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China's Fair Competition Review: Insights from the U.S. Experience

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Hon. Maureen K. Ohlhausen*
Commissioner, Federal Trade Commission

* The views expressed in these remarks are my own and do not necessarily reflect the views of the Federal Trade Commission or any other Commissioner.

Good morning. I am delighted to be here. This is my eighth trip to China and I have always enjoyed a warm welcome. But, apart from learning about the fascinating history and culture of China, what I have truly found remarkable in my visits is how quickly Chinese competition agencies, judges, and academics have advanced in their antitrust thinking. I am delighted to join the discussion with my Chinese colleagues once again.

Competition law typically scrutinizes private business conduct for anticompetitive effects. It is thus unremarkable that, since the advent of China's antimonopoly law (AML), antitrust enforcers, scholars, and industry observers have primarily focused on how the Chinese antitrust system treats private business behavior, such as mergers, resale pricing, and the licensing of intellectual property. As an FTC Commissioner and former head of the Commission's competition advocacy program, however, I have learned that competition officials must be alert to threats to competition from many sources, including from government itself.¹

The AML has always prohibited anticompetitive government behavior, but that provision has received relatively little attention, until now. As you know, in June 2016, the Chinese State Council promulgated an opinion establishing a "Fair Competition Review System" to further a unified, competitive market by preventing "excessive and inappropriate government intervention in market[s]. . . ."²

I applaud the Chinese agencies' efforts to widen their oversight to include undue government restraints on competition. Although competition enforcers properly focus on private

¹ See Maureen K. Ohlhausen & Gregory P. Luib, *Brother, May I?: The Challenge of Competitor Control over Market Entry* [hereinafter *Brother, May I?*], 4 J. ANTITRUST ENFORCEMENT 111 (2015), <https://www.ftc.gov/public-statements/2015/09/brother-may-i-challenge-competitor-control-over-market-entry>; Maureen K. Ohlhausen, *Identifying, Challenging, and Assigning Political Responsibility for State Regulation Restricting Competition*, 2 COMPETITION POL'Y INT'L 151 (2006).

² Opinions of the State Council on Establishing a Free-Market System During the Development of Market-oriented Systems, June 1, 2016; see also Shelley Zhang, *China's Fair Competition Review System: China Takes Another Significant Step Eight Years After Enacting the Anti-Monopoly Law*, July 1, 2016, <http://blogs.orrick.com/antitrust/2016/07/01/chinas-fair-competition-review-system-china-takes-another-significant-step-eight-years-after-enacting-the-anti-monopoly-law/>.

anticompetitive conduct, that is only part of the task of fostering a robust market economy. Blocking only one channel of anticompetitive behavior—private conduct—does not stop and may actually increase pressure on the other channel—government-sponsored or -sheltered anticompetitive behavior.³

China is emerging from a long period with a state-controlled economy, and it is thus unsurprising that anticompetitive regulatory approaches or mindsets remain. The State Council Opinion itself identified these vestiges, such as “local protectionism, regional blockade, industry barriers, business monopoly, granting preferential policies in violation of the law or illegally prejudicing the interests of market players[.]”⁴ But even in a long-established free-market system, such as the United States, parties often seek through government regulation what they cannot lawfully obtain through private activity, whether it be a fixed price, a divided market, or the exclusion of upstart rivals.

Anticompetitive restraints are not only less risky to attain through government fiat than by private action, they are also easier to enforce. The government can exclude new rivals or maverick incumbents by law enforcement or by limiting licenses for providers, without regard to demand.

Consumers are poorly positioned to counter these efforts politically, as the economic theory of regulation long recognized.⁵ Their interests are unorganized and the costs associated with the anticompetitive restraint for any individual consumer is typically small. Thus, it is hard to marshal political pressure for consumer interests. By contrast, the entities that seek shelter

³ See Timothy J Muris, *Principles for a Successful Competitive Agency*, 72 U. CHI. L. REV. 165, 170 (2005). (“Protecting competition by focusing solely on private restraints is like trying to stop the water flow at a fork in a stream by blocking only one channel.”).

⁴ Opinions of the State Council, *supra* note 2.

⁵ See Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 71 (1983); Sam Peltzman, *Toward a More General Theory of Regulation*, 19 J.L. & ECON. 211, 213 (1976); George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. 3, 11 (1971).

from competition are organized firms or trade associations that reap concentrated benefits, and they can generate focused political pressure for the restrictions. In an already highly regulatory environment, competitors have many opportunities to use regulatory mechanisms to keep out competitors.⁶

Competition officials can rebalance the scales by scrutinizing anticompetitive regulation. They can be a voice for consumer interests in a discussion that might otherwise be dominated by organized interests seeking government protection from competition. They can also give unbiased guidance to regulators who are unfamiliar or uncomfortable with market competition. In the language of the economic theory of regulation, they can help to solve “consumers’ collective action problem by acting within the political system to advocate for regulations that do not restrict competition unless there is a compelling consumer protection rationale for imposing such costs on consumers.”⁷

This morning, I will discuss approaches for identifying and combating anticompetitive government regulation. I hope these approaches, while helpful for any competition official, may be particularly useful to Chinese officials as they employ their Fair Competition Review Mechanism. My views reflect regulatory theory combined with my previous experience leading the FTC’s competition advocacy program, which oversees the Commission’s efforts to persuade government policymakers to pursue policies that promote competition and enhance consumer

⁶ See, e.g., ROBERT BORK, *THE ANTITRUST PARADOX: A POLICY AT WAR WITH ITSELF* 347 (1978) (“In order to enter the market and vie for consumers’ favor, businesses of all types must gain various types of approval from governmental agencies, departments, and officials. Licensing authorities, planning boards, zoning commissions, health departments, building inspectors, public utilities commissions, and many other bodies and officials control and qualify the would-be competitor’s access to the marketplace.”).

⁷ James C. Cooper, *et al.*, *Theory and Practice of Competition Advocacy at the FTC*, 72 *ANTITRUST L.J.* 1091, 1092 (2005).

choice. I will also draw on my years as a Commissioner, during which I have continued to advocate for removing barriers to competition.⁸

The task of challenging anticompetitive regulation is undoubtedly a large one for Chinese officials, given the vestiges of a planned economy. As preeminent Chinese antitrust scholar and our host Professor Huang observed, the problem of administrative monopoly in China arises from two factors. The first is a tradition “hundreds of years old” that “state power controls every single aspect of the society’s economic life.”⁹ The second is “the current political and economic structure, which has closely linked monopoly enterprises to the government since the 1949 revolution.”¹⁰

Although their task may be bigger, Chinese officials enjoy some advantages over U.S. competition officials in challenging anticompetitive regulation. The U.S. political system comprises individual sovereign states in a federal system. Hence, states can lawfully limit competition, as the U.S. Supreme Court recognized in *Parker vs. Brown*.¹¹ Thus, the FTC and Justice Department do not always have the power to challenge such state-imposed restraints on trade.

By contrast, the Fair Competition Review Mechanism allows Chinese competition officials to challenge anticompetitive government action broadly. Further, the Review Mechanism requires departments under the State Council and provincial governments to include a competition review when drafting new regulations and policies. If they fail to include such a

⁸ *License to Compete: Occupational Licensing and the State Action Doctrine: Hearing Before the S. Subcomm. On Antitrust, Competition Policy and Consumer Rights of the Comm. on the Judiciary* (Feb. 2, 2016) (statement of Comm’r Maureen K. Ohlhausen, Federal Trade Commission), <https://www.ftc.gov/public-statements/2016/02/prepared-statement-federal-trade-commission-license-compete-occupational>.

⁹ Yong Huang, *Pursuing the Second Best: The History, Momentum, and Remaining Issues of China’s Anti-monopoly Law*, 75 ANTITRUST L.J. 117, 121 (2008).

¹⁰ *Id.* at 122.

¹¹ *Parker v. Brown*, 317 U.S. 341(1943).

review, they cannot submit their proposals to higher authorities for approval. They must also gradually phase out existing anticompetitive regulations and practices.

Given this new tool, how can Chinese competition officials focus their attention most fruitfully? The FTC’s experience with competition advocacy may provide some useful guidance. A key insight is that a market economy is not only the best method for distributing resources, it also provides fundamental protection to consumers in terms of price, quality, and convenience.¹² But, we all recognize that some regulation is often necessary, even in a free-market system. So, how can a competition official discern whether an individual regulation serves consumer interests?

Proponents of particular regulations often portray them as necessary to protect consumers from harms, such as poor-quality goods or services. While some such justifications are well founded, others may be false, exaggerated or self-serving. Those who champion protectionist regulations may find a sympathetic audience in well-intentioned regulators who lack confidence in market forces and seek to replace those forces with price controls,¹³ excessive quality standards,¹⁴ and limited licensing.¹⁵

¹² “The assumption that competition is the best method of allocating resources in a free market recognizes that all elements of a bargain—quality, service, safety, and durability—and not just the immediate cost, are favorably affected by the free opportunity to select among alternative offers.” Nat’l Soc. of Prof’l Eng’rs v. United States, 435 U.S. 679, 695 (1978).

¹³ For example, in the U.S., state regulators have sometimes tried to control the price of gasoline by setting either a ceiling to limit “price gouging” (ostensibly to protect consumers) or a floor to prevent below-cost gasoline sales (to protect competing sellers of gasoline). The FTC has opposed both of these types of price controls. *See, e.g.*, FED. TRADE COMM’N, REPORT ON THE FTC’S INVESTIGATION OF GASOLINE PRICE MANIPULATION AND POST KATRINA PRICE INCREASES (2006), <http://www.ftc.gov/reports/060518PublicGasolinePricesInvestigationReportFinal.pdf>; Comment from FTC Staff to the Honorable Robert F. McDonnell Concerning Virginia S.B. 458 to Prohibit the Below-Cost Retail Sale of Motor Fuel (Feb. 15, 2002), <https://www.ftc.gov/policy/policy-actions/advocacy-filings/2002/02/ftc-staff-comment-honorable-robert-f-mcdonnell>; Comment from FTC Staff to the Hon. Roy Cooper and the Hon. Daniel Clodfelter Concerning North Carolina H.B. 1203 / S.B. 787 to Amend North Carolinas Motor Fuel Marketing Act (May 19, 2003), <https://www.ftc.gov/policy/policy-actions/advocacy-filings/2003/05/ftc-staff-comment-honorable-roy-cooper-and-honorable>.

¹⁴ *See, e.g.*, N.C. State Bd. of Dental Examiners v. FTC, 717 F.3d 359 (2013).

¹⁵ *See, e.g.*, Comment from FTC Staff to Alderman Brendan Reilly of the Chicago City Council on Proposed Regulation of Transportation Network Providers (Apr. 21, 2014), <https://www.ftc.gov/news-events/press-releases/2014/04/ftc-staff-submits-comments-chicago-city-council-proposed>; Comment from FTC Staff to Jacques

The Opinion by the State Council enumerates certain types of suspect regulations, including discriminatory access conditions; policies that discriminate against non-local or imported goods, services, bidders, or investments; preferential policies favoring certain businesses; and disclosures of sensitive information about business operations. It also provides for exceptions based on national, economic, or cultural security; defense construction; disaster relief; poverty reduction; energy conservation; environmental concerns; and other circumstances prescribed by law.

One guide I would offer for assessing whether government regulations best serve consumer—rather than competitor—interests is a time-tested U.S. Executive Order from 1993, Order 12866.¹⁶

P. Lerner of the DC Taxicab Commission on Proposed Passenger Motor Vehicle Transportation Rules (June 7, 2013) <https://www.ftc.gov/policy/policy-actions/advocacy-filings/2013/06/ftc-staff-comments-district-columbia-taxicab>; Comment from FTC Staff to Anchorage Assembly Member Debbie Ossiander, Concerning AO NO. 2013-36, Proposing Changes to the Regulatory Framework for the Licensing and Permitting of Taxicabs, Limousines, and Other Vehicles for Hire (Apr. 19, 2013), <https://www.ftc.gov/policy/policy-actions/advocacy-filings/2013/04/ftc-staff-comment-anchorage-assembly-member-debbie>.

¹⁶ Exec. Order No. 12866, 58 Fed. Reg. 51735 (1993), *supplemented by* Exec. Order No. 13563, 76 Fed. Reg. 3821 (2011). E.O. 12866 sets forth the following twelve principles that agencies should follow to the extent permitted by law and where applicable:

1. Each agency shall identify the problem that it intends to address (including, where applicable, the failures of private markets or public institutions that warrant new agency action) as well as assess the significance of that problem.
2. Each agency shall examine whether existing regulations (or other law) have created, or contributed to, the problem that a new regulation is intended to correct and whether those regulations (or other laws) should be modified to achieve the intended goal of regulation more effectively.
3. Each agency shall identify and assess available alternatives to direct regulation, including providing economic incentives to encourage the desired behavior or providing information upon which choices can be made by the public.
4. In setting regulatory priorities, each agency shall consider, to the extent reasonable, the degree and nature of the risks posed by various substances or activities within its jurisdiction.
5. When an agency determines that a regulation is the best available method of achieving the regulatory objective, it shall design its regulations in the most cost-effective manner to achieve the regulatory objective. In doing so, each agency shall consider incentives for innovation, consistency, predictability, the costs of enforcement and compliance (to the government, regulated entities, and the public), flexibility, distributive impacts, and equity.
6. Each agency shall assess both the costs and benefits of the intended regulation and, recognizing that some costs and benefits are difficult to quantify, propose or adopt a regulation only upon a reasoned determination that the benefits of the intended regulation justify its costs.
7. Each agency shall base its decisions on the best reasonably obtainable scientific, technical, economic, and other information concerning the need for, and consequences of, the intended regulation.

Establishing a regulatory philosophy, this Order offered twelve principles for federal agencies to use in deciding whether and how to regulate. Its purpose is to ensure that a regulation benefits the public. It requires the regulator to identify a significant market failure or systemic problem, to evaluate alternative approaches to regulation, to choose the regulatory action that maximizes net benefits, to base the proposal on strong economic evidence, and to understand the expected effects of the regulation on those it hurts and benefits. An analysis using the Order 12866 principles can reduce the lingering effects of a planned economy, where businesses needed government approval before taking most actions.

Another path is to focus on competitor control over market entry, or what I call the “Brother, May I?” problem.¹⁷ In this situation, “would-be entrants are effectively required to obtain permission from incumbent competitors to enter or expand within a particular market.”¹⁸ This arises when a trade or professional association controls licensing or terms of services or when active market participants control a government body that regulates their business.

One of the best ways to identify anticompetitive regulations is through in-depth research in particular industries. The FTC has often done this through workshops focused on specific industries.

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8. Each agency shall identify and assess alternative forms of regulation and shall, to the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt.
 9. Wherever feasible, agencies shall seek views of appropriate state, local, and tribal officials before imposing regulatory requirements that might significantly or uniquely affect those governmental entities.
 10. Each agency shall avoid regulations that are inconsistent, incompatible, or duplicative with its other regulations or those of other federal agencies.
 11. Each agency shall tailor its regulations to impose the least burden on society, including individuals, businesses of differing sizes, and other entities, consistent with obtaining the regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations.
 12. Each agency shall draft its regulations to be simple and easy to understand, with the goal of minimizing the potential for uncertainty and litigation arising from such uncertainty.

Id. s 1(b).

¹⁷ *Brother, May I?*, *supra* note 1.

¹⁸ *Id.* This is not to say that a competitor exercising a valid patent right to exclude rivals is a competitive problem, given that protecting intellectual property rights ultimately spurs innovation and enhances competition.

Such workshops have often led to reports, economic research, and suggestions for how to remove regulatory barriers to competition in the market. Moreover, the attention official interest brings to a topic often sparks legal and economic research by academics, whose work adds knowledge about competition issues in a particular industry.

The FTC is not alone in this effort. The U.K. Competition and Markets Authority, and its predecessor, the Office of Fair Trading have conducted market studies to evaluate government regulation.¹⁹ In one of its reports, the Office of Fair Trading endorsed market studies as a way to “examine restrictions on competition that can arise through Government regulation or public policy.”²⁰ In another example, the (then-named) Irish Competition Authority examined the legal profession in 2006 and found it was “permeated with unnecessary and disproportionate restrictions on competition which should be removed[.]”²¹ Among the identified restrictions were entry restraints imposed by the Law Society and King’s Inns, which are private professional associations that control access to the market for legal services. The Authority recommended reforms, some of which the legislature subsequently enacted into law.²²

Anticompetitive restrictions appear in various guises, whether in law directly or through public policies that allow private entities to control entry in the market. Competition officials thus enjoy a wealth of targets when looking for such restrictions. The real challenge lies in selecting topics that provide the most consumer benefit.

¹⁹ See, e.g., OFFICE OF FAIR TRADING [currently U.K. COMPETITION & MARKETS AUTH.], MARKET STUDIES: GUIDANCE ON THE OFT APPROACH (2010), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/284421/oft519.pdf; OFFICE OF FAIR TRADING [currently U.K. COMPETITION & MARKETS AUTH.], DENTISTRY: AN OFT MARKET STUDY (2012) http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.oft.gov.uk/shared_oft/market-studies/Dentistry/OFT1414.pdf.

²⁰ OFT APPROACH, *supra* note 19, at 2.

²¹ See IRISH COMPETITION AUTH. [currently COMPETITION AND CONSUMER PROTECTION COMMISSION], COMPETITION IN PROF’L SERVS.: SOLICITORS & BARRISTERS iii (2006), <http://ccpc.ie/sites/default/files/documents/Solicitors%20and%20barristers%20full%20report.pdf>.

²² *Id.*; Legal Services Reg. Act 2015, No. 65 of 2015, <http://www.irishstatutebook.ie/eli/2015/act/65/enacted/en/pdf>.

The FTC has generally focused its research, advocacy, and enforcement in healthcare; other expensive transactions for consumers, such as home purchases and mortgages; and emerging technology-driven business models, such as online sales and the sharing economy.

A recurring problem that I have seen many times is an effort by entrenched incumbents to use government regulation or the rules of an association of competitors to restrict market entry by an upstart competitor that uses new technology to unbundle services and offer them at a lower price. Competition officials should be alert to such attempts by incumbents to cement into place restrictions that prevent consumers from enjoying the increased competition brought by new technologies. Frequently, industry argues such restrictions are necessary to protect consumers from low quality offerings but government officials should examine these arguments carefully and require evidence of consumer harm.

Chinese antitrust enforcers might look first to sectors of their economy with similar characteristics to search out regulations that deter competition and harm consumers.

In conclusion, given China's past state-controlled economy, it is unsurprising that anticompetitive regulatory approaches or mindsets remain. In a market system, however, consumer demand should determine products and business models. Misguided government regulation can foreclose competition, and regulators should be alert to regulations that favor particular competitors. Whether the state picks winners and losers itself or effectively delegates that role to self-interested actors makes little difference. Either way, consumers pay the price. Thus, I wish the Chinese AML agencies well in using the Fair Competition Review Mechanism and hope that they find the FTC's experience helpful to their efforts.

Thank you.