Exporting antitrust law to China

As the reality of a Chinese anti-monopoly law draws nearer, John Harkrider and Joshua Gray of Axinn, Veltrop & Harkrider LLP discuss the obstacles in the path of a sound regime for China

China entered the World Trade Organsation on 11 December 2001. Consistent with its obligations to the WTO, China is planning to adopt a comprehensive competition law, perhaps as early as this year.

The proposed Anti-Monopoly Law is the product of a decade of drafting and debate. China already has several laws regulating trade and establishing 'toehold' competition policies. None are as comprehensive as the draft anti-monopoly law. In 1993, when China renounced its planned economy by amending its constitution to recognise a "socialist market economy", China also adopted an Anti-Unfair Competition Law. This was followed by the 1997 Price Law, the 2000 Bid and Tender Law, and the 2003 Provisional Regulation of Foreign Investors Merging with or Acquiring Domestic Enterprises. Other laws regulate competition in specific industries, such as telecommunications. Lodged in different agencies with varying expertise and power, they have not resulted in a coherent overall competition policy.

Foreign input

The anti-monopoly law seeks to do exactly that. The most recent draft, circulated in April 2005, shows a commitment to markets for the production and distribution of goods and resources, for import and export, as well as internally within China. It draws heavily on foreign models, mainly those of the EU, Germany, Japan and the United States.

The draft anti-monopoly law covers four main areas: agreements in restraint of trade, abuses of market dominance, mergers and acquisitions, and 'administrative monopoly', or the restriction of competition by unauthorised official action. Lawyers practising antitrust or competition law elsewhere around the globe will find many provisions of the first three parts of the anti-monopoly law familiar, even while recognising places where the language or concepts could be refined to bring them closer to international best practices. The provisions concerning 'administrative monopoly' are less familiar but address the critical challenge of how to separate newly private enterprises from state controls. This reflects China's unique history as a former command economy.

Representatives of the European Commission and both of the US federal antitrust agencies have met with the drafters of the anti-monopoly law. The American Bar Association has commented several times on the drafts. Most of the comments focused on how to improve the specific rules and policies articulated by the law. Among other things, the ABA recommended eliminating vague or disfavoured concepts, like 'fair competition', 'essential facilities', or 'shared monopolies'. It also suggested discarding economically unsupported presumptions, including an inference of market power based on market shares alone.

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The ABA also made some recommendations concerning practice and procedure. These included recommendations to create a single enforcement agency with responsibility for the entire anti-monopoly law, to favour injunctive relief over monetary penalties, and to coordinate the waiting periods for merger notification with foreign requirements. While some of these suggestions are simply practical, others hint at what may turn out to be the biggest challenge for China – developing institutions that will effectively and independently enforce the draft anti-monopoly law.

Challenges

China faces unique challenges rooted in its history as a state-dominated economy. It has not fully adopted other basic institutions of a free-market system, such as strong and transferable property rights or contract law. Foreign governments and corporations worry that the anti-monopoly law might be applied first against multinationals with substantial sales to China, like Kodak or Microsoft. There is also reason to be concerned that a transitional economy with fledgling civil law may not be prepared to tackle the more esoteric areas of antitrust, such as monopolisation and merger review. But the antimonopoly law's prohibitions against price-fixing and other cartel activities may be more effective than current law. Also, the prohibitions against 'administrative monopoly' might liberalise domestic markets in ways that could benefit foreign companies seeking access to Chinese consumers. So there are grounds for optimism as well as concern.

China will need to marry economically-sound rules and policies with effective institutions to enforce the anti-monopoly law. On economics, experience is vital and China can borrow directly from foreign sources. The far more difficult task will be to adopt legal institutions and practices that will produce good results. While foreign experiences will be helpful, China must develop solutions that fit its own circumstances. Even a substantively perfect law may be useless – or misused – if not matched with good enforcement practices. All law enforcement depends on the integrity of the institutions that investigate and decide cases. Given the high economic stakes in competition cases, the independence and effectiveness of the enforcer is paramount.

Economics

Economic concepts are easily consulted and adopted by others. In this respect, China should aspire 'to stand on the shoulders' of foreign experience. One example is the

European and American understanding that competition markets should be defined with reference to the elasticity of demand and of supply. Market definition troubled US courts for decades. In many decisions that are still cited today, courts defined product markets with reference to industry usage and recognition in business documents. Even when the US Supreme Court in *United States v du Pont* finally settled on the critical importance of cross-elasticity of demand, it famously botched the definition of the relevant market. Today, the US antitrust agencies, DG Comp, and an increasing number of courts apply a test like the one articulated by the US Horizontal Merger Guidelines, asking whether a hypothetical monopolist could profitably impose a small price increase over the goods in the proposed market. While this test is often difficult to implement, leading to guesswork, there is agreement that it addresses the correct economic question. China's draft anti-monopoly law does not articulate a test for how to define markets, but there is every reason for the Chinese to follow the international consensus in favour of the hypothetical monopolist test.

There are numerous other examples of economic concepts that can be borrowed from the laws of other countries; many are discussed by the commentary on the draft anti-monopoly law. Outside China, experience has led to the rejection of other concepts, such as the notion of a fair price, which should also be instructive. This learning is universal and China may adopt it in whole.

Institutional foundations

Institutions are imperfect, so the goal may be to find the solution with the fewest flaws. While some lawyers favour the adversarial process practised in the US, few would urge others to adopt the burdensome discovery required by the 'second request' process. Yet, extensive discovery is related to the use of adversarial processes. Conversely, the EU practice may allow DG Comp and the parties to join issue on key points earlier on in the process, but may also lead to undue reliance on the parties' representations about the marketplace. As has been true in other countries with longstanding competition laws, institutional questions may present the greatest challenges in China.

Antitrust has a distinct advantage over other forms of regulation because it seeks to articulate generally applicable rules that promote competition across industries. By comparison, industry-specific regulation, as the US formerly practised in transportation industries and still does in telecoms and energy markets, allows the regulated industry to influence the regulators and shape they way the view the world. The result is sometimes called 'capture' – a system of regulation in the interest of the regulated parties rather than that of the public welfare. In regulated industries, there is an ongoing dialogue between the regulator and the leading firms, often concerning the most important aspects of the business, such as prices, capacity, technology, etc. The benefit of antitrust is that it does much less. Interactions between the regulator and industry are infrequent and typically relate to firm-specific transactions or practices as opposed to industry-wide conduct.

A system of competition enforcement needs to advance three goals. It must be independent from political or competitor influence. It must be insulated from politicians who might seek to use competition policy to grant favours to allies and separate from other regulations affecting businesses and the economy, such as trade or labour policy.

Second, the system must foster economic expertise. Any agency charged with enforcing the anti-monopoly law will require professionals – economists, lawyers, or bureaucrats – with training that will allow them to make economically informed decisions and to articulate coherent policies.

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Third, the system must be credible, meaning sufficiently powerful and ubiquitous to shape private incentives and achieve widespread compliance. A weak enforcer cannot stamp out every violation; a strong enforcer will not have to.

Different systems can achieve these goals. The correct answer depends, in part, on the trust and esteem afforded to the particular institutions and the closely related ability to attract talented and well-trained employees who will protect the independence of the enforcement authority. In the US antitrust system, the federal courts play a central role. For better or worse, a significant part of all enforcement is private litigation supervised by judges and frequently motivated by the prospect of treble damages. The federal agencies also cannot act on mergers or misconduct without opportunity for prior judicial review. By comparison, the EU depends more on administrative agencies and process, allows DG Comp to stop conduct and mergers prior to review by the Court of First Instance, and still relies less on private litigation. These differences reflect the greater prestige of judges in the US and of administrative agencies in Europe.

Like the EU, China will opt for an administrative model. It does not have a judiciary with the power or independence of the US courts. Chinese bureaucracies, however, are highly regarded and often strong. China's challenge will be to develop an agency and body of administrative law that represents consumers' interests. This requires a vast change in perspective from past practice where law making and enforcement were a means of maintaining the power of the state. It also requires a staff qualified by economic training rather than party loyalty and top-level decisions makers who are insulated from politics. At a minimum, they must be protected from retribution by those they choose to prosecute. China's political leadership also must resist intervening.

These basic protections will be difficult to achieve. The anti-monopoly law may be administered by a new agency or an addition to an existing agency, such as the powerful Ministry of Commerce. If it is effective, the new law will threaten other government agencies. The anti-monopoly law's own provisions recognise that there are many official actions which conflict with sound competition policy. Examples are easy to find. In 1999, China's Bureau of Civil Aviation issued an order against discounting tickets citing the harmful effect on airline industry development. Local governments currently prohibit the purchase of staples like beer or fertiliser from firms located in other parts of China. Even the agency that issues marriage licences has designated a single photographer for the required photograph. Such habits are hard to break. Some speculate concern about the disruptive potential of the anti-monopoly law has delayed its enactment. This may be partly good news because it suggests that the positive potential of the anti-monopoly law to reform economic practices is being taken seriously by other agencies. Whatever its form, China's new antitrust agency needs to harness public respect to create a growing basis for sound action, independent from the political forces that may put other interests before the welfare of consumers..