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Commentary: Kenneth Davidson, The Future of Free Markets in Three Chinas

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COMMENTARY

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THE FUTURE OF FREE MARKETS IN THREE CHINAS,
a commentary on
COMPETITION LAW AND POLICY IN CHINA, HONG KONG, AND TAIWAN by
Mark Williams, Cambridge University Press, 2005 (US \$110)

This is an important book. China by virtue of its size, rate of economic growth and ambitions is going to be an important player, if not the most important player, in the 21st Century. Thus the setting for Williams' book is compelling.

The book attempts to illuminate the attitudes toward and implementation of competition policy in what Williams classifies as three parts of China. The circumstances of each part could not be more different. The Peoples Republic of China (which I will refer to as the PRC, Chinese Mainland, or China) has been emerging from a centralized economy to a market economy since 1978 but still has substantial centralized control and substantial control exercised by regional authorities. China has an official position in favor of a strong comprehensive competition law and is in the process of adopting a new competition law. Presumably this reflects as much its commitment to WTO as it does to a real consensus on how to achieve effective economic growth.

Hong Kong, in contrast, has a long history of a competitive economy and is reluctant to commit internally or externally to regulation of business activity through constraints on business activity.

Taiwan, like China, combined a centrally directed economy with an economic oligarchy that is more like other transitional economies, but, over the past 25 years, its has established free market competition institutions in tandem with an extension of democratic rights to its population. How each China has fared and what is the prospect for each is a compelling question both as models for developing competition in

transitional economies and for the economic impact China will have on the world in the coming century.

Mark Williams is on the faculty of Hong Kong Polytechnic University. He is one of a group of “western” legal writers, including Alan Fels, William Kovacic, Eleanor Fox, and others, who have focused on how to establish effective competition agencies in transitional economies. I was on a Competition Law panel with Mark Williams in Singapore at the Asian Law Institute’s first annual conference in 2004. He impressed me with the candor of his evaluation of the Thai competition law, which he characterized as ineffective and unpromising due to corruption, the lack of the rule of law, and dominance by an economic oligarchy.

My paper at that conference, based on a year as Resident Advisor to the Indonesian competition agency and traveling in Southeast Asia, was more general, entitled “Designing Competition Agencies for Transitional Economies.” Like my 2005 article in the Asian Pacific Law and Policy Journal, my consulting with Resident Advisors to other newly formed competition agencies and my graduate courses, I begin by referring to Bill (now FTC Commissioner William) Kovacic’s five prerequisites to having a competition law. Kovacic’s list includes a functioning legal system that recognizes property rights, contract rights, rights to form business entities, capital raising institutions, and a workable bankruptcy law. I added *trust* between suppliers, manufacturers, retailers and consumers as an additional prerequisite.

Trust is not a small point; it is, as Nobelist Kenneth Arrow pointed out in his book, *The Limits of Organization*, an essential element to the efficient functioning of a market economy:

Trust is an important lubricant of a social system. It is extremely efficient; it saves a lot of trouble to have a fair degree of reliance on other people’s word. Unfortunately this is not a commodity that can be bought [or enforced] very easily. If you have to buy it, you already have some doubts about what you have bought. Trust and similar values, loyalty and truth-telling are examples of what the economist would call “externalities.” They are goods, they are commodities; they have real, practical, economic value; they increase the efficiency of the system, enable you to produce more goods or more of whatever values you hold in high esteem, but they are not commodities for which trade on the open market is technically possible or even meaningful. (at 23)

This “fair degree of reliance” is a loose enough standard to survive the Enron, World Com, Mutual Fund, and S & L scandals within the American context, but nonetheless insists that a general ability to rely on others is central to the operation of a market economy. Law cannot replace trust. In a free market, the rule of law supplements institutional arrangements and agreements by which people have agreed to conduct business. The Soviet experience showed that central planning and force cannot match the economic results of a free market and trust. Williams would add democracy to the Kovacic list, an important thesis of the book to which we shall return. This digression on

the importance of trust to free markets is central to a critique of this book on competition law in the three Chinas.

The People's Republic of China

Williams' book is a monumental contribution to our understanding of barriers to the creation of free markets and effective competition laws in transitional economies. He cites history and current events to show how difficult it would be to reform the People's Republic of China, that is, the Chinese Mainland, by the creation of a comprehensive competition law. He traces the efforts since the early 1990s to establish a viable competition law and analyzes both the language of drafts and fights over jurisdiction. The barriers appear to be formidable. The ruling group of the PRC is deeply split on ideological grounds about the acceptability of a free market. For many reasons, the banking system is used to maintain what otherwise would be failing state enterprises. This limits the development of capital markets. Chinese provinces have internal trade barriers which seem to have been designed to safeguard the security of the country in case of invasion. Provinces, which collect most of that nation's tax and other local revenues, are designed to continue to fight on in an invasive war because of their ability to produce goods and services even if major industrial sectors were captured or destroyed. This has resulted in the perpetuation of thousands of less than efficient scale enterprises which are insulated from effective competition -- even from Chinese goods and services made in other provinces. It also means that the central government has little capacity to enforce reform, including the 1993 competition law. The court system is both corrupt and incompetent. Lawyers and judges are untrained in commercial matters and court decisions are subject to political review. In other words, trust and the rule of law are weak. Williams pessimistically predicts the collapse of the central government as the membership in the WTO forces China to confront foreign competition.

Williams' preoccupation with the many problems of mainland China ignores the booming Chinese economy that appears formidable to most foreigners. Whatever the failings of the political and legal system, China has made enormous strides in creating huge pockets of a modern industrial society. Its defects of pollution, corruption, and exploitation are well known. By popular account, they are much more prevalent than the political, environmental or economic scandals of the United States or the EU, but they may not exceed American excesses during the eighteenth and nineteenth century industrial revolution. We might imagine, therefore, a revolution against the Lords of the communist party and the army, by the wealthy economic commoners of Shanghai and other industrial cities. Not necessarily an armed rebellion, but a series of confrontations and accommodations in which substantial power is transferred from state agencies to economically more productive powers. Indeed Williams implies that since Chairman Deng's declaration in 1978 to open China to foreign economic contacts, there have been factions of the central government who see the advantages to substantial change.

But there is no reason to be confident that the change will be orderly or entirely peaceful. Neither the British Lords nor the Luddite craftsman accepted change without protest. To be sure, there are worlds of differences between China today and the birth of modern

capitalism. Britain prided itself on the rule of law and lawyers, the rights of individuals and of an elected parliament. But all of these were the product of historical struggles, not the centrally planned transition that Williams implies is necessary. Market forces have their own inertia and, having been unleashed, they will not be easily constrained.

There is a fourth Chinese economy, Singapore, that has followed the orderly path to the modern industrial state that Williams seems to advocate. Although the British colonial service may have left some institutions that facilitated development, there is little question but that the island country transformed itself from an undeveloped economy to a first world economy in less than forty years. While there is some debate about how free or how democratic the country is, there is no debate about the high ranking of literacy, housing, health or economic status of the country or its citizens. Whether the transformation was a product of charismatic democratic leaders or ruthless visionaries (or some combination), the economic results are undeniable and have been achieved without violence or disorder, and without an antitrust law. Singapore passed its competition law only in the past few years and only at the urging of its trading partners.

Of course, there is a substantial difference between transforming a small island and the world's most populous country, but given the ethnic similarities one would think there would be lessons for mainland China and that Singapore nationals could contribute professional skills to the development of the mainland. China has an even greater resource throughout Southeast Asia where an expatriate Chinese community has thrived in many countries. Indeed, ethnic Chinese groups are commonly thought to dominate many of these market based economies. Under the right circumstances, there is reason to believe many of these people might be willing to return to China and bring with them their experience in law, medicine, technology, etc.

I have no crystal ball and am no expert on China, but I would be less pessimistic than Williams. He has done yeoman service in setting forth obstacles facing China's transformation into a market economy. For anyone who seeks to implement market reform in China, his book should be required reading. But they should not stop there. China has many more resources than those explored in his book. In any case, antitrust law is not an answer to the economic problems of China or any other country. If properly drawn and administered, a competition law can aid the growth and development of an economy but that will depend primarily on other aspects of the country's culture, resources, and leadership.

The Hong Kong Special Administrative Region

Williams' discussion of Hong Kong, where he lives and teaches, is the longest section of the book. It is often fascinating and revealing because he knows the characters and their personal histories as well as its controversies over law and development. Hong Kong is an anomaly that is often found in asterisks of economic and development texts. This is partly because it is not an independent nation, having been a British Crown Colony until it was returned to China in 1997 as a Special Administrative Region (HKSAR). More significantly, its singular status is reflected by the fact that the per capita GDP of Hong

Kong is not only many times that of China, but it was substantially higher than the per capita GDP of Britain at the time of its return. It is not surprising therefore that China granted Hong Kong a special status to preserve this economic dynamo.

Williams rejects the claim of the Hong Kong government that it has the freest economy in the world where competition is “red in tooth and claw.” The government asserts that an antitrust law is not only unnecessary but might be harmful to the economy. Williams goes to extraordinary lengths to show that these claims are untrue. He notes that several sectors are dominated by public enterprises, including housing, education, and that medical services and electricity and transportation are heavily regulated. But his major criticism is that the government is dominated by an oligarchy:

It will be submitted that the underlying reason for the policy stance adopted is not a lack of evidence or an inability to legislate or enforce competition policy but rather the lack of a functioning democratic government. The concentration of economic and effective political power in the hands of a small economic, oligarchic elite that benefits from collusive economic practices and would suffer from a competitive market, is the real reason for the government’s overt and illogical hostility to regulation, in the public interest, in this field.

Williams carefully marshals his evidence that; (1) Hong Kong is not a democracy; (2) the local economy reflects cartels, corruption and abuse of dominance; and (3) Hong Kong has the institutional and professional capacity to implement a comprehensive competition law and is disadvantaged by its partial effort to impose competition obligations on two sectors – telecommunications and television broadcasting. His evidence is compelling.

What is less clear is why Williams cares whether Hong Kong has a comprehensive competition law. The general case that competition laws benefit developing economies does not apply to Hong Kong. As noted above, its *per capita* GDP is higher than that of most developed nations. While distributional fairness, *i.e.*, income equity, is advocated by many proponents of competition law, Williams does not seem committed to minimizing consumer costs. He does not cite wealth data showing distribution of income percentiles in Hong Kong or other economies. In his introduction, he cites a variety of supporters of competition including those who see allocative efficiency as the only legitimate goal of competition laws. He concludes with a quote from Professor Whish:

Competitive markets seem, on the whole, to deliver better outcomes than monopolistic ones. That is why competition policy has been so widely embraced in recent years; there is probably a greater global consensus on the desirability of competition and free markets today than at any time in the history of human economic behavior.

This author [Williams] agrees and this book will seek to demonstrate how the governments of China, Hong Kong and Taiwan seek to deal with (or tolerate) competition problems in their jurisdictions. (at 38)

Despite the scholarship of Chicago and other neoclassical economists, I do not think that free markets or competition law can be justified solely on the grounds of allocative efficiency. It is justified in my view by a combination of productive and moral objectives. An economy must succeed on both objectives. John Kay describes in his insightful book, *Culture and Prosperity- why some nations are rich while others remain poor*, the disastrous effects in New Zealand of :

enthusiastic free market policies, supported by an able and ideologically committed group of Treasury officials led by Graham Scott. . . . From 1984 to 1999, New Zealand followed policies of privatization and deregulation and pursued labor market flexibility and reductions in social benefit. During this period, New Zealand experienced the worst economic performance of any rich state. * * * New Zealand GDP per head had fallen from 125% of the average of rich states in 1960 to 60% of the average in 2000. (at 61-2)

The decision to adopt a particular type of markets economy or competition policy is not based on esthetic choices or what some might term theoretical economic choices, it is a set of practical decisions based on multiple objectives of a society. The limitations on democracy in Hong Kong, both under rule by the British and by the communist authorities, have not prevented economic success in Hong Kong. Members of business and professional communities now elect thirty representatives to the Hong Kong Council while the public at large elects only 24 members and the Chief Executives have all been members of the economic elite. The Beijing government retains ultimate decisional powers on many basic issues. The business elite in Hong Kong have used their control of property to make it impossible for French owned Carrefour to find sufficient blocs of real estate to establish their hypermarket grocery stores in Hong Kong. The economic elite use cross ownership to set prices and lower the interest rates paid by banks.

These arrangements certainly distort wealth distribution and economic opportunity, but what country (apart from New Zealand's short lived experiment) does not interfere with market forces in a host of ways? What strikes me as most remarkable about Hong Kong is how typical the economic framework is of less developed nations where a small oligarchy dominates the nation and erects barriers to foreign competition. Even large democratic powerful, successful industrial nations like Japan have notorious histories of protectionism. To be sure, some blame the economic troubles of Japan on the protection they have given most prominently to their retail and agricultural industries. The United States is continually engaged in disagreements with other nations about protectionism. But the ongoing fight at the WTO about EU subsidies to their farmers is just one example among many disagreements between member who profess support of free markets and democratic societies.

Nor is Williams' demonstration surprising that the Hong Kong civil service and legal profession are fully capable of drafting and enforcing competition laws in two sectors, telecommunications and broadcasting. It may be questioned in political debates in Hong

Kong but the evidence that Hong Kong has the skills to formulate and enforce a competition law seems overwhelming. The issue is one of policy not possibility.

Moreover, the emphasis on demonstrating the possibility of having a Hong Kong competition law ignores question of why such a law is necessary given the remarkable competitive success of Hong Kong in world trade, both as a transshipment port, economic intermediary and as a manufacturer (even though most of those facilities are on designated areas of the Mainland). That success seems most related to the honesty, trust and rule of law that Hong Kong offers in the administration of its commercial law.

Is Williams' argument that unless Hong Kong adopts a comprehensive competition law, it will lose its economic advantage? If that is his point, I think he needs to make it more clearly and present evidence that: (1) the current economic strength of Hong Kong is unsustainable; and (2) that a particular set of competition and regulatory policies would strengthen Hong Kong.

I believe that a competition law would be beneficial to Hong Kong and its residents because it would lower the cost of goods, increase their variety and quality, and open economic opportunity to persons who are currently excluded, but that seems contrary to the interests of the oligarchy that is currently in power. I also believe that it would probably be beneficial to have a more open and democratic government, but as the case of Taiwan shows, steps by Hong Kong to assert such freedoms may result in a negative reaction by the Mainland government and the loss of current privileges. So my value preferences are unlikely to be persuasive.

If there are arguments that might be persuasive to those who currently hold power such arguments probably will have to be focused, initially at least, on the economic weakness created by the current oligarchy. Hong Kong has already lost its status as the only effective point of entry and exit for international trade with China as other Chinese cities gain in economic power and stature. It now has competition in the exchange of foreign and Chinese goods. If economic opportunity and cost of living become better in other Chinese cities, Hong Kong is likely to suffer. In such circumstances a comprehensive competition law or more personal freedom might help Hong Kong compete with other Chinese cities for people, investment and business.

Williams' discussion of the details of Hong Kong's two competition laws is informative but it does not advance his thesis that a "functional democracy" is necessary to the passage of a competition law or even that it would make passage more likely. In the United States, for example, unions and management often combine forces to erect protectionist barrier; consequently democracy does not seem to guarantee the implementation of procompetition policies.

The Island of Taiwan

Williams presents Taiwan as his model for development. As in the description of his two other Chinas, his history of the Kuo Ming Tang (KMT) and its political and economic

domination of the island is informative. Moreover his description of how competition law and policy coincided with the rise of democratic political power of the Taiwanese people against the domination by the Mainland refugees lends support for his thesis that in a democracy, populist sentiment can be a support for the creation and enforcement of competition laws.

The history of Taiwan over the past century is a key to the economic and political development of the island. It was controlled by Japan for fifty years following the 1894 war between China and Japan. Following World War II, the Japanese ceded the island to what remained of Chiang Kai-shek's KMT government which had taken refuge on the island following military defeats throughout the Mainland by the Chinese Communist Party. Williams reports that the Taiwanese viewed rule by the KMT as a transfer from one colonial power to another. That view reflected the fact that the Mainland KMT assumed administration of the government and the economy and suspended the democratic provisions of the Republic of China constitution on the grounds that the "rebellion" by the communist forces created a state of emergency. As a result, the island operated under martial law throughout the life of Chiang Kai-shek. Change began to occur after 1978 when his son Ching Ching-kuo assumed the presidency. Ching-kuo made significant attempts to reduce corruption and to integrate Taiwan natives into the KMT. Finally in 1986, he declared an end to martial law and allowed the formation of opposition parties. Finally, in the early 1990s, democratic elections were held in Taiwan and ultimately the KMT lost the presidency to the head of the opposition DPP party. In 1992, Taiwan passed its first comprehensive competition law.

Williams attributes these changes to a combination of political and economic motives. The government of Taiwan accepted that it would have to establish itself as an entity independent of Mainland China and to this end it sought entry into GATT and the WTO. This political end run gave international status to Taiwan despite world recognition that the government of China rested in Beijing with the CCP and coincided with the growing economic importance in world trade in electronics and computer components. Liberalization also gave Taiwan natives the opportunity to break the corruption of the KMT that had controlled the economy and establish their own place in the Taiwanese market. The competition law was part of this effort to open the economic system.

The Taiwanese Fair Trade Law of 1992 and its successors offer an interesting model for implementing a competition law. The drafting of the law was heavily influenced by German competition scholars. For the first four or five years of its existence the Fair Trade Commission engaged primarily in competition advocacy. This strikes me as a sensible strategy in a country where commercial deals, legal and illegal, have been traditionally made in secret and without the aid of courts that tend to be corrupt.

According to Williams, trade liberalization in tandem with this educational sunshine policy had substantial effects:

The entry of multi-national enterprises into the Taiwan market has had a salutary effect However, . . . one should not underestimate the impact and effect, both

psychological and real, of the competition advocacy undertaken by the FTC Raising public consciousness, through the effective use of the media and other methods of familiarising the public and industry with the precepts of competition, has no doubt contributed to a change in attitudes toward competition and assisted in achieving the government liberalisation goal. (at 397)

Of course nothing in life is perfect. Williams traces the history of amendments to the law that were necessary to make it more effective. He critiques certain enforcement cases as inappropriate, but on the whole he describes an active and able agency that supplements the changed attitudes to a free market economy; however, he concedes that corruption remains a major problem. He cites the 2004 Global Corruption Report as ranking Taiwan as thirty whereas Hong Kong, whatever its problems, has a much better rating as fourteenth least corrupt nation.

And what of Williams' argument about the importance of having a "functioning democracy?" He observes:

Thus, despite reservations, Taiwan does seem to satisfy the necessary elements of a functioning democracy – representative government, independent state institutions that exhibit a separation of powers, the rule of law, competent exercise of executive power and a lively civil society. (at 376)

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In surveying the first decade of implementation of the FTL concerning monopolisation, one is struck by the fact that the number of decisions in which enforcement penalties have been levied is small but that the structural changes in the overall economy in relation to formerly monopolised products and services has been great. (at 403)

He concludes:

It is submitted that the reason Taiwan has been able to achieve this is the existence of an effective democratic process which has encompassed the inclusion of a competition regime as part of economic and political liberalisation. (at 410)

and cites various Taiwanese sources in support of the thesis.

Williams' argument that there is a necessary relationship between economic development and democracy is very much in line with the writing of Nobel Economist Amartya Sen in *Development As Freedom*. Professor Sen has a more expansive concept of freedom and its central role in the development of transitional economies. It includes but is not limited to the right to vote. It includes rights to vote, to employment and to education and argues that these have practical effects on the lives of individuals. Sen notes, for example, that although famine has been common around the world since the end of World War II, there has not been a single famine in a democratic country, even very poor areas of countries

like India. The idea of coupling of democracy, free markets and competition has a distinguished lineage in the United States where in the late nineteenth and early twentieth century the American progressive movement sought to counter the economic abuses of American monopolistic and oligopolistic groups. One of the greatest successes of this movement was the passage of the world's first comprehensive competition laws.

Competition law has been promoted most strongly on grounds of productive efficiency and economic integration. That seems to have been the case in China and Hong Kong as well as in Taiwan. But, as the political and economic descriptions of Professor Williams show, much more is at issue for those in the three Chinas who argue the merits of an effective competition law.