

COMPETITION

THE STORY SO FAR

Competition policy promotes rivalry among firms to maximize societal and economic welfare. In advanced economies, competition policy includes antitrust laws that protect consumer welfare from monopolistic behavior and other rules to prevent collusion, unfair practices that restrict competition and other abuses, and barriers to market entry and exit. As China has reached a more advanced development stage, it has ratcheted up its competition policy objectives. Beijing passed a long-awaited antitrust law in 2008 after 13 years of discussion. The 2013 Third Plenum plan declared “developing an environment for fair competition” a priority. However, long-standing instincts to favor the interests of state-owned firms over consumers – and domestic firms over foreign – are still embedded in the Chinese system with little regard for consumer welfare or fair competition.

- Since May 2013, the State Council has streamlined a wide range of administrative procedures related to business registration and taxation. New business registrations have risen steadily in recent years as a result, and in 2018 the World Bank recognized progress by substantially increasing its scoring of China’s “ease of doing business” compared with other countries. The State Council has promised to similarly reduce barriers to market exit, but progress has been much more limited.
- In June 2016, the State Council launched a “fair competition review mechanism” to clean up anticompetitive policies issued by government agencies at all levels. The mechanism did not clarify whether industrial policies should be considered anticompetitive, did not establish a transparent process to identify which current policies were anticompetitive, and did not prevent new anticompetitive policies from being implemented.
- Beijing has updated several competition-related laws since 2013 to reflect changing market conditions. In November 2017, China revised its 24-year-old Anti-unfair Competition Law (ACL) to cover newly emerging issues, such as commercial bribery and competition in new technologies like software and networks. In August 2018, the government also passed a new E-commerce Law to govern competition between internet companies. And it is in the process of revising patent and antitrust laws, ostensibly to strengthen legal protections for companies, though unequal enforcement between state and private firms and between domestic and foreign firms remains a major concern.
- In March 2018, China’s National People’s Congress approved a government restructuring plan that merged functions from various agencies responsible for enforcing

competition policy. The new agency, named the State Administration for Market Regulation (SAMR), now oversees all aspects of China’s competition policy regime including business registration, mergers and acquisitions (M&A) reviews, pricing policy, food security, consumer protection, and intellectual property protection. On paper, SAMR’s creation reduced the influence of industrial policy regulators, but these bureaucratic changes have yet to drive any real improvement in China’s competition regime as measured in our indicators.

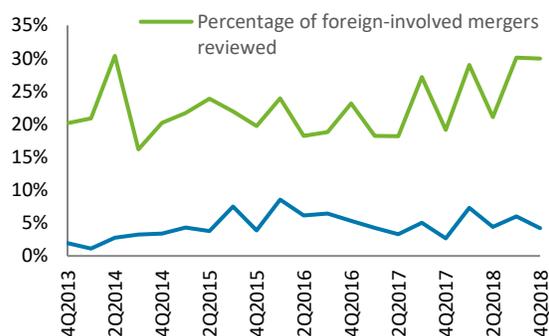
METHODOLOGY

Competition policy is an amalgam of law, economic analysis, and politics, and gauging outcomes is challenging. Our primary indicator looks for convergence in reviews of foreign versus domestic mergers conducted by SAMR. Supplemental data look at the number of merger cases reviewed, disclosure of the results of competition-related court cases, new business starts and closures (market entries and exits), and the ability of firms to obtain viable profits in healthy markets.

QUARTERLY ASSESSMENT AND OUTLOOK

Primary Indicator: Merger Reviews

4qma, percentage



Source: Ministry of Commerce, Bloomberg, Rhodium Group

- Our assessment of competition reform remains negative, at the same level as in our last review. Our primary indicator shows that foreign firms are still treated differently in merger reviews despite regulatory reforms—our litmus test for progress.
- There are some bright spots in our supplemental data: courts are handling more competition-related disputes, and the government is making progress in lowering barriers to market exit.
- Beijing renewed commitments to competition-related reform at the National People’s Congress (NPC) in March, and efforts to curtail market-distorting policies by local governments are proceeding. However, there is little sign of intent to fix the most structural and fundamental

problems related to state-owned enterprises and industrial policies.

THIS QUARTER'S NUMBERS

Our primary indicator shows that foreign and domestic companies are still treated unequally in China, despite all the recent talk of “competitive neutrality” (see **Winter 2019** edition). In 4Q2018, SAMR reviewed 88 mergers, 70% of which involved foreign companies. Compared with the number of deals announced during the period, 30% of all foreign-involved mergers were subject to additional regulatory scrutiny but fewer than 4% of purely domestic mergers received the same treatment.

Despite this asymmetry, SAMR claimed in a press conference during the NPC on March 16 that the agency applies a “neutral” regulatory approach to all firms, citing data that 40% of its antitrust investigations in 2018 were of state-owned enterprises (SOEs), while only 10% of investigations were of foreign companies. This might be true if one includes investigations into anticompetitive behaviors such as market division and price collusion, but it is unclear whether those investigations led to fair outcomes for firms of different ownership. At least for merger reviews, our data (see **Results of Merger Reviews**) show that regulators have never halted a merger involving domestic firms, whereas 24 foreign mergers had to adjust their plans as a result of reviews since 4Q2012.

Judicial transparency also has great room for improvement, making it hard for businesses to defend their competitive positions through the legal system. The Supreme Court published 12,829 cases settled in 2018 related to competition and intellectual property disputes (see **Judicial System Transparency**). More cases may be published over time, but for now they account for only 4% of the 305,000 cases accepted by Chinese courts throughout the year; this number was a 42% increase in the number of cases reviewed in 2018 from 2017. In other words, Chinese courts are handling significantly more competition-related cases each year, but the degree of transparency around these proceedings has not improved.

One bright spot is that Beijing has lowered barriers for market exit. This is an important improvement in China’s competitive environment—less efficient firms must exit the market for more efficient ones to grow market share and gain pricing power (see **Pricing Power Index**). Based on annual data of existing companies from SAMR, we estimate that 2.3 million companies exited the market in 2018, 36% more than in 2017 (see **Market Entry and Exit**). In addition, many more bankruptcy-related cases were settled in the courts, which is a fairer process for investors to agree on claims: courts nationwide handled 18,823 bankruptcy cases in 2018, compared with 10,195 cases in 2017 and 4,081 in 2016. This is progress.

Supplemental 1: Results of Merger Reviews

Number of cases



Source: Ministry of Commerce, Rhodium Group.

Supplemental 2: Judicial System Transparency

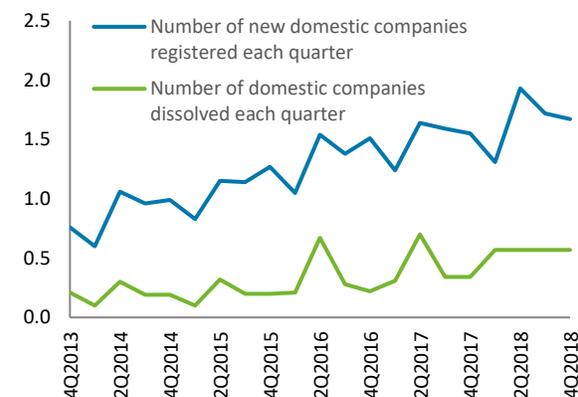
Number of court cases



Source: Judgements Online, Supreme Court.

Supplemental 3: Market Entry and Exit

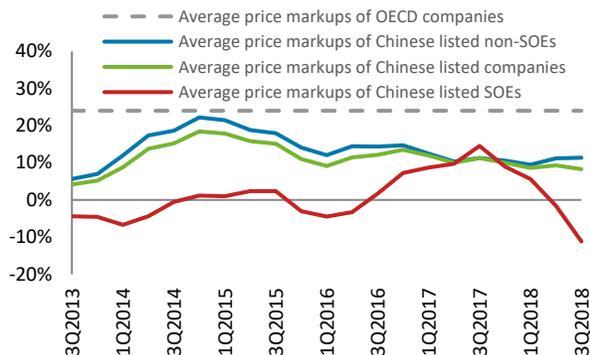
Millions



Source: State Administration for Industry & Commerce, Rhodium Group.

Supplemental 4: Pricing Power Index

Percentage



Source: Bloomberg, Rhodium Group.

POLICY ANALYSIS

Leaders talked a lot about competition policies in the review period, likely in response to a growing swell of global (including Chinese) worry about trends in China’s attitude toward market competition. Leading Chinese economists grew bolder in speaking up about the importance of marketization and competition; in major capitals abroad, officials grew much more aggressive in debating responses to China. Local-level policy efforts in China have addressed some competition-related details, but they have not confronted core concerns, such as unequal antitrust enforcement and market access and—in our view, most importantly—the basic definition of which industries should be treated as normal for competition policy purposes and which require special government control. Still, leadership attention to some competition policy-related commitments is a sign that the message is getting through.

Discussion of the competitive environment was featured at the NPC in March. In his annual report on the government’s work, Premier Li Keqiang identified “balancing the relationship between the government and the market” as one of three principles for this year. This is the highest profile this goal has been given since the 2013 Third Plenum, suggesting an elevation of markets and competition policy. Li also listed “promoting a fair competitive environment” as Beijing’s second priority for 2019, after fiscal stimulus, stating, “markets are the most efficient way to allocate resources.” This language has been largely absent in Li’s work reports since 2014. In addition to “streamlining administrative procedures,” one of Li’s top agenda items throughout his tenure, the report also pledged for the first time to apply “fair regulation” and “competitive neutrality” to firms of different ownership types in resource allocation, market access, business operations, and government procurement.

While these central leadership pledges are encouraging, the only actual policy changes we saw this period were at the local level. In February, SAMR announced progress in China’s

“fair competition review mechanism”—a program initiated by the State Council in June 2016 to reduce anticompetitive policies by local governments (see **Winter 2018** edition for more details). The program is meant to constrain local governments from issuing policies that restrict market access, subsidize favored firms, or cause other distortions, especially if those are inconsistent with central government policies. According to SAMR, 98% of municipal governments and 85% of county governments have now implemented the mechanism, leading to amendments to at least 20,000 local-level policies throughout 2018. SAMR plans to extend these efforts into 2019 and introduce third-party evaluation to improve the effectiveness and fairness of the program.

China has much further to go to shape a fair competitive environment nationwide. Pledges of “competitive neutrality” will be inadequate if Beijing does not reduce SOE political advantages (see **SOE Reform**) or address the distortive impacts of industrial policies (see **Innovation**). The competitive neutrality concept has a complicated history among the advanced economies, and it means different things to different people. As discussed in our **Cross-border Investment** cluster, the new Foreign Investment Law passed in March was one potential step forward to address foreign industry concerns around issues like technology transfer and market access, though many questions remain about how the law will be implemented. Taken together, we do not see decisive actions to address fundamental shortfalls in the competition policy regime. Until such time, we will remain cautious in this area.