

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 neutral assessment of competition policy reform. Data and policy developments sent mixed signals in 4Q2019.
- China’s market regulator continued to strengthen antitrust enforcement but disproportionately targeted foreign-involved mergers. Market entry barriers for small businesses increased, but exit barriers for formally registered companies have fallen.
- Beijing vowed again to improve China’s competition environment. While the focus on reform is encouraging, thus far specific measures do not appear promising given unfair enforcement in the past.

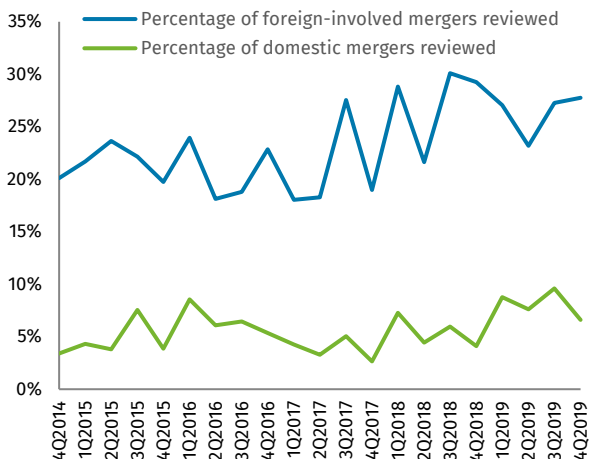
This Quarter’s Numbers

Beijing stepped up antitrust enforcement but focused disproportionately on foreign firms. In 4Q2019, the State Administration for Market Regulation (SAMR) reviewed 53 foreign-involved mergers and 46 domestic ones, up from 51 and 43 in 3Q2019, respectively. That means 28% of foreign-involved merger deals were reviewed, slightly up from 27% in 3Q2019. But for domestic firms, that

percentage fell from 10% to 7%, even as domestic mergers increased by 56% (250 more deals) from 3Q2019 to 4Q2019. In other words, the asymmetric treatment of foreign and domestic firms worsened in 4Q2019.

Primary Indicator: Merger Reviews

Percentage



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

Foreign firms reduced new activity in China in the fourth quarter, suggesting they may be losing confidence in China's reform outlook. Foreign firms announced only 2% (or just 4) more mergers this quarter. Since 2016, the number of foreign-involved deals has consistently declined while domestic deals climbed. The COVID-19 outbreak will likely accelerate these trends in 2020.

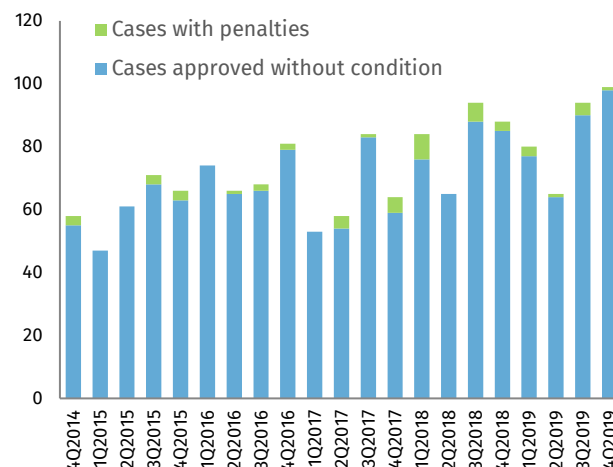
China's judicial system remains opaque for businesses to protect their interests. The Supreme Court announced that it received more than 420,000 competition-related cases in 2019, a 41% increase from 2018. But its website only published 23,472 cases, 25% more than last quarter but much lower than the rise in new cases (see **Judicial System Transparency**). Foreign complaints, such as the [U.S. Special 301 Report](#) released in April 2020, are increasingly focused on these rule of law concerns.

Despite Beijing's repeated emphasis on supporting small businesses and entrepreneurship, it was significantly more difficult for *getihu* (i.e., small, sole proprietorship businesses) to enter the market in 2019. According to SAMR, the number of newly registered companies increased by 10.4% (see **Market Entry and Exit**), on par with 2017–2018, but the number of *getihu* dropped by 2.8%, compared with 12.3% growth in 2018. The retreat of *getihu* is likely related to the difficulties for informal businesses to access funding amid slowing growth and tight credit—conditions that will worsen in 2020.

At the same time, companies had less difficulty exiting the market. SAMR reported that 38.6 million companies were in the market at the end of 2019 (up 11.1% from 2018). One-fifth of those (7.4 million) were newly registered and 3.6 million were dissolved, up 55% from 2018. Given that economic conditions in 2019 were similar to those in 2018, the increase is likely due to better dissolution procedures than to a more adverse business environment. Indeed, SAMR reported that 1.3 million companies (36%) were dissolved via simplified procedures, significantly up from 0.5 million (20%) between March 2017 (when the simplified procedures were enacted) and February 2018. This outcome validates the World Bank's move to upgrade China's ease of doing business rating (ironically, in as much as we are talking about how easy it is to shut down!).

Supplemental 1: Results of Merger Reviews

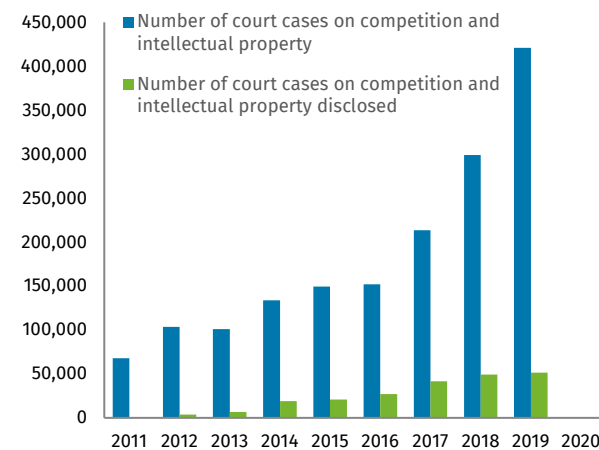
Number of cases



Source: State Administration for Market Regulation, Rhodium Group.

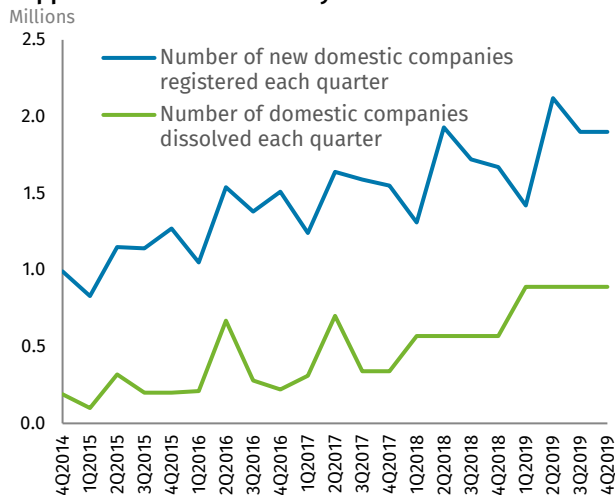
Supplemental 2: Judicial System Transparency

Number of court cases



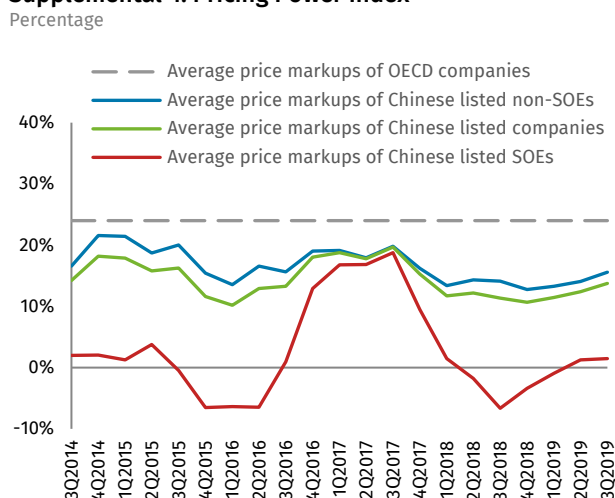
Source: Judgements Online, Supreme Court.

Supplemental 3: Market Entry and Exit



Source: State Administration for Market Regulation, Rhodium Group.

Supplemental 4: Pricing Power Index



Source: Bloomberg, Rhodium Group.

Policy Analysis

Beijing vowed to improve China’s competition environment in recent months. On April 9, 2020, the Communist Party and the State Council jointly released an opinion on improving market mechanisms to allocate production factors. This is the most comprehensive document since the 2013 Third Plenum on the role of the market and competition policy.

The opinion repeated long-standing admonitions to “strengthen the foundation of competition policy, break local protectionism, clean up anti-competitive rules, further reduce the role of government in the direct allocation of production factors, and treat all firms equally.” Little progress has been made on any of these fronts in recent years, and details in the new opinion are too scant to tell whether this time will prove to be any

different. But it is notable that Beijing is emphasizing the centrality of market-oriented, pro-competitive reform as a necessary response to the COVID-19 economic calamity – this is a reversion we have anticipated.

The opinion also discussed three elements of market pricing reform. First, Beijing committed to “establish a mechanism to benchmark civil servants’ salaries to those of company employees.” This implies civil servants’ salaries will be allowed to fluctuate with the market to incentivize officials to work hard. Beijing also pledged to raise civil servants’ salaries to attract more talent. The changes show an ambition to introduce market mechanisms into the government, rather than withdrawing government from the market. It is not clear to us that salary structures for predictable public sector work *should* mirror those of commercial endeavor risk taking.

Second, the opinion proposes to change the government’s role in pricing mechanisms from “setting specific price levels to setting pricing rules.” Only seven types of prices are set by the central government in China (according to the updated March 2020 “Central Pricing Catalog”): electricity distribution; oil and gas distribution; rail, port, and air transportation; water supply; postage; bank charges; and some pharmaceuticals. The inclusion of “oil and gas distribution” marks a change from the 2015 catalog, from pricing oil and gas to pricing distribution. This change implies Beijing will liberalize oil and gas prices while controlling distribution markups (similar to electricity prices), enabled by the December 2019 separation of pipeline businesses from national oil companies.

Last, the opinion promised to strengthen antitrust enforcement on market pricing, which is critical to the prevention of abuse of market power once prices are liberalized. However, we do not expect much progress here. Just as increased merger review authority has not been applied even-handedly (recall that foreign firms are targeted disproportionately), more power on pricing does not assure a fair outcome. To overcome limited manpower at the central level, Beijing authorized local governments to enforce antitrust rules (see **Summer 2019 edition**). But local governments are far more likely to protect local champions given their contributions to local tax revenue and employment stability. That is why, worldwide, competition policy authorities tend to be centralized, not devolved locally.