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 favoring the interests of state-owned enterprises (SOEs) over consumers—and domestic firms over foreign ones—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. However, 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 to cover 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, although 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 (NPC) 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, the 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 the SAMR. Supplemental data look at the number of merger cases reviewed, disclosure of 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

- Our reform score in 1Q2019 remains negative and unchanged as foreign firms continue to be targeted disproportionately in merger reviews.

- Judicial transparency has deteriorated, with courts removing relevant cases from the public record. New business registration is slowing despite Beijing’s efforts to lower market entry barriers; high market exit barriers have kept inefficient firms operating, thereby limiting pricing power.

- Leaders are trumpeting “competitive neutrality,” but policies to make it a reality are missing. The delegation of antitrust enforcement to local governments is likely counterproductive, as subnational officials are more incentivized to protect special interests than promote fair competition.

This Quarter’s Numbers

Our primary indicator shows that foreign companies are targeted disproportionately for merger reviews in China, reflecting an unlevel playing field. In 1Q2019, the State Administration for Market Regulation (SAMR) reviewed 28% of foreign-involved mergers but only 9% of domestic mergers. The difference is smaller in the previous quarter—when 30% of foreign-involved and 4% of domestic mergers were reviewed—but the 28% chance of review for foreign-involved mergers remains among the highest on record. The increased percentage of domestic merger reviews is mainly attributable to fewer domestic mergers (347 in 1Q2019 compared with 620 in 4Q2018) rather than more reviews (31 in 1Q2019 compared with 26 in 4Q2018).

Out of 80 cases that the SAMR reviewed in 1Q2019, 61% involved foreign companies. This share is lower than the 70% reviewed in 4Q2018 but around the average since 2016. The SAMR used these reviews to impose conditions on the merger of two foreign electronics manufacturers, KLA from Silicon Valley and Orbotech from Israel. It has never restricted a domestic merger.

At the same time, China’s poor judicial transparency has deteriorated further. Courts publish less than 5% of the competition and intellectual property disputes they handle each year, with significant delay (see Judicial System Transparency). In 1Q2019, the courts even removed previously published cases (400–600 cases a year) from their websites. Cases may be removed upon request from involved parties because of sensitive issues like business secrets, but this is the first time we have observed a net reduction of published cases, adding concerns to the reliability and credibility of China’s judicial system.

Efforts to lower market entry barriers seem to be flagging. New business registration grew by 7.9% year-on-year in 1Q2019, barely an improvement from 4Q2018, when economic activity was much weaker (see Market Entry and Exit). Inefficient firms competing on low prices are not being forced to exit, making the market less attractive for new entrants. Our Pricing Power Index indicator shows that listed companies in China subsidize much lower margins than their Organisation for Economic Co-operation and Development peers on average. Listed SOEs do not even charge enough to cover their production costs and investments, and they still enjoy lower average capital costs (9.2% in 1Q2019) than listed private firms (10.3%). Pricing power for both SOEs and private listed companies improved slightly in 1Q2019 as the economy rebounded temporarily, but not enough to attract a substantial number of new entrants, especially as access to capital remains skewed toward SOEs.
Policy Analysis

Despite Premier Li Keqiang’s promotion of competitive neutrality for state-owned and private firms at the NPC in March (see the Spring 2019 edition for further discussion), policy developments are not moving closer to this goal. In May, the SAMR chaired a national antitrust work conference and identified 17 work priorities, none of which concerned new measures to ensure neutral treatment for firms of different ownership. It is common to hear officials use the term “competitive neutrality” to defend SOE interests abroad rather than to limit their privileges at home.

Beijing acted to strengthen antitrust enforcement on July 1 (after the 1Q2019 review period), with the SAMR publishing three regulations to be effective on September 1. These regulations detail the antitrust enforcement procedures for monopoly agreements, abuse of market power, and administrative monopoly (i.e., government intervention in the market via anticompetitive policies, discrimination in procurement, etc.). While these regulations are part of the consolidation of previously divided antitrust enforcement powers under the SAMR following the government restructuring plan announced in March 2018, they will likely be counterproductive. They authorize local governments to enforce antitrust rules in their own jurisdictions, while the SAMR will only oversee cases it sees as needing its intervention, such as cross-province cases, especially complex ones, and influential cases.

This change marks a significant departure from practice over the last two decades. Antitrust enforcement previously was centralized, with local governments acting only with specific central authorization. Now local...
governments are empowered to act at will. In practice, local officials generally have neither the specialized knowledge nor the political willingness to act to foster competition. Local governments and SOEs more often are the source of anticompetitive practices.

Two other developments during the review period illustrate the persistent gap in achieving fair and nondiscriminatory antitrust enforcement. As discussed in our SOE Reform assessment, antitrust authorities remain silent on central SOE mergers (especially the merger of shipbuilding SOEs), despite the implications for domestic and global markets. In addition, Beijing announced the creation of an “Unreliable Entity List” in response to Washington’s placement of Huawei on the U.S. Department of Commerce’s “Entity List.” Beijing claimed that its Anti-Monopoly Law (AML) was grounds for this action (along with the Foreign Trade Law and National Security Law); however, it seems that Beijing is using the AML to pursue objectives beyond safeguarding competition.