THE RELATIONSHIP BETWEEN COMPETITION AGENCIES AND OTHER UNITS OF GOVERNMENT

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It is a privilege to return to China to participate in this International Seminar on the Review of the Draft Anti-Monopoly Law. We in the United States recognize the tremendous resources that the Chinese government has been devoting for many years to ensure that the legislation will be based on sound principles and practices aimed at contributing to the growth of China's economy and the welfare of its people. The rules of competition are crucial to the successful operation of an economy based upon market activity, and we believe that a well-crafted Anti-Monopoly Law will hold the promise of benefits for both China and the rest of the world. As you know, we have attended numerous seminars and meetings over the past year to discuss the topics to be covered in the legislation. We are grateful to the Ministry of Commerce, the Asian Development Bank, and the Organisation for Economic Cooperation and Development for taking the lead in organizing this week's seminar and for bringing us to the beautiful West Lake and city of Hangzhou.

In May of last year, I had the honor to participate in the International Symposium on the Draft Anti-Monopoly Law of the People's Republic of China, held in Beijing under the sponsorship of the Legislative Affairs Office of the State Council, together with the Ministry of Commerce and the State Administration for Industry and Commerce. My remarks there addressed three topics – abuse of dominant position, merger control, and agency structure.[1] My presentation today will elaborate on the earlier discussion of

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* The views expressed in this presentation are those of the author and do not necessarily represent the views of the Federal Trade Commission or of any individual Commissioner.

[1] *See* William Blumenthal, *Presentation to the International Symposium on the Draft Anti-Monopoly Law of the People's Republic of China* (May 23-24, 2005), *available at* http://www.ftc.gov/speeches/blumenthal/20050523SCLAOFinal.pdf.

agency structure. In particular, I would like to focus today principally on the relationship between competition agencies and other units of government. My colleague, Gerald Masoudi of the U.S. Department of Justice, will express the views of the United States on the remaining topics that we believe are raised by this seminar's working draft of the Anti-Monopoly Law.

THE POTENTIAL INJURY FROM GOVERNMENT INHIBITIONS ON COMPETITION

As a starting point for analyzing the relationship between competition agencies and other units of government, I would respectfully direct your attention to a speech that my agency's Chairman delivered last month in Beijing.[2] In that speech Chairman Majoras explained "why government inhibitions on competition are particularly troubling, why they are an attractive avenue for businesses who want protection from competition, and how we try to combat these restrictions through persuasion, when we cannot reach them through enforcement."[3]

The speech focused mainly on what we call "competition advocacy" – our role in persuading other governmental agencies, which may not necessarily be subject to a competition mandate, to make decisions or take official actions that are consistent with the objectives of competition policy. In explaining this role, though, the speech makes a number of important observations that go beyond competition advocacy and are relevant to some of the broader questions presented in the analysis of the draft Anti-Monopoly Law.

The first observation is that "[t]he idea of competition as a way to organize an economy often must struggle against other regulatory structures that are hostile to free markets."[4] The Chairman's speech recounts numerous examples of such hostility from past regulatory experience in the United States – price and capacity controls on the airline, rail, intercity busing, and trucking industries until they were successfully deregulated; shipment barriers in the wine industry; and limitations on truthful advertising claims.[5] Other examples of adverse regulatory structures can be found in medical services, legal services, funeral homes, real estate brokerage, and other industries with professional licensing.[6]

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[2] Remarks by Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, *Promoting a Culture of Competition* (Apr. 10, 2006) (hereinafter "*Culture of Competition*"), *available at* http://beijing.usembassy.gov/041006e.html.

[3] *Id.*, at pt. I.

[4] *Id.*

[5] *Id.*, at pts. I-III.

[6] *See* Deborah Platt Majoras, Chairman, Fed. Trade Comm'n, *A Dose of Our Own Medicine: Applying a Cost/Benefit Analysis to the FTC's Advocacy Program*, Address before Charles River Associates Program on Current Topics in Antitrust Economics and Competition Policy (Feb. 8, 2005), available at http://www.ftc.gov/speeches/majoras/050208currebttopics.pdf; Timothy J.

Examples are not limited to the United States, of course. It is now commonplace for competition authorities to express caution over the anticompetitive consequences that often flow from regulatory capture and rent-seeking.[7] Many jurisdictions have also adopted policies that limit governmental favoritism in the form of state aid; the most widely recognized example is in the European Union, where the Treaty of Rome prohibits Member States from interfering with commerce among themselves.[8]

A second observation from the Chairman's speech relates to the reasons that governmental intervention can be so attractive to businesses seeking a haven from the rigors of competition:

> Engaging in private anticompetitive conduct is risky for firms: predatory pricing requires the predator to lose profits in the short term; collusive behavior has the risk of cheating on the cartel; and there is the risk of detection and legal punishment. By contrast, persuading the government to adopt an anticompetitive restriction is much less risky: the costs of lobbying are low; the government enforces the restriction, which reduces the likelihood of cheating; and the ability of the competition agencies to intervene is limited.[9]

Government-imposed restraints on competition often prove to be especially effective and durable. In our experience, restraints authorized for government-controlled enterprises or

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Muris, Chairman, Fed. Trade Comm'n, *Creating a Culture of Competition: The Essential Role of Competition Advocacy*, Remarks before International Competition Network Panel on Competition Advocacy and Antitrust Authorities (Sept. 28, 2002), available at http://www.ftc.gov/speeches/muris/020928naples.htm.

[7] *See, e.g.*, Dr. Ulf Böge, President, Bundeskartellamt, *State-Imposed Restrictions of Competition and Competition Advocacy*, Remarks before Opening Session of 2004 Seoul Competition Forum (Apr. 20, 2004).

[8] Article 86 of the Treaty limits the powers of the Member States to enact measures adversely affecting competition, and Article 87 authorizes the European Commission to challenge and order repayment of competition-distorting state aid.

[9] *Culture of Competition*, *supra* note 2, at pt. I. *See also* Timothy J. Muris, Chairman, Fed. Trade Comm'n, *State Intervention/State Action – A U.S. Perspective*, Remarks before Fordham Annual Conference on International Antitrust Law & Policy, at 2 (Oct. 24, 2003), available at http://www.ftc.gov/speeches/muris/fordham031024.pdf. Muris writes:

> public restraints are far more effective and efficient at restraining competition. Unlike private restraints, there is no need to maintain backroom secrecy or to incur the costs of conducting a covert cartel. Public restraints can be open and notorious. Public restraints are also a more efficient means of solving the entry problem. Rather than ceaselessly monitoring the marketplace for new rivals, a firm can simply rely on a public regime that, for example, provides for only a limited number of licenses. Perhaps the clearest advantage of public restraints is that they frequently include a built-in cartel enforcement mechanism. While cheating often besets private cartels, public cartels suffer from no such defect. Cheaters, once identified, can be sanctioned through government processes.

imposed on the private sector pursuant to government regulation often have a greater adverse effect than anticompetitive conduct by private firms.

A third observation from Chairman Majoras's speech is the identification of one reason that government can be persuaded to adopt restraints that injure competition and yield little public benefit:

> the interests of the companies and the interests of the consumers are typically not well-balanced in this situation. The businesses who support these restrictions are usually well organized, have . . . access to lawmakers, and have strong incentives to get the restriction enacted because they will reap all of the supracompetitive returns. By contrast, consumers who would be harmed by the restriction are often unlikely to know about it, are poorly organized, and have limited incentives to stop the restriction because it may only cost any individual consumer a small amount of money, even though it costs consumers a large amount in the aggregate.[10]

This imbalance is addressed and modeled in an extensive economic literature that now traces back four decades.[11]

A fourth observation – and the last one I will provide this morning before turning to the draft Anti-Monopoly Law – is that tremendous damage to consumer interests has been done over the years in many jurisdictions, including my own, in the name of "consumer protection."[12] Too often, well-meaning government officials seek to protect the public by imposing regulations that have the unintended effect of elevating cost, limiting entry, and depriving consumers of marketplace options. We recognize, of course, that markets sometimes suffer from imperfections and that consumers sometimes require protection through regulatory intervention. It is important, however, fully to analyze the competitive effects of the intervention; and it will be extremely rare that the appropriate form of protection will require suspension of competition as an organizing principle for the market.

In addressing the relationship between perceived marketplace problems and available regulatory tools, I often begin with scholarly work conducted by a Justice of our Supreme Court while he was a law professor at an earlier stage of his career.[13] During

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[10] *Culture of Competition*, *supra* note 2, at pt. I.

[11] *See, e.g.*, MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION (1965). For one of many useful discussions of the literature and theory, see W. KIP VISCUSI, JOSEPH E. HARRINGTON, JR. & JOHN M. VERNON, ECONOMICS OF REGULATION AND ANTITRUST 382 (4th ed. 2005).

[12] In the words of Chairman Majoras, "[s]ome producers cloak their requests for anticompetitive government action as consumer protection but, in reality, they are looking for a dispensation from market forces and a reduction in consumer choice." *Culture of Competition*, *supra* note 2, at pt. I.

[13] STEPHEN BREYER, REGULATION AND ITS REFORM (1982) (hereinafter BREYER). The book elaborates on and develops views initially presented in a law review article that is often easier to locate today. Stephen Breyer, *Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform*, 92 HARV. L. REV. 547 (1979).

the late 1970s and early 1980s, Justice Stephen Breyer developed a list of marketplace problems that might justify intervention and a separate list of possible regulatory tools, and he observed that certain tools were best suited to certain problems.[14] Where regulation was unsuccessful, as was often the case in the United States during that era, the reason could often be traced to selection of the wrong tool for the particular problem. In his words, "regulatory failure sometimes means a failure to correctly match the tool to the problem at hand. Classical regulation may represent the wrong governmental response to the perceived market defect."[15] He also noted that "[t]he most traditional and persistent rationale for governmental regulation of a firm's prices and profits is the existence of a 'natural monopoly.'"[16] While the extensive regulation that this would require might sometimes be justified, such circumstances would be found in only a limited set of industries. Other regulatory tools, coupled with a competitive marketplace, would more often be appropriate.

ALLOCATING RESPONSIBILITIES BETWEEN COMPETITION AUTHORITIES AND SECTORAL REGULATORS

With that background, let me turn our attention now to the content of the draft Anti-Monopoly Law. For purposes of this seminar, we have been asked to base our comments on the draft of the Law dated July 25, 2005. We recognize, of course, that the drafters have done additional work on the Law over the intervening ten months. That work undoubtedly addresses a number of concerns about particular provisions of the July draft that we will be raising over the course of this seminar. We were heartened by the focus on the July draft, though, in one respect that relates to the subject of my remarks this morning – namely, the draft's Chapter V, which addresses Prohibition of Abuse of Administrative Powers to Restrict Competition. We had seen press reports in the Fall indicating that there was some question as to whether Chapter V would be retained. But we have also noted more recent press reports, such as an article in the Study Times of the Central Party School, that acknowledge the importance of the concepts underlying Chapter V to the economic transformation of the Chinese economy.

As I stated in my comments to the International Symposium in May of last year, the relationship between competition authorities and sectoral regulators is a source of complexity throughout the globe:

> Establishing the proper relationship between the competition agency and regulators is a significant and ongoing challenge in most countries. The issue has been discussed and debated in international fora in recent years. No single solution has emerged. Different jurisdictions have different approaches, and even within a single jurisdiction the approach

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[14] *See* BREYER, *supra* note 13, at 192. The marketplace problems include natural monopoly, rent control, spillovers, information inadequacies, and moral hazard. The regulatory tools include cost-of-service ratemaking, nationalization, taxes, marketable rights, antitrust, information disclosure, and standard-setting.

[15] *Id*. at 191.

[16] *Id*. at 16.

> to the relationship can vary. In one jurisdiction a competition agency has statutory powers for some aspects of sector regulation. In another, sector regulators and the competition authority exercise concurrent jurisdiction. In yet another, a formal agreement establishes a framework for cooperation between the sectoral regulators and the competition authority.[17]

In virtually every modern economy, a large swath of productive activity is subject to some form of regulatory intervention that goes beyond competition law. Even in a relatively unregulated economy such as ours in the United States, numerous industries are subject to some form of regulation at the federal level – banking, securities, transportation, agriculture, energy, pharmaceuticals, commodities, and telecommunications, among others. And other industries are subject to some form of regulation at the state or local level – health care, legal services, real estate, liquor, and even hairdressers and taxicabs.

Focusing on our experience in the United States, competition law applies to each of these industries, at least to some significant degree. But sectoral regulators sometimes have other objectives, which are not always consistent with competition, and there are times when sectoral regulators favor those other objectives. Depending on the structure of the governing law, competition considerations may or may not prevail. With respect to specific activities within industries that are subject to sectoral regulation, competition considerations and other considerations can be reconciled through any of several mechanisms:

- Competition law and sectoral law may operate in parallel, with competition authorities overseeing competition considerations and sectoral regulators overseeing other considerations;

- Competition authorities and sectoral regulators may have shared jurisdiction over competition considerations;

- Sectoral regulators may be assigned under their governing law with sole authority over competition, at least for certain classes of conduct or certain industry segments; and

- Competition law may be expressly exempted or impliedly repealed as a result of the law governing sectoral regulation.[18]

Where a competition authority has jurisdiction, either by itself or on a shared basis, its role in dealing with the sectoral regulator will largely be one of coordination so as to assure that the agencies act consistently. Where the competition authority lacks

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[17] *See Presentation*, *supra* note 1, at 15.

[18] *See id.* As I note there with respect to the fourth mechanism identified in the text above, "exemptions of this type are often historical anomalies that should be viewed with disfavor, and they increasingly have been eliminated in the United States and other jurisdictions."

jurisdiction, its role will become one of advocacy – even if the competition authority cannot control the outcome of a given decision, it will be important to take steps to assure that the sectoral regulator with decision-making responsibility adequately recognizes and gives weight to competition considerations.[19]

More generally, if a country has selected *markets* as the primary basis for organizing its economic system and if it wants those markets to function well, it needs to protect the competitive process. That objective will often encounter resistance, because the government will face recurring pressure to consider interests and values other than competition. Those interests and values will sometimes be legitimate in their own right, but they will have other champions. The responsibility to serve as a leading champion for competition interests will frequently fall on the competition authority – by urging competition as an organizing principle for the economy, by explaining the benefits of competition to the public and to others in government, by engaging in appropriate investigations and interventions when it has jurisdiction, and by engaging in advocacy before other regulators when it does not.

THREE FORESEEABLE CHALLENGES FACING COMPETITION AUTHORITIES

As it goes about its mission of protecting the competitive process, virtually every competition authority is likely to face three predictable challenges, which I am about to describe. We in the United States face these challenges, as do our counterparts in other countries, but we are a long-established agency in an economic system that has widely embraced competition as an organizing principle. For new competition agencies and for agencies in transitional economies that are unaccustomed to competitive markets, these challenges can be especially great.

The first challenge involves efforts to limit the agency's jurisdiction by excluding certain industries or certain segments of the economy, often on grounds that those industries or segments are ill-suited for competition either because they suffer from "excessive competition" or because they are "natural monopolies." The excessive competition rationale has been characterized by scholars as an "empty box" that will never apply – it simply "does not provide an adequate justification for regulation."[20] The natural monopoly rationale is more complicated – natural monopolies have been known to exist, but the assertion in a particular instance will seldom survive scrutiny for several reasons:

- Most industries that claim to be natural monopolies do not satisfy the technical criteria. Under the economists' formal definition of the term, a "natural monopoly" is an industry in which the long-run average cost (LRAC) declines for all outputs, such that long-run marginal cost necessarily lies

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[19] For a more extended discussion of competition advocacy and the related advisory role of a competition agency, see *Presentation*, *supra* note 1, at 12.

[20] *See, e.g.*, BREYER, *supra* note 13, at 29, 193.

everywhere below it.[21] In the limited circumstances in which this condition is present, advocates of exemption are correct in asserting that a competitive outcome is infeasible, such that the "monopoly problem cannot be left to the unregulated marketplace or to the antitrust laws for correction."[22] The usual solution is comprehensive oversight by a sectoral regulator. Most industries, however, are structurally competitive and are not characterized by the cost structure required for "natural monopoly" treatment to apply.

- An industry that once had the attributes of a natural monopoly does not necessarily have those attributes forever. As technology evolves, the cost characteristics of an industry change, so that an industry that formerly had constantly-declining LRAC may become structurally competitive. As an example, shifts in telecommunications technology have brought competition to certain businesses that were once viewed as natural monopolies.

- An industry that qualifies as a natural monopoly in some locations is not necessarily a natural monopoly in all locations. In particular, while an industry may have constantly-declining LRAC over a typical range of outputs, high levels of output or density may place operations in a range where costs flatten or begin to increase. In those locations, at least, the business can be structurally competitive. An example is traditional local wireline telephone service – while this service was historically treated as a natural monopoly (wholly aside from recent technology shifts and from potential for competition from wireless service), certain localities had sufficient density to realize virtually all scale economies and to support multiple competing systems.

- An industry that qualifies as a natural monopoly for some stages of operation is not necessarily a natural monopoly for all stages of operation. If the industries products or services can be provided on an unintegrated basis, natural monopoly regulation can be limited to those stages of operation that are not structurally competitive. An example is electric service – transmission might be a natural monopoly that should be regulated accordingly, but generation might be separately marketable competitively. Based on our experience in the United States,[23] we note that dis-integration of formerly integrated businesses and deregulation of formerly regulated activities need to be carefully analyzed and properly structured.

A second challenge facing competition authorities involves the tendency by regional and local government units to engage in preferences favoring their businesses within their territories, typically to the disadvantage of more distant competitors and

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[21] *See* VISCUSI ET AL., *supra* note 11, at 401.

[22] BREYER, *supra* note 13, at 191.

[23] *See* VISCUSI ET AL., *supra* note 11, at 456-61 (describing restructuring of electric power regulation in California and other states).

sometimes to the unintended detriment of their own citizens. Our good friends at the European Commission regularly encounter this issue in connection with competition-distorting state aid and with some Member States' regulatory interventions in favor of national champions.[24] The problem is less pronounced in the United States thanks to the Commerce Clause[25] in our Constitution, now more than two hundred years old. That Clause has been interpreted as prohibiting state laws that mandate "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."[26] The Clause is widely recognized as having been essential to the commercial integration of the United States economy and to the successes that the integration yielded.[27]

Even in the United States, however, the competition agencies regularly find ourselves engaging in advocacy and interventions against state-level restraints. Relying heavily on a report issued by my agency's staff in 2003,[28] our Supreme Court recently invalidated two states' bans on interstate shipment of wine.[29] More generally, our states have the power to exempt conduct from the application of the federal antitrust laws where the intention to displace competition is clearly articulated and where resulting private conduct is actively supervised by the state.[30] The FTC and our colleagues at the U.S. Department of Justice devote substantial resources to advocacy that alerts states to the possible harms from such displacement.[31] The agencies also devote substantial resources to investigation and litigation over whether the "clear articulation" and "active supervision" necessary to qualify for a claimed exemption are satisfied.[32]

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[24] *See supra* note 8 and accompanying text.

[25] U.S. Const. art. I, § 8, cl. 3.

[26] Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore., 511 U.S. 93, 99 (1994), quoted in Granholm v. Heald, 125 S. Ct. 1885, 1895 (2005).

[27] *See, e.g.*, *Granholm*, 125 S. Ct. at 1895-96 (recalling objectives of Constitution's Framers and reasons for prohibiting discrimination against out-of-state interests).

[28] POSSIBLE ANTICOMPETITIVE BARRIERS TO E-COMMERCE: WINE (2003), *available at* http://www.ftc.gov/os/2003/07/winereport2.pdf.

[29] *See Granholm*, *supra* note 26. The agency's activities with respect to barriers to shipment of wine are described in *Culture of Competition*, *supra* note 2, at pt. II.A.

[30] *See generally* II ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 1213-22 (5th ed. 2002).

[31] FTC advocacy filings are collected at http://www.ftc.gov/be/advofileother.htm#2006. U.S. Department of Justice Antitrust Division advocacy filings are collected at http://www.usdoj.gov/atr/public/comments/comments.htm. The materials collected at those sites include filings not only with state governments, but also with other federal agencies, and the state-level materials include filings not only not only exemptions, but also as to regulations having competitive effect on non-exempt conduct.

[32] *See, e.g.*, South Carolina State Board of Dentistry v. FTC, ____ F.3d ____ (4th Cir. slip op. May 1, 2006) (recent decision involving jurisdictional issue in case challenging asserted state action immunity).

I will close my remarks this morning by addressing a third challenge facing competition authorities: to sustain the faith of the public and of other units of government in competition as an organizing principle, because you will encounter moments of doubt. The competitive process can be painful at times. Inefficient firms will wither. Many surviving firms will have a less comfortable existence than they enjoyed under an alternative economic system. The beneficiaries will often be diffuse, and the benefits may sometimes be difficult to identify. There will be moments when the number of competitors has dwindled, when a handful of survivors or innovators are enjoying high shares, or when market forces have led to elevated prices and high profits for the victors in the competitive battle.

The challenge will be to convince yourselves and to convince the public that the pattern I have just described is fine – because it is. Competition needs to be understood as a dynamic process, one that plays out over time. The promise of profits and short-term gain is the lure that attracts entry, encourages investment, encourages innovation, justifies entrepreneurial risk. This can be a difficult concept, particularly for sectoral regulators who have been trained in engineering and accounting rather than in industrial organization economics. In conducting competitive analysis, they will commonly ask how many competitors are in the market at a given moment and what returns those competitors are earning. These questions are not irrelevant, but they reflect a secondary aspect of competition, and they must not be permitted to dictate policy.

As the government of China enters the next phase towards completing the new Anti-Monopoly Law, I hope the drafters will think foremost about the incentive structure they are creating – not for competitive outcomes at a given moment, but for a competitive process that stretches out over many years, with entry, exit, technical progress, and economic growth all driven by the private entrepreneur's desire to prevail in the marketplace and earn returns for investors. That desire can be abused; and when it is, the mission of the competition authority is to curtail the wrongful practices. But care needs to be taken not unduly to encumber the competitive process in the name of kind behavior or the short-term appearance of competitive structure.

In the words of Chairman Majoras: "Living with competition is hard. Living without it would be harder."[33]

CONCLUSION

Let me again thank the Ministry of Commerce, the Asian Development Bank, and the Organisation for Economic Cooperation and Development for having asked me to participate in this seminar. It has been a great honor to speak with you this morning. I eagerly look forward to our discussions over the next two days on the details of the draft Anti-Monopoly Law.

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[33] *Culture of Competition*, *supra* note 2, at pt. V (quoting Robert J. Samuelson, *Competition's Anxious Victory*, WASH. POST, Feb. 2, 2005, at A-23).