



On China's Adoption of Competitive Neutrality Policy

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Abstract

China should introduce a competitive neutrality policy in order to let the market play a decisive role in allocating resources and for the practical needs of blending in regional multi-lateral free trade markets. There is a potential risk, however, that the country may fall into the trap of trade protectionism resulting from an inaccurately positioned policy. Thus the competitive neutrality policy to be implemented by China should be accurately positioned and focus on the role of the government to promote fair competition. Unless under certain conditions such as government control in non-marketized sectors, national security review in foreign investment and asymmetric government support for the purpose of creating competition, competitive neutrality policy requires that the government should abide by the three principles of conduct that it must be neutral on trading opportunities, operating burdens and investment return. China should implement its competitive neutrality policy through administrative enforcement, institutional reform and promotion of competition, and facilitates the implantation based on a model of "pilot program-gradual spread out-international promotion".

Introduction

The concept of competitive neutrality policy ("CN policy") was first created in Australia's economic reform. The Commonwealth of Australia initially expressed the idea in the *Commonwealth Competitive Neutrality Policy Statement* published in 1996 ("Australian version") that "... government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership."² The OECD published a number of thematic reports such as *Competitive Neutrality: Maintaining a level playing field between public and private business*, to advocate the competitive neutrality policy concentrated in eight initiatives such as tax neutrality, regulatory neutrality, debt and subsidy neutrality ("OECD version").³ Ever since Chinese businesses quickly built up strength in the international market, and especially after the United States initiated the negotiation on the Trans-Pacific Partnership (TPP), the US has criticized in a number of occasions that the "state capitalism" in China is against competitive neutrality policy and emphasized that competitive neutrality means that competition is not subject to intervention from outside factors ("US version").⁴ As a result of all these factors, competitive neutrality policy was "borrowed" to China and became an important issue attracting the attention of the government, businesses and academia. The Chinese society reached a common idea that competitive neutrality policy should be introduced because of the country's internal need for the decisive role of the market in allocating resources and its practical external need in relation to regional multilateral free trade negotiations. However, the OECD and the US versions of competitive neutrality policy tend to cause trade protectionism for developed countries. In other words, developed countries, in order to maintain dominant market position of their companies, can take advantage of a CN policy, which procedurally applies, to themselves and developing countries on an equal basis, but in essence restrain the ability of the latter to take certain measures to rectify substantively unfair situations in international competition. Therefore how China should implement competitive neutrality policy becomes

the focus of the issue on which we will provide our recommendations from three aspects – the positioning, content and implementation of the policy.

Positioning of Competitive Neutrality Policy

The situation China currently faces requires us to distinguish what appears to be right and what's essentially right, in order to ensure that China's competitive neutrality policy is accurately and rationally positioned.

1. Role of Government in CN Policy

Although the diversified roles of the government (e.g. no government intervention, restriction over non-neutral government intervention) is supported in theory by varied interpretation of the term competitive neutrality policy, that diversity is often limited due to market failure in the sectors (marketized sectors) in which CN policy is applicable. Market failure either in domestic and international markets makes it necessary for the government to step in. It is evident that the role of the government defined in the US version of CN policy that "competition should be free of outside interference", i.e. the government should refrain from any intervention, is not a sound idea after all. The Australian and OECD versions both applauded government intervention to the extent that it should be confined to fair competition between state-owned enterprises (SOEs) instead of non-neutral government interference. Their definition of the role of the government in competitive neutrality policy, despite slightly confined vision, is generally rational and complies with the objective law of market-government coupling. Just as the *Decision of the Central Committee of the Communist Party of China on Some Major Issues Concerning Comprehensively Deepening the Reform* put, "[the] main responsibility and role of the government is to maintain the stability of the macro-economy, strengthen and improve public services, safeguard fair competition, strengthen oversight of the market, maintain market order, promote sustainable development and common prosperity, and intervene in situations where market failure occurs." CN policy should allow governments to step in while restricting their non-neutral involvement in the market.

This form of restriction, however, is not the absolute neutrality enunciated in the OECD version of CN policy. CN policy allows governments to take appropriate non-neutral measures to intervene. This is clearly reflected in how the Australian version has been implemented. Australia has taken some non-neutral measures from time to time when implementing its CN policy. For instance, the Australian version requires that at least 10% of equipment & hardware procurement contract go to small and medium-sized enterprises.⁵ In fact, it was not an isolated case that the Australian government took non-neutral intervention measures as it is empowered by many of the country's laws to do so where appropriate. For example, Article 46 of the *Competition and Consumer Act 2010* provides: "A corporation that has a substantial degree of market power in a trans-Tasman market must not take advantage of that power for the purpose of: (a) eliminating or substantially damaging a competitor of the corporation, or of a body corporate that is related to the corporation, in an impact market; or (b) preventing the entry of a person into an impact market; or (c) deterring or preventing a person from engaging in competitive conduct in an impact market." Similar articles, which in nature provide

non-neutral intervention measures, can be found in competition laws in many other jurisdictions, including the United States. As German jurist Dietrich Hoffmann vividly put, "an action, which taken by other companies may be seen as regular competition, can become an 'abuse' and forbidden if it were taken by a company which had dominant market position."⁶ This phenomenon is no coincidence; non-neutral government intervention is necessitated by the inherent market failure where the natural law of "survival of the fittest" turns competition into monopoly, provided that the law should stringently restrict such intervention to cope with potential government failure. Therefore, CN policy allows the government to intervene in markets while in principle confines their non-neutral intervention in applicable conditions where at least permissible under law.

2. Mission of CN Policy as It Ought to Have

As the very origin of CN policy, Australia's objective in implementing this policy is to ensure fair competition. As Professor Frederick G. Hilmer, former Chair of the National Competition Policy Review Committee of Australia, highlighted in the *National Competition Policy*, a report resulted in the creation of Australia's CN policy, that "[e]very modern market economy has a set of rules designed to ensure that the competitive process is not undermined by the anticompetitive behavior of firms, whether acting collusively or individually. ...In Australia these rules are contained in Part IV of the *Commonwealth Trade Practices Act 1974*.... The most pressing issue is to ensure that unjustified gaps in their application are filled in a way that promotes a nationally consistent legal framework for business activity."⁷ This is a very rational approach consistent to the modern society's understanding of competition mechanisms in a market economy. The idea of free competition has been abandoned because of lessons learned from history, and the competition policy and laws in almost every country choose fair competition as the main goal in order to increase economic efficiency. On that point, the *Australian Government Competitive Neutrality Guidelines for Managers* published in 2004 made a special statement that "[the] Australian Government (the Government) is committed to accountable and transparent administration and the efficient allocation and utilization of public resources. One way to realize this commitment is to apply competitive neutrality (CN) policy to government business activities."⁸ Promoting fair competition should be the mission of a CN policy and it should also serve as the only criteria for assessing whether a government's non-neutral intervention should be restricted in principle or allowed under special circumstances.

This fairness in competition, however, should not only cover procedural fairness, but ought to extend to substantive fairness. The conflict between procedural fairness and substantive fairness at a certain point may result in a situation where it is procedurally equal but substantively not; this is especially prominent when CN policy comes from domestic market to the international stage. In a domestic market where entry barrier exists as a result of state sovereignty, the economic wealth created by optimizing allocation of resources in a certain country usually is significantly in line with the national interest of that country. In this case procedurally equal CN policy often can ensure substantive fairness in market competition. However, in the international market where there usually is a large gap between the economic

wealth created by optimized allocation of resources and the interests of an individual country, a procedurally equal CN policy could easily lead to substantive unfairness in market competition. Taking the OECD version of CN policy (aiming at the international market) as an example, it appeared that the OECD version enunciated the eight principles of conduct for CN policy in an objective way. However, it failed to make a reasonable argument on the difference in strength among different countries because of historical reasons. As a result the OECD version only lingered over procedural fairness, and in effect enhanced the various forms of advantages of more developed countries over the underdeveloped. Therefore, CN policy should attach importance not only to procedural fairness, but also more importantly, to substantive fairness.

In addition, the fairness should cover competition among all businesses rather than that between SOEs and private companies. Firstly, competitive relations exist in an intricate manner among different categories of market players, and commodity supply substitution happens not only between SOEs and private companies in a country, but also among all of them. Despite that SOEs often gain advantage in competition owing to the unreasonable “special treatment” offered to them by the government, the additional advantage does not apply to all SOEs in a balanced way. Moreover, in practice, gaining advantage through the government’s unreasonable interference is not exclusive to SOEs, it is commonplace that private companies obtain competitive edge through commercial bribery, lobbying and asymmetric government regulation. Secondly, it would diverge from the principle of fairness if CN policy only targets the competition between SOEs and private companies, or SOEs of a certain country and other private businesses. In fact, the CN policy implemented by Australia does not target the competition between SOEs and private companies alone, but focus more on this point for its severity and the fact that it is the main cause of the problems. The Trade Practices Act 1974 of Australia, which succeeded the Trade Practices Act 1965, still had many problems. In addition to the fact that exemptions (many of which deal with SOE privilege) granted by laws of the Commonwealth and states still have priority, the Act could not be applied to trade practices of non-legal persons, such as partnerships and household business, operating within each state. These problems were addressed and solved when Australia launched its CN policy.

Content of the Competitive Neutrality Policy

In order to guarantee enforceability, the provisions in China’s CN policy which aim at promoting fair competition must be clear, complete, and systematic and be able to guide the government effectively in its effort to promote economic reform.

1. Principles of Conduct of CN Policy

Neutrality on trading opportunities is the first principle in a CN Policy that requires the government to provide on an equal basis trading opportunities to all participants in the allocation of market resources. Trading opportunities are a precondition of competition, thus CN policy requires that the government should keep neutral on trading opportunities. The

neutrality on trading opportunities can be divided into two parts, i.e. neutrality on market entry and neutrality on government purchase. Neutrality on market entry requires the government to remain neutral in acquisition of business license, expansion of operation and conclusion of commercial contracts by companies so that they can contest, on an equal footing, for trading opportunities provided "internally" by the market. Neutrality on government purchase requires the government to remain neutrality with regard to the identity of participants, form of participation, information disclosure and evaluation mechanisms, so that companies can compete fairly for trading opportunities provided "externally" by the government.

Neutrality on operating burdens is the second principle of conduct in a CN Policy under which the government is required to deal with, on an equal basis, the operating burdens of participants in allocation of market resources ranging from compulsory burdens unilaterally imposed by the government, e.g. taxes, regulation, social responsibility, to negotiable burdens such as loans and financing, default liabilities and tort liabilities. Operating burdens in any trading opportunities directly or indirectly becomes operating costs of a company, while the level of operating costs directly determines whether the company will be able to successfully implement an overall cost leadership strategy so as to gain a competitive edge. Therefore, CN policy requires that the government should maintain neutral on operating burdens, including imposition of compulsory burdens and reduction of negotiable burdens.

Neutrality on investment return, the third principle of CN policy, requires the government to impact, on an equal basis, the investment return of all participants in allocating market resources. Commercialized operation means that any of a company's action, either competing for trading opportunity or assuming operating burdens, is for return on investment, and whether and how much the company can secure investment return determines its fate in competition. Despite that how much investment return a company can obtain mainly depends on how fast it innovates its technology, how effective it controls costs and its marketing capability, government intervention, in many occasions, come into play as an external factor. Therefore, CN policy again requires that the government should remain neutral in relation to investment returns. This principle concentrates on two aspects, namely neutrality in price regulation and in government subsidy. Neutrality in price regulation requires the government to prevent undertakings possessing dominant market position from "selling commodities at unfairly high prices or buying commodities at unfairly low prices", so as to ensure that all companies can gain revenue from the market equally. Neutrality in government subsidy requires the government to equally manage the subsidy supported by public funds, so that all companies have equal access to government subsidy.

2. Exemptions in Application of CN Policy

CN policy does not apply in government regulation in non-marketized areas. The international community focuses on the completion mechanism, which aims to optimize allocation of resources; and that mechanism is based on the market. Therefore, the implementation of CN policy must be based on the marketization of certain areas; otherwise it would not have been practicable. Even if government initiatives had impact on fair competition, they are not

restricted by CN policy. Military procurement provides a good example. “Military procurement is not an independent market activity. In order to safeguard national defense interests, it is necessary to provide support to the defense industry and preferential policy on military procurement and relevant government authorities should apply coordinated control and furnish preferential policy and quality services pursuant to relevant laws and regulations.”⁹

CN policy does not apply in national security review of foreign investment. It has become a common practice of governments to perform national security review on foreign investment in marketized areas. The United States, in addition to a number of enactments, including the Defense Production Act of 1950 and the Export Administration Act of 1979, to enhance national security review on foreign investment, also promulgated the Foreign Investment and National Security Act of 2007, just before its participation in the negotiation on Trans-Pacific Partnership (TPP), to strengthen its national security check on foreign investment. It has also been fully revealed in a number of cases, such as the failed buyout attempt of a United States oil company Unocal Corporation by the China National Offshore Oil Corporation, that national security review can cause unfair competition between domestic and foreign companies or even between two foreign companies in a relevant market. However, as it becomes internationally accepted that people should respect the authority of a government to carry out national security review in accordance with the law of its country, CN Policy does not restrict this type of government intervention.

CN policy does not apply in asymmetric support for the purpose of creating competition. In order to break a monopolistic situation, especially a monopolistic market, the government would apply asymmetric support initiatives under certain conditions. Taking the early stage reform of the British telecommunication sector for example, the UK government authorized the incorporation of Mercury Communication to create a competitor for British Telecommunication. The UK government provided a certain degree of support to the newly formed Mercury, but was not particularly interested in diminishing BT.¹⁰ It is evident that this type of asymmetric support is unfair to the competitor of the beneficiary. Government neutrality, however, is necessitated by the existence of competition in a market; otherwise it would not be necessary to do so. Therefore this type of government intervention is not restricted by CN policy either.

Implementation of CN Policy

The stable and sound development of its market economy requires that China's CN policy should be implemented in a well-organized and phase-by-phase manner.

1. Approaches for implementing CN policy

1.1 Administrative enforcement. Law governs market economy and administrative enforcement is the main way of government intervention in the market.¹¹ Therefore, administrative is the basic approach for the government to implement its policy on economy,

including CN policy. The implementation of CN policy requires the government to abide by the principle of fairness and/or standards set out in the law as a whole in the process of administrative enforcement. In consideration of the risk of government failure, many laws, especially those dealing with the economy, while authorizing the government to intervene in the market, imposed certain restrictions on it, the most commonly used being the requirement that enforcement should be carried out fairly. This is exactly what CN policy intends to do, and fair enforcement by the government is an important basis of fair competition. The Report on the Business Development Environment in China 2013 even raised a point that creating a fair environment in the market is more important than government subsidy. More importantly, it is crucial to the implement of CN policy in China that the Anti-Monopoly Law, which provides indiscriminating principles to ban abuse of administrative power by the government to eliminate or restrict competition, be enforced effectively. Therefore, China should step up amending laws to provide its competition enforcement agencies with statutory powers to control administrative monopoly and more approaches to deal with it.

1.2 Institutional reform. A well-timed institutional reform is an important approach to implement important economic policies of a government. The implementation of the CN policy must rely more on institutional reform because many of the existing unfairness issues in market competition have gone far beyond the scope of the law. To implement the CN Policy, the government is required to 1) remove unreasonable market entry barriers created by the system, industry entry barriers and geographical entry barriers, and redesign or optimize the system based on the causes of these barriers; 2) eliminate discrimination (special treatments either beneficial or harmful for some companies) in the market created by the system and redesign or optimize it accordingly.

1.3 Competition advocacy. "Anything done by the competition authorities to improve the competition environment other than enforcement can be categorized as actions that advocate competition. These actions are important to promoting and providing supplements to anti-monopoly enforcement, pushing forward effective implementation of competition policy and facilitating competition awareness building."¹² China needs to immediately and comprehensively promote competition given the significant lack of competition awareness in the country. In order to implement the CN policy, the competition authorities need to take pertinent measures as awareness (competition law) building, compliance guidance and theoretical studies to promote the idea of fair competition to relevant authorities. Therefore, in order to effectively implement the CN policy, the competition authorities in China, including the National Development and Reform Commission, the Ministry of Commerce, the State Administration for Industry and Commerce and the provincial agencies authorize by them should, in addition to law enforcement, work together with the Anti-Monopoly Committee of the State Council to take measures, such as promotional events, debriefing meetings on cases and regulatory guidance, to raise the awareness of other governmental agencies about fair competition and gradually improve their understanding of fair enforcement and their willingness to protect competition.

2. Model of implementing CN policy

2.1 Pilot programs – setting up pilot free trade zones within the borders. For risk control reasons and based on past experience, China should not hastily implement the CN policy in a comprehensive and in-depth manner before running a few trial programs. Since 2013, China has approved the establishment of several pilot free trade zones within its borders. These pilot programs, being launched at the right time and having appropriate objectives, provide ideal platforms for testing the CN policy in China. In addition to its continued effort to explore approaches of administrative enforcement and promote competition, the government should put its focus on institutional reform related to CN policy.

2.2 Spreading out experience gradually in overall economic reform. Under appropriate condition, the government should timely extend, with a reasonable pace and in an appropriate order, the experience gained in those pilot free trade zones and can be used in other areas, to the overall economic reform in the country. The government could, based on the practical condition, design and implement plans for implementing the CN policy according to different groups of issues. China should refer to the experience of Australia in implementing CN policy, and it may be a good idea to first settle the unfairness in the competition between SOEs and domestic private companies which currently is a prominent conflict. In other words, SOEs and domestic companies in the private sector should be the first priority. When domestic companies develop relatively strong competitiveness, or at the time it is necessary to introduce competitive force to promote innovation among domestic businesses, China may, under the premise that WTO rules are not violated, gradually cancel differentiated treatment for foreign companies in certain areas. In other words, foreign companies should be the second priority. The government could, based on the practical condition, make and implement plans in which CN policy is implemented according to a sequence of different industrial sectors. Although every sector is an integral part of the market in a country, their levels of importance in the national economy differ. This provides room for the government to introduce competition mechanisms in the market in a differentiated manner. According to practical experience, different sectors vary significantly in terms of the levels of marketization, ranging from complete competition, half-controlled competition and complete monopoly. The difference between the actual condition and the expected marketization levels of market sectors not only sets different pace of reform for them, it also allows room for implementing the CN policy on a phase-by-phase basis. The government could and should, based on the importance of a sector in the national economy and the level of marketization in that sector, determine the timetable and extent of implementation of the CN policy. In other words, whether it should apply only to domestic SOEs and private companies or to all undertakings including foreign companies.

2.3 International promotion through multilateral free trade agreements. CN policy will inevitably become a substantive subject no matter a country voluntarily or is compelled to accede to any multilateral free trade agreement (FTAs). As a responsible major country, China should introduce to the rest of the world its CN policy explored and created in the process of its reform, which ought to be objective, fair, clear, free of ambiguity and systematic and repackaged in accordance with the requirements of international free trade negotiations. In

the process of negotiating different multilateral FTAs, China should bring forward exemptions from CN policy based on the overall condition of the other parties. In different multilateral FTA negotiations, the overall strength of participating countries could differ widely and the relative advantage/disadvantage of Chinese companies could vary significantly. The potential gaps could push China to two opposite extremes in multilateral FTA negotiations, either a perpetrator or a victim of international trade protectionism, neither of which should be China's original intention to participate in multilateral FTA negotiations. The only way to prevent or mitigate this type of potential risk is to seek agreement on different exemptions from CN policy in different multilateral FTA negotiations based on the belief of mutual benefit and exert best effort to ensure that the contracting parties' companies could compete on the relevant markets on an equal footing.

Conclusion

If we were to refer the competitive neutrality policy to be implemented by China as the "Chinese version", then it should be defined, according to the analysis made above, as a policy under which the government treats all participants of resources allocation in the market on an equal footing, where effective competition is maintained in marketized sectors, except when it intervenes in the market with reasonable non-neutral measures because of the need for solving market failure. The Chinese version of CN policy will draw reference from the Australian, OECD and US versions and be more objective, fair, comprehensive and systematic. Its implementation will put even higher requirements on the government regarding its intervention in the market, and government initiatives, which have an impact on competition, will be subject to more stringent evaluation as to the fairness of such initiatives. The experience of Australia tells us that the implementation of CN policy will pose major challenges for governments, which will directly test their determination and wisdom to push forward reform. The experience of China in the reform and opening up since 1978 and in its accession to the World Trade Organization in 2001 have proven that every major reform of the socialist market economy boosts the leap-forward development of the country. Mr. Li Keqiang, Premier of China, said: "over the last 36 years, it has been reform that has allowed China to make achievements in economic and social development that have captivated the world. Now that we have entered the 'deep-end' of reform, ... [w]e may say that the opportunities for reform are unprecedented, but it is also true that the complexity, difficulty, risks, and challenges of reform are unprecedented, too. Then, how should we respond to such a situation? The fact of the matter is that we have no choice. This is because the deep-seated problems we are now encountering are already posing a formidable obstacle to our economic and social development, and this obstacle cannot be evaded, circumnavigated, or ignored. If we do not implement reform, we will have no way of moving forwards; and if we are slow to act on reform, we will miss an important window of opportunity, and the price we pay in the future will be greater as a result. Therefore, with a keen awareness of our historical mission and responsibility, we must advance reform with the determination and courage to take the knife to our own flesh where necessary."¹³ Therefore, we should implement the Chinese version of CN policy in a timely manner, in order to optimize the relationship between the government and the market, fully take advantage of the decisive role of the market in allocating resources

and improve the government's role in it, and to create an even fairer environment for competition that supports steady, continuous and efficient economic development in China.

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³ *Competitive Neutrality: Maintaining a level playing field between public and private business*, 2012, pp.29-77, <http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/50302961.pdf>.

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⁶ Cao Shibing, Study on Anti-Monopoly Law, China Law Press, 1996, page 140.

⁷ Australia, *National Competition Policy*, 1993, p.25, <http://ncp.ncc.gov.au/docs/National%20Competition%20Policy%20Review%20report%2C%20The%20Hilmer%20Report%2C%20August%201993.pdf>.

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¹² Zhang Zhanjiang, Study on Competition Advocating, *Legal Studies*, 5th Issue, 2010.

¹³ Li Keqiang, On Deepening Economic Reform, *Qiushi*, 9th Issue, 2014.