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DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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Summary Record: ANNEX TO THE SUMMARY RECORD OF THE 123rd MEETING OF THE COMPETITION COMMITTEE HELD ON 15-19 JUNE 2015

Summary of Discussion of the Hearing on Competitive Neutrality: Horizontal Challenges

16-18 June 2015
Paris, France

The attached document is an annex to the Summary Record of the meeting held on 15-19 June 2015.

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Summary of Discussion of the Hearing on Competitive Neutrality: Horizontal Challenges

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By the Secretariat

1. In June 2015, the Competition Committee held a Hearing on Competitive Neutrality ('Hearing'). The aim of the Hearing was to engage in a dialogue with other OECD policy communities, to understand what they mean by competitive neutrality and how they address competitive neutrality concerns. The Hearing benefited from the participation of experts from various OECD policy fields: corporate governance, investment, economic indicators, tax, telecom, trade and transport. Experts from each of these areas presented on the competitive neutrality distortions their community is most concerned with, how they address them, and what challenges remain. The experts also presented the ongoing work on competitive neutrality in their respective OECD Committees.

2. The Hearing was divided in two parts: one dedicated to policy experts, and a second one to industry experts. This document is a short record of the interventions of the different experts.

1. Policy expert presentations

1. *Corporate governance and SOEs by* Lars Erik Fredriksson (Vice chair Working Party on State Ownership and Privatisation Practices, and Investment Director at Swedish Enterprise Ministry)

3. The OECD instruments in the area of corporate governance aim to ensure that state owned enterprises ('SOEs') operate on a level playing field when competing (or potentially competing) with the private sector.

4. The OECD SOE Guidelines were updated and revised in 2015 to take into account developments since their adoption in 2005 and the experiences of a growing number of countries with their implementation. The revised Guidelines include a new chapter on the rationales for state ownership and the chapter on 'SOEs in the marketplace' was revamped to deal exclusively with competition between SOEs and private enterprises.

5. As for future challenges, some difficulties still persist, especially regarding to i) the implementation of the new OECD SOE Guidelines and ii) the behaviour of SOEs on the international level. As regards the latter, the OECD is working on an important horizontal project and publication addressing 'SOEs in the Global Marketplace', which is looking at the role of SOEs operating in cross boarder contexts from a variety of policy angles including competition.

2. *Fair treatment in cross-border investment by* Michael Tracton (Vice Chair of the OECD Investment Committee, and Director of the Office of Investment Affairs at the U.S. Department of State)

6. There is a growing interest from the Investment Committee in competitive neutrality, for various reasons: SOEs started to expand outside of their home markets, accounting for 20% of global cross-border M&A activity in 2009. This phenomenon gave rise to a number of concerns, especially pertaining to unfair competition in international markets (e.g. if SOEs have unfair preferential access to finance in their home country) and security.

7. The Freedom of Investment ('FOI') Roundtable of the Investment Committee focuses on better understanding the economics of competitive neutrality concerns and the existing policy frameworks addressing such concerns at national and international levels. The 2014 OECD Ministerial Meeting asked for more work in this area and a new work program was initiated in the FOI regarding SOEs in the Global Marketplace with the participation of various

OECD committees, as mentioned earlier by Mr. Fredriksson. The project is still in fact-finding phase, but Mr. Tracton underlined that participants will consider in October 2015 whether concerns related to the internationalization of SOEs might need to be addressed by policy makers.

8. According to Mr. Tracton the term ‘competitive neutrality’ has not been the subject of a precise definition and may encompass a wide range of issues which are currently being discussed in many policy communities, as this Hearing demonstrates. However, the Investment Committee values the horizontal approach to this issue at the OECD, a way to gather a wide range of expertise present within the OECD. Moreover, it supports analytical work on SOEs in the global marketplace, to better understand market distortions that can result from preferential treatment of SOEs arising by virtue of state ownership. Better understanding these issues can help avoiding an uneven playing field in favour of SOEs in relation to other investors.

3. *Trade policy and non-discrimination by* Tiina Pitkanen (DG Trade, European Commission) and Przemek Kowalski (OECD, Trade and Agricultural Department)

9. There is wide recognition among trade experts that competitive neutrality is a concern which has to be addressed both in a domestic and in an international/cross-border context.

10. From a trade policy perspective the aim is to i) minimise distortions created by SOEs and ii) restrain undue protectionism. To that end, two policy instruments are important: i) the OECD Business Survey on State Influence on Competition in International Markets (‘Survey’) and ii) the Database on National Practices and Regulations (‘Database’). The Survey aims at improving the understanding of the extent and nature of the distortions. The Database takes stock of country-specific practices and regulations (41 indicators from 43 countries) relevant for understanding the competitive position of SOEs.

11. From the EU perspective, the competitive neutrality framework consists of competition law, state aid, public procurement and internal market rules. Past and future work of the OECD can further help to ensure competitive neutrality, by i) enhancing transparency, reporting and other governance issues of SOEs, ii) analysing the distortions of the level playing field, iii) reflecting together on the different definitions of SOEs and iv) ensuring the interaction of different rules (e.g. trade policy, investment, competition, subsidies, government procurement, corporate governance).

4. *Harmful tax competition & distortions by* Edouard Marcus Co-Chair Forum on Harmful Tax Practices)

12. Competitive neutrality is an important tax policy principle: economics generally support neutrality (e.g. to avoid market distortions and limit resistance to taxation), while legal system requires neutrality (e.g. to ensure fair business competition). Tax policies can have a significant impact on competition, for instance by fostering growth through drivers such as R&D and by encouraging responsible behavior. Various suggestions can be put forward to ensure fair competition in taxation, e.g. i) by facilitating the work on harmful tax practices and ii) through the enforcement of state aids rules in taxation.

13. Regarding the work done by the Forum on Harmful Tax Practices (‘FHTP’) on preferential regimes, two reports are worth mentioning:

- the *Report on Harmful Tax Competition: An Emerging Global Issue* from 1998 which described and assessed harmful preferential regimes (with low or no tax jurisdictions); and

- the *FHTP 2006 Report* which focused on the progress made in connection with the work on potentially harmful preferential tax regimes of OECD member countries.

14. The Base Erosion and Profit Shifting (‘BEPS’) project is also relevant to competitive neutrality. In this project, the FHTP applies a holistic approach to evaluate preferential tax regimes. The project was launched by the G20 and the OECD in 2012. On the basis of the existing framework BEPS aims at considering revisions or additions to the existing framework to close the gaps in existing international rules that allow corporate profits to « disappear » or to be artificially shifted to low/no tax environments, where little or no economic activity takes place. The BEPS’s project pursues three main goals: i) to tackle aggressive tax planning and harmful tax competition, ii) to ensure

substantial activity requirement for any preferential regime and iii) to improve transparency, including through exchanges on rulings related to preferential regimes. As regards OECD countries, the ongoing work covers 30 preferential regimes and takes into account fair competition issues.

2. Economics and industry expert presentations

5. *The OECD's indicators on product market regulation (PMR) by* Isabell Koske (OECD, Advisor to the Secretary-General)

15. The OECD indicators on product market regulation ('PMR') measure a country's regulatory regime and barriers to competitive product market environment, and track reform progress over time. There are economy-wide PMR indicators, as well as more granular PMR indicators at the sector level. The aggregate (economy-wide) PMR indicator is the simple average across three high-level indicators of i) state control, ii) barriers to entrepreneurship and iii) barriers to trade and investment.

16. State control, includes public ownership and involvement in business operations. Figures show that the level of public ownership varies widely across countries, while the overall level of state control has declined over time. The same observation applies to government's involvement (e.g. price control), which varies substantially across countries and has also decreased over time.

17. Regarding barriers to entrepreneurship, the PMR indicators show sector-specific restrictions to entry (e.g. legal barriers to entry, barriers in services sectors/network sectors). Barriers to entrepreneurship are typically driven by a strong protection of incumbents in networks and services sectors and high administrative burdens on specific firms such as retail shops and road freight companies. Figures show that barriers to entry have fallen in network industries, but not in service sectors.

18. Competition authorities could use these indicators, in various ways: indicators enable competition authorities to establish links between regulatory restrictions and economic performance which contributes to the benchmarking of the country's performance internationally. This in turn helps identifying reform priorities over time.

6. *Competition distortions in telecom and lessons from net neutrality by* Bengt Mölleryd (Vice chair CISP, Swedish Telecom & Postal Regulator)

19. Competitive neutrality distortions are a concern also in the telecom industry. In some countries liberalisation opened existing infrastructure and allowed better service competition and easier entry; while in countries opted for infrastructure competition directly, implying very high barriers of entry for new entrants. Networks are bottlenecks and regulatory intervention may be required to ensure fair access and create a level playing field.

20. Another challenge arises from new fibre networks, which require massive capital expenditures whilst the sector is struggling with revenue decline and too high costs. Alternative operators are reluctant to invest, whereas incumbents are deploying networks in urban areas, establishing a competitive advantage. Public intervention is required in order to establish a utility and avoid monopolistic markets.

21. In telecom, establishing open and neutral markets is crucial. Therefore, networks that control or prioritise certain products or services are not desirable. For example, the digital world relies on net neutrality, namely on an open Internet with a free flow of information and content. This is essential for users to be able to make their own choices. Where net neutrality cannot be assured by the market, regulatory intervention may be required.

7. *Competition distortions in transportation by* Alain Lumbroso (Economist, International Transport Forum)

22. The International Transport Forum ('ITF') is housed by the OECD and acts as a think-tank for transport policy. It includes 34 OECD and 23 non-OECD countries. The ITF organises the Annual Summit of transport ministers; it is the only global body that covers all transportation modes.

23. SOEs are prevalent in transportation (e.g. public transport, railways, and airlines) and often are partially or fully shielded from competition. Addressing competitive neutrality distortions and levelling the playing field is an increasingly growing issue in transportation sectors, notably in aviation. Various factors in the transportation sector can lead to competitive neutrality distortions:

- *The operators*: selective application of policies to protect local operators from strong foreign ones (e.g. Gulf Carriers);
- *The location*: place of establishment creates competitive differences within a global industry;
- *The modes of transport*: national policy favouring one transportation mode (i.e. short-sea shipping) over another (i.e. trucking) for environmental purposes;
- *Passengers vs. freight*: more liberal access regimes in air freight transport than in air passenger transport, rail private competition in freight but state-owned monopoly for passengers.

24. Various considerations, however, make it difficult to ensure level playing field in the transportation sector. Among others, the issue of connectivity to the global markets is one of the most important goals of national transportation policy as it is key to prosperity. However, Governments face difficulties in being competitively neutral and adopt meaningful transportation policies at the same time.