profile case competition law case against Microsoft in the late 90s. At the time that the competition law regulators made their decision against Microsoft, Google was not even a dot on the horizon.

The competition law regulators in both the United States and Europe simply had no idea that such a new competitive threat would emerge which would challenge Microsoft's position and reshape the personal computer market.



The regulators simply got it completely wrong. But the truth is they can never get it right. They can never accurately predict what new competitors will enter the market, what new products will be launched, what new markets will be created or how existing markets will be reshaped in the years ahead. The best economists in the world guided by the most sophisticated economic modeling can not accurately predict this.

1.1.2 How Government Imposed Barriers to Entry Reduce Competition

The key economic points to grasp are that:

1. The only way a business or group of businesses (no matter how big) can permanently monopolize a market or dictate the price that a particular good is sold at is if there are government-imposed barriers to entry into a particular industry keeping potential new competitors out.
2. The only way that any business behavior can be said to reduce competition in a market – i.e. reduce the potential for new competitors to enter the market - is where there are government-imposed barriers to entry keeping new competitor out.
3. Where a government regulation creates a closed-market – i.e. one where new competitors can not freely enter then - there is an arguable case for some sort competition regulator. However, the establishment of a regulator in a closed market will always be a second best solution as the regulator will never be able to determine what the level of competition would be where the market open to new competitors. The best solution is to remove the government-imposed barrier to entry and create an open market.

It is because Hong Kong – with certain limited exceptions – has created an open market in which competitors may freely enter that it does not need a competition law.

Hong Kong simply does not have anywhere near the same extent of government barriers to entry that are found other countries with competition laws such as tariffs, government subsidy, arbitrary bureaucratic licensing regimes, unnecessary complicated regulations which favor incumbents and outright bans on new competitors in a particular industry. Notable exceptions, however, include healthcare, gambling and gaming, capital-raising through stock markets and amusement parks.

1.1.3 Why Private Actions By Incumbents Can Not Reduce Contestability of a Market

Many proponents of competition laws would give lip service to many of the above statements. However, they would content that even with no government barriers to entry the potential for new competitors to emerge can also be reduced the *private* actions of by incumbents i.e. by agreements that private companies make between themselves, or by particular market behavior that drives out competition or dissuades new competitors from entering the market.

Real world experience is that private actions by existing incumbents can never reduce the potential for new competitors to enter the market. The fact that a large amount of capital is required to enter particular industries is not a barrier to entry to new competitors when capital markets are efficient as in Hong Kong.



Agreements between existing incumbents 1) rarely hold for long 2) invite new entrants 3) may increase efficiency and deliver welfare gains 4) can be challenged by both buyers and suppliers.

A competition law regulator – as outlined in the Detailed Proposal - would do nothing to remove government-imposed barriers to entry in industries where they exist. It simply accepts such barriers as a given. Nothing in the Detailed Proposal indicates that it will open up those industries in Hong Kong for which there is an outright ban on new competitors such as The Jockey Club. Equally nothing in the Detailed Proposal indicates that it will remove any of those limited indirect government barriers to entry of new competitors in the Hong Kong market.

Where there are no government-imposed barriers to entry in a particular industry a competition law regulator is simply redundant and interferes with legitimate business competition. It imposes direct and indirect costs which will be discussed further in [1.4 – Fails Cost / Benefit Analysis].

1.2 Who are the economists who support the Detailed Proposal?

The Detailed Proposal does not cite one single economist in support of the law it is proposing. The debate in Hong Kong has been dominated by lawyers, not by leading economists. It is notable that many of the leading participants in the debate lack any formal economic credentials.

This is not surprising. The “antitrust community” is itself a large interest group that is seeking to expand globally. It is estimated that “the worldwide gross receipts of the antitrust community of lawyers, economists, and government officials in the more than 100 countries that now have such regimes totals at least \$20 billion annually (and that does not count the cost to the businesses involved).” (Ky P. Ewing, Jr. *The antitrust source*, April 2008)

The government repeatedly claims they are relied on “expert” economic advisors when compiling the Detailed Proposal however they have never publicly stated who these leading economists are.

If the economics behind the Detailed Proposal is so uncontroversial, as proponents of the competition law regulator claim, surely the government should be able to provide a clear list of those leading economists which are in favor of the law. If the government is so confident in the abilities and the status of the economists which are advising it, why the need for so much apparent secrecy surrounding who these individuals are?

In fact, leading local economists, including Richard Wong of Hong Kong University and Francis Lui of HKUST, specifically examining Hong Kong’s situation have spoken out against such a law for Hong Kong – in some cases for decades.

1.3 Why does the Detailed Proposal ignore the economists who are against competition laws?

The Detailed Proposal shows little awareness of eminent economists who oppose competition laws.

Given that Hong Kong has been able to prosper without the need for a cross-sector competition regulator for so long it is incumbent on the government to at the very least provide some sort of honest critique about why it disagrees with the economists who oppose competition laws. There is an additional obligation on the government to respond to those economists, like Milton Friedman, whose economic policies Hong Kong has largely followed for at least the last 50 years.

Some from the government have informally suggested to us that we are misreading the criticism by leading economists of competition law and that the comments of Milton Friedman, James Buchanan, Ronald Coase, Alan Greenspan and others were somehow confined to competition laws in the United States or focused on competition laws as they existed in the past.

We believe that no honest reading of their work or statements would support such a claim. Their statements attack the flawed economic principles behind competition laws and there is no reason why their attack on the economics of competition law should be confined to one particular country. After all, the laws of economics are not country specific. In any event, any critique that the competition laws in the United States are unnecessary, meddlesome or lack economic logic would equally apply to those same laws in the European Union which are widely recognized as being more anti-business in both substance and in application than those in the United States (witness the more onerous fines applied in Europe in the Microsoft case, the more prompt clearance of the proposed BHP-Rio Tinto merge in the United States as opposed to that in the EU, etc.).

We do not rely simply on argument by authority. The rules being proposed do not make sense even on their own terms. Take, for example, the rules against "price fixing".

Why Rules Against So-called "Price Fixing" Do Not Make Sense in an Open Market

The following example illustrates why laws against price fixing do not stand up to any rigorous scrutiny. Consider the following:

Scenario A: Imagine there a market where there is a single supplier of a particular good or service. The single supplier has 100% share of the market. The single supplier decides increase the price of the good or service by 20%.

Scenario B: Imagine there is a market with only two (or three or more) suppliers of a good or service. The incumbent suppliers have together 100% share of the market. Both agree to increase the price they are selling their good or service by 20%.

Competition laws nowhere in the world would prohibit the price increase in Scenario A. They would almost certainly scrutinize and likely penalize Scenario B. However, the economic effect is exactly the same in both case i.e. the cost of a particular good or service increases by 20%.

Why penalize Scenario B where the economic effect is identical to Scenario A?

Again, the only way that competition can be reduced in a market - i.e. where the contestability of a market is reduced - is where there are government barriers to entry (either direct or indirect) which restrict the ability of new competitors to enter the market.

In an open market, a single supplier controlling 100% of the market can charge whatever it likes - but its ability to continue to increase the price is constrained by the threat that a new competitor will enter the market.

Where two existing suppliers decide to agree to effectively "act as one" by agreeing to charge the same price they should be free to do so. However, their ability to continue to charge this price - or even higher prices - will be constrained by the threat that a new supplier will enter the market.



2 Legal Concerns

The proposal would penalize (or at the very least subject to intrusive, unwarranted and costly regulatory scrutiny) certain business agreements or business conduct which are currently legal in Hong Kong.

The Detailed Proposal contains two broad general prohibitions:

- (a) participation in agreements and concerted practices that have the purpose or effect¹ of substantially lessening competition; and
- (b) abusing substantial market power with the purpose or effect of substantially lessening competition.

The Detailed Proposal has indicated that the to-be-established Competition Commission will issue guidelines on behavior the exact type of behavior will be generally considers to infringe these two broad prohibitions.

2.1 Vague, Arbitrary Law

Because of the broad prohibitions and the broad powers delegated to the Competition Commission, it is impossible to say under the Detailed Proposal exactly what sort of commercial conduct will be prohibited at present.

One immediately sees the legal concerns with such vague wording used in the Detailed Proposal if one simply replaces the word “competition” from the two general prohibitions. For example, imagine if the government were to establish a regulator with the power to prosecute Hong Kong businesses or individuals for any of the following:

“Participation in agreements and concerted practices that have the purpose or effect of:

1. *substantially lessening patriotic feeling*
2. *substantially lessening morality*
3. *substantially lessening national security*
4. *substantially threatening state secrets.”*

At the very least if the government felt the need to enact a law on any of these matters then it would be imperative that the type of conduct that was trying to be caught by the regulator was spelt out in minute detail. The powers of the regulator to prosecute a company or individual for breach of the law would also have to be carefully prescribed. Any new refinement in the type of activity which would be subject to prosecution would deserve full legislative in advance of the law being changed rather than simply delegating the power to make law to an unelected body.

The government may believe there is a clearer rationale for prosecuting “anti-competitive” conducts rather than “anti-patriotic” conduct (although as explained in 1.1 the economic rationale for the proposed competition law is seriously flawed). However, as purely a legal matter there is no

¹ See comments in 2 (point 7) on why “economic harm” rather than “purpose or effect” should be used.



difference in type between such vague arbitrary laws regardless whether the ultimate concern driving them is economic or political.

It is important to understand that even if no prosecution or investigation is ever launched by the Competition Commission simply by having these vague arbitrary laws on the books undoubtedly leads to greater legal uncertainty and regulatory risk for business. There is simply no way of knowing by reading the law itself whether a particular type of business agreement or behavior would be prosecuted under the law.

There is, as many have noted, not even a definition of ‘competition’ in the Detailed Proposal.

Without such a definition how is it possible to say for certain exactly what type of conduct “substantially reduces” competition?

2.2 Why Giving Power to Competition Commission To Exclude Arrangement Where the Economic Benefit Outweighs the Economic Harm is No Reassurance for Business

It is true that the Competition Commission has wide-ranging powers to exclude particular business conduct from the law if the economic harm outweighs the economic benefit or whether there is a public interest. Proponents of the law claim that this should eliminate any concerns that the Commission may abuse its powers. However, what the proponents of the law fail to appreciate is that by giving the regulator such powers in the first place to determine what conduct will and will not be prohibited fundamentally changes the relationship between business and the state in Hong Kong.

It is commonly said that the biggest difference between a free society and a unfree society is that in the a free society there is a presumption that unless the law specifically forbids you from engaging in a particular action you may do it whereas in an unfree society there is a presumption that you may not engage in a particular action unless you are specifically permitted to do.

The introduction of a competition law regulator would change the presumption and make Hong Kong a less free place to do business.

It would have a chilling effect on Hong Kong business because one would not be able to say with any certainty (and without the official approval of the regulator) exactly whether an agreement, a pricing strategy, a distribution agreement, or any variation of agreements would be permitted. Without such certainty and with the risk of possible legal penalties businesses will simply decide that it is not worth the risk to strike particular business deals to the ultimate detriment of the Hong Kong economy.

2.3 Harmful to Rule of Law

The Detailed Proposal gives enormous power to the competition law regulators. The experience in other jurisdictions has been that there is inevitably pressure to target unpopular business personality or businesses that are deemed “too successful”. Political pressure is also brought to bear on the regulator to take against those services which are consumers interact with daily i.e. petrol, groceries, etc.

2.4 Constitutional vulnerabilities

2.4.1 *Koon Wong Yee*

We understand that the government is aware and has already has received submissions from The Hong Kong Law Society and others regarding the constitutional vulnerabilities relating to the proposed penalty regime outlined under the Detailed Proposal. The problem is that fines under the competition law proposal which are sufficiently large to be a deterrent may be treated as criminal rather than simply and administrative fine. Thus, without providing the recipient of the fine the same protections that would apply in a criminal case the penalty regimen may be struck down as being unconstitutional.

2.4.2 *Basic Law*

We believe what has not been given due consideration is that the introduction of a competition law regulation may also be subject to challenge for being in breach of the Basic Law.

Many of the provisions of the Basic Law have not been tested and would provide an arguable basis for invalidating many if not all of the powers of the competition law regulator as well as its ability to effective law making powers. We will not outline all the potential bases for action but the following should be of some concern:

2.4.2.1 Article 5 – ‘Socialist Systems and Policies’?

There is a general question of whether these proposed laws are inherently ‘socialist systems and policies’ or alternatively the arguably lesser standard of not being in accordance with the ‘capitalist system and way of life’ as existed prior to July 1, 1997. While some may be inclined to dismiss such concerns there are certainly a number of credible economists who would be able to provide expert testimony on the socialist thinking behind the enactment of these laws and/or the socialist effect of these laws elsewhere in the world.

If Article 5 means anything it provides at least some form of bulwark against the expansion of the state control over the economy. In this respect it should be noted that there is simply no precedent in pre-July 1, 1997 Hong Kong for a government regulator having the ability to effectively regulate the entire private sector economy of Hong Kong according to what are very broad (and as we have noted highly contested) economic principles.

2.4.2.2 Article 8 - ‘Competition Commission as Legislature?’

Article 8 requires that “*the laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene this Law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region*”.

While certain delegated legislation is permitted there are legitimate concerns as to whether delegating a to-be-established regulator what amounts to broad-ranging legislative authority to make what are arguably laws about what conduct individuals and corporations can not engage in amounts to the ability to make laws for Hong Kong which should be the exclusive responsibility of the legislature (Article 66).



3 Concerns about over-reaching the consensus on this Issue

The Lion Rock Institute has concerns about whether the legal and economic advice the Hong Kong government is receiving on the issue of competition law is consistent with the earlier input from consultative processes, world-class and impartial.

We acknowledge that some in Hong Kong have in good faith argued for cross sector competition law in Hong Kong. However, the extensive prior consultative process pointed to a consensus on the need for any such law to be narrowly focused on a defined set of behaviors that have given rise to concerns competitive markets may be undermined. Many leading participants have suggested that Hong Kong needed law that:

- 1) Took into account the specific issues of Hong Kong as a very open economy
- 2) Avoided the uncertainties and regulatory burden of European and US competition law as it stands
- 3) Was consistent with the common law traditions and constitutional arrangements in Hong Kong.

What was wanted was a minimalist approach that possibly codified existing practices on specific issues where concerns have been raised.

What is offered in the detailed proposal is at odds with this mandate.

Although there is no draft legislation, the scheme offered is a standard adoption of international competition law and the administrative apparatus to support that.

Gestures to customizing a very standard approach to a Hong Kong environment are the suggestion that a specific merger law not be adopted, that different concentration thresholds be used, allowance for exemptions and authorization and the exclusion of government activities and directing attention away from vertical agreements.

However, these gestures are at odds with the specific proposals likely to be legislated.

Public Choice theory offers some reasons why what is offered by the Detailed Proposal is distant from the needs of the Hong Kong community. In a simplified account this theory suggests that concentrated interests have a strong incentive to influence policy outcomes, whilst the dispersed interests of the community will be under represented.

The Detailed Proposal reads strongly as influenced by interests that have directed outcomes towards a preferred model that is not appropriate for Hong Kong:

1. Drafting of the proposal has engaged lawyers who have made proposals closely modeled on their own experience in other countries. Law firms have a strong interest in maximizing their investment in existing approaches and structures. They also have an incentive to prefer models with more potential fees to minimal approaches or codification of existing practices;



2. The civil service has been closely involved in the framing of the proposals. They have an incentive to maximize opportunities for expanding the administrative roles and discretion available under the model; and
3. Existing businesses that have limited competition (large through government policy) have a strong incentive to avoid the consequences of the law.

Given these inherent “public choice” problems, a careful process needs to be designed to ensure suitable outcomes for the wider community in Hong Kong.

However, two particular issues suggest that the process has not been careful to avoid these problems:

1. Hong Kong government engaged a law firm owned by a member of Hong Kong’s executive council as its principle advisor.

Ron Arculli is a member of the Hong Kong Executive Council. He is also a senior partner of the law firm Arculli, Fong & Ng. It would be most unusual (and almost certainly forbidden) in most other developed jurisdiction for the government to instruct the law firm of a cabinet-level official to provide advice on a new law such as this especially where they stand to gain financially.

We do not allege any wrong-doing. However, the outcome of the proposals is deficient in analytical rigor and that there is a need for greater transparency from the government on this point.

2. The principle advisor has close ties to heavily government regulated and uncompetitive firms.

In addition to role on the Executive Council, Ron Arculli is also currently the Chairman of the Hong Kong Stock Exchange. He is also a former chairman of the Hong Kong Jockey Club. The Hong Kong Jockey Club has a government-created monopoly over gambling in Hong Kong (by law no other competitors are allowed). The Hong Kong Stock Exchange is not strictly speaking a government-created monopoly but an application to establish a new stock exchange requires the approval of the Hong Kong government and it is unlikely that such approval will be granted in the foreseeable future².

We believe that given Mr. Arculli’s close association with two of the biggest government-created monopolies in Hong Kong there is at the very least a perception of a potential conflict of interest. We do not allege any wrongdoing but would simply alert the Hong Kong government to the fact that any advice, particularly in relation to which entities it is appropriate to grant exceptions to, may be compromised.

² The fact that the Hong Kong government owns a stake in the Hong Kong Stock Exchange creates a disincentive to approve new exchanges (because this would mean the value of the Hong Kong government stake would be likely to fall). It is thus likely that the Hong Kong Stock Exchange will be the only exchange in Hong Kong – or at least the only one covering equities.



4 Fails Cost / Benefit Analysis

The introduction of a cross-sector competition law regulator in Hong Kong does not make sense if the economic costs to the Hong Kong economy – both direct and indirect – exceed the purported benefits of this new legal regime.

4.1 Benefits?

As outlined earlier is simply not possible for the regulator to anticipate what new competitors or new products will enter the market in future to threaten the position of existing incumbents. Thus any economic benefits a regulator claims it is bringing to Hong Kong's economy is based on flawed understanding of what competition actually is.

At the very least the supposed benefits of the competition law regulator are speculative and unsubstantiated. Even if one accepts that any of future rulings could provide an economic benefit to the Hong Kong economy these benefits would have to be shown to exceed the economic costs or the competition law regulator would result in net loss to the economy.

4.2 Costs – Direct and Indirect

The direct costs of operating the competition law regulator are estimated by the government to be at least HKD 86 million per year³. We should also add the costs the government has incurred in instructing outside counsel as well as the individual public servant man hours which have been spent on the Detailed Proposal. To that we should also add any legal advice which Hong Kong corporations have had to incur in preparing for the possible introduction of the new law.

The more significant costs in introducing the new competition regulator will be the indirect costs. The Detailed Report does not mention these suggesting it has either deliberately ignored them or is unaware that they exist – but they are very real. Hong Kong businesses will be forced to incur significant legal fees in ensuring that they are in compliance with the new law as well as in defending themselves against the inevitable actions which will be taken against them by the regulator and the general public. These costs will regrettably be passed on the Hong Kong consumers in the form of higher prices or a less wide range of goods. The introduction of a new competition law will also result in making Hong Kong a less attractive destination for foreign multinationals. Large foreign companies are often targeted by competition law regulators globally and Hong Kong will be no exception.

³ The government website indicates that: “*the competition commission would require an annual budget of up to \$80 million and the initial cost of operating the [competition] tribunal would be about \$6 million a year*” : (<http://news.gov.hk/en/category/businessandfinance/080506/html/080506en03001.htm>).



5 Contrary to Policy Which Has Caused Hong Kong's Economic Success

One of the arguments routinely used by those in favor of introducing a cross-sector competition law regulator in Hong Kong is that “other countries have one”. However, this argument is open-ended – does it mean that we should similar mirror all of the onerous regulation, high tax rates and other legislation that exist in Europe or North America? This argument also avoids any analysis about the experience of overseas jurisdictions and whether there has been any evidence that competition laws have actually improved their economies.

Hong Kong has a proud reputation of rejecting unnecessary regulation and owes its economic prosperity to this approach. If Hong Kong had simply adopted the regulatory proposals that had come out of Europe in the last 50 years then it would be significantly poorer than it is today.

The proposal to introduce a competition law also flies in the face of Hong Kong's well established policy of “positive non-interventionism”. While the exact wording of this policy has varied what has remained constant is that the Hong Kong government has not unnecessarily meddled in the economy unless there is absolutely compelling rationale for doing so. This clearly does not exist in the case of the Detailed Proposal.



6 Possible Ways of Mitigating the Harmful Effects of Law

We regrettably feel that the Hong Kong government has raised expectations that it will pass a competition law. We believe very strongly that the best solution is not to pass such a law and for Hong Kong officials to explain to the public clearly why it is not in the territory's economic interest to do so. However, if the competition law is to be introduced then we would propose the following ways of mitigating the harmful effects of the law.

1. Introduce threshold requirement to prove that there is some government restriction or regulation which limits the ability of new competitors to enter the market before any action is taken by the regulator

As we have tried to explain throughout this submission it does not make sense to have a competition law regulator in open markets i.e. those in which there are no direct or indirect government-imposed barriers to entry which restrict the entry of new competitors.

There are some areas of Hong Kong economy in which there are direct or indirect barriers (imposed by government) which do impose some type of legitimate regulatory barrier to the entry of new competitors.

We would thus propose that there be a threshold requirement before either any action is taken by the Competition Commission that it is required to demonstrate that there is some government barrier to entry keeping other competitors out of a particular market. We would also insist that this threshold requirement be satisfied before any private action can be taken in civil action by a potentially plaintiff.

By implementing this change the government would go a long way to satisfying the concerns of the Lion Rock Institute.

2. Exclude Goods

Even the proponents of competition law regime have trouble explaining why goods should be included in the competition law regime and tend to focus their comments on the service industries. In an open market like Hong Kong where goods are freely imported from all corners of the world and there are effectively no tariffs on any goods it does not make sense to make out that any one type of goods can not be replaced by another sourced from elsewhere.

3. Exclude SMEs

The Detailed Proposal has provided for a *de minimus* exception for SME. However, it states that these enterprises could still be subject to “hard core” conduct such as price rigging, bid-rigging, output restrictions and market allocation.

However, none of these forms of so-called “hard core” conduct make sense – see Appendix D for further explanation. We would thus propose that it would simply make more sense to completely exclude SME from the new competition law regime.

4. Use more narrowly defined tests than “substantial lessening of competition” and “market power” and ensure market definition is not geographically bounded



Other jurisdictions have explored ways to limit competition law by narrowing the tests used to assess conduct. One option would be to require demonstration of “market dominance” rather than simply market power. Rather than “substantially lessening competition”, a general test, specific forms of conduct could be proscribed.

We also believe that in drafting, it is important to ensure that the application of tests for market power look at markets that are broader than Hong Kong and recognize open borders for goods, services and people. For example, it is clear that in many industries the potential for entry from China based companies is a substantial contributor to competitive rivalry, even if China firms do not today operate in Hong Kong. We find it difficult analytically to find many markets where the relevant market would be defined as Hong Kong. Framing the legislation should not force artificial boundaries to be imposed on analysis by the limited jurisdiction of the HKSAR government. Too narrowly defining markets leads to excessive competition law interference because market concentration is artificially defined based on political rather than economic boundaries.

5. Firm the commitment not to introduce a merger law

By not ruling out a merger law and framing an open ended process of complaint or Competition Commission initiated review, the government creates significant uncertainty for mergers and business combinations that reach the proposed market share thresholds for scrutiny of markets. Introduction of a merger section should be specifically ruled out.

6. Sunset clause

No evidence has been offered of a continuous problem in Hong Kong with lack of competition. Rather specific reform areas (often heavily influenced by government intervention) have been highlighted as needing scrutiny. This suggests that a sunset clause on the structures created would be a suitable way to deliver the scrutiny in a time limited way, whilst minimizing the risk of creating a highly interventionist structure that would undermine competitive processes in dynamic markets. We suggest a 5 year limit would be appropriate.

7. Law should focus on “Economic Effect” not “Purpose and Effect”

As explained earlier, the use of the term ‘purpose or effect’ means that even agreements that can be shown not to have any economically detrimental effect are caught by the prohibition. In other words if two café owners decided to jointly increase the price of a cup of coffee to USD 100 then the law would say that they should be prosecuted because they had the purpose of reducing competition regardless of the fact that other cafes continue selling their coffee at USD 2 per cup and there is no economic downside to consumers. The whole supposed rationale for a competition regulator is based on reducing economic harm. The use of “purpose or effect” results in the law being widened to include behavior for which there is no harmful economic effect.

8. Give private businesses the ability to challenge the government statutory bodies which distort the Hong Kong market.

If the objective of this law is to create a more competitive business environment in Hong Kong then the government would be better off taking action to remove the harmful effects of the government statutory bodies which distort the market and hurt the private sector. We suggest that at the very least there should be a process that would allow for private businesses to force the proposed competition regulator to make an assessment about the damage that a particular statutory

organization is causing in the market and whether the business being run by the government would be better off being disbanded. Foremost among these are bodies like the Hospital Authority which crowding the private sector out of 85% of the healthcare market. It should also address monopoly licensing bodies like the Medical Council, Jockey Club and Hong Kong Stock Exchange. Finally consideration must be given to reducing the distorting effect which the government has as the biggest landlord in the territory.

Conclusion

The Hong Kong government is fond of indicating to those who disagree with the proposed competition law regime that they simply need to educate themselves better so as to assuage their fears. We think that it is rather the Hong Kong government which needs to educate themselves. The Detailed Proposal simply does not reflect very sophisticated economic or legal thinking. We hope that this submission has given you food for thought and would be pleased to arrange a time to meet further to discuss our criticisms and suggestions in further detail.

By and On Behalf of:

Andrew Work

Dan Ryan

Bill Stacey

Peter Wong



The Lion Rock Institute



APPENDIX A

Who are the winners/losers if Hong Kong enacts a cross-sector competition law?

Winners

- 1 *Lawyers*: law firms clearly stand to benefit as there will be an increase of competition law cases. Businesses will be required to have law firms vet an increasing number of new and existing documentation to ensure it is in compliance with the proposed law. Businesses will be forced to hire more internal counsel to deal with these matters. It is interesting to note that some of the most vehement critics of this type of law include ex-lawyers and judges who specialized in this area, including Robert Bork and Edward Rockefeller⁴.
- 2 *Government regulators, government economists, bureaucrats and competition law academics*: Competition law disputes require the input of academics, government economists and other academics in determining whether particular forms of conduct have infringed the competition law rules. Many of them thus have an interest in ensuring the expansion of competition law and increasing powers for the agency.
- 3 *Uncompetitive businesses*: Uncompetitive businesses which have seen their market share decline will have the option of alleging that this has been the result of 'unfair' or 'illegitimate' competition or collusion by competitors rather than simply fair but fierce competition. Unscrupulous business people who entered into a contract that ultimately did not suit them and wanted to get out there would be a significant incentive to allege that the contract contained "anti-competitive" provisions and threaten to go to the new competition regulator. The very risk that action could potentially be brought would be enough in many cases for one businessman to force another to agree to terminate a legitimate and legally binding contract where one would otherwise not have done so.

Losers

- 1 *Hong Kong businesses – large and small*: As indicated above the Detailed Proposal would mean that potentially all agreements could be subject to scrutiny by the new competition regulator and subject to intrusive, costly scrutiny at the very least, and fines and costly litigation at the worst.. Whether you agree or disagree with the new competition law there is no doubt that its introduction will result in greater regulatory risk for businesses in Hong Kong and restrictions and uncertainty on the activities they undertake.
- 2 *Hong Kong consumers*: Competition laws do not benefit consumers. Some consumers are attracted to these laws because they think they will be a means to drive prices down. However, the way that competition is increased is to lower tariffs and reduce government-imposed barriers to entry into particular industries. Competition laws do nothing to assist this.
- 3 *Foreign companies*: Competition law investigations are inevitably triggered by an increase in the cost of particular goods and services. This causes political pressure for the government to act and accusations that business is somehow "ripping off" consumers. Inevitably foreign companies are most vulnerable to these complaints and thus are routinely targeted by competition law regulators worldwide.
- 4 *Hong Kong's Business Reputation*: Hong Kong in an extremely competitive global environment. One of the best attributes we have is that compared to many other countries our government has not been hostile to business. The introduction of criminal penalties for the conduct in the Bill would rightly be viewed with serious concern by global businesses. Given the extra risk many will decide not to invest in Hong Kong resulting in a loss of potential jobs, a reduction in investment, and reduction of new products for consumers in the Hong Kong marketplace.

⁴ Rockefeller, Edward S. (2007). *The Antitrust Religion*. Cato Institute. DC, USA.



- 5 *Hong Kong Government's Reputation* In this commentary, we have noted the legal possibility of a constitutional challenge to this law, reminiscent of the LINK REIT and Article 23 battles. Also, a body appointed by government and open to discretionary action will face local and international accusations of political favoritism both for cases it does and the cases it does not choose to prosecute. This is a lose-lose situation. The discretionary powers meant to reassure the business community will be turned instead against the government. Recriminations of unfair treatment in the face of a vague, highly discretionary law will be unavoidable, threatening the reputation of Hong Kong and her government.



Appendix B

List of Statements by Leading Economists Against Competition Laws

“Allegations have been made that some pricing and sale strategies (of large market players) appear to reflect market power, economic theory does not support such allegations. Incumbent firms do not have an exclusive right in deploying such strategies; any new entrant is free to imitate and to further innovate.”

Richard Wong
Deputy Vice-Chancellor of the University of Hong Kong

“When the prices went up, the judges said it was monopoly. When the prices went down, they said it was predatory pricing, and when they stayed the same, they said it was tacit collusion.”

Ronald Coase
Nobel Prize Winner for Economics 1991

“No one will ever know what new products, processes, machines, and cost-saving mergers failed to come into existence, killed by the Sherman Act [the United States competition law] before they were born. No one can ever compute the price that all of us have paid for that Act which, by inducing less effective use of capital, has kept our standard of living lower than would otherwise have been possible.”

Alan Greenspan
Former Chairman of the United States Federal Reserve

“I have gradually come to the conclusion that antitrust laws do far more harm than good and that we would be better off if we didn’t have them at all, if we could get rid of them.”

Milton Friedman
Nobel Prize Winner in Economics 1976

“The financial demise of a competitor is not the same as getting rid of competition. The courts have long paid lip service to the distinction that economists make between competition — a set of economic conditions — and existing competitors, though it is hard to see how much difference that has made in judicial decisions. Too often, it seems, if you have hurt competitors, then you have hurt competition, as far as the judges are concerned.”

Thomas Sowell
Rose and Milton Friedman Senior Fellow
The Hoover Institution
Stanford University

Many people cite Adam Smith, the eighteenth century patron saint of markets, in support of regulatory provisions to ensure competition keeps prices low. Those wishing to use Smith’s work selectively to press for a regulatory agenda are often fond of quoting his aphorism:

People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.

But Smith went on to counsel against intervention by the authorities saying:

In a free trade an effectual combination cannot be established but by the unanimous consent of every single trader, and it cannot last longer than every single trader continues of the same mind.

Moreover, in a statement that ventured into general political matters he said:



It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice.

He realized that monopoly could only persist if empowered to do so by government. He also recognized that a body set up to target agreements between private operators would end up bringing far more harm than good.

Alan Moran
Director of Deregulation Unit
The Centre for Independent Studies

For more than a century, American antitrust laws have been used as a protectionist tool to stifle competition. They have always been used to protect competitors from competition and not to protect consumers, as the American public has been told. The end result has been reduced productivity and diminished international competitiveness. It saddens me to see other countries such as Hong Kong imitating some of our most disastrous economic policies.

Dr. Thomas DiLorenzo
Professor of Economics
Selling School of Business and Management
Given the openness of the Hong Kong economy, I am surprised that Hong Kong would be considering a competition law.

Robert W. Crandall
Senior Fellow
Economic Studies
The Brookings Institution

My reaction to the current discussion about competition law in Hong Kong is that it appears to lack any empirical grounding. I don't see any discussion of the efficiency costs of alleged anti-competitive behavior and I don't see any estimates of the welfare gain that the proposed competition law will provide to consumers.

Clifford Winston
Senior Fellow
Economic Studies
The Brookings Institution

No monopoly can survive for long without government regulations to protect it.

Alan Reynolds
Senior Fellow
CATO Institute

Hong Kong gets top rankings for economic freedom in part because it does not have intrusive laws that cause market uncertainty and hinder economic dynamism. Adopting a competition law invariably will hurt Hong Kong's economy and tarnish its global reputation. Lawyers and bureaucrats will benefit, but the people of Hong Kong will enjoy less prosperity if the law is adopted.

Daniel J. Mitchell
Senior Fellow
CATO



The proposed legislation in Hong Kong government's "Detailed Proposals for a Competition Law" would be disastrous for business, government and the consumer alike. It would have the opposite to the intended effect, because it would open the door to lobbying by vested interests. The consumer would lose out due to a less competitive business environment, as stronger businesses are discouraged from acquiring or driving out of business the weaker ones. But even worse, the government's new role of deciding who is competing "fairly" will expand the opportunities for corruption and encourage the private sector to seek advantages through government action rather than their own efforts. Hong Kong has clearly benefited from government staying out of the business realm, so it is a mystery why it would want to throw away this competitive advantage now.

Hugo Restall
Editor
Far Eastern Economic Review



Appendix C

Selected Opinion Page Articles Critical of Hong Kong's Proposed Competition Law

- Dan Ryan “How to Make Hong Kong Uncompetitive” *The Wall Street Journal*
- Dan Ryan “Obstacle Course” *South China Morning Post*
- Yeung Wai-Hong “Hong Kong’s Non-Compete Clause” *The Wall Street Journal*
- 施永青 “沒有競爭法 香港仍勝出” *am730*
- 施永青 “自由競爭勝公平競爭” *am730*
- 曾淵滄 “香港不需要競爭法” *大公報*
- 黃健明 “聯手加價與競爭法皆不可取” *信報財經新聞*
- 王弼 “競爭法使中小企得不償失” *信報財經新聞*
- 王弼 “沒有公平的競爭法” *信報財經新聞*
- Andrew Work, Bill Stacey, Simon Lee “The Road to Hell is Paved with Good Intentions: The Guardrails are Antitrust Laws” *Hong Kong Lawyer* <http://www.hk-lawyer.com/2005-7/Cover.pdf>



Appendix D

Misleading and Misused Terminology in the Detailed Proposal

“Collusion”

An important distinction needs to be drawn between deals made between the government and private enterprise and deals made between private operators.

There is something clearly improper when the government agrees to privilege or give a particular sweet-heart deal to a private company ahead of others. These types of deals between the government and private enterprises can be properly described as “collusion”. However, competition law would do nothing to stop this type of behavior and there is already a government agency to deal with complaints where there is collusion between the government and private sector – it is called the ICAC.

It is simply not correct to say that there is anything improper in an open market about agreements between companies in the private sector with respect to the price they will sell their goods or services. Agreements between private competitors should simply not be described as “collusion” and no moral opprobrium should be attached to such agreements. In an open market there is simply no economic justification for the government, in the name of competition, interfering in contracts between business people.

“Cartel”

It is incorrect in an open market to describe any business or group of companies as a “cartel”. A cartel, properly defined, is where one company or more companies has a permanent and exclusive right to sell a particular good or service. The only way this can be achieved on any sort of permanent basis is where government keeps other competitors out through regulation. In Hong Kong, The Hong Kong Jockey Club is one of the only organizations which can correctly be labeled a ‘cartel’ as, by law, no other competitors are allowed to engage in the gaming business in the territory.

“Predatory Pricing”⁵

Predatory pricing means selling goods below cost with the intention of driving out competitors. It is known fondly by consumers as “cheap stuff on sale”. Businesses hate price wars or selling stuff at a loss because they lose money, but even if they are successful in driving out a competitor then there is no guarantee that has soon as they try to recoup the money they have lost by increasing the price again, some new competitor will simply come in to take its place. It is always sad when a small business fails because it is unable to compete but small businesses fail every day of the week and no business has a right to exist. The small businesses that do succeed are those that have particular niche product or service. The fact that 98% of the Hong Kong economy is employed by the small business sector (one of the highest proportions in the world) means that the absence of a competition regulator is not detrimental to the success and growth of the small business sector.

“Bid Rigging”

Companies and government are perfectly entitled to establish as part of the terms of their tender that there will be no agreements between those tendering for the job. Any breach of these agreements would be subject to contractual penalties (and potentially fines in the case of tenders for government work).

In the absence of any contractual prohibition in the tender or the terms of the auction, then there should be no prohibition on two bidders agreeing with each other what price they will submit. In an open market there

⁵ Although not strictly speaking used in the Detailed Proposal it may be included as part of the guidelines issued by the Competition Commission.



will always be the possibility that a new bidder will place a price higher or lower than the price that the two bidders who are working in tandem.

“Price-fixing”

All businesses should be free to state the price at which they will sell their goods and services. The amount they can charge is constrained by what others are charging and by the threat that a new competitor could come in and sell at a lower price.

Simply because one business agrees (either tacitly or formally) with another to sell at the same price does not mean that they will be able to continue to sell at the agreed price permanently. In an open market there will always be the threat that an existing or future competitor will come into the market to sell at a lower cost.

“Market Allocation”

If a business in Hong Kong Island (say a café owner) decided with another business on Lan Tau (another café owner) that each would not open up a café in the others territory then they should be perfectly entitled to do that. In an open market they would not be able to prevent a third party from opening up a new café in either Hong Kong Island or Lan Tau.

“Output Restrictions”

In an open market, the problem with any arrangement between one or more companies to reduce output of particular goods or services is that there is always the potential that a new competitor will emerge to supply a similar or identical product.

