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# Exemption from the competition law – has the Government made its case?

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December 2008

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# Introduction

**Whether the Government and statutory bodies should get wholesale exemption needs to be assessed taking into account the unique structure of Hong Kong's constitution and economy**

I therefore propose to look at:

- Hong Kong's market driven policy & constitution
- The interplay of that policy with current sectoral competition law in telecommunications
- Government activity in the private sector
- The land system
- The proposed exemptions and reasons advanced by Government

# Basic Law constraints on Government

## Hong Kong is a capitalist society

Probably the most capitalist society in the world

Not an accident of history: is a matter of long standing government policy and, since the enactment of Hong Kong's Basic Law, a constitutional right

Article 5 of the Basic Law provides that:

*"The socialist system and policies shall not be practised in the Hong Kong Special Administrative Region, and the previous capitalist system and way of life shall remain unchanged for 50 years."*

# small government, **Big Business**

**The capitalist nature of Hong Kong must be reflected in, and inform, Government policy making**

Essentially, this requires that Hong Kong protect private property rights while giving market forces the widest possible reign

Consistent with this, the Government of Hong Kong adopts a 'small government, big business' policy

The focus of this policy is on:

- free trade
- low taxation
- minimal government

# Minimal government and competition law in Hong Kong

**Hong Kong currently has a light-handed sector-specific approach to competition policy**

This policy is consistent with minimal government

Under this approach, there has been limited need to consider, to date, the interaction between the 'minimal government' policy and competition law

However, an example is found in telecommunications - a sector subject to competition law at present

# Telecommunications liberalisation

## **Liberalisation commenced in 1990's**

When first opened to competition *ex ante* regulatory intervention was exercised on various fronts

This was done on the basis that new entrants had to deal with an incumbent in a dominant position

Market failure was presumed and regulatory facilitation of competition (i.e. liberalization) was pursued by the regulator at the time

Not unlike approach taken to liberalisation in other jurisdictions

# The move to an *ex post* competition regime

**The regulator has now concluded that the market is fully liberalized**

*Ex ante* regulation is being removed

Under the prevailing *ex post* competition law the regulator has expressly stated that there should only be intervention:

- *in the clear circumstances that market forces have failed, or are likely to fail*

*but only if*

- *it is demonstrable that regulation can do better*

This sets a high threshold for intervention

Even when it can be shown that there has been anticompetitive conduct, it is often difficult to convincingly make the case that regulatory intervention can do better

# General competition law the challenge for Hong Kong

**To develop a competition law and enforcement policy consistent with its unique capitalist constitution**

Proposed distinction between multi-firm and single firm conduct sits at the heart of much competition law and antitrust analysis around the world and is a flexible and useful tool in competition analysis

Government's proposal promotes clear drafting, while enshrining (with the possible exception of merger regulations) principles of competition law commonly seen in other jurisdictions

If properly administered, this should meet policy goal of a competition law that gives pre-eminence to market forces

However, it will only do so if due regard is given to the high threshold for intervention that must necessarily apply in Hong Kong



# Why small Government?

**Virtually no debate in mainstream economics about the inefficiency of government monopolies – those created by coercive State power - and the distortions in the competitive process that they can cause**

Critique extends to franchises, exclusive licences and other instruments used by Government, without good reason, to restrict entry into a particular field of economic activity

It is this philosophy, premised on a belief that private entrepreneurs are better positioned to make decisions about allocation and deployment of capital than politicians and bureaucrats, that sits behind Hong Kong's 'small government' policy

# But what about public services?

## **Hong Kong obviously does provide various public services**

Where the case justifies it, exemptions from competition law should be considered

To ensure that due consideration is given to Hong Kong's market driven policy, each exemption should be judged on its own merits

Given the small size of Hong Kong's public sector (a factor of the 'minimal Government' policy), this is not overly burdensome

# Government in the markets

## Cyberport

- Wholly owned by the Hong Kong Government
- Developed on a 24-hectare site at Telegraph Bay in the Hong Kong Island.
- Comprises four office buildings, a five-star hotel, a retail entertainment complex and a deluxe residential development

## Ocean Park

- One of the major tourist attractions in HK and Asia
- Wholly owned by the Hong Kong government
- Operated by the Ocean Park corporation, a statutory board

## Hong Kong Disneyland

- 57% owned by the Hong Kong Government
- The second Disney theme park in Asia
- attracted 5.2 million visitors in its first year and 4 million in its second year

## Hong Kong Housing Authority

- *"The ... HA owns a vast portfolio of shopping centres providing enormous business opportunities..."*
- Retail and car parking facilities
- Promotional venues

# Government projects

## Current construction proposals:

A cruise ship terminal at Kai Tak to *"help Hong Kong become a regional cruise hub"*

The West Kowloon Cultural District - described as *"an important strategic project that will support Hong Kong's development as a creative economy and global metropolis"*

A number of large infrastructure projects (mainly transport related)

# Regulation of land

**Of considerable importance in this context is the Government's continued control of land**

Government regulates:

- supply - releasing plots of land to the market through an auction process
- land development policy - through, for example, lease covenants, the land premium system and the Urban Renewal Authority

# The land system – some commentary

## Various criticism of the Government's regulation of land in Hong Kong as impacting on competition

A commentator recently said that *"land ownership and property development are the true sources of Hong Kong's competition problems"*

Not surprising that Government control of land should come under such attack in the context of a competition law debate

Ludwig von Mises once said: *"[g]enuine monopolies can be established only by control of land or mineral resources"*

# Impact of land regulation

## **Hong Kong's land system has particular potential to distort efficient outcomes:**

- relatively limited space available in Hong Kong
- Government controls supply
- Many developments (e.g. Urban Renewal Authority projects) are centrally planned
- System will naturally favour significant economies of scale
- Has the potential to distort competition in numerous related sectors of the economy, such as the retail sector

# The exemptions – what is proposed?



# Economic benefit exemptions

## **For agreements (including block exemptions) on grounds of economic benefit**

Where they are likely to yield economic benefit that outweighs any anti-competitive harm

Not an apparently objectionable exemption

Appears to provide for *ex ante* examination of whether a particular agreement or group of agreements raises competition concerns

Increased regulatory certainty for contracting parties

# Public interest exemptions

## **For undertakings entrusted with the operation of services of general economic interest**

Government refers to similar exemptions overseas for industries such as public transport, water supply, power supply and postal services

Not a surprising proposal given the existing regulatory structure of various of these industries

Might be difficult to justify in industries such as transport, given the high contestability and developed infrastructure in the region

# Public policy exemptions

**Government says will only be invoked where there are *"sound reasons of public policy for so doing"***

Not clear yet how this exclusion might operate

If limited and applied on a 'rule of reason' basis and only in exceptional circumstances, it may not be objectionable

For reasons to be discussed shortly, this appears the proper basis on which to assess any proposed Government and statutory body exemptions

# Non-application to the Government and statutory bodies

## Reasons given for the exemption

1. Activities of the public sector almost invariably would fall under the criteria for exemptions and exclusions
2. Ensures that the operation of Government and statutory bodies would not be affected by unfounded and misconceived complaints
3. Hong Kong has a relatively small public sector
4. Many services that are provided in other economies by the public sector are in Hong Kong provided by the private sector
5. The main concern is anti-competitive conduct in the private sector

# 1. Activities of the public sector almost invariably would fall under the criteria for exemptions and exclusions

## **Argument has an obvious circularity**

If activities of Government and statutory bodies are likely to fall within a public policy exemption, then assess them under that criteria, which requires "sound reasons" for the exemption to be shown

Particularly compelling argument where public sector is minimal and burden therefore low

Proposed to limit application of the law to "undertakings", i.e. organizations engaging in economic activity – such Government and statutory bodies should be subject to competition law

# 1. Activities of the public sector almost invariably would fall under the criteria for exemptions and exclusions (Cont'd)

*Per se* exemption draws attention away from whether operating in the public sphere

Puts Government and statutory bodies engaging in economic activities at a significant competitive and/or regulatory advantage over private organizations

Discipline of a competition framework would also encourage the Government to critically examine the efficiency arguments around its activities

## 2. Ensure that the operation of Government and statutory bodies is not affected by unfounded and misconceived complaints

### **There is a certain irony in this argument**

In a market driven economy why should business be shackled with the burden of potentially "*unfounded and misconceived*" complaints if Government finds that burden intolerable

Private complaints subject to safeguards against excessive litigation - can be applied equally to claims against Government or statutory bodies

Would promote a damaging culture within Government agencies, suggesting that they were immune from the necessity to behave efficiently or to be exposed to competition where possible

Would fundamentally undermine the proper administration of Hong Kong's small government principle

### 3. Hong Kong has a relatively small public sector

**Arguments made re category 1 above apply equally here**

Not clear how the Government argues that the size is a relevant factor

If the argument is that small government is unlikely to be able to engage in anticompetitive conduct, this should be addressed on a case by case basis

Should be remembered in this regard that Government has a considerable advantage in any activity it undertakes – a monopoly on the coercive use of force



## 4. Many services that are provided in other economies by the public sector are in Hong Kong provided by the private sector

Difficult to see the logic in this argument

Appears to do nothing to support the Government's case for exemptions

If anything, this would be an argument in favour of private sector exemptions

# 5. The main concern is anti-competitive conduct in the private sector

**If Government does not think it will breach the law, then it should not be concerned about being subject to it**

Widely accepted that the most damaging influence on markets and healthy competition is Government monopoly and other unjustified interference by Government in economic activity

Use of the word 'main' suggests an express concession that there are competition concerns in Government owned or controlled enterprises

Government is engaged in a number of private sector activities and potentially distorts competition in numerous sectors by the manner in which it controls land supply and use in Hong Kong

TO GRANT A WHOLESAL EXEMPTION WILL RESULT IN A LAW THAT CAN ADDRESS SOME OF THE SYMPTOMS BUT WHICH IS INCAPABLE OF PROVIDING A CURE

# What do other jurisdictions do?

**Appropriateness of any regime for Hong Kong needs to consider Hong Kong's unique constitution and economic/political structure**

However, worth observing that numerous jurisdictions around the world subject their governments to competition law, particularly in so far as their public bodies or undertakings engage in economic activities

Many are mixed market economies with a high degree of government involvement

If they don't exempt their governments from the rigours of competition law, it is hard to see why a capitalist economy such as Hong Kong should

# What do other jurisdictions do? (Cont'd)

## United Nations Conference on Trade and Development report in 2002 observed

*"[i]n a number of jurisdictions, exemptions are granted for "special" sectors such as ... government enterprises. In most of these cases there are no credible bases for exempting these sectors or types of economic activities from competitive pressures"*

# Summary

## **No apparent justification for the Government's proposed wholesale exemption**

Introduction of a general competition law is an important opportunity to review and assess the merits of current Government activity against a strict economic efficiency criteria

Should be welcomed as consistent with Hong Kong's desire to have minimal and efficient Government