

Testimony before the United States China Economic and Security Review Commission

Hearing on: “The Foreign Investment Climate in China”

by

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Regarding the Legal and Regulatory Context for China’s Antitrust Enforcement

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Mr. Chairman and members of the Commission, thank you for inviting me to participate in this hearing. My name is Elizabeth Wang. I am a competition economist based in Boston at Charles River Associates, a global consulting firm specializing in litigation, regulatory, and financial consulting. I am a Co-Chair of the China Committee and a Vice Chair of the International Antitrust Committee of the International Law Section of the American Bar Association. I am also a Senior Research Fellow and Economist at the Competition Law Centre, University of International Business and Economics, in Beijing, China. I was born and raised in China, and I received my PhD in economics from the University of Chicago. I have 15 years of experience consulting on antitrust matters both in the US and in China. With regard to my work related to China, I advise clients on merger reviews, antitrust investigations, and private litigation. I also frequently meet with Chinese regulators and economists at conferences and through my case work. My testimony today reflects my knowledge of China’s antitrust enforcement from my experience as an economic consultant.

I. Background on China’s Anti-Monopoly Law and its Enforcement Agencies

I will start my remarks with a brief background on China’s Anti-Monopoly Law (AML) and its enforcement agencies to provide a general context to help understand some of the characteristics of China’s enforcement of the AML.

A. General Context

First, China is in the process of transitioning from a planned economy to a market economy. It does not yet have the same type of open and mature market economy as that in the US, Europe, Japan, and many other developed countries. Many companies are state owned. Certain others, while private, lack the full autonomy to make key business decisions such as setting prices, developing new product lines, and selecting the company’s management.² While economic reform and privatization have changed the economic landscape, it is taking some time for policy makers and even business people to adopt a full

¹ The views expressed herein are the views and opinions of my own and do not necessarily reflect or represent the views of Charles River Associates, or any of the organizations with which I am affiliated.

² For more discussion about China's transition from a planned to market economy, see Greg C. Chow, “Development of a more market-oriented economy in China,” *Science*, vol. 235, January 16, 1987, pp. 295-299.

market economy mind-set, or for market price signals to allocate resources. These are key steps to developing a free and open marketplace.

Second, China is still at an early stage in implementing the AML. Antitrust law is complex, evolving, and constantly presents new challenges. Antitrust law has 125 years of history in the United States.

Experience has taught antitrust practitioners that competition analysis often requires a fact-intensive, case-by-case assessment, guided by economic principles and backed by empirical analysis. Since China's AML went into effect six years ago, the agencies in charge of enforcing the AML have made efforts to raise the awareness of the AML with key stakeholders, such as consumers, government administrative bodies, courts, and business communities in China and abroad. Nonetheless, China's AML enforcement teams are resource constrained, and they are still in the process of developing institutional knowledge and gaining practical case experience working with, and applying, economic models of competition and empirical techniques. The AML agencies are new and have been operating with a relatively small group of regulators and antitrust practitioners. It is my understanding that the three AML agencies combined have fewer than a dozen PhD economists. By comparison, the Antitrust Division of the US Department of Justice (DOJ) and the Federal Trade Commission (FTC) together employ well over 100 PhD economists.

B. AML Enforcement Agencies – Resources and Roles

China has three agencies charged with the responsibility of enforcing different areas of the AML. The AML bureaus were established around the time when the AML became effective in August 2008.

- The Anti-Monopoly Bureau is within the Ministry of Commerce (MOFCOM). MOFCOM is a large ministry whose primary responsibility is to grow China's international trade and foreign investment. The Anti-Monopoly Bureau is responsible for antitrust review of proposed mergers and acquisitions. It is one of 31 bureaus in MOFCOM. Currently, the Anti-Monopoly Bureau has 30 to 40 staff members, roughly half of whom are involved in case handling. Only three of its staff members have PhDs in economics.³
- The Price Supervision and Anti-Monopoly Bureau is part of the National Development and Reform Commission (NDRC). The NDRC's primary responsibility is to develop plans for China's economic and social development, such as energy policy, the balance of economic activity across China's geographic regions, and pricing regulations. The Price Supervision and Anti-Monopoly Bureau is one of 33 bureaus within the NDRC. It is responsible for the enforcement of prohibitions against price-related monopolistic conduct under the AML. The Bureau's antitrust enforcement team currently has over 40 staff members, five or six of whom have PhDs in economics.
- The Anti-Monopoly and Anti-Unfair Competition Bureau is part of the State Administration for Industry and Commerce (SAIC). The SAIC has the primary responsibility for market supervision and regulation including consumer protection, trademark registration, and enterprise registration. The Anti-Monopoly and Anti-Unfair Competition Bureau is one of 15 bureaus within the SAIC. It is responsible for the enforcement of prohibitions against non-price-related monopolistic conduct under the AML. The Bureau's antitrust enforcement team

³ There is no publicly available information on staffing levels at the three AML agencies. The information provided here is based on personal observation.

currently has approximately 15 to 20 staff members, one or two of whom has a PhD in economics.

The NDRC and SAIC also have regional offices involved in AML investigations. However, high profile cases are handled by the central office which provides guidance and direction for local enforcement.

II. Enforcement of AML

There have been many AML enforcement actions since 2008. I will provide an overview of these merger reviews and administrative enforcement actions, with a particular focus on foreign firms in the context of case selection and outcome.

A. Merger Review

Like US antitrust law, the AML requires that *all* mergers and acquisitions meeting certain thresholds obtain antitrust clearance with MOFCOM before a transaction can be consummated.⁴ From August 2008 through the end of 2014, MOFCOM reviewed 1,006 proposed mergers and acquisitions. The agency approved 980 transactions (97.4% of total reviewed) without conditions, rejected two proposed transactions outright, and approved 24 transactions with conditions.⁵

Two publicly available studies indicate that a large majority of transactions reviewed by MOFCOM involve foreign companies. One study shows that from August 2008 to June 2013, 82% of acquisitions and 90% of non-acquisitions (mostly joint ventures) reviewed by MOFCOM involved at least one foreign company.⁶ The other study shows that from August 2008 through the first quarter of 2014, 92.4% of transactions reviewed by MOFCOM involved at least one foreign company.⁷

These statistics do not include all the transactions that should be filed for the AML review. MOFCOM has recognized the issue of under-reported (particularly domestic) transactions⁸ and has taken steps to punish companies who fail to notify the agency of transactions meeting reporting thresholds. On December 2, 2014, MOFCOM imposed its first fine of RMB 300,000 (approximately USD 48,000) on Tsinghua Unigroup for failure to notify its acquisition of RDA Microelectronics in 2013, an acquisition involving two Chinese companies.⁹

As previously noted, 97.4% of the transactions reviewed by MOFCOM have been cleared without conditions. This is comparable to similar statistics in the US and EU. In the 26 cases where MOFCOM

⁴ These thresholds are: each of at least two business operators must have sales in China in excess of RMB 400 million (USD 65 million), and the combined sales of all the business operators must exceed (i) RMB 10 billion (USD 1.6 billion) on a worldwide basis; or (ii) RMB 2 billion (USD 325 million) in China. These thresholds are lower than those required in the EU. The US Hart-Scott-Rodino filing uses a different approach so it is difficult to make an apples-to-apples comparison.

⁵ MOFCOM statistics about transactions cleared without conditions and MOFCOM's announcements about transactions with intervention are available on the MOFCOM website. The information is in Chinese.

⁶ Fei Deng and Cunzhen Huang, "A Five Year Review of Merger Enforcement in China," *The Antitrust Source*, chart 3, October 2013.

⁷ Lester Ross and Kenneth Zhou, "MOFCOM to Publicize Administrative Penalties for Illegal Implementation of Concentrations," WilmerHale, April 21, 2014.

⁸ MOFCOM press release, January 10, 2012 (in Chinese). MOFCOM's press conference regarding draft regulations on the investigation and treatment of failure to report concentration.

⁹ MOFCOM Administrative Penalty Announcement No. [2014] 788, December 8, 2014 (in Chinese).

intervened, none were purely domestic transactions (that is, involving two Chinese companies) though five involved at least one Chinese party, and the remaining 21 involved solely foreign firms. MOFCOM reports its economic findings and competition concerns for each of the transactions in which it intervenes. These announcements over time have provided increasing detail and evidence of growing sophistication. The business and antitrust communities could further benefit from announcements that provide more detailed reasoning and fuller descriptions of the supporting evidence behind MOFCOM's decisions.

B. Administrative Investigations of Monopolistic Conduct

To date, investigations initiated by the NDRC account for a majority of China's administrative investigations into alleged AML violations related to monopolistic conduct. The investigations have focused on price fixing agreements, retail price maintenance agreements, and abuse of dominance matters alleging excessive prices. While excessive pricing is not an antitrust concern under US law, it is included as a concern in the AML. Based on the statistics provided by the Director General of the Price Supervision and Anti-Monopoly Bureau of NDRC, between August 2008 and the summer of 2014, the NDRC and its local branches investigated 339 entities. Of these entities, 33 (10%) were foreign or foreign-controlled companies. The rest (90%) were state-owned enterprises, private domestic firms, and industry associations.¹⁰

The NDRC has not disclosed information on all of the penalties it has imposed as a result of AML violations. While the NDRC often imposes multiple types of penalties for a given violation,¹¹ fines expressed as a percentage of an entity's yearly revenue in China is a measure that may be used to compare the size of penalties across different companies. The NDRC website reports that information for 70 entities (including 50 Chinese entities and 20 foreign entities) in a number of industries such as insurance, travel agencies, auto parts, and retail. These data indicate that the average fine percentage imposed was roughly 2.2% of annual revenues for Chinese entities, and 4.0% for foreign entities.¹² More data and more complete analyses are needed before any definitive conclusions can be drawn as to whether foreign firms pay systematically different fines than Chinese firms, while controlling for other relevant economic factors.

From August 2008 to the end of 2014, the SAIC and its local branches investigated 43 cases of alleged AML violations, concluded 19 investigations, and suspended one investigation. Two investigations (5%) involved foreign-invested companies, while the remaining 41 cases involved Chinese firms or industry associations.¹³ To date, SAIC investigations have focused on cartel agreements (e.g. market division) and

¹⁰ "Foreign companies are a minority among targets of Chinese antitrust regulators, senior official says," *MLex*, December 8, 2014.

¹¹ For example, in NDRC's investigation of LCD price fixing, the penalties imposed on the six LCD suppliers include restitution in the amount of their illegitimate profit from the sale of LCDs in China, and commitment to abide by China's laws, engage in fair competition and extend the warranties on LCD products, in addition to paying fines based on their revenues.

¹² NDRC penalty information collected from penalty announcements on NDRC website (in Chinese). I supplemented NDRC's announcements with general internet searches for information about several high profile investigations and about specific fine amounts.

¹³ "China's SAIC, local agencies initiated 13 new antitrust investigations in 2014, official says," *MLex*, December 8, 2014.

abuse of dominance conduct (e.g. bundling). The SAIC imposed fines totaling RMB 19.7 million in 2013 and 2014 combined, all of which were on Chinese firms.¹⁴ Both of the SAIC investigations involving foreign companies are ongoing as of this testimony.

Based on the statistics provided by the two agencies, 10% of the entities investigated by the NDRC and 5% of the cases investigated by the SAIC involved foreign firms. These figures by themselves do not suggest a conclusion that there has been a systematic targeting of foreign firms in administrative AML investigations. However, there is insufficient data to allow us to conclude whether fines imposed on foreign firms are systematically different than those imposed on Chinese firms when fines are imposed, after controlling for other relevant factors.

III. Non-traditional Considerations in AML Enforcement

In principle, the AML allows the state and the AML enforcement agencies to take into account factors beyond traditional antitrust considerations in AML enforcement. Article 27.5 of the AML states that “the development of [China’s] national economy” shall be considered as one of the factors in China’s merger review. A broad reading of Article 4 (“The State will formulate and implement competition rules compatible with the socialist market economy, perfect macroeconomic control and develop a sound uniform, open, competitive and orderly market system.”) could allow the NDRC and the SAIC to take into account factors beyond traditional competition issues in their AML investigations.

In addition, the institutional context of the three AML enforcement agencies might allow their respective “supervising” ministries, which have a wide range of administrative functions, to influence AML enforcement. The personnel of each AML enforcement bureau are appointed by their respective ministry. In principle, the ministry leadership approves the final decision in major AML cases. Therefore, ministry goals beyond AML goals could possibly influence AML enforcement through various means.

It is unclear at this stage whether non-traditional competition factors have actually affected AML enforcement decisions; and if so, exactly which factors played a role in which cases, to what extent such non-traditional competition factors influenced the case outcome, and whether China applies a different standard in considering those factors when analyzing purely domestic conduct versus conduct involving foreign firms. One key challenge to understanding this effect is the lack of sufficient transparency in reasoning and fact finding behind some enforcement decisions. Information on AML agencies’ decisions is scarce. When the information is made available, it is often brief and offers limited insight into the agencies’ thinking process, especially for complex antitrust matters not involving cartels.

The agencies often have access to information (sometimes confidential information) that they cannot and do not make available to the parties involved or to the general public. For example, MOFCOM often seeks and receives information from stakeholders such as trade associations and customers. As a result, it is difficult to unravel the boundaries of competition concerns and to refute suspicion that non-traditional competition factors might affect AML enforcement decisions. Regular dialogue with the case teams and parties involved, with an emphasis on fact finding and economic analysis of the information provided,

¹⁴ “Comment: SAIC ends 2014 with record fines of 14.5 million yuan, seen active in 2015,” *MLex*, January 7, 2015.

could lead to a greater understanding of how non-traditional competition factors, if any, are considered in AML enforcement.

IV. Conclusion

China's AML regime features new agencies carrying a heavy case load involving complex antitrust issues within a changing economic and legal framework, due to, at least in part, China's large, diversified, and dynamic economy. These factors combined magnify the difficulties and challenges the AML enforcers face. News coverage has provided anecdotes of foreign companies frustrated with China's AML enforcement. My understanding is that a good amount of the frustration is due to growing pains associated with the early stages of a developing antitrust regime in China's transitioning economy. Working with Chinese AML agencies to help them move along the learning curve expeditiously will be useful in overcoming these effects. Future efforts could include engaging in detailed dialogue on the agencies' decision-making, encouraging more transparency through disclosure of economic analysis and fact finding, and helping regulators focus on competition analysis.