

NSS Economics Curriculum-Anti-competitive
behaviours and competition law: concepts, cases and
concerns – Part 3

Common Concerns over Competition Law

Victor Hung

Hong Kong Consumer Council

Introduction

- Competition Policy is the policy to enhance market competition, it can in terms of several policy components:
 - Market liberalization policy
 - Deregulation
 - Most important the competition provisions
 - Modern competition law can be viewed as a basic system of rules which are designed as far as possible to allow markets to function properly. It is designed to prohibit abuses of market power, whether by an individual firm or by a group of firms acting collectively, but otherwise to allow markets to operate unhindered.
 - Why we need competition?
-

Competition Policy Advocacy

- The driving force of free enterprise is competition, and that when competition works, the market economy functions to the overall benefit of business and consumers alike.
 - Experience shows market mechanism drives economic efficiency.
 - Theoretically, it can demonstrate that “perfect” market competition maximizes total sum of consumer wealth and producer efficiency.
 - A workable and contestable market is a good **achievable** economic policy goal for the public
-

Competition Policy Advocacy

- Competition law implicitly advocates the norms and rule of the market competition to achieve the best form of capitalist economy
 - “While the absence of rules make the playing field uneven, too many rules of the wrong kind make it uneven again—a truly free and competitive market occupies a **very delicate middle ground** between the absence of rules and the presence of suffocating rules. It is because this middle ground is so narrow that capitalism in its best form is very unstable. It easily degenerates into a system of the incumbents, for the incumbents, by the incumbents.”

*--Raghuram Rajan & Luigi Zingales
Authors of Saving Capitalism from Capitalists*

Competition Policy Advocacy

- It is believed that the market works well for the consumers and **direct government intervention** on prices, profit and trade practices would be **disproportionate and unduly regulatory**.
 - As other side of the coin of competition safeguards are for consumer protection, it is believed that the essential purpose of the competition law should be to protect the interests of consumers, **not by protecting the competitive process** itself.
-

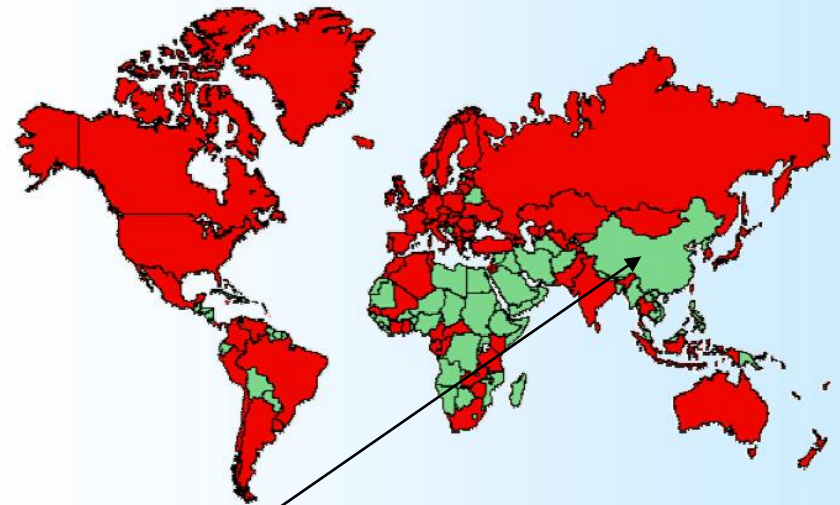
Global Development of Competition Law

1990



Laws enacted in 1990 or before

Today



Laws enacted in 2004 or before

In Sept 2007
China passed
the Anti-
Monopoly Bill

A Brief Navigation on Development of Competition Policy in Hong Kong

- In response to CC's 1996 report, the Competition Policy Advisory Group (COMPAG) established by Govt. in 1997 and chaired by the Financial Secretary.

 - “*Statement on Competition Policy*” was issued in 1998 by Govt. and stated that **its pro-competition principles:**
 - Maximizing reliance on, and minimizing interference with, market mechanism

 - Maintaining a level-playing field

 - Minimizing uncertainty and fostering confidence in system fairness and predictability
-

A Brief Navigation on Development of Competition Policy in Hong Kong

- Government adopted a **sector-specific** competition policy instead of general competition policy and seeks for **self-regulations**
 - <http://www.hkbu.edu.hk/~sktsang/ArchiveII.html>

 - Only limited sector regulations, telecommunications and broadcasting contains competition provisions
 - For example Competition Provisions in Hong Kong Chapter 106 Telecommunication Ordinances 7K : S.1 A licensee (entity) shall not engage in conduct which, in the opinion of the Authority, has the purpose or effect of preventing or substantially restricting competition in a “telecommunications” market.

 - Other sectors like public transport, electricity and airport have direct Government regulation.
-

A Brief Navigation on Development of Competition Policy in Hong Kong

- In Nov 1999, IMF conducted its annual Article IV consultation **exercise expressed concern about domestic competition** in Hong Kong and praised the work of the CC.
- In 2000, concerns was repeated by IMF and also echoed by European Parliament
- In 2003, published the Guidelines on Competition Policy strengthen its competition statement but still relied on self-regulation on non-regulated sectors.
- In 2005, a Competition Policy Review Committee appointed by COMPAG to review Hong Kong's competition policy, the Committee concluded that **'legislative backing is needed for the effective enforcement of Hong Kong's competition policy'** and recommended that a cross-sector competition law be introduced to safeguard markets against anti-competitive conduct in 2006.

Concerns over Competition Law

- Intervention to the market system?
 - Modern market economy is no longer a Darwin type jungle society. Fitness and strongest are not the only members to be survived.
 - Humanity has evolved and adopted the principles of more open, equal opportunity and level playing field society
-

Concerns over Competition Law

- Government only has bad policy?
 - There is no perfect government but no private corporation is aimed at preserve public interest.
 - Policy to strike the balance of different interest and maintain the public interest.
 - Status quo is only for the incumbent
-

Concerns over Competition Law

- Limit creative destruction?
 - Competition law evolution to deal with new technology but no doubt people uses intellectual property right or property right to sustain their dominance power
-

Concerns over Competition Law

- Regulate successful firm?
 - Competition law does not regulate successful firms or do not protect small firms
 - Only regulate abuse of dominance
-

Concerns over Competition Law

- Competition law affects competitiveness
 - It is instructive to note that in the 2006 Heritage Foundation Country Competitiveness Rankings:
 - *The nations that appear most frequently have low levels of taxes, spending, and regulation. The United States is on top (9 of 9), but the other nations that show up most frequently—Singapore (7), Australia (7), Switzerland (6), Denmark (6), Hong Kong (5), Ireland (5) and the United Kingdom (5). They are generally considered among the world's most market-oriented jurisdictions.*
-

Concerns over Competition Law

- No anti-competition cases in most sectors and complaints are only concentrated in some sectors;
 - Overseas experience demonstrates that like vitamin cartels, the auction house cartel between Sotheby's and Christie's, and the Danish building heating pipe cartel are tight organizations, their activities mostly held in secret and that it is almost impossible to uncover those activities without formal investigation power.
-

Recent Development of Competition Policy in Hong Kong

- In late 2006, the Government issued a consultation paper whether a cross-sector competition law be introduced to safeguard markets against anti-competitive conduct.
 - In March 2007, the Government concluded that it would enact a competition law with an authority to implement the law.
 - In October 2007, the Government announced that a further consultation about the content of the legislation will be held in next February and will have the Bill ready for LegCo in coming 2008, it is planned to enact the law in 2009.
-

Different Content in Different Jurisdictions

- Per se illegal conducts versus proof damage of conduct on competition
 - Civil case versus criminal case
 - Financial penalty versus imprisonment
 - Personal liability versus company liability
-

The Content of the Proposed Competition Law in 2010

- the definition of anti-competitive conduct to be covered and the introduction of an appropriate prohibition against such conduct;
- the establishment of a Competition Commission as the regulatory authority;
- a mechanism for exempting from the application of the law conduct that was considered to be in the wider economic or public interest;
- provisions related to confidentiality and a leniency program; and
- the penalties that are applicable to a breach of the prohibition against anti-competitive conduct, refusal to cooperate with investigations or unauthorized disclosure of confidential information.

What Social Value Achieve Through Competition Law

- The Competition Law does not attempt to change the result of the market competition
 - Not directly affect the distribution of the wealth and income allocation.
 - Not directly affect the market tradeoff between economic inputs and economic output.
- The Competition Law only attempt to offer more freedom to engage market competition
 - Reduce man-made barriers to entry, allow greater opportunities to participate contested market, to fully utilize market potential and offer more choices. However, it does not guarantee equal assess to market information to make appropriate decision.

Goal of Competition Law

- Competition law encourages market competition to increase economic efficiency and hence to improve consumer welfare



消費者委員會
CONSUMER COUNCIL

- If the market has more competition, consumers have more choices
-

Competition Benefit Consumer

- **More information**

- As consumers have more and better choices to choose from competitive business, they eager to provide more information.
- Is reputation matter?
- Verifying information?

- **Better Quality**

- Competition also gives business incentives to win consumers by
 - Higher quality products
 - More prompt repairs and support service
 - Better customer services
-

Competition With Few Competitors

- The extent of the market limits the number of the rivals.
 - Few firms, an oligopoly market, take rivals' reactions into account in setting prices or outputs.
 - Study of pricing behaviour of UK firms indicated that a significant proportion were reluctant to cut prices for fear of triggering a price war.
 - Hall, Walsh and Yates (1996): How do UK Companies Set Prices, *Bank of England, Quarterly Bulletin* (May).
-

Market Likely Outcome

- *John Nash, the Nobel Prize winner* analyzing selfish rivalries in market phenomena if each firm does its best it can given rival's actions
 - For example the duopoly market:
 - Two firms both do their best it can, given expectation of their rival behaviors
 - Behaviors are *non-cooperative*
 - Two firms when considering a low price or a high price strategy, it formulates its strategy upon its rival's response
 - Cooperation has an anti-trust implication
-

Competitive Outcomes

Nash
Equilibrium
of repeated
business
interaction

Cement
producer B

Nash
Equilibrium
of a
single/finite
business
interaction

Cement
producer A

	One Plant	Two Plant
One Plant	HK\$50M HK\$50M	HK\$20M HK\$75M
Two Plant	HK\$75M HK\$20M	HK\$25M HK\$25M

Anti-competitive Harms Consumers

■ Firms Collude

- ❑ Cooperative agreement that market players engaged in anti-competitive behavior, and to reap higher profits from consumers.
 - ❑ Different markets have different ways of collective behaviour. Any business combination, is very likely that consumers are the ultimate victims.
 - ❑ If the firms involved is not lions (big firms) but wide dogs (SMEs), should they be treated differently?
-

The Lysine Cartel

- Agreement on price
 - Volume allocation
 - The problem of “cheating”
 - “No one has yet invented a way to advertise price reductions which brings them to the attention of numerous customers but not to that of any rivals.”
 - Stigler (1964), A Theory of Oligopoly, *Journal of Political Economy*, 72: 44-61.
 - Side payments
 - Role of Trade Associations
 - Secrecy
 - Adverse effect on buyers 25% mark up
 - Understand more about cartels with Modern Game Theory Model
-

Explicit Collusion

- The Lysine Cartel
 - US DoJ Antitrust Division Website Case filings *United States v. Michael Andreas and Terence Wilson*.
 - ADM new entrant initiate the cartel
 - Famous quote “Our competitors are our friends; our customers are the enemy”. (Senior ADM executive outlining the company’s philosophy at a cartel meeting)
-

Per Se Rule against Price Fixing

- *Per se* rule means that only need to prove the conduct such as a cartel agreement, no need to show economic harm.
- *Per se* subsequently upheld by the Supreme Court *Standard Oil Company of New Jersey et. al. v. US*, 221 US 1 (1911).
 - US Supreme Court subsequently rejected claims that it was legal to fix prices provided they were reasonable.
 - “The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves the power to control the market and to fix arbitrary and unreasonable prices. The reasonable price fixed today may through economic and business changes become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition secured by the agreement for a price reasonable when fixed.”
US v. Trenton Potteries Company et. al. 273 US 392 (1927).

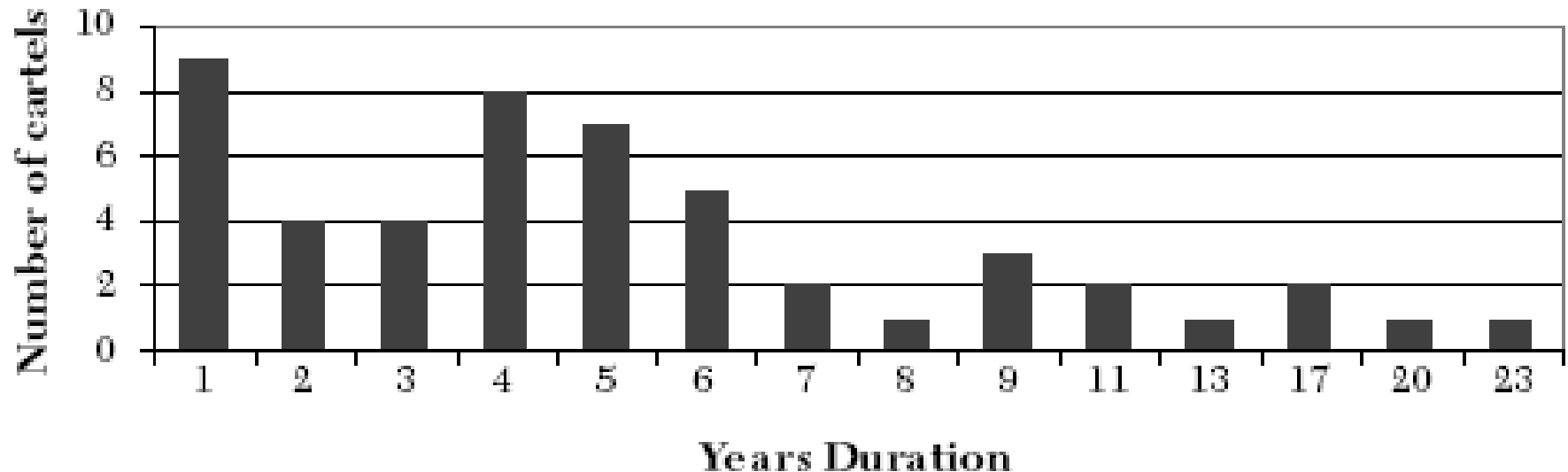
Explicit v. Tacit Collusion

- Philips (1995): they have the same objectives
 - Explicit collusion aims at putting the members of an agreement at the point on the profit frontier at which their joint profit is maximised.
 - Tacit collusion aims at increasing the profits of the colluders above the level implied by a non-cooperative Cournot-Nash equilibrium until, hopefully, the joint profit maximising point is reached.
 - More complicated with tacit collusion due to absence of agreement in the form of a legally enforceable contract
 - Explicit collusion typically because such contracts are illegal under competition law
-

Duration of Cartel

Is the cartel inherently unstable?

Distribution of Duration for Contemporary International Cartels



Levenstein M. and V Y Suslow (2006): “What Determine Cartel Success?”
Journal of Economic Literature March 2006 pp.43-95.

Concentration of Industry with Cartel

TABLE 4
CONCENTRATION AND NUMBER OF FIRMS:
SELECTED CASE STUDIES

<i>Industry</i>	<i>Number of Participants</i>	<i>Concentration^a</i>
Beer (U.S.)	550–780	C1 = 4% ^b
Beer (Sweden)	23–193	Very low, but increasing over cartel period
Bromine	7–15	
Cement	4	C3 = 95%
Coal	70–100	HHI between 256 and 396
Diamonds		C1 declined from nearly 100% in 1880 to 80% in 1994
Electrical Equipment	40	
Ocean Shipping	2–8	C2 = 50% in one South African market
Oil	19–50	
Parcel Post	5	C5 nearly 100%

Levenstein M. and V Y Suslow (2006): “What Determine Cartel Success?”
Journal of Economic Literature March 2006 pp.43-95.

Discipline of Cartel

TABLE 11
CARTEL ORGANIZATION: THE USE OF VARIOUS TECHNIQUES FOR MONITORING,
REWARDING, AND DISCIPLINING CARTEL MEMBERS

	<i>Hay & Kelley^a</i>	<i>Fraas & Greer</i>	<i>Posner</i>	<i>Gallo et al.</i>
Trade Association Involvement	29%	36%	44%	23%
Market Allocation ^b	35%	26%	26%	27%
Single Sales Agent		3%	6%	
Terms and Conditions of Sales Set	14%	5%	14%	
Disciplinary or Coercive Practices; Exclusion	5%	12%		
Policing; Fines; Audits			4%	

Levenstein M. and V Y Suslow (2006): “What Determine Cartel Success?”
Journal of Economic Literature March 2006 pp.43-95.

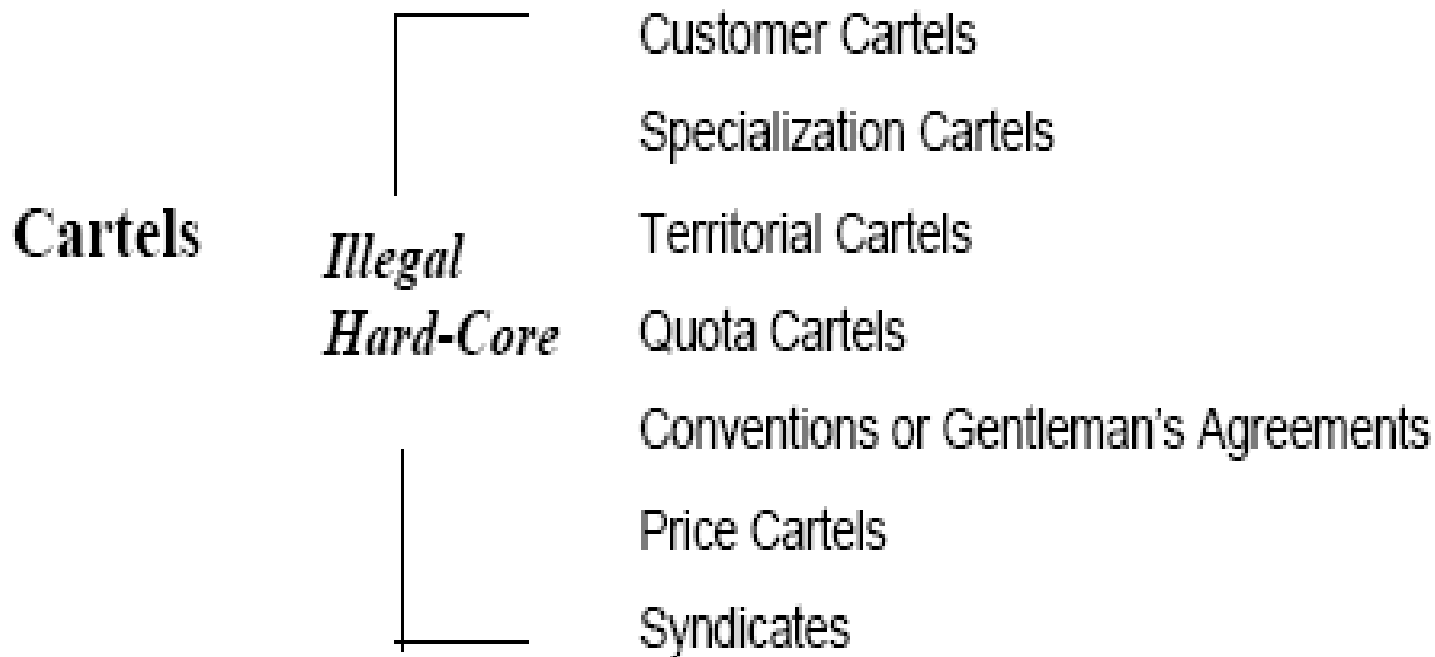
Anti-competitive Harms Consumers

- In some jurisdiction of competition law states: “Trade associations should not have collective actions to exclude competitors”

Referred to collective action, any contracts, agreements or otherwise of the agreements, amongst competitive relationship undertakings that determine the price of the goods or services, or limit the quantity, technology, products specification, equipment, trading objects, trading areas, etc. ... said collective action.

Association Articles of Association or by members of the General Assembly, management, board meeting resolution or other means for the binding behavior of business activity, ... enough to affect the production, trading goods or services, the market supply and demand functions are limited ... Are also included.

Cartels – Regulated market cooperation



~~Jeffrey Fear (2006) “Cartels and Competition: Neither Markets nor Hierarchies” HBS Working Paper~~

Cartels – An “efficiency” cooperation

Markets

Spot Markets

Oligopolistic Competition (Implicit Collusion)

Trade/Industry Associations

Private Self- Regulation (Associations)

Procedural

Contractual or Condition Cartels

Type or Standards Cartels

Environmental Safety

Product Quality Processes

Patent or Patent-Licensing Cartels

Calculation Cartels

Discounting Cartels

Tender Cartels

Cartels – A policy-induced cooperation

Hierarchies

*Industrial/
Social
Policy*

Import/Export Cartels

Rationalization Cartels

Recession Cartels

└─ Emergency or Structural Crisis

Cooperative Marketing/Purchasing Arrangements

Long-Term Contracts

Networks

└─ Enterprise Groups

└─ Subcontractors

(Non-equity) Strategic Alliances

(Equity-based) Joint Ventures

Firms

Increase
hierarchies
organization
arrangement

Jeffrey Fear (2006) “Cartels and Competition: Neither Markets nor Hierarchies” HBS Working Paper

Abuse of Substantial Market Power

- Large enterprises have significant impacts on the market.
 - Improper use of market influence, not only stifle the survival of other companies, but also to suppress any attempt to enter the market competitors. Effects:
 - ❑ Prices increase
 - ❑ Reduce the choice
 - ❑ Hurt SMEs
 - ❑ Companies with market power to reduce the incentive for innovation
 - ❑ Decreased product quality
-

Crucial elements to ensure consumer interests with competition law

- Some reference to ‘consumer welfare’ should be stated in the objectives of the proposed legislation.
 - A general approach, rather than a prescriptive approach, should ideally be taken in the legislative test for assessing anticompetitive conduct.
 - The concept of dominance or substantial market power should be extended to collective dominance for effective consumer protection and anticompetitive mergers and acquisitions should come under the law.
-

Ensure consumer interests

- A general approach, rather than a prescriptive approach, should ideally be taken in the legislative test for assessing anticompetitive conduct.
 - For example: Controversial bundling practices in case of GE/Honeywell, Tetra Laval/Sidel and the recent Microsoft decision. Should there be a (modified) *per se* legality rule for bundling?
 - General approach should not be treated as case by case analysis and is suggested to be more suitable in small economies for most relevant activities and practices at the expense of *per se* offenses.
-

Crucial elements to ensure consumer interests

- A general approach, rather than a prescriptive approach, should ideally be taken in the legislative test for assessing anticompetitive conduct.
 - Develop rule differentiation by minimizing the sum of the welfare cost caused by decision errors of type I (“false positive”) and type II (“false negative”).
 - A general provision regime can be compatible with the demand for a “rule of law”.
 - General approach uses economics for the formulation of appropriate competition rules.
-

Crucial elements to ensure consumer interests

- The concept of dominance should be extended to **collective dominance** for effective consumer protection and **anticompetitive mergers and acquisitions** should come under the law.
 - The literature suggests that in small economies competition law should focus on efficiency evaluations of mergers and trade practices.
 - However, competition issues that arise in the so-called new economy industries should be examined placing most weight on dynamic efficiency rather than traditional measures of market structure.
-

Crucial elements to ensure consumer interests

- The concept of dominance should be extended to **collective dominance** for effective consumer protection and **anticompetitive mergers** and acquisitions should come under the law.
 - **Small market** measured by the ratio of the size of the relevant market, that is, the output that would be demanded at a price just sufficient to cover minimum unit costs, to the size of a unit of production that is just sufficiently large to achieve lowest average costs of production, **supporting oligopolistic competition**. Oligopoly market induces coordinated effect between rivalries. Authority should also prohibit of abuse of collective dominance.
-

Other elements to ensure consumer interests

- A **transparent and public process** should be provided in regard to the granting of **exemptions** for anticompetitive conduct.
 - The structure of the competition authority should be such as to **represent** consumer interests.
 - Some **mechanism should be available to allow civil claims** for damages by consumers.
-

Public Policy Perspective

- Competition policy is not only an economic policy, it represents the safeguard of the open and democratic society
 - As US President Roosevelt warned Congress in 1938 that “The liberty of a democracy is not state if the people tolerate the growth of a private power to a point where it becomes stronger than the democratic (government) itself ... Among us today a concentration of private power without equal in history is growing”
 - Competition law represents a social movement.
 - “More economic power brings out more responsibility to preserve the opportunities for under privileges to gain economic power”
-

Public policy Perspective

- Incumbents never give up to fight even the issue is settled.
 - Over last 13 months, there were over hundred newspaper articles repeatedly against enacting cross-sector competition law to alter the public opinion.
 - Devils are in details. Incumbents will introduce amendments in the legislation making the law ineffective.
 - Public discussion needs to be focus on the content rather than whether HK needs the law.
 - More works are needed to explain to public about the benefits of the law.
-