Hearing on the Foreign Investment Climate in China: Present Challenges and Potential for Reform

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Introduction: China's Antitrust Experience in Context

In any country, the introduction of a system of competition law is a difficult, time-consuming endeavor. No nation gets it right in the first year, or even the first decade. In the United States, for example, it took roughly a half-century (from 1890 to 1940) for the country to settle upon competition as the core principle for economic organization and to give antitrust enforcement a central role in making markets work for consumers.[2] Modern U.S. antitrust experience has featured important changes in the legislative framework, doctrine, and enforcement policy. The process of building an effective competition law system is an ongoing process of experimentation, assessment, and refinement.[3]

The challenge of creating an effective competition law system is still greater in countries, such as China, which have adopted competition laws to facilitate the transition from reliance on central planning and state ownership toward a market-based economic regime in which the private sector assumes greater responsibility for the production of goods and services.[4] Three basic obstacles have confronted the implementation of China's Antimonopoly Law (AML), which

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[2] This history is recounted in William E. Kovacic & Carl Shapiro, Antitrust Policy: A Century of Economic and Legal Thinking, 14 Journal of Economic Perspectives 43 (2000).
[3] This cycle is analyzed in William E. Kovacic, Achieving Better Practices in the Design of Competition Policy Institutions, 20 Antitrust Bulletin 511 (Fall 2005).
[4] The difficulties of creating a competition policy system in formerly planned economies are examined in William E. Kovacic, Institutional Foundations for Economic Legal Reform: The Case of Competition Policy and Antitrust Enforcement, 77 Chicago-Kent Law Review 265 (2001).

took effect in August 2008. The first is to build awareness of the competition law and to gain acceptance for market-based competition as the foundation for good economic performance. This is an especially daunting task where powerful interests within and outside the government regard competition with suspicion and desire to protect economic structures established during the era of planning and comprehensive state ownership.

Competition creates considerable benefits for society, but it also disrupts. Competition can dramatically alter the fortunes of individual firms and the communities in which they reside. A competition agency in any country must persuade government policy makers and the larger society of the benefits of the continuous process of competition-driven industry transformation, and it must discourage reliance on economic policies that would freeze in place an existing configuration of products and services and the firms that supply them.

A second formidable endeavor is to establish effective institutions to implement the law.[5] Among other measures, this requires the formation of new entities to enforce the competition law and the establishment of capacity within existing bodies (e.g., the courts) to carry out duties related to the new law. Good performance by these bodies, in turn, requires the development of a strong supporting intellectual infrastructure – including the establishment of university departments that teach courses in economics, business, law, and public administration relevant to competition policy. No jurisdiction can succeed in implementing a competition law without the contributions of these and other collateral institutions.

A third necessary measure is to establish a culture of public administration that emphasizes informative disclosure of decisions taken by the competition agency and the reasons for the agency's actions. This is not a natural or welcome step within a bureaucratic tradition that has no custom of explaining administrative decisions or making public officials available for routine discussions of agency policy in settings such as conferences convened by professional societies.

[5] On the institutional design choices associated with the creation of a competition policy regime, see David A. Hyman & William E. Kovacic, Competition Agency Design: What's on the Menu?, 8 European Competition Journal 527 (2012).

Approximately 125 jurisdictions have created systems of competition law. Some of these systems (e.g., Canada and the United States) were formed in the late 19th century. Most systems are relatively new. All but roughly twenty of the existing competition law systems have been formed since 1990. No two of the jurisdictions to enact competition laws are identical. Variations in cultural, economic, historical, legal, and political circumstances abound. Despite these differences, it is possible to derive at least two generally applicable principles from experience with competition law.

First, the construction of an effective competition law system takes considerable time. Accomplishment of the tasks identified above can be, and often is, a long journey. It can easily require decades to set the foundations of the implementing institutions soundly in place and to establish the capacity of the new enforcement agencies to apply the law in an effective manner. It is important to keep in mind that China is still in the earliest stages of developing its competition law system. China has made considerable progress in a relatively short time to implement its law, yet considerable work remains to be done.

The second proposition is that successful competition systems require periodic upgrades. The starting point for a new system, in terms of the design of the law and its implementing institutions, is perhaps less important than the care with which a jurisdiction takes stock of its experience and makes improvements over time. Good practice consists of a commitment to assess the existing framework on a regular basis and to make refinements. Experience in other jurisdictions suggests that an ideal time for a new regime to assess its progress and consider refinements is between five and ten years out from the creation of the system. Thus, a reexamination of China's antimonopoly system, six years since its establishment, is timely and desirable.

Compared to other relatively new competition systems, China has accumulated substantial experience in the implementation of the AML in a very short period of time. Given the difficulty of creating a new legal regime in any country and the specific difficulties of establishing a competition regime as part of a fundamental economic transition, this record is a major accomplishment. Thus, from a comparative perspective, China has progressed relatively rapidly down the learning curve.

No legal reform of this magnitude is frictionless. All nations that have adopted competition laws have learned that the emergence of an effective new regime is a slow growth. From careful reflection upon international experience, it is possible for a newer system to mitigate implementation difficulties, if only by anticipating problems that appear universally, regardless of the distinctive circumstances of each jurisdiction. Even with astute examination of foreign experience, some difficulties in the reform process are unavoidable. Even when a driver is equipped with excellent maps and guidebooks, the experience of driving an automobile for the first time in a large, unfamiliar city is a voyage of discovery. The only way to discovery the best way around town is to drive the car through it.

Experience with the implementation of competition laws in over 125 jurisdictions with competition law systems indicates the benefits to any nation (including China) of periodic upgrades. That is why there is special value to a new system from undertaking a basic assessment of possible reforms from five to ten years after the enactment of the competition law. This provides sufficient experience to understand the strengths and weaknesses of the initial design.

China's Antimonopoly System: Possible Focal Points for Refinement

As established in 2008, China's antimonopoly law contains the basic portfolio of commands that one would observe in many of the world's competition systems. After carefully examining experience in other jurisdictions, China devised what in many respects is a state of the art law that addressed the core areas of competition law: horizontal restraints, vertical constraints, mergers, and abuse of dominance. Presented below are some possible focal points for examination as China considers the path ahead.

Competition Law in Multi-function Agencies

China assigned enforcement responsibility to three agencies: the Ministry of Commerce (MOFCOM, which performs merger control; the National Development and Reform Commission (NDRC), which has jurisdiction over price-related offenses; and the State Administration for Industry and Commerce (SAIC), which has jurisdiction over non-price related offenses. NDRC and SAIC, have preexisting mandates that are related to the AML and continue to bear upon the implementation of the AML. NDRC has competence to enforce China's pricing

law, which supplies a separate mandate to set limits on some pricing decisions. The NDRC unit that enforces the AML also is responsible for enforcing the pricing law, and there have been NDRC investigations whose foundations – pricing law or AML – have not been clearly specified. In addition to its AML duties, SAIC has competence to enforce China's law prohibiting unfair competition, a command that applies, among other matters, to misleading advertising and marketing practices. The SAIC unit responsible for AML enforcement also is entrusted the implementation of the unfair competition law.

China is not alone in giving the competition authority other law enforcement duties.[6] A number of other jurisdictions have given the competition agency a mandate to enforce prohibitions on unfair competition. The question of which agency should do what depends heavily on the analytical connection across the different functions. Where there are strong conceptual complementarities across the functions, it can make sense to combine them in a single agency. Where the functions are intellectual substitutes, it is ordinarily best to locate the functions in separate bodies. The possibility for conflict between functions would be greater between NDRC's residual price control authority and its duties under the AML.

Even when the functions are complementary, the unification of discrete tasks in one body can blur the "brand" of the institution and reduce the clarity of its mission. A single-function agency has the advantage of being able to define its aims clearly and to resist confusion about its aims and priorities.

The Structure of Public Enforcement Institutions

For a variety of understandable reasons, China distributed public enforcement authority across three agencies. For the future, China might revisit this decision and consider a rationalization that would unify the AML functions of the three existing antimonopoly bureaus in a single institution. The historical trend in many other jurisdictions (though not all nations) has been to move antitrust-related functions to a stand-alone entity. Were China to take this path, non-AML functions would remain with their existing host institutions. Thus, NDRC would continue to enforce the price law, and SAIC would continue to enforce the law on

[6] See David A. Hyman & William E. Kovacic, Why Who Does What Matters: Governmental Design and Agency Performance, 82 George Washington University Law Review 1446 (2014).

unfair competition – perhaps as part of a larger mandate that would make SAIC China's principal consumer protection agency.

In all three of these agencies, the antimonopoly bureau is a small unit within a large, diverse bureaucracy. In each case, the new antimonopoly bureau has confronted the task of establishing a presence within an institution with well-ingrained customs and power centers. To a considerable extent, the competition policy mandate of the antimonopoly bureau coexists with other duties that are in tension with or inconsistent with pro-competition economic policy.

The subdivision of policymaking authority across various government bodies also can undermine the coherence of the competition policy regime. The foremost concerns in this respect arise in the relationship between NDRC and SAIC. As noted above, NDRC is responsible for price-related non-merger matters, and SAIC oversees price-related conduct. This is an inherently murky delineation of policy tasks. One could argue that many (if not most) business practices ultimately affect the prices a firm charges. By this reckoning, NDRC could assert that its mandate covers non-price arrangements (e.g., a tying agreement or an exclusive dealing contract) nominally assigned to SAIC. In addition, there are a number of instances in which a firm adopts a strategy that employs a combination of practices – some price-related, some "non-price." A consumer goods producer, for example, might use a resale price maintenance and exclusive territories to distribute its goods. Is such a case properly assigned to NDRC, SAIC, or to both? Such questions of allocating enforcement tasks inevitably will arise between NDRC and SAIC in the implementation of the AML. Not only is this a source of possible tension and a coordination burden between NDRC and SAIC, but it also is a source of uncertainty for firms which are attempting to discern which Chinese agency has authority to review specific episodes of business conduct.

Nor is it safe to assume that merger control has no connection to non-merger areas of competition law. The scrutiny of cartels and the evaluation of coordinated effects theories of merger control share a common analytical core.[7] In the course of enforcing prohibitions against cartels, an agency can learn a great deal that is useful in predicting when firms might succeed in engaging in tacit coordination following a merger. It is possible for separate cartel (NDRC) and

[7] These connections are explored in William E. Kovacic, Robert C. Marshall, Leslie M. Marx & Steven P. Schulenberg, Quantitative Analysis of Coordinated Effects, 76 Antitrust Law Journal 397 (2009).

merger (MOFCOM) agencies to share relevant information and analytical perspectives through interagency cooperation, but the joining up of relevant information might take place more readily and completely if carried out within the same institution.

For any jurisdiction, multi-agency configurations raise the costs of coordination not only at home but in foreign relations. Such complications arise when China's antimonopoly system interacts with other competition systems internationally. Having three institutions increases the effort that must be taken to define and articulate the Chinese view about antimonopoly issues to individual foreign agencies or before larger international organizations.

Experience in other jurisdictions would suggest that at some point China will revisit the design of its public enforcement mechanism. A reassessment of the existing framework might consider whether to undertake a restructuring that would combine the functions of all three existing antimonopoly units into a single body, and whether to establish the unified institution as a stand-alone body. In other jurisdictions, these types of adjustment have sought to accomplish two ends. The first is to give the antimonopoly function greater coherence and visibility by removing the enforcement function from diversified policy conglomerates (in China's case, MOFCOM, NDRC, and SAIC) in which the competition mandates run a risk of being submerged or subordinated to other policy interests. The second is to unify policy responsibility to overcome the uncertainties associated with determining jurisdictional boundaries across agencies (e.g., the price/nonprice delineation of power between NDRC and SAIC) and to avoid the costs associated with coordinating activity among different institutions.

Restructuring measures along the lines sketched above would align China's system with trends globally in competition law. Within the past ten years, several jurisdictions (including Brazil, France, Portugal, Spain, and the United Kingdom) have combined two or more competition policy entities into a single public body. A number of relatively new systems (including Mexico and Morocco) have moved the competition enforcement function from a bureau within a larger ministry to give the antimonopoly function to a separate, stand-alone institution.

Not all jurisdictions have undertaken the simplification and integration measures outline above. Perhaps most notably, the United States continues to allocate enforcement responsibility between two public agencies (the Antitrust Division of the Department of Justice and the Federal Trade Commission). I have worked within the U.S. system for the past 35 years and has studied its operation carefully. I raise the possibility of simplification with an awareness of the costs that the United States regime incurs by sustaining its dual-agency enforcement mechanism.[8] I also acknowledge the tremendous forces of inertia that can impede, as they have in the United States, structural reforms.

It is important to note that public enforcement is not the only means for the implementation of competition law in China. An important design feature of the AML is the creation of private rights of action. As observed in experience with other competition law systems, the establishment of a private enforcement mechanism has two important implications. The first is that it divests the public institutions of their capacity to be the sole gatekeeper to determine the content and sequencing of enforcement matters. Private rights enable private parties – individual firms or consumers – to bring cases that the public authorities, for various reasons, have chosen not to prosecute and to accelerate the prosecution of matters that the public agency might have preferred to bring at another time.

Private rights provide a potentially powerful engine for doctrinal development and policy implementation beyond the control of government enforcement agencies. In only a few years, private rights of action have played an important part in the enforcement of the AML. Private cases have yielded important judicial decisions concerning abuse of dominance and resale price maintenance. The People's Supreme Court has issued guidelines to facilitate discovery and the presentation of evidence in private cases.

Agency Autonomy

It is a common precept of international experience with competition law that competition agencies should be "independent." Definitions of this concept vary, but the core idea is that the competition agency should have autonomy from

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[8] The costs of the federal dual enforcement mechanism in the United States are reviewed in William E. Kovacic, Antitrust in High-Tech Industries: Improving the Federal Antitrust Joint Venture, 19 George Mason Law Review 1097 (2012).

political branches of government in exercising its authority to initiate or resolve cases. At the same time, there is general agreement that a competition agency should be accountable to the political process for its policy choices – for example, by being required to disclose the basis for its decisions, by issuing statements of its priorities and enforcement guidelines, and appearing before political officials from time to time to discuss their enforcement programs. There also is a general awareness that a competition agency must have some connection with the political process if it is to function effectively as an advocate for competition before other government bodies.

China has no experience with "independent" regulatory bodies as the concept is defined immediately above. China's antimonopoly agencies confront at least two conditions related to their capacity to apply their enforcement powers with a necessary level of autonomy. As noted above, the antimonopoly bureaus of MOFCOM, NDRC, and SAIC are small subunits of large, diversified policy conglomerates. Within its host institution, each unit coexists with well-established bureaus with economic interests and policy views in tension with the competition law.

China's antimonopoly bureaus also face countervailing policy views and economic interests from government bodies located outside their own institutions. Examples include other ministries that oversee specific sectors or individual state-owned enterprises or government administrations at the provincial or municipal level. As in many other countries, these external bodies sometimes press the antimonopoly units to resolve individual matters in ways that favor the interests represented by the external bodies.

Procedure

To speak of good procedure for a competition system, I have three things in mind: quality control in the sense of a rigorous testing of evidence that leads to an accurate diagnosis of observed behavior, legitimacy that comes from the use of processes that give affected parties and the general public confidence in the soundness of the agency's methods and substantive conclusions, and the minimization of delay.

From international experience, it is evident that several characteristics of competition agency practice tend to promote the attainment of these ends. One essential foundation, is meaningful disclosure, or transparency. Competition agencies (or all government agencies, for that matter) do not always willingly embrace norms that promote fuller, meaningful revelation of information about their operations and decisions. I have noticed that this tendency is more pronounced in newer systems. The reluctance of newer competition agencies to disclose more information has many sources, including the fear of being bound in a rigid manner by past decisions, or the uncertainty that comes from limited experience with a field of law.

These misgivings are understandable, yet fuller disclosure serves to accelerate an agency's progress by strengthening internal decision processes and educating external audiences more effectively. For example, a leniency program is unlikely to succeed unless the competition agency is clear about the terms on which leniency will be available and about the conditions that firms must satisfy to quality. Meaningful disclosure also can stimulate a healthy debate about what the agency has done and assist the agency to identify possible improvements in its analysis and procedures. Thus, as a source of better guidance to affected parties and as a symbol of good governance, broader disclosure serves the interests of a new competition agency.

Over time, China's antimonopoly agencies have taken progressively greater steps to explain how they intend to apply the AML. In developing enforcement guidelines, China has followed the internationally accepted practice of issuing draft documents and soliciting comments from external groups. This is a valuable means for achieving a necessary degree of transparency – the meaningful disclosure of information about substantive decisions taken, the agency's priorities, and the analytical approach it uses to do its work.

As suggested above, agencies in the first phase of their institutional life tend to function more effectively as they disclose more about how they do business. This consideration presses in the direction of expanding existing initiatives to provide further guidance about enforcement intentions and analytical methodologies. Expansion of existing MOFCOM, NDRC, and SAIC efforts to provide guidance about agency enforcement intentions and analytical methods likely would serve to improve the implementation of China's AML. Means to this end include the

issuance of additional formal guidelines (e.g., the pending SAIC guidelines on competition law and intellectual property rights), public speeches and appearances at conferences, and the publication of answers to "frequently asked questions" about the content and application of the AML. These and elated measures can increase the effectiveness of China's enforcement regime by improving the transparency of its operations.

A second necessary element of good process is to provide the subjects of agency inquiries a meaningful opportunity to discuss the agency's theory of harm and to provide its own view of the theories and evidence the agency intends to apply. In widely accepted international practice, this approach involves allowing representatives of the company and its external advisors (e.g., its law firms and economic consultancies) to meet with the agency to discuss pending inquiries and proposed enforcement measures. The agency also should be responsive to the requests of affected parties about the status of existing agency inquiries and about the expected path of deliberations going ahead.

A third foundation for good process is judicial review of agency action. Recourse to effective judicial review provides an important safeguard against serious agency error and impels the agency to maintain high levels of internal quality control.

Perhaps the single area in which the urgency to increase the speed of agency decision making is merger review. Inordinate delays raise the uncertainty associated with carrying out routine transactions and complicate the completion of mergers involving firms active in dozens of jurisdictions. MOFCOM has taken major steps to introduce a simplified merger review procedure for matters that appear to pose no competitive hazards.

A further element of good process is a commitment to examine past experience as a way to improve future performance. A fundamental question concerning the enforcement of a competition law in any jurisdiction is effectiveness: How do we know that an enforcement program is accomplishing its intended aims – to cure existing competitive harms, to compensate victims, to deter future offenses? In many areas of competition law, enforcement has an inherent element of experimentation. Over time, a competition agency tests a number of approaches to solve specific competition problems, curing the effects of past anticompetitive

behavior, and obtaining deterrence. An important component of the selection of remedies is the development of even rudimentary means to assess whether they are working as intended.[9] Among other means, this can be achieved by performing even a rough comparison between the agency's expectations about future commercial developments and what actually transpired.

Human Resources

No single factor is more vital the success of a competition agency than the quality of its human capital. Through adequate resourcing and by building a high quality professional and administrative staff, an agency improves its ability to analyze accurately the competitive significance of business conduct and increases the speed with which it performs its work. Competition law systems with serious deficiencies in human capital often encounter a crippling mismatch between the commitments embodied in the competition law and the capacity of public institutions to fulfill their duties properly.

From the first days of the AML's implementation, China has given the three antimonopoly agencies too few resources to carry out their responsibilities. All three agencies have recruited some highly capable professionals and administrators, but the level of staffing falls well below the numbers that competition agencies in other jurisdictions have found necessary to operate effectively.

Understaffing can create at least five distortions in a competition law system. First, the agencies have too few resources to conduct in-depth inquiries in matters that warrant careful fact-gathering and analysis. Pursuant to the commands of the AML, the three antimonopoly agencies have undertaken ambitious agendas, including the examination of behavior involving considerable analytical and factual complexity.

Second, the lack of resources creates tremendous pressure upon the competition agency to obtain settlements to resolve apparent violations of the law. In some cases, agencies may press parties to make concessions early in the life cycle of a matter, in lieu of a more deliberate process of evidence-gathering and analysis.

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[9] On the importance of this type of assessment, see William E. Kovacic, Using Ex Post Evaluation to Improve the Performance of Competition Policy Authorities, 31 Journal of Corporate Law 503 (2006).

Proper resourcing relaxes the pressure to use settlement short-cuts to address complex commercial phenomena that deserve closer study and fuller deliberation.

Third, inadequate resourcing tends to extend the duration of matters for which the agencies have chosen to undertake a more elaborate investigation. This is particularly true where an agency is running two or more complex inquiries at one time.

Fourth, weak resourcing can deny an agency the means it requires to monitor fulfillment of obligations imposed on firms through decisions taken by the antimonopoly agencies (by settlement or otherwise). The credibility of undertakings provided by companies depends heavily upon the expectation of business operators that the competition authority will oversee compliance with their terms. As a related point, an agency with too few resources is likely to invest too little effort to determine whether specific remedies achieved their intended effects. This form of evaluation provides valuable insights to the competition about how to design resources in future cases.

Fifth, under-resourcing impedes an agency's engagement in valuable work beyond the investigation and prosecution of cases. Relevant tasks beyond investigation and prosecution include the preparation of guidelines or other policy instruments that inform businesses about the agency's priorities and its intentions about the application of the law. These non-litigation activities can play a useful role in gaining compliance with the law, but the demands of law enforcement matters can tend to divert resources away from these initiatives A weakly resourced competition agency will be especially prone to invest too little effort to use non-enforcement instruments to improve the performance of the competition system.

The Role of the Courts

The development of China's antimonopoly system has been accompanied by major enhancements in the country's judiciary, especially within the chamber of the Supreme People's Court responsible for intellectual property issues. This chamber has played a crucial role in the evolution of private rights of action and in providing a forum for the resolution of cases brought by the government

agencies. In many countries, judicial decisions have provided valuable interpretations of competition laws and have raised the quality of competition policy analysis within the jurisdiction. In effect, the courts engage in a long-running conversation with the enforcement agencies, academics, and the business community.

The reported decisions in the Qihoo/Tencent and Johnson & Johnson cases are examples of instances in which China's courts can raise the quality of discourse about competition law. The judges of the intellectual property chamber have participated in a wide array of judicial education programs related to competition law, and their work in dealing with competition law disputes reveals an impressive sophistication in this field.

International experience suggests that effective judicial review is a valuable means to improve the quality of decisions by administrative agencies and to increase the perceived legitimacy of a competition system. A major question for the future development of China's competition law system is the availability of judicial review to oversee decisions taken by the three public antimonopoly bureaus. In theory, recourse to judicial review is available to challenge agency action. In practice, I am aware of no instance in which a party has used the existing machinery of judicial oversight to challenge agency action.