

# **Anti-competitive Behaviour and Competition Policy: A Review**

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# Outline

- **(I) Approaches to competition analysis**
- **(II) Forms of anti-competitive behaviour**
- **(III) Examples of competition analysis**
- **(IV) International experience**
- **(V) The sector specific approach in Hong Kong so far**
- **(VI) References**

# **(I) Approaches to competition analysis**

- The basic approaches to competition policy (Boner and Krueger, 1991) encompass three key aspects:
  - **(1) Structure;**
  - **(2) Performance;** and
  - **(3) Conduct.**
- The traditional perspective emphasises market structure and the degree of business concentration. A potential problem is that there could be a presumption that “being big” is in itself suspicious. Critics of competition policies/laws may argue that they penalise victors and help losers in the market place.

# (I) Approaches to competition analysis

- The modern tendency is to investigate in detail “conduct” without neglecting structure and performance. The crux of the matter is whether any economic agent is engaged in the “abuse of market power”, and thereby “undermining fair competition”.
- **(1) Structure:** the focus is on market concentration, which may serve as a trigger for examination that would take into account the definition of the “relevant” market from both supply and demand sides, and determining factors such as substitutability, geographical and temporal considerations. Issues of monopolies, mergers and acquisitions and their consequences usually from the core of the structural perspective.

# **(I) Approaches to competition analysis**

- **(2) Performance:** the key concerns are the prices charged and outputs produced by dominant market players, and the possibilities of “abnormal profits”. A competition authority may choose to monitor and publish statistics regularly to alert the public, with or without further remedial actions.
- **(3) Conduct:** the attention is centred on the abuse of dominant position, horizontal and vertical restrictions and unfair trade practices.

# (I) Approaches to competition analysis

- For most competitive analyses, a starting point is to delineate a market before the investigation of market power and its possible abuse can be pursued. The boundary of a “**relevant**” market depends, amongst other factors, on supply elasticity and substitutability; and there are basically four dimensions to the definition of a market: (1) product; (2) geography; (3) functions; and (4) time (Shenefield and Stelzer, 1998).
- The rule of reason standard is an important perspective. To quote Boner and Krueger (1991), “Antitrust enforcement policies generally address the complex economic effects of conduct by recognizing mitigating circumstances in judging legality. The law may regard a specific restraint as illegal *per se* or as illegal under *a rule of reason*.”

# (I) Approaches to competition analysis

- “Generally, legality under the rule of reason explicitly recognizes that certain kinds of conduct may have efficiency-enhancing characteristics offsetting any harm to competition. In this circumstance, prosecution under the law proceeds on a case-by-case basis and requires proof that, in the light of any mitigating circumstances, the overall effect of the conduct is to harm competition without sufficiently enhancing efficiency.” (p.48)

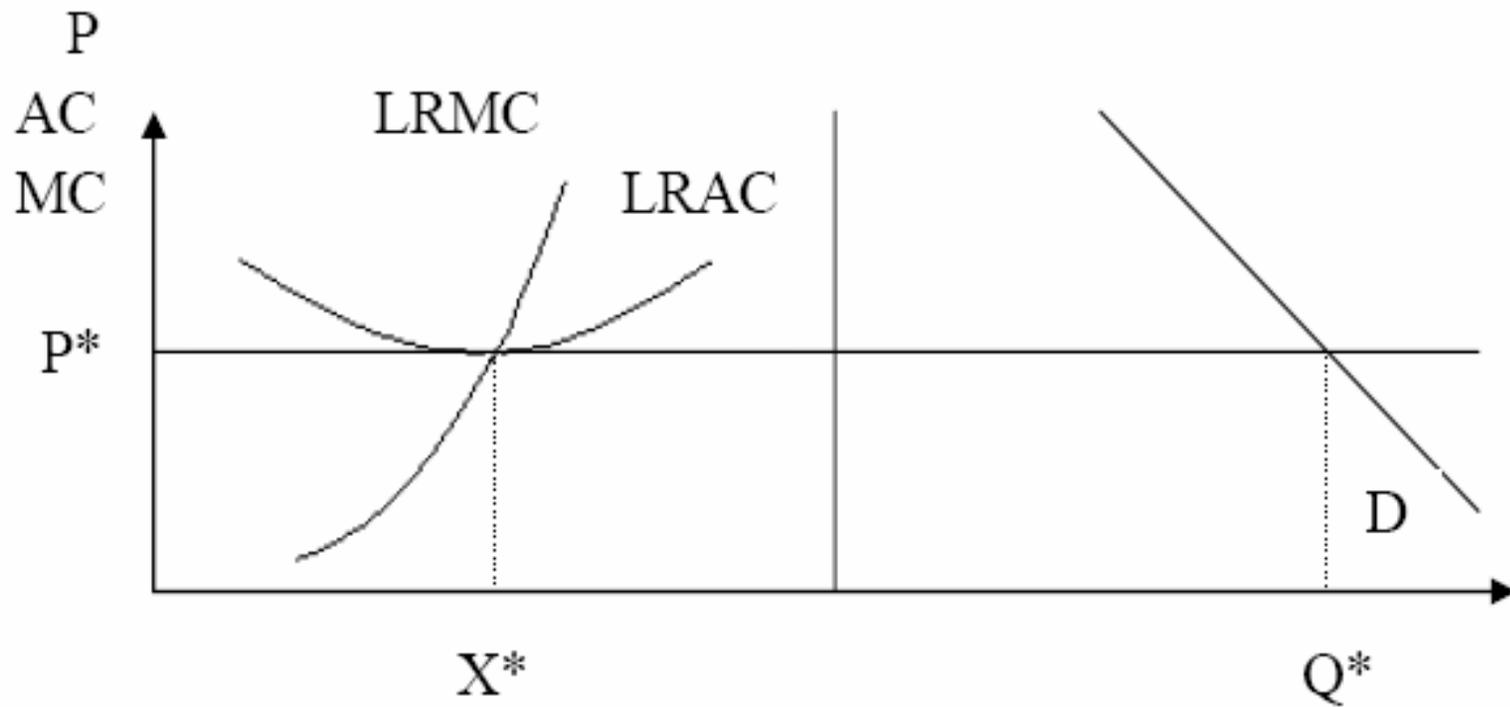
## (II) Forms of anti-competitive behaviour

- Forms of anti-competitive behaviour that are identified in the literature can be classified into the following overlapping categories:
  - 1. Monopoly and cartels
  - 2. Abuse of dominant position
  - 3. Horizontal restrictive practices
  - 4. Vertical restrictive practices
  - 5. Unfair trade practices
- Useful quick references for the *glossary* of various terms in these categories can be found in Directorate-General for Competition, EC (2002) and OECD (1993).

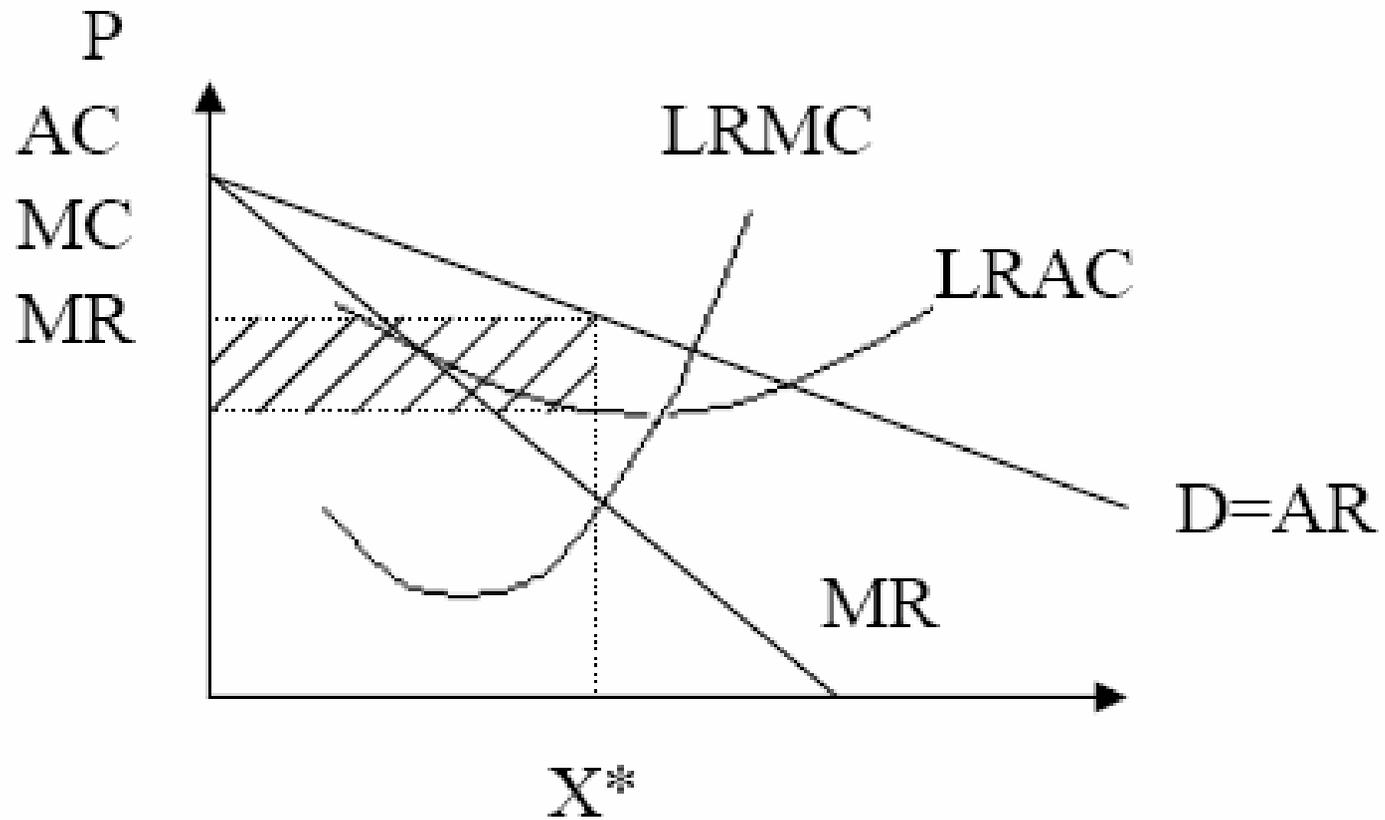
## (II) Forms of anti-competitive behaviour

- **1. Monopoly and cartels**
- This is the traditional core of attention on anti-competitive behaviour. Perfect competition is the ideal analytical benchmark, whereas a monopolistic firm may be prone to restrict output and raise price, thereby obtaining abnormal profit. It will result in social welfare loss.
- In the case of monopoly, whether “natural” (because of pervasive economies of scale) or “artificial” (as a result of man-made barriers, including legal and economic), regulation or introduction of competition/de-regulation may be the policy response.

# Perfect competition: $P=MC$



# Monopoly: $P > MC$



## (II) Forms of anti-competitive behaviour

- Oligopoly is a market structure with only a few suppliers because of “natural” or “artificial” factors. Oligopolistic firms could engage in heated competition, and the market may become “**contestable**”.
- On the other hand, cartels may be formed by collusion among players with “market power” in an oligopoly. Efficiency and welfare loss would also result. Regulation or competition policy would be possible responses by the authority.

# (II) Forms of anti-competitive behaviour

- **2. Abuse of dominant position**
- When a market is “dominated” by a player with “power” among a number of much smaller suppliers, it is neither monopoly nor oligopoly in the strict sense.
- The player may misuse its “dominance” (which could well have been acquired in perfectly **fair manner in the first place**) by “abusive or improper exploitation” of market power aimed at restricting competition, e.g. predatory pricing (selling at below incremental costs/average variable costs/“avoidable costs”) with the objective of driving out competitors.

## (II) Forms of anti-competitive behaviour

- In other words, the dominant firm is **now** exercising its market power in an unfair manner to undermine competition. To sanction against such behaviour is therefore **not** to “penalise” a victor.
- Regulation or competition policy would be a possible response. In the EU, Canada, the term “abuse of dominant position” has been incorporated explicitly in competition legislation.

# (II) Forms of anti-competitive behaviour

- **3. Horizontal restrictive practices**
- (a) price fixing: an agreement between firms to fix or raise price to restrict competition and earn higher profits;
- (b) collusive bidding/bid rigging: (i) firms agreeing to submit common bids, thus eliminating price competition; (ii) firms agreeing to submit the lowest bid by rotation and thereby each getting a certain amount of contracts;
- {(a) and (b) are regarded as the cardinal offence in the US, Canada, UK and other jurisdictions; and they often result in criminal penalties if proven guilty. }
- (c) market division: in products and locations;
- (d) customer allocation/joint boycotts (refusal to sell);
- (e) sales and production quotas.

## (II) Forms of anti-competitive behaviour

- **4. Vertical restrictive practices**
- (a) resale price maintenance (RPM): a supplier specifying the minimum or maximum price at which a product must be re-sold to customers by downstream firms, hence maintaining profit margins;
- (b) tie-in sales/tied selling: the sale of one good on the condition that another good is purchased;
- (c) bundling/full-line forcing (package tie-in): which could be a more extensive offence than (b);

## (II) Forms of anti-competitive behaviour

- (d) exclusive dealing;
  1. sole distributor
  2. exclusive purchase
  3. exclusive agency
  4. bilateral exclusive distribution arrangement
  5. selective exclusive distributorship
  6. exclusive dealing arrangement
  7. requirement contract.
- Categories of conduct (b) to (d) can obviously be treated as “horizontal restrictive practices” in some cases.

# (II) Forms of anti-competitive behaviour

- **5. Unfair trade practices**
- They refer to practices which are regarded as against “fair competition”, such as “damages to others’ reputation” and “unfair or discriminatory standards”.
- They can include any of the items discussed above in so far as they affect consumer welfare, e.g. price fixing and tied selling. Other forms that are not directly aimed at competitors but considered to be “unfair to consumers ” include:
  - (a) false trade descriptions of goods;
  - (b) misleading advertisements;

## (II) Forms of anti-competitive behaviour

- (c) pyramid selling schemes;
- (d) unconscionable contracts;
- (e) other misleading and deceptive practices.
- These practices are possible because the suppliers of the products or services concerned possess a certain extent of “market power”, which they “abuse” in various ways.

## (II) Forms of anti-competitive behaviour

- Among the above overlapping categories of anti-competitive behaviour, vertical restrictive practices are more controversial. Critics of competition policies often argue that they are necessary for efficiency considerations, e.g. RPM is essential for viable after-sale maintenance service; while package tie-in is beneficial to consumers etc.
- As a result, the OECD coined the term “**hard core cartels**”, which refers to firms engaging in largely horizontal restrictive practices such as price fixing, bid rigging, market and customer division (OECD, 2000).

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# (III) Examples of competition analysis

- “**Hard core cartels**” are forms of conduct by firms with market power which are almost universally regarded as undesirable (OECD, 2000). They should be in the crux of any competition legislation.
- In actual competition analysis, a common starting point is the definition of the relevant market. It involves both economic (industrial organisation) and legal perspectives.
- In many cases, specific situations have to be considered carefully, and the rule of reason standard applied intelligently.

# (III) Examples of competition analysis: geographical markets

- Tsang (2000a): geographical boundary of the petrol market in Hong Kong
- Why is there uniformity of petrol prices in almost all areas in Hong Kong? And not in large cities like Sydney or Vancouver?
- What is the definition of the relevant market for petrol in Hong Kong? Is it just the “product”? Are auxiliary services, discounts and gift items providing genuine competition? Is geographic location of the gas stations important in determining costs and therefore prices? What about the price elasticity of demand?
- On the other hand, is competition desirable in such a “small and mature” market like Hong Kong’s?

# (III) Examples of competition analysis: network economics

- Tsang (2000b): the “necessary” market power of networks.
- A network good or service exhibits “network externalities” in the sense that adding another customer increases the value of the network to existing customers. The optimal size of the network is not clear and multiple equilibria may result.
- In order to be viable and sustained, the network needs to achieve a “fulfilled expectations equilibrium” which is of a non-zero “critical mass” (Economides and Himmelberg, 1995).

Figure 1, adapted from Economides and Himmelberg (1995), illustrates the point quite well. Suppose the willingness of consumer indexed by  $y$  to pay for one unit of the good in a network of the expected size  $n^e$  is  $u(y, n^e) = yh(n^e)$  and the cumulative distribution function is  $G(y)$ . Economides and Himmelberg show that in equilibrium where the actual size of the network  $n$  is equal to  $n^e$ , the mapping  $p(n, n) = h(n)G^{-1}(1 - n)$  defines the price level that supports a network of size  $n$ .

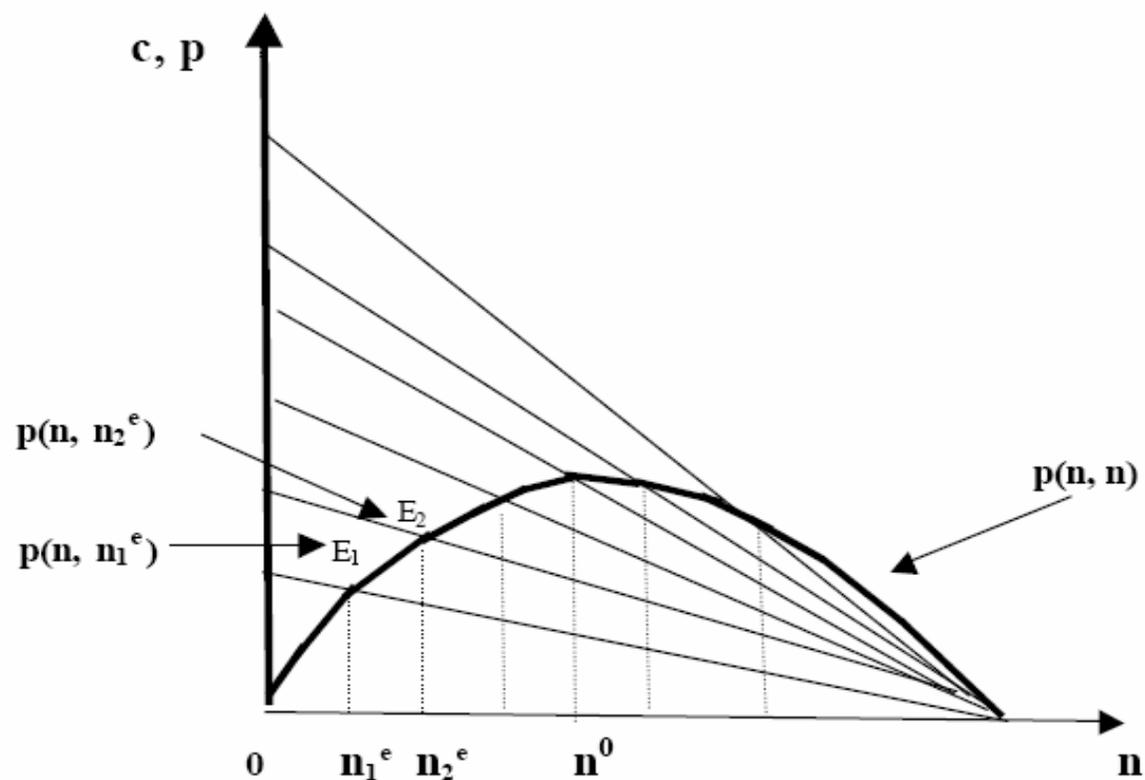


Figure 1 *Fulfilled Expectations Demand*

## **(III) Examples of competition analysis**

- Typical examples include telephony, electricity supply, transport, and credit/debit card systems. The authorities should therefore not insist on perfect competition. Otherwise, the network would simply not be able to “take off”. Potential users might then suffer.
- So the Easy Pay System (EPS) in Hong Kong needs to be allowed to build up its “market power” up to a point (Tsang, 2000b). But what point?

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## (IV) International Experience

- According to information compiled by UNCTAD (2006), **there are over 100 “competition authorities” in the world.**

Notable examples are:

- The Americas: USA, Canada, Mexico, Argentina, Brazil, Chile, Peru and Venezuela;
- Asia: Japan, South Korea, Mainland China, Taiwan, Thailand, Indonesia, India, Philippines, Malaysia and Singapore;

## (IV) International Experience

- Pacific: Australia, New Zealand, and Fiji;
- Europe: all members of EU, Russia and most of eastern Europe;
- Middle East: Israel, Turkey;
- Africa: South Africa, Zimbabwe, and Algeria.

# (IV) International Experience

- **Coverage** of competition legislation may include:
  - merger and acquisition
  - abuse of dominant position
  - vertical and horizontal restrictions
  - unfair trade practices
  - etc.
- **Exemptions:** on the basis of certain public interests, some structures, conduct or performance can be exempted from the competition law, e.g. R&D cartels, networks.
- However, the process of granting exemptions and waivers should be transparent; and they should be regularly reviewed.

# (IV) International Experience

- **International tendencies**
  - Focusing on anti-competitive conduct
  - Starting from “hard core cartels”: price fixing, bid rigging, collusive restrictions on output and division of markets (mainly horizontal restraints) (OECD, 2000) and refining legislation and enforcement over time
  - Increasing transparency in the implementation of competition laws
  - “Leniency” programmes to alleviate investigation and sanction problems
  - Promoting international cooperation in dealing with multinational cartels

## (IV) International Experience

- For the links to various competition authorities, visit “Anti-trust and Regulatory Sites List” (<http://www.clubi.ie/competition/compframesite/WorldsBiggestAntiTrustSitesList.html>).
- There is a wide variety of competition regimes in the world. Tsang and Cameron (2001) highlighted **several stylised models**:
  - US: the court approach ([www.usdoj.gov/atr](http://www.usdoj.gov/atr))
  - Australia: the hybrid agency and court approach ([www.accc.gov.au](http://www.accc.gov.au))
  - Taiwan: the agency approach ([www.ftc.gov.tw](http://www.ftc.gov.tw))

# (IV) International Experience

- An important criterion to distinguish regimes is whether civil and criminal sanctions/penalties are applied against offenders.
- A very quick (perhaps not fully updated) summary:
- **US's court approach:** the FTC/DoJ act according to anti-trust laws to put offenders through courts. Both civil and criminal penalties (fines and fines/imprisonment) could result for infringements.
- **Australia's hybrid approach:** the ACCC has partial autonomy. In most cases implementation is through courts. Offenders are subject to mainly civil penalties with criminal sanctions of fines applying only to individuals.

# (IV) International Experience

- **Taiwan's agency approach:** the FTC executes the Fair Trade Law; has autonomy on civil sanctions; and prosecutes against criminal infringements through courts.
- In all these models, there are appeals channels, as well as regulators in special sectors which are not fully susceptible to rigorous competition.
- Other variants of competition regimes include the UK model, which has a relatively powerful enforcement agency (OFT) and sanctions cover both civil and criminal penalties (with the latter through courts), as well as the models of the European Union and Singapore, under which the agency imposes only civil fines, and the courts are responsible for appeals.

# **(V) The sector specific approach in Hong Kong so far**

- **Milestones in HK's competition policies:**
  - Various forms of franchise and schemes of control were issued in different years.
  - 1974: the Hong Kong Consumer Council was established. It has no investigative or sanctioning power. Key functions according to its governing ordinance include “collecting, receiving and disseminating information concerning goods, services and irremovable property”.
  - 1987 : The Broadcasting Authority (BA) was set up.

## **(V) The sector specific approach in Hong Kong so far**

- 1992: At HK Government's request, the Consumer Council began competition analysis for various sectors.
- 1993: The Telecommunications Authority (TA) was set up.
- 11/1996: After seven sectoral reports, the Consumer Council produced a summary document: "Fair Competition: the Key to Hong Kong's Prosperity" advocating the establishment of a competition law and a competition authority.
- 1997: Formal response by the Government, and the setting up of the Competition Policy Advisory Group (COMPAG) chaired by the Financial Secretary.

## **(V) The sector specific approach in Hong Kong so far**

- 5/1998: The SAR Government put forth a “Statement on Competition Policy”.
- 11/1999: In the concluding statement of Article IV consultation on Hong Kong , the IMF for the first time expressed concern about domestic competition in the SAR and praised the work of the Consumer Council.
- 2000: The power of the BA’s and TA’s in monitoring and sanctioning against anti-competitive behaviour and abuse of dominance was enhanced through the amendments of ordinances.
- 2000: The European Parliament voiced concern on domestic competition in Hong Kong; while the IMF did it again in the concluding statement of Article IV consultation.

## **(V) The sector specific approach in Hong Kong so far**

- 2001: The HKSARG set up the Telecommunications (Competition Provisions) Appeal Board “to determine appeals against the Telecommunications Authority in enforcing fair competition in the telecommunications market in Hong Kong”.
- 2004: The HKSARG said it was “looking at merging the Telecommunications Authority and the Broadcasting Authority into a single, lean and skilled, responsive regulator overseeing the entire electronic communications sector.”
- **Hong Kong’s policy stance up to the recent years has been regulation complemented by sector specific competition oversight.**

## **(V) The sector specific approach in Hong Kong so far**

- Regulation has been based largely on rates of returns controls (in electricity, transport) and price controls (in telecommunications).
- Competition policy is largely “sector specific”: legislation and enforcement for the sectors of telecommunications (after buy-back of franchise from HK Telecom) and broadcasting.
- Up to now, there is no comprehensive, cross-sector competition law and an agency to implement it in the form of a competition authority.

## (V) The sector specific approach in Hong Kong so far

- Conventional arguments for the sector specific approach : No excessive interference in the market place and maintenance of flexibility.
- To be fair, the changes in BA's and TA's power from 2000 onwards made them look like “mini-competition authorities”.
- A **debate** has emerged in Hong Kong on the merits and demerits of sector specific versus comprehensive (cross-sector) competition legislation/policies.
- A small collection can be found on my website [www.hkbu.edu.hk/~sktsang/ArchiveII.html](http://www.hkbu.edu.hk/~sktsang/ArchiveII.html).

# **(V) The sector specific approach in Hong Kong so far**

- **Major arguments and counter-arguments**
- Tradable versus non-tradable sectors: different meanings of freedom and competition.
- Dominant non-tradable sectors: real estates, energy, transport, legal and medical services, supermarket chains, banks etc.
- Traditionally, a small open economy (SOE) has to depend on regulation to guarantee reliable, reasonably-priced and agreeable supplies of non-tradable goods and services.

# **(V) The sector specific approach in Hong Kong so far**

- The key trouble for SOEs is that because of the relatively small sizes of markets, thresholds of economies of scale and scope are lower and it is easier for market power of the incumbents to emerge, no matter how fair the power was achieved in the first place.
- For an SOE, considerations on regulation versus competition have to take into account:
  - **(1) technological developments**
  - **(2) market dynamics**
  - **(3) changes in the boundaries of markets**

# (V) The sector specific approach in Hong Kong so far

- **(1) Technological developments** : a “divorce” between natural monopoly and economies of scale (e.g. mini-generators) unfolds in many sectors. The implication may be that more competition plus better-informed regulation would be needed.
- **(2) Market dynamics**: conglomerates that transcend traditional boundaries of industries and even nations emerge. Cross-sector “bundling” (e.g. property plus internet service) could spread.
- **(3) Boundaries of sectors**: Both (1) and (2) are re-writing the definitions of sectors and markets. Sector specific approach runs the risk of being outdated.

## **(V) The sector specific approach in Hong Kong so far**

- Of course, regulatory authorities are still necessary in more complicated sectors, which set standards, codes of practices and guidelines. But as far as competition is concerned, their rulings have to be consistent with a comprehensive competition law, subject to exemptions, waivers and/or specific regulations.

# (V) The sector specific approach in Hong Kong so far

- Common counter-arguments in Hong Kong and responses
- (1) **Excessive intervention**: the competition law is just a rule book, and the authority like a referee. The referee sanctions against wrong-doings, but would not instruct the players on how to play.
- (2) **“The problems are not serious”**. But the concentration ratios in many domestic sectors are a cause for worry. Without proper complaint and redressing mechanisms, one never quite knows how serious the problems actually are.

# (V) The sector specific approach in Hong Kong so far

- (3) A competition law and a competition authority are **expensive**. This is not necessarily the case (Tsang and Cameron, 2001).
- **Rebutting the counter-arguments**: the problems of the sector specific approach include
  - **Lagged responses**: cross-sector misconduct would not become noticeable before turning serious.
  - **Cross-sector injustice**: why should price fixing be regarded as illegal in telecommunications and broadcasting, but not in other business sectors?
  - **Regulatory capture**: the regulator being “captured” unfortunately by the regulated firm(s) in the sector, and his behaviour might become biased. A comprehensive cross-sector regime would reduce the inevitably close connections between the two parties.

## (V) The sector specific approach in Hong Kong so far

- Based on considerations similar to those above, the **Hong Kong Consumer Council (1996)** regarded a comprehensive approach to building a competition regime as preferable to the sector specific approach, because it is cross-sector, forward looking and less susceptible to “regulatory capture”. In terms of cost and benefit, it yields more synergy.
- A comprehensive competition regime is a way to stimulate the enhancement of efficiency in Hong Kong’s non-tradable sectors. It will benefit the whole economy in the long run.

# (V) The sector specific approach in Hong Kong so far

- In his first **Policy Address (2005-06)**, Donald Tsang appeared to be open-minded about a comprehensive competition law:
- “35. A level playing field that allows enterprising people to start and run their own businesses is important for sustaining the vitality and harmony of society. Hong Kong has long been recognised as the world’s freest economy. The international community has commented very favourably about the upholding of fair competition in Hong Kong. However, as Hong Kong enterprises grow in strength, with some acquiring world-class status, coupled with an increased presence of multinational enterprises, it is possible that forces capable of cornering the market may emerge in Hong Kong.

# **(V) The sector specific approach in Hong Kong so far**

- “36. The Government introduced a Statement on Competitive Policy in May 1998. Since then we have gained experience from the implementation of sector-specific competition policies. The results we have achieved in promoting competition in the telecommunications market have been particularly noteworthy. To ensure that our competition policy continues to serve the public interest and provide a business-friendly environment, and in response to the views of Legislative Councillors and the public, we appointed a Competition Policy Review Committee a few months ago. ....

## **(V) The sector specific approach in Hong Kong so far**

- “.... The newly established independent Committee, chaired by a Non-official with members drawn from different sectors, is tasked to review the effectiveness of our existing competition policy. The Committee will consider, among other things, whether the implementation of our policy is in line with the times, and whether available investigative powers are adequate. The Committee will also draw on international experience and discuss the need to introduce in Hong Kong a comprehensive and cross-sector law on fair competition, as well as its scope and application. The Committee expects its review to be completed in mid-2006.

# **(V) The sector specific approach in Hong Kong so far**

- “37. We do not seek to intervene in the market. Rather, we want to actively protect market order and fair competition by preventing manipulative practices such as price fixing, bid rigging and market sharing. Any additional measures, including legislation, will aim to facilitate new ventures by individuals and help small and medium enterprises operate and grow. We can take reference from the comprehensive competition laws enacted in scores of jurisdictions so that we can avoid as far as possible any negative impact stemming from legislation or other related measures. ....”

# (V) The sector specific approach in Hong Kong so far

- The Competition Policy Review Committee submitted a report to the HKSAR government in June 2006.
- On 6 November 2006, the HKSAR government launched the **“Public Consultation on the Way Forward for Hong Kong's Competition Policy”**.
- The consultation document can be downloaded from:  
[http://www.edlb.gov.hk/eng/press/ue\\_press/com\\_upload/P461/Booklet\\_\(Eng\)\\_Final.pdf](http://www.edlb.gov.hk/eng/press/ue_press/com_upload/P461/Booklet_(Eng)_Final.pdf).

# **(V) The sector specific approach in Hong Kong so far**

- The document presents an interpretation of the international variety of competition regimes (see Tables 1 and 2) and some details concerning their operation.
- Without presuming that a comprehensive (cross-sector) competition regime is required in Hong Kong, it offers three options for consideration in case it is deemed so:
  - **1. A single authority with power to investigate and adjudicate** (e.g. EU, Singapore and UK);
  - **2. Separation of investigation and adjudication** (e.g. Australia and USA);
  - **3. Adjudication by a special tribunal** (e.g. Canada).

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