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Mark Williams

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Mark Williams

Hong Kong has a reputation for being a free and open economy. Historically, the government has maintained that the economic environment is business-friendly, with a small public sector and that competition is the bedrock of sustained growth. The rule of law provides security of property rights and the light-touch regulatory environment allows the invisible hand of competition to work effectively. Unfortunately, this characterization is not an accurate representation of competition conditions in the domestic, non-traded sector of the economy. The government monopoly of the supply of land has facilitated the development of dominant, family-owned conglomerates that extract monopoly rents in many business sectors. Private monopolies in gas and electricity supply, a duopoly in the supermarket sector, tight oligopolies in port services and oil supply, and numerous well-known cartels are prominent features of the local economy. The government now recognizes that the traditional laissez-faire policy needs reconsideration and has announced that a comprehensive competition law will be promulgated. This article outlines the development of competition policy in Hong Kong and examines whether the new ordinance will effectively resolve its entrenched competition problems.

The author is Associate Professor of Law at Hong Kong Polytechnic University.

I. Introduction

For decades Hong Kong has been cited, often uncritically, as the best example of the benefits of a laissez-faire economic policy in ensuring rapid and flexible economic development.[1] This view often reflects an ideological stance and ignores the fact that other small Asian economies—such as Taiwan and Singapore—have also experienced stellar economic performance in the post-war period, but with markedly more government direction, guidance, or state sponsorship. While it is true that Hong Kong has largely maintained a classical mid-19th century liberal political economy model since British colonization in 1841, it is also true that the domestic non-traded sector of the economy is riddled with monopolies, cartels, and anticompetitive, interlocking conglomerate structures.

It is a fallacy to equate the economic freedom found in Hong Kong with the inevitability that such freedom from governmental constraints ensures a vibrantly competitive domestic economy. In fact, the process of competition is impeded by structural factors in the domestic economy and a government monopoly in the supply and regulation of real estate. This article explains these issues and their impact on competition in Hong Kong.

This paper offers a sketch of existing domestic industrial structure and provides examples of anticompetitive behavior, followed by an account of the development of pro-competition policies over the last fifteen years. Existing sectoral competition rules are examined and the probable content of the upcoming general competition law is also discussed. In conclusion, the likely content of the new law is measured against the competition problems that exist in Hong Kong to determine whether the new ordinance will sufficiently address the competition problems in the domestic Hong Kong economy.

II. Political Economy and Domestic Economic Structures[2]

Hong Kong has few legal barriers to entry in the domestic market. There are no import quotas, but duties are levied at the border on petroleum, tobacco, alcohol, and cosmetics. There are no significant barriers to the import or export of capital. The local currency is fully convertible and foreigners may invest in real estate, in the capital markets, or in enterprises as there are no legally restricted business sectors. Consequently, one might expect that foreign capital plays a significant part

1 *See, e.g.*, HERITAGE FOUNDATION, 2007 INDEX OF ECONOMIC FREEDOM (2007), *available at* http://www.heritage.org/index/; and JAMES D. GWARTNEY & ROBERT A. LAWSON, ECONOMIC FREEDOM OF THE WORLD (2007), *available at* http://www.fraserinstitute.ca/economicfreedom/index.asp?snav=ef.

2 For a summary account of Hong Kong's economic history, *see* Catherine R. Schenk, *Economic History of Hong Kong* (February 10, 2005), *at* http://eh.net/encyclopedia/article/schenk.HongKong (last visited Oct. 3, 2007). For an extended discussion, *see* D.R. MEYER, HONG KONG AS A GLOBAL METROPOLIS (2000).

in the capital-intensive domestic economy, but this is not the case. While many multinational corporations locate their regional head offices in Hong Kong and the major international investment banks have a large presence in Hong Kong, foreign corporations play a small role in the domestic economy overall.

Local family-controlled conglomerates, most of which are ultimately real estate developers, dominate most capital-intensive sectors. Gas, electricity, bus and ferry services, the seaport, supermarkets and large retail chains, the major air carrier, telecommunications services, and the residential housing supply are all controlled by local interests. Often the ultimate holding companies have broad cross-sector interests that tend to contract with other group companies, creating high barriers to entry that restrict or prevent competition. The government's land monopoly is the ultimate reason why this web of conglomerates and their interlocking subsidiaries exist.

When Britain took possession of Hong Kong in 1841, the first colonial government was faced with an immediate problem of raising sufficient public revenue to finance its operations. The decision was made that, in order to encourage trade, facilitate commerce, and enhance Hong Kong's position as the premier destination for conducting trade in China, there would be no significant import duties. Thus, the only source of funds was the sale of land rights that the Crown claimed as a result of the conquest and the Treaty of Nanking which ceded Hong Kong Island from China to Great Britain in perpetuity. Subsequently, in 1861, the Treaty of Peking ceded further territory on the Kowloon peninsula on similar terms. The majority of the former Colony's land mass—the New Territories—was ceded on a 99-year lease that ran until 1997. This limited land grant precipitated the diplomatic agreement between the United Kingdom and the People's Republic of China in 1984 that conceded retrocession of the whole colony, as the smaller fraction of the territory held in perpetuity was not viable without integration with the mainland.[3]

THE SYSTEM REMAINS LARGELY UNCHANGED TODAY, WITH GOVERNMENT OBTAINING APPROXIMATELY 30 PERCENT OF ITS PRESENT INCOME FROM THE SALE OF LEASES, FEES FOR ALTERATION OF PERMITTED USER, STAMP DUTIES, AND ASSOCIATED LAND-BASED PROPERTY TAXES. THE DEPENDENCE ON LAND-BASED REVENUES HAS BROUGHT ABOUT THE ENRICHMENT OF NOT ONLY THE PUBLIC PURSE, BUT ALSO OF THE MAJOR LAND DEVELOPMENT COMPANIES.

The first colonial government began the immediate sale of leasehold land rights, which became its major source of revenue. The system remains largely unchanged today, with government obtaining approximately 30 percent of its present income from the sale of leases, fees for alteration of permitted user, stamp duties, and associated land-based property taxes. The dependence on land-based revenues has brought about the enrich-

3 Steve Tsang, A Modern History of Hong Kong 1841-1997 (2004).

ment of not only the public purse, but also of the major land development companies. Hong Kong has no public sector debt and has huge fiscal reserves. The real estate developers reaped enormous profits over decades that were largely reinvested in Hong Kong to diversify the parent companies and convert them into conglomerates. Today these conglomerates dominate the non-traded domestic sectors of the economy such as utilities, infrastructure, and retail as well as the real estate market. The Hong Kong banks also fed market demand for mortgage lending to a population that craved the security of tangible assets, especially since many of Hong Kong's residents were economic refugees from the Maoist regime in the mainland between 1949 and 1978.

Consequently, the government and big business became symbiotically dependent on each other. The developers were beholden to the monopoly supplier of land and the government was reliant on the income generated by land sales. Because the government lacked a democratic mandate, direct taxes on the population were kept low, and even today Hong Kong does not have sales taxes. The government, therefore, had to act like any good monopolist by drip-feeding the real estate market to ensure scarcity, maximizing prices and thereby its tax revenues. By utilizing this revenue-raising model, the Hong Kong government has been able to maintain the appearance of being non-interventionist in economic affairs.

A tight land supply policy has had several significant economic effects. Real estate prices for commercial, industrial, and residential uses have been maintained at very high levels for decades. Until 1997, investing in real estate in Hong Kong was usually a one-way bet. Prices rose almost continually, fueled by demand from an increasing population and expanding mainland commerce. The government, developers, banks (who lent on mortgage security to buyers), and investors made money easily. By 1997, real estate prices had reached dizzying levels, but the boom imploded with the onset of the Asian financial crisis and values fell 60 percent by 2003. On several occasions during that time the government attempted to restrict supply and bolster demand. The government attempted to reverse expansionist public housing projects and halted all land sales. As a result of its dependence on land-based revenues, the Hong Kong government experienced current account deficits for four successive years for the first time (with the exception of wartime).

To address the weak domestic economy, mainland policies were adjusted to bolster the Hong Kong economy and to maintain political stability. The central authorities boosted inbound tourism by removing administrative travel restrictions and directed mainland, state-owned companies to undertake initial public offerings in Hong Kong, rather than on foreign stock markets. Beijing also agreed to a new trade pact to facilitate cross-border trade and economic integration. As a result, since 2004, the situation has since reversed and the Hong Kong government now enjoys a record fiscal surplus and real estate values have risen dramatically, though not to the heights of 1997.

Another malign effect of the government's intimate connection with the supply of land is the fact that over 40 percent of Hong Kong's population lives in public-subsidized housing. This surprising statistic arose from a housing crisis caused by the huge influx of poor migrants from the mainland that fled the political and economic turmoil of the 1950's and 1960's. Most of these people were unskilled and unable to afford private sector real estate prices. The government responded by creating an enormous number of public housing units as well as entirely new towns in the New Territories. Today, public housing rents are highly subsidized and access to new units is via a means test and waiting list system. The difference in the cost of rent for a public housing unit and the cost of a mortgage down payment and loan repayments on a private sector apartment is very large. This disparity is a direct result of the restrictive government real estate policy.

The government also prefers to sell relatively large lots of land at auctions. This requires huge, upfront immediate payments that only the largest developers can afford to finance since most developments are of large skyscraper apartment or office complexes, often as high as forty to eighty stories. The cost and lag time to develop such projects requires huge capital reserves. As a result, only a few local companies have the capacity to acquire development sites, ensuring that a tight oligopoly has developed. No foreign players have entered the market as a result.

Tacit collusion between the developers, with respect to land auctions and the sale of completed apartments, has long been suspected. Occasionally, this endemic behavior is revealed as an active bid-rigging ring. In March 2007, at a government land auction, two rival bidders concluded a joint bidding arrangement in full view of the television cameras.[4] Bid-rigging and other cartel practices are perfectly lawful in Hong Kong. The exception is bid-rigging that amounts to a conspiracy to defraud which is potentially a criminal offense under common law. However, it should be noted that in the telecommunications and broadcasting sectors, price-fixing and other cartel behavior are prohibited by sector-specific legislation.[5]

The government's land policy has almost certainly increased the cost of living and doing business in Hong Kong to a significant extent, as the price of land is higher than if the supply was subject to market forces rather than administrative control. These higher costs may, in the long run, affect Hong Kong's international competitiveness. Rents and housing prices are among the highest in the world. Real estate prices are often two-thirds higher than those in adjacent Shenzhen, the mainland special economic zone 25 miles to the north of Hong Kong, though

4 *Move to Ban Land Auction Deals*, The Standard, Mar. 15, 2007, *available at* http://www.thestandard.com.hk/news_detail.asp?pp_cat=11&art_id=40191&sid=12666307&con_type=1&d_str=20070315&sear_year=2007.

5 *See* Telecommunications Ordinance, c. 106 (2007) and Broadcasting Ordinance, c. 562 (2007), *available at* http://www.legislation.gov.hk/eng/home.htm.

this margin has decreased in recent years as a result of the booming mainland real estate market. The cross-boundary differential in real estate prices illustrates the effects of the restrictive land supply policies of the Hong Kong government.

Hong Kong is primarily a service-based economy with over 90 percent of its gross domestic product arising from the services sector. Financial services, logistics, and tourism are the mainstays of the local economy. Manufacturing has largely migrated to mainland sites due to much lower land and labor costs though finance, design, and logistics are still usually handled in Hong Kong. The economy is increasingly dependent on the greater Pearl River delta and China's economy generally. Most of the trade at the port is trans-shipment of goods to and from the mainland. The airport cargo and passenger sectors are increasingly becoming hubs for China-related markets. The vast majority of tourist arrivals are from China. The banking, financial services, legal, and accounting sectors are also heavily dependent on the mainland economy.

Given the ever-increasing dependence of Hong Kong on the mainland, the issue of whether the domestic, non-traded sector of the Hong Kong economy is flexible and nimble enough to withstand future economic shocks is an increasing concern. Hong Kong has not developed significant research-intensive, high-technology industries such as electronics, pharmaceuticals, or biomedicine. Health care and educational services are comparatively inward-looking. They have not developed their capacity fully to become preeminent centers of regional excellence that could attract large numbers of foreign patients or students with a more diversified income stream or that could serve as an incubator of highly skilled human capital. Hong Kong's population skill profile has become a matter of considerable concern to the government as part of the ongoing efforts to maintain a competitive edge over increasingly confident regional rivals such as Shanghai and Singapore.

Hong Kong is a small economy by most standards. With a population of approximately seven million and a geographical extent of just over 1,000 square kilometers, high concentration ratios might be considered inevitable given the need to obtain economies of scale. While this is true, the unique characteristic of the Hong Kong economy is the tight, cross-sector ownership of the domestic conglomerates. In some ways, this is similar to the chaebol phenomenon found in South Korea, and to a somewhat lesser extent in other East Asian economies, but the scale of the problem in Hong Kong is exceptional.

Given the lack of overt government barriers to entry in most markets, one might expect to see either a very competitive domestic economy or a highly concentrated sluggish one dominated by entrenched monopolies and cartels formed as a result of unfettered consolidation. In reality there is a dichotomy between small-scale business that is largely competitive and large-scale business that is highly concentrated and often lacks robust competition. This situation has arisen because historically the government's non-interventionist policies have combined low external trade barriers and a laissez-faire domestic economic policy with minimal intervention in economic affairs, including no industrial policy imperatives, and government provides only basic public services (e.g., security, water supply, rail services, health care, educational services and social housing), financed by a low direct tax system. This orthodoxy has dogmatically asserted that a competition law is interventionist and not to be tolerated. The mindset of successive Hong Kong governments has been perfectly aligned with that of the local tycoons. The renowned business friendliness of the Hong Kong authorities has become an effective abdication of responsibility for the wider public interest in maintaining competitive domestic markets.[6]

This ideological position has facilitated the creation of the existing structure of the domestic non-traded sector—high levels of concentration, substantial cross-sector ownership, and family control. Entry into many markets is difficult or impossible for a number of reasons, including the dominance of incumbents and the inability of new entrants to acquire sufficient scale of operations due to site scarcity or relatively small volumes of local demand. These structural impediments are compounded by tacit "no poaching" arrangements between incumbents or by overt anticompetitive practices to discourage the entry of rivals. Invisible privately erected barriers to market entry are common.

The cross-ownership and the small number of players in capital-intensive sectors are the roots of the competition problems found in the Hong Kong economy. To address the structural impediments effectively, a competition law must contain powers to review mergers to prevent further concentrations that could create or buttress positions of market power. The new law also needs the ability to dismantle existing economic structures that are shown to prevent competition from taking place. As this paper will discuss later, these are exactly the powers that the Hong Kong government has been reluctant to grant to the new competition authority. Lobbying by vested economic interests with political leverage may well have a powerful effect on the competition regime that emerges from the ongoing policy debate.

III. Anticompetitive Behavior

As other jurisdictions have witnessed, prior to the implementation of new competition laws, businesses take action to preserve their self-interest. They strengthen positions of market power through takeovers and mergers, creating higher concentration ratios. When a merger is not possible, then collaboration between competitors to reduce competitive intensity is often a successful substitute to protect profit margins, particularly if market entry is difficult or if the number of firms involved in the relevant market is not too great. This is especially true in oligopolistic markets in which mutual surveillance by conspirators

6 For a discussion of these issues, *see* Leo F. Goodstadt, Uneasy Partners: The Conflict Between Public Interest and Private Profit in Hong Kong (2005); and Tony Latter, Hands On, Hands Off, The Nature and Process of Economic Policy In Hong Kong (2007).

to ensure against cheating is more easily accomplished, and in small, isolated economies in which all of the business actors are readily identifiable and may participate in trade associations that facilitate collaboration. Even if active collusion is not practiced, smallness facilitates price leadership and tacit collusion.

Structural conditions, as well as the cultural homogeneity of the Hong Kong business community, facilitate the use of both exclusionary and exploitative tactics by dominant incumbents with market power. Structure and culture also promote restrictive business practices between nominal competitors, so that cartels proliferate to fix prices, share markets, or engage in bid-rigging. The absence of any legal prohibitions against such activities, with the exception of fraudulent criminal conspiracy cases and sectoral prohibitions in the telecommunications and broadcasting industries, means that not only is such behavior tolerated, but that such contracts may be legally enforceable under common law.[7]

CHALLENGERS TO DOMINANT UNDERTAKINGS OR CARTELS ARE DISSUADED FROM COMPLAINING BY THE UNRESTRAINED ABILITY OF THE INCUMBENTS TO RETALIATE COMMERCIALLY. THE SHEER DIFFICULTY, EVEN IMPOSSIBILITY, OF GAINING A FOOTHOLD IN SOME MARKETS OFTEN MEANS THAT NEW ENTRANTS ARE DETERRED FROM ENTRY, OR IF THEY DO ATTEMPT TO ENTER, IT IS OFTEN AS A JOINT VENTURE WITH AN INCUMBENT WHO KNOWS THE RULES.

Several examples, discussed in the sections that follow, demonstrate the numerous types of anticompetitive behavior that exist in Hong Kong. However, the true extent of the problem is largely hidden from view. Businesses do not advertise such practices as they are generally not defensible to skeptical consumers. Challengers to dominant undertakings or cartels are dissuaded from complaining by the unrestrained ability of the incumbents to retaliate commercially. The sheer difficulty, even impossibility, of gaining a foothold in some markets often means that new entrants are deterred from entry, or if they do attempt to enter, it is often as a joint venture with an incumbent who knows the rules. The fact that such commercial behavior is regarded as within the socially and legally permissible norms reinforces the contention that complaints to the authorities are futile in the absence of any legal prohibition. This may well explain the abject failure of the government's competition watchdog, the Competition Policy Advisory Group (COMPAG), to foster a more dynamic domestic market.

A. THE UTILITY SECTOR

In the utility sector, the supply of piped gas is a privately owned monopoly that is entirely unrestrained by effective competition. Gas supply is not subject to price

7 Such restrictive agreements might be upheld by the reasonable restraint of trade doctrine enunciated in such old common law cases as Mitchel v. Reynolds, 24 Eng. Rep. 347 (K.B. 1711) and Nordenfeld v. Maxim Nordenfeld Guns and Ammunition Co., [1884] App. Cas. 535.

regulation and there is no network access regime. Consequently, the gas supply company is highly profitable and is not subject to any competitive restraint. The gas monopoly is controlled by one of the local property-based conglomerate.

Electricity is supplied by two private firms. The smaller one, Hong Kong Electric, is part of the real estate-based Hutchinson-Whampoa/Cheung Kong property conglomerate. The larger one, China Light and Power, is probably Hong Kong's most significant monopolist. Each firm has a geographic monopoly over separate parts of Hong Kong's very small territory. Both companies are signatories to voluntary schemes of control whereby they agree, with the government, to limits on tariffs that yield them guaranteed rates of return of between 13.5 and 15 percent per year. They are not subject to competitive pressures or mandatory access regimes.[8]

The incumbents have responded to complaints about high prices with a propaganda campaign claiming that opening the distribution grid to competition would adversely affect the security of supply. An ongoing periodic review of the schemes of control by the government is unlikely to yield any significant changes. The creation of a third-party access regime that would facilitate the creation of a market in electricity seems unlikely. To court populism, the government may attempt to enforce a lower rate of return, but even this is still uncertain. Huge sunk costs and the physical limitations of both the supply of gas and electricity plainly make it impossible for new players to enter either market. The monopolists' positions in both these utility markets appear to be unassailable.

B. PRICE-FIXING AT THE PORTS

The seaport was the principle reason for the British seizure of Hong Kong in the 19th century. It was one of the few deep-water, typhoon-sheltered anchorages along the southern coast of China. The port remains one of the world's busiest container terminals, but the vast majority of its throughput originates in, or is destined for, mainland markets, not domestic Hong Kong consumption. Approximately 20 million containers are handled annually but growth has been slowing in recent years due to several factors discussed later in this paper. The port is owned by two local, property-based companies Hutchinson-Whampoa and Warf Holdings, which control approximately 80 percent of the traffic, and by Dubai's DP World and Singapore's port monopolist, which controls the other 20 percent.

Hong Kong has the highest terminal handling charges (THCs) in the world. Port operators set the THC with shipping lines which charge the freight shippers the THC in addition to freight rates. The calculation of the THC is not transparent and shippers suspect that there is a high profit element split between the

8 For details of the Schemes of Control, *see* HK Electric, *Scheme of Control Agreement* (May 6, 2005), *at* http://www.hec.com.hk/hehWeb/AboutUs/SchemeOfControlAgreement/Index_en.htm (last visited Oct. 4, 2007).

port operators and the shipping lines. It is well-known that THC rates and cargo handling capacity utilization are set among the three port Hong Kong operators. In a 2005 *Financial Times* article, the managing director of the largest operator admitted to this price-fixing and capacity arrangement when the ownership of one of the smaller operators changed and the incumbents were anxious that the new owner would destabilize the existing cartel arrangement.[9] But cartels are lawful in Hong Kong and the government has no power to investigate or sanction such arrangements.

New port facilities immediately to the north of Hong Kong in the Pearl River delta create uncertainty for the future of Hong Kong's port. Most of the cargo handled by the Hong Kong port originates in, or is destined for, this manufacturing hub, and land transport of containers to the new, more proximate ports is considerably less costly than trucking the goods to Hong Kong. Shipping the goods through Hong Kong involves two sets of customs procedures as strict border controls exist between Hong Kong and the mainland. Terminal handling charges are also substantially lower at the mainland ports, reflecting the much lower costs of land and wages in the mainland compared to Hong Kong.

Until recently, the mainland ports were less efficient than Hong Kong and had less international connectivity, but these deficiencies are being addressed as container volumes increase and more shipping lines call at these new ports. Interestingly, both of the major Hong Kong port operators also have large equity stakes in the new mainland ports through various joint ventures with local mainland governments and state-owned shipping firms. As a result, the incumbents have a substantial conflict of interest in maintaining the competitive position of the Hong Kong ports. While they will continue to extract as much profit from their Hong Kong operations as they can, if the Hong Kong port declines over time, then the redundant prime waterfront sites could be easily redeveloped by their real estate-developer parent companies.

Both the existing structure and the behavior of the existing port operators need to be addressed in order to maintain the Hong Kong port's competitiveness, but it is a moot point as to whether the proposed competition law will have appropriate powers to deal with the relevant issues.[10]

C. THE RETAIL SECTOR

Turning to the retail sector, two incumbents, Park'nShop and Wellcome, dominate approximately 80 percent of the supermarket sector in Hong Kong. The

9 *Quoted in* Russell Barling, *End the Apathy, Mr. Tsang, and give our port a chance*, SOUTH CHINA MORNING POST, Feb. 3, 2006.

10 For an analysis of some of the issues facing the port, *see* ECONOMIC DEVELOPMENT AND LABOUR BUREAU, STUDY ON HONG KONG PORT – MASTER PLAN 2020 (2004), *available at* http://www.pdc.gov.hk/eng/plan2020/pdf/annex.pdf.

Hutchinson-Whampoa real estate conglomerate is the parent of the Watson's retail group. This entity controls Hong Kong's leading electrical retailer, Fortress, the leading personal care chain, Watson's, and the largest supermarket chain, Park'nShop. Wellcome is owned by Dairy Farm, the retail subsidiary of the local Jardine Matheson conglomerate. Supermarkets in Hong Kong are small by international standards and the local market has significant idiosyncrasies. Most shoppers buy only what they can carry home from the stores since 90 percent of Hong Kong residents do not own automobiles. Grocery shopping is done on a daily basis, especially for fruit, meat, and fish, because of limited storage capacity in cramped Hong Kong kitchens and a cultural preference for fresh produce. Most supermarkets are within the vicinity of large condominium developments, where the vast majority of the population live (houses are the preserve of the very rich or of traditional village dwellers). Supermarkets in Hong Kong are not located on standalone sites with extensive parking lots. These peculiarities of the local market, along with site scarcity, determine market structure.

Both organic growth and the acquisition of sites enabled the two incumbents to attain their dominant positions. International grocery retailers have attempted to enter the local market, but have failed to gain sufficient sites to make operations viable. Allegations have surfaced that landlords affiliated with the two main players were reluctant to lease premises and that all available sites were already occupied. Hong Kong's urban area is extremely densely packed and large retail sites are very rare. Carrefour, the French grocery giant, opened and then withdrew from the local market in the 1990's citing these constraints. Later it alleged that the incumbents were unhappy that Carrefour might sell at discounted prices. Allegedly, suppliers, either voluntarily or at the behest of the incumbents, applied commercial pressure by threatening to deny supplies of merchandise unless retail price maintenance was adopted to ensure that price competition was suppressed.

Another example of alleged abuse of dominance occurred when a new market entrant, Ad Mart, sought to adopt a no-store Internet and telephone ordering service with free home delivery. This new entrant was allegedly forced out of business by the actions of the two incumbents. Selective price-cutting and pressure on suppliers not to deal with Ad Mart forced the closure of the newcomer within nine months. Such practices are lawful, however, and no investigation of the allegations was undertaken. The Hong Kong Consumer Council has made allegations of price-gouging against the incumbents, but the firms have resolutely denied price-fixing or any collusive conduct and, in any event, the government is powerless to determine the facts or take any action given the lack of a general competition law.[11]

11 For an analysis of the supermarket sector in Hong Kong, *see* Mark Williams, *The Supermarket Sector in China and Hong Kong: A Tale of Two Systems*, 3(2) Competition L. Rev. 251 (2007), *available at* http://www.clasf.org/CompLRev/downloads/Vol3Issue2.htm.

D. PETROLEUM PRODUCTS

The supply of petroleum products has generated substantial controversy over the years in Hong Kong. The market for fuel for private vehicles is small and highly concentrated as less than 10 percent of the Hong Kong population owns an automobile. The supply of motor fuel was investigated by government-appointed consultants in an attempt to discover if the lack of price competition results from the inherent oligopolistic structure of the market or whether actual collusion between suppliers takes place. Unfortunately, the study was fundamentally flawed as the investigators had no legal power to obtain evidence or question the parties. As a result, the investigating legal firm delivered an unsatisfactory report that could only rely on publicly available information or information that was provided voluntarily by the oil companies. Unsurprisingly, the report concluded that there was no evidence of actual collusion, despite the absence of price competition.[12]

E. CONSTRUCTION AND CARTELS

The construction industry in Hong Kong is widely suspected of engaging in extensive cartel activities. In 2005, the government attempted a criminal prosecution of a bid-rigging cartel that supplied iron gate sets for public housing units. The cartel was alleged to be a fraudulent criminal conspiracy at common law.[13] The participants did not dispute the existence of the bid-rigging ring, but denied dishonesty, an essential element of the offense. They maintained that they had received legal advice, had a commercial contract drawn up to regulate the consortium's activities, and had at no stage considered that they were acting unlawfully. Their lawyer gave confirmatory evidence at their trial. The judge dismissed the charge on the basis that the contractors honestly believed that they were not acting unlawfully, and that the prosecution could not provide evidence of the necessary dishonest intent.[14]

The supply of cement is also suspected to be cartelized, as are many other industries. The noodle manufacturers association sometimes announces uniform price increases.[15] The driving instructors association has attempted to set minimum prices for lessons on the basis that pernicious competition between instructors, and a declining market, was causing income reductions for instructors.[16]

12 Economic Development and Labour Bureau, Study of the Auto Fuel Retail Market (Dec. 31, 2005), *available at* http://www.compag.gov.hk/reference/fuel.pdf.

13 HKSAR v Chan William Cheu-hung and Others (DCCC 132 / 2005, District Court, March 16, 2005) (Wright J.).

14 *See id*.

15 *Consumers pay the price for HK's 'Free' Economy,* South China Morning Post, Jan. 6, 2005.

16 Polly Hui, *Driving school cartel stifling competition*, South China Morning Post, Apr. 8, 2005.

F. LAND SUPPLY

The supply of new private apartments is controlled by a tight oligopoly. Four main suppliers dominate the market, supplying over 80 percent of new apartments. The manipulation of apartment prices with tactics that artificially inflate sales and create a false market is common. The industry is also riddled with unfair trade practices such as deceptive calculations of usable floor area, which are virtually unregulated. Consumer protection laws are weak and the government refuses to enact stronger legislation. Coordination between sellers is also thought to exist to maintain price levels by inducing artificial scarcity. The two largest suppliers of apartments have the market power to independently set prices. Bid-rigging at government land auctions also takes place, as described earlier in this paper. The developers are able to influence or dictate government land supply and provision of public housing programs to ensure that prices, and therefore profits, are not depressed. Government stabilization measures during the great asset-price deflation from 1997 to 2003 attempted to cut off the supply of land and new public-sector units for sale to drive prices up. The government and the developers are intimately connected.

G. OTHER SERVICES

In the professional services sector, the medical association examination for foreign-trained doctors who wish to practice in Hong Kong has a very low success rate and may well be a disguised barrier to entry to protect local doctors' fee income. In the air-passenger market, it is suspected that a cartel operates at the wholesale level, though this has not been investigated by the public authorities.

Government procurement and the disposal of public assets (especially land), licensing schemes, and direct governmental participation in certain markets also distorts competition. For instance, funeral services in Hong Kong are provided by private firms, but they must be conducted from two large licensed premises owned by the government. Periodically, leases for funeral halls within these premises are auctioned. In the last round of auctions, the relevant department sold the leases on offer to the highest bidder, who was also the existing dominant operator in the market. This firm's existing position of market power was considerably increased so that it now controls over 70 percent of the funeral services market. As a result, it is likely also able to act independently of rival suppliers that hold very small market shares compared to the dominant undertaking. The effect on competition in the market was ignored—only the amount of revenue the government would reap was considered in the auction process.[17]

Government intervention in markets also has a propensity to create monopolies. For example, all trade exhibition facilities in Hong Kong are government-owned and operated, foreclosing this market to private firms completely. In

17 Sherry Lee, *Funeral threat to take over prices*, South China Morning Post, Dec. 8, 2006.

another case, the government took an equity stake in a trade logistics software company granting it a long-term monopoly in the electronic trade facilitation and customs clearance market. Legal gambling, as permitted by statute, is monopolized by a private institution, the Hong Kong Jockey Club. All other gambling is criminalized. As a result, government action directly creates and maintains some commercial monopolies for no apparent economic rationale.

International cartels affect Hong Kong markets in much the same way that they affect markets in other countries. Consequently, major construction projects, the supply of pharmaceuticals, heavy engineering machinery, and international air and sea transport are likely to be affected. Many of these cartels will increase public spending by applying higher-than-market costs to government procurement as well as directly affecting consumers. At present, the government is powerless to protect the public revenue or the consuming public from such abuses.

These examples demonstrate some of the competition problems faced in Hong Kong. Despite these obvious deficiencies in the competitive environment, there is intense skepticism, and often outright hostility, to the enactment of a general competition law by many business figures and industry associations in Hong Kong. They publicly claim that such legislation is an unnecessary and unjustified intrusion on their commercial freedom. They also fear government interference in their business operations and the specter of additional governmental control. However, this hostility is often contrived and irrational. In reality, business dislikes the notion of a competition law and simply desires the maintenance of the status quo to ensure that the intensity of domestic competition is suppressed so that incumbents can maintain existing levels of profitability. The next section outlines the contemporary competition debate and the development of policy in this area.

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IV. Pro-Competition Policy Development

The current policy debate commenced in 1992 when Lord Patten, the last British governor of Hong Kong, suggested that restrictive business practices might be harming Hong Kong's competitiveness. He initiated a number of sectoral inquiries to be carried out by the Consumer Council that culminated in a report on whether a competition law should be adopted and, if so, what kind would be most appropriate. The Consumer Council was, and still is, a statutory body funded by the government that had no mandatory powers to demand documentary evidence or to interrogate witnesses. The Council set about its work over the next four years and produced reports on various business sectors including banking, residential housing, supermarkets, domestic fuel supply, broadcasting, and telecommunications. The methodologies employed may have lacked investigatory powers, but nonetheless, significant competition failures were found. A final report issued in 1996 recommended the enactment of a comprehensive, cross-sector competition law.[18]

During the same period, the government took active measures to liberalize the monopolized telecommunications sector. The incumbent, Cable and Wireless, had a private, unregulated monopoly of all internal and external circuits. The introduction of pagers, and later mobile telephony, ate into its monolithic structure. The government created a telecommunications authority to oversee market liberalization through a licensing regime that impeded the dominant incumbent from destroying nascent competitors, subjected it to price control, and also to pro-competition licensing conditions. Other operators' licenses contained similar prohibitions against abuse of dominance and cartel activities as well. Broadcasting was also subjected to market liberalization and a pro-competition regulatory regime.

The government's response to the Consumer Council's final report did not emerge until December 1997, more than five months after the retrocession of Hong Kong's sovereignty to the People's Republic. The Patten administration probably would have endorsed the report and proceeded with comprehensive competition legislation given its record in the telecommunications and broadcasting sectors, but the new administration, headed by a scion of one of the most important tycoon families, Tung Chee-wah, resolutely rejected the case for a cross-sector competition law. The government claimed that competition problems in Hong Kong were few, expressed skepticism that such laws were beneficial—especially in the particular context of Hong Kong, and questioned the need for anything more than an exhortation to businesses to abide by fair competition rules. The government offered a vague promise of sector-specific regulations, if necessary, in industries where egregious competition abuses could be proved to be causing serious economic damage. The government also set up the ad hoc interdepartmental committee, COMPAG, to monitor developments, promote the benefits of competition, and receive complaints.

COMPAG proved to be a toothless tiger. The committee promulgated exhortatory pro-competition policy statements, but received very few complaints. This was not surprising given that it had no staff, expertise, or legal powers to investigate, adjudicate, or sanction breaches of the policy guidelines.[19] On the other hand, commercial retribution for those who did complain was a powerful disin-

18 Consumer Council, *Competition Policy: The Key to Hong Kong's Future Economic Success* (November 1996), *available at* http://www2.consumer.org.hk/trd96/TRD96_E.HTM.

19 *See* Competition Policy Advisory Group, *About COMPAG* (June 8, 2007), *at* http://www.compag.gov.hk/about/ (last visited Oct. 4, 2007).

centive to dissent. Consumer-friendly political parties initiated legislative debates on the issues periodically, but received anodyne, stonewalling responses from ministers. The media highlighted apparent competition abuses on a fairly regular basis, but the government downplayed their importance and maintained the existing policy line. The exception was in the telecommunications sector in which the government responded somewhat differently, proposing and legislating substantive prohibitions with regard to abuse of dominance and restrictive agreements in 2000, and introducing a merger control regime in the sector in 2003.[20] The rationale for its differential treatment was not explained.

Essentially, government hostility to a general competition regime remained until the resignation of Mr. Tung and the assumption of power by his chief lieutenant, Donald Tsang Yam-kuen, in March 2005. Within a week of Tsang taking office the Financial Secretary announced the formation of a new government sponsored committee, the Competition Policy Review Committee (hereinafter the "Committee"), to revisit the existing policy position. The composition of the Committee included the Chief Executive of China Light and Power, various other representatives of businesses interests, and only two (out of thirteen members in total) consumer advocates, raising the specter that the review process was rigged. Despite this skewed membership, in June 2006, the Committee reported in favor of a cross-sector competition law[21] with three caveats:

1. the law should exempt natural monopolies (although natural monopolies were undefined);
2. the law should not contain a merger and acquisition control procedure; and
3. the competition authority should not have any structural divestment powers if the structure of an industry or a particular firm is seen to be having anticompetitive effects.

The Committee favored the formation of rules to prohibit abuse of dominance and anticompetitive agreements, the establishment of a competition authority, and the ability to impose penalties. The Committee did not recommend a particular structure for enforcement or indicate whether an administrative body with investigatory and adjudicatory powers or a prosecutorial agency that would have to prove cases before special tribunal or the ordinary courts would be more appropriate. The Committee did not explain the need for a change of policy or the rationale for its recommendations. After a five-month public consultation period from October 2006 to March 2007, the government announced that it had

20 *See* Telecommunications Ordinance, c. 106 (2007), at §§ 7K, L, M, N & P, *available at* http://www.legislation.gov.hk/eng/home.htm.

21 Competition Policy Review Committee, *Report on the Review of Hong Kong's Competition Policy* (June 2006), *available at* http://www.cedb.gov.hk/citb/ehtml/pdf/speech3/CPRC.pdf.

accepted the recommendation of the Committee to proceed with enacting a cross-sector law, but that the details of the ordinance would be subject to further consultation prior to the introduction of draft legislation in December 2007.[22]

The government has a number of contentious issues to resolve before finalizing the new competition bill. First, Hong Kong is not a democracy. The government does not command automatic majority support in the legislature, but instead, depends on ad hoc coalitions of interest groups to secure passage of legislation. Business constituencies control 50 percent of the Legislative Council seats and effectively wield a veto power over legislation that is considered unfriendly to business interests. Consequently, the passage of legislation is never a forgone conclusion.

Second, the case for natural monopolies exemption is exceptionally weak since, with the exception of the water supply, all of the companies in the utility sector are privately owned and not subject to a regulatory regime. In the absence of competitive pressure or regulatory control, private monopolists have every incentive to favor shareholder profits over the public interest. Indeed, the directors have a fiduciary duty to shareholders to maximize returns on investment to company members, but no corresponding legal obligation to any other stakeholders. Consequently, the argument to exempt private sector natural monopolies has no rational basis and is no more than a political compromise to assuage the opposition of the powerful incumbents.

Third, exempting mergers or acquisitions would clearly create an incentive for cartel operators to combine into single economic entities to avoid the illegality of continuing cartel arrangements. If consolidation proved difficult, alternatively conglomerates could exchange assets (e.g., a tycoon-led firm might swap its ports assets for a rival's retail assets), becoming more dominant in a particular sector, but relinquishing a presence in others. Merger control already exists in the telecommunications and broadcasting sectors and it is logically indefensible to not have a regime in other sectors, if it is accepted that a level regulatory playing field is beneficial. Providing such powers to a regulatory authority is necessary to create a well-functioning and comprehensive, pro-competition system. The best solution is probably to delay introduction of the merger rules until the new system is established, with the possibility of swiftly implementing it should a merger wave develop.

Fourth, the possible lack of appropriate powers for the new competition authority to investigate passive structural impediments to competition and, if necessary, to require divestiture so as to promote competition, significantly weakens the effectiveness of a pro-competition regime. The dominance of a small

22 News Release, Hong Kong Economic and Trade Office, Government Releases Report on Public Consultation on Competition Policy (March 19, 2007), *available at* http://www.hketosf.gov.hk/usa/press/2007/mar07/031907.htm.

number of conglomerates in the Hong Kong economic landscape is probably the single biggest inhibitor of new market entrants. Clearly, such divestiture provisions are complex to administer and fraught with potential difficulties, but they should be available as a last resort in situations in which a behavioral remedy is difficult to apply or impossible to monitor.

At present, it is impossible to say whether the government will act wisely and impartially, or whether the political calculus of assuaging the vested interests will outweigh the public interest in coherent legislation. Passage of the bill, even in an attenuated form, may be a first step along the path to the introduction of a rational and comprehensive system. The temporary sacrifice of an optimal regime may be the price the government has to pay to establish a rudimentary antitrust system in Hong Kong.

A final issue worth highlighting is the matter of the telecommunications and broadcasting sectors. The government has already announced that, in light of technological convergence and international regulatory developments, it intends to unify the substantive law governing these sectors and to create a communications authority to replace the existing sector-specific regulations and administrative bodies. Both of these sectors are currently subject to competition rules, but they are not congruent, either in terms of the statutory language or administrative structure. The issue is whether the new communications authority should assume competition powers or whether the new general competition agency should assume them in the communications sector as well as in all other sectors of the economy.

Existing competition authorities handle this matter in different ways. In the United Kingdom, there is concurrency between the regulatory and competition authorities. In Australia, the competition agency handles communication competition matters itself. Hong Kong has abundant financial resources, but very limited human capital in the competition field. It would seem most appropriate, given Hong Kong's small economy, for competition expertise to be focused in one agency rather than split between two bureaucracies to benefit from economies of scale and scope.

V. Conclusion

The analysis presented in this paper suggests that Hong Kong, while admirable in many ways from a laissez-faire economic perspective, has a number of hidden structural imperfections that prevent competition from taking place at all in some sectors and reduce the intensity of competition in many more. The government's land monopoly, its direct intervention and control of some markets, and some of its regulatory schemes that restrict competition are all cause for concern. While the previous policy of denial and evasion has given way to a tacit acceptance that problems do exist, political influence and the power of vested commercial interests may force the government to propose an unsatisfactory or compromised antitrust regime that will fail to address the important competition issues inhibiting the Hong Kong economy. The development of the ordinance in the next year should reveal whether these concerns are well-founded or not. Whatever the outcome, at least Hong Kong will have the semblance of a general competition regime in place at long last.