

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

- We maintain our slightly negative assessment of China’s competition policy reform this quarter. The data are mixed and some policies are encouraging, but the political environment is concerning.
- In 2Q2020, Beijing reviewed fewer foreign-involved mergers and more domestic mergers than in 1Q2020, but as a share of total deals foreign firms are still disproportionately scrutinized. New business registrations have recovered to pre-pandemic levels, but large firms have continued to use their market power at the expense of smaller peers.
- U.S.-China tensions overshadowed efforts to improve competition through judicial system reform. Achieving equal treatment of foreign firms appears increasingly unlikely as China’s leaders emphasize self-reliance in response to an unfavorable external environment.

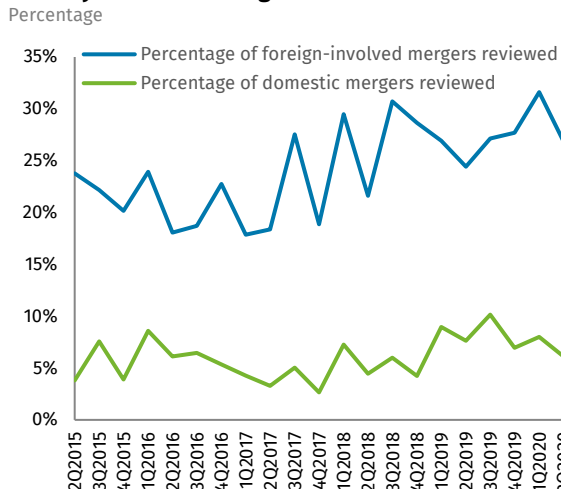
This Quarter's Numbers

Authorities reviewed fewer foreign-involved mergers and more domestic deals in 2Q2020 but still disproportionately targeted foreign firms for review as a share of total deals. The State Administration for Market Regulation (SAMR) reviewed 40 foreign-involved mergers, 18% fewer than in 1Q2020, and 35 domestic mergers, 35% more than 1Q2020. Skewing these comparisons, however, was the breakdown of deals in the quarter: the number of foreign-involved transactions fell slightly while domestic deals nearly doubled. Overall, the share of foreign-involved mergers subject to scrutiny decreased to 27% in 2Q2020 from 32% in 1Q2020 but remains far higher than domestic reviews at 6%.

China's domestic business environment continues to show signs of recovery from the pandemic. In September, the SAMR [reported](#) that new business registrations in China averaged 21,000 per day in the first seven months of 2020. Third-party data show a similar number, with a sharp decline in 1Q2020 and a strong rebound in 2Q2020. The SAMR also reported that on a net basis, 11,000 new businesses were registered per day in the period, implying 10,000 were dissolved per day. This number may look impressive, but it is only 2.5% higher than the 2019 average— and more troubling it is not significant considering the impact of the pandemic.

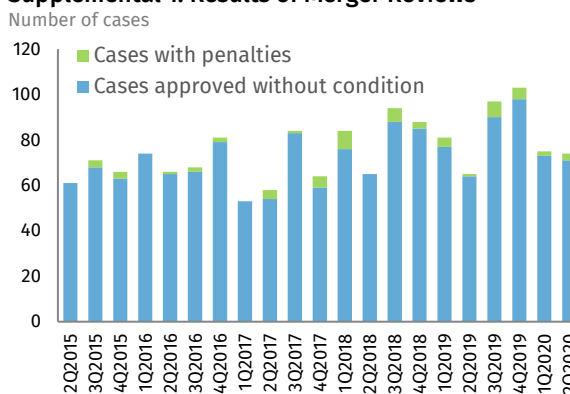
Looking ahead, large firms may continue to squeeze out smaller rivals. The pricing power of large listed companies, especially private firms, surpassed the OECD average in the quarter. This could be seen as a positive sign in pre-COVID circumstances, indicating that private firms are charging enough for their goods and services to recover a reasonable profit. However, the increase during the pandemic implies that large firms abused their market power against smaller competitors, customers, and vendors, suggesting a less competitive environment.

Primary Indicator: Merger Reviews



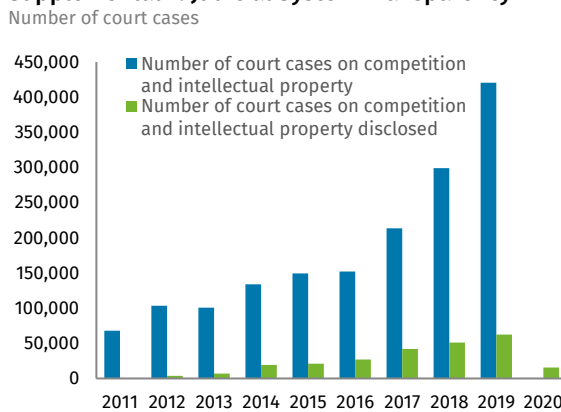
Source: State Administration for Market Regulation, Bloomberg, Rhodium Group.

Supplemental 1: Results of Merger Reviews



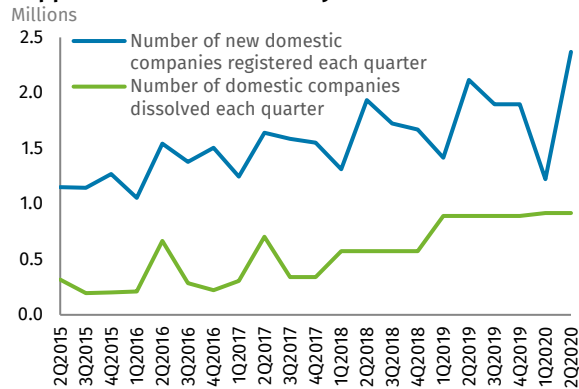
Source: Source: State Administration for Market Regulation, Rhodium Group.

Supplemental 2: Judicial System Transparency



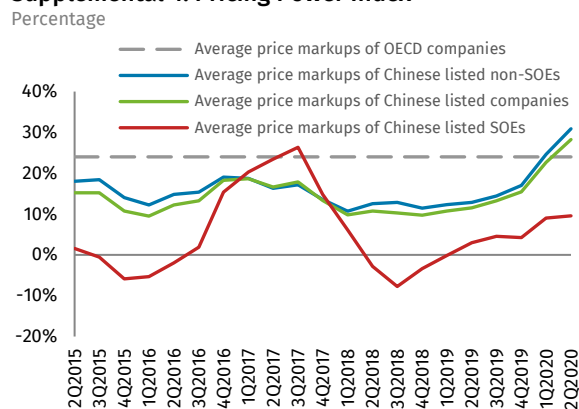
Source: Judgements Online, Supreme Court.

Supplemental 3: Market Entry and Exit



Source: State Administration for Market Regulation, Rhodium Group.

Supplemental 4: Pricing Power Index



Source: Bloomberg, Rhodium Group.

Policy Analysis

Beijing’s attempts to improve the business environment in China, which focused on strengthening the judicial system, were overshadowed by rising political tensions with the United States. On September 4, SAMR released [draft](#) trade secret protection rules (a follow-up to the revised Anti-Unfair Competition Law in 2017) for public comment. On September 25, the Supreme Court [promised](#) to improve judicial services for foreign businesses to support cross-border trade, investment, and intellectual property protection. On October 17, the National People’s Congress Standing Committee [passed](#) the revised Patent Law, which significantly increased penalties for violations. A lack of meaningful penalties in the previous version of the law had led to continued patent infringements.

Amid these improvements, Beijing also took several steps that have led to a chill in the business environment for foreign firms. These actions raised doubts about whether judicial system and regulatory regime reforms would lead to a level playing field. Most notably, [published](#) rules on “unreliable entities” (September 19), released after the

United States moved to ban TikTok and WeChat, raised the specter of more politicized competition conditions.

Final Dashboard Assessment

Overall, China’s progress on competition policy reform since the 2013 Third Plenum is mixed. It has delivered some improvements; however, on balance, they do not go far enough to convince foreign firms that they will receive fair and equal treatment in China. Beijing has simplified the process for registering new businesses, a move that has led to a doubling of such registrations over a five-year period. It has also made it easier for firms to exit the market and file bankruptcy claims. This led the World Bank to upgrade China’s ease of doing business ranking in 2019 (see [Spring 2020 Edition](#)). Beijing forced local governments to amend more than 20,000 anti-competitive rules in 2018 alone (see [Spring 2019 Edition](#)), revised the Anti-Unfair Competition Law (see [Spring 2018 Edition](#)), and is in the process of revising the Antitrust Law (see [Winter 2020 Edition](#)).

But the core questions remain unanswered: will China treat foreign and domestic firms equally, and will China use its competition laws to actually promote competition or to make things difficult for foreign firms? Beijing has promised equal treatment, but our primary indicator shows that foreign firms still face more scrutiny than domestic peers in merger reviews and face higher barriers in China’s court system. Beijing is likely to continue to assess foreign firms (especially U.S. firms) as presenting a special economic competition risk, given the tensions of the Trump years. As the government doubles down on self-sufficiency through initiatives like “dual circulation,” foreign tensions may well rise further. This depends on the pro-competitive spirit with which China pursues policy, not just the letter of the rules.