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.

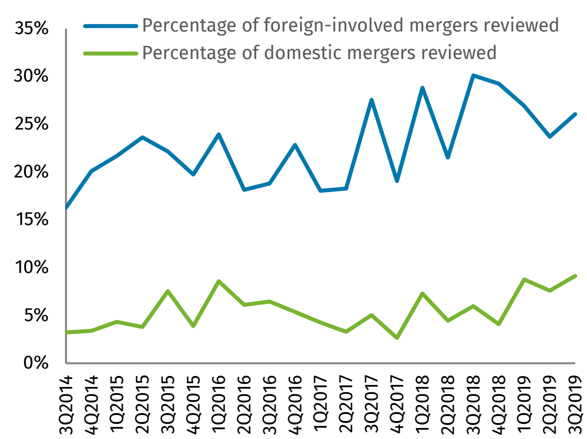
- In March 2018, China's National People's Congress (NPC) approved a government restructuring plan that merged functions from various agencies responsible for enforcing competition policy. The new agency, named the State Administration for Market Regulation (SAMR), now oversees all aspects of China's 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
Percentage



Source: State Administration for Market Regulation, Rhodium Group.

- Competition policy reform progressed this quarter but on net has not advanced. Beijing announced policies to protect foreign and private firms and their intellectual property (IP) with enforcement mechanisms, which appear serious.

- Foreign firms remain disproportionally targeted in merger reviews, but authorities are steadily increasing reviews of domestic firms. New business registration data were missing this quarter, suggesting it was disappointing.

- Policymakers have incorporated IP protection into metrics for evaluating officials' job performance and their legal responsibilities, as well as into regular U.S.-China trade talks. Beijing also started revising an 11-year-old Anti-monopoly Law with a focus on disciplining domestic firms.

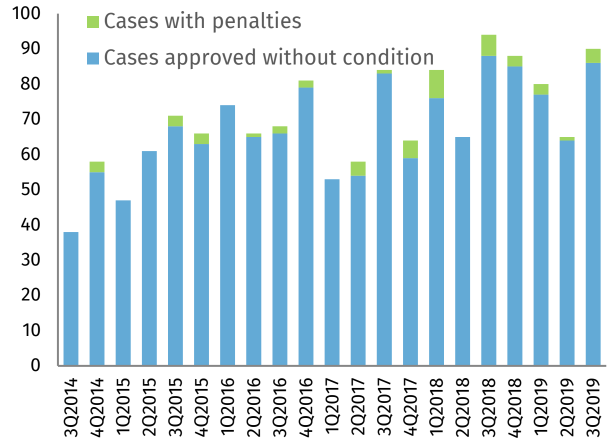
This Quarter's Numbers

China stepped up merger reviews this quarter. In 3Q2019, the State Administration for Market Regulation (SAMR) reviewed 49 foreign-involved and 41 domestic mergers, an increase from 32 and 33, respectively, in 2Q2019. Proportionally, that means 26% of foreign-involved and 9% of domestic-only mergers were reviewed, compared with 24% and 8%, respectively, in 2Q2019, indicating lack of meaningful change. But the number of domestic mergers reviewed has steadily increased and in 3Q2019 reached the highest level on record in both absolute and percentage terms. However, foreign-related transactions remain disproportionally targeted for review.

Meanwhile, China's judicial system remains too opaque to protect market participant interests. Courts continue to publish more competition-related cases, but at a pace that lags the growth in disputes. In the third quarter, courts published 18,728 new cases, bringing the 2019 total to 32,741 cases – lower than the 46,078 in 2018. Courts may catch up on more old cases in the future, but overall the pace of publication is slow compared with the more than 40% growth of disputes a year since 2017 (see **Judicial System Transparency**).

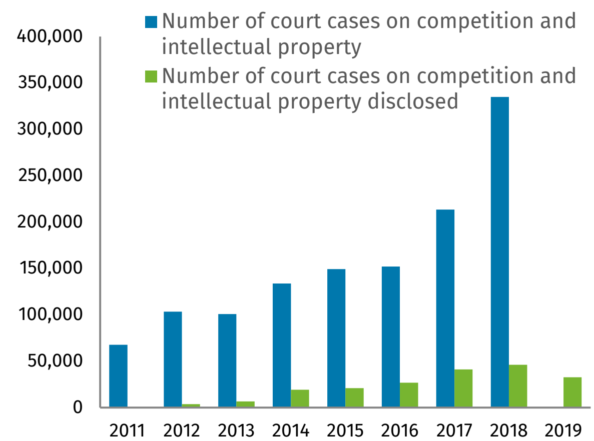
Unfortunately, authorities did not release data needed to assess market conditions this quarter. SAMR has been silent on new company registration and dissolution figures for six months, the longest stretch of unreported data since 2012. It is not uncommon for China's statistical authorities to withhold data when the figures present a negative picture. On December 31, SAMR did announce that 21.8 million new entities (including companies and *getihu* – that is, small, sole proprietorship businesses) were registered in 2019, only 1.4% more than in 2018, a much slower growth than the 11.7% from 2017 to 2018.

Supplemental 1: Results of Merger Reviews
Number of cases



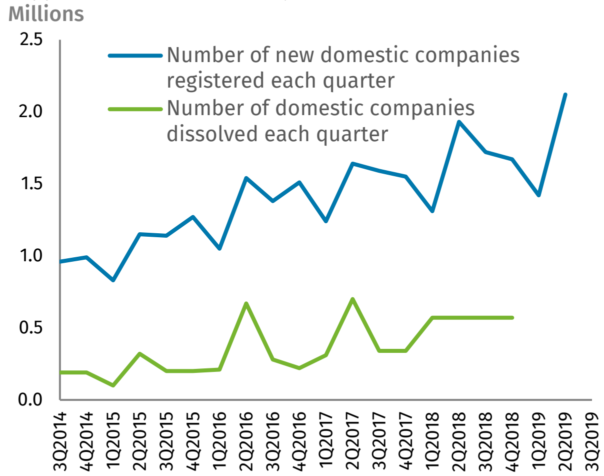
Source: Source: State Administration for Market Regulation, Rhodium Group.

Supplemental 2: Judicial System Transparency
Number of court cases



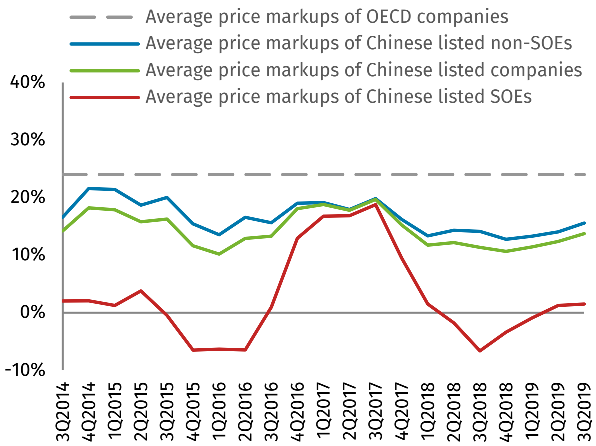
Source: Judgements Online, Supreme Court.

Supplemental 3: Market Entry and Exit
Millions



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

Supplemental 4: Pricing Power Index
Percentage



Source: Bloomberg, Rhodium Group.

Policy Analysis

Beijing announced many encouraging policies in the period, all of which aimed at strengthening enforcement mechanisms. On November 24, the Party and the State Council jointly issued an "Opinion on Strengthening IP Protection." On December 31, the State Council passed implementation measures for the new Foreign Investment Law, effective January 1, 2020. And on January 2, SAMR released a draft revision of China's Anti-monopoly Law for public comments.

The November opinion on strengthening IP protection reflects heightened government prioritization of this issue. It sets out a timeline: by 2022 IP infringement should be contained, and by 2025 IP should be well protected in general. To arrive there, the opinion calls for increasing punishment for infringement and counterfeiting, improving the judicial system, and streamlining administrative processes. Importantly, it introduces a new mechanism to enforce the rules: IP protection will be included in local official performance evaluations.

The implementation measures of the new Foreign Investment Law (the *Measures*) also emphasize IP protection. They commit Beijing to provide equal protection to foreign investors and increase punishment for IP infringement. Furthermore, they explicitly prohibit governments from conducting forced technology transfers – a practice that China generally denies. With the *Measures*, foreign investors no longer need to file with the Ministry of Commerce to start businesses; they only need to register with SAMR, if not constrained by the still-fulsome negative list. At the same time, the *Measures* require all government bodies to publish regulatory documents related to foreign investments and fulfill their commitments (e.g., tax benefits, favorable policies) to foreign investors. Officials violating these rules, informally restricting foreign investor capital flows, or treating foreign firms unfairly in the procurement process are to be held legally responsible and punished.

China is also holding itself to external commitments to strengthen IP protection. With the signing of the U.S.-China Phase 1 deal on January 15, China pledged to take certain actions with explicit timelines (e.g., increasing enforcement actions to stop counterfeiting goods within three months) and demonstrate improvement in IP protection via bilateral check-ins with the United States. Although these are not new responsibilities for China – Beijing has been assuring foreign partners that the spirit of these points would be kept for several decades now – the fresh commitments will raise the stakes for China's credibility and relations with the United States if they are not clearly and straightforwardly met.

Meanwhile, China also started the process of revising its 11-year-old Anti-monopoly Law, with a focus on disciplining domestic firms. The revision would increase monetary penalties for some violations by 10 to 100 times. More importantly, firms failing to properly report mergers to regulators would now face fines of up to 10% of gross revenues in the previous year, up exponentially from a 0.5 million yuan ($71,000) ceiling. For example, China Duty Free, which acquired Sunrise Duty Free in November 2018 and was fined only 0.3 million yuan ($42,000) for not reporting the deal, could now be fined 1.5 billion yuan ($200 million) based on 2017 revenue. The impact on domestic firms will be huge – our record shows that so far 16 domestic mergers have been fined for failure to notify authorities, compared with just seven foreign-involved mergers (see **Results of Merger Reviews**). The revision also adds guidance on analyzing the monopolistic positions of internet companies – arguably the most powerful companies in China today.