

Rule of Law in China: Chinese Law and Business

Development of a Legal and Policy Framework on Competition

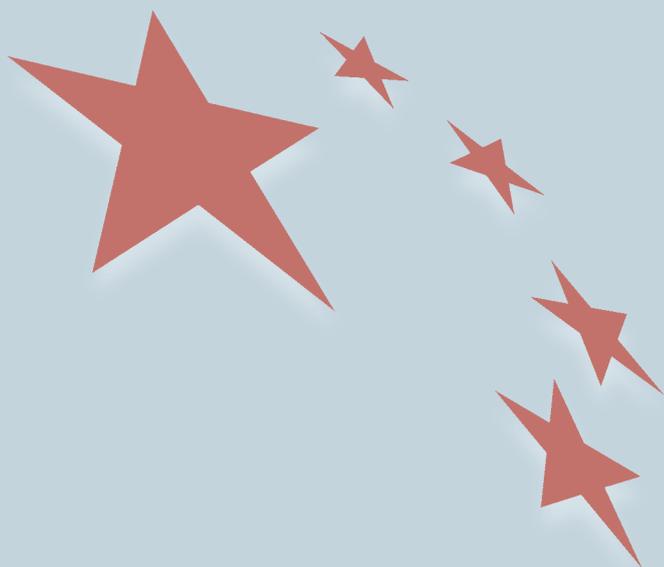
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Executive Summary

- Different approaches are needed to address three different types of competition problems. First are problems such as price cartels or pricing agreements, abuse of dominant positions and anti-monopoly concerns in merger and acquisition transactions. These involve violation of anti-monopoly law and may be dealt with by legal action.
- A second type of case is more complex, and involves coordination or interaction between policy and law. For example, a dominant position by two Chinese domestic companies in a certain sector may be formed, due not to their deliberate actions, but to the effects of trade policy, such as anti-dumping measures, which block the entry of foreign companies into the market. This type of case demonstrates the need for coordination between trade policy and competition policy, rather than outright legal action against the monopoly.
- A third case is more suitably dealt with under a competition policy framework. For example, a natural monopoly may exist in certain sectors due to economies of scale, as in telecommunications, railway, power transmission, energy and postal services.
- While the legalistic approach of the anti-monopoly law is effective when applied to micro-level monopoly activities of enterprises, it is less effective when applied to competition issues arising at the macro-level, such as issues relating to the centrally planned economy, state ownership and the development of certain strategic sectors. These issues are more effectively addressed through a competition policy framework.
- In a developing country with a transition economy such as China, many anti-monopoly issues are inseparable from other development and reform policies and issues. These issues may be most effectively addressed through a system that allows for coordination in making and implementing competition and anti-monopoly policies.
- To set up such a policy framework requires:
 - (i) high-level and broad-based recognition of the importance of competition policy;
 - (ii) a continuous policy process led by a core policymaking body with political power, analytical capacity, coordinatory ability and implementation effectiveness; and
 - (iii) effective, coordinated implementation mechanisms including administrative, legal and judicial systems.
- Accordingly, a policy framework along the lines outlined in this brief should be developed in conjunction with the drafting of the Anti-Monopoly Law.

Development of a Legal and Policy Framework on Competition

Respective roles of the policy and legal framework

The issues to be addressed in the area of competition and anti-monopoly law can be grouped into three types. Different approaches are needed to address each type individually.

The first are the cases involving violation of anti-monopoly law, which may be dealt with by legal action. These might appear on the surface to be relatively straightforward and clear, but in reality they are not so simple. They include price cartels or pricing agreements, abuse of dominant position and anti-monopoly concerns in merger and acquisition transactions.

A more complex type of case involves coordination or interaction between policy and law. An example of this would be where a dominant position is formed by two Chinese domestic companies in a certain sector as a result not of their deliberate actions, but due to the effects of trade policy, such as anti-dumping measures, which block the entry of foreign companies into the market. This type of case demonstrates the need for coordination between trade policy and competition policy, rather than outright legal action against the monopoly. Of course, if the Chinese companies took advantage of their monopoly status to fix prices or engage in some other unfair competition practices, this would be a straightforward case of the application of anti-monopoly law.

Another example is the European Union case involving Microsoft. While the action against Microsoft's alleged abuse of its dominant position in the operating system market is based on anti-monopoly law, Microsoft's defence relies on the legal protection of intellectual property rights. Obviously, application of antitrust law triggers the need for analysis and adjustment between two policy objectives: the protection of intellectual property and anti-monopoly concerns.

A third type of issue is more suitably dealt with under a competition policy framework. For example, a natural monopoly may exist in certain sectors due to economies of scale, as in telecommunications, railway, power transmission, energy and postal services. The industrialization policy pursued by the government of a developing country or a centrally planned economy, even when the natural monopoly conditions were not present, could result in large-scale industrial sectors with high concentration in terms of market share and capacity.

In addition, many competition issues relating to the creation of monopoly in certain industries may assume various forms of direct or indirect subsidies by the government, such as access to financing (including bank lending facilities and capital markets), taxation, dividends distribution policy, supply of materials and other related services, and protection from merger and acquisition. Sound competition policy would require careful, periodic analysis of these subsidies and preferential treatment, and the adoption of measures to reduce or eliminate the competition-reducing or distorting factors.

Finally, competition policy-makers should also have a long-term strategy to reduce and, where feasible, eventually break such monopolies, and prepare practical steps to the realization of such a strategy. In short, the second and third categories of cases cannot be effectively dealt with by a simplistic application of anti-monopoly law.

Legal framework: anti-monopoly law

The legal framework of competition is based on anti-monopoly law. The focus of the law is on the micro-level, targeting the monopoly activities of enterprises. The following features make the law an effective weapon to deal with the illegal monopoly activities of enterprises:

- clearly defined criteria to determine monopoly activities, which thereby provide effective guidance for business firms to follow in their strategic planning and business operations;
- a specific enforcement authority with appropriate powers to undertake investigation, including searching the files of suspect companies;
- clear procedures and authority to undertake anti-monopoly investigations;
- empowerment of all concerned parties including individual consumers, enterprises and government authorities to initiate the investigation; and
- tough penalties to be imposed on enterprises, entities and individual company officials, including criminal sanctions imposed on individual managerial personnel, for forming price cartels.

Competition policy framework: a policy process

While the legalistic approach of anti-monopoly law is effective when applied to micro-level monopoly activities of enterprises, it is less effective when applied to competition issues arising at the macro-level, such as issues relating to the centrally planned economy, state ownership and the development of certain strategic sectors. These issues are more effectively addressed through the competition policy framework.

The focus of the competition policy framework is how to create and maintain a fully competitive market and level the playing field for all competing enterprises. In pursuance of this objective, it should provide effective implementation and enforcement of the Anti-Monopoly Law and other competition laws (such as the Law against Unfair Competition) in coordination with other development, reform, micro-economic and regulatory policies.

In contrast to the legal framework for anti-monopoly law, the competition policy framework is a process of policy formulation, coordination and implementation, dealing with issues that cannot be solved by the simplistic application of anti-monopoly law. To set up such a policy framework requires: (i) a high-level and broad-based recognition of, and consensus on, the

importance of competition policy; (ii) a continuous policy process led by a core policymaking body with political power, analytical capacity, coordinatory ability and implementation effectiveness; and (iii) effective, coordinated implementation mechanisms including administrative, legal and judicial systems.

In order to achieve the proposed policy framework, there must be, first of all, recognition by the highest levels of policymaking authority of the importance of competition policy as fundamental, and of similar importance to monetary, fiscal and trade policies. This recognition must be shared by all relevant economic agencies and sector regulators. Competition policy should be a major dimension of their policy formulation and implementation processes.

This policy process will also have the following elements:

- review and assessment of the level of competition, and the ability to devise various measures, reforms and programmes to create and maintain the optimal level of competition;
- establishment of a working framework that includes various sectors' regulators to contribute to competition policy;
- coordination with other policy objectives, such as liberalization, state-owned enterprise restructuring, trade and intellectual property protection; and
- coordination of the implementation of anti-monopoly law alongside other laws regarding competition, including the preparation of a strategy and phasing programme to extend the application of the Anti-Monopoly Law to those sectors that have undergone reform and transformation as part of the overall competition policy framework.

Transition

Competition policy will inevitably interact with and impinge upon other development, reform, micro-economic and regulatory policies. These other policies may include trade policy, regional development, industry development, labour, state-owned enterprise restructuring, foreign investment and intellectual property protection policy.

China's particular competition policy will emerge from interaction with and consideration of these other policies. At least for the time being, this process has to be carried out through a policy framework in China, rather than solely through a legal framework based on anti-monopoly law.

The Chinese government has played a major role in mobilizing resources for industrialization and the development of large-scale infrastructure and public utilities, which constituted the backbone of the state-owned enterprise sector. Reforms are ongoing in these sectors. In general, the trend has been toward greater liberalization, with key sectors increasingly opened to a greater number and wider range of investors and operations, including non-state firms and foreign enterprises. In addition, state-owned enterprises have been restructured through the sale of shares to domestic and foreign private investors. Without the appropriate safeguards to ensure competition, privatizing the public sector may lead to a substitution of private monopolies for public sector monopolies, with concomitant negative impacts on social welfare.

Competition policy, together with other reform policies to open the various sectors to non-state investors and to restructure state-owned enterprises, will make such sectors and enterprises true market players, and thus make it easier to subject them to the Anti-Monopoly Law.

To different extents, many countries have gone through a transition process from a policy-oriented approach to a legal approach with regard to competition. This is reflected, in Germany for example, in the expansion of the application and

scope of anti-monopoly law to certain sectors which had previously been shielded from the scrutiny of anti-monopoly law.

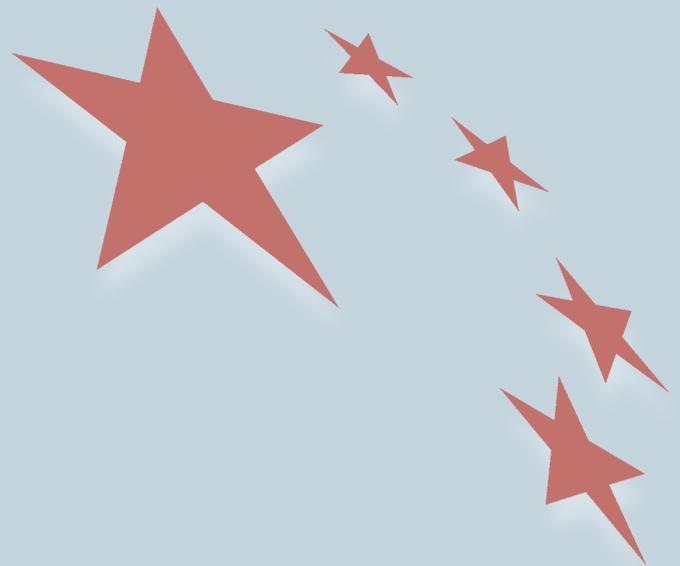
By reducing macroeconomic issues to micro-level issues for which the legal framework may be more appropriate, the reform process in China may also lead to the eventual expansion of the scope of application of the Anti-Monopoly Law. Nevertheless, it is worth pointing out that in the long term, even after most of the reform agenda is accomplished, there will still be an occasional need for coordination between competition policy and anti-monopoly law to address new issues that may emerge.

Conclusion

Competition policy and anti-monopoly laws may work together to create and maintain an efficient competitive market, but they have different roles to play. A policy framework is needed to address general policy matters and to coordinate policies, thus creating the conditions for a more broadly applied and effectively implemented Anti-Monopoly Law.

In a developing country with a transition economy, many anti-monopoly issues are inseparable from other development and reform policies and issues. These issues may be most effectively addressed through a system that allows for coordination in making and implementing competition and anti-monopoly policies.

Accordingly, a policy framework along the lines suggested above should be developed in conjunction with the drafting of the Anti-Monopoly Law.



The Foundation

The mission of the Foundation is to study, reflect on and promote an understanding of the role law plays in society. This is achieved by identifying and analysing issues of contemporary interest and importance. In doing so, it draws on the work of scholars and researchers, and aims to make its work easily accessible to practitioners and professionals, whether in government, business or the law.

Rule of Law in China: Chinese Law and Business

The main objective of the programme is to study the ways in which Chinese law and legal institutions encounter and interact with the social environment, including economic and political factors, at local, regional, national, and international levels.

The Foundation's perspective in pursuing this objective is that of entrepreneurs considering investment in China, the lawyers advising them, executives of an international institution or non-governmental authority, or senior public officials of another country. The combination of this objective and our particular perspective constitutes a unique approach to the study of the role of law and its relationship to other aspects of society in China.

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