

9

COMPETITION POLICY

In the EU and the US, the purpose of competition policy is to limit the monopoly powers and monopolizing conduct of large firms. In the PRC, however, the purpose of competition policy should be to reduce the monopoly power of governments.¹ This is especially true in the Western Region, where provincial and other local governments monopolize various rights that should be left open to the market. It is a vicious circle: because governments need revenue, they seek to use their monopoly powers in issuing licenses and charge management fees that maximize revenues from enterprises. As a consequence, firms have no incentives to invest, and this reduces the tax revenues of local governments, making them even poorer, and the regions less developed.

Role of government in promoting competition

In the context of the economic development of the Western Region, the central issue of competition policy for the Government is not how to regulate the private sector but how to progressively give up its own monopoly powers, facilitate the entry of the private sector, and therefore promote economic development.

EXTENT OF MONOPOLY POWER IN THE PRC

Although there are no publicly available data on the concentration ratios of industries in the PRC, most industries and enterprises are operating in a fairly competitive market after 20 years of economic reforms that have promoted the private sector.

Monopoly and market power are therefore mainly the privilege of large-scale SOEs and the infrastructure sector because of their important positions in the national economy, such as in banking and insurance, managed funds, telecommunications, electricity, and, to a lesser extent, automobiles and the airline industry. For these protected industries, monopoly powers are further enhanced by the decentralized public administration introduced in 1994.

Therefore, competition policy (or the lack of it) in the PRC mainly relates to state monopolies and local protectionism. This is especially true in the Western Region. Twenty years down the track, there will be many large private sector enterprises. The Government is promoting the formation of large enterprises via merger and acquisition, hoping that they can compete with multinational enterprises now that the PRC is a member of the WTO. Therefore, competition policy should extend naturally to include unfair business practices that lessen market competition.

INTERNATIONAL PRACTICE

International experience shows that competition policy aims at promoting competition by limiting

market power and outlawing business practices that lead to large enterprises attaining a dominant position in the market. Antitrust laws, such as the Sherman Antitrust Act of 1890 in the US, the Restrictive Trade Practices Act in the UK, and the Trade Practices Act in Australia, grant legal status to the competition policies of the respective governments, which are normally implemented by legislative bodies. After the 1980s, there was more concern to reduce the market power of State monopolies, following academic studies and the implementation of policies of “deregulation,” “privatization,” and “access regimes.” In many countries with federal constitutions (such as the US, Canada, Australia, India, Germany, and Brazil) a major issue has been eliminating regional barriers to free trade.

REGULATORY FRAMEWORK

As yet, the PRC does not have a complete set of laws or decrees necessary to support competition policy. Instead, the country has proceeded through administrative measures and by negotiation. In many cases, a negotiated compromise was the only feasible outcome. Such compromise sometimes creates a minimal reaction and is often boycotted by concerned parties whose interests may be adversely affected. Therefore, the PRC faces the challenge of implementing meaningful reforms that would establish a coherent competition regime.

Although there is no equivalent competition law or antitrust law in the PRC, there is certainly much academic interest and plenty of government interaction. This follows a reform model one could call “crossing the river by holding stones,” a sort of “acting after trials” strategy. For example, in relation to the legislative process, although private enterprise was allowed in the early 1980s, only in 1999 was an item protecting the private ownership of enterprises added to the Constitution.

The PRC does have two regulations that contain some elements of a standard competition policy.

The Anti-Unfair Competition Law of 1993 outlawed business conduct regarded as unfair competition, such as misrepresentation, imitation of trademarks, blocking of access for nonlocal companies, bribery, or stealing of business secrets. The Anti-Unfair Competition Law is more like a consumer protection regulation than a standard competition law. Notable omissions include sections dealing with monopoly and monopolization, price fixing and other predatory pricing strategies, merger and acquisition, and exclusive dealings and territory. More importantly, the law mainly targets the private sector, rather than problems of monopolistic conduct by administrative departments and local governments.

The Telecommunication Industry law was passed on 25 September 2000 to regulate the operation of the information and communication technology (ICT) industry. The bylaw gave exclusive power to the Ministry of Information Industry to administer and regulate the whole information industry. The Ministry became a neutral regulator by taking over the initially confusing regulatory functions of the Ministry of Post and Telecommunication, the Ministry of Electrical Power, and the National Information Industry Steering Commission.

This is the first and so far the only law in the PRC to set up a framework for the division of responsibility between the state regulatory body, the State Government, and possible private operators. The law unbundles the ICT industry into (i) basic infrastructure for infrastructure and communication services, and (ii) value-added information and communication services. While the State retains its monopoly power in the basic infrastructure for information and communication services with a legal *minimum* share of 51 percent, the private sector has rather unprecedented freedom to enter into the value-added information and communication services business. Some provisions of the law are very similar to those that underpin regulatory regimes in most western countries, such as:

- The dominant providers of information and communication services cannot set up barriers to keep new firms from entering the market. The State retains the power to tear down any such barriers.
- The State could either allocate for a fee or auction among bidders ICT resources such as radio spectrum, satellite orbit, or domain names.
- The State retains the right to set the standards in the nationwide telecommunication network.

SHORTCOMINGS OF PRESENT ARRANGEMENTS

Senior government officials readily admit that the present laws and regulations on competition are inadequate. It is fair to say that the PRC lacks a competition policy that would reduce the monopoly power of governments. As noted by two journalists of the *Southern Weekend*:²

Monopoly has become the major obstacle for the development of the economy. If we could break up monopoly, abolish industrial entry approval, the GDP could increase by 30 percent in the next couple of years. However, the breakup of the monopoly will not only touch the administrative system, but also the interest groups associated with the current monopoly. Asking the government to break up its own monopoly is like asking a person to cut off his own arm. It is too difficult.

The PRC's accession to the WTO will call for the further opening up of private investment and trade. In most sectors, restrictions on private sector entry run against the spirit of the rule of law, since they are typically based on irrelevant distinctions. It is rarely the case that the form of ownership should be part of the ascertainable qualifications to perform specific economic activities. Therefore, all sectors in which form of ownership in the above sense is an irrelevant distinction should be open to private investors. Furthermore, it is a matter of urgency that the treatment of market access across localities be unified, especially since this would be required for WTO membership. Adjustment programs in various sectors should also be examined for their impact on

private sector entry. More active involvement from private enterprises should be encouraged, for example, through mergers and acquisitions.

The Anti-Unfair Competition Law of 1993 requires stricter enforcement of laws and regulations. The PRC is bound under WTO agreements to give “national treatment” to foreign institutions in a number of sectors. Establishing national treatment in such sectors should therefore be a priority. In this context, preferential policies toward SOEs and foreign investments should be gradually phased out and a policy of national treatments adopted to enable domestic private enterprises to compete with SOEs and foreign firms on an equal footing. Foreign trading rights should be extended to all qualified private enterprises to allow them to participate directly and more widely in the PRC’s foreign trade.

ENFORCEMENT OF LAWS AND REGULATIONS

PRC government experts have pointed out that good laws cannot produce good results by themselves; effective judicial and administrative systems as well as public understanding and confidence are also necessary. Law enforcement is neither strict nor just, legal efficiency is low, and responsibility is unclear, giving rise to frequent complaints. Governments at all levels at and above county level are responsible for enforcing competition law, yet these local governments themselves often engage in monopolistic conduct. An independent judicial system is therefore vital.

Obstacles to competition

DIVISION OF POWERS BETWEEN LEVELS OF GOVERNMENT

Uncompleted administrative decentralization could be the major obstacle to competition. The PRC inherited a public administration system with powers well beyond the scope of providing public goods. Importantly, the previous third round and the current fourth round of public administration decentralization have mainly concentrated on redistributing administrative duties

from the Central Government to local governments rather than abolishing those duties. This “stuck-in-the-middle” system has created a complex scenario. The Central Government has lost control over issues that need nationwide cooperation; at the same time some local governments are abusing power to the point of restricting the entry of products into other provinces and setting up barriers to the entry of products into their own jurisdictions.

LOCAL GOVERNMENT PRACTICE

In the Western Region, local governments are the major obstacles to competition.³

- Most local governments are still absorbed in the traditional “planning economy” and disallow any market entry without their permission.
- They reject any investment from outside their region and any repatriation of profits to other regions or other countries.
- Local governments have imposed many “gray taxes and duties” on the private sector, especially on small private companies financed with foreign investment. This has significantly increased the costs of investing in the Western Region to finance their enlarging fiscal deficits.⁵
- The merger and acquisition of SOEs in the Western Region by investors or companies from outside the region normally encounter intervention from local governments.
- Local governments protect local SOEs in which they have a stake against inter- and intraregional competition.

VIEWS OF ACADEMICS IN THE PRC

Less significantly, there are misconceptions, even among academics in the PRC, about the functions of competition law. These incorrect notions include the following:

- Competition law should regulate the business conduct only of the private sector, not of the public sector.
- Competition policy will reduce the scale and scope of business.

- SMEs will not be able to compete with the multinational enterprises following the PRC's entry into the WTO.
- Competition law will hinder the reform of SOEs, because it outlaws the recommended contractual reform of mergers and acquisitions.
- The Anti-Unfair Competition Law already exists, and it is equivalent to a competition law.

Subregional issues

INTERREGIONAL TRADE

A survey conducted by the Institute of Finance of the Chinese Academy of Social Sciences from 1987 to 1991 found a decline in interprovincial trade among six provinces and municipalities. With the exception of Shaanxi, all the other provinces had decreased their dependence on interprovincial trade from 25.1 percent to 22.3 percent. In Shanghai, of the 201,100 million yuan in retail trade and 130,000 million yuan in wholesale trade in 1997, goods sold to other provinces accounted for only 23,000 million yuan, or 17.6 percent.

Measured by their similarity in industrial structure, the Central and Western regions have a similarity index of 97.9 percent, the Eastern and Western regions 93.5 percent, and the Central and Eastern regions 93.4 percent.⁴ This is an alarming indication that, in contrast to the globalization trend in the world, the national market in the PRC is a disintegrating.

REGIONAL PROTECTIONISM

Regional protectionism, in the form of territorial segmentation and confrontation, has gradually emerged as a major obstacle to national competition in the PRC, probably because of the incomplete decentralization of public administration. Poor regions responded to the negative effects of reform with protectionist behavior. They hoarded local resources and products, and blocked interregional trade, regardless of wastefulness, duplication, inefficiency, or the poor quality of local production by national standards. The local regions saw themselves

as better off with regionalism, thinking that at least they were not losing current interests.

To protect their markets, local governments prohibited the importation of products and commodities from other regions or the sale of products from other regions in local markets. In the 1980s and 1990s many wars for the sake of protectionism were reported across the country. There have been trade wars over television sets, refrigerators, air conditioners, fertilizer, steel and iron, and cars.

The significant benefits resulting from favorable treatment in the special economic zones and coastal open cities also promoted competition for favorable policies. Local governments competing with one another for outside investments promulgated special policies. Many investment projects were begun simply to take advantage of favorable treatment, regardless of duplication, small scale of operation, low demand, inappropriate location, and thus low efficiency.⁵

DANGERS OF REGIONAL PROTECTIONISM

Because of the PRC's vast size and internal natural barriers, its poor communications and inadequate transportation, its diverse dialects and identities and disparate traditions, there is segmentation in the country. Closed economic systems impair national economic coherence. Decentralization, administrative as well as economic, has turned out to be divisive and an explosive political issue, reinforced as it has been by latent but regionally significant factors that have emerged more recently in the PRC. Tibet's and Xinjiang's independence movements and the "rebellion or separatist riots" in the early and late 1980s and mid-1990s partly reflect these tensions.

Implications for competition policy

IMPROVING COMPETITION IN THE NEXT FIVE YEARS

Implicit in the Government's strategy for the Western Region is recognition of the need to break up

government monopolies.⁶ The Government should treat the establishment of a well-functioning competition law as the major vehicle for microeconomic reform. It should put in sufficient effort to create an economic environment that will force firms to adopt modern corporate governance structures to become more competitive. This task should be regarded as a short-term policy and finished within the Tenth FYP period. The failure to have such a well-functioning Competition Law in place within the next five years may leave PRC firms at a disadvantage when competing with multinational enterprises once the country attains full membership in the WTO.

Specific measures that the Government could consider include the following:

- Organizing a capacity building campaign to increase awareness that competition law should be independent of government administration and its legislative power should therefore extend to government administration.
- Inviting international donor organizations to support the preparation of a competition law.
- Passing a comprehensive competition law that prohibits monopolizing conduct in the private sector and provides for the progressive elimination of government monopoly on market access control. The law should set no barriers *ex ante* to free market entry but should rather emphasize *ex post* consumer protection after the entry.
- The fourth round of public administration decentralization should change its focus from redistribution to the abolition of administrative powers that should be left to the market. For consistency with the proposed competition law, the reform of public administration should be gradually handed over by the Government (the State Council) to the National People's Congress.
- Establishing a national regulatory body under the National People's Congress that is independent of the Government (the State Council) and has

the task of interpreting and overseeing the implementation of the competition law.

- Furthering reforming SOEs to sever their links with all levels of government. Mergers and acquisitions should be approved by the proposed regulatory body and managed by the companies involved, not by the central or local governments.
- Further simplifying the local taxation system and making duties more accountable and transparent (see Chapter 2 for economic analysis and policy recommendations).
- Facilitating the mobility of resources to promote inter- and intraregional competition.

IMPROVING COMPETITION IN THE MEDIUM TO LONG TERM

In the longer term, in order to achieve a consistent and broad economic development strategy toward 2020, the PRC Government could consider the international practice of introducing overlapping jurisdictions as a way to promote competition and reduce corruption. That is, public officials could be given overlapping domains for these duties that must be managed by the governments. Multiple offices should be established to manage a single duty, like the issuing of construction permits. Even better, private companies should be allowed to bid for the management of a public duty. The experience of the state of Victoria, Australia, has shown clearly the advantages of this private provision of public goods.⁷

Notes

- 1 In the airline industry, for example, the Government introduced a price-fixing policy in 2000. According to the policy, airlines had to stick to a price published by the Bureau of Civil Aviation and could not sell discounted tickets to customers. A one-way economy-class air ticket from Beijing to Shanghai sold for 1,040 yuan. The Bureau of Civil Aviation abolished the price-fixing policy on 8 March 2001. Now customers can buy a one-way economy-class

air ticket from Beijing to Shanghai for as low as 650 yuan.

The Government's price-fixing policy for automobile sales was reported by the *Financial Daily* on 23 May 2001 (page 2). In the PRC, automobile production has to be approved by the Government through the restrictive "catalog management system." Even after approval, manufacturers must seek a separate approval for any change in the type of automobile produced. Car sales are subject to 10% consumption tax. Local governments also impose other types of local tax, such as environment protection tax and city management fees. Taxes and fees come up to about 130% of the purchase price of a car.

2 *Southern Weekend*, 31 May 2001, p.10.

3 Fieldwork in Gansu, Xinjiang, Sichuan, and Yunnan. April and May 2001.

4 Lizhen Yun (2001).

5 A typical example was the property and airport craze of the early 1990s, which spread through the entire country, but particularly in Guangdong, where more than 20 airports were to be built as each county wanted one. One such airport had only 6,000 passengers a year. Throughout the country the craze left in its wake hundreds of hectares of barren land, construction sites, and incomplete buildings.

6 In regard to the opening up of the initially monopolized domestic markets, the Circular suggested that:

The pilot operations of foreign investment in banks, retail stores, and foreign trade enterprises will be extended to municipalities directly under the central government and the capital cities of provinces and autonomous regions. Foreign banks in the Western Region will be allowed to engage in RMB transactions gradually, and telecommunications, insurance and tourism will be opened to foreign direct investment in accordance with relevant laws and regulations. Foreign investors are allowed to set up such Chinese-foreign joint ventures as accounting and law firms, engineering design companies, railway and highway cargo transport companies, and enterprises engaged in municipal public utilities and in other sectors designated to be opened to foreign investment. Priority is given to the Western Region in carrying out pilot operations in some of the sectors designated to open up to foreign investment.

7 Under the Jeff Kennet government of Victoria, Australia, many local councils' duties have been privatized. Inspecting and issuing of building permits used to be a duty of local councils. The new arrangement allowed professional architecture consulting firms to apply for the right to inspect and issue building permits. To promote competition, there is at least one designated company in each suburb. The duty is overlapping in the sense that if one household is not happy with the company in the suburb, it can choose any company even outside the suburb. To prevent possible corruption, any other company may report forged building permits to the local council.

