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"Competition Policy Framework in Hong Kong"

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The Benefits of Competition

The relevant market as defined for the purpose of competition analysis is essentially a sphere of activities where suppliers of substitutable products compete for consumers. From the consumers' perspective, the relevant market includes all interchangeable products that serve their particular needs. The determination of what are close substitutes defines the boundaries of the market. In market definition analysis, the preliminary market boundary is normally established by reference to the functional characteristics of the product in question. This preliminary boundary is then expanded to include all other products that are close substitutes to the product in question.

Competition is derived from the rivalry between firms for the patronage of customers. The rivalry is driven by forces of supply and demand – the firms' interest in maximizing their profits and the customers' interest in maximizing their utility. Competition produces three distinct economic benefits:

- allocative efficiency – resources shifted to the production of those products and services more highly valued by consumers;

- productive efficiency – firms driven to adopt less costly and more technically efficient means of production; and

- dynamic efficiency – incentives for firms to gain competitive edge over time through new investment and product innovation.

Therefore, competition encourages economic efficiency of markets and gives rise to benefits in terms of quality products, continuous innovation, incentives for investment and downward pressure on price.

Sector-specific Competition Regulation

In Hong Kong, an open economy that is already highly competitive, the Government sees no need to enact an all-embracing competition law. A major reason for this is that the structural openness of the Hong Kong economy is conducive to competition, thereby reducing the need for resorting to legislation. The Government issued a Statement on Competition Policy in 1998, proclaimed its policy of adopting the principles of competition as the means to achieve the economic objectives of free trade. The competition policy framework is reinforced with sector-specific measures and minimum government intervention.

Competition regulation is considered necessary in telecommunications and broadcasting sectors. These two sectors are fundamental to an economy and indispensable for modern life. They are public utilities that are characterized by supply-side economies of scale and demand-side “network effects”. With scale economies, a few firms in a small economy might be able to meet market demand more efficiently than a large number of firms. With “network effects”, the value of a firm’s services is augmented with the services’ increasing consumption. Besides, public utilities involve considerable barriers to entry or exit, established by the incumbent’s commitment to high investment costs, and erected by its control of access to scarce resources and essential facilities. It follows from this that telecommunications and broadcasting activities are performed by only a relatively small number of service providers.

The concentration of firms in the market and the high barriers to entry or exit are both not conducive to the free play of competitive forces. The incumbent is inherently endowed with concentrated market power, unconstrained by the threat of new entry while the few service providers are prone to collude on prices.

The incumbents in the telecommunications and broadcasting sectors may wield significant market power, the legacy of their dominant positions. Sector-specific regulation is therefore required to provide the necessary checks and balances.

A sector-specific regulator brings certain advantages. Principals among these are the regulator’s ability to focus on the specific industry needs, expertise in technical issues and authority to regulate the incumbent’s market power.

Among the specific measures adopted under dominant operator regulation, one example is the tariff approval regime that subjects the dominant operator to specific requirements regarding the approval, revision and publication of tariffs. It limits the dominant operator's ability to cross-subsidize between market sectors, to leverage its market power from non-competitive sectors to the competitive ones. It prevents anti-competitive practices such as predatory pricing and bundled or tied service offerings.

Dominant operator regulation will facilitate new entrants to establish themselves in the market. It provides a regulatory safety net to preserve competition but not to shield the inefficient players from the market discipline. Non-dominant participants by definition have less market power and will be disciplined by the market through the natural process of rationalization, consolidation and exit by the weakest players.

Competitive Safeguards

In telecommunications and broadcasting sectors, a degree of regulatory supervision is necessary to ensure fair market conditions prevail and to prevent the dominant player from abusing its market power. The regulatory response to this situation is to put in place a set of competitive safeguards. In Hong Kong, the competition provisions of the Telecommunications Ordinance and the Broadcasting Ordinance were enacted in 2000 and 2001 respectively. The following are the major competitive safeguards adopted.

(i) Prohibition against anti-competitive conduct

Anti-competitive conduct may take many forms. It may exhibit collusive behaviour such as price-fixing, cartels, bid rigging and market sharing. In some jurisdictions collusion is prohibited per se.

In Hong Kong, the relevant competition provisions dealing with anti-competitive conduct are stipulated in section 7K of the Telecommunications Ordinance and section 13 of the Broadcasting Ordinance. They prohibit telecommunications and broadcasting licensees from engaging in conduct that has the purpose or effect of preventing or substantially restricting competition in a telecommunications market or a television programme service market respectively.

In assessing whether the conduct has anti-competitive purpose or effect, the following are relevant considerations: price-fixing agreements, action preventing or restricting supply to competitors, market-sharing agreements etc.

(ii) Prohibition against abuse of dominance

In situations where market power exists, competition provisions need to be enacted to control the abuse of that power for anti-competitive purposes.

In Hong Kong, section 7L of the Telecommunications Ordinance and section 14 of the Broadcasting Ordinance prohibit licensees from abusing a dominant position in a telecommunications or a television programme service market respectively.

A firm (or a group of firms acting collectively) is dominant when it is able to act without significant competitive restraint. For example, it is able to charge prices above competitive levels without fear of new entrants undercutting its price or taking customers away.

Prohibition against abuse of dominance is designed to stop powerful firms from damaging the competitive process. The classic example is predatory pricing. While low prices are often a welcomed result of genuine competition, a drastically below-cost service could stifle the competitors before they have a chance to gain a foothold. Pricing becomes predatory when selling is below cost for the purpose of driving out competition, followed by subsequent excessive pricing to recoup the losses.

In assessing an abuse of dominance, conducts that warrant examination include but are not limited to predatory pricing, price or other forms of discrimination, harsh terms and conditions imposed by the incumbent on other operators, and conditional or tie-in arrangements.

(iii) Prohibition against discriminatory behaviour

In sectors with high sunk costs such as telecommunications and broadcasting, vertical integration can help reduce the investment risk. For example, a service provider may wish to integrate upstream into distribution to reduce the risk of being held captive to the owner of the necessary network infrastructure.

Where there is market power at one of the input levels in the supply chain, a vertically integrated operator has every incentive to hinder or foreclose competition in downstream markets by denying access to the essential inputs. Alternatively, access may be given only on discriminatory and competitively disadvantageous terms. Indeed, the terms may be so unrealistic that they are tantamount to a refusal to provide access.

In Hong Kong, section 7N of the Telecommunications Ordinance prohibits exclusive or selective arrangements (e.g. in distribution or supply) with the intention of obstructing new entry or limiting market accessibility.

Discrimination relating to charges, performance characteristics or other terms and conditions of supply is prohibited where such discrimination has the purpose or effect of preventing or substantially restricting competition.

(iv) Prohibition against misleading and deceptive practices

To promote fair competition and to foster good trade practices, misleading and deceptive advertising or marketing practices should be prohibited. Consumers must be protected against firms employing misleading or deceptive tactics to distort competition.

In Hong Kong, section 7M of the Telecommunications Ordinance prohibits licensees from engaging in conduct which is misleading or deceptive, including (but not limited to) conduct relating to promoting, marketing or advertising the network, system, installation, customer equipment or service.

(v) Proposed legislative framework to regulate mergers and acquisitions

It is recognized that most mergers and acquisitions do not raise regulatory concerns. Indeed, mergers and acquisitions are part of normal business activities that may be economically beneficial to the society. However, when the relevant transaction gives rise to market power that may substantially lessen competition in the market, it warrants regulatory intervention.

Prohibition against anti-competitive mergers differs from other competition provisions because it addresses questions of market structure rather than questions of market conduct. It prevents the acquisition of market power from the outset. The test in a merger analysis is whether the merger has the effect of substantially lessening competition in a market.

In Hong Kong, amendment to the Telecommunications Ordinance is currently proposed to provide a clear and comprehensive regulatory framework to regulate mergers and acquisitions in the telecommunications market with a view to promoting fair and effective competition. The regulatory framework is proposed to apply initially only to carrier licensees. A number of procedural safeguards are proposed, and the Telecommunications Authority is required to issue guidelines on the assessment criteria to ensure a transparent and efficient regulatory regime.

As to the nature of the regulatory regime, there is no universal rule as regards ex ante or ex post regulation adopted in overseas jurisdictions. An ex post regime will be adopted in Hong Kong, with a channel provided for carrier licensees to voluntarily seek the Telecommunications Authority's prior approval. In essence, the regime does not require pre-notification to the Telecommunications Authority for approval of any significant proposed changes in control of, or influence over, a carrier. But an option is available to the carrier licensees whether to seek prior approval, balancing against the risk of being penalized subsequently if the activity is found to be anti-competitive. Given such flexibility, the burden of compliance is minimized without compromising the requisites for regulation.

Conclusion

Hong Kong is renowned as a free enterprise and open market. Opportunities abound for enterprises to take advantage of Hong Kong's favourable environment for business.

Hong Kong is already served by a world-class infrastructure. The competition policy is to intervene where justified by the presence of market power and to do so in a way that minimizes the intervention so that it is proportionate to the dynamics of the market. The guiding hand of light-touch and transparent regulation is to liberalize the telecommunications and broadcasting sectors to open them to competition. Competitive safeguards are put in place to ensure the necessary conditions for competition, coupled with continued regulatory vigilance to build on the hard-earned success in the liberalizing process.

The Government has provided a dedicated forum under the Financial Secretary – the Competition Policy Advisory Group or "COMPAG" in short – to review policy issues related to competition. The Trade Practices Division of the Consumer Council is commissioned by COMPAG to conduct competition-related studies to monitor and review business practices in sectors prone to anti-competitive behaviour. This speaks for the Government's commitment in facilitating competition, while allowing the market mechanism to work.

Therefore, the framework best suited to Hong Kong may indeed be the most obvious one: a flexible, non-intrusive framework that allows the market to evolve in response to competition.

The views expressed in this paper are the personal views of the author and do not necessarily represent the views of the Office of the Telecommunications Authority or the Hong Kong Government.