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IMPACT OF CHINA'S ANTITRUST LAW AND OTHER COMPETITION POLICIES ON U.S. COMPANIES

HEARING

BEFORE THE

SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

OF THE

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http://www.brooklaw.edu/~/media/PDF/LawJournals/BJI__PDF/bji__vol27i.ashx

IMPACT OF CHINA'S ANTITRUST LAW AND OTHER COMPETITION POLICIES ON U.S. COMPANIES

TUESDAY, JULY 13, 2010

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COURTS AND
COMPETITION POLICY
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 4:10 p.m., in room 2237, Rayburn House Office Building, the Honorable Henry C. "Hank" Johnson, Jr. (Chairman of the Subcommittee) presiding.

Present: Representatives Johnson, Jackson Lee, and Coble.

Staff Present: (Majority) Christal Sheppard, Subcommittee Chief Counsel; Eric Garduno, Counsel; Rosalind Jackson, Professional Staff Member; (Minority) Stewart Jeffries, Counsel; Tim Cook, Staff Assistant; and John Mautz, Legislative Director.

Mr. JOHNSON. The hearing on the impact of China's Antitrust Law and Other Competition Policies on U.S. Companies will now come to order. And without objection, the Chair is authorized to declare a recess. We have called this hearing because there is concern within the U.S. business community that China's new anti-monopoly law, AML for short, might be applied or interpreted in a discriminatory manner. The net effect of this would weaken the ability of U.S. companies to compete in China. If this is happening, it would contribute to the uneven balance of trade we already have with China and ultimately lead to more American jobs shipped overseas.

China is a sovereign nation entitled to design its laws the way it wants. At the same time it is unfair for Chinese companies to benefit from our antitrust laws which do not discriminate against them, while at the same time, applying their AML in a discriminatory manner against U.S. companies. In these troubled economic times, we must be vigilant in ensuring U.S. companies and entrepreneurs are not discriminated against, particularly in markets as big and important as China. This is why Congress and the Administration have given so much attention to examining a variety of Chinese economic policies, including its currency valuation, intellectual property enforcement and indigenous innovation rules.

We today are adding to this effort by focusing upon China's anti-monopoly law. The results regarding the AML that have been expressed to date and which our witnesses will focus on include the

seemingly uneven application of the merger review requirement, the potential for the abuse of dominance provisions to encompass normal business activity and the ambiguity in how the AML's abuse of intellectual property provision will be applied. Our witnesses will also focus upon the status of State-Owned Enterprises, SOEs, under the AML. I understand that up to 50 percent of China's GDP comes from SOEs and that generally China's SOEs operate as commercial entities like the Verizons and Fords of the world rather than, say, a state run utility. I think it is important that the AML is applied to China's SOEs like any other businesses, though I am told this is not the case. I look to the witnesses today to verify this and for them to elaborate on how SOEs and the concept of a planned economy fit into the antitrust regime. I also want to note that I am planning to lead a congressional delegation to China during the August recess to see firsthand various aspects of how the Chinese competition laws and their enforcement affect American business.

I am very much looking forward to the trip and the opportunity to interface with Chinese competition policymakers on these issues. Lastly, while it is important that China establish a level playing field with regard to its antitrust laws it should also be mentioned that the AML is brand new. The Chinese should be commended for updating their antitrust law. This is a positive development for all businesses in China, both Chinese and foreign. And an important step as China becomes a key player in international economic relations. Because the AML came into effect less than 2 years ago, the Chinese government is still developing and implementing regulations for most of the AML's provisions. That is why at present I see no reason to start ringing bells over the AML.

Nevertheless, we must keep our attention on how China goes about applying and enforcing the AML. I also think we should make it a priority to continue working with the Chinese to ensure discrimination based upon country of origin and the closing off of the Chinese market to American businesses does not occur. To this end, I hope the witnesses can provide constructive advice on how best to engage Chinese policymakers to ensure that the AML isn't applied in a discriminatory manner. I will now recognize my colleague, Howard Coble, the distinguished Ranking Member of the Subcommittee, for his opening remarks.

Mr. COBLE. Thank you, Mr. Chairman, for calling the hearing. Good to have our panel of witnesses with us today. Our trade philosophy is that the United States can and should compete in the global market. By opening trade and competition with other countries, those countries have a new opportunity to prosper economically and build new long lasting relationships that are driven by mutual interests. We have benefited from our trade with China, but we have also experienced some serious difficulties, mainly job losses. While I firmly believe, Mr. Chairman, that the United States can compete with any country, this only applies if there is a level playing field. That means the equivalent rules and standards and ensuring matters such as product safety, accurate currency rates, rights and protections for workers, intellectual property protection and enforcement, environmental protection, nuclear nonproliferation and most importantly human rights are para-

mount. The United States and China have engaged in a constructive dialogue for nearly 3 decades. We have not always agreed but we work through our disagreements to forge a strong relationship it seems to me. During this time, China has moved from a state controlled economy to an economy and society that reflect mutual interests embodied in its trade policies.

In North Carolina, trade with China has had a significant impact. Many of our textile plants sit empty and many other products including furniture that were once manufactured in our district are now either a symbol or shipped to North Carolina retail stores from China. North Carolina is rebuilding and retooling, but we also need a level playing field where we can compete against other countries, not unlike China.

To that end, we have the opportunity today to discuss competition policy in China and how it impacts the United States. The United States was the first country to codify a competition law, the Sherman Antitrust Act of 1890. Since that time, over 100 nations have implemented some form of competition act. These laws have the potential to lower prices and increase innovation for products and services around the globe but if they are implemented improperly, they can unfairly benefit comic companies at the expense of foreign rivals.

In 2007, China, as you pointed out, Mr. Chairman, adopted the Anti-Monopoly Law. While the AML bears all the hallmarks of a modern competition statute, we have yet to see how it will be implemented. I look forward to hearing from our panel of witnesses today about the potential of the AML. I am also interested to learn what more Congress and the Administration can do to ensure that China can benefit from our experiences developing competition policies. A sound and effective competition policy is in our mutual interest in seems to me. And I am hopeful that today's hearing will help us understand China's AML and why it is in our mutual interest. I yield back the balance of my time, Mr. Chairman.

Mr. JOHNSON. Thank you, Mr. Coble. Without objection, any other Members' opening statements will be included in the record. And at this time, I am now pleased to introduce the witnesses for today's hearing.

Our first witness is Mr. Shanker Singham, a partner at Squires Sanders law firm where he specializes in antitrust and international trade law, including WTO and market access issues. Mr. Singham is speaking on behalf of the global regulatory cooperation project of the U.S. Chamber of Commerce. Mr. Singham is also the chairman of the International Roundtable on Trade and Competition Policy. Welcome, sir.

Our next witness is Mr. Tad Lipsky, a partner at the law firm of Latham & Watkins where he specializes in U.S. and international antitrust and competition law. I also want to note that from 1992 through 2002, he served as the chief antitrust lawyer for the Coca-Cola company, a company which is close to my heart. And welcome, sir.

Next we have Professor Susan Beth Farmer, a professor of law at Penn State's Dickinson School of Law where she teaches courses in American and comparative antitrust law. She was also a Fulbright scholar in 2008 at the University of International Business

in Economics in Beijing, China, where she researched and studied the Chinese legal testimony, particularly the AML. Welcome.

And last but not least, we have Mr. Thomas Barnett, a partner at the law firm of Covington & Burling where he specializes in global antitrust and competitive law. From 2005 through 2008, he was the assistant attorney general of the Antitrust Division of the United States Department of Justice. I want to thank you all for your willingness to come and participate in today's hearing. Without objection, your written statements will be placed into the record and we would ask that you limit your oral remarks to 5 minutes. You will note that we have a lighting system that starts with the green light and in 4 minutes it goes to yellow and then in 5 minutes red. After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions subject to the 5-minute limit. Mr. Singham, please begin.

TESTIMONY OF SHANKER A. SINGHAM, PARTNER, SQUIRE SANDERS, LLP, ON BEHALF OF THE UNITED STATES CHAMBER OF COMMERCE, WASHINGTON, DC

Mr. SINGHAM. Chairman, Members of the Subcommittee, I am honored by the opportunity to address you today on the subject of China and competition policy on behalf of the U.S. Chamber of Commerce. As we noted in our written testimony, China's transition to a market economy where competition on the business merits is the norm continues to be a challenging one. It should not surprise anyone given the history, but China's attempts to move in this direction should be applauded. However, there are some systemic issues that the U.S. Government must consider in developing a responsible approach to China and its transition. First, China's transition is not yet complete. And there are profound challenges in the operation of a competition agency embedded in an economy that has not yet fully accepted competition policy as a normative organizing principle. In these cases, there is a danger that competition agencies may become another tool in the hands of an industrial policy focused government to distort markets rather than to ensure their competitiveness. We have seen evidence of a number of policies, such as compulsory licensing in China's new patent law and China's indigenous innovation policies that are focused on skewing the marketplace away from business competition on the merits and toward preferring certain technologies and certain firms. China's competition law, the AML, will not operate in isolation. Indeed it would not be surprising if China's competition agencies were used to achieve some of the industrial policy goals that some of the more recent developments in intellectual property and indigenous innovation are intended to express.

While we generally applaud the development of the competition law in China, which is a significant part of China's transition to a market economy, we note that in the unique market that is China, there remain concerns as to whether the AML will deliver on its goal of ensuring that firms of all nationalities operating in China will find a competitive marketplace there. We have summarized these concerns in our written testimony and they are broadly one. Will China's state-owned enterprises as well as its state privi-

leged private firms be subject to the same disciplines as other private enterprises?

The AML, as written, suggests differential treatment will be applied and this will lead to anti-competitive market distortions. Currently, China is forcing a number of administrative mergers without competition review to better position certain China SOEs in the market.

Two, will China use its AML to erode intellectual property rights of U.S. and other foreign firms in order to give advantage to that China competitiveness? Based on the revisions to the patent law which increase the scope for the use of compulsory licensing and other methods of technology transfer, as well as China's recent indigenous innovation policy, this danger is real.

Three, is there a danger that China will rely on discredited antitrust doctrines to promote industrial policy goals in the areas of merger control and unilateral conduct by giving greater weight to the welfare of competitors as opposed to consumers. Of particular concern is the use of discredited doctrines to build an anti-competitive approach to refusals to deal at essential facilities that would be completely outside the mainstream of international best practice. The type of analysis that the Chinese competition agencies are pushing with respect to unilateral conduct in particular, which involves branding certain firms dominant and then severely restricting their scope of action is very problematic.

In response to this concern, the U.S. Government should be careful and consistent in its own messaging on domestic policy as only departure from consumer welfare and business competition on the merits however slight will likely be seized on by China to justify its own policy. Four, there is concern about China's approach with respect to activates in both public and private sector where cartels formed in China have significant impacts on U.S. and other foreign markets. We believe as we make clear in our written testimony that all of the distortions referred to above some of which may emanate from the application of the AML have some which come from other laws and policies are anti-competitive market distortions, ACMDs which incidentally are not necessarily unique to China. But in China, these affect both U.S. firms, as well as Chinese consumers in the Chinese economy. It is, therefore, in both the interests of the U.S. and China to limit ACMDs and we suggest in our written testimony ways in which this can be done.

To summarize, one, we suggest a new intra-agency process built around ACMDs. This process would involve key stakeholders in the U.S. Government that have vested interest in their reduction, as well as sound application implementation and enforcement of the AML. We suggest this group report to Congress on the competition effects of ACMDs. We suggest evaluation of the potential for international agreements on ACMDs and we support the excellent technical assistance programs that the FTC and DOJ already provide to recognize the fundamental reality in the Chinese market. In summary, we are very willing to help the Committee as it tackles this subject and we can respond to any questions the Committee has.

Mr. JOHNSON. Thank you, Mr. Singham. Next, Mr. Lipsky, please.

[The prepared statement of Mr. Singham follows:]

PREPARED STATEMENT OF SHANKER A. SINGHAM

STATEMENT
of the U.S. Chamber of Commerce

ON: **Testimony - Hearing on China's AML and its impact on U.S. firms**

TO: **U.S. House Judiciary Subcommittee on Competition and the Courts**

DATE: **July 13, 2010**

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

China and Competition Policy

My name is Shanker Singham, and I am the Chairman of the International Roundtable on Trade and Competition Policy, and a partner at global law firm, Squire Sanders & Dempsey, L.L.P. I am making this testimony on behalf of the U.S. Chamber of Commerce, its Global Regulatory Cooperation (GRC) Project, and its Asia Program. The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber's GRC Project seeks to align trade, regulatory and competition policy in support of open and competitive markets, and its Asia Program gives voice to policies that help American companies compete and succeed in Asia's dynamic marketplace.

In addition to drawing upon the U.S. Chamber's numerous submissions to People's Republic of China (PRC) and U.S. government authorities on antitrust, foreign investment, intellectual property rights protection, standards setting, and public sector restraints on trade, many of these comments are drawn from my book, A General Theory of Trade and Competition; Trade Liberalization and Competitive Markets (CMP Publishing, 2007). The purpose of my remarks is to put China's developments towards the implementation of competition policy into context, and to help Members of Congress better understand how to best manage the economic and trade relationship with China to the benefit of both countries. First, it is important to understand the genesis of China's Anti-Monopoly Law (AML).

I. Towards a Competition Policy in China: Genesis of China's AML

The development of China's competition law has been a long journey that predates China's WTO accession in 2001. Initially as China's economy opened up, the virtues and benefits of an open economy were recognized by significant elements of the Chinese government. It was also recognized, at least by some in China, that it would be important to have competitive markets inside the border to supplement this trade openness, and ensure that the Chinese economy was able to grow in ways that benefited all its consumers. These developments in China are to be applauded.

However, it is important to note that China's efforts to establish an antitrust regime accelerated significantly following the failed bid of CNOOC for Unocal, which was blocked after a review by the Committee on Foreign Investment in the United States (CFIUS). Certain members of the Chinese administration saw the AML as an opportunity to invoke similar regulatory procedures to block foreign acquisitions of Chinese companies and to allow Chinese regulators to secure jurisdiction over global M&A activity. This was an unfortunate start to the road to implementation of the AML, as it mixed two very different concepts, the idea of a competition review based on sound economic analysis of how markets are affected by a merger (based on impact on consumers), and a national security review based on very different considerations. The latter review is particularly vulnerable to mercantilist thinking.

II. Competition Policy in a Country Governed by Non-Competition Concerns

Competition law implementation generally works best in countries that have already accepted competition as a normative organizing principle for the economy, i.e., countries that advocate regulatory frameworks that tend to maximize and facilitate business competition on the merits. There are some questions as to the direction of China's economic development – in particular whether state-led economic development and industrial policy are the driving forces behind regulatory promulgation. There are some serious challenges associated with placing a competition agency in an environment where industrial policy is the operating governing principle, and there is a real danger that such an agency could become another tool of industrial policy in the hands of those who would favor certain State-Owned Enterprises (SOEs) or other national champions over other competitors. This concern is a real one in the case of China, and one that the U.S. government must be mindful of, particularly given the fact that the three agencies responsible for enforcing the AML each has pre-existing missions tied to implementation of industrial policy, including state planning and the regulation of foreign investment and trade.

III. Concerns Emanating out of China AML

In light of the above, the U.S. government should pay particularly close attention to certain aspects of the AML and how it is being enforced.

1) Approach to SOEs and Firms Benefiting from Anti-Competitive Market Distortions

The China AML has provisions addressing SOEs. However, at best these provisions are ambiguous, and at worst they appear to exempt the strict application of competition policy to SOEs.

The AML's treatment of China's SOEs and state-influenced companies will serve as a critical barometer of China's commitment going forward to market-based economic reforms as well as the ability of foreign and domestic private companies to compete in critical sectors of the Chinese economy. The roles of the PRC government and Communist Party in the Chinese economy remain pervasive and have arguably increased in the wake of the global financial crisis. They are unlikely to shrink given the direction of the government's policies and the Party's objectives for economic development, as evidenced by the State-Owned Assets Supervision and Administration Commission (SASAC) December 2008 announcement that it would protect what the government considered to be "economic lifeline" sectors.

In its announcement, SASAC divided state industries it wanted to protect through continued government ownership between "key" industries that would remain "state dominated," meaning majority owned and controlled by the government, and "underpinning" industries that would remain "largely in state hands."

The key industries named by SASAC are: armaments, power generation and distribution, oil and petrochemicals, telecommunications, coal, aviation and air freight industries. The exact meaning of "state dominated" was not clearly spelled out. It is likely to mean different things for these seven industries and their subsectors. It was made clear that for arms, oil, natural gas and telecommunications infrastructure that the government will have sole ownership or absolute control of all the central enterprises and all the "major" subsidiaries associated with these industries. SASAC's circular also includes an "etcetera" at the end of the list of sectors, thereby leaving room for expansion in the future.

For aviation and air freight, the circular said that the state retains sole ownership and absolute control of the central enterprises but not the subsidiaries. For the "downstream products of petrochemicals" and the "telecommunications value-added service industry" the government would continue to encourage foreign investment and promote "diversity in property rights," according to the circular.

The circular said that the state would play a large supervisory role in the "underpinning" industries of equipment manufacturing, automobiles, electronic communications, architecture, steel, nonferrous metals, chemicals, surveying and design, and science and technology. This term also means different things depending on the industry. For equipment manufacturing, automobiles, electronic communication, architecture, steel and nonferrous metals, the state will retain absolute control or conditional corporate control of the central enterprises associated with these industries, according to the circular. For science and technology and surveys and design, the state will have a "majority stake" in directing central enterprises to undertake these tasks.

SASAC also announced a plan to make the SOEs more competitive through mergers and acquisitions to create some 20 or 30 powerhouse companies that would become "internationally competitive."

Given the dominant role of SOEs in China's economy (many of which enjoy monopoly- or oligopoly-status in the market and benefit from significant state subsidies and an artificially low cost of capital), America's leading firms are already in competition with them and, in the future, will increasingly compete with China's SOEs for markets and investment opportunities in China, in third-country markets, and at home in the United States.

How China enforces its AML vis-à-vis its SOEs is therefore highly relevant to not only the future trajectory of market-based reforms in its economy, but also the future commercial opportunities and competitive position of foreign companies in the China market.

The real problem associated with China SOEs is not the SOEs per se, but rather the government activities that distort the market in ways that damage welfare. These can include low-cost (or no cost) loans from state-controlled banks, tax laws that artificially lower the cost base of certain preferred firms, or regulatory exemptions that put certain preferred firms on a different footing than their competitors. While it is clearly important that China implement its competition law in ways that create a level playing field as

between SOEs and private firms, it is equally important that internal anti-competitive market distortions that give certain preferred firms advantages are minimized.

In this respect it is very important that China's new competition agencies exercise their competition advocacy responsibilities properly and completely. Competition advocacy is one of the most important tasks of competition agencies, particularly in countries where they are new and notions of competition are also new. It will be very important to see real evidence that the Chinese agencies are able to engage other branches of the Chinese government in the promotion and promulgation of pro-competitive regulations, laws and principles. This will also include, as specifically stated in the AML, that the anti-monopoly agencies will intervene with SOEs themselves to ensure pro-competitive behavior.

It is important to note that in any discussion of the disciplining of anti-competitive SOE behavior, while the outcome should be a level playing field between SOEs and their private competitors, this does not mean that precisely the same test must be used as between SOEs and private firms. SOEs, and government-preferred entities in general, are able to sustain below cost pricing for indefinite periods, for example, and are at best revenue maximizers rather than profit maximizers. The tests that one would rely on to discipline predatory pricing by private firms (requiring market power, below cost pricing and requiring the ability of the predator to recoup lost profits in the future as a monopolist)[1] may have to modified in the case of SOEs to require only below cost pricing as a required element.

Finally, in the analysis, it should also be noted that there is a spectrum of what constitutes a state-owned or state-influenced enterprise. At one extreme is the fully government owned company. At the other end of the spectrum, there is a private firm that benefits from government tax and other privileges and advantages. Both, unchecked, can distort the market in ways that damage welfare and their rival firms. An important approach which is shared by the Chinese competition agencies and the U.S. government is to therefore try to lower anti-competitive distortions that can lead to welfare diminishing outcomes.

2) Competition and Intellectual Property: Real or Imagined Tension

Conventional wisdom suggests that competition and intellectual property are in tension. In reality, competition and intellectual property policy share the same welfare enhancing goals. Intellectual property as a type of property right is precisely what firms compete with, and it is welfare increasing to facilitate and encourage this type of competition. However, if the guiding light of competition enforcement is not an economic, welfare-oriented concern, but rather an industrial policy-born concern protecting competitors as opposed to consumers, then intellectual property and competition policy may well find themselves in tension.

In the case of China, there are some troubling developments indicating that an industrial policy drive to erode foreign intellectual property rights and to encourage technology transfer and compulsory licensing will find their way into the implementation of antitrust law. For example, despite heavy pressure by other governments and foreign industry, China's patent law is still not consistent with the significant restrictions on compulsory

[1] See for example Brooke Group Limited v. Brown and Williamson Tobacco Corp, 509 U.S. 209 (1993)

licensing established by Article 31 of the WTO Trade Related Intellectual Property Rights Agreement (TRIPS). Contrary to TRIPS, the 2008 amendments to China's patent law fail to limit the ability of PRC authorities to issue compulsory licenses to access only the patent(s) involved in any conduct found to be anti-competitive. The word "competition" is often used to ground compulsory license grants in many emerging markets. However, the analysis used to justify the grant of a compulsory license is often based on non-economic, competitor and not consumer welfare concerns. Where this is the case, the resulting erosion of IPRs will lead to a less competitive marketplace, not a more competitive one.

The panoply of policies under the heading of Indigenous Innovation strongly suggests that the Chinese government is tilting the market in favor of certain technologies and certain preferred companies at the expense of foreign intellectual property rights holders. The recent guidelines of China's Supreme People's Court regarding the implementation of China's national IP strategy contain several troublesome paragraphs indicating the judiciary's propensity to advance China's national innovation agenda. For instance, they note:

> *We should intensify the protection of core technologies which may become a breakthrough in boosting the economic growth and which have independent intellectual property rights so as to promote the development of the high and new technology industries and newly rising industries, improve the independent innovation capabilities of our country and enhance the national core competitiveness.*[2]

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[2] Guidelines of the Supreme People's Court on Several Issues Regarding the Implementation of the National Intellectual Property Strategy, Par. 9 (No. 16 [2009] of the Supreme People's Court March 29, 2009). The Guidelines also note that judges should:

- "fully apprehend that the implementation of the intellectual property strategy is an urgent need to build an innovative country, . . . and a crucial move to enhance the national core competitiveness by taking into account such aspects as helping to enhance the independent innovative capabilities of our country, improve the system of social market economy of our country, enhance the market competitiveness of the enterprises of our country, enhance the national core competitiveness and open wider to the outside world." (Par. 1).
- "ensure the correct political direction . . . also improve the enterprises' independent innovation capabilities." (Par. 8).
- "protect the know-how in integrated circuit designs *and timely grant judicial remedies so as to promote the development of the integrated circuit industry*." (Par. 14, emphasis added).
- "properly deal with the relationship between the competition policies and industrial policies. . . ." (Par. 16).
- ". . . create intellectual property out of the independent innovation fruits, and to have them commercialized, industrialized and marketized." (Par. 17).

Already successful U.S. companies which have brought IP infringement claims against local companies have been faced with meritless counterclaims of IP abuse. Enforcement of IP rights is unpredictable, and the PRC court system is often unreliable and influenced by Chinese policy makers who have openly expressed a desire to force the transfer of foreign IP to better enable local companies to innovate and compete in key industries.

In light of the indigenous innovation policy of replacing foreign technology in critical infrastructure and the high level government mandate to reduce the use of foreign technology to less than 30 percent in the entire Chinese economy, multinationals with dominant market shares globally and in China may find the Chinese Anti-Monopoly Law knocking at their door.

In fact, some PRC officials have tried to use the AML to force technology transfers. The State Administration for Industry and Commerce (SAIC), which enforces the AML, has drafted a regulation that would allow compulsory licensing of intellectual property owned by a dominant company that unilaterally refuses to license its IP if access to such IP is "essential" for others to effectively compete and innovate.[3] The refusal to license in such cases would be considered by SAIC to be an "abuse of IP." A similar provision was included in a 2005 draft of the AML itself, but extensive foreign criticism persuaded China to remove it.[4] The concept has quietly resurfaced in SAIC's draft regulation, which could be used to force compulsory licensing of MNC technology to a budding Chinese competitor that alleges foreign IP is impeding its innovation capabilities. This policy approach once again draws on antiquated concepts of competition policy and law that have long since been discarded by more advanced competition agencies around the world. The danger is that this approach will make the China market less competitive rather than more competitive and will lead to significant restraints on innovation.

3) <u>How Will China AML Apply to Single Firm Conduct</u>

The U.S. government should also be concerned about how the AML will apply to single firm conduct. Currently, the AML suggests an "abuse of dominant position" test where the decision as to what constitutes an abuse of dominance consists of a bifurcated analysis where dominance is first defined primarily by reference to market share, and then there is a separate analysis of whether there has been an abuse.[5] Market shares are a legitimate

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[3] *See* Article 18, Guidelines for Anti-Monopoly Law Enforcement in the Area of Intellectual Property Rights (Fourth Draft Revision).

[4] The AML as enacted condemns "abuse of IP" by a dominant company but does not define the concept or the remedy for the conduct. *See* Article 55, Anti-Monopoly Law of the People's Republic of China (Adopted at the 29th Meeting of the Standing Committee of the National People's Congress on August 30, 2007). Article 55 states that an entity can be charged with abusing its IP under the AML only if its exercise of IP is not in accordance with China's IP laws and regulations.

[5] See AML Article 19 Undertakings that have any of the following conditions can be presumed to hold a dominant market position:

（一）一个经营者在相关市场的市场份额达到二分之一的；

(i) the market share of one undertaking in relevant market reaches 1/2;

starting point for a single one-step analysis of whether a particular single firm activity has led to damage to competition, but they are only a starting point. Indeed, the International Competition Network (ICN) has noted in its Recommended Practices for Dominance/Substantial Market Power Analysis (2008) that

> "All jurisdictions agree that unilateral conduct laws address specific conduct and its anticompetitive effects, rather than the mere possession of dominance/substantial market power or its creation through competition on the merits. All jurisdictions also agree that the goal of enforcement is to identify and act against conduct that is anticompetitive, although it can be difficult to distinguish between pro- and anticompetitive unilateral conduct. Determining whether a firm possesses dominance/substantial market power generally is the first step in the evaluation of potentially anti-competitive unilateral conduct. Laws differ in the way dominance/substantial market power is defined. Most jurisdictions find that a rigorous assessment of whether a firm possesses dominance/substantial market power, going well beyond market shares, is highly desirable. In jurisdictions with a more formalistic definition of dominance based on market shares, it is recommended that agencies be particularly rigorous in their analysis of the conduct at issue."

Moreover, last month, SAIC issued draft provisions on prohibiting abuse of dominance that would establish a presumption of illegality for routine transactions by dominant businesses. Basically, the draft would force dominant companies to justify any reduction of trade or refusal to enter into specified business transactions with competitors and other entities without first requiring the agency to prove anti-competitive effects existed. The draft provisions would thus vest far too much discretion in SAIC to "manage" competition. For example, under its draft broad refusal to deal provisions, the agency could force dominant MNCs to grant competing Chinese entities access to their prized assets (e.g., supply or distribution chains).

The U.S. government should be concerned about whether China's AML will be implemented in this area in such a way as to deliberately target large U.S. firms in order to favor their Chinese rivals. An approach that is inordinately based on market share or which presumes dominance based on a particular market share, and which suggests the use of

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（二）两个经营者在相关市场的市场份额合计达到三分之二的；

(ii) the joint market share of two undertakings as a whole in relevant market reaches 2/3; or

（三）三个经营者在相关市场的市场份额合计达到四分之三的。

(iii) the joint market share of three undertakings as a whole in relevant market reaches 3/4.

有前款第二项、第三项规定的情形，其中有的经营者市场份额不足十分之一的，不应当推定该经营者具有市场支配地位。

In situations stipulated in the preceding items (ii) and (iii), if an undertaking has market share less than 1/10, it shall not be presumed to hold a dominant market position.

non-economic concerns (such as having a fragmented market for its own sake) could harm U.S. firms operating in China, could damage the Chinese economy and critically take away incentives for innovation.

4) Merger Control

The merger control regimen raises similar concerns as those set out for single firm conduct. If China's competition agencies adopt an approach to merger enforcement that does not evaluate mergers based on their alleged harm to competition and their welfare diminishing consequences, but rather relies on non-economic factors such as a fragmented market for its own sake, or an undue reliance on competitor welfare, then this will allow the China authorities to block mergers and acquisitions that do not cause consumer welfare losses, but may fall foul of a particular China government industrial policy. We have arguably already seen this in the case of Coca-Cola's attempted acquisition of the Huiyuan Juice Group Limited. The concern in that case was that the decision to block the acquisition was responsive to complaints from some quarters in China about potential loss of a major Chinese brand to a U.S. company. In the case, Coca-Cola was attempting to acquire an entity that had 32.6% market share of what was a very unconcentrated pure juice business.

5) Cartel Enforcement

Of particular concern, China's AML can be interpreted to provide an implicit exemption for export cartels, which litter the Chinese landscape. Therefore, U.S. firms may be competing in third countries against Chinese firms which have been authorized to collude.[6] Further, U.S. consumers can be victims of such anticompetitive behavior as those export cartels distort markets by colluding to set price in foreign markets. It will be important for the U.S. Department of Justice to remain vigilant and prepared to aggressively prosecute such practices and not accept any claim by China that such export cartels are operating under the control of the state as an excuse as appeared to be the case in the Chinese Vitamin C case.[7] Such claims by China stand in direct contrast to its repeated claims, including at the May 2010 meeting of the Strategic and Economic Dialogue and in advance of its updated offer in July 2010 to accede to the WTO Agreement on Government Procurement, that its SOEs operate solely as commercial actors, independent of state influence and benefit.[8]

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[6] See AML Article 15: Any agreement among undertakings with one of the following objectives as proved by the undertakings shall be exempted from application of Article 13 and 14: ... (vi) to safeguard the legitimate interests in foreign trade and economic cooperation...

[7] China Defends Price Fixing by Vitamin Makers, John Wilke, November 25, 2008, Wall Street Journal.

[8] China made very substantial commitments as part of its accession to the WTO. Many of these obligations are recorded in the WTO's Working Party Report on China's Accession. Among the most important of the commitments is the statement by the representative of the Government of China that China would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g. price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement.

IV. Recommendations for Action

The Chamber's recommendations for action coincide with a number of books and articles I have written which are referred to below and which should be added into the record.[9] These recommendations note that decisions by China's antitrust agencies to act or not act which are non-economic in nature are a subset of other market distorting practices by governments. Simply because a competition agency takes action does not mean that the result of that action will automatically lead to more competitive markets. Indeed, for reasons we have highlighted above, if the competition agency is being used as a tool to effect industrial policy this will be an anti-competitive market distortion in and of itself. The Chamber recommends that the U.S. government re-orient its policy responses based on this reality, but notes that these recommendations are not intended to be a substitute for existing international policy in this area but rather additive to it.

A. Reform Inter-Agency Process to Deal Squarely With Anti-Competitive Market Distortions from a Competition Policy Perspective

The Chamber recommends developing a new inter-agency group around anti-competitive market distortions which would include distortive decisions by competition agencies. This group should comprise representatives of all U.S. government actors with a stake in ensuring that the Chinese (and indeed other) markets are competitive, including not only the Department of Justice (DOJ) and the Federal Trade Commission (FTC), but also, and equally important, the Department of Commerce (DOC), and the Office of the United States Trade Representative (USTR), which lead the annual U.S.-China Joint Commission on Commerce and Trade (JCCT), and the Department of the Treasury and Department of State, which lead the annual U.S.-China Strategic and Economic Dialogue.

B. Congressional Reports on Foreign Country Market Distortions

Along the lines of USTR's National Trade Estimate, the above group should be required to report to Congress the state of the competitive landscape in China and on any damage caused by an anti-competitive market distortion in the market. Such information would be useful in promoting a dialogue on the impact of market distortions and should help lead to their ultimate minimization.

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[9] Shanker Singham, A General Theory of Trade and Competition: Trade Liberalization and Competitive Markets (CMP Publishing, 2007); Shanker Singham and Daniel Sokol, Public Sector Restraints: Behind-the-Border Trade Barriers, 39 Tex. Int'l L.J. 625 (2004); Shanker Singham, Is it Time for an International Agreement on Uncompetitive Public Sector Practice?, 27 Brook. J. Int'l L. 35 (2001-2002); Shanker Singham, Trading Up, The National Interest, July/August, 2007; Shanker Singham and Donna Hrinak, Poverty and Globalization, The National Interest, Winter 2005/6

C. Stricter Enforcement (and Increasing Scope) of U.S. Antitrust Laws under the Foreign Trade Antitrust Improvements Act

Current U.S .law enables the U.S. antitrust agencies to look at anti-competitive behavior which takes place abroad but which has effects in the U.S. market. More rigorous enforcement of these laws when dealing with private anti-competitive practices is required, but the law should also be applicable to public sector restraints on trade that are anti-competitive.

D. Stricter Enforcement (and Increasing Scope) of Section 337 of the Trade Act where Anti-Competitive Practices are Alleged/Competition Safeguard

Section 337 of the Trade Act enables the U.S. to block imports of products that have been produced as a result of intellectual property violations and anti-competitive practices. While 337 cases are regularly brought to block IP infringing products, few are brought under the head of anti-competitive practices, and even fewer are brought where those anti-competitive practices emanate from the public sector.

In the alternative, a competition safeguard could be fashioned which would be applied in cases of proven allegations of anti-competitive market distortions giving rise to trade advantages. The safeguard could be linked to the level of distortion (as measured by welfare effect), and would be reduced as the level of distortion was itself reduced.

E. Evaluation of International Agreements on Anti-Competitive Market Distortions

Ultimately, international disciplines are needed to address anti-competitive market distortions. The outlines of such an agreement are already in place with certain provisions of existing WTO agreements (e.g., Article IX, GATS, Article XVII, GATT, Reference Paper on Competition Safeguards annexed to the Basic Telecommunications Agreement). There is also useful material in the European Union's State Aids laws, and jurisprudence as well as some of U.S. Free Trade Agreements. The current competition chapter being negotiated as part of the Trans-Pacific Partnership Agreement represents an excellent opportunity to advance competition policy disciplines that promote consumer welfare, rein in industrial policies, and discipline anticompetitive behavior of SOEs.

F. Technical Assistance

None of the above limits the importance and role of technical assistance. The U.S. government already provides extensive technical assistance to China with respect to the AML, including via a landmark training program initiated by the U.S. Trade and Development Agency (USTDA), with strong support from the U.S. private sector. The initiative has brought together an interagency steering committee comprised of the DOJ, the FTC, the DOC, and USTR to develop a series of training modules for China's AML authority on the U.S. experience in implementing antitrust law in a manner that promotes competition, as opposed to protecting competitors, and advances consumer welfare. The

U.S. Chamber of Commerce has been honored to serve as the private sector liaison to the interagency steering committee. To date, the interagency, in collaboration with the private sector, has conducted seven training programs in China under the initiative, with an eighth scheduled for this fall.

However such technical assistance is provided in the same way that the U.S. provides technical assistance to any country with a new competition agency. While the technical assistance program is to be commended, the U.S. government should be more pro-active in the selection of key topics for technical assistance. It should be recognized that technical assistance is currently being provided by a number of countries whose competition policy is not necessarily guided by economic welfare concerns. Technical assistance should be focused on (i) competition advocacy; (ii) economic principles of competition implementation and enforcement; (iii) unilateral conduct; (iv) interface with IPR and standards; (v) merger control. However, in each of these areas, a significant part of the training should be devoted to the fundamental economics that underpins the legislative framework.

V. Conclusion

The U.S. Chamber of Commerce recognizes that promulgation of the AML is only the first step in China's effort to establish a comprehensive, nationwide competitive market place, where business competition on the merits determines winners and losers. We look forward to continued engagement with Chinese authorities and are committed to sharing the U.S private sector's experience in the area of antitrust.

We also look forward to further clarification concerning the AML's application in certain key areas, such as substantive rules against anticompetitive conduct, substantive standards for administrative monopolies, procedures for reviewing transactions on both competition and national security grounds, enforcement mechanisms, defining abuses of intellectual property rights, and penalties.

The U.S. Chamber sincerely hopes that China's competition authorities will focus on modern economic principles and prevailing international practices when applying the new law. We will be observing with interest how the law is put into practice and look forward to continuing to support the government's moves to develop its competition-law system.

TESTIMONY OF TAD LIPSKY, PARTNER, LATHAM & WATKINS, LLP, WASHINGTON, DC

Mr. LIPSKY. Thank you, Mr. Chairman. Thank you very much to the Subcommittee for this opportunity to appear. Shanker in his written testimony and in his brief oral statement, has just summarized the matter very effectively and it is also obvious from your own introductory statements that the level of knowledge you have about the development of the AML and the current situation we are in is already pretty well developed. We agree that the law is new and many of the potential problems have been identified are largely questions of implementation and I would identify myself very strongly with the Chairman's statement that we need to—I don't recall his exact words, but the feeling was we need to continue and intensify our engagement with the Chinese agencies and the Chinese officials who concern themselves with antitrust enforcement in China and who develop policy. And Congressman Coble, you have asked the very simple question, what can we do?

So let me, in my very brief oral summary of my statement, try to contribute to that question because I support the idea of continuing and intensifying our engagement. First, the United States should have a coherent message about what antitrust law is all about. We stand, I think, first in the world in identifying ourselves with the purpose of antitrust being to encourage competition on the merits, policy that rewards innovation, efficiency, productivity and competitiveness to maximize the wealth that our societies can create with our scarce resources. I think other nations are either—do not implement or do not implement as effectively that approach to antitrust, and I think the United States has a lot to say and why this is a policy that makes sense and why a failure to unify antitrust policy around the concept of competition on the merits renders the enforcement of the law incoherent, unpredictable and susceptible to parochial influence, ultimately dragging down economic performance and conflicting with many of the economic and trade goals that you identified in your opening statements.

So the United States, number one, should be a vigorous advocate of competition on the merits as the central focus of antitrust. As Shanker mentioned, this makes it imperative that the U.S. antitrust agencies conduct themselves with great care when they present views on issues of antitrust policy to the business community and the public. The whole world watches these 100 jurisdictions that now have be antitrust enforcement when the United States speaks about antitrust because we have still, by far, the longest and strongest tradition of antitrust enforcement. When we put forth new ideas, we have to make sure that great care is taken to make sure that abroad where there is much less experience with antitrust, things are not taken the wrong way.

Our current policy discussion on the possibilities of extending the reach of section 5 of the Federal Trade Commission Act I submit would stand as an example of how we might have been a little bit careless in conducting a domestic dialogue without thinking very carefully about how that dialogue is heard at foreign antitrust agencies. Once we have a coherent message, we neat advocacy and we need engagement with the Chinese agencies as has been men-

tioned. Shanker mentioned the possibility of an interagency task force with regard to China. I support that.

Let me just mention one other idea here in my brief time. So far as I am aware, even though we rely on our antitrust agencies to have dialogue with China and other foreign antitrust agencies, so far as I am aware there is no direct recognition in the statutes that authorize our antitrust agencies to act in their organic statutes or in their appropriation statutes. There is nothing that directly authorizes them to engage in these activities of having dialogue with the Chinese officials, nor with the officials of any other antitrust agency around the world or with the international organizations that concern themselves with antitrust policy.

This would be the international competition network, the competition committee of the OECD and some others that have been mentioned. There is an excellent recommendation in the Antitrust Modernization Commission Report that there be some specific budgetary and recognition and some recognition in the authority for the agencies so that they are encouraged to engage because Congress has, in effect—if Congress would, in effect, certify and approve and fund efforts of this nature, I think they would feel much more at liberty to be presenting the kind of dynamic advocacy that I think it sounds like all of us here recognize is required.

Let me conclude my remarks there. Thank you very much for the opportunity to appear. And, of course, I will be glad to answer any questions.

Mr. JOHNSON. Thank you, Mr. Lipsky.

[The prepared statement of Mr. Lipsky follows:]

PREPARED STATEMENT OF TAD LIPSKY

Statement of

Tad Lipsky
Latham & Watkins LLP
Washington, D.C.

before the

Subcommittee on Courts and Competition Policy
Committee on the Judiciary
United States House of Representatives
Washington, D.C.

Regarding

ENFORCEMENT OF THE ANTIMONOPOLY LAW OF THE PEOPLE'S REPUBLIC OF CHINA:

Effects on U.S. and Global Business – Issues and Prospects

July 13, 2010

INTRODUCTION

I am honored by your invitation to appear before the Subcommittee on the important questions involving the recent enactment and first steps taken to enforce the broad-based competition law of the People's Republic of China, known as the Antimonopoly Law (AML). I understand that the Subcommittee is interested primarily in how these developments affect United States business. This presentation represents only my personal views, based on my individual understanding and experience. This testimony does not represent the views of Latham & Watkins LLP or any of its clients, or of any other individual or institution for that matter, although such views may unintentionally coincide.

As you can see from the biography submitted to Subcommittee staff counsel, I've spent my entire career as an antitrust lawyer and have experienced the full force of the unprecedented expansion of antitrust law around the world during the last quarter-century. The year that I graduated from law school, 1976, was the same year that the Hart-Scott-Rodino Act created the world's first premerger notification system. At that time and for the previous eighty-six years, antitrust law enforcement was an activity almost completely confined to the United States. Today, there is serious antitrust enforcement in over 100 jurisdictions throughout the world, including all major trading nations. Although the United States still has by far the longest and most extensive record in all forms of antitrust enforcement, other jurisdictions are rapidly gaining on us. They are adopting more severe penalties and remedies, increasing the scope and power of their procedural options both for government agencies and private litigants, and banding together in more creative forms of bilateral and multilateral enforcement cooperation.[1] To my knowledge this spectacular expansion in antitrust coverage is unprecedented in its speed and impact, compared to any other field of law. It has led to an enormous expansion in the cost and complexity of antitrust compliance for U.S. and other global businesses, and it has created

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[1] The scope and speed of these developments is traced in two articles, Abbott B. Lipsky, Jr., *To the Edge: Maintaining Incentives for Innovation After the Global Antitrust Explosions*, 35 Georgetown J. Int'l L. 521 (2004), and Abbott B. Lipsky, Jr., *The Global Antitrust Explosion: Safeguarding Trade and Commerce or Runaway Regulation?*, 26 Fletcher Forum of World Affairs 59 (2002).

dramatic growth in the study of legal, economic and policy issues related to competition, and in the practice of antitrust law in all its forms.

RAPID IMPLEMENTATION OF AML MERGER ENFORCEMENT

China's antitrust rules were a long time in gestation, dating back at least to the early 1990's, but when the law was finally enacted in 2007, there was no time wasted in implementation. Within a very short time after China implemented its merger review process under the new AML, the responsible Chinese government agency, the Ministry of Commerce (known by its acronym MOFCOM), was conducting in-depth merger investigations and blocking or placing significant conditions on transactions involving major firms based in the United States and in other jurisdictions. By contrast, the European Union did not have a mandatory merger notification and approval process in place until 1990 – more than forty years after European competition rules were first adopted in the Treaty of Rome, which created the EU's first main predecessor, the European Economic Community. So, while China came a bit late to the antitrust "party", it finds itself seated near the head of the table.

In principal we should welcome China's arrival among the antitrust community enthusiastically. Particularly for a great nation with such an important place in the history of civilization, China's enactment of a competition law represents an important symbolic endorsement of free markets, competition, economic progress and the spirit of enterprise – ideas shared by the United States and other nations that we regard as sympathetic to our basic traditions. At a time when even our own nation's basic commitment to those ideals has been brought into question by some, China's embrace of antitrust law makes us realize how far the world has traveled from the era when the main danger to civilization was thermonuclear conflagration and the key international confrontations involved the profoundly conflicting economic visions of two feuding geopolitical blocs. As we begin to consider in detail how the implementation of China's AML is affecting U.S. and other businesses, we need to maintain the broader perspective so that the gauge and temper of our concern is not misconstrued as the early beginnings of any fundamental quarrel.

UNIQUE FEATURES OF AML IMPLEMENTATION

Among a variety of unique features of the AML and its legal and economic context, China is attempting to implement a complex, multiparty allocation of antitrust enforcement authority. While the merger review authority is lodged within the Antimonopoly Bureau of MOFCOM, authority over anticompetitive agreements and abusive conduct by dominant firms is divided between the National Development and Reform Commission and the State Administration for Industry and Commerce according to a distinction between price and non-price conduct. While the line between price and non-price conduct is familiar to antitrust lawyers from the United States and other jurisdictions, I am not aware that it has ever been used as the key means to divide enforcement responsibility between different antitrust enforcement agencies. There is also an Antimonopoly Commission at a higher policy level that coordinates the operations of the three main enforcement agencies and reports on antitrust matters to the State Council, the senior administrative authority of China's central government. The AML also provides possibilities for AML enforcement authority to be delegated to provincial or even municipal authorities in some circumstances.

Second, the enforcement mechanisms associated with conduct other than mergers, acquisitions and other structural transactions are still much less developed and less frequently exercised (so far as public information reveals) than the merger authority wielded by MOFCOM. While there have been a few reported investigations and cases involving price-fixing agreements or other types of anticompetitive conduct outside the merger sphere, the resolution of these cases does not always clearly rest on the AML alone, but often involves reliance on other Chinese statutes that can be used to regulate competitive conduct, such as the Price Law. You may be aware of commentary on the NDRC proceedings involving an alleged price increase by the Chinese Instant Noodle Association, which is sometimes used to provide an example of this tendency to involve multiple sources of law in the pursuit of specific cases involving market practices. But in general there is an intense contrast between enforcement of the merger rules – which look very much like the merger notification and approval processes of other familiar jurisdictions – and the enforcement of other rules. But there is no doubt that these other rules are coming into focus and will soon be tested by specific enforcement initiatives. Both SAIC and

NDRC have issued interim rules that will govern AML enforcement efforts under their jurisdiction.

A third important feature characterizing implementation of the AML is the substantial range of unknown variables that must be considered in predicting the likely enforcement intentions of the Chinese agencies that have responsibility under the AML. The Chinese took advantage of many opportunities to examine antitrust laws in jurisdictions in Asia and throughout the world, including Europe and the United States, in the long period of study and legislative work that led to the enactment of the AML. They relied on Chinese and foreign academics, and had extensive discussions with private lawyers from other jurisdictions, officials from government antitrust enforcement agencies in other nations and non-Chinese professional groups such as the American Bar Association Section of Antitrust Law. But the system developed by the Chinese, while based almost entirely on recognizable precedents from other jurisdictions, is uniquely Chinese.

The specific content of the AML provisions and the structure of the Chinese AML enforcement agencies are in some respects the least of the differences between Chinese antitrust enforcement and competition law as it is experienced in other parts of the world. The Chinese AML occurs within a broader economic, political and institutional context that is unfamiliar to U.S. business firms and other companies that participate in the global economy. China still bears many fundamental and unmistakable signs of its heritage, which included a lengthy period of heavy reliance on the ideology and practical instruments of central planning. This is manifested by a persistent legacy of government involvement in Chinese businesses and a certain pattern of governmental and economic structure. Importantly, the judicial system, which has played such a critical role in placing limits and imposing structure on U.S. antitrust enforcement, does not appear to play such a significant role in China at the moment, although the possibility that it could play a major role in the future is evident. This is in part due to differences in the role of judicial processes in China and in the position of the courts in the Chinese government structure, as compared with jurisdictions like the U.S.

ADJUSTING TO THE DYNAMICS OF AML IMPLEMENTATION

With so many elements of the Chinese AML and its enforcement structure shrouded in uncertainty and subject to a broad range of potential outcomes, it becomes extremely difficult to predict how U.S. business operations that come in contact with China might be affected by AML enforcement. Some significant part of this uncertainty is attributable to the usual breaking-in period that any new legal structure experiences. There are so many dynamic elements of Chinese law, policy, and economic patterns, however, that the uncertainties associated with the AML are compounded to an extent. Of course uncertainty is always a burden and a threat to business, whether U.S. businesses or other businesses that seek to benefit from the enormous opportunities that are clearly present in China.

There can be no serious question that U.S. businesses and others will benefit enormously from enhanced clarity in the rules and institutions of AML enforcement (including substantive rules, procedures and remedies), from an increased emphasis on the interpretation and application of competition law to maximize the productivity and social wealth-creating capacity of the economy, from a clear and consistent separation between the implementation of competition law and the implementation of other policies that are in tension or conflict with the wealth-maximization objectives of competition law (such as protection of domestic firms or industries, export promotion and protection of small and medium-sized businesses) and from a clear commitment to the placement of productive resources in business institutions that lack government ownership, government financing, government management, and other forms of government participation. The same could be said of almost any other jurisdiction -- and I specifically include the United States itself in that statement. The challenges of AML enforcement, however, offer some particularly interesting challenges that will require sustained effort and consistent advocacy by earlier travelers down the road of market institutions and competition-law enforcement.

HOW CONGRESS CAN HELP

There is a very rich menu of specific activities that Congress and the other branches of government can undertake to advocate approaches that would help clear the path for U.S. and other businesses to participate vigorously and productively in the ongoing transformation of China and the world economy. There are many individuals and institutions involved in dialogue with and advocacy before Chinese authorities, seeking to clarify and rationalize substantive and procedural rules, and to make sense of the institutional pattern formed by the AML against the backdrop of other influential Chinese government entities. Many bar and business groups – the U.S. Chamber of Commerce, the United States Council on International Business, the American Bar Association (through its Section on Antitrust Law and Section in International Law), to name just a very few – contribute to dialogue with the Chinese antitrust agency officials. U.S. antitrust officials have frequently traveled to China for meetings with enforcement agency officials and have just as frequently hosted their Chinese colleagues here in the U.S.

Congress should support the development of a coherent U.S. government approach to the issues presented by implementation and enforcement of the AML. It should provide resources for advocacy of that approach before appropriate Chinese officials and government bodies, so that the voice of the United States is heard clearly by the audiences in China that concern themselves with competition and related spheres of economic and legal policy. There are always institutional opportunities and options to consider in pursuit of these broad objectives. I would be happy to assist the Subcommittee in identifying and assessing some of those options.

Again, thank you for the honor of inviting me to appear. I will be pleased to answer any questions.

Mr. JOHNSON. Next, Professor Farmer.

TESTIMONY OF SUSAN BETH FARMER, PROFESSOR OF LAW, PENNSYLVANIA STATE UNIVERSITY, DICKINSON SCHOOL OF LAW, UNIVERSITY PARK, PA

Ms. FARMER. Thank you. Chairman Johnson and Ranking Member Coble, I appreciate the invitation to discuss the developments of the Chinese antitrust law and their effect on American business. International competition law and enforcement certainly raises important policy issues and congressional attention is appropriately focused on these considerations. The AML, however, is only 2 years old. It went into effect in 2008 and in that short time, three separate agencies have been organized to enforce the various aspects of the law. They have issued many rulings, guidelines and procedures and have begun to investigate and take decisions on individual cases. Of course, the AML had been in development for more than a decade.

So the 2-year life of the law may understate its actual development. Importantly, a number of the decisions and the regulations will affect and have affected American businesses operating in China. In order to assess the impact of the AML, I would start with the words of American Justice Oliver Wendell Holmes. He explained that the life of law has not been logic, it has been experience and these experiences included the felt necessities of the time, the prevalent moral and political theories and intuitions of public policy. He concluded that the law embodies the story of a nation's development through many centuries and it cannot be dealt with as if it contained only the axioms found in a math book.

China's experience shows the difficulties of moving from theory to law to implementation rules to the construction of the efficient apparatus for implementation and then finally to enforcement within a system that has frankly grown far more quickly than its administrative capacities. Based on that background, I would like to comment on a few features of the AML that you both raised as important considerations. First, the AML considers the same kinds of categories of businesses as the American Sherman and Clayton Acts. The general prohibitions concern anti-competitive agreements, monopolization or abuse of the dominant position and anti-competitive mergers.

However, the AML goes further and because there are Chinese characteristics to be considered and it has separate sections on the important category of the Chinese economy state-owned enterprises and administrative monopolies.

In addition, China has chosen to have three enforcement agencies enforcing separate sections of the law which however are not airtight. It is important that they be able to communicate with each other and that their regulations are both consistent and transparent. There are some overlaps and there may be some differences of concern.

Finally, unlike current American policy, Chinese law explicitly incorporates other noncompetition factors into the analysis. This is found in Article 1 and Article 4. The sections on merger control and abuse of dominance regulated by MOFCOM and the SAIC probably affect American business more than other of the provisions of the

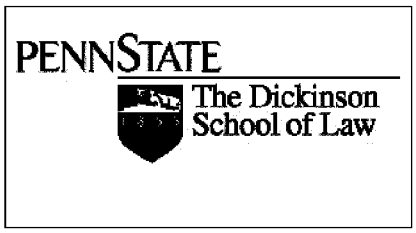
AML. During the first year of the AML, MOFCOM reviewed 52 transactions. There is no official statistics available for the second year, but if the review is moving along at the same pace, the Commission may have reviewed up to 100 mergers. During the first year, out of the 52 transactions, only one was prohibited and 5 were approved with conditions. All of these mergers involved one or more American parties. The abuse of dominance section and the merger control provision both contain explicit statements that national security, economic development, noncompetition issues may be considered in deciding the merger and determining whether or not a firm with a large share of the market has dominance. This is a concern. However, it is important to note that both of the agencies have been busy issuing their own rules and regulations and SAIC is a good example in that it has issued 2 regulations, one in 2009 a revision just a few months ago asking for and receiving comments from American experts, including some sitting at this table and they were listened to.

So while there are some important differences between the American antitrust law and the Chinese, it appears that they are committed to capacity building. And while the development certainly involves Chinese characteristics, there is a trend toward viewing antitrust through a lens of consumer welfare along with the majority of jurisdictions, including the American. Thank you.

Mr. JOHNSON. Thank you, Professor Farmer.

[The prepared statement of Ms. Farmer follows:]

PREPARED STATEMENT OF SUSAN BETH FARMER



Before the House Committee on the Judiciary
Subcommittee on Courts and Competition Policy

Hearing on:
THE IMPACT OF CHINA'S ANTITRUST LAW AND OTHER COMPETITION POLICIES ON U.S. COMPANIES

Written Testimony of Susan Beth Farmer
Professor of Law
Pennsylvania State University
Dickinson Law School

Tuesday, July 13, 2010
2237 Rayburn House Office Building
4:00 p.m.

Chairman Johnson, Ranking Member Coble, and members of the Subcommittee on Courts and Competition Policy, I appreciate the invitation to discuss developments in the Chinese antitrust law and their effect on American businesses.

International competition law and enforcement raise serious policy issues, and Congressional attention is appropriately focused on these important questions. The Chinese Anti-Monopoly law is now nearly two years old, having gone into effect on August 1, 2008. In that short time, three separate agencies have been organized to enforce various aspects of the law, have issued many rules, regulations and procedures, and have begun to investigate and make rulings on individual cases. Importantly, a number of these decisions have involved American businesses operating in China.

I am a professor of law at Pennsylvania State University, Dickinson Law School, where I teach American and comparative antitrust law, among other subjects. My research and writing concerns competition law and policy, and I had the opportunity to teach and research the Chinese legal system on a Fulbright fellowship at the University of International Business and Economics (UIBE) in Beijing in the spring semester of 2008.

SUMMARY

In assessing the impact of the Chinese Anti-Monopoly Law, I would begin with the words of American Justice Oliver Wendell Holmes, writing in **The Common Law.** He explained that

> The life of the law has not been logic: it has been experience. The felt necessities of the time, the prevalent moral and political theories, intuitions of public policy ... have had a good deal more to do than the syllogism in determining the rules by which men should be governed. The law embodies the story of a nation's development through many centuries, and it cannot be dealt with as if it contained only the axioms and corollaries of a book of mathematics.[1]

The 'experience' of Chinese antitrust law encompasses the language of the statute, agency interpretations and decisions, and judicial rulings, all made against the backdrop of history. With this in mind, I would like to highlight the following key trends in the development and application of the law:

1. The Chinese Anti-Monopoly Law (the AML) concerns the same categories of business conduct as the American Sherman and Clayton Acts: horizontal cartels, anticompetitive mergers, monopolization and unreasonable restraints on distribution. Unlike the situation in the U.S., three government agencies are responsible for enforcing separate provisions of the AML. Also unlike American antitrust policy, the Chinese law explicitly incorporates other, non-competition factors into the analysis.

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[1]Oliver Wendell Holmes, Jr., **The Common Law** 1 - 2 (Boston: Little, Brown & Co. 1881).

2. American businesses are particularly affected by the Chinese merger control provisions because the law and its regulations require pre-merger notification based on the parties' total sales in China, not solely the nexus of the transaction to China. During the first year of the AML, more than 52 transactions were reviewed. One proposed merger was prohibited and five were approved with conditions. All of these transactions involved at least one foreign firm. The agency guidelines and language of the decisions employ mainstream analytic concepts but also may import non-economic factors such as "national economic development"[2] and "national security" in mergers involving foreign investors.[3]. Greater transparency in the analysis would facilitate business planning and international investment.

3. American antitrust law prohibits monopolization[4]. The AML prohibits abuse of dominant market positions and "monopoly agreements" (market power is not a prerequisite). These offenses may be defined so broadly in regulations that they limit the ability of firms to make independent decisions, for example choosing their business partners, under the first provision, or prohibit purely parallel behavior under the latter. The Abuse of Dominance regulations also appear to include a non-competition factor into the analysis, requiring consideration of the "impact of relevant actions on the economic operation efficiency, social public interests and economic development."[5 The Chinese agencies have not yet brought cases charging abuse of dominance and the private cases to date have not involved American firms. Further experience is needed to know whether the application of Chinese competition law in these areas is consistent with mainstream analysis.

4. Even after decades of liberalization and privatization, thousands of State Owned Enterprises (SOEs) may account for as much as half the economy.[6] These Chinese firms include traditional utilities as well as industrial sectors of the economy. Although SOEs meet the definition of "business operators" under the AML, they may be subject to different standards and sectoral regulations, even if they possess a dominant share of the market.

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[2]AML Art. 27(5).

[3]AML Art. 31.

[4]Unlawful monopolization requires more than merely a large share of a market. The elements of the offense are (1) monopoly power and (2) predatory or anticompetitive conduct. Sherman Act §1 also prohibits horizontal and vertical conspiracies and agreements in restraint of trade, but discussion of those agreements is beyond the scope of this statement

[5]Regulations on the Prohibition of the Abuse of Dominant Market Positions by Industrial & Commercial Administration Authorities (Draft for Comments) (May 25, 2010 (unofficial translation by Freshfields Bruckhaus Deringer LLP).

[6]See Joel R. Samuels, "Tain't What You Do": Effect of China's Proposed Anti-Monopoly Law on State Owned Enterprises, 26 Penn State Int'l L. Rev. 169 (2007).

5. In the field of intellectual property, dual policy concerns should be promoted. First, legitimate intellectual property rights (IPR) are entitled to protection against infringement. Second, the mere exercise of an IPR should not be deemed to be unlawful monopolization. The first concern is addressed under Chinese laws on patents, copyrights and trademarks and in international agreements which China has joined. Second, the AML, consistent with U.S. antitrust law, provides that exercising intellectual property rights is not prohibited, that is, patents, for example, are not unlawful abuses of dominance.

BACKGROUND AND STRUCTURE OF THE CHINESE COMPETITION LAW

Globally, competition laws have been developing at a rapid pace over the past several decades, supported by technical assistance and recommendations from a diverse collection of organizations including the OECD, the United Nations Conference on Trade and Development (UNCTAD) and the International Competition Network (ICN). China adopted the Anti-Monopoly Law (AML), its first comprehensive antitrust law of general application in 2007, and it became effective on August 1, 2008.[7]. It is part of important legal reforms that began as early as the "reform and opening up" of 1978, and implementation of the "socialist market economy" in 1992.[8].

Antitrust law comprises distinct types of trade restraints including horizontal agreements, both hard core cartels and other procompetitive price and non-price cooperation agreements; vertical price and non-price distribution restraints, including resale price maintenance and tying arrangements; monopolization; and mergers. Overall, the touchstone of antitrust law is the protection of consumer welfare and promotion of competition, but not special deference for particular competitors.

There is general consensus worldwide about many antitrust issues, but others are marked by divergent views in different jurisdictions. These differences may arise from unique national policies their antitrust laws are designed to promote. For example, there is widespread agreement that horizontal cartels are among the most harmful practices and should be prohibited. There is less agreement on the precise contours of where the outside boundaries lie, for example whether the appropriate enforcement mechanism should be limited to governmental actions or also provide private rights of action, and whether criminal or civil remedies are appropriate. There is less

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[7]Anti-Monopoly Law of the People's Republic of China (promulgated by the Standing Committee of the National People's Congress on Aug. 30, 2007, effective Aug. 1, 2008). The AML had been under development for more than a decade before it was adopted.

[8]Zhenguo Wu, Perspectives on the Chinese Anti-Monopoly Law, 75 Antitrust L.J. 73 (2008); Donald C. Clarke, China: Creating a Legal System for a Market Economy (prepared for the Asian Development Bank, Nov. 9, 2007). These articles provide a valuable description of the history and developments culminating in Chinese law reform, including adoption of the first antitrust law of general application.

consensus about some vertical restraints and distribution practices. Monopolization, or abuse of a dominant position, is another substantive area where there is general agreement about the competitive harm of monopolization but some divergence about other issues, i.e. whether and under what circumstances competition the law can deal with oligopolistic market structures and where, precisely, the boundary lies between vigorous competition and unlawful conduct.

Merger control laws fall in a different category of antitrust enforcement in several respects. Most significantly, modern merger statutes speak in predictive terms; mergers may be prohibited if they "tend substantially to restrict competition" in a properly defined relevant market and may be blocked before consummation. In a globalized world, many large transactions cross national borders and are thus subject to review by more than one national antitrust agency. Some acquisitions may involve key national industries or may tread upon national security interests or national champion firms. Finally, government enforcement agencies investigating proposed mergers do not have the luxury of lengthy investigations. Time is of the essence in a proposed merger and failure to prohibit a transaction before it is consummated makes any future challenge as difficult as unscrambling eggs. If countries operate on different timetables, require merging firms to produce very different information, or apply different substantive standards, then the ability to compete cross-border may be hampered.

It is unsurprising that global competition laws diverge in substance and process, analysis and fundamental approach to a greater or lesser degree. The AML follows approach of the majority of antitrust laws, dealing separately with agreements in restraint of trade, monopolization, and mergers. The prohibitions of anticompetitive agreements and monopolization borrow heavily from the language of Articles 101 and 102 of the European Union treaty, with important Chinese characteristics. There are special provisions covering State Owned Enterprises and Administrative Monopolies, both of which are especially relevant in the Chinese economy. Intellectual property rights are addressed specifically. The American standards on pre-merger notification and substantive analysis have been influential worldwide, and they are clearly the ancestor of the Chinese merger law.

However, AML Articles 1 and 4 diverge from the traditional model of antitrust analysis that is based solely on competition principles. These provisions suggest that interpretation and application of the Chinese antitrust law may differ in some important respects from American standards. Article 1 provides that "[t]his law is enacted for the purpose of preventing and curbing monopolistic conduct, protecting fair market conditions, enhancing economic efficiency, maintaining the consumer interests and the public interests, and promoting the healthy development of socialist market economy." Article 4 empowers the State to promulgate "and implement competition rules suitable for the socialist market economy, perfect the macro control, and improve a united, open, competitive and well-ordered market system."

Since 2008, three separate government agencies have been established and assigned responsibility for individual antitrust issues under the AML: the Ministry of Commerce, Anti-Monopoly Bureau (MOFCOM), the State Administration for Industry and Commerce (SAIC), and

the National Development and Reform Commission (NDRC). MOFCOM is responsible for reviewing proposed mergers, referred to as "concentrations" in the AML and enforcing the anti-merger articles of the law. SAIC has responsibility for enforcing the prohibitions against abuse of dominant positions, monopoly agreements and anti-administrative monopoly regulation. The NRDC is responsible for price agreements and has issued regulations on anti-pricing monopoly regulation. These categories are not airtight, so it is important that the regulations are consistent and applied transparently.

The agencies have been busy drafting and adopting rules and regulations, reviewing mergers, including transactions involving multinational firms, and rendering decisions in the nearly two years since the law became operational. Some of the proposed regulations have invited comments from interested parties, including the American legal experts testifying today, and the ABA Antitrust Law and International Law Sections and the American Chamber of Commerce - People's Republic of China (AmCham) have provided extensive analysis and recommendations that have been reflected in some revised regulations.

Most recently, SAIC disseminated three regulations on May 25, 2010, concerning monopoly agreements, abuse of a dominant market position and abuse of administrative powers. Comments were invited and provided by the ABA Sections of Antitrust Law and International Law, among other parties. These documents were revisions of earlier drafts and reflect some of the previous recommendations. On July 5, 2010, MOFCOM released a set of provisional rules concerning divestitures in merger cases, but did not seek comments at this stage. The openness of the Chinese enforcement agencies to considering views and recommendations of international competition experts is salutary. International benchmarking and promulgation of recommended practices have become features of effective antitrust enforcement in this era of global competition. Much of the networking now occurs in organizations such as the International Competition Network, but there is an important place for bilateral consultation and sharing of expertise among agencies and with non-governmental advisors. Future consultation on these and other draft regulations should be encouraged and should involve a variety of experts. Ultimately, clear rules based on sound economic principles will benefit the agencies enforcing the law, businesses seeking to comply, and the ultimate consumers. Beyond agency regulation, investigation and enforcement, Chinese courts have rendered a number of decisions in private actions under the dominance articles of the AML, none involving U.S. businesses.

In a 2010 Policy Brief, the OECD reported on positive economic developments and challenges China faces. The Report praises the growing competitive market economy, increased privatization, and new antitrust policy, stating that "market forces are now generally the main determinant of price formation and economic behaviour."[9]. It recommends lowering barriers to private competition and promoting foreign investment by limiting government intervention in

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[9]OECD Policy Brief, Economic Survey of China, 2010 (Feb. 2010).

markets, including State Owned Enterprises.[10].

The trend towards a market economy in China carries the promise of continuing harmonization with modern antitrust analysis, but the AML's application of non-economic factors, undefined national security considerations in merger review, and potential special treatment of SOEs indicate that there may be some important divergences. American businesses operating in China are subject to the Chinese antitrust law for the "conduct of economic activities within the territory of the People's Republic of China" and for extraterritorial activities that have "the effect of eliminating or restricting competition on the domestic market of China."[11]. Indeed, American firms that meet the threshold turnover in China are subject to the mandatory pre-merger notification requirements for transactions that may, or may not, have a significant impact in China.

1. LEGAL STANDARDS INCLUDE NON-ECONOMIC FACTORS

The stated legislative purposes of the AML include traditional theories of consumer welfare, for example, protecting competition, enhancing efficiency and prohibiting monopolization. Article 1 of the law goes further, however, and also seeks to advance the "healthy development of [a] socialist market economy" and promote "public interests." These non-competition goals are not defined in the statute, but Article 4 empowers the State to "make and implement" regulations "suitable for the socialist market economy, [to] perfect the macro control, and improve a united, open, competitive and well-ordered market system."

The SAIC Regulations on the Prohibition of the Abuse of Dominant market Positions (draft for comments, May 25, 2010), article 8, may have incorporated one such non-economic consideration into the list of justifications for firms charged with abusing a dominant market position. These listed factors include competitive effects and business justifications (both traditional economic considerations) but also the effect on "social public interests and economic development."[12] This provision is in accord with the AML legislative purposes, but is not generally within the mainstream of modern antitrust analysis.

2. MERGER REGULATIONS AND DECISIONS

Even before the Anti-Monopoly Law, MOFCOM promulgated guidelines for foreign acquisitions of Chinese firms. The Provisions on Acquisition of Domestic Enterprises by Foreign Investors law (Foreign M&A Rules) provide that "when a foreign investor acquires a domestic enterprise, it shall abide by Chinese laws ... and adhere to the principles of fairness, reasonableness, compensation of equal value and good faith. It shall not ... disturb the socio-economic order, damage

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[10]Id.

[11]AML Art. 2.

[12]Regulations on the Prohibition of the Abuse of Dominant Market Positions by Industrial & Commercial Administration Authorities (Draft for Comments) (May 25, 2010)(translation by Freshfields Bruckhaus Deringer).

the public interest ..." Article 12 requires "parties involved in acquisitions of domestic firms by foreign investors" to obtain approval if the "acquisition involves in any major industry, or has or may have an impact on the state economy security, or may result in transfer of the actual controlling right of the domestic enterprise owning any famous trademarks or traditional Chinese brands." Approval is also required if the transaction "involves in any major industry, or has or may have an impact on the state economy security, or may result in transfer of the actual controlling right of the domestic enterprise owning any famous trademarks or traditional Chinese brands." This concept was transplanted, in part, to AML Article 31, which provides for additional review of transactions between foreign buyers and domestic firms and "national security" is implicated. That term is undefined in the AML and has not yet been explicated in regulations, so the breadth of the concept is unclear. Does it include economic interests of the state or solely national defense? As discussed above, the potential consideration of non-economic factors could inhibit competition and decrease consumer welfare, a result antithetical to the generally-recognized goals of antitrust.

Since 2008, MOFCOM has supplemented the Anti-Monopoly Law with a series of regulations that set monetary thresholds for pre-merger notification, describe the filing requirements in more detail, define relevant markets and establish standards for investigations of transactions below the filing thresholds or are otherwise not notified. These regulations were first produced in draft form and, in accord with the best practices recommended above, comments were solicited and provided by a number of sources including American antitrust experts.

Adding to the body of regulatory law, MOFCOM distributed new rules on divestiture standards and procedures on July 5, 2010. These regulations are concrete and practical, applying to any divestiture of assets required by the agency or agreed by the parties as a condition for approval of the proposed merger. Generally, the parties are required to maintain any such assets, operate them independently, and provide information and assistance to prospective buyers. The rules require appointment of a trustee to monitor the entire process and, if the parties cannot find an appropriate buyer, require another trustee to do so. There was no opportunity to comment on the specifics of the regulation, but preservation of assets and efficient divestiture practices appear sound and within the mainstream of antitrust practice.

The reputation of merger enforcement will depend on transparent analysis based on sound principals and equitable treatment of all proposed transactions, whether they involve foreign or domestic firms. This process has the additional effect of protecting the competitive process rather than individual firms and ultimately benefits consumers by offering them more choice in the competitive market. As Justice Holmes observed, the life of the Chinese anti-merger law, supplemented by its rules and regulations, is revealed most clearly by experience in the cases. Current official statistics are unavailable, but it is reported that MOFCOM reviewed 52 proposed transactions during the first year of the AML (August 2008 to July 2009) and approved 46 of them without conditions.[13]. One transaction was prohibited and five were approved with conditions.

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[13]Mayer-Brown JSM, China's Anti-Monopoly Law Merger Control Regime - 10 Key Questions Answered (Part 1) (March 2, 2010). Assuming a fairly constant stream of transactions, it is

The prohibited transaction, Coca-Cola/Huiyuan, involved a foreign buyer seeking to acquire a well-known domestic firm. The five transactions approved with conditions all involved foreign firms and, according to the same source, no transaction involving two domestic firms was rejected outright or approved subject to conditions.[14]. A recent briefing paper commented that the AML merger articles generally do not reflect "inherent bias" against non-domestic firms, while expressing concern about Article 31 and the specific transaction discussed below.[15].

The prohibited merger of Coca Cola / China Huiyuan Juice Group is an early but instructive example of the merger control process. Huiyuan, the Chinese target firm, was founded in 1992, in Shandong Province and, by the date of the proposed transaction, had a national distribution network. It was the largest privately owned juice-producer in China, selling juice, water, tea, dairy and nectar drinks. The acquirer, Coca Cola had marketed carbonated soft drinks in China since 1976, and Minute Maid juice since 2007. The proposed transaction was a $2.4 billion all cash offer, made in 2008. The reaction of Chinese netizens to the proposed acquisition was strongly negative. A Sina.com poll found that 80% of 229,000 responders voted against the proposed merger because foreign firms should not take over Chinese "pillar brands."

The first step in merger analysis, both in the United States and under the AML, is a determination of the product and geographic markets. The firms had less than 10% of a hypothetical market that included "all beverages." Huiyuan was the largest juice firm in China, with under 46% of the 100% pure juice market. If the merger had been approved, the merged firm would have possessed approximately 37% of a market defined as "juice drinks," but only 18% of a market defined as "carbonated soft drinks." Coke itself had 16.3% of "carbonated soft drink" market pre-merger, less than the 17.9% market share of the largest firm in the market, Groupe Danone.

The parties to the transaction notified MOFCOM under the pre-merger notification requirement and the review proceeded through a second stage review, which stated that the investigation was proceeding under AML and not the foreign M&A law. On April 18, 2009, MOFCOM prohibited the transaction and published a brief analysis finding that there was a threat to competition, which was not offset by any justification in the AML. The decision does not provide a detailed economic analysis of the product market, defined as "fruit juice." The threatened anticompetitive harm, according to the decision, was Coke's power to use its dominance in the carbonated soda market to limit competition in the juice market, resulting in higher prices and fewer

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possible that MOFCOM has reviewed nearly twice that number at the 2-year anniversary of the law.

[14]Id. The conditional approvals were InBev/Anheuser Busch, Mitsubishi Rayon/Lucite, Pfizer/Wyeth, GM/Delphi, and Sanyo/Panasonic.

[15]Id. The paper expresses concern but does not contend that the process is permanently flawed and recommends careful compliance with the merger regulations and cultivation of good relationships.

choices for consumers, a monopoly leveraging theory. In an official statement, the agency stated: "If the acquisition went into effect, Coca-Cola was very likely to reach a dominant position in the domestic market and consumers may have had to accept a higher price fixed by the company as they would not have much choice." Additionally, the decision found that power of the brands in the transaction would raise barriers to entry and threaten small and medium juice firms. The Foreign Ministry rejected concerns that the decision was based on national protectionism. The case raises several issues not yet clearly answered under the AML and the merger regulations: did the transaction implicate national security? Does acquisition of a famous domestic brand threaten economic security?

3. ABUSE OF DOMINANT MARKET POSITION/MONOPOLIZATION

In the first two years of the AML, standards of the offense of abuse of dominance have been developed through SAIC rules and private enforcement actions. There have been a number of private actions, but no reported dominance cases involving U.S. firms. The important policy considerations in the monopolization cases are both procedural and substantive.

Abuse of dominance cases are complex, requiring the decision-maker to apply sophisticated economic analysis to distinguish between lawful competition and unlawful predation. The SAIC itself is responsible for investigation and enforcement in cases alleging abuse of dominance or monopoly agreement. It has broad authority to decide whether or not to initiate and decide a case at the SAIC level, or, where appropriate, to delegate the matter to one of the provincial, autonomous regional or municipal agencies[16]. The need for judicial expertise is also appreciated and cases are likely to be directed to the Intellectual Property sections of lower courts or to the Intermediate Courts because of their experience in handling complex cases. This is a positive development that should give litigants' confidence in the quality and efficiency of the decisions.

4. STATE OWNED INDUSTRIES, ADMINISTRATIVE MONOPOLIES

AML Article 7 provides that "With respect to the industries controlled by the State-owned economy and concerning the lifeline of national economy and national security ... the State shall protect the lawful business operations ... and shall supervise and control the business operations of and the prices of commodities and services ... to protect the consumer interests and facilitate technological progress." Further, it requires SOEs to "be honest, faithful and strictly self-disciplined, and accept public supervision, and shall not harm the consumer interest by taking advantage of their controlling or exclusive dealing position."

Articles 32 - 37 prohibit the abuse of administrative power. These strong provisions prohibit public agencies from abusing their power to limit competition or benefit particular firms, prohibit discrimination among national regions, and prohibit special consideration for local firms in public

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[16]Procedural Rules by Administration of Industry and Commerce Regarding Investigation and Handling of Cases relating to Monopoly Agreement and Abuse of Dominant Market Position (unofficial translation by Jones Day) (2009)(referred to as Administration of Industry and Commerce (AIC) authorities).

purchasing and bidding. These sections, as supported by the July 2010 SAIC regulations, are not typically found in antitrust laws, but they are appropriate and pro-competitive in the highly regulated Chinese context. If enforced, these sections are both pro-consumer, because they promote competition, and pro-private enterprise, including American businesses that wish to operate in China.

5. INTELLECTUAL PROPERTY

AML Article 55 provides that the mere exercise of intellectual property rights is not prohibited and is not a violation of the antitrust law, but "abuse" of intellectual property rights that restrains competition does violate the statute.[17]. This provision has the potential to advance the dual considerations important to intellectual property: legal protection of IP as property rights and recognition that the intellectual property, even including patents, does not necessarily give the owner the kind of "power" prohibited by the abuse of dominance provisions.[18].

While a detailed discussion of the Chinese laws and international agreements protecting intellectual property rights is beyond the scope of this comment, the legal infrastructure, including creation of special IP courts, is in development.[19].

CONCLUSIONS

Chinese antitrust law, interpretation and enforcement have undergone significant reform in the two years since the AML came into effect. The organization and staffing of the enforcement agencies and the publication of numerous procedures, guidelines and regulations suggest that capacity building is important and ongoing. The Holmesian 'life' of this law shows consideration of international best practices and a trend towards the consumer welfare model of antitrust thought, mediated by domestic approaches to national policy and governance. Finally, the AML and regulations include certain non-economic considerations and other provisions, such as treatment of SOEs and administrative monopolies, that are specific to the national history and development of the Chinese market economy.

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[17]AML Art. 55.

[18]This is in accord with the recent Supreme Court decision in Illinois Tool Works, Inc. v. Independent. Ink, Inc., 129 U.S. 1109 (2006). Although the case concerned a tying arrangement and not a monopoly, the issue was whether market power should be presumed when a product is patented. The Court rejected the presumption of power and held that proof of power was required.

[19]For brief summaries, see Kristina Sepetys and Alan Cox, Intellectual Property Rights Protection in China: Trends in Litigation and Economic Damages, (NERA 2009), Righard S. Gruner, Intellectual Property in the Four Chinas, 37 Int'l Law News (ABA Section of Int'l Law, Spring 2008).

Mr. JOHNSON. Now, Mr. Barnett.

TESTIMONY OF THE HONORABLE THOMAS O. BARNETT, PARTNER, COVINGTON & BURLING, LLP, FORMER ASSISTANT ATTORNEY GENERAL OF THE ANTITRUST DIVISION, UNITED STATES DEPARTMENT OF JUSTICE, WASHINGTON, DC

Mr. BARNETT. Thank you, Mr. Chairman, for the opportunity to address the Subcommittee on this important topic. I should say I

am testifying in my personal capacity today. I view the AML as holding great promise. The adoption of this competition law regime in China is part of the transformation of the Chinese economy from a centrally directed economy to a market-based economy and that is a very critical change. My experience with the AML principally comes from my time as the head of the Antitrust Division. During that time, we were heavily engaged with the Chinese officials who are drafting the AML. I spent time on two trips in Beijing meeting with various senior Chinese officials as well as many of my staff meeting in Beijing as well as in the United States. Our impression was uniform, that the Chinese officials were well informed, open to exchanging ideas and sincerely focused on crafting a first-class competition law regime.

They understand what the U.S. Supreme Court has explained. Our competition laws rest on the premise that unrestrained interaction of competitive forces yields the best allocation of resources, lowest prices, highest quality and greatest material progress. On a closely related point, the U.S. Antitrust Modernization Commission which this Committee helped to establish has underscored that regulation or governmental control can be the antithesis of competition, tending to preserve monopolies and other noncompetitive market structures. Accordingly, by reducing barriers to entry and encouraging investment and innovation, the AML and the market oriented approach that it represents should promote economic growth in part by providing greater opportunities for U.S. businesses in China. With respect to the AML itself, as many people have noted, the Chinese government succeeded in crafting a competition law that generally falls within international norms.

And I would like to think that our consultations made a difference. They listened to our comments and as various iterations of the AML came out, they incorporated those comments and improved the final product. I would particularly commend the AML for including a prohibition on the use of administrative powers to create a monopoly or restrict competition. These are some of the most enduring and harmful types of restrictions on competition. There are provisions in the AML which do not necessarily reflect an international consensus, Professor Farmer has pointed out the three different agencies. There are also prohibitions on dominant firms charging too high or too low a price, something that is very difficult to administer and that can be counterproductive. The key question as many have noted is implementation. It needs to be enforced in a way that promotes economic growth with a focus on efficiency and improving welfare. This fundamental challenge is as true in China as it is here in the United States and around the world. The short version is it is too early to tell how it is being enforced in China.

To take an example that the Chairman pointed out, Article 55 of the AML talks about the right to exercise intellectual property rights, but also talks about how it can be an abuse without defining where the line is. That is a line that we are still looking to see drawn. Our focus, I suggest, should be on helping the Chinese agencies to implement the law in a principled and effective manner that will spur economic growth and which should have the effect

of opening opportunities for U.S. and other businesses operating in China.

Specifically, the U.S. agencies should continue to exchange ideas and best practices with Chinese agencies, both in general and in specific enforcement matters. Second, private businesses operating in China need to ensure their compliance with the AML, but they should also participate in the policy discussions. Both the Chinese agencies and the business community can learn from each other in this process. Third, we should encourage further agency guidance. Each of the agencies has been issuing guidance. Indeed the NDRC issued something today with a call for public comment for which I commend them.

Fourth, we should encourage participation by the Chinese agencies in international organizations such as the International Competition Network. That very dialogue can help promote better practices and convergence. As I said, the AML holds great promise. If implemented in a manner consistent with international norms, the AML should provide a win-win-win situation for all involved including not only Chinese consumers, but U.S. businesses. Mr. Chairman, thank you for the opportunity to participate in the hearing.

[The prepared statement of Mr. Barnett follows:]

PREPARED STATEMENT OF THOMAS O. BARNETT

STATEMENT OF

THOMAS O. BARNETT[1]

BEFORE THE

SUBCOMMITTEE ON COURTS AND COMPETITION POLICY
COMMITTEE ON THE JUDICIARY
UNITED STATES HOUSE OF REPRESENTATIVES

CONCERNING

THE IMPACT OF CHINA'S ANTITRUST LAW AND
OTHER COMPETITION POLICIES ON U.S. COMPANIES

July 13, 2010

[1] Mr. Barnett is co-chair of the global competition practice at Covington & Burling and previously served as the Assistant Attorney General for Antitust at the U.S. Department of Justice. He is testifying in his personal capacity.

I. Introduction

Mr. Chairman, thank you for the opportunity to address the House Judiciary Subcommittee on Courts and Competition Policy regarding issues faced by U.S. businesses in China under the new Antimonopoly Law ("AML"). At the most basic level, U.S. businesses should applaud the enactment of the AML. The AML represents a critical step on the road toward introducing market competition into the Chinese economy. Competition laws provide a backstop that enables governments to deregulate sectors of the economy. This evolution promises tremendous benefits for all participants in the Chinese economy, including Chinese consumers, all companies doing business in China, and consumers in the U.S. and around the world. In other words, the AML has the potential to provide a win-win-win situation.

At the same time, however, a competition law regime can cause more harm than good. If the law includes overbroad, rigid prohibitions, for example, it can prevent beneficial economic growth. Similarly, selective enforcement of the law can inhibit competition by creating barriers to entry and undermining incentives to compete. Competition laws need to be appropriately structured and enforced to prohibit only conduct that is likely to cause significant harm to the competitive process. They should not be enforced to protect individual competitors. This focus helps to ensure that the law enhances -- rather than harms -- economic growth and consumer welfare. Achieving this goal is a fundamental challenge that applies as much in China as it does in the United States and elsewhere.

From this perspective, China has taken significant positive steps forward by adopting a well-consider competition law regime that generally comports with international norms. It is, however, too early to draw conclusions on the implementation process. Our focus in the U.S. should be on helping the Chinese agencies to implement the law in a principled and effective

manner that will spur economic growth, which also should have the effect of opening opportunities for U.S. and other businesses operating in China.

II. The Benefits and Risks of a Competition Law Regime

As our Supreme Court has explained:

> "[Our competition law] rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions."[2]

Thus, the adoption of a competition law regime in China should be viewed in the broader context of the transformation of the Chinese economy from a centrally directed to a market-based economy. As markets become less regulated, they generally become more efficient and produce better quality products and services at lower prices for all those who participate in these markets. Such markets also tend to be more open with greater opportunities for entry by new firms. As the U.S. Antitrust Modernization Commission ("AMC") has explained, regulation can be "the 'antithesis' of competition, tending to preserve monopolies and other non-competitive market structures by restricting entry, controlling price, skewing investment, and limiting or delaying innovation."[3]

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[2] *Northern Pac. Ry. Co. v. United States*, 356 U.S. 1, 4 (1958).

[3] Antitrust Modernization Commission Report (April 2007) at 357, available at http://govinfo.library.unt.edu/amc/report_recommendation/toc.htm. Indeed, the AMC cites empirical estimates "that the U.S. economy has gained $36-$46 billion *annually* (in 1990 dollars) from deregulation . . ." *Id.* at 334. The AMC was a bipartisan commission established by Congress -- with the leadership of this Committee -- to study the U.S. antitrutst laws.

Importantly for purposes of this hearing, by reducing barriers to entry and encouraging investment and innovation, the AML and the market-oriented approach that it represents should provide greater opportunites for U.S. businesses in China.

At the same time, however, competition laws can inhibit economic growth if they are not structured or enforced appropriately. Laws with rigid, per se prohibitions can prohibit beneficial conduct, such as mergers that would generate cost savings or price cutting that would lower costs to consumers. Even with a carefully structured law, enforcement requires the evaluation of sometimes complex legal and economic issues. To take just one example, Article 55 of the AML clarifies that the law does not prohibit companies from excercising their intellectual property rights. The same section, however, indicates that the AML may prohibit restrictions on competition from an "abuse" of intellectual property rights. Determining what is a lawful exercise of an IP right and what is an abuse presents significant challenges.

More generally, a lack of transparency and predictability can create uncertainty that will deter businesses from making beneficial investments. Thus, while it is important to make the right substantive decisions, the administrative process for investigating and making decisions is critical as well.

III. The Antimonpoly Law in China

The Chinese government deserves great credit for carefully studying competition law regimes and experience from around the world and adopting a law in the AML that generally conforms with internation norms. Various components of the Chinese government spent more than a decade evaluating the issues and drafting the AML that became effective on August 1, 2008. The U.S. Department of Justice and Federal Trade Commission played important roles in this deliberative process. Both agencies sent and received delegations to exchange ideas with the Chinese officials drafting the AML and with the agencies that would enforce the law after its

adoption. And the consultations made a difference. The various iterations of the draft AML incorporated comments received from the U.S. as well as other jurisdictions and improved the final product.

Thus, the AML is a world class competition law. In this regard, it contains key elements including the following:

- A purpose of promoting economic efficiency and consumer welfare (AML at Article 1);
- A recognition that agreements among competitors, although potentially harmful, also can promote cost reductions and product innovation (Article 15);
- A clear prohibition on price fixing and other cartel activities (Article 13);
- A more nuanced standard for assessing mergers and single firm conduct (Articles 17 and 28);
- A definition of dominance that is not based solely on market definition (Articles 18 and 19);
- A recognitiion of the importance and legitimacy of intellectual property rights Article 55;
- A premerger review process that limits the time for review and that has a filing requirement that is triggered only if there is a nexus between the transaction and the Chinese economy) (Article 26); and
- A provision calling for the issuance of guidelines to enhance compliance with the AML (Article 9).

The AML deserves particular commendation for its inclusion of a prohibiton on the use of administrative powers to create a monopoly or restrict competition.[4] Our experience in the U.S. has shown that governmentally imposed or sanctioned restrictions on competition can be

[4] *See, e.g.*, Chapter Five of the AML (Articles 32-37).

some of the most enduring and harmful.[5] At the same time, it can raise significant political sensitivities for a broad range of governmental entities to be required to comply with a particular law. Accordingly, China should be applauded for specifically providing for the application of the AML to governmental administrative entities.

The AML does have some provisions for which there is not the same international consensus, such as the following:

- Assignment of enforcement responsibility to three different agencies: The Ministry of Commerce for merger review, the State Adminstration for Industry and Commerce for non-price-related conduct, and the National Development and Reform Commission for pricing-related conduct. This structure can create inefficiencies and potentially even conflicting standards.[6] The three agencies therefore need to coordinate their actions to increase transparency and consistency of enforcement standards and to reduce the burden on economic activity from the operation of multiple enforcement entities.

- Prohibitions on dominant firms charging too high a price or from paying too low a price (Article 17). While China is not the only country with such a competition law provision, the U.S. has learned that trying to regulate price levels -- as opposed to the competitive process -- can be adminsitratively burdensome and counterproductive, such as by preventing beneficial price cutting.

IV. Enforcement

Having adopted a competition law that generally comports with international norms, China now joins the U.S. and other countries in the challenge of enforcing its competition law in a manner that will promote economic growth and enhance consumer welfare. This challenge should not be underestimated. The United States has had over 100 years of experience in

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[5] "State Intervention/State Action – A U.S. Perspective," Remarks of Timothy J. Muris before Fordham Annual Conference on International Antitrust Law & Policy (October 24, 2003) ("In many ways, public restraints are far more effective and efficient at restraining competition.").

[6] See AMC Report at iv-v (providing recommendations for reducing inefficiencies from dual enforcement by the U.S. DOJ and FTC).

enforcing the Sherman Act, and we are still engaged in vigorous discussions about the best approaches. While China can draw upon the collective competition enforcement experience around the world, the AML has been in effect for only two years, and the Chinese agencies are still trying to determine how best to enforce the AML in many significant respects.

Accordingly, we should be focusing on continuing to engage with the Chinese agencies to exchange ideas and best practices. There are a range of useful topics to be addressed, such as the following:

- How best to define objective standards that are based on enhancing economic efficiency and consumer welfare;
- How to ensure that targets of investigations receive due process;[7]
- The importance of transparency in the decisionmaking process and the issuance of substantive explanations for decisions to enforce -- or not enforce -- the law in particular situations;
- How to meet the competition agencies' objectives while reducing the burden on commerce imposed by administration of the AML;
- The advisability of pursuing non-competitoin goals through competition laws; and
- How to avoid inconsistent decisions across jurisdictions.

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[7] The current Assistant Attorney General for Antitrust, Christine Varney, has said it well:

> "Regardless of the substantive outcome of a government investigation, it is important that parties involved know that the process used to reach that outcome was fair. The two concerns—substance and process—go hand in hand. Complaints about process lead to concern that substantive results are flawed, whereas a fair, predictable, and transparent process bolsters the legitimacy of the substantive outcome."

"Procedural Fairness," Remarks before the 13th Annual Competition Conference of the International Bar Association (September 12, 2009) available at http://www.justice.gov/atr/public/speeches/249974.htm.

V. Recommendations for the U.S.

A key issue for the U.S. -- both the governmental and private sector -- is how to engage the Chinese agencies. We should encourage them to enforce the AML in a manner that promotes economic efficiency. We do not want them to cause harm to the competitive process by, for example, creating artificial barriers for foreign firms doing business in China. Here are a number of observations to help in this regard:

1. The U.S. agencies should continue to exchange ideas and best practices with the Chinese agencies, both in general and in specific enforcement matters.

Chinese officials have been open to exchanging ideas with the U.S. Department of Justice and the U.S. Federal Trade Commission regarding the drafting of the AML and general enforcement policy. These exchanges have been taking place on a bilateral basis both here and in China, at the level of senior management and operational staff, in public, and in private. The dialogue proved useful during the drafting of the AML and should be continued with a focus on implementation. Indeed, the exchange of ideas is beneficial to all of the participants.

A key focus of future exchanges should be on helping to educate the individuals who enforce the AML on economic concepts, the analytical tools that are available, and the kinds of problems that arise in practice in enforcing a competition law.

2. Private businesses operating in China need to ensure their compliance with the AML, but also should participate in the policy discussions.

The AML is new and many of the details of how it will be enforced are only beginning to emerge. Accordingly, businesses need to ensure that they understand what guidance is available so that they can pursue opportunities in a manner that comports with the law. At the same time, the agencies in China are learning how to enforce AML. They will benefit from businesses engaging them in a constructive dialogue about legal standards and practices that are working

well and those that could be improved. Business should therefore seek opportunities to offer feedback to the agencies in this regard.

3. Encourage further agency guidance

The AML expressly provides for the issuance of guidance, and the agencies already have responded. The Ministry of Commerce has issue draft regulations on merger review while the State Administration for Industry and Commerce has issued draft guidance on abuse of dominance for administrative agencies, monopolies, and private abuse of dominance. The National Development and Reform Commission has issued guidance for pricing practices. These efforts should be applauded, and further efforts should be encouraged.

In this regard, we should encourage the Chinese competition agencies to provide an opportunity for public comment on guidelines and other regulations before they are issued in final form. As discussed above, the business community and other interested parties can provide useful feedback that can help the agencies do their jobs more efficiently and effectively.

4. Encourage participation by Chinese enforcement agencies in the International Competition Network and other international competition organizations.

There is a robust dialogue among competition agencies around the world, and the U.S. should encourage China to participate. Every agency has a valuable perspective and experience to bring to bear on the issues, and the Chinese agencies can both contribute to and learn from the dialogue.

* * *

Mr. Chairman, thank you for the opportunity to participate in this hearing. I look forward to answering any questions.

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Mr. JOHNSON. Thank you, Mr. Barnett. We will begin questioning. This question is for all of the panelists. It has been asserted that China's state-owned enterprises are not subject to the AML. Do you believe this? Let me ask you this question also. If China's state-owned enterprises are not subject to the AML, what

recourse, if any, do other countries have in addressing competitive distortions that are created by non-application of the AML to state-owned enterprises?

Mr. SINGHAM. Mr. Chairman, I think the application of the AML to state-owned enterprises, the language could be at best somewhat ambiguous and at worst there is a direct equivalent application between private firms and state-owned enterprises. However, the Chinese agencies do have the right to conduct competition advocacy directly with state-owned enterprises and with administrative agencies to promote competitive outcomes, and I think one of the things that we could be encouraging the Chinese competition agencies to do is to engage in complete and effective competition advocacy with state-owned enterprises.

It is certainly important that there is a level playing field and that competition law apply to state-owned enterprises as well as private firm, but it is important to note that that does not necessarily mean that exactly the same antitrust tests would be applied as between private enterprises and state owned firms. State-owned firms are revenue maximizers at best. They are able to sustain low cost pricing for long periods of time. They gain benefits from their connections to government and therefore the tests that you might apply would be different and we would encourage the Chinese agencies to bear that in mind as they conduct that type of advocacy. But we would certainly think that it is very important for the agencies to engage in constructive competition advocacy and that we take advantage of our technical assistance programs that the FTC and DOJ are engaged with the Chinese on to stress the importance of advocacy.

Mr. JOHNSON. What is the difference between advocacy and enforcement in this context?

Mr. SINGHAM. The difference is under the law, a different approach will be applied between private firms and state-owned enterprises in terms of actual implementation. So what the Chinese have done through the AML is create a vehicle for the Chinese competition agencies to directly advocate competition and advocate pro competitive solutions to state-owned enterprises. Every country's competition agency ought to be conducting competition advocacy with respect to domestic regulation as well as actual state-owned enterprises and so forth.

Mr. JOHNSON. But what about enforcement?

Mr. SINGHAM. Well, we certainly would like to see enforcement both with private firms and state-owned enterprises. As you pointed out in your opening statement, China's state-owned enterprises are operating as commercial companies. In China, they have effects in the U.S. market, they have effects in third country markets and U.S. firms that are competing against China state-owned enterprises in China, in the U.S. and in third-country markets need to have some assurance that the benefits and privileges that state-owned enterprises are receiving as a result of their connections to government do not lead to artificial reductions in cost and therefore an advantage that does not derive from business competition on the merits. I should point out that there is a spectrum of state owned enterprises in China.

You have one extreme, a fully government owned company; on the other extreme, you have a private firm that simply benefits from state privileges and tax preferences and so forth. And so the real problem with respect to state-owned enterprises and competition in China is the network of anti-competitive market distortions that benefit certain firms in China and disbenefit other firms and obviously have been impact on U.S. firms as well.

So you can't really answer your question without developing some tools that the U.S. Government would be able to deploy to deal with these anti-competitive market distortions. Be they tax distortion, be they special regulatory exemptions, however the distortion occurs. But we need to develop some tools to be able to deal with those from a competition perspective.

Mr. JOHNSON. All right. Thank you, Mr. Lipsky.

Mr. LIPSKY. Thank you. I think Shanker has dealt very effectively with this question. I think a way to consider a way to think about the problem, think back to the days when our own aviation air transportation industry was heavily regulated. There was an administrative agency, the Civil Aeronautics Board, airlines could not enter a route or leave a route without the permission of the Civil Aeronautics Board. They could not merge without permission. They could not make agreements without permission. As a matter of fact, they couldn't even have a discussion about a potential agreement without the permission of the CAB.

In that format, the only thing that was left to the competition agencies was actually to appear before the Civil Aeronautics Board and say please allow more competition, allow prices to be more flexible, allow more carriers to enter and leave routes.

So this is a very long-term process. We should think of this as the beginning of a very long road to implement all of the things that China needs to do to make the full transition from the legacy of central planning to a competitive economy that much more resembles the United States, other OECD jurisdictions. This is why we need to get organized for advocacy with the Chinese and the same could be said with some other countries because if you look at all of the steps necessary for the transition, it not only involves placing more and more assets and productive activities in private hands, reducing the involvement of the government, the government ownership, the government financing, the government management, the presence of government officials in private firms. That is a very tall order and a very grand transformation. There is no silver bullet or magic words we can say. We need to think of this as a long-term prospect of making the transition complete. And that would be my recommendation.

Mr. JOHNSON. So you are pretty much saying just kind of stay the course, wait and see what develops?

Mr. LIPSKY. I don't think I am saying wait. I am saying we need to ramp up our involvement. We need to ramp up the dialogue, the commitment, the way that we articulate, the very good values and economic principles and legal approaches that are already reflected in our law. I am not saying they translate directly to the Chinese case. In many respects they won't. But we need to keep focus on the issue, keep dialogue with the officials, keep proving to them again and again this lesson of history that the free market competi-

tion is the best way to get a productive and innovative and progressive economy, creating benefits for all of the consumers, both the Chinese and the countries like the United States with which the Chinese trade. So I guess it would be constant pressure constantly applied is maybe the way I would put it.

Mr. JOHNSON. All right. Thank you. Professor.

Ms. FARMER. Thank you. I agree that reducing the state-owned enterprises is an important goal and China has been working on that, making slow but some steady progress because frankly a state owned enterprise may not be as efficient as a privately owned one.

Mr. JOHNSON. I am sorry. Would you say the last part?

Ms. FARMER. An SOE may provide large employment, but it may not be as efficient. There are a couple of tea leaves that we may be able to read. Just recently, the State Council has adopted a policy encouraging foreign investment. And since a number of the large industries are currently state-owned, this may indicate some opening wedge. State-owned enterprises are not limited to railroads and public utilities. They include construction, salt and tobacco. Two recent cases send mixed messages. There was a private monopolization case filed against China Netcom. The case was settled in favor of the private individual. So that suggests that the AML may well apply. On the other hand, there was a recent telco merger which apparently was not notified to MOFCOM and the justification was apparently that the telcos are state-owned enterprises and they were regulated by the sector regulator. So there is still a little bit of flux in the system. But I certainly agree with the other panelists that continued progress on lowering state ownership would be a positive development.

Mr. JOHNSON. Does that include state-owned ownership? Does that include ownership by persons who are in key positions within various units of Chinese society?

Ms. FARMER. Yes, I think Mr. Singham was quite correct in explaining that it is a fairly complicated picture. It is not just ownership by the central government.

Mr. JOHNSON. Mr. Barnett.

Mr. BARNETT. Mr. Chairman, I think it is important to keep perspective here in that it is quite clear that 2 years ago, none of these state-owned enterprises were subject to any anti-monopoly law. Today you have a law that on its face says that they must comport or operate their businesses in accordance with the law. And certainly that is a position that the United States should encouraging to the extent that they are engaged in commercial enterprises, they should be subject to the same competition laws as any other commercial enterprise.

From my perspective, though, I am going to dissent slightly from Mr. Lipsky's predicate, although I agree with his conclusion. The U.S. Government, I think, to commend it has been very engaged with the Chinese on this front on a multiprong effort, everything from the trade folks over at USTR to the competition agencies, the FTC and the DOJ, as well as the Department of Commerce, USAID in part working with the Chamber. There has been an intensive focus on trying to encouraging the Chinese to explain to them, as Professor Farmer was saying, these state-owned enterprises, if you protect them, you are going to protect inefficiency. If you want to

promote and maintain the kind of economic growth that you have enjoyed for the last 15 years or so, you are going to need real competition to drive innovation, drive costs down.

And there are officials in China who, I believe, understand that and who are pushing toward the application of these competition laws to all entities, including state-owned enterprises. Is it clear that they have accomplished that yet? No. And that is why I agree with the conclusion that the U.S. Government should—and the U.S. business community should remain very focused on trying to encouraging them in that direction.

Mr. JOHNSON. So you believe that they are headed in that direction. What is your suspicion as to the outcome?

Mr. BARNETT. I suspect it is going to be a slow process that will not an steady process it may well be, you know, 3 steps forward, 1 or 2 steps back. As I think Mr. Lipsky was pointing out, these are complicated issues. Even in the United States they are complicated issues. And so in the long run, though, I believe that you will see more and more of these state-owned enterprises probably both becoming more private and in any event more subject to competition law discipline if you will. And so I am an optimist on this front. But I do think patience and persistence are called for.

Mr. JOHNSON. Will that process lead to more individual freedoms in China?

Mr. BARNETT. That is the a fascinating question. There are certainly many who believe that economic liberty and other liberties, political liberties often go hand in hand. I guess what I would focus on is to say if the AML is implemented in the way it is set up to be implemented, that it will lead to greater economic liberty, greater material wealth for Chinese consumers, Chinese citizens and that that is ultimately a good on multiple fronts. But how it plays out in other realms, I leave that to other experts.

Mr. JOHNSON. Anyone care to give an opinion about that?

Mr. SINGHAM. Well, I would agree with Mr. Barnett's comment there that economic freedom is derived from the kind of competition policy, competitive marketplace where consumers are empowered and become real economic actors in their own right. It doesn't answer the question. It doesn't tell you that this will lead ultimately to greater freedom measured by other indicia. But certainly this is a pathway to greater levels of economic liberty for Chinese citizens and for Chinese firms.

Mr. JOHNSON. All right. I will now yield to questions from Mr. Coble, the Ranking Member.

Mr. COBLE. Thank you, Mr. Chairman. I thank the panel again for being with us. Mr. Barnett, you referenced the tension between China's recognition of intellectual property rights and its condemnation of the abuse thereof. How do you see this balance playing out today, A? And, B, are you concerned that China may try to appropriate U.S. companies' intellectual property for their own use?

Mr. BARNETT. I do think that there is a risk that the Chinese competition agencies, as well as other competition agencies around the world can look at the normal exercise of an IP right, a refusal to license or a request for a royalty rate that the licensee views as too high as something that violates their competition laws. From

my perspective, that would be an unfortunate and counterproductive implementation of the AML. We have not really seen that yet, but it is something that we should very much keep an eye on because the agencies, I don't believe, have indicated clearly where they will draw the line.

On this point, I want to underscore something that Mr. Lipsky said. This is an issue in the United States and Europe and elsewhere as to what is a lawful exercise of an IP right and what is an abuse. In having our domestic dialogue and/or our dialogue with our European counterparts and other, it is very important that we keep in mind that others, including the Chinese agencies are watching carefully what we say and do. And that that should be part of the thinking as we engage on these issues.

Mr. COBLE. Thank you, sir. Professor Farmer, in our discussion of state-owned enterprises, some of you raise concerns about prominent Chinese officials owning Chinese companies. Does this mean that you have concerns about U.S. officials owning or having significant ownership in U.S. companies?

Ms. FARMER. That is a difficult question to answer.

Mr. BARNETT. If I understand the question, there is the issue that the U.S. Government has in the last couple of years become a major shareholder for example in a number of large U.S. corporations. And that is an issue that while it may have been necessary given the circumstances at the time, in my own view that is something that the U.S. Government should be trying to get out of as quickly as possible so that it can then let the market, the private market continue to work without direct governmental involvement.

Mr. COBLE. By the same token, Mr. Barnett, or Professor Farmer, do you think that the Chinese should also withdraw?

Mr. BARNETT. I would say if you are talking about commercial activity as opposed to traditional governmental activity, I believe it is better to have that kind of activity in the private sector. It is ultimately, as Professor Farmer was alluding to, likely to lead to more efficient companies, higher quality products, lower prices to consumers.

Mr. COBLE. I got you. Thank you.

Mr. BARNETT. In both countries.

Mr. COBLE. Thank you, thank you, Professor. Mr. Lipsky, you alluded over 100 countries have some sort of antitrust or competition law, including the European union. Today's hearing focuses on concern that China could use its recently enacted anti-monopoly law to discriminate against modern competitors. Have United States companies faced this kind of discrimination from other nations with antitrust regimes and if so how was it handled or how it was disposed of?

Mr. LIPSKY. Let me answer this way, not necessarily focusing specifically on the European union's competition law, but competition laws of general applicability, which is what most antitrust laws are, applying to restrictive agreements, mergers acquisitions and all kinds of structural transactions. These are extremely broad and powerful systems of law. And to the extent they are enforced seriously, you have tremendous potential for very serious effects on the structure of particular industrious and on trade in particular commodities and services.

In many jurisdictions, we find a lot of the same issues that we have been discussing with respect to China today, namely the potential that these very powerful legal tools will be applied in a way that is not transparent, that tends to favor parochial interests, rather than to pursue competition on the merits. So we have had a lot of issues trying to get—just as we are trying to do with China today, trying to get other jurisdictions to clarify, to commit themselves to nondiscrimination, to non-protectionist policies. And a good place may be to look for a kind of catalog as to how to go about this.

The antitrust section of the American Bar Association has for at least about 18 years now had a regular program of becoming aware of and commenting upon the adoption of antitrust laws, amendments to antitrust laws, the issuance of regulations pursuant to antitrust law, including in China, and under a certain authority of the American Bar Association, the section of antitrust law in combination with other sections like the section on international law has commented and has made specific recommendations with respect to the laws, the regulations and the procedures, remedies, virtually any topic you can think of.

And so there is a very broad menu of jurisdictions and legal principles and procedures and remedies where this very same potential that we are discussing with respect to China today also exists and there again, the solution is engagement. We can't force these other jurisdictions to conform their antitrust laws to our ideas. But we can persuade. We can show them the lessons of history. So that is a concern in many, many jurisdictions throughout the word.

Mr. COBLE. Thank you, Mr. Lipsky.

Mr. Singham, what rights and remedies does a U.S corporation have for anti-competitive conduct in China by a Chinese company? And does China recognize private rights of action? And, finally, if so, has any non-Chinese company brought suit or initiated suit against a Chinese company for violation of the AML.

Mr. SINGHAM. There have been private cases in China involving violations of the AML. A number of those cases have sort of fallen on technicalities, but your question raises another serious point, to what extent can U.S. companies and other foreign companies rely on Chinese courts and how does that system operate in conjunction with the AML? And certainly there are some concerns about the ability of the courts to, A, grasp these issues and, B, to operate in ways that aren't distorted by protection of Chinese companies' type interests. That's not unusual, and that's not unique certainly to China. That's the case in many, many countries that are new to competition law.

I think training of judiciaries has been an effective way of engraining competition principles and competition culture into judiciaries of many countries. I think that's something we would certainly recommend with respect to China.

Mr. COBLE. I thank you. I thank the panel.

Mr. Chairman, I yield back.

Mr. JOHNSON. Yes, if it's okay, I would like to engage in another round of questions.

Mr. COBLE. Yes.

Mr. JOHNSON. All right. Thank you.

Mr. Singham, I believe you mentioned that there had been 100 cases filed within the last couple of years in China. Was that you or was that Mr. Lipsky? Or that was you, Ms. Farmer? One hundred cases, and I think five had been approved with conditions, and one had been denied.

Ms. FARMER. Yes, that's the merger control regulation. We don't have official statistics for the full 2 years, but we know that 52 cases were notified and reviewed over the first year. And of those 52, one, the Coke Huijuan Juice merger, was prohibited and five additional were approved with additional conditions. And of those five they involved one or both parties that were non-Chinese firms. So if the number of pre-merger filings is approximately the same, then MOFCOM may have reviewed up to 100 mergers, but the statistics have not been released yet.

Mr. JOHNSON. Are they going to be released or is that a matter of secrecy?

Ms. FARMER. Obtaining information in a timely manner can be difficult, because these are relatively new agencies that are still engaged in capacity building, but the information does become available.

Mr. JOHNSON. Anyone else have any comment about how the U.S. can actually monitor the progress of the application of the AML? Yes, sir.

Mr. BARNETT. Well, Mr. Chairman, it is difficult to get specific information, but one of the things that I encourage the U.S. Government to focus on when engaging the agencies is the importance of transparency and good process in their decision making. And that includes not only during the review process, ensuring that the parties know what's going on, know what the issues are and understand what the evidence is but when you make a decision that you explain the decision to the parties and to the world. That type of sunlight, if you will, can be a good disciplining force on the decision-making process and can help others understand what you're doing, I think.

And I commend the current Attorney General, Christine Varney, who has made this one of the centerpieces of her international dialogue, the importance of this kind of transparency in merger review and other cases; and I couldn't agree more with it.

Ms. FARMER. If I could turn from merger cases to monopolization or dominance cases. Five—at least five have been filed, not by the government but private parties. It's interesting to note that they are occurring in Beijing and Shanghai. The Supreme Court of China has determined that these cases are so complicated that they should be filed at the immediate court level or in the intellectual property section of the lower court because these courts are experienced in dealing with complex cases and economic consideration. So I think that's a salutary feature of the law going forward.

Mr. JOHNSON. Mr. Singham.

Mr. SINGHAM. I think we've talked a lot in this hearing about the importance of persuasion and persuading the Chinese competition agencies to adopt an economic-welfare-oriented approach to competition policy implementation. I think that's very important, and we should continue to do that. But I would agree with Mr. Barnett that I think the agencies have done a very good job of trying to per-

suade the Chinese about the benefits of economic welfare and consumer welfare as a guiding light for competition policy enforcement.

But I think we also have to be realistic. And China's competition policy and the AML does not sit in a vacuum. It doesn't rely entirely on academic niceties. I think Professor Farmer alluded to this. And in view of that realism I think what we need to do is have greater tools for accountability so that where there are divergences from those types of normative principles, especially whether there are that are beyond international best practice. And I think there is a serious risk that we may well see this in the area of intellectual property and competition policy.

Mr. JOHNSON. What kind of tools are you talking about? You mean for U.S. companies or outside companies or what are you referring to?

Mr. SINGHAM. I think the starting point—and I think Mr. Lipsky made this comment as well—is——

Mr. JOHNSON. I'm sorry to keep asking questions about what others have gone over.

Mr. SINGHAM [continuing]. The need to really organize ourselves on how we address competition policy not just in China but in other countries as well in terms of how we express our views best in the interagency process. We have a history of being very successful with countries that have newly incorporated competition laws or antitrust laws in terms of technical assistance, but many of those countries are countries that have basically accepted competition policy as an organizing principle in the economy.

And the China of today is not necessarily the China of even 5 or 6 years ago. I think it is very important that we therefore reorganize or at least organize an additional interagency process around these kinds of anti-competitive market distortions. Simply because a competition agency is doing something does not mean that it is pro-competitive. There may be many examples of competition agency action that actually take you away from a competitive market, and we need to ensure that where that occurs we have tools for engaging the Chinese in a dialogue and that we have a metric-based, rule-based way of doing that so we are not sort of constantly playing whack a mole with each new regulation or decision or whatever comes out of China but we have a consistent policy that's based on persuasion certainly, persuading people of what the normative principles ought to be in competition policy enforcement and why it is good for their own economies but also with a bit of a stick as well.

Mr. JOHNSON. Yes, Mr. Lipsky. It just seems like we're dancing tenderly. We're tiptoeing in terms of testimony, I'm saying. This is not getting right to the—I suppose this is a tough issue to deal with with a sledgehammer.

Mr. LIPSKY. It is tempting to look for a silver bullet or something concrete to do that will materially advance things.

I wanted to just address there's a mild suggestion that has crept into the remarks here that I was perhaps critical of previous U.S. Government in action on this issue, and I want to remove any such suggestion by saying that there should be—I think we're all saying there should be additional focus, there should be additional re-

sources, there should be encouragement, there should be recognition, there should be better structure and organization to monitor what's happening in China; and the same could be said elsewhere.

I didn't mean to cast aspersions, but, nevertheless, I believe it is still correct to say that there's no place in the statutes of the United States or in the statements that accompany budgetary appropriations or authorization, there is no place that says, Department of Justice Antitrust Division, Federal Trade Commission, please do this, please monitor how these other antitrust laws affect U.S. business. It is I think perhaps indirect, and it's implicit. It has certainly become a custom and a very creditable custom in the agencies to engage in these matters.

And yet I have to say that, having been at this for a while, every time there is a change in leadership at the Antitrust Division or at the Federal Trade Commission, the officials that we would expect to really take the opportunity and spearhead the American interest in foreign antitrust enforcement and how it affects the global economy and U.S. business, there is always a momentary—a moment of butterflies in the stomach where you hear, well, I hear he doesn't like to travel or I hear she won't participate in the Japan-U.S. bilateral because she won't eat sushi under any circumstances. There's always a question as to how the personal preferences and predilections of the senior officials will affect the way that the United States agencies participate in this very, very important dialect.

Well, it shouldn't be a question of personal predilection. It should be a welcome responsibility.

Mr. JOHNSON. Should that come through some form of legislation or some regulatory rule?

Mr. LIPSKY. Well, certainly the first step would be simply to recognize that it is a proper activity, an activity that the Congress is aware of and acknowledges. And I don't know——

Mr. JOHNSON. I hear you right now and—but I'm just wondering, in your view, what would need to be done in order to ensure that we have some continuity in this area between changes in our personnel?

Mr. LIPSKY. I believe that even the simplest expression of recognition, support, and encouragement of this activity, whether it was in the authorization legislation or report or many flexible ways that Congress could deal with this short of enrolled legislation it seems to me.

I'm confident that the agencies—I would be very interested in Mr. Barnett's view on this, but I'm confident that an explicit congressional recognition of the value and importance of this function would be embraced eagerly by the officials of these agencies.

Mr. JOHNSON. Yes, sir.

Mr. BARNETT. I heartily endorse the sentiment that the agencies should be engaging with many other countries, but China in particular in many ways, one of the most important.

I guess I would say to me it's mainly a question of making sure they have adequate resources. I believe and it was certainly my perception at the time that I understood quite clearly that Congress was interested in our focusing on that. There are multiple ways for Congress to do that. There was certainly not an authority

or lack of authority to do it, given the amount of time and resources that we devoted to it. But it could well be that even more resources are valuable.

In that respect, and also to address the continuity point, one specific thing that probably could use more—even more focus or more opportunity is not so much the exchange between senior officials but opportunities to interact at the career level, at the staff level. And I'll use the example of the relationship between the U.S. agencies and the European Commission.

There used to be a lot—well, there can be divergences, but there used to be a lot more. The agencies have now developed a relationship so they talk on almost on a daily basis on major matters, and they educate each other, and they end up coming to more convergent results. And we've not seen the same sort of divergence we saw 10 years ago.

It's very dif—it's harder to do that with the Chinese agencies, but if we can find ways for career staff to spend time with the career staff of the Chinese agencies—and, remember, Professor Farmer talked about capacity building. These are complex issues, and you're asking people who grew up in a centrally directed economy to apply a set of principles that derive from a market-based economy that's not necessarily intuitive to them. It's hard to overestimate the importance of training the rank and file on these principles, on the economics and how to do this best. That I think is largely a matter of resources.

Mr. JOHNSON. Are the Chinese receptive to that kind of dialogue?

Mr. BARNETT. They were. I certainly raised this expressly with them when I was in Beijing even before the AML was enacted, looking ahead and realizing that implementation would be key. And we talked about—they seemed very open to it.

In that regard, I will commend—I think it is in Mr. Singham's testimony—there is, for example, one program with the USAID that sets up a series of conferences and seminars, and that's a positive thing. But I'm talking about more of this and more person-to-person interaction. I think they will be cautious about it, but I think they are eager to learn. And if you structure it in the right way I think they will be open to it.

Mr. JOHNSON. Yes, sir.

Mr. SINGHAM. I think there's one issue that we haven't addressed necessarily here that we need to address in order to do all these things more effectively, and that is there is a disconnect between the level of authority of the competition agencies in the U.S. with respect to other members of the U.S. Government. And particularly in countries that are new to competition or new competition agencies, those agencies are not very powerful at all. They have very little political power within their own systems. And so there is a slight disconnect there in terms of our expectations of them.

And particularly in China there are many decisions that are really competition decisions that are not made and will not be made by the competition agencies in China going forward. They will be made by other branches of the government, and they will be imposed to some extent the Chinese competition agencies. And for that reason, while I agree with everything that everyone has said here in terms of the persuasion, the technical assistance, the—even

to the extent Mr. Barnett suggested the placement of resident advisors, which I think is one of the best methods of technical assistance that you can find generally—we also need to have some tools—and these may be legislative tools—that gives some measure of accountability where an anti-competitive market distortion occurs either because the competition agency is engaged in it or because it is going on in the Chinese market and the competition agency is doing nothing about it. That enables us to be more effective in our advocacy of competition policy concerns.

We suggested in our written testimony reform of the interagency process and also congressional reports by that interagency group, the reports from that interagency group to Congress on anti-competitive market distortions, measurable market distortions that have welfare-damaging impacts. Because that is also a tool that can be used in China and in other countries to demonstrate that a particular anti-competitive market distortion visits a certain amount of harm on that country's own consumers and their own economy. And that would enable us to build up those forces and people within countries not just in China but around the world who want to have competition policy implementation enforcement based on economics and not on support of national champions or what have you.

Mr. JOHNSON. All right. Mr. Coble.

Mr. COBLE. Thank you, Mr. Chairman.

I have two questions, Mr. Chairman.

Mr. Singham, how would you would rate the current Administration's engagement with China on the issues of competition policy?

Mr. SINGHAM. I would commend the current Administration as well as the previous Administration on engagement with China on a very, very difficult issue. I think everyone is agreed that the transition of a country from a completely centrally planned economy to a market economy is a hugely challenging task, and I think the current Administration is doing a good job of engaging in the technical assistance area and engaging in other dialogues with the Chinese to persuade them to adopt a competition policy that is more in line with international best practice than was the case 2 or 3 years ago in our ongoing discussion with them which has been going on for about 15 years on this competition law.

I would say, though, that the Administration is limited in its ability to be effective because of the paucity of tools that it has. In our written testimony, we suggest increasing the toolbox to enable actors not just in DOJ and the Federal Trade Commission but in other agencies that have a stake in a competitive market in China to also engage.

Mr. COBLE. Thank you, sir.

Mr. Lipsky, finally, it is virtually impossible to discuss China without talking about the country's human rights situation. Google recently had its licensed renewed in China despite a very public dispute with the country regarding censorship. In the meantime, Google's share of the Chinese market seems to have fallen relative to its Chinese competitor Baidu. While the licensing issue does not seem to implicate China's AML per se, it seems possible that China could pursue a lengthy and costly legal campaign against a com-

pany that is critical of any of China's internal policies. Is this a real concern and, if so, how should it be addressed?

Mr. LIPSKY. Well, the—I am not privy to the details of that particular dispute——

Mr. COBLE. And nor am I.

Mr. LIPSKY. But the generic issue of mixing these different policy considerations always has the potential to lead to the perception that the competition aspect has been inappropriately mixed with a non-competition policy and thus that the competition enforcement standard has been distorted. And I would point out that the history of monopolization proceedings in the United States has also from time to time raised this question, abuse of dominance proceedings in the European Union have raised this question, and we need to be vigilant. We need to urge transparency. That really is the only way to control the inappropriate or the abusive reliance on competition law proceedings to achieve what is not an economically efficient result.

The case United States vs. IBM lasted 13 years. There were some very lengthy, expensive, and complex proceedings brought under section 5 of the Federal Trade Commission Act against the breakfast cereal makers and against the oil companies. And that same potential always exists, and it will exist under the cognate provisions of the Chinese law. And so I think we just have to be vigilant, urge transparency, insist on accountability, and continue to pursue that over time.

Mr. COBLE. Thank you.

Mr. Chairman, I yield back.

Mr. JOHNSON. Thank you.

Sheila Jackson Lee, our distinguished congresswoman from Houston, Texas.

Ms. JACKSON LEE. Mr. Chairman, thank you so very much; and my apologies to the witnesses. I have just landed, flying into Washington, D.C. But I am delighted that I was able to make the hearing before it had concluded.

I want to thank the Chairman and the Ranking Member for what is a vital discussion; and I hope that you will engage me as I pursue some issues that I think are very, very important.

I have been engaged in this issue for a number of years ago the Member of the Judiciary Committee when Chairman Hyde was a Member and a Chairman, of course, and raised a number of issues about the abuse of intellectual property. And certainly as I respect our friends and allies in China and have marveled at the ability to develop a very thriving middle class, one that is continuing to grow, I've also been appalled at the extensive abuse of intellectual property, much of it coming from the United States.

Many of our friends are prone to talk about the trillions of dollars of debt that we have—I think $14 trillion may be the number at this point—and look awry at any efforts that our present government, my party, has engaged in to invigorate the economy which sometimes calls for stimulating it. But part of our crisis, if you will, goes a lot to the imbalance of export and import.

And, frankly, I do not want to be quoted to suggest that the abuse of intellectual property is such a cause of it, but I would say that the inequities in markets like China and China having a large

part of our debt, which makes me enormously unhappy because I think the playing field in China is not even uneven. It doesn't exist. We were advocates of China getting into the World Trade Organization as I understand that they are in. But, more importantly, this Congress went against its better judgement and supported the PNTR, the Permanent Normal Trade Relations, and I think the U.S. Chamber of Commerce might have been enthusiastic about it. We thought it was going to be a quid pro quo.

Now all we get from China is lost jobs and closed doors. We get the sanctioning and censorship of Google and others. As the Ranking Member mentioned, we get continued human rights violations. And we get a big, empty bank account where we are losing money, even more so now with the approach that they are taking on trade, but, more importantly, over the years where they have abused intellectual property, where they have gained their economic edge because they have stood up on the backs and shoulders of Americans, from my perspective.

So my question to the—I am not interested in soft-pedaling this potential crisis, meaning the AML laws that may, in essence, make us more than second-class international citizens. It may not even put us on the ballpark, if you will. Probably be something like some of the soccer games that we saw and the rulings of some of those referees that ruled us out.

So I would like to pose to Mr. Singham, who is with the U.S. Chamber of Commerce, that we may find it a grand opportunity to be in alliance. Why is everyone soft-pedaling some of the legal schemes that are being proposed? And if these AML laws thrive, then they'll have some other laws, which is, knock three times at our door, we'll think about it and let you know in about 10 years whether you can do business in China or whether you can do it in an even playing field.

So I would like to know some real solutions to laws that can be passed by a sovereign entity, which China is, to make them part of the international arena and, to be very frank with you, to get back some of the bounty that they've taken from the American people and others around the world that have advanced them to our disadvantage.

Mr. Singham.

Mr. SINGHAM. Congresswoman, you make some excellent points; and I'd like to—and you make your point that it is sort of way beyond the narrow scope of the AML, but I agree and I said in my oral testimony and the written testimony that it is very important that we do not regard the AML in a vacuum, that in China it is not in a vacuum.

Other policies and other laws in China do affect the implementation of the AML, but you raise a much, much greater and bigger point which is the issue of trade liberalization and competitive markets, which is essentially trade liberalization only really works when you have competitive markets inside the border and how can we get there with respect to China.

One of the things that we absolutely have to do—and I would agree with you on this point—it is to ensure that we are not competing—U.S. firms are not competing with firms that have their costs artificially reduced through anti-competitive market distor-

tions, whether they are in China or anywhere else, quite frankly. And so I would agree with you that we need to have a much more proactive approach to the issue of anti-competitive market distortions.

When trade barriers were high, it didn't really matter what happened inside markets that we were trading with. As trade barriers have come down, these kinds of behind-the-border barriers, these kinds of anti-competitive distortions have become much, much more significant.

I would certainly argue that they are just as if not more important now than the sort of traditional border trade barriers, and that's one of the reasons that the U.S. Chamber has set up a global regulatory corporation project to try to align some of these policies and try to deal with this particular problem, which affects not only U.S. firms but it affects U.S. jobs, it affects—because it is not just a competition in China or in the U.S., but it is a global competition, and U.S. firms are competing globally, and supply chains are competing globally. And where there are these kinds of distortions you are going to have an effect on the profitability of U.S. firms and their ability to employ U.S. people.

I agree with you. There's a complete alignment here between U.S. firms and U.S. workers on this point. We ought to be able to say that business competition on the merits is the way that economies grow. And we ought to be able to agree that that is how economies develop, that is how consumers are empowered, and that's how the global economy grows. We all have a vested interest in that.

While we say that, we ought to be able to say to our people, let competition decide our outcomes. Business competition on the merits, let that be the decider of outcomes. But we will be aggressive if we see that countries or government departments are artificially distorting their markets and, therefore, lowering the costs in an artificial way of businesses that are competing directly or indirectly with U.S. firms.

So in our written testimony we've advocated a revision of the interagency process around anti-competitive market distortions, a way of measuring anti-competitive distortions so that we are actually dealing in real data and metrics. We've talked about looking at evaluating international agreements on anti-competitive market distortions. Many of these provisions already exist in existing trade agreements or the beginnings of them exist. We are debating now in the Trans-Pacific Partnership Agreement a chapter on competition policy that deals with some of these issues.

If the AML is used by Chinese competition agencies in the way that you fear, we ought to have a set of tools to look at that interference, which is what it would be in the market as an anti-competitive distortion, and we ought to have a way of dealing with that. So I think there we are in a lot of agreement.

Just on your point about intellectual property abuse—and this is critical because, as other members of the panel have noted intellectual property abuse—many competition agencies are taking the view, not the U.S. but other country's competition agencies—many other country's competition agencies are taking the view that refusal to license the intellectual property is by itself an abuse, is by

itself a competition problem that the competition agency should get involved in. And we see some of that certainly in the provisions of the SAIC and other parts of the Chinese government in terms of how we will apply Article 55 on abuse of intellectual property.

But I would make this point. For those competition agencies, competition policy and intellectual property are intention. But if you have a welfare-enhancing economic approach to competition policy and implementation, there is no tension between competition policy and intellectual property policy. Both policies have the same innovation and welfare-enhancing goals. So if we can succeed—however we do it, with whatever tools we can use, but if we can succeed in getting and insuring that the AML is applied in ways that make economic sense, that are welfare enhancing, then we will not have a situation where the AML is being essentially abused to erode the intellectual property rights of U.S. and other firms.

Now there are certainly cases where firms do abuse intellectual property rights, and I'm not talking about that right now. But the key here is to ensure that the AML is implemented in a way that is based on economics, sound economics and consumer welfare. If you do that, then all the provisions that could be used—could be abused, I would say, to erode intellectual property rights won't be used in that way. So I think that's the key with respect to intellectual property.

Ms. JACKSON LEE. Mr. Chairman, if you would indulge me for a moment, I'm on a line of questioning.

I think intellectually, Mr. Singham, you're absolutely right, if we analyze it in the way that you've analyzed it. And of course I think the modems and policies that you're speaking of I assume is policies that the U.S. Chamber of Commerce is looking at as you engage in doing business or helping your members do business—a lot of your members are very large companies—as they do business internationally around the world.

I'm reading just a paraphrase of the language of AML, and what strikes me is language that says monopolistic conduct and economic activities within China, which is what AML is supposed to apply to, and foreign conduct that eliminates or has a restrictive effect on competition. Now, if you have one judge, then any foreign business that comes out of a climate of capitalism versus government-owned, directed, controlled businesses as China does could be found to be in violation of the AML, and it could be in violation on the basis of they are getting too much of the market share and making too much money.

And so if I might—if someone else wants to launch in and let me yield to any of the other persons about the danger of language that, in essence, would close the door. Our companies that might make the first trip over—and I'm, obviously, using metaphors because we've been over—would be large companies to a certain extent and could be easily accused of conduct that eliminates or has a restrictive effect on competition and be a foreign entity.

My thought is the Chairman has held this hearing and what are we doing in terms of protective laws from our perspective? We're in the WTO. We've got the PNTR. I have not seen major—I shouldn't say that. I assume the existence of Google and others—

there is probably a long litany of companies, obviously, doing business there. The question is, where is the balance?

But do we now need to look at laws that would match the laws that China has if they are laws that are preventative or blocking rather of our businesses from the United States—and that's what I'm framing my question around—loss of jobs and the businesses that have either gone there or not been able to thrive because they have been blocked from coming into China. Do we not need laws that respond to that kind of litmus test?

Mr. Lipsky.

Mr. LIPSKY. Let me address this concern as follows:

The law that you referred to, the provision of the AML that you've referred to, is in many respects consummate with legal norms that have emerged in other jurisdictions. In other words, in the United States, we have a statute which says that foreign conduct can be reached under U.S. antitrust law so long—I'm paraphrasing and simplifying quite a bit—but essentially as long as that conduct has a substantial direct and foreseeable effect on U.S. commerce.

Ms. JACKSON LEE. Just for a moment, I understand that we interpret our laws differently or at least in a more open manner than I perceive a law like this as it relates to China. So I think we're talking about two different approaches in interpretation of individual laws.

Mr. LIPSKY. Well, to the extent that the law is interpreted to create the kind of disadvantage for U.S. companies or foreign companies, we do have some historical experience with a somewhat similar situation where trade remedies were proposed. There was a provision of our trade act—I am not a trade expert, Shanker is, and he may wish to comment—but I think it was referred to as Special 301. It was a provision—as far as I know, there was never a successful proceeding invoked under that provision.

There was a very intense, competitive battle reflected in the Kodak/Fuji case. Ultimately, I think a trade complaint was filed on behalf of Kodak. But, as I recall, it was not a Special 301 complaint. It was—they stepped right to the brink of invoking that provision but never invoked it.

So we can certainly consider similar provisions to the extent we are encountering tilting of the playing field under the guise of competition law enforcement. Or, in that case, I think it was actually an accusation of lack of competition law enforcement in Japan.

My own feeling, having not studied the matter carefully but just based on my own experience with this and similar disputes of this nature, is that what we are advocating is probably more likely to work out better for all parties in the long run. I think if we think of our relationship to China with respect to trade and related matters primarily and a partnership, I mean, our success is bound up with theirs and vice versa. If they do hold a lot of debt, that means they have a great percentage in our success.

So we're going to be in this dialogue for the very long run, and I'm not saying we shouldn't use sticks. If there is serious trade distorting—unjustified trade distorting conduct, wouldn't discourage Congress from applying the appropriate stick. But you can't use only sticks. You have to feel your way through the dialogue. It's

like any long-running, important partnership. Both parties have to give and take. There are a huge number of issues on the table in the bilateral relationship between the United States and China, and I——

Again, we're kind of at the inception of the AML. A lot of jurisdictions go through tremendous adjustments. When the European Union implemented its rules on restrictive agreements in 1962, it was kind of a bureaucratic catastrophe, because they elicited thousands and thousands of petitions from businesses who were afraid that their arrangements were going to be condemned, and then they had bureaucratic gridlock for years and years. So I'm sure I could think of examples of United States enforcement. Our initial experience with the Sherman Act and the Clayton Act was not an entirely happy experience.

So I think the door has in a sense just opened, and we need to look at the record as it rolls out and pay close attention and try to insist on transparency and accountability and impose a little discipline and encourage our executive branch to get on it and stay on it and see where we are as time progresses.

Mr. JOHNSON. Mr. Barnett.

Mr. BARNETT. If I could make expand slightly on that, to put it in perspective. You raise a lot of very important issues, but one way to think about this is should we view the AML itself as something that's good or something that's bad for U.S. businesses? In my view, it should by viewed as generally something good. There is certainly the potential for it to be applied in a way that could be protectionist or harmful to U.S. businesses and Chinese consumers, but, importantly, it is substituting for a regime that before had much more direct ways to exclude U.S. businesses from operating in China. It is an instrument to open up the markets there.

There is a long ways to go, as Mr. Singham has pointed out. And you've not heard the witnesses say that the AML has been abused in very clear circumstances. What you've heard is that it may be in the future. A lot of the examples that have been pointed to of concern are other laws in other areas.

In that respect, there is an additional potential benefit to the AML. Not everyone in China thinks the same way. You now have individuals at the various agencies, to the extent that they are persuaded that a market-based economy is the way to encourage growth and a focus on opening up markets to competition, including foreign competition, they can be a voice within the government to advocate for opening up and bringing down trade barriers. We have seen that type of advocacy be effective in other countries.

So without minimizing your point that those are very serious issues and agreeing that we should bring a lot of different tools to bear on it, I just want to put in perspective that the AML itself can be an engine for good.

Mr. SINGHAM. Yes, I think that's right. One of the most important provisions in the AML is the provision that deals with advocacy and competition advocacy by Chinese competition agencies with other branches of the Chinese government.

Now if you look at—as Mr. Barnett said, if you look at what we had before the AML, there was really no way that there would be a voice of competition or a voice for competition in any branch of

the Chinese government. So we shouldn't underestimate how important that is.

Now that it is there, it doesn't mean it will be a force for positive pro-competitive markets necessarily, but I think it is incumbent on us to try to work with the Chinese, recognizing the efforts that have been made and to develop the kind of individuals who can lead the charge on promoting competitive markets in China.

It's interesting that in the field of competition what a difference individuals can make. I did a lot of work with Brazil when Brazil was starting its road on competition policy and happened to have some very, very good heads of competition agencies in Brazil who made huge inroads into what was also a—perhaps not as planned as the Chinese economy but was emerging from import substitution and a sort of command economy in Brazil. So I think we shouldn't underestimate the power of these competition agencies to be a force for pro-competitive markets.

I would say, in answer to your question about laws and so forth, that there are a number of laws already on the books that apply—could be applied in this area. Mr. Lipsky mentioned the Kodak/Fuji case. Where there are anti-competitive practices in foreign markets that have an effect in the U.S. under the Foreign Trade Antitrust Improvements Act, you can rely on U.S. antitrust law.

There was a case in New York involving a vitamin C cartel where the Chinese government essentially said that it was a state-owned enterprise and the state basically forced the anti-competitive activity. And this was a defense in the case that was brought in New York.

I think those are cases where, under the FTAIA, our antitrust agencies could meaningfully be involved.

And on the trade side, many of our trade laws, section 337, section 301, the GSP preferences that we have, there are many, many trade laws that apply disciplines where there is anti-competitive activity. Now, historically, that has been rarely used; and it tends to be contained to private anti-competitive activity.

I think the one area where legislative—some analysis of potential legislative solution could be explored is the area of where you have a market where the anti-competitive activities are primarily in the public sector or primarily government anti-competitive activities. But we ought to include those within what we count as anti-competitive practices for the purposes of those laws. So I think that certainly could be done. That would require us to apply the same discipline as to ourselves.

And the Antitrust Modernization Commission, which has been mentioned on this panel, did make a recommendation to look at the state action exemption. The state action exemption protects state activity and allows states to essentially get away from anti-competitive activities where they are acting as states, as opposed to market participants. We need to revisit that, quite frankly. But there's a lot of those types of laws that we refer to in our written testimony where we can do that.

But I do agree with what Mr. Barnett said, is we need to bear our problems. We do need to address the problems and develop tools to address the problems, but we also need to take a 25,000-

foot look and say, well, there has been progress here. Let's try and build up——

Ms. JACKSON LEE. If you could wrap up, and I appreciate it.

Professor, I didn't know if you want to finish.

Let me just thank the Chairman and indicate and comment to the answer to my question is, of course, I think, Mr. Barnett, you're right. The underlying premise of anti-monopolistic laws is good. I mean, our laws, our antitrust laws started with a framework to enhance competition opportunity.

Those of who are still practicing law—I practiced law previously—know that, depending on what side of the case you are, sometimes our antitrust laws are paper tigers. You've seen mergers come and go and meet a basic standard and most people say how in the world could we allow these two entities to merge? They've obviously created an anti-competitive marketplace.

I would only offer that this is a very important hearing; and I think all of these variables have to be integrated—deficits, the abuse of intellectual property, the potential—and I use that example because it is the most consumer-based, glaring example of when technology and design and talent that is taken from another and is utilized in this instance by China with anti-monopolistic laws if misinterpreted or used in a one-sided manner. No matter what country or what company is attempting to interact with China it is to the disadvantage of the overall market or the overall economy as we look at the world economy. And my point is let us not tiptoe through the violence.

I would like to help China have a vigorous marketplace that has its doors open to all of us, and I'd like for the United States in particular to benefit from its partnership with China. My disappointment is that—and maybe I need a 10-year or 20-year view. I voted on the PNTR in the late '90's—is to actually look at what the benefit is bringing to the United States when we engage in the PNTR. It seems that we always get a lopsided impact when we engage in——

Mr. Chairman, I think that we should continue to be cautious. I think this review is very important. We want an invigorated market, but we don't want a lopsided market. I look forward to more extensive testimony and considering legislation or not depending upon how we see the future.

I thank the Chairman and I thank the witnesses very much for their testimony. I yield back.

Mr. JOHNSON. Thank you. I thank the gentlewoman from Texas.

I also thank the witnesses. This has been a relatively long hearing, but at least there were no breaks and so you could keep moving along with the discussion. So I want to thank you all for contributing to it and for coming. This is a very important hearing, and I look forward to this Committee following up on some of the recommendations that have been made by you. Thank you very much.

Let me see, I'm getting a little ahead of myself here. Members will have 5 legislative days to submit any additional written questions which we will forward to the witnesses and ask that you answer as promptly as possible to be made a part of the record.

Without objection, the record will remain open for 5 legislative days for the submission of any other additional materials.

With that, this hearing for the Subcommittee on Courts and Competition Policy is adjourned.

[Whereupon, at 6:02 p.m., the Subcommittee was adjourned.]

APPENDIX

MATERIAL SUBMITTED FOR THE HEARING RECORD

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Trading Up

Shanker A. Singham

AFTER DECADES of progress, the process of trade liberalization seems to be in danger of grinding to a halt. Both the political elite and average citizens express waning enthusiasm for freer trade. The World Trade Organization's (WTO) Doha Development Round, which seeks to improve trade terms for developing countries, has yet to produce significant breakthroughs and has now missed countless deadlines. Anxious publics, in developed and developing countries alike, perceive that liberalization and globalization have brought insufficient benefits. Rather than recognizing that such problems arise from domestic regulatory barriers to further liberalization, consumers fault global economic integration. When this misguided economic frustration finds political expression, publics elect populist candidates who promise some form of economic nationalism or mercantilism.

Venezuelan President Hugo Chávez is one leader who has successfully manipulated public preoccupations about "foreign exploitation" and economic insecurity. "We have buried Adam Smith", he triumphantly announced in 2006. Chávez may be at the forefront of the economic-populist trend, but he is hardly alone. Ecuador and Bolivia have notably taken turns towards economic nationalism, as have some of the developing countries in Eastern and Central Europe.

The leaders of developed countries may not have followed Chávez's lead in attempting to re-inter the long-deceased champion of free markets, but they too have embraced the rhetoric of economic nationalism. In France, President Nicolas Sarkozy has promised sweeping economic reform, although he has exhibited protectionist impulses in the past. As finance minister, Sarkozy approved of the government's disbursal of favors to French firms designated as "national champions." In the United States, several Democratic candidates have railed against the president's free-trade agenda (describing themselves as supporters of "fair trade").

In all of these examples, both consumers and their leaders have failed to recognize that domestic economic liberalization, not higher barriers to trade, will spur the economic progress that, in turn, generates jobs and prosperity. When previously protected sectors of the domestic economy are exposed to greater international competition, it is true that specific groups of individuals—tied to relatively

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uncompetitive industries—may suffer. However, as long as these industries receive protection from foreign competition, consumers that purchase these industries' products must pay higher prices than they would in a more competitive market.

While freer trade can cause economic pain in the short run, international competition allows countries to specialize in the industries in which they have a comparative advantage in the long run. Ultimately, trade and specialization benefit a diffuse group of consumers by lowering prices of many goods and services. Trade—to quote Federal Reserve Board Chairman Ben Bernanke—allows countries to "transform what [they] have into what [they] need or want under increasingly beneficial terms." Trade liberalization, in spite of the economic dislocations it may create, is not a zero-sum game. The entry of foreign firms, products and services into the domestic market—an inevitable consequence of trade liberalization—need not be feared: It benefits the average consumer.

Free or Fair?

YET BOTH economic nationalists (some of whom are both against free markets and free trade) and fair traders are not convinced that freer trade is a desirable goal. Both concentrate on trade liberalization's perils, though fair traders often frame the issue in social-justice terms, rather than simply positing a link between restricted trade, job protection for domestic workers and a healthy domestic economy. Free trade's opponents note that a purely market-based approach to trade will have "unfair consequences" if domestic regulations—such as labor rules, internal taxes or laws affecting international distribution—between the trading partners differ. Unfortunately, the fair-trade approach is not the cure-all that its advocates claim it to be. Fair-trade policies undercut comparative advantage, the foundation of trade theory. If trade is only "fair" when domestic regulations in developing countries are identical to those found in developed countries, or if trade is only fair if labor costs are the same, then developing countries—which rely on low labor costs for continued economic growth—would be especially hard-hit. Thus, a new definition of "fairness" is needed—one that captures how domestic-market conditions affect international-trade patterns.

Publics that are skeptical about trade liberalization's benefits often presume that it is impossible to compete "fairly" on the world's economic playing field. As noted earlier, this current concept of fairness does little to truly level the field—and may even be detrimental to economic growth and consumer welfare. If trade liberalization is to continue, the term "unfair" must be applied to restraints and regulations that hinder competition—not the concept of competition itself. These "unfair", anti-competitive policies distort consumer choices, to the detriment of consumers and to the benefit of specific firms or industries. It is the anti-competitive restrictions on market activity, not trade liberalization, that impede economic growth and prevent the gains of trade from spreading to consumers.

One only needs to look at the WTO-mediated telecommunications dispute between the United States and Mexico to grasp the deleterious effects of the lack of competition. In 2004, the WTO concluded that Mexico's International Telecommunications Long Distance Rules unfairly disadvantaged U.S. telecommunications firms. These anti-competitive rules allowed TelMex, Mexico's principal telecommunications firm, to charge both U.S. and Mexican consumers artificially inflated prices for calls placed to and from Mexico. Estimates indicate that the anti-competitive rules cost U.S. consumers alone an extra one billion dollars be-

tween 2000 and 2004. Instead of taking the interests of Mexican consumers into account, the Mexican government used domestic regulations to benefit local producers.

Firms that benefit from anti-competitive restrictions are quite distinct from firms that simply make efficient use of their inputs. A firm that benefits from an "unfair" legal environment is at least partially shielded from competition, so it has little incentive to cater to consumer preferences. The offerings of the American automobile industry while it was protected from Japanese competition serve as unfortunate reminders of this phenomenon.

On the other hand, a cost-effective firm operating in a competitive environment will oblige other firms to engage in competition for profits. When these firms struggle for dominance, basic economic theory states that the average consumer benefits, usually in terms of lower prices for goods and services. Such highly competitive markets, though beneficial to consumers, are difficult to create in practice.

Moving from an "unfair" domestic market towards greater competition is a slow, politically fraught, easily derailed process. Firms that have much to lose from economic liberalization—like some of America's textile producers—will lobby to protect their interests. Meanwhile, the vast mass of consumers cannot effectively organize to counteract the influence of these industry-based interest groups.

When domestic economic deregulation is thwarted by such political maneuvering, the gains from trade liberalization become less apparent to consumers. Domestic regulation hinders the ability of foreign firms to enter what should have been an open market, so consumers in that particular market are unable to benefit from increased competition among firms. Instead of faulting domestic economic policies, consumers blame liberalization and globalization for the lack of improvement in their material circumstances.

Since the public does not recognize the connection between trade and domestic-market competition, it gives its support to leaders who enact crowd-pleasing but economically unsound policies. This scenario is almost a vicious cycle: When populations perceive that trade liberalization has not benefited them, they clamor for anti-competitive economic policies. When these domestic policies are enacted, they further prevent the disgruntled populace from benefiting from integration into the global economy.

SO WHY has the link between domestic regulation and trade liberalization been ignored during the formulation of international trade policy? This can be at least partially explained by the overwhelming producer bias in trade-policy negotiations. The fair-trade-versus-free-trade debate merely obscures the true dichotomy in trade: a producer-welfare orientation versus a consumer-welfare orientation. If consumers are to derive greater benefits from trade liberalization, trade-policy discussions must adopt a more consumer-oriented perspective.

A producer-welfare orientation sees only producers that make products in one country and that sell those products to people in another country. It is in the interests of these producers to block import competition in their home markets while securing market access abroad. Ultimately, this is a purely mercantilist outlook. This kind of approach leads to economic nationalism and protectionism, in which the state plays an ever-increasing role in the economy. It is a zero-sum world, where borders are important and consumers are not—and where people are encouraged to view themselves only in their producer roles.

A consumer-welfare orientation puts forward an opposing view: Trade is not

a zero-sum game. The consumer orientation operates on the premise that the modern world is not one in which producers export goods from one country to another; rather, it is a world of closely connected global supply chains for goods, services and people. This is a world where national borders are less meaningful (with all that that entails for immigration policy and cultural identity). In this model, businesses are consumers too, so they also benefit from reduced prices. A consumer-oriented approach, then, calls for reductions in import costs for exporters, as well as for producers who sell their wares primarily in the domestic market. Cost reductions lead to greater efficiency and greater global-supply-chain integration, ultimately leading to lower prices for a product's final consumers.

Embracing a consumer-oriented perspective will require action on both the domestic and international planes. At the domestic level, countries should ensure that market-distorting regulations and activities—like government grants or preferential loans to certain firms—play minimal roles within national borders. Countries that do not have laws enshrining competition should create and enforce them via domestic competition agencies. These laws must be carefully crafted so that they effectively cover both private- and public-sector anti-competitive actions. If such laws are to serve their purpose, domestic competition agencies must not try to design outcomes for these markets or act as overzealous regulators. Instead, they must facilitate freely competitive markets and intervene only when there is failure.

At the international level, trade negotiators must change their tactics, as the producer-oriented method has run out of steam. For the last half-century, trade negotiators have focused on the needs of producers in reducing trade barriers, cleverly harnessing the forces of mercantilism to craft cross-cutting agreements. Now, however, the producer-oriented approach's mercantilist rhetoric cannot effectively combat the domestic anti-competitive regulations that act as barriers to trade. The stalled Doha Round negotiations—and the lack of corporate concern about its eventual outcome—demonstrate that the days of furthering trade liberalization by trading off producer interests are over.

Trade negotiators must acknowledge the reality of modern trade negotiations. They must recognize that concentrating on competition and consumer welfare will benefit their respective economies, since producers are also consumers. Negotiators must embrace a consumer-oriented dialogue in order for domestic-market impediments to trade liberalization—anti-competitive legislation and regulation, and general government interference—to be removed.

IN ORDER for the consumer-welfare orientation to inform trade negotiations, policymakers must factor notions of competition into their decisions. Yet so far, the link between competition and trade has had a checkered history at the WTO. Although competition underpins much of trade theory and is enshrined in a number of WTO agreements, developing countries rejected a formal competition-trade nexus prior to the 2001 launch of the Doha Development Round.

The developing countries' opposition to the competition-and-trade agenda stems from objections to the WTO's dispute-resolution mechanism. The WTO's dispute-resolution procedures mandate that a state accused of erecting illegal barriers to trade may face various penalties, including sanctions, for failing to uphold its WTO obligations. A product of the WTO's Uruguay Round, the current dispute-resolution process is intended to evenhandedly enforce the organization's trade-liberalization agreements in a legal and non-diplomatic manner. Yet

developing countries are concerned the dispute-resolution mechanism and its associated competition rules actually favor developed countries. Developing countries allege that these competition rules represent a disguised way of achieving market access, violating their national sovereignty.

In light of developing-countries' distaste for the dispute-resolution process, other methods of promoting competition in domestic markets—and thus creating the conditions for freer trade—must be explored. WTO member states should consider public-sector restraint disciplines, in which signatory countries promise to curb anti-competitive, trade-restricting regulation and to apply the competition rules that govern private-sector firms to their state-owned companies as well. The EU's state-aid laws, which prevent certain types of government assistance to private companies, could serve as a starting point, as could more recent attempts to scale back the anti-competitive state-action exemption in U.S. antitrust law.

To convince developing countries to approve public-sector restraint agreements, these pacts could be implemented without resorting to the current dispute-resolution process. A very limited dispute-resolution mechanism might be feasible, but, barring that, other workable alternatives exist. The General Agreement on Trade and Services—which brought trade in services under the WTO's watch—contains competition disciplines that prescribe consultations, rather than impose trade sanctions, to settle disputes. A peer-review mechanism, akin to the Trade Policy Review Mechanism (TPRM), presents another option. The TPRM allows for the monitoring of WTO members' trade practices and policies, inspiring increased observance of WTO mandates.

A new or revised dispute-resolution process could incorporate input from domestic competition agencies, giving the competition "notion" greater credibility at the domestic level.

Since the current dispute-resolution mechanism cannot be applied to these agreements, they must be self-enforcing. That is, governments must want to abide by the agreements because it would harm their reputations, domestically and internationally, to do otherwise. Self-enforcing agreements might be more viable if trade negotiations take a consumer-oriented perspective. Governments could only object to an agreement on the basis that they wanted to reserve the right to harm their own consumers. Such a position would be politically difficult to take, particularly if the country's negotiating partners used the deviation from the agreement as a bargaining chip.

In addition to formulating disciplines to deal with anti-competitive public-sector restraints, WTO member countries should attempt to bolster the credibility of domestic competition agencies. These agencies are crucial to promoting freer markets, as they can contest the consumer welfare–harming, anti-competitive regulations that function as barriers to trade. Unfortunately, in many countries, these agencies are unable to face down the powerful groups that have benefited from the lack of competition. Public-sector restraint disciplines or agreements, by eliminating certain anti-competitive domestic regulations—and therefore unlocking consumer welfare–enhancing market forces—will help build the external credibility of these agencies.

PERHAPS MORE significantly, public-sector restraint agreements enhance the credibility of competition organizations because these agreements bolster the credibility of *all* domestic economic institutions. In developing and emerging markets, where economic institutions are weak, these agreements could prove to be especially significant to continued economic

development. Robust institutions, many scholars believe, would enable economic growth to reach a wider segment of the developing countries' populations. If economic growth touches wide swathes of the populace in the developing world, a competition and market culture could take root there. If the institutions in this part of the world are made stronger, conventional wisdom suggests the developing world might actually develop.

Currently, institution-strengthening is a top-down affair. Large amounts of development money are directed towards this effort, and much energy is expended training officials that will man these institutions in the future. Yet this approach is incorrect, as institutions cannot simply be constructed and then expected to work properly immediately.

Institutions, in the economic setting, are ways to channel the very real forces of competition and the market. There can be no strong or robust institutions unless the restrictions on the free flow of those forces are removed. Only when these forces are liberated can the resultant consumer empowerment support the building of strong institutions. In many ways these forces are at the core of building functioning liberal democracy. Elections or institutions built from the top down will not lead to the unleashing of these forces; indeed, both will simply become corrupted by the very obstacles to the proper operation of the market.

To assume that functioning markets will flow from elections is to put the cart before the horse. Institutions do not create markets. Functioning markets produce, by necessity, robust institutions. Institutions are created and strengthened by their continuous exposure to the winds of competition and the market. It is these forces that operate on man-made institutions like the wind on a rock face, giving them resilience and strength. By fortifying economic institutions, public-sector restraint agreements would also help to restore public faith in the market's ability to encourage economic progress.

THE INCREASING interplay between trade and competition has rendered the existing producer-oriented trade-liberalization dialogues obsolete. If competitive markets are to be allowed to flourish, and if regulatory reform is to occur, domestic politicians and trade negotiators must adopt a fresh, consumer-oriented perspective. This consumer-oriented approach to trade liberalization would allow a new trade dialogue to occur between those who advocate for exporters (typically trade ministries) and those who advocate for domestic consumers (typically competition agencies). Instead of a dialogue of the deaf between two opposed trade ministries arguing their own mercantilist logic, this new discussion would seek to achieve the maximization of consumer welfare. Such a discussion would be more likely to produce meaningful results and would more completely satisfy the underlying purposes of international free trade.

A consumer-oriented dialogue is more appropriate for the real world of international trade in the 21st century. Our 21st-century world is one of competing global supply chains and decreasing costs—a world where the consumer, more than ever before, is king. ∟

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Poverty and Globalization

Shanker Singham & Donna Hrinak

MOST OF the world's people live in countries where markets do not work properly and resources are not efficiently allocated. The notion that liberal economics has "failed" misses the point that in many areas of the world it has not really been tried.

Poverty—often cast as the fault of multinational corporations or "imperialist governments"—is the most virulent killer on our planet. Many continue to believe that increased government regulation and control, particularly when it comes to international trade, is the best way to combat poverty, ignoring the fact that real liberalization—truly free and competitive markets—is in fact the agenda of the world's poor.

It is therefore ironic that efforts to ensure that markets are competitive often fall on the sword of "national interest." Alleged threats to sovereignty are often cited by countries as reason not to negotiate on matters that touch domestic regulation and policies. In practice, this means that they reserve the right to maintain the status quo in which local producer interests trump consumer welfare. Allowing such notions of sovereignty to dominate over economic empowerment of people is to consign the vast majority of citizens to poverty.

It is remarkable that one of the most effective vehicles for empowering individual citizens—global trade negotiations—has largely disregarded this pivotal element of its work. Trade discussions have long centered on enhancing the welfare of producers, rather than on empowering consumers, despite the fact that the fundamental principles on which trade agreements are based are consumer-welfare enhancing ones. Today, the divide between those who would adopt a more consumer-led approach to market-opening and economic growth and those who maintain a producer-led focus represents a major factor opposing free trade and contributes notably to the stagnation of the international trade agenda.

One of the main problems is that governments and elites have refused to recognize the most basic fact of economic life: We are all consumers. Even businesses are also consumers of raw materials or finished or unfinished products. Yet trade negotiations are conducted with a strong bias toward mercantilism. It is quite revealing that in trade talks negotiators continue to refer to tariff cuts as con-

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cessions, as if lowering a tariff requires a "payment" by one's trading partner. This mercantilist logic is now applied to a whole raft of rules-based negotiations. Countries that employ this approach are really saying that they reserve the right to harm their consumers so that producers may receive a benefit in some unrelated area. This is irrational and destructive economics, which if not rooted out will perpetuate misery for billions of people. The recent Eminent Persons' Report prepared by a group chaired by former WTO Director General Peter Sutherland offered an opportunity to redirect the mercantilist approach toward trade. Sadly, however, the word "consumer" never appears in the text of that report.

Because so little attention was paid to consumer welfare, the unprecedented amount of trade liberalization that occurred in the 1990s did not lead to the competitive markets as had been predicted. At first this lag went unnoticed by trade negotiators from major developed countries, such as the United States and the EU countries, where competitive markets were much more the norm. The assumption was that removing trade barriers would inevitably lead to competitive markets inside the border.

But these negotiators failed to factor in the decades of state control and import-substitution economics that had pervaded most of the world's markets. In this context, removal of at-the-border barriers, which were often accompanied by significant privatization programs, often only enriched the gatekeepers, who initially invested in the privatizations at the expense of new entrants. Consumers in countries with low levels of competition were not always empowered by an opening to trade because the prices they paid for products were determined not by tariffs but by levels of competition in the market, which had not changed. The result was an increase in the perceived—and actual—disparity of wealth between the gatekeepers and consumers while poverty persisted. So instead of reacting by advocating more competitive markets and greater pro-competitive regulation inside borders, consumers questioned the entire process of liberalization itself.

Reform Fatigue in Latin American

IN LATIN America, the reaction has been so pervasive that one would be hard pressed to find anyone in the region who would not agree that the privatizations and liberalization of the 1990s had been a costly failure. Few would identify that failure with a lack of competitive markets, but they are linked. In many cases, public monopolies with regulation were simply converted into private monopolies without regulation. In other situations, laws were left on the statute books that not only tolerated but actually mandated anti-competitive conduct by private parties, such as laws that prevented foreign suppliers from severing relationships with failed distributors or taxes that discriminated against new market entrants, especially through foreign investment.

Today, the economic environment in many countries in Latin America and the Caribbean is dominated by two conditions: fatigue and fear. We talk about societies inflicted with "reform fatigue": They are tired of dealing with economic reforms that fail to fulfill their promise of growth and development. And we lament studies that show many Latin Americans and citizens throughout the Caribbean, some of whom lived under authoritarian rule and military dictatorships just twenty years ago, are today also tired of democracy—tired of a system of government that guarantees free and fair elections at regular intervals but that brings no concrete benefits in between.

It's easy to see why many societies in our region are experiencing reform fatigue. Today in our hemisphere, after

over a decade of supposed free market economics and democratic government, there are still eighty million people who live on less than $2 per day. For these eighty million people, all the political and economic reforms have been largely meaningless.

This fatigue with reforms is dangerous, because when countries, peoples and societies are tired, they often opt for the easy way out. Today, there is a new wave of populist leaders—from Hugo Chavez in Venezuela to Nestor Kirchner in Argentina to potential leaders like Evo Morales in Bolivia—prepared to offer that alternative. Their rhetoric varies somewhat from country to country, of course, but the message at its core is that those who are poor find themselves in that circumstance because others are rich—because the pie of prosperity is only so big and someone has taken your piece. And the only way to change the status quo is to cut the pie a different way, to take your piece back. That view also figures in the populists' foreign policy, which holds that the developed world has grown rich only through the exploitation of other countries and that the emerging world is poor because of that abuse.

While overly simplistic, these claims deserve serious examination, because they contain a kernel of truth. They accurately describe the zero-sum game that has too long distorted reform initiatives and liberalization. Too often there have been cozy arrangements between the political and business elites that have ignored the welfare of the majority of the people. One example of this is the much-studied Mexican telecommunications sector, which has recently been the subject of a WTO case for anti-competitive post-privatization practices. Another example is the plethora of dealer-protection laws around the hemisphere, where it is almost impossible for foreign suppliers to terminate their local distributors, because the laws effectively mandate that supplier-distributor relationships go on forever. This chokes off competition at the distribution level and leads to rent-seeking behavior by the gatekeepers of the economy, in this case the local distributors. As a result of such laws, the prices of some basic products are kept artificially high. In the case of medicines in some countries, local distributors have been able to maintain 100 percent profit margins. Indeed, there are examples of local distributors refusing to allow suppliers to make charitable donations, claiming that such an act would effectively terminate the agreement between them and trigger the very high termination indemnities under these laws. The financial benefits that these gatekeepers acquire are then ploughed back into the system in an effort to preserve the anti-competitive regulation. There are also examples of privatization that merely lead to an uncompetitive and uncontrolled private monopoly, as opposed to a state-controlled and sanctioned one, largely because of the focus on government revenue generation. Even in the UK, where the privatization experience has been more pro-competitive than most, initial electricity privatization did not result in enough competition at the generation level and caused competitive problems downstream. Rarely is there a focus on unleashing the forces of competition. Privatization, countries have learned, does not automatically lead to a competitive market. That depends on the quality of the domestic regulatory system.

The oft-quoted remark that there are winners and losers in free trade unfortunately reinforces the idea of a zero-sum environment by suggesting that if someone is winning, someone else is losing. Positing the idea that someone must end up on the zero side of the free trade ledger engenders fear. The fearful believe that, in this new world, they will not be able to compete. A good example of this is the resistance in some Latin American countries, notably Ecuador and the Do-

minican Republic, to a competition law. Viewed through the lens of producers only, local producers do not want to face competition in their markets and do not want to change their customary practices, however damaging those practices are to consumers. But competition can benefit local producers also. Viewed through a consumer-welfare lens, even small businesses, which often buy raw materials for their productive processes, would benefit enormously from more competitive practices at this level.

Strengthening Competition

IN THE current discourse, we have tended to classify countries into those that espouse free market economics with all its implications, and those that favor central control or greater government interference. In weighing their policy options, few countries look at microeconomic policy through a consumer lens.

The current model for trade negotiations is for all partners to defend their producer interests, which almost inevitably clash, leading to an impasse in the talks or, as in the case of negotiations to create the Free Trade Area of the Americas (FTAA), to such a limited set of objectives that the goal of free trade is virtually set aside. In the case of the FTAA, before negotiation stalled completely, some countries, led by the Mercosur trade bloc, resisted the notion that the trade agreement should cover more than traditional border measures and reach into the domestic regulatory measures in states. Attempts to introduce a consumer-welfare-oriented competition policy or to protect intellectual property rights were sacrificed to national sovereignty, as countries maintained that they reserved the right to have whatever domestic policies they chose. But this is a canard. International trade rules have already impacted domestic policy: A country's tariff law is itself a national law. What is really being said, in effect, is that they reserve the right to harm their own consumers or not to protect property rights. If this is indeed the claim, their own people should be aware of it.

To express more clearly the central importance of consumers, competition policy should be brought into the mainstream of trade negotiations. Competition policy must move from being merely an add-on to driving trade talks. Issues that affect the business climate in the target market—such as a country's rules on standards or the way it enforces intellectual property rights—are increasingly cited as legitimate topics for trade negotiators. It is also essential to ensure that the level of competition in the market is not itself a barrier to entry that would undermine the real goal of free trade. The principal benefactors of this approach will be consumers, who will have access to a greater variety of higher quality goods and services at lower prices and, not coincidentally, efficient producers capable of competing on a level playing field.

The last decade has seen an increase in the number of competition agencies throughout the world. Twenty years ago, the primary competition agencies were in the United States and Europe. There are now almost one hundred competition agencies in the world, including many in Latin America. These include agencies in Brazil, Argentina and Mexico, as well as in smaller countries, such as Costa Rica and Panama.

Unfortunately, the impact that these agencies can have on their local economies has been decidedly mixed. This is largely because they are dealing with the powerful entrenched forces noted earlier. They are also dealing, in many countries, with an environment that does not necessarily accept the notion that competition should be the chief economic organizing principle. And as long as many countries do not define "non-optimal" economic

behavior as that which leads to harm to consumers, they are not in a position to ensure that the playing field will be level and that the rules of the game will apply to everyone.

Thus, we come back to the importance of international trade negotiations. By incorporating specific provisions regarding competition, multilateral trade agreements can enhance the external credibility—and the real independence—of domestic competition agencies. But more importantly, negotiators need to recall their primordial obligation within the trade system to construct and agree on rules that are more likely to lead to free trade and free markets, and to adopt a consumer welfare lens in their negotiations.

Despite the furor about introducing competition principles into the WTO, we should point out that it already does address competition issues in many of its existing provisions, both in the agreement that applies to goods and especially in the agreement that applies to services. However, there are some ways to link the level of competition in markets to liberalization processes. Tariff reductions by one side could be linked to the ending of public sector anti-competitive practices by the other side. This makes economic sense, since the benefits of these tariff reductions will be vitiated if there are anti-competitive public sector restraints in the market. Competition safeguards, which could be triggered by demonstrating anti-competitive practices by a government or perhaps a private party, could also be established. Additionally, there is a need for some kind of discipline over public sector restraints that are anti-competitive, akin to the EU's state aids provisions.

Such innovations in trade agreements would bring the interests of exporting companies and foreign investment into alliance with consumers in the trading partner. Local producers would no longer be able to dominate the debate about what is best for the particular country. We have intuitively known that local producers do not always speak for the best interests of their country—even Adam Smith stated that local producers were very good at proving that what was in their interests was in the interests of the country as a whole, when the opposite was often the case.

The principal benefactors of a new approach to trade liberalization would be consumers. While the WTO and World Bank have noted in studies savings of close to half a trillion dollars to the world economy if the Doha Development Agenda succeeds in substantial liberalization, little of that will accrue to consumers unless internal markets function competitively.

What Will It Take?

AT PRESENT, one cannot point to any country in the world that has fully embraced the cause of consumer welfare in its trade negotiations. It is often too difficult to ask trade ministries to see beyond the forces that their producer constituencies are exerting on them. Countries or specific economic sectors (since frequently countries are two-faced on these issues depending on which sector you are analyzing) often move back and forth between measures that protect producers and those that would empower consumers. While embracing certain aspects of free market norms, countries will advocate for old-style industrial policy in the building of national champions through government subventions. This occurs even in developed countries, such as France, where the government recently decided to list certain companies that are deemed strategically important and are therefore protected from foreign takeover. Recently, certain EU member states rejected the process of service liberalization within the European Union. The inventory of

seriously liberalizing service offers from WTO members is bare indeed, even at this last stage of the game prior to the WTO's Hong Kong summit in December. Even postal privatization in Japan, which the overwhelming number of Japanese favor, became such a heated subject that it caused Prime Minister Junichiro Koizumi to dissolve Parliament when the reform was rejected there. What we see is countries trying to have their cake and eat it, too—good old-fashioned mercantilism—seeking better market access for their producers while resisting competition for their own markets. In addition, countries are seeking to adopt some aspects of the free market slate, particularly with respect to macroeconomic policy, while not adopting others, particularly in the microeconomic arena, or by adopting an industrial policy that favors the development of national champions (again, a producer-led vision). The problem is that in today's globalized world one simply cannot try to have a sound macroeconomic policy while tolerating or even encouraging the very practices domestically that will ultimately erode the path to economic progress. When governments try to intervene in markets to guarantee certain outcomes, the government subsidy or aid may distort the market in a particular sector, thus enriching one particular producer at the expense of consumers and even producers in other related sectors.

What we are witnessing now is the teasing out of these differences at the global level. China provides us a very good example of this—where the guiding economic principle is the "socialist market economy." Here, China is moving to a competitive market, complete with a competition authority, while at the same time operating in an environment with a large number of state-owned companies and corporate welfare. However, examples of this kind of picking of options from both sides of the consumer-producer ledger are certainly not confined to China and exist in many countries and many sectors. This is not a developed-versus-developing-world dichotomy, but rather a problem that plagues both developing and developed countries alike.

Clearly, open trade and competitive markets are just two of the factors required if the world economy is to grow and develop and to ensure that growth and development are sustainable and broad-based. In several public speeches, former U.S. Trade Representative and now Deputy Secretary of State Robert Zoellick has made the most skillful and inspiring case for free trade as an effective weapon in the fight against poverty. Speaking at the FTAA trade ministerial meeting in Quito, Ecuador, in November 2002, Zoellick said, "Our ultimate objective is not to have an agreement; it is not to increase trade. Our objective is to grow our economies, reduce poverty, generate jobs, offer opportunities and above all, to create hope." Indeed, free trade and competitive markets can convert the fears about the new economy into hope and the fatigue over reform into energy—if we will only use them to those ends. ❑

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PUBLIC SECTOR RESTRAINTS: BEHIND-THE-BORDER TRADE BARRIERS

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I. Introduction

A. The Current Situation Toward Open Markets and the Benefits of Trade

The post-Cancun atmosphere has resulted in much push-back of the free trade agenda. A number of countries have begun to lose faith in open markets, as illustrated by the collapse of the Cancun World Trade Organization (WTO) meeting in 2003. From this backward pressure and loss of faith, we are seeing a shift away from essential progress in the area of public sector restraints. Developing countries, already afraid of their old commitments, are hesitant to make new ones. Meanwhile, the environmental and labor activism showcased in Seattle reveals the agenda of interest groups in developed nations: trade protectionism under the guise of upholding standards of living and keeping jobs within the country.

Nevertheless, the argument for maintaining open markets in order to benefit from trade rests on the assumption that free trade raises aggregate economic efficiency. This is now generally accepted as common wisdom, and there is ample economic theory to prove the point. The more well-known theories include the Ricardian model,[1] the Immobile Factor and Specific Factor models,[2] and the Heckscher-Ohlin model.[3] These models show that trade can provide greater production and consumption efficiency.

The benefits of international trade are better understood when built up from the benefits of inter-household trade. Let us examine static trade. Households do not generally produce all the goods and services they need--to do so would be understandably inefficient. For example, a biologist produces important research publications but does not farm for his or her family in

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[1] See generally Steven M. Suranovic, International Trade Theory & Policy Analysis ch. 40 (2000) (explaining the Ricardian economic theory), available at http://internationalecon.com/v1.0/ch40/ch40.html (last visited Apr. 16, 2004).
[2] Id. ch. 70 (explaining the Immobile Factor and Specific Factor economic theories), available at http://internationalecon.com/v1.0/ch70/ch70.html (last visited Apr. 16, 2004).
[3] Id. ch. 60 (explaining the Heckscher-Ohlin economic theory), available at http://internationalecon.com/v1.0/ch60/ch60.html (last visited Apr. 16, 2004).

Electronic copy available at: http://ssrn.com/abstract=611061

addition to conducting lab work. At the state level, individual states specialize in certain fields--New York specializes in finance while Wisconsin specializes in dairy agriculture. Tim Muris, chairman of the Federal Trade Commission, notes that the U.S. experience has been that interstate trade was and is crucial to the economic growth of the United States.[4] Given the benefits of household and domestic trade, the implicit third step involves international free trade. The standard Ricardian model of specialization leading to most efficient outcomes explains that if England and Portugal were to produce both wine and cloth, this would lead to inefficient outcomes. Instead, each country would specialize in the product for which it had the comparative advantage--wine for Portugal and cloth for England. Leaving this static model, there are also possible dynamic gains in trade. Evidence in this area shows that developments such as technological change or an improved macroeconomic policy can lead to greater gain from trade.[5]

B. Public Sector Restraints: The New Trade Barrier

In the United States and in many other countries, private sector restraints, monopolization, and collusive behavior are addressed by statute. Thus, by law, this path of private anticompetitive behavior is blocked. It is not always the case that public sector restraints are addressed. For example, as a result of U.S. political economic history and a lack of significant state intervention (such as nationalized industries), public restraints are not covered under U.S. antitrust statutes, but rather by case law.[6] As Muris states:

> Attempting to protect competition by focusing solely on private restraints is like trying to stop the flow of water at a fork in a stream by blocking only one of the channels. Unless you block both channels, you are not likely to even slow, much less stop, the flow . . . . The same is true of antitrust enforcement. If you create a system in which private price fixing results in a jail sentence, but accomplishing the same objective through government regulation is always legal, you have not completely addressed the competitive problem.[7]

Public sector restraints are anticompetitive regulations set by the governments that adversely affect international trade. These regulations come in many forms.[8] However, the uniting factor in public sector restraints is that they stifle competition. Although competition law and trade law have been separately analyzed in economic literature to a large extent, the interaction of competition law and trade law remains underdeveloped.

The foundation of dealing with public sector restraints at a global level already exists. The

[4] See Timothy J. Muris, State Intervention/State Action--A U.S. Perspective, Remarks Before the Fordham Annual Conference on International Antitrust Law & Policy 5 (Oct. 24, 2003), available at http://www.ftc.gov/speeches/muris/fordham03124.pdf (last visited Apr. 16, 2004).
[5] See, e.g., Romain Wacziarg, Measuring the Dynamic Gains from Trade, 15 World Bank Econ. Rev. 393 (2001), available at http://www.stanford.edu/~ wacziarg/downloads/trade.pdf (last visited May 2, 2004).
[6] Muris, supra note 4, at 5-6.
[7] Id.
[8] See discussion infra Part II.

Electronic copy available at: http://ssrn.com/abstract=611061

Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS)[9] provides for National Treatment in Article III,[10] and Most-Favored-Nation treatment further extends equal treatment across the board in Article IV.[11] Competition disciplines are also embodied in the WTO Telecom Reference Paper[12] and the Agreement on Trade Related Investment Measures (TRIMs).[13] Functionally, competition provisions already exist in these chapters. To that extent, the aim of discussing competition is not to introduce the issue, but rather to make the efforts already in place more effective. The way to do this is to address the issue of public sector restraints.

C. Public Sector Restraints: The New Political Risk

Public sector restraints function as a new kind of international political risk for businesses in the international economy. As the days of direct governmental expropriation wane, public sector restraints are the next kind of international political risk. In fact, government overregulation ranked first in a Wall Street Journal survey of threats that CEOs identified to their businesses, outranking increased competition, currency fluctuations, price deflation, and global terrorism, among many other threats.[14] International political risk falls into three broad categories: governmental, societal, and external.[15] Of these, we focus on governmental risks. This includes capricious and arbitrary changes in existing government policies, discriminatory taxation, regulatory takings, passing new laws making previously acceptable actions now illegal, requiring local ownership, or mandating joint ventures favoring local companies in a discriminatory manner.

Public sector restraints are a source of international political risk, and therefore, carry the effects of such. Political risk has been shown to affect foreign investment by reducing the level of overall investment as well as lowering the desirability of current investments.[16] Because

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[9] Agreement on Trade-Related Aspects of Intellectual Property Rights. Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1C, Legal Instruments--Results of the Uruguay Round vol. 31, 33 I.L.M. 1125, 1197 (1994) [hereinafter TRIPS Agreement].

[10] Id. art. III.

[11] Id. art. IV.

[12] WTO, Fourth Protocol to the General Agreement on Trade in Services: Reference Paper, Apr. 30, 1996, 36 I.L.M. 366, 367 (1997). The Reference Paper was distributed by the WTO Secretariat but never formally issued as a WTO document. Laura B. Sherman, Introductory Note to WTO Agreement on Telecommunications Services (Fourth Protocol to General Agreement on Trade in Services), 36 I.L.M. 354, 357 n.21 (1997).

[13] Agreement on Trade-Related Investment Measures, in WTO Agreement, supra note 9, Annex 1A [hereinafter TRIMS Agreement], available at http:// www.wto.org/english/docs_e/legal_e/18-trims.pdf (last visited Apr. 16, 2004).

[14] Marc Champion, CEOs' Worst Nightmares, Wall St. J., Jan. 21, 2004, at A13.

[15] See generally 4 Global Risk Assessments: Issues, Concepts & Applications (Jerry Rogers ed., 1997) (discussing business environment risk assessment, investment, and trade risk analysis, and political risk assessment and management).

[16] See Joseph A. Cherian & Enrico Perotti, Option Pricing and Foreign Investment Under Political Risk 3-4 (Centre for Econ. Pol'y Res., Discussion Paper No. 2327, 1999) (discussing the impact of political risk on foreign investment), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_ id=162348 (last visited Apr. 16, 2004); see generally Sumru Altug et al., Political Risk and Irreversible Investment: Theory and an Application to Quebec (Centre for Econ. Pol'y Res., Discussion Paper No. 2405, 2000) (applying an analytical model to the political risk involved in a Quebec-Canada separation scenario), available at http:// ideas.repec.org/p/cpr/ceprdp/2405.html (last visited May 12, 2004).

foreign investment is negatively affected, trade is necessarily reduced since the investment's exports and imports do not take place. The inflow of capital to establish the investment is also passed up, further reducing possible trade figures. Additionally, there are links of trade openness to foreign direct investment in general that raise concern. The pattern has been that trade openness is positively correlated to foreign direct investment. Therefore, low foreign direct investment not only implicates political risks, but also raises the issue of trade barriers.[17]

II. Case Studies

In the following case studies, examples will illustrate how specific public sector restraints have resulted in suboptimal economic equilibriums.

A. Price Controls: Pharmaceutical Price Ceilings

The nature and mechanisms of price controls are straightforward: a maximum price is declared by the government and must not be exceeded. Basic economic theory dictates that if this price ceiling is below the equilibrium price of the good or service, then there will be an excess demand resulting in shortage. An industry currently under control from price ceilings in many countries is pharmaceuticals. Although the United States does not impose price ceilings on pharmaceuticals, various other nations have done so for varying reasons. However, the nature of the pharmaceutical industry causes price ceilings to be both anticompetitive as well as result in suboptimal economic equilibrium.

The pharmaceutical industry is characterized by high costs of research and development followed by a few successful products that are large financial successes. Therefore, this industry is especially susceptible to inefficiencies arising from the lack of intellectual property rights laws and tampering from price controls.[18] Currently, several countries practice price controls, including Canada, the Netherlands, Portugal, Greece,[19] Brazil,[20] Honduras, Nicaragua, Panama,[21] Ecuador,[22] and Venezuela.[23] The mechanisms for price control are different in each country,[24]

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[17] See Tonia Kandiero & Margaret Chitiga, Trade Openness and Foreign Direct Investment in Africa, Paper Prepared for the Economic Society of Southern Africa 2003 Annual Conference 15 (Oct. 2003) (analyzing the impact of openness to trade on foreign direct investment in Africa), available at http:// www.cssa.org.za/download/2003Conference/Kandiero&Chitiga_Trade%20openness% 20and%20foreign%20direct%20investment%20in%20Africa.pdf (last visited Apr. 16, 2004).

[18] See generally Pharmaceutical Research and Manufacturers of America (PhRMA), National Trade Estimate Report on Foreign Trade Barriers (NTE) 2004 (Dec. 12, 2003) [hereinafter NTE 2004], available at http:// www.phrma.org/international/resources/2003-12-18.459.pdf (last visited Apr. 16, 2004).

[19] John E. Calfee, The High Price of Cheap Drugs 1 (Am. Enterprise Inst. for Pub. Pol'y Res., July 14, 2003), at http:// www.aei.org/docLib/20030715_%2315530Calfeegraphics.pdf (last visited Apr. 16, 2004).

[20] NTE 2004, supra note 18, at 184.

[21] Id. at 194.

[22] Id. at 206.

[23] Id. at 212.

[24] See, e.g., id. at 184 (noting that the Brazilian government permitted pharmaceutical companies to increase their prices only twice in 2002, and again twice in 2003); id. at 206 (observing that Ecuador imposed a price freeze on pharmaceuticals).

but in each case, the price control is set below free market value.[25]

Of interest is how these price controls affect competition not merely in the domestic market, but also how the controls create negative externalities in other markets. One major issue is parallel importation, the re-exportation of imported drugs from one country to another. Because price controls cause drugs to be sold abroad at cheaper prices than in a domestic market, re-importation is becoming a lucrative concept. There are several economic problems with this result.

In the United States, importation of drugs would cause a fall in drug prices. This is because the local market for drugs has to, in effect, compete against its own products that are now becoming available at lower prices. The result would be that the U.S.-based drug companies that researched the drug would face crippled profits.[26] However, consumers also would be hurt by the ensuing situation. Because U.S. drug companies would probably not be willing to suffer huge losses to support small foreign markets, they could potentially limit the size of orders to foreign markets in an effort to curb re-importation.[27] This would result in two things: lesser availability of cutting edge drugs in foreign markets and a resulting shortage that would have to be cleared in the market by a rise in prices. The result is illustrated in a like situation in the financial market: the effect that arbitrage has on currencies is no different from the price effects that will influence drugs when parallel importation occurs as cheaper prices in one country are re-imported to another country with higher prices.

This is illustrated in a study by Mattias Ganslandt and Keith Maskus that analyzes the price effects of parallel importation.[28] The study, using parallel importation of drugs into the Swedish market by way of Spain and Italy, analyzes the effect of parallel imports on the prices of drugs in Sweden as well as the relative benefits accrued to consumers in the home market relative to resource costs involved in parallel trade.[29] Ganslandt and Maskus find that the prices of drugs facing competition due to parallel imports fell by four percent relative to drugs not facing parallel imports.[30] According to Ganslandt and Maskus, this fall in prices occurs partially due to a deterrence strategy by drug companies. That is, in order to deter parallel imports, drug companies are forced to reduce prices in their home markets.[31] Keeping this in mind, three-fourths of the fall in prices was due to parallel imports, while the remaining one-fourth reduction in prices was due to manufacturers' reductions in prices. In their study, Ganslandt and Maskus note that the increased consumer welfare experienced due to lower drug costs could be outweighed by resource costs associated with parallel trade.[32]

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[25] Calfee, supra note 19, at 1 (noting that Canadian pharmaceuticals prices "steadily fall behind free-market levels"); NTE 2004, supra note 18, at 184 (arguing that the price increases allowed by the Brazilian government were "clearly inadequate" to raise the prices to free market values).
[26] Calfee, supra note 23, at 2-3.
[27] Id. at 2.
[28] Mattias Ganslandt & Keith. E. Maskus, Parallel Imports and the Pricing of Pharmaceutical Products: Evidence from the European Union (2004), available at http://www.fordschool.umich.edu/rsie/seminar/Maskus.pdf (last visited May 12, 2004).
[29] Id.
[30] Id. at 27.
[31] Id. at 11.
[32] Id. at 3.

The fall in drug prices results in a host of other problems. The average cost of bringing a new drug to market is currently estimated at $802 million.[33] As such, the nature of the pharmaceuticals industry is marked by high research and development (R&D) costs and relatively low marginal costs of production.[34] That is, once the huge R&D costs of a successful new drug are incurred, the cost of producing extra units of that drug are minimal. Therefore, if differential pricing could be effectively enforced, it would be possible for lower-income countries to be charged at lower prices, closer to marginal cost. This is because prices in developed countries would be at a point above marginal cost where R&D costs could be recovered; hence, R&D costs would be recouped in developed countries. Because that market would take care of the R&D costs, the extra drugs sold to developing countries could be charged at marginal cost (the cost of merely producing the drug).

If drug companies are no longer able to reap the free market benefits of their research costs, drug development could no longer be a profitable endeavor. The result would be a reduction in new drugs coming to the market and a less active pharmaceutical industry.[35] Evidence for this is already beginning to show in Brazil where drug companies have had to downsize and reduce operations due to lower revenue resulting from imposed price controls.[36] This is in no small part reflective of an estimated market decline from $7.2 billion in 1998 to $4.08 billion in 2002.[37] The general reduction of drug research can be seen as a market failure, the result of which is an inferior equilibrium.

Additionally, the European Union's (EU) policy of exhaustion of rights causes problems with price discrimination between European countries. Exhaustion of rights means that under prevailing EU law foreign patent rights holders exhaust their patent rights with respect to parallel trade once they place their drugs on sale anywhere within the EU. Although the aim is to allow parallel importation to bring down prices within Europe and thus promote a single market, the unintended effect is that prices have to be held high in all parts of the EU to protect high-price markets from becoming less profitable.[38] Even if prices were brought down all across the EU, the outcome would be inefficient, or at least, unfair. Because drug companies cannot recoup the cost of their research in overseas markets that are price controlled, they do so only in the U.S. market. Essentially, U.S. consumers would be paying for the drug research costs of even the wealthy EU nations.[39]

Besides the inferior equilibrium that would be attained, we also see governments using price

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[33] Joseph A. DiMasi et al., The Price of Innovation: New Estimates of Drug Development Costs, 22 J. Health Econ. 151, 180 (2003).
[34] Patricia M. Danzon & Adrian Towse, Differential Pricing for Pharmaceuticals: Reconciling Access, R&D and Patents, 3 Int'l J. Health Care Fin. & Econ. 183, 185 (2003).
[35] Fiona M. Scott Morton, The Problems of Price Controls, 24 Regulation 50, 50 (2001).
[36] NTE 2004, supra note 18, at 184.
[37] Id. at 187.
[38] See id. at 90.
[39] See U.S. Senate Repub. Pol'y Comm., Pharmaceutical Price Controls Abroad: An Unfair Trade Policy 3 (Nov. 6, 2003) (noting that U.S. consumers currently pay most of the costs of developing new drugs, and that the increased use of foreign price controls will force U.S. consumers to continue bearing that burden), available at http://rpc.senate.gov/_files/hc110603.pdf (last visited Apr. 16, 2004).

controls as regulations that are tantamount to protectionism. In Honduras, Nicaragua, and Panama, governments "impose[] price controls on innovative pharmaceutical products."[40] Because there are no viable local industries, this becomes a discriminatory practice that only affects foreign firms, such as those in the United States, that create innovative pharmaceuticals.[41]

The above countries have placed price controls on innovative pharmaceuticals to reduce healthcare costs. Such price controls are discriminatory, since domestic producers do not engage in production of innovative pharmaceuticals. By placing a price ceiling on the pharmaceuticals that are developed by U.S. companies, these governments are attempting to shift the burden of R&D costs to U.S. consumers.

Price controls also pose a significant international political risk. As in the case of the Brazilian price controls imposed in 2003, price controls are imposed suddenly and involuntarily.[42] If a pharmaceutical company enters a new market after a cost-benefit analysis based on free market value, this new price ceiling could potentially cause the company to run into losses. As long as price ceilings remain prevalent in foreign markets, this is an international political risk of doing business that will be accounted for in ways that are detrimental to the host country. For example, a country with a record of sudden price ceiling impositions would be less attractive to pharmaceutical firms looking to invest or even to establish distribution. It would make sense from a business perspective to avoid such nations in favor of more open-market minded neighbors, resulting in a loss of investment as well as possible consumer harm if the company chooses to limit distribution of its drugs in that country due to pricing concerns.

B. Entry and Exit Restrictions: Dealer Protection Laws

Easy entry and exit of firms into an open market is essential in maintaining free trade. Firms face obstacles to entering a new market, usually involving the raising of capital as well as filing governmental paperwork. Nevertheless, the extent of the regulations required to enter a new market affects the ease of entry. A wide range of national regulations exists regarding the cost of starting a business. In Mozambique, the process takes 149 business days, nineteen procedures, and US$256 in fees.[43] In Canada, the same process takes only two days, two procedures, and US$280 in fees.[44]

Excessive fees and regulations and the resulting difficulties in entering markets cause a deterrence for firms that are interested in the market. Therefore, these regulations are often public sector restraints that provide protection for local firms. This is especially the case when a double standard is used, enforcing excessive regulations only on foreign firms.

Barriers to entry are detrimental to the growth of an economy, as illustrated in the 2002 World Bank World Development Report:

Entry and exit has been shown to be an important source of industrywide productivity growth

[40] NTE 2004, supra note 18, at 194.
[41] Id.
[42] Id. at 184.
[43] Simeon Djankov et al., The Regulation of Entry, 117 Q.J. Econ. 1, 1 (2002).
[44] Id. at 2.

in semi-industrialized countries such as Chile (1979-85) and Morocco (1984-87) . . . . [T]he priority for policymakers should be to ensure the free entry and exit of firms and exposure to international competition . . . . In developing countries the main institutional barriers . . . are government regulations on exit and entry of firms. Even in the tradable sector, international competition may not lead to domestic competition, partly because of institutional barriers to competition, such as government regulations in product and factor markets that deter firm entry, exit, and growth . . . . [T]he monopolization of domestic distribution channels can mean that even when a good can be imported freely, there still may not be competition in the domestic market for that good.[45]

Dealer laws result in vertical restraints as they lock in the supplier-distributor relationship. Articles have reviewed the impact of vertical restraints as import barriers in the context of the Japanese market, which is widely believed to be uncompetitive as a result of distribution restraints.[46] One paper notes the low level of imports into the Japanese market and strongly urges the Japanese to eliminate their internal restraints, which operate as trade barriers.[47] In another article, the issue is further developed and asks what causes traded-goods to attract higher prices in the Japanese market than in comparable markets.[48] The article notes that, according to a 1991 survey conducted by the U.S. Department of Commerce and the Japanese Ministry of International Trade and Industry, prices of identical or comparable goods were thirty-seven percent higher in Japan than in the United States.[49] This research provides strong evidence that the network of closed arrangements among distributors in Japan (so-called Keiretsu practices) lead to restrictions in the distribution sector, which in turn lead directly to higher prices. The report suggests that the elimination of these Keiretsu effects would lead to a fall in prices by forty-one percent.[50]

Another example of business entry and exit restrictions can be seen in the Dominican Republic Dealer Protection Law, or Law 173 (Dealer Law).[51] The Dealer Law is designed to protect representatives or agents of foreign companies as well as distributors of foreign products. Essentially, the Law provides sanctions for foreign companies that terminate local representatives or distributors without "just cause."[52] In practice, "just cause" for termination applies to only the most egregious situations and is rarely, if ever, found by the courts.

The Law defines just cause as a breach of one of the essential obligations of a distributorship contract, which adversely and substantially affects the interests of the supplier.[53] The Dealer Law specifies that all distributorship agreements must be registered with the Foreign Exchange

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[45] World Bank, World Development Report 2002: Building Institutions for Markets 134-35 (2002), available at http://econ.worldbank.org/wdr/WDR2002/text-2394/ (last visited Apr. 2, 2004).
[46] See, e.g., Robert Z. Lawrence, Japan's Different Trade Regime: An Analysis with Particular Reference to Keiretsu, 7 J. Econ. Persp. 3, 3 (1993) (discussing the theory that Japan's market is "unusually closed").
[47] Id. at 13-15 (discussing the adverse impact of Japanese corporate groups, or keiretsu, on trade).
[48] Marcus Noland, Why Are Prices in Japan so High?, 7 Japan & World Econ. 255, 255-57 (1995).
[49] Id. at 255.
[50] Id. at 259-60.
[51] Law No. 173 of Apr. 6, 1966, G.O. No. 8979 (1974) (Dom. Rep.), reprinted in Law 173 Concerning Protection to Agents, Importers of Merchandise and/or Products, Dated April 6/1966, at 18 (Milton Messina et al. eds., 1981) (on file with author).
[52] Law No. 173 of Apr. 6, 1966, art. 3 (Dom. Rep.).
[53] Id. art. 1(d).

Department of the Dominican Central Bank within sixty days of their execution.[54] The scope of the Dealer Law also represents a problem--it far exceeds most dealer laws in the region to include all forms of relations established between a licensee and a licensor through which the licensee engages in the Dominican Republic to promote or manage the "import, distribution, or sale of products or services," the rent or any form of trade or exploitation of products coming from abroad or manufactured in the country, and the "services related with such negotiations . . . whether he acts as agent, representative, importer, commission merchant, licensee, or under any other denomination."[55] The scope is therefore very broad and extends far beyond agents, through distributors, franchisees, and anyone else remotely concerned with the sale of products. Therefore, even agents who operate on their own accounts, and are usually subject to much less protection than dealers, are provided with inordinate amounts of protection.

Besides the scope of the Law, the extent of protection provided for in the Dealer Law is also excessive. The protection clause of the Dealer Law basically provides for compensation in the form of a termination indemnity in favor of the representative when the licensor terminates the relationship without "just cause."[56] The termination indemnity includes the following elements: all of the distributor's expenses and losses arising from the termination;[57] the value of the distributor's investment in the business;[58] the value of the promotional efforts of the distributor;[59] an amount equal to the distributor's "gross profit" for the preceding five years;[60] and an amount equal to the distributor's "gross profit" for the duration of the relationship divided by ten for every year over the fifth.[61]

In the event of unilateral termination of the agency relationship by the licensor or its unilateral refusal to renew the agency relationship once its term has been reached, the licensor will not be able to continue its distribution activities in the local market unless it proves to the court that a "just cause" did exist and was the reason for terminating the agreement or pays the compensation set forth by the Dealer Law.[62] In the event that the terminated dealer is replaced with another by the licensor, the law deems the licensor and the new dealer as jointly liable to the terminated dealer.[63]

The major problem with the Dealer Law is its impact on the domestic economy of the Dominican Republic, because it limits competition at the distributor level and therefore increases prices and decreases consumer choice. The Dealer Law prevents an effective, functioning, competitive market at the distribution level from operating in the country. In many areas, because the freedom of choice of the suppliers is limited, distributors may refuse to service

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[54] Law No. 664 of Sept. 21, 1977, art. 2, G.O. No. 9447 (1977) (Dom. Rep.), reprinted in Law 173 Concerning Protection to Agents, Importers of Merchandise and/or Products, Dated April 6/1966, at 18 (Milton Messina et al. eds., 1981) (on file with author).
[55] Law No. 173 of Apr. 6, 1966, art. 1(a) (Dom. Rep.).
[56] Id. art. 3.
[57] Id. art. 3(a).
[58] Id. art. 3(b).
[59] Id. art. 3(c).
[60] Id. art. 3(d).
[61] Law No. 173 of Apr. 6, 1966, art. 3(d) (Dom. Rep.).
[62] Id. art. 6.
[63] Id.

certain sectors of the market. Suppliers then have no way of reaching those sectors. Dominican citizens are also being denied basic products and services as a result of the law.

The primary economic impact of the Dealer Law is in the economic incentives it sets up. Since the termination indemnities are set so high, and dealer profit margins are very high, this pushes economic actors to go into potentially lucrative distributorships as opposed to going into manufacturing or other service jobs that might grow the domestic economy. This distorts and holds back the local economy and prevents the growth of the domestic production sector.

Additionally, domestic regulatory barriers can be particularly damaging as they impede entry by many more players. The Dealer Law has a profound effect on markup rates, since it imposes a high cost of entry both domestically and on imports. The net effect of the Dealer Law is to limit new entry, by making it difficult to change supplier-distributor vertical relationships. The net effect is to lead to very high pressures to increase markup levels, thus hurting domestic consumers.

The impact of the Foreign Investment Law of 1995[64] on the Dominican economy is particularly telling of the restrictiveness of the Dealer Law. The Foreign Investment Law of 1995 made a significant impact on the Dominican economy. The Law for the first time allowed foreign investor and traders to set up their own distribution systems in the country.[65] Since their own distribution systems (or indeed those of other foreign companies) were unlikely to utilize the Dealer Law, this meant that the economic choice of foreign suppliers was increased. Greater competition was therefore introduced into the market for new supplier-distributor relationships. As a result of a series of reforms in the area of tax and tariffs, the economy of the country grew dramatically in the late 1990s.[66] However, it is important to note that the Foreign Investment Law does nothing to alter the network of supplier-distributor relationships that predate the law's enactment in 1995, and therefore the anticompetitive impact of these locked-in relationships continues to adversely affect the Dominican economy.[67]

C. Government Procurement: Microsoft and Open Source

Procurement of products and services by government agencies for their own purposes represents an important share of total government expenditures and thus has a significant role in domestic economies. As a result, there is the possibility of rent seeking by governments to achieve certain other domestic policy goals through their purchasing decisions, such as promotion of local industrial sectors or business groups rather than open and transparent decision-making based on price and other considerations. Measures that would be anticompetitive may be either explicitly prescribed in national legislations or in the form of less overt measures or practices, which have the effect of denying foreign products, services, and

[64] Law No. 16-95 of Nov. 20, 1995 (Dom. Rep.).
[65] See Ingrid Suarez, A Change for the Better: An Inside Look to the Judicial Reform of the Dominican Republic, 9 ILSA J. Int'l & Comp. L. 541, 558 (2003) ("[The Foreign Investment Law] provide[s] investors, both foreign and domestic, the same rights and obligations regarding investment matters.").
[66] Abacci Atlas, The Economy of the Dominican Republic, at http://www.abacci.com/atlas/economy.asp?countryID=185 (last visited Apr. 25, 2004).
[67] See, e.g., Larry Luxner, A Presidential Brew, Americas, Sept. 1, 2002, at 4 (observing that one beer company, Cerveceria Nacional Dominicana S.A., controls ninety-eight percent of the beer market in the Dominican Republic).

suppliers the opportunity to compete in domestic government procurement markets. Such practices include excessive use of single or selective tendering, or the lack of transparency in tendering procedures.

A major issue in government procurement has emerged in the form of software procurement. Public and governmental bodies are the largest consumers of software products in most countries.[68] Because this is the case, any legislation favoring one kind of software over another immediately falls under scrutiny as being anticompetitive. To understand this issue, it is important to distinguish between the proprietary software market and open source. Open source means that the source code of a software program is made available to others at no additional charge.[69] Further, open source allows users not just the right to use the software but also to adapt it and to then redistribute the adapted (or the original) software to others.[70] There are two types of open source software. Under the Berkeley Software Distribution (BSD) license, recipients may modify such code and distribute the modified code under a BSD license.[71] Alternatively, recipients may modify and then sell the program for profit. The more common open source software is General Public License (GPL). Under GPL, anybody who distributes software that is based on a source code covered by GPL must release all variations of that software under the GPL.[72]

In contrast, proprietary software is software that is purchased from a software company that conducts R&D and protects such R&D through intellectual property rights (IPRs), such as copyright or patent.[73] The proprietary software company re-coups its R&D costs by selling its products at a profit. In order to protect themselves, these companies need to enforce IPRs and protect its programming code.

A key player in the proprietary market is Microsoft. Because of the market prevalence of its products, such as Microsoft Windows and Microsoft Office, many governments use Microsoft software. Recently, however, legislation across the world is being passed that favors the use of open-source software. It is from this legislation that anticompetitive regulation results in a public sector restraint.

Such legislation favoring the use of open source software exists in many cities throughout Brazil and Australia, and countries adopting open source include Canada, France, Germany,

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[68] See, e.g., Sharifah Kasim, Govt Seeks Software Vendors' Commitment, New Strait Times (Malay.), Sept. 18, 2000, at 1 (stating that the government is one of Malaysia's "biggest users of information technology"); Anh-Thu Phan, Panda Eyes Government Deals with New Software Venture, S. China Morning Post, Apr. 9, 2002, at 24 (observing that "[g]overnment offices are among the biggest buyers of software [in China]").

[69] Bruce Perens, The Open Source Definition (2004), at http:// www.opensource.org/docs/definition.php (last visited May 12, 2004).

[70] Id.

[71] Open Source Initiative, The BSD License (2004), at http:// www.opensource.org/licenses/bsd-license.php (last visited May 12, 2004).

[72] Robert W. Hahn, Government Policy Toward Open Source Software: An Overview, in Government Policy Toward Open Source Software 1, 4 (Robert W. Hahn ed., 2002), available at http://www.aei-brookings.org/admin/authorpdfs/page.php?id=210 (last visited Apr. 16, 2004).

[73] Bellevue Linex Users Group, Proprietary Software Definition (2004), at http://www.bellevuelinux.org/proprietary.html (last visited May 12, 2004).

Mexico, Peru, Korea, Taiwan, and the United Kingdom.[74] Even in the United States, pressure has been exerted on the government, pressing it to consider passing legislation favoring open-source software. Examples of said pressure include a letter from Ralph Nader to the Office of Management and Budget, pressing for the adoption of legislation favoring open source.[75]

The prevalence of Microsoft products has taken place in a free market context. The success of Microsoft products has occurred through consumer free choice, without government legislation. To pass legislation favoring open source as government procured software is by nature anticompetitive, since it reduces consumer choice.

The problem is not that governments may choose open source over proprietary software. Rather, governments are no longer free to choose whether or not open source is right for their needs because it is mandated for them by legislative fiat. Even if governments do not prefer Microsoft Windows, no compelling reason exists for governments to back actively an alternative to it. It is for the market to decide if such an alternative should exist. As with other goods, government should not interfere with software products except in the case of market failures. In making such a determination, the first question is whether or not there is a market failure. The major types of market failure include: externality, natural monopoly, market power, and inadequate or asymmetric information.[76] First, externalities are those failures which the market may not account for when one party's actions impose uncompensated costs (or benefits) on another party. Examples of externalities include pollution or public goods.[77] A second type of market failure is when there is a natural monopoly, such as a water or electric utility.[78] The third type of market failure is when firms exert monopoly power in anticompetitive ways, such as through monopolization or tying.[79] The final form of market failure is when there is an information problem through inadequate or asymmetric information that harms consumers.[80] Insider trading is illegal in order to address this kind of market failure. None of these four types of market failures apply to the government procurement of an operating system.[81] An operating system does not have negative externalities. Operating platforms also are not natural monopolies.[82] The fact that open source competes with Microsoft proves that the barriers to entry are low enough for operating systems. This proves that there is no market failure. Finally,

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[74] For further information regarding legislation favoring the use of open source software, see the Consumer Project on Technology, Government Procurement of Software, at http://www.cptech.org/ecom/gp.html (last visited Apr. 16, 2004).

[75] Letter from Ralph Nader & James Love, to Mitchell E. Daniels, Jr., Dir., Office of Mgmt. & Budget (June 4, 2002), available at http:// www.cptech.org/at/ms/omb4jun02ms.html (last visited Apr. 16, 2004).

[76] See Stephen Breyer, Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform, 92 Harv. L. Rev. 549, 553-58 (1979) (discussing "spillovers" or externalities, natural monopoly, and inadequate information as classical market failures).

[77] Thomas W. Hazlett, Is Federal Preemption Efficient in Cellular Phone Regulation?, 56 Fed. Comm. L.J. 155, 170-71 (2003).

[78] Michael J. Trebilcock & Edward M. Iacobucci, Privatization and Accountability, 116 Harv. L. Rev. 1422, 1434-35 (2003).

[79] Thomas G. Krattenmaker et al., Monopoly Power and Market Power in Antitrust Law, 76 Geo. L.J. 241, 246 (1987).

[80] Breyer, supra note 76, at 556.

[81] David S. Evans & Bernard J. Reddy, Government Preferences for Promoting Open-Source Software: A Solution in Search of a Problem, 9 Mich. Telecomm. Tech. L. Rev. 313, 337 (2003).

[82] Id. at 330-31.

informational problems do not apply in the procurement of operating systems.

Because there has been no actual market failure, government should be very hesitant to try to "correct" a perceived competition issue of two different operating systems when such issue can be resolved at relatively low cost by market participants themselves. The better product will be the one that consumers choose. Government would otherwise distort market dynamics by choosing one product over another, which would shield the government "winner" from the effects of competition. Even subsidies (explicit or implicit through hard or soft preferences) for one option could have effects on the industry as a whole if it means that the tipping point has been reached and the network externalities begin to take effect. Such subsidies therefore have deleterious effects:

> If there are strong network effects, the market equilibrium depends on consumers' expectations regarding future adoption decisions of other players. In this case, government intervention may make the market tip in one direction . . . . Furthermore, if network effects are less strong and if two competing products are going to stay in the market, artificially favoring one product by requiring government agencies to buy it may actually reduce competition, increase prices, and lower innovation and social welfare.[83]

Thus, in order for government intervention to make economic sense, the government intervention actually needs to improve the situation and solve the market failure.[84]

Since consumers can on their own make the decision that is right for them, there is no reason why governments should intervene in the procurement process by favoring one form of platform over another. As a purchaser, a government should view itself as no different than any other sort of business. As with any other business, it must make its business decisions based on the merit of the products that it would procure. The reasons for such decisions may vary. Such decisions may be determined on the basis of price, ease of use, security, technological capabilities, or a combination of these. Sometimes people or governments may choose proprietary software because of the network effects of such software. That is, the more people that use a certain platform, the more applications and additional software that is produced for such a platform. Additionally, there may be switching costs associated with the adoption of a new type of software. The switching costs occur because the buyer of the product has already made an investment in a particular product that will need to be duplicated if the buyer switches to a new

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[83] Klaus M. Schmidt & Monika Schnitzer, Public Subsidies for Open Source? Some Economic Policy Issues of the Software Market, 16 Harv. J.L. & Tech. 473, 501 (2003).

[84] A similar issue emerges in antitrust enforcement. The 1995 Department of Justice and Federal Trade Commission Antitrust Guidelines for the Licensing of Intellectual Property discuss how an innovation market should be defined. Dep't of Just. & Fed. Trade Comm'n, Antitrust Guidelines for the Licensing of Intellectual Property 10-13 (1995). available at http:// www.usdoj.gov/atr/public/guidelines/ipguide.pdf (last visited Apr. 16, 2004). However, agencies need to be very careful in their use of technology markets since technology markets are subject to increased rate of innovation, a relative ease of entry and an instability of market shares for market participants. Overbroad enforcement would stifle innovation because the government would make decisions about possible outcomes based on information that is by nature speculative regarding research and development. As Robert Hahn cautions, "[w]ithout a better understanding of the economic impacts of proposed and actual interventions in new economy markets, antitrust officials often will be flying blind." Robert W. Hahn, A Primer on Competition Policy and the New Economy 10 (AEI-Brookings Joint Center for Reg. Stud., Working Paper No. 01-03, 2001).

seller that has a different product that performs the same task. Economic inefficiencies may result from passing legislation that favors open source. Faced with legislation, a forced switch from one system to another may cause high switching costs that lead to inefficiencies due to incompatibility with other systems. Open source may be the best decision for procurement based on business factors. Alternatively, proprietary software may be the best option. In either case, the government should be free to choose which option makes the most sense for it given its own business needs on a case-by-case basis.

WTO decisions suggest why neutrality in decision making on technology platforms is the correct course of action. The key provision of the WTO Agreement that deals with government procurement is Article XVII, entitled State Trading Enterprises (STEs).[85] Article XVII provides that:

> (a) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.
>
> (b) The provisions of sub-paragraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.[86]

Thus, STEs are required to abide by general principles of non-discriminatory treatment using commercial considerations. Case law develops the meaning of the non-discriminatory standard and the use of commercial consideration.

Article XVII also covers the importation of products used for "immediate or ultimate [governmental] consumption."[87] Article XVII(2) states that "[w]ith respect to such imports, each contracting party shall accord to the trade of the other contracting parties fair and equitable treatment."[88] The fair and equitable standard is rather opaque and no decisions explicitly touch on this definition, nor is fair and equitable treatment used elsewhere as a standard in another WTO agreement article.[89] Assuming that fair and equitable are similar criteria to those of Article

[85] WTO Agreement, supra note 9, Annex 1A, art. XVII, available at http://www.wto.org/english/docs_e/legal_e/gatt47_e.pdf (last visited Apr. 16, 2004).
[86] Id. art. XVII(1).
[87] Id. art. XVII(2).
[88] Id.
[89] Fair and equitable treatment, however, is mentioned in Article VII(1)(b) of the Agreement on Textiles and Clothing (Annex 1A of the WTO Agreement) in relation to "fair and equitable trading conditions as regards textiles and clothing in such areas as dumping and anti-dumping rules and procedures, subsidies and countervailing

XVII(1), fair and equitable, if applied to the context of open source, would seem to require government neutrality, especially given that Article XVII implicates Article III of GATT on national treatment.[90]

A recent decision addresses more generally the issue of how an STE must treat competitors that cover the principles of non-discrimination and commercial consideration for such procurement (Article XVII(1)). The Korea--Measures Affecting the Import of Fresh, Chilled and Frozen Beef case affirmed that Article XVII applies the national treatment principle in GATT Article III in addition to the most favored nation principle in GATT Article I.[91] In the case, the panel very clearly held that "this general principle of non-discrimination includes at least the provisions of Articles I and III of GATT."[92] Furthermore, the panel clarified the relationship between the "non-discrimination principle" of Article XVII(1)(a) and the "commercial consideration" obligation in 1(b). The panel stated that:

> The lists of variables that can be used to assess whether a state-trading action is based on commercial consideration (prices, availability etc. . . .) are to be used to facilitate the assessment whether the state-trading enterprise has acted in respect of the general principles of non-discrimination. A conclusion that the principle of non-discrimination was violated would suffice to prove a violation of Article XVII; similarly, a conclusion that a decision to purchase or buy was not based on "commercial considerations", would also suffice to show a violation of Article XVII.[93]

Under this approach, price, quality, availability, marketability, and other elements are used to gauge the commerciality of a disputed state trading enterprise's business transaction. Such elements are also used to decide whether the non-discrimination obligation has been violated. Further, the panel noted, "[a]n entity infringes the general principles of non-discriminatory treatment where it fails to act on commercial considerations, or afford importers adequate

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measures, and protection of intellectual property rights." Agreement on Textiles and Clothing, in WTO Agreement, supra note 9, Annex 1A, art. VII(1)(b), available at http:// www.wto.org/english/docs_c/legal_c/16-tex.pdf (last visited Apr. 16, 2004).

[90] See WTO Dispute Settlement Body Panel Report, Korea--Measures Affecting Imports of Fresh, Chilled and Frozen Beef, para. 753, WTO Docs. WT/DS161/R & WT/DS169/R (July 31, 2000) [hereinafter Dispute Panel Report on Korea] (discussing the implications of Article III), available at http:// www.wto.org/english/tratop_e/dispu_e/dispu_status&uscore;e.htm#1999 (last visited Apr. 16, 2004); see discussion infra Part II.C.

[91] Dispute Panel Report on Korea, supra note 90, para. 753.

[92] Id. para. 753. In the appellate decision, the Appellate Body stated that there are three elements in any GATT Article III(4) violation:

(1) The imported and domestic products are "like products."

(2) The trade measure in question is a "law, regulation, or requirement" that affects the "internal sale, offering for sale, purchase, transportation, distribution, or use" of the imported products.

(3) The imported products are accorded "less favorable" treatment.

WTO Appellate Body, Korea--Measures Affecting Imports of Fresh, Chilled and Frozen Beef, para. 133, WTO Docs. WT/DS161/AB/R & WT/DS169/AB/R (Dec. 11, 2000), available at http://www.wto.org/english/tratop_e/dispu_e/dispu_status_ e.htm#1999 (last visited Apr. 16, 2004).

[93] Dispute Panel Report on Korea, supra note 90, para. 757. In the Korea decision, the panel found that Korea's lack of, and delays in calling for, tenders for beef and Korea's practice of distinguishing based on non-commercial considerations between grain and grass fed beef violated Article XI of GATT. Id. para. 845.

opportunity to compete."[94] This is clearly the situation with which government support for open source preferences violates non-discrimination and commercial considerations. One might argue that similarly, this treatment would not seem fair and equitable (because the government is picking winners) and therefore violates the spirit of Article XVII(2). This conclusion holds because Article XVII imports the Article III national treatment. In turn, the Article III national treatment violation sets up an Article XVII violation because it is in the government realm--both from the government itself and also through STEs. Clearly, favoring one type of software over another is a public sector restraint that is anticompetitive and needs to see liberalization from governmental control.

D. Technical Standards Restrictions

Countries set legal standards covering various industries for several reasons. In the case of food standards, the concern is that of health and cleanliness. Another example is of automotive safety requirements--most governments require new cars to have seatbelts, and the United States goes so far as to mandate dual front airbags. Aside from quality and safety standards, governments also set standards to streamline and coordinate within industries. Picking a certain voltage for the national power grid can be seen as an example of this, as can a government's regulation of radio frequencies. Without standards, national phone systems could not exist, and neither could the private companies that provide phone service. Therefore, these standards can be seen as a measure to promote competition. However, because the government is vested with the power of setting standards, it is possible for these standards to be set in a way that is anticompetitive. Furthermore, in the context of world trade, standards can be set in a manner that is anticompetitive in the form of a non-tariff trade barrier.

The WTO addresses anticompetitive standard setting in the Technical Barriers to Trade (TBT) Agreement.[95] In this agreement, technical restrictions acting as public sector restraints are defined as "unnecessary obstacles to international trade" that can result when (a) a regulation is more restrictive than necessary to achieve a given policy objective, or (b) it does not fulfill a legitimate objective.[96] A regulation is more restrictive than necessary when the objective pursued can be achieved through alternative measures that have less trade-restricting effects, "taking account of the risks non-fulfilment [of the objective] would create."[97] Elements that Members can use for risk assessment are "available scientific and technical information, related processing technology or intended end-uses of products."[98] Article 2.2 of the Agreement specifies that "legitimate objectives are, inter alia: national security requirements; prevention of deceptive practices; protection of human health or safety, animal or plant life or health; or the environment."[99]

As such, certain kinds of regulations may be protectionist. Restrictions that are aimed at keeping out imports by complicating the certification process are anticompetitive in nature and

[94] Id. para. 320.
[95] Agreement on Technical Barriers to Trade, in WTO Agreement, supra note 9, Annex 1A, available at http://www.wto.org/english/docs_e/legal_e/17- tbt.pdf (last visited Apr. 16, 2004).
[96] Id. art. 2.2.
[97] Id.
[98] Id.
[99] Id.

are characteristic of public sector restraints. Discriminatory standards that apply only to foreign producers also often have an element of protectionism. Even selecting a standard that a local company has picked can be anticompetitive if it automatically excludes the standards of foreign companies.

The WTO recognizes that the imposition of discriminatory standards can hurt competition in four ways.[100] First, special procedures required of foreign producers results in a loss of economies of scale to the foreign producer.[101] For example, if imported goods require a special certification process that necessitates the repackaging of goods, a producer must produce these units separately. This raises the cost of production to the supplier, which may make it uneconomical to enter the market. The second way is through conformity assessment costs, which would accrue to the foreign producer if a local government unnecessarily sets regulations that differ from international standards.[102] Third, information costs could affect the foreign producer.[103] Information costs are those costs associated with examining the technical impact of compliance with foreign regulations, disseminating product information, and hiring experts. Finally, firms subject to special regulations could face surprise costs--that is, costs of compliance that local firms usually have an advantage conforming to because of the disparate impact of such regulations on foreign firms.[104]

All of the above costs have one effect: they raise the cost of doing business in another country. Because this can make it uneconomical for a company to enter into a country, the regulations can be tantamount to trade barriers. When this is the case, the regulations can be seen in the context of public sector restraints that are becoming more and more common. In fact, a World Bank working paper by Sherry M. Stephenson recognizes and emphasizes the fact that the significance of these kinds of protectionist methods has increased as conventional tariff and non-tariff barriers have been brought down.[105] Additionally, studies show that local producers create unilateral standards that raise the cost of doing business for foreign firms.[106] Studies examining technical barriers to trade show that domestic firms generally lobby for standards that would raise the aforementioned cost to a level that makes it uneconomical for foreign firms to compete in the home market, or no standards at all.[107]

A common example of using technical barriers to trade occurs in the agricultural sector. The agriculture sector is covered in large part not under the TBT Agreement but under the Sanitary

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[100] WTO, TBT: Divergent Regulations--Costs for Exporters, at http://www.wto.org/english/thewto_e/whatis_e/col/e/wto03/wto3_7.htm (last visited Apr. 21, 2004).
[101] Id.
[102] Id.
[103] Id.
[104] Id.
[105] Sherry M. Stephenson, Standards, Conformity Assessment and Developing Countries 4 (World Bank, Working Paper No. 1826, 1997), available at http://econ.worldbank.org/docs/398.pdf (last visited Apr. 16, 2004).
[106] Leonardo Iacovone, Analysis and Impact of Sanitary and Phytosanitary Measures 12-13 (2003), available at http:// www.cid.harvard.edu/cidtrade/Papers/iacovone.pdf (last visited Apr. 16, 2004).
[107] See, e.g., Ronald D. Fischer & Pablo Serra, Protección y Estándares, in Las Nuevas Caras del Proteccionismo (Ronald D. Fischer ed., 1996).

and Phytosanitary (SPS) WTO Agreement.[108] The SPS WTO Agreement allows for countries to protect the health of their agricultural and related sectors through various technical measures. This protection must be based on the principle that all such measures must be non-discriminatory in their application and scientifically justified. However, at times SPS measures have been abused by an overzealous application of the precautionary principle. Under the precautionary principle, a lack of scientific certainty or scientific consensus does not prevent a country from taking action to protect the environment or public health. However, as with the Beef Hormones or GMO cases, at times the precautionary principle has been used as a trade barrier rather than to protect the environment or public health. For example, no studies have ever shown that GMOs are dangerous to human health. Another example of such measures is the European ban on hormone treated beef. Due to expressed "health concerns," the EU bans all imports of hormone treated beef. This has resulted in complaints being filed by the United States, Canada, and several Latin American countries.[109] The roots of the ban originated in 1980 when Italian babies were thought to be adversely affected by a hormone known as dimethyl stilbenes (DES).[110] The resulting public concern led to an investigation of five other hormones known to be used in the growing of cattle. The studies, conducted by the EC with European scientists, found the five hormones to be harmless.[111] Nonetheless, the EC chose to ban all hormone-treated meat before a formal report could be issued. This occurred for two reasons: to create a uniform SPS standard across all European countries and in response to consumer pressure.[112]

The irony is that the ban was created in part to address issues of trade facilitation within EC nations at the time. Because individual countries held differing policies regarding hormone-treated meat, a common denominator of a total ban was established across the entire area. Less than ten percent of the United States' $120 million worth of beef exports to the EC were hormone-free.[113] Because there was no scientifically established basis for the ban, this had the effect of a technical barrier to trade under WTO rules, and was ruled accordingly. Ultimately, the WTO arbitrators held that impairment suffered by the United States amounted to $116.8 million per year.[114] This figure was reached by estimating the trade loss and calculating the value of that trade loss due to the hormone beef ban.[115] The main objections presented to the WTO rested on the point that no scientific basis had been established for the danger of the

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[108] Agreement on the Application of Sanitary and Phytosanitary Measures, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization [hereinafter WTO Agreement], Annex 1A, Legal Instruments-- Results of the Uruguay Round vol. 1, 33 I.L.M. 1125, 1153 (1994).

[109] See, e.g., Bush Administration Filing Suit over EU Biotech Ban, Zoellick Says, Associated Press, May, 13, 2003 (noting that the United States filed a formal complaint with the WTO, joined by Canada, Argentina, and Egypt).

[110] Amanda Brand & Andre Ellerton, Report on Hormone Treated Meat 29 (1989).

[111] Three of the five hormones were found harmless in the original studies conducted by the EC's scientific working group, known as the Lanning Commission. U.S. Int'l Trade Comm'n, The Effects of Greater Economic Integration Within the European Community on the United States: First Follow-Up Report 6-50 (USITC Publication No. 2268, 1990). The Lanning Commission was reportedly close to clearing the remaining two hormones when its studies were cancelled for political reasons. Id. The two hormones, however, were cleared in later studies. David Vogel, Trading Up: Consumer and Environmental Regulation in a Global Economy 155 (1995).

[112] Vogel, supra note 111, at 155-56.

[113] Id. at 159.

[114] Decision of the Arbitrators on European Communities--Measures Concerning Meat and Meat Products (Hormones), para. 83, WTO Doc. WT/DS26/ARB (July 12, 1999), available at http://www.wto.org/english/tratop_e/dispu_ e/dispu_status_e.htm#1999 (last visited Apr. 16, 2004).

[115] Id. Annex 1 & 2.

hormones.[116] Unbelievably, despite the WTO's ruling in favor of the United States, the EU continues to ban imports of beef from hormone-treated cattle.[117] The EU's response was that consumers could choose to ban a substance according to their preferences. The argument went that if European consumers prefer hormone-free meat, then they should be free to choose so.

It is true that no scientific basis is necessary for the consumer preferences of Europeans. However, the issue here is not whether or not Europeans consume hormone-treated meat. The problem lies in the fact that legislation has been established that effectively limits the choice of the European consumer. If it is true that European consumers would rather not consume hormone-treated meat, then no legislation is necessary. As long as the proper legislation is passed to ensure the labeling of hormone-treated meats, the private sector should be able to phase out hormone-treated meats by their own accord: through exercising consumer choice. When the government legislates this choice, however, we enter the realm of technical barriers to trade that have the effect of protectionism.

The results of this protectionism are problematic, and lie in basic economic theory. First, it creates distortion through protection in the European agriculture market, which is already marked by protectionist distortion in the form of the Common Agricultural Policy. Second, consumers no longer have the choice of beef from many parts of the United States, Canada, and Latin America. All other things held equal, this raises the cost of meat due to reduced competition. Although the price effects on the individual consumer may not be substantial, the effect on businesses that rely on hormone-treated meat can be considerable.

E. Government Created Monopolies and Cross-Subsidization: Telecom

The pitfalls of monopoly are well known, and consist of higher prices and lower production.[118] However, where there are significant economies of scale, a situation might exist where a monopoly would be to the benefit of society. These situations are referred to as natural monopolies. In natural monopolies, competition would require the installation of redundant systems. To prevent this inefficiency, governments sometimes allow monopolies in areas where natural monopolies occur. In other instances, the government creates a monopoly in such areas by its own accord because of political ideologies, such as nationalization or import substitution. However, this creates a host of problems that do not occur with private monopolies.

Most significant is the fact that a government-created monopoly is no longer a profit maximizing business. The guarantee of its monopoly power and its regulation by a governmental agency changes its behavior from economic to political--it must influence and manipulate the regulatory agency for its own gain. In addition to attempts to increase costs or hide profits in cost to allow it to earn excessive profits, the monopolist may also try to curry favor with influential figures. This can take the form of creating pricing schemes to appeal to

[116] Julie Teel, Regulating Genetically Modified Products and Processes: An Overview of Approaches, 8 N.Y.U. Envtl. L.J. 649, 694 (2000).
[117] U.S. Trade Representative, 2003 National Trade Estimate Report on Foreign Trade Barriers 113 (2003), available at http:// www.ustr.gov/reports/nte/2003/eu.pdf (last visited Apr. 3, 2004).
[118] Michal S. Gal, Market Conditions Under the Magnifying Glass: The Effects of Market Size on Optimal Competition Policy, 50 Am. J. Comp. L. 303, 312-13 (2002).

political allies or paying its employees inflated salaries to mobilize a constituency base highly interested in influencing the regulatory agency.[119] The power of the regulatory agency over their functions leaves the monopoly with little if any incentive to respond to actual consumer demands or market conditions.[120]

Recently, many governments have recognized the benefits of competition and chosen to privatize several state monopolies. During this privatization process, the enforcement of competition law becomes all the more crucial. This is because privatization in itself is not a guarantee of increased competition and the accompanying benefits. If a state monopoly is privatized without the removal of the public sector restraints (such as anticompetitive legislation) that protected its monopoly power, then it will come as no surprise that the result of the privatization will be a private monopoly. When the aim of reform is to increase competition, public sector restraints leading to private monopoly will result in the failure of those aims.

***643** Nowhere was this kind of privatization problem more evident than in the privatization of Teléfonos de México (Telmex). Anticompetitive behavior by Telmex has been prevalent even after the expiration of its six-year monopoly period, implicating the need for stronger competition law and enforcement. This has resulted in a U.S. request for consultation to the WTO regarding Mexico's violation of several GATT articles in the Telmex situation.[121] The complaint, dated August 29, 2000, stated five main complaints:

(1) [Mexico] enacted and maintained laws, regulations, rules, and other measures that deny or limit market access, national treatment, and additional commitments for service suppliers seeking to provide basic and value-added telecommunications services into and within Mexico;

(2) [Mexico] failed to issue and enact regulations, permits, or other measures to ensure implementation of Mexico's market access, national treatment, and additional commitments for service suppliers seeking to provide basic and value-added telecommunications services into and within Mexico;

(3) [Mexico] failed to enforce regulations and other measures to ensure compliance with Mexico's market access, national treatment, and additional commitments for service suppliers seeking to provide basic and value-added telecommunications services into and within Mexico;

(4) [Mexico] failed to regulate, control and prevent its major supplier, Teléfonos de México (Telmex), from engaging in activity that denies or limits Mexico's market access, national treatment, and additional commitments for service suppliers seeking to provide basic and value-added telecommunications services into and within Mexico; and

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[119] Richard A. Posner, The Effects of Deregulation on Competition: The Experience of the United States, 23 Fordham Int'l L.J. S7, S10 (2000).

[120] Id. at S11; see also David E.M. Sappington & J. Gregory Sidak, Competition Law for State-Owned Enterprises, 71 Antitrust L.J. 479, 492-94 (2003) (arguing that government imposed obligations direct the incentives of state-owned enterprises, not consumer demands).

[121] Request for Consultations by the United States on Mexico--Measures Affecting Telecommunications Services, WTO Doc. WT/DS204/1 (Aug. 29, 2000) [hereinafter Request for Consultations], available at http://www.wto.org/english/tratop_e/dispu_e/dispu_status_e.htm#2000 (last visited Apr. 16, 2004).

(5) [Mexico] failed to administer measures of general application governing basic and value-added telecommunications services in a reasonable, objective, and impartial manner, ensure that decisions and procedures used by Mexico's telecommunications regulator are impartial with respect to all market participants, and ensure access to and use of public telecommunications transport networks and services on reasonable and non-discriminatory terms and conditions for the supply of basic and value-added telecommunications services.[122]

Telmex prevented U.S. suppliers from supplying cross-border telecom services, from obtaining competitive rates for termination in Mexico, and from leasing lines.[123] Termination rates are the rates charged for calls made from abroad whose final destination is Mexico. A U.S. Trade Representative press release highlights two problems with call termination in Mexico: price and the mechanism for determining the price of call termination.[124] The structure in Mexico allows for only the dominant carrier--who has an incentive to keep prices as high as possible--to negotiate an international termination rate. All other carriers in the country must accept this rate, protecting the rate from competition. This has resulted in termination costs in Mexico being nineteen cents a minute, whereas in Canada and the United Kingdom termination costs are six cents a minute.[125]

Another serious problem mentioned in both the WTO filing and press release concerns interconnection.[126] "By their nature, telecom services have network characteristics. The more significant the network characteristic is, the more consumers will be attracted to the firm with the largest market share. For this reason, interconnection is crucial."[127] On certain occasions, Telmex has outright refused to provide interconnection.[128] Even where it does provide for interconnection, however, the situation is less than ideal. While interconnection rates in the United States, Canada, and Chile are at half a U.S. cent per minute, Telmex charges 4.6 cents in Mexico.[129]

Furthermore, the complaints against Telmex for anticompetitive behavior read like a textbook of anticompetitive strategy. These include: anticompetitive cross-subsidization; anticompetitive pricing; discriminatory tariffs to regions where Telmex maintains a monopoly; unregistered tariff and discount plans; requiring competitors to lease unnecessary private lines; discriminatory billing and collection practices; use of information obtained from competitors towards anticompetitive ends; failure to make available technical information necessary for operation; refusal to provide private lines and circuits; denials of private lines to internet service providers; and discriminatory treatment for calls to internet service providers by Telmex.[130]

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[122] Id. at 2.
[123] Press Release, U.S. Trade Representative, U.S. to Request WTO Consultations with Mexico Regarding Telecommunications Trade Barriers (July 28, 2000) [hereinafter USTR Press Release], available at http://www.ustr.gov/releases/2000/07/00-57.pdf (last visited Apr. 25, 2004).
[124] Id.
[125] Id.
[126] Request for Consultations, supra note 121, at 5-6; USTR Press Release, supra note 123.
[127] D. Daniel Sokol, Barriers to Entry in Mexican Telecommunications: Problems and Solutions, 27 Brook. J. Int'l L. 1, 10 (2001).
[128] USTR Press Release, supra note 123.
[129] Id.
[130] Request for Consultations, supra note 121, at 4-5.

Telmex's anticompetitive cross-subsidization prevents other providers from effectively competing in the long-distance market. What Telmex has done is cross-subsidize its long distance service with its local service, where it maintains a monopoly. Because Telmex has a monopoly on local service, it can raise the prices of local service to raise revenue, which can subsidize its long distance services. Anticompetitive measures such as this one raise the prices in both the local and long-distance markets by exercise of monopoly power, hurting consumers.

The recent panel decision, Measures Affecting Telecommunications Services,[131] involved telecommunications obligations assumed by Mexico as part of the GATS. The decision can be seen as a legal victory for the U.S. position against Telmex on most issues. The panel concluded that Mexico had undertaken market access and national treatment commitments in its schedule regarding cross-border supply of the service.[132] Such commitments provided the basis for Mexican interconnection commitments, which applied to U.S. service suppliers.[133] The panel concluded that the interconnection rates charged by Telmex to U.S. suppliers of the services at issue were not "cost-oriented" within the meaning of Section 2.2(b) of Mexico's Reference Paper, such that the costs were higher than the costs incurred in providing the interconnection.[134] The panel also found that Mexico had not maintained "appropriate measures" to prevent anticompetitive practices under Section 1.1 of the Reference Paper.[135] The panel ruled that Mexico did not violate Sections 5(a) and 5(b) of the GATS Telecom Annex regarding cross-border supply, on a non-facilities basis in Mexico, of the basic telecom services.[136] It did rule, however, that Mexico had violated its obligations under Section 5(a) of the GATS Telecommunications Annex in its failure to ensure "access to and use of public telecommunications transport networks and services on reasonable terms to United States service suppliers for the cross-border supply, on a facilities basis in Mexico, of the basic telecommunications services at issue."[137] The panel also found that Mexico failed to meet its obligations under Section 5(b) that "United States commercial agencies . . . have access to and use of private leased circuits [in] Mexico, and [interconnection of] these circuits to public telecommunications transport networks and services or with circuits of other service suppliers."[138]

III. Conclusion

With the fall of traditional tariff and non-tariff barriers under international pressure, we have seen a rise in the cases of public sector restraints. In an international trade context, these anticompetitive regulations have become a new form of non-tariff barriers. As illustrated in the

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[131] WTO Dispute Settlement Body Panel Report, Mexico--Measures Affecting Telecommunications Services, WTO Doc. WT/DS204/R (Apr. 2, 2004) [hereinafter Dispute Panel Report on Mexico], available at http://www.worldtradelaw.net/reports/wtopanelsfull/mexico-telecoms(panel)(full).pdf (last visited May 18, 2004).
[132] Id. para. 7.73.
[133] Id. para. 7.92.
[134] Id. para. 7.216.
[135] Id. para. 7.269.
[136] Id. para. 8.2.
[137] Dispute Panel Report on Mexico, supra note 131, para. 8.1.
[138] Id.

theory and examples throughout this paper, these public sector restraints have caused anticompetitive environments at the cost of consumer welfare through reductions in consumer and producer efficiency.

As we seek to reduce trade barriers, it is also important to address these issues of competitive environments. It is not sufficient to lower trade barriers if it is still exceedingly difficult to compete in such markets because of regulatory barriers. To this end, the creation of multilateral competition policy and competition agencies as well as competition policy disciplines at the bilateral and WTO level is crucial to true trade liberalization.

It is public sector restraints that harm trade, affecting the welfare of all people. The pernicious nature of anticompetitive regulations lies in their ability to exist under the radar of our common-sense trade liberalization horizon. Left alone, these restraints will hinder competition and innovation. This is a cost that will be accrued by people at every level of consumption for the benefit of entrenched local elites who lobby their governments so as to extract rents. In order to extend the benefits of competition and innovation to everyone, it is essential to address and reduce public sector restraints.

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