

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
COMPETITION COMMITTEE**

ROUNDTABLE ON COMPETITION NEUTRALITY

-- Note by Thomas Cheng, University of Hong Kong --

16-18 June 2015

This paper by Thomas Cheng (Associate Professor of Law at the University of Hong Kong, People's Republic of China) was submitted as background material for Item 9 of the 123rd meeting of the OECD Competition Committee on 16-18 June 2015.

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More documents related to this discussion can be found at www.oecd.org/daf/competition/competitive-neutrality-in-competition-enforcement.htm.

JT03378304

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COMPETITIVE NEUTRALITY FROM AN ASIAN PERSPECTIVE

*Note by Thomas K. Cheng**

1. This paper addresses competitive neutrality issues arising in Asia, in particular, (1) which competitive neutrality issues are particularly acute in Asia, (2) what are the sectors in which the degree of state intervention is higher in Asia as compared to other regions, (3) what tools and practices exist in Asian countries to address these issues, (4) what is the role of competition authorities in Asia in advancing competitive neutrality, (5) what are the most relevant concerns in host countries when Asian state-backed entities make outbound foreign investments, and lastly (6) what are the cutting-edges issues pertaining to competitive neutrality that were discussed in “Competition and the State”, a volume published by the Stanford University Press for which I served as one of the co-editors.

2. Given the vastness of the region and the diversity in economic structure, ranging from fully free-market economies such as Japan and Korea, to capitalist economies with heavy state presence such as India, to socialist market economies such as China and Vietnam, the state of competitive neutrality in the region does not lend itself to easy generalizations. In particular, China is probably an outlier in Asia (and the world for that matter) in terms of state relation to the economy. However, any discussion of competitive neutrality and the treatment of state enterprises in the economy in Asia would be incomplete without some discussion of China, given its economic importance. This paper will address the issues enumerated in the previous paragraph one by one with reference to China, India, Malaysia, and Hong Kong¹.

3. Before we begin examining the state of competitive neutrality in Asia, it is important first to define the meaning of the term. A number of international organizations such as the OECD itself and the United Nations Conference on Trade and Development (“UNCTAD”) have studied the issue of competitive neutrality. The overarching recommendation in Chapter 1 of the OECD Guidelines on Corporate Governance of State-Owned Enterprises encapsulates the spirit of competitive neutrality by stating that “[t]he legal and regulatory framework for state-owned enterprises should ensure a level-playing field in markets where state-owned enterprises and private sector companies compete in order to avoid market distortions.”² Deborah Healey, writing in an UNCTAD report on competitive neutrality in developing countries, summarizes competition neutrality as the notion that “government business activities that are in competition with the private sector should not have a competitive advantage merely by virtue of government ownership and control.”³ However, competitive neutrality has also been mentioned in the context of ensuring equal regulatory treatment of different kinds of firms that offer the same service in the

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¹ Hong Kong is obviously not independent country; it is a special administrative region in China. But its economic structure is so different from that in the Mainland that it deserves to be treated as a separate entity for the purpose of this paper.

² Org. for Econ. Cooperation and Dev. [OECD], *OECD Guidelines on Corporate Governance of State-Owned Enterprises*, at 18 (2005), available at <http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf>.

³ Deborah Healey, *Competitive Neutrality: The Concept*, in UNCTAD RESEARCH PARTNERSHIP PLATFORM: COMPETITIVE NEUTRALITY AND ITS APPLICATION IN SELECTED DEVELOPING COUNTRIES (2014), at 12, available at http://unctad.org/en/PublicationsLibrary/ditccplpmisc2014d1_en.pdf.

market, such as banks and insurance companies, regardless of ownership.⁴ Therefore, the notion of competitive neutrality need not be confined to the public-private ownership context and can be extended to all sorts of scenario in which there is differential treatment of firms competing in the same market.

4. There are many issues that fall within the rubric of competitive neutrality. The most obvious one is the issue of state aid, or state assistance to companies on non-commercial terms which may give the recipient an undue advantage. There is the issue of preferential treatment of SOEs. To the extent that SOEs are being offered preferential treatment such as preferential access to financing, government explicit or implicit guarantees of debts, advantageous fiscal measures, captive equity and lack of obligation to distribute dividends, lack of requirement to achieve a market rate of return, and exemption from bankruptcy rules, SOEs may enjoy an undue advantage in the market and the playing field may be tilted. Competitive neutrality can also be extended to public procurement rules. These rules may be designed to explicitly or implicitly favor certain participants in the market, most often SOEs, which again may cause the playing field to be tilted. Governments may enact laws and regulations that distort the market by deliberately or inadvertently favoring some firms over others. The most notable examples are what is known as abuse of administrative monopoly in China, which refers to government measures and conduct that seek to protect local undertakings from non-local competition. While these measures and conduct are most often overtly protectionist, government regulations may have inadvertent consequences on competitive neutrality.

5. Given the wide range of scenarios in which competitive neutrality can be implicated, it is useful to classify them for ease of understanding and analysis. There are a number of dimensions along which these scenarios can be classified. First, and the most intuitively obvious, is a distinction between measures and conduct. Measures refer to government interventions of a more permanent nature that have broad applications. The most obvious example are laws and regulations that tilt the playing field and public procurement rules that favor some firms over others. Conduct refers to one-time, discrete government interventions that are usually targeted at one or a distinct group of recipients. This can encompass state assistance to a particular firm or industry in the form of grants or preferential loans, or in the case of abuse of administrative monopoly in China, outright blockade in highways to prevent non-local goods from entering the locality. This distinction is relevant because it usually affects whether a competition authority can intervene against a government intervention, and if so, the form of intervention it can take. Competition authorities are usually tasked to police against anticompetitive conduct perpetrated by a particular firm or group of firms. Therefore, as far as enforcement goes, competition authorities probably have greater room for maneuver with respect to conduct than measures.

6. Second, competitive neutrality issues can be viewed along three levels of manifestation. The first level of manifestation is anticompetitive conduct by firms that have received state assistance or been the beneficiary of state policies that violate competitive neutrality. For example, it has been widely acknowledged that due to their lack of focus on profit maximization, SOEs are more likely to engage in predatory pricing in order to increase their market share and hence revenue. This level of manifestation is clearly within the reach of competition authorities. The second level of manifestation is government policies that purport to tilt the playing field. It is oftentimes these policies that allow the beneficiary firms to pursue anticompetitive conduct in the first place. With respect to this level of manifestation, the competition authorities probably have a more limited arsenal. In many cases, the competition authorities are limited to advocacy in seeking to change competition-distortionate government policies, although in some countries, enforcement can be an option as well. As has been mentioned already, there are the abuse of administrative monopoly provisions in the Anti-Monopoly Law in China. Australia and its states and territories have set up complaint mechanisms to allow victims to report failure of the government to

⁴ Harald A. Benink & David T. Llewellyn, *Systemic Stability and Competitive Neutrality Issues in the International Regulation of Banking and Securities*, in 9 J. FIN. SERV. RESEARCH 393 (1995).

comply with competitive neutrality. But these remain the exception rather than the rule. Lastly, the issue of competitive neutrality can be taken to the first principle level of whether the state should be involved in certain sectors and what policy considerations justify state participation and intervention in markets. Justifications may include provisions of public services, control of natural monopoly, grooming of national champions as a tool of economic development, etc. At this level of manifestation competition authorities are most likely to be limited to advocacy, attempting to have a say in the highest level of decision making. But this is also the root of the issue of competitive neutrality.

7. For the purpose of this paper, we will focus on the application of the concept in the public-private ownership context.

1. The State of Competitive Neutrality in Asia

8. It is obviously impossible to survey all the Asian countries to ascertain their landscape for competitive neutrality. This paper will focus on China, India, and Malaysia. As it is impossible to catalogue all the competitive neutrality issues, the discussion is based on a selection of relevant examples.

1.1 China

1.1.1 History of Reform

9. The Chinese state sector is vast and extensive. When assessing the extent of state intervention in the economy, it is important to bear in mind that China began its journey from a different starting point from most western capitalist economies. In the latter, the presumption is private ownership of property and productive resources. State ownership only steps in when justified by circumstances, such as market failure, natural monopoly, provision of public goods, performance of universal service obligations, etc. In stark contrast, the modern, post-reform Chinese economy began when state ownership was omnipresent. In 1978, when economic reform began, SOEs controlled 99.8% of the national economy.⁵ What has followed since then has been a gradual reduction of state presence in the economy and reform and restructuring of SOEs. Despite more than thirty years of reform, however, SOEs have still maintained a strong presence in many sectors.

10. When China began its “Open Door” policy in the late-1970s, it was very much a centrally planned economy with close to no private ownership of productive resources. SOEs dominated practically every sector of the economy. SOE reforms were conducted in conjunction with the liberalization of the price system, both of which proceeded in a gradualist manner. In the 1990s, the government accelerated the pace of reform. It actively pursued a policy which has come to be known as “grasping the large and letting go of the small”.⁶ Under this policy, the government focused on turning around large SOEs. Small SOEs were either merged with each other, merged into larger SOEs, or allowed to go bust. As a result, the number of SOEs dropped. So did their relevance in the economy. SOEs’ share in industrial output fell from 78% in 1978 to 33% in 1996. Between 1998 and 2010, SOEs’ share in the total number of industrial enterprises fell from 39.2% to 4.5%, its share in total industrial assets from 68.8% to 42.4%, while its share in national employment declined from 60.5% to 19.4%.⁷ Their share in China’s exports dropped from 57%

⁵ Bruce M. Owen et al., *Antitrust in China: The Problem of Incentive Compatibility*, 1 J. COMPETITION L. & ECON. 123-48 (2005).

⁶ Peter Nolan & Wang Xiaoqiang, *Beyond Privatization: Institutional Innovation and Growth in China’s Large State-Owned Enterprises*, 27 WORLD DEV. 183, 186 (1999).

⁷ World Bank, *China 2030: Structural Reforms for a Modern, Harmonious, Creative High-Income Society* 110 (2012), available at <https://openknowledge.worldbank.org/handle/10986/12925>.

in 1997 to 15% in 2010.⁸ These statistics show that although the absolute number of SOEs has declined, they have become larger and more capital intensive.

11. Over time, the government's SOE policy has taken on a sectorial focus. This approach has been described as a "backward and forward" approach by Chinese scholars.⁹ It has moved forward in the sense that SOEs have exited certain industries while private enterprises are encouraged to enter these industries and compete. These industries included electronics, chemicals, and textiles.¹⁰ Through several rounds of restructuring, the government dissolved the ministries that oversaw these industries and replaced them with industrial associations.¹¹ Between 2005 and 2009, SOEs retreated from twenty manufacturing industries which were characterized as generally competitive. It has moved backward in the sense that it has identified a number of strategic sectors over which the state would maintain tight control to the exclusion of private firms. These sectors would be dominated by enterprises directly owned by the state.

12. In 1999, the Fourth Plenary of the 15th Chinese Communist Party Central Committee identified four areas which SOEs must control: those related to national security, natural monopoly, vital public services, and pillar industries and key high-tech industries. In 2006, the State-Owned Assets Supervision and Administration Commission ("SASAC") issued the "Guidelines for Adjusting State Capital Structure and Deepening SOEs' Restructuring", which further defined natural monopoly as important infrastructure and natural resources. In 2006, a former director of the SASAC identified seven strategic sectors over which the state would maintain absolute control. These included defense, electric generation and distribution, petroleum and petrochemicals, telecom, coal, civil aviation, and waterway transport.¹² In these sectors, a number of SOEs compete with each other while being protected from new entry. Some of the firms in these sectors are groomed to be national champions, which are given privileged positions in the domestic market to allow them to grow to a sufficient size to be competitive internationally. Examples include the three dominant state-owned oil companies.

13. The government also designated as pillar industries machinery, automobiles, IT, construction, steel, base metals, and chemicals, where the state would maintain somewhat strong influence.¹³ In these sectors, private participants could face a range of entry barriers or other constraints on operation and expansion. To sum up, the current SOE policy of the Chinese government consists of the following prongs: (1) dominate and expand in key industries affecting national security and the "commanding heights" of the national economy, (2) compete on equal footing with non-state enterprises in competitive industries, (3) compete mainly among SOEs in natural monopoly industries such as telecom and electricity, and (4) serve as the main instrument of industrial policy: develop pillar industries such as steel and automobiles and create national champions to compete internationally.

14. With these reform measures, SOEs in China have continued to grow in size. Fifty-five of the Fortune Global 500 Companies in 2011 were Chinese SOEs. 316 of the top 500 Chinese companies were SOEs. Their proportion of revenues, profits, and assets among the top 500 firms were 83%, 82%, and 90% respectively. The top ten industrial SOEs accounted for 82.8% of total industrial SOE production and 81.4% of the total net profits. Despite the government's effort to merge SOEs and reduce their number,

⁸ *Id.*

⁹ Yong Huang et al., *China's Anti-Monopoly Law: Competition and the Chinese Petroleum Industry*, 31 ENERGY L.J. 361(2010).

¹⁰ Owen et al., *supra* note 5, at 9.

¹¹ *Id.*

¹² World Bank, *supra* note 7, at 113.

¹³ *Id.*

there were still 20,510 SOEs in the industrial sector and about 10,000 non-financial SOEs in the service sector in 2010. The industrial SOEs are mainly found in energy, raw materials, and equipment manufacturing, while the service SOEs tend to operate in construction, telecom, aviation, shipping, retail, restaurants, tourism, and real estate.

1.1.2 Current State of Competitive Neutrality — The Oil Industry

15. Given the pervasiveness of the state sector in China, it is very difficult to catalogue instances of violation of the competitive neutrality principle exhaustively. Instead, this paper will pick the oil industry as an illustrative example to demonstrate how the state-owned oil giants have been unfairly assisted by the government. There are currently three large state-owned oil companies in China: China National Offshore Oil Corporation (“CNOOC”), China Petrochemical Corporation (“Sinopec”), and China National Petroleum Corporation (“CNPC”). CNPC mainly operates in northern China, Sinopec in southern China, and CNOOC in the coastal areas along eastern, southeastern, and southern China. CNPC’s business focuses in oil extraction and transportation, Sinopec’s on oil refining and chemical production, and CNOOC’s on offshore oil extraction and refining. In addition, all three of them also operate retail petrol stations. The three oil companies were never granted exclusivity through legislation but have established their spheres of operation with the help of administrative documents of arguable applicability. The dominance of the three state-owned oil giants in the Chinese domestic market is said to originate from the promulgation of the *Opinions on Monitoring and Rectifying Small Refineries and Regulating the Order of Circulation of Crude Oil and Petroleum Products* (Guo Ban Fa [1999] No. 38) (hereinafter “Document No. 38”).¹⁴ As mentioned earlier, this document is not legislation adopted by the National People’s Congress, the PRC legislature, but instead is a document issued by the General Office of the State Council, an internal subsidiary of an administrative organization. Scholars have questioned the validity of the document as a legal basis for the exclusivity of the three oil giants.¹⁵ Specifically, Document No. 38 authorizes CNPC and Sinopec to restructure small, qualified refineries through joint venture, equity participation, or acquisition. More importantly, Document No. 38 stipulates that all petroleum products produced by domestic refineries were to be wholesaled by CNPC and Sinopec. The refineries were prohibited from selling their products on their own. Subsequently, relying on other normative documents restricting or eliminating competition issued by the various levels of government¹⁶, the three state-owned oil giants successfully extended their monopoly power from the wholesaling sector to other sectors, such as importation, transportation, and retail. For instance, at present, the vast majority of retail petrol stations in China are owned and operated by the three oil giants. Before 1998, 85% of the domestic refined oil market was made up of private enterprises. By 2010, 79% was accounted for CNPC and Sinopec alone.¹⁷

16. Apart from granting exclusivity to the state-owned oil companies through various administrative and normative documents, the government has also assisted and protected the state-owned companies in various other ways. In oil extraction, enterprises in China are required to obtain extraction licenses in order

¹⁴ Shiyong Xu, *Competitive Neutrality of SOEs in China*, in UNCTAD RESEARCH PARTNERSHIP PLATFORM: COMPETITIVE NEUTRALITY AND ITS APPLICATION IN SELECTED DEVELOPING COUNTRIES (2014), at 62, available at http://unctad.org/en/PublicationsLibrary/ditcclpmisc2014d1_en.pdf.

¹⁵ *Id.* at 66-67.

¹⁶ For instance, the *Plan on Expansion of the Pilot Scope of Ethanol Gasoline* and the *Detailed Rules for Expansion of the Pilot Scope of Ethanol Gasoline* enacted by eight commissions and ministries in 2004 states that CNPC and Sinopec will take charge of producing and supplying ethanol gasoline. To implement these two normative documents, the Heilongjiang provincial government adopted the *Measures to Promote the Use of Ethanol Gasoline in Heilongjiang Province*, which stipulates that all ethanol gasoline in the province must be supplied by the Heilongjiang branch of CNPC exclusively.

¹⁷ Xu, *supra* note 14, at 65.

to engage in the business of oil exploration and extraction. At the moment, only a small number of state-owned companies such as the three oil giants have received these licenses. The result is that oil extraction in China is dominated by state-owned companies. In 2010, state-owned companies accounted for 94.7% of the national output in oil extraction. In oil distribution, there are also government restrictions. In 2003, the Ministry of Railways adopted the *Notice on Strengthening the Management of Petroleum Transportation*, which stipulates that plans of oil transportation must be submitted by CNPC or Sinopec.¹⁸ Submissions by other oil companies will not be accepted. This administrative intervention essentially forced private refineries to turn to road transportation for their products, which is several times more costly than railway transportation. In oil importation, if oil companies other than CNPC and Sinopec want to import crude oil, they must obtain a certification of production plan arrangement issued by CNPC and Sinopec in order to receive customs clearance and arrange for railway transportation.¹⁹ Even then, after importation, the crude oil must be bought back by CNPC or Sinopec.

17. Other advantages afforded to the state-owned oil companies include free land grant, subsidies, and close link with government officials. Eight of the fourteen members of the board of directors of CNPC once served in the government. Seven out of fifteen Sinopec board members once served in the government. Given the importance of access to the government for doing business in China, this close connection with the state no doubt benefits CNPC and Sinopec. The Chinese government has also offered free land grants to CNPC and Sinopec. The only obligation imposed on the two oil companies was to pay business tax on land rented to the local tax authorities. The result of this policy is heavy subsidy to the two oil companies. For example, in 2009, Sinopec saved on land rent to the tune of RMB 75 billion (USD12 billion) and in 2010, CNPC saved on land rent for approximately RMB265 billion (USD43 billion).²⁰ Lastly, the Chinese government provides artificial subsidy to CNPC and Sinopec by setting administrative prices for oil products that exceed the international prices. In the latter half of the last decade, this subsidy to CNPC and Sinopec amounted to RMB19 billion (USD3 billion) and RMB58 billion (USD9.3 billion) respectively.²¹

1.1.3 Current State of Competitive Neutrality — Other Examples

18. Aside from competition-distortive government regulations and overt and implicit subsidies of various kinds in the oil industry, there have been other reported instances of violation of the competitive neutrality principle in various industries across the country. One kind of scenario is government directly interfering in the market to favor its own preferred, state-owned enterprise. On the day the Anti-Monopoly Law came into effect on August 1, 2008, eight Chinese companies involved in electronic anti-counterfeiting technologies brought a suit against the Administration of Quality Supervision, Inspection and Quarantine (“AQSIQ”) for abuse of administrative monopoly in the Beijing First Intermediate People’s Court.²² In particular, it was alleged that since 2005, AQSIQ required companies using the electronic quality control online system PIATS to pay a registration fee in order to ascertain the authenticity of the product.²³ The measure was all the more suspicious because AQSIQ owned a 30 per cent stake in the company that operates PIATS. In 2009-10, the Heyuan municipal government of Guangdong province adopted the GPS tracking and monitoring platform of New Space-Time Navigation

¹⁸ *Id.* at 63.

¹⁹ *Id.* at 64.

²⁰ *Id.* at 68.

²¹ *Id.* at 71.

²² Asialaw.com, ‘China’s Anti-Monopoly Law—Six Months On’, [available at](http://www.asialaw.com/Article/2121760/Channel/16707/Chinas-Anti-monopoly-Lawsix-months-on.html) <http://www.asialaw.com/Article/2121760/Channel/16707/Chinas-Anti-monopoly-Lawsix-months-on.html>.

²³ *Id.*

Technology (“NST”), a state-owned enterprise, as the only approved municipal tracking and monitoring platform.²⁴ All the other GPS operators were required to upload their monitoring data onto NST’s platform. NST was allowed to charge the other GPS operators a data upload service fee of no more than RMB30 per vehicle. The decision at the meeting was subsequently confirmed by the *Working Plans for Promoting GPS Vehicle Data Recorder*. In order to ensure compliance with the *Working Plan*, the Heyuan government later asked its traffic management bureau to fail the annual review of vehicles whose monitoring data were not uploaded to NST’s platform.

1.1.4 Selective Enforcement of the AML

19. Another kind of violation is selective enforcement of the Anti-Monopoly Law (“AML”). When the AML was first adopted, some have suggested that state-owned enterprises are exempted from the law under Article 7, which adopts rather ambiguous language to describe the applicability of the AML to state-owned enterprises. In 2009, when the Ministry of Industry and Information Technology restructured the Chinese telecom sector to merge four providers into three, a number of mergers took place. These mergers would all have met the notification thresholds promulgated by the Ministry of Commerce (“MOFCOM”), the authority in charge of merger review in China, and should have been notified. However, MOFCOM confirmed that the merger between China Unicom and China Netcom was not notified to MOFCOM.²⁵ This gave rise to allegations of selective enforcement of the AML against state-owned enterprises. However, subsequent investigations against state-owned enterprises such as China Telecom, China Unicom, Wuliangye and Moutai emphatically confirmed that the AML applies to state-owned enterprises in China. Lastly, Chinese state-owned banks have been known to provide preferential access to capital by state-owned enterprises. This issue has raised concerns among China’s trading partners. In *Coated Free Sheet Paper from the People’s Republic of China*, the U.S. Department of Commerce investigated whether illegal subsidies are provided to the Chinese paper industry through preferential lending by state-owned banks.²⁶ The Department of Commerce found that funds continue to be allocated in a “manner consistent with the general policy to maintain the state-owned industrial sector”²⁷ and concluded that Chinese paper manufacturers did receive illegal subsidy.

1.2 India

20. Compared to China, India’s state sector is less prominent in the economy. But this does not mean that the state sector is small by any means. There are quite a few prominent state-owned enterprises, such as in coal, aviation, and railway, which can be said to be the legacy of the socialist economic model pursued by Prime Minister Jawaharlal Nehru since independence. In the Industrial Policy Resolution adopted in 1956, it was stated that one of the main objectives of setting up state-owned enterprises was to achieve rapid economic growth and industrialization. Nehru’s vision was that SOEs would capture the commanding heights of the economy. The most frequently mentioned competitive neutrality issues in India

²⁴ Susan Ning, Huang Jing & Ranran Yin, *First Enforcement Action under Anti-Monopoly Law against Administrative Monopoly*, CHINA LAW INSIGHT, Aug. 12, 2011, available at <http://www.chinalawinsight.com/2011/08/articles/corporate/antitrust-competition/first-enforcement-action-under-antimonopoly-law-against-administrative-monopoly/>.

²⁵ TINGTING WEINREICH-ZHAO, CHINESE MERGER CONTROL LAW: AN ASSESSMENT OF ITS COMPETITION-POLICY ORIENTATION AFTER THE FIRST YEARS OF APPLICATION 186 (2015)

²⁶ Wentong Zheng, *State-owned Enterprises versus the State: Lessons from Trade Law*, in COMPETITION AND THE STATE 87 (Thomas K. Cheng, Ioannis Lianos & D. Danny Sokol eds., 2014).

²⁷ Coated Free Sheet Paper From the People's Republic of China: Amended Preliminary Affirmative Countervailing Duty Determination, 72 Fed. Reg. 17,484 (Dep’t of Commerce Apr. 9, 2007), available at <http://enforcement.trade.gov/frn/2007/0704frn/E7-6498.txt>.

also seem to center around these state-owned enterprises. And unlike China, where as far as the author is aware there is seldom any acknowledgement of the importance of competitive neutrality, former Prime Minister Manmohan Singh characterized competitive neutrality as follows: “Several possible distortions can arise because of the advantages some SOEs have due to their government ownership. Competitive neutrality requires that the government does not use its legislative and fiscal powers to give undue advantage to its own business over the private sector.”²⁸ A host of competitive neutrality issues have arisen in various sectors.

1.2.1 Energy Sector

21. In the energy sector, Coal India and its associate companies enjoy a monopoly over the production of coal in India. It has enjoyed protection from competition for forty-two years. For years it has been blamed for the shortage of coal in India. Power companies in India have been forced to import coal from countries such as Indonesia at much higher prices as a result of the domestic shortage. However, since Prime Minister Narendra Modi’s assumption of power last year, there have been discussions of plans to end the monopoly of Coal India. Coal India is also a culprit for the violation of competitive neutrality. Until 2012, Coal India supplied coal to private power companies on discriminatory terms that favor their public counterparts. For instance, under the previous Fuel Supply Agreement, Coal India could terminate the contract unilaterally in the case of a dispute. However, with a public power company, termination can only be undertaken after approval from the government.

1.2.2 Oil Industry

22. In the oil industry, the three public sector oil companies allegedly coordinated their parallel price increases with each other through Oil Ministry. Using public officials to help coordinate a price increase is more feasible for public sector undertakings as these companies have closer connections to the government. This kind of government facilitation of cartel conduct on the part of public sector undertakings is not confined to the oil industry. It can also be found in the insurance industry. In a letter to the chairmen and managing directors of the state-owned insurance companies, the Finance Ministry explicitly urged these companies to avoid competition between them and to share competitively sensitive information concerning premium and claims between them. Specifically, the letter asked these companies not to use low prices to attract their rivals’ customers when the customers are up for renewal. In addition, the Indian government provides subsidies on diesel which are only available to the public sector undertakings and not to private companies. This obviously tilts the playing field in favor of the public companies. In fact, the distortionate effect was so serious that the private oil companies were forced out of the market in the last decade after failing to compete with their public sector counterparts.

1.2.3 Railway Industry

23. In the railway industry, Indian Railways is reported to have heavily cross-subsidized its passenger business with revenue from its freight business. The passenger fare-to-freight ratio was at 0.25:1 in 2011, while the corresponding ratio was at 1.4:1 in South Korea, 1.3:1 in France, and 1.2:1 in China. It was also reported that passengers accounted for 60% of the railway’s capacity but generated only 28.7% of its revenue. What this means is that competitors of the passenger business of the railway was placed at a disadvantage as compared to if the passenger business fully bore its share of the costs.

²⁸ Manmohan Singh, Inaugural speech at BRICS International Competition Conference, New Delhi (Nov. 21 2013), available at http://www.cci.gov.in/May2011/Home/Speech_PM_3rdBRICS_Nov212013.pdf.

1.2.4 Aviation Industry

24. In the aviation industry, the prominent issue in recent years seems to be state aid for the struggling national carrier, Air India. The Indian government bailed out the struggling airline in 2012 to the tune of Rs300 billion (USD4.8 billion), despite doubts about the viability of the airline and the wisdom of having a national flagship carrier. The distortion of competition resulting from this bailout package is all the more starkly illustrated when one compares the fate of Air India with that of Kingfisher Airlines, which was denied a bailout and allowed to collapse in 2012. In a concerted effort to prop up Air India, the Oil Ministry arranged to have the public sector oil companies offer a discount of 8% to 8.5% on jet fuel to Air India. This saved the company Rs7 billion (USD110 million) to Rs8 billion (USD130 million) alone in 2013. Moreover, the government paid the Rs43 billion (USD680 million) debt owed by Air India to the public sector oil companies on behalf of Air India. There were wide expectations that the airline would not meet the performance benchmarks laid down by the government as part of the bailout package. There are other instances of violation of competitive neutrality with respect to the national carrier. Air India is given a procurement advantage by Indian government officials when they are required to fly the airline when traveling on official business. Apart from Air India, Hindustan Aeronautics has also held a privileged position. Hindustan Aeronautics used to enjoy a monopoly position in the manufacture and assembly of aircrafts, navigation and communication related equipment. To further protect the market for Hindustan Aeronautics, the government imposed caps on foreign investment to limit the presence of foreign companies into the sector. This state of affairs did not change until 2014, when the government finally relaxed restrictions on entry into the sector.

1.2.5 Preferential Access to Financing

25. SOEs in India receive favorable financial treatment from the government and state-owned banks. Access to credit from state-owned banks is allegedly easier for central public sector undertakings. The government also provides both loan and equity finance to these undertakings through government ministries. In some exceptional cases, their loans are guaranteed by the government. For example, under the Life Insurance Corporation Act of 1956, the state-owned Life Insurance Corporation enjoys sovereign guarantee for its debts, which obviously gives it an unfair advantage over rivals. The government also offers bailout packages to SOEs. These include direct loans or loan guarantees. The government may also provide budgetary support for the payment of wages and may finance cash components for revival packages through ministries and departments. Examples of recipients of such bailout packages include the aforementioned Air India and the state-owned telecom companies MTNL and BSNL.

1.2.6 Unfair Treatment in Procurement

26. There have also been allegations of unfair treatment in procurement. When Mazagon Dock, a state-owned shipbuilding company, was looking for a joint venture partner to build warships for the Indian navy, it put out a tender which it concluded in a fortnight, without waiting for the submission of detailed business plans of all the yards it had sought. Mazagon Dock picked Pipavav shipyard as the joint venture partner, after which the competing bidders cried foul, complaining about the total lack of transparency in evaluation and the non-disclosure of selection criteria. There were suspicions of favoritism as a former Mazagon Dock chairman and managing director sat on the board of Pipavav Shipyard. The Defense Ministry initially put the tender on hold to appease the competing bidders. However, the Mazagon Dock-Pipavav joint venture eventually were approved by the government. Moreover, starting in 1992, the Indian government implemented a purchase preference policy whereby the state sector could enjoy purchase preference from central government departments and central public sector undertakings if the price quoted by it in a tender exercise falls within 10% of the lowest bidder's quote. This policy was initially intended to operate for three years to give SOEs time to adjust to the new economic environment following the 1991 economic reforms. However, the policy was repeatedly extended until it was finally discontinued in 2008.

27. Other instances of preference for state-owned entities in public procurement arose when, in 2012, the Securities and Exchange Board of India decided to deposit its surplus funds in fixed deposits with state-owned banks even when the private banks offered a higher rate of return. This represented a shift from the previous policy, which required a competitive bidding process between public and private banks. This preference for public sector banks is not limited to the securities regulator. From 2008 onward, the Indian government has directed all ministries, departments, and public enterprises to deposit at least 60% of their surplus with the state-owned banks. In 2014, the Supreme Court of India restricted its tender for a six-month deposit to state-owned banks. Private banks were not allowed to take part in the tender. In 2005, the government approved exclusive purchase preferences for pharmaceutical SOEs and their subsidiaries in respect of 102 medicines. The policy was extended in 2013 for another five years with respect to 103 medicines. A slight variation of the preference for public enterprises in procurement relates to public hospitals, which are allowed to import medical devices and equipment at a lower duty rate if the product is directly sourced from the manufacturer. This is not a preference in procurement in favor of a public sector undertaking, but a preferential treatment for public sector undertakings in their procurement which nonetheless will tilt the playing field.

1.2.7 *Reverse Discrimination Against SOEs*

28. However, disparate treatment is not always in favor of the state-owned enterprises. There have been quite a few reported instances of reverse discrimination against SOEs. For instance, in 2011, when the Indian government revoked the licenses of the power companies and took back coal blocks from them, state-owned companies were allegedly disadvantaged. Their blocks were taken back even though they had already made substantial investments in them, while private firms that had not done much with theirs were allowed to keep them. It is unclear what accounts for this disparate treatment. Moreover, state-owned operators are subject to universal service obligations and other public service obligations. For example, in 2011, the Indian government asked public sector banks to open branches in every unbanked block in the northeastern India by September 2012. The states to be covered included Arunachal Pradesh, Assam, Meghalaya, Manipur, Mizoram, Nagaland, and Tripura, which were home to 70 unbanked blocks and 55 underserved districts. Government regulations of fees and charges by state-owned enterprises can also tilt the playing field in favor of private companies. For instance, until the end of 2013, the authorities of twelve ports owned by the government must set their charges according to government regulations and cannot respond to market conditions. This allowed the privately run ports to undercut the prices of the publicly run ports and take business away from the latter. Reverse discrimination has also been observed in public procurement. The Indian Air Force allegedly barred public sector undertakings from participating in a Rs120 billion (USD1.91 billion) tender, even though these undertakings met all the technical requirements. In addition, the national railway company of India allegedly favored private coach manufacturers over its own in-house manufacturer in an effort to encourage private participation in coach manufacturing.

1.3 *Malaysia*

29. Like India, Malaysia is also a market economy with a fairly substantial state sector. On competitive neutrality, it has been argued that the country is not ready to embrace the concept.²⁹ Regarding negotiations of the SOE chapter of the Trans-Pacific Partnership, the Malaysian government, while acknowledging that a level playing field is necessary to allow domestic and foreign companies to grow, argues that countries have different economic systems and SOEs and GLCs have an important role to play

²⁹ Wan Khatina Nawawi & Saovane Chan Somchit, *SOE Regulation and the Competitive Neutrality Principle*, in UNCTAD RESEARCH PARTNERSHIP PLATFORM: COMPETITIVE NEUTRALITY AND ITS APPLICATION IN SELECTED DEVELOPING COUNTRIES (2014), at 216, available at http://unctad.org/en/PublicationsLibrary/ditccplmisc2014d1_en.pdf.

in economies such as Malaysia's.³⁰ State-owned enterprises, which are known as government-linked companies ("GLCs"), accounted for more than one-third of the market capitalization on Bursa Malaysia, the national stock exchange, and contributed about 10% of the national GDP as of June 2010. Eight of the twenty largest companies on the national stock exchange are GLCs. GLCs account for 36.8% of the agriculture, forestry, and fishing sector, 59.6% of the banking sector, 43.7% of the communications sector, 72.3% of transportation and warehousing sector, and 98.2% of the utilities sector.³¹ Some notable Malaysian SOEs include Malaysian Airlines, Petronas, the state oil company, and Tenaga Nasional Berhad ("TNB"), the state power transmission operator. And as in other countries, the substantial presence of SOEs has created some competitive neutrality issues in the country. For instance, the Malaysian SOEs receive various subsidies and financial assistance from the government and other SOEs. TNB obtains gas at subsidized prices from the state-owned Petronas. The government also provides guarantee of the debts of SOEs, although this practice has been on the decline. JCorp, the investment corporation of the state of Johor in southern Malaysia, received guarantees from both the Malaysian federal government and the Johor state government for its issuance of RM3 billion (USD830 million) of Islamic bonds. In 2012, only 16.7% of the total SOE medium- and long-term debts, to the amount of RM11.59 billion (approximately USD3.19 billion), were guaranteed by the government. Moreover, the nation's Auditor General found that between 2009-11, eighteen of the SOEs audited had received loans from the government. IWK, the national sewage company, received substantial government subsidies for its operation. In fact, the 2012 Auditor General report noted that the company was too reliant on government subsidies to cover its operational expenses. Perhaps it should be of no surprise that an SOE that relies on government subsidies for its operational expenses sustains heavy losses. As of the end of 2010, its accumulated losses came to approximately RM889 million (USD244.65 million).

30. However, unlike in some countries where the SOEs are exempted from taxes and dividend payment obligations to their shareholders, SOEs in Malaysia are subject to full tax liability and pay dividends to the government. Under Treasury Circular Letter No.11/1993, SOEs are required to pay at least 10% dividend annually to the government and the percentage may be higher if the SOE records unusually high profit in a given year. For example, Khazanah Nasional Berhad, Malaysia's sovereign investment fund, and Petronas paid RM3 billion (USD830 million) and RM28 billion (USD7.71 billion) worth of dividend respectively to the government in 2012. Between 2009 and 2011, these two companies paid RM3.8 billion (USD1.05 billion) and RM80.2 billion (USD22.07 billion) worth of corporate tax to the government. In addition to corporate tax, SOEs such as Petronas also pay petroleum tax and petroleum export duties to the government.

31. Based on the foregoing discussion, one may conclude that the most prevalent issue pertaining to competitive neutrality in Asia, or at least the three countries surveyed, is the issue of preferential treatment of SOEs. There have been instances of outright subsidies, preferential access to financing and loan guarantees, preferential treatment in public procurement, selective enforcement of competition law, or even administrative intervention to protect or advantage SOEs. Exemption from competition law or sovereign immunity do not seem to be an issue as the competition statutes of all three jurisdictions apply equally to SOEs. In terms of sectoral incidence of competitive neutrality issues, natural resources and infrastructure sectors seem to feature prominently in all three countries. Oil, coal, aviation, and railway have been found to be sectors plagued by competitive neutrality issues. This may be because in these countries, SOEs often have exclusive rights of operation, properly granted or not, in these sectors, such as the state-owned oil companies in China and India.

³⁰ Ministry International Trade and Industry, Malaysia, *Brief on the Trans-Pacific Partnership (TPP)* 6, available at http://www.miti.gov.my/storage/documents/c94/com.tms.cms.document.Document_62357eea-c0a8156f-2c11008e-9a1ecbed/1/TPP%20-%20Briefing%20Notes.pdf

³¹ Jayant Menon & Thiam Hee Ng, *Are Government-Linked Corporations Crowding out Private Investment in Malaysia?*, ADB Economics Working Paper Series No. 345 (April 2013) 5-6.

2. Tackling Competitive Neutrality Issues in Asia and the Role of Competition Authorities

32. Given the broad range of issues that fall within the ambit of competitive neutrality, competition authorities in Asia, as elsewhere, have a variety of toolkits to tackle them. The kind of tools available depends on the legislation of the jurisdiction at issue. In most jurisdictions, the least that the competition authority can do is to address the first level of manifestation of competitive neutrality and enforce competition law against SOEs which have committed anticompetitive conduct with government assistance. An example is the alleged price coordination behavior by the state-owned oil companies in India with the assistance of the Oil Ministry. In all three countries surveyed the competition statute applies to SOEs. In India and Malaysia, it even applies to government departments and agencies that engage in economic activities. Enforcement is occasionally an option for the second level of manifestation of competitive neutrality, such as state subsidy, preferential access to finance, preferential tax treatment, or preferential treatment under public procurement rules. This is the case in the EU, where there are rules against illegal state aid and rules that regulate how public procurement is done. Unfortunately, this is not the case in the three countries surveyed in this paper. However, the Chinese Anti-Monopoly Law contains a chapter addressing abuse of administrative monopoly. Oftentimes the conduct is perpetrated with a view to protect local enterprises, usually state-owned ones. The chapter does not address issues such as state aid or public procurement, but instead targets attempts by the local government to favor local enterprises through discriminatory fees or inspection standards, among other measures. When enforcement is not an option, advocacy seems to be the most effective tool for competition authorities to address the second level of manifestation of competitive neutrality. Beyond the tools at the command of the competition authorities, other measures we have seen in China, India, and Malaysia to deal with competitive neutrality issues have included a proposed national competition policy in India and partial privatization pursued by the Malaysian government. Although the competition authorities may have some role to play in the pursuit of these measures, these measures usually require higher-level involvement by the government.

2.1 Application of Competition Law to SOEs

33. Asian countries have adopted a variety of measures to promote competitive neutrality. These include ensuring equal application of their competition laws to SOEs, consideration of a national competition policy, legislation to prevent government distortion of the market, and advocacy. As mentioned earlier, the competition statute in all three countries applies to SOEs. In China, the AML applies to undertakings that engage in economic activities. During the initial years of the enforcement of the AML, some have questioned whether the AML applies to SOEs. Article 7 of the AML contains some ambiguous language that may suggest a possible exemption. However, this ambiguity was quickly dispelled in 2011 when one of the enforcement authorities, the National Development and Reform Commission (“NDRC”), launched an investigation into two state-owned telecom giants, China Telecom and China Unicom.³² Although the investigation did not result in any fines, it clearly signaled that the AML applies to SOEs, even at the highest level. If there was any lingering doubt concerning the applicability of the AML to SOEs, it was cleared once and for all by the decision of the local counterparts of the NDRC to fine Moutai and Wuliangye, two state-owned liquor producers, hundreds of millions of RMB for violations of the AML.³³ Section 2(h) of the Indian Competition Act defines enterprises as “a person or a department of the Government” that has engaged in an economic activity. Therefore, it is clear that the Indian Competition

³² Susan Ning, Han Wu & Yiming Sun, China: Latest Development re NDRC's Antitrust Investigation against China Telecom and China Unicom, Mondaq, March 21, 2012, available at <http://www.mondaq.com/x/169330/Antitrust+Competition/Latest+Development+re+NDRCs+Antitrust+Investigation+against+China+Telecom+and+China+Unicom>.

³³ Wuliangye Fined RMB202 million or Price Monopoly (Szechuan DRC, Feb. 22, 2013), available at <http://www.scdrc.gov.cn/dir25/159074.htm>; Zhong Jingjing, Moutai, Wuliangye Fined RMB449 million for Price Monopoly, BJNEWS, Feb. 20, 2013, <http://www.bjnews.com.cn/finance/2013/02/20/248977.html>.

Act applies to SOEs. In fact, aside from acting in the capacity of performance of sovereign functions, the Act also applies to government departments and agencies. This interpretation has been affirmed by the High Court of Delhi. Similarly, the Malaysian Competition Act applies to all commercial activities that affect competition in Malaysian markets. It applies to SOEs. This was confirmed by the Malaysian Competition Commission's enforcement action against the Air Asia-Malaysian Airlines market sharing agreement in 2012, which resulted in a fine for both entities.³⁴ On the application of the competition statute to SOEs, it may be interesting to note that Hong Kong, arguably one of the most free market economies in Asia, if not the world, is one of the few Asian jurisdictions where the competition law does not apply to SOEs. Hong Kong does not have SOEs as such. The closest thing to SOEs that can be found in Hong Kong are what are known as statutory bodies, which are bodies corporate set up by statutes to perform a variety of functions, which are sometimes commercial in nature. The government has tallied all the statutory bodies in the territory and found that close to a third, or about 160 of them, engage in economic activities. Unfortunately, Section 3 of the Competition Ordinance explicitly exempts all but six of the statutory bodies from the competition statute.³⁵

2.2 *Enforcement Against Public Bodies*

34. Apart from enforcement against SOEs, China's Anti-Monopoly Law also provides for enforcement against government bodies which have pursued anticompetitive measures or conduct that may tilt the playing field in favor of SOEs. The relevant chapter is Chapter 5 of the AML, containing Articles 32 to 37. Article 32 prohibits government bodies from compelling purchases of goods or services from designated undertakings, which was fairly common during the heyday of abuse of administrative monopoly. Article 33 proscribes administrative measures that impede the free movement of goods, including discriminatory charges, discriminatory technical or inspection standards, discriminatory licensing procedures, and roadblocks. Article 34 ensures equal treatment of non-local firms in public procurement exercises. Article 35 bans discrimination against non-local investments and discrimination against non-local firms setting up branches in the locality, which is crucial to a company's operation in a particular locality in China. Article 36 prevents government bodies from compelling undertakings to engage in anticompetitive conduct otherwise proscribed by the Anti-Monopoly Law. And Article 37, which may be considered as a catch-all provision, instructs government bodies not to issue regulations that eliminate or restrict competition. It can be applied to protectionist measures that do not directly fall within the previous five provisions. Even though Chapter 5 provides for enforcement against offending government bodies, the remedy available renders it less like enforcement and more like advocacy. This is because under Article 51 of the AML, the enforcement authorities are not empowered to fine or otherwise punish the offending government body. All that they are allowed to do is to inform the superior authority of the offending body about the violation. The superior authority is then expected to instruct the offending body to stop the violation. This is indeed what happened in the Heyuan GPS case discussed earlier. Therefore, given the lack of teeth of the remedy available, Chapter 5 of the AML perhaps can be better viewed as providing a legislative basis for the two enforcement authorities to conduct semi-binding advocacy against the superior authority of the offending body.

2.3 *Advocacy*

35. When enforcement action is not available, competition authorities can resort to advocacy. Advocacy is explicitly provided for in the competition statute of a number of Asian countries. In India, Section 49 of the Competition Act mandates the Competition Commission of India ("CCI") to take suitable measures to promotion competition. Under this mandate, CCI organizes advocacy workshops with key

³⁴ *AirAsia, Malaysia Airlines fined for flouting competition rules*, Reuters, Sept. 6, 2013, available at <http://www.reuters.com/article/2013/09/06/us-malaysia-airlines-idUSBRE9850GT20130906>.

³⁵ Competition Ordinance, (2012) Cap. 619, § 3. (H.K.)

ministries and departments of the central and state governments to highlight the importance of government policies in ensuring competition and emphasize how competitive impact assessment of legislations and policies can help remove distortions in the market. South Korea is probably the leader among Asian countries in providing for a legislative framework for advocacy. Article 36 of the Monopoly Regulation and Fair Trade Act provides for the legislative basis for the advocacy work of the authority in Korea, the Korea Fair Trade Commission (“KFTC”). The Article provides that “matters related to competition promotion policies through the consultation and coordination of legislation and administrative measures that restrict competition” fall within the jurisdiction of the KFTC.³⁶ Apart from providing for advocacy by the KFTC in the abstract, the MRFTA puts in place concrete mechanisms to allow KFTC to conduct this work. Article 63 of the MRFTA obliges the chief officer of the competent administrative authority to consult or give prior notice when proposing an administrative legislation that may restrict competition. Moreover, the KFTC can on its motion opine on laws and regulations that may restrict competition. This kind of opinion, however, does not have binding legal effect and the KFTC cannot require the administrative authority to incorporate its recommendations. However, statistics show that the KFTC’s advisory opinions are influential. From 1991 to 2003, the KFTC issued 850 opinions, of which 633 were implemented by the administrative authorities at issue.³⁷ One feature that further enhances the effectiveness of KFTC’s advocacy work is the fact that since 1996, the chairman of the KFTC has been promoted to the rank of a minister. Because the enactment or amendment of statutory laws is deliberated in the State Council, being a minister gives the KFTC access to the deliberation and an opportunity to provide a pro-competition perspective. In 1998, the Korean government created a Regulatory Reform Committee, which was granted the power to conduct regulatory impact assessment and to examine draft central and local laws that either impose duties or restrict the rights of Korean nationals. The KFTC may perform a competition impact assessment as part of the regulatory impact assessment. Since accepting the OECD’s recommendation to implement regulatory impact assessment in 2008, Korea became the first regime where all administrative departments are required to create a regulatory impact assessment report on all proposed regulation or amendments. In 2009, the first year of the implementation of this system, the KFTC conducted 330 assessments and proposed amendments to 35 legislative proposals.³⁸

2.4 *General Competitive Neutrality Policy*

36. India is one of the few countries in Asia to have considered the adoption of a general competitive neutrality policy following the Australian model. In June 2011, the Ministry of Corporate Affairs convened the Committee on National Competition Policy to make suggestions on the formulation of such a policy. The fundamental objective of the National Competition Policy (“NCP”) is the integration of the principles of competition into government economic policies to maximize the benefits of competition. A basic premise of this policy is that the government should not restrict market activity any more than is necessary to achieve its social and other goals. Any deviation from the principles of competition should only be made to meet desirable social and other national objectives. The draft NCP suggests the institution of a comprehensive competition impact assessment of all proposed and existing laws, regulations, and policies to identify provisions that may cause distortion to competition. The draft NCP also proposes the establishment of a “Cabinet Committee on Competition”, a high-level body to oversee the implementation of the NCP. It is further proposed that a National Competition Policy Council be set up with the participation of various government ministries and the Planning Commission. Very much like the Australian National Competition Policy, the draft Indian NCP also provides for the institution of an incentive scheme whereby financial grants to state governments are calibrated to their progress in the

³⁶ Dae-Sik Hong, *Competition Advocacy of the Korean Competition Authority*, in *COMPETITION AND THE STATE* 153 (Thomas K. Cheng, Ioannis Lianos & D. Danny Sokol eds., 2014).

³⁷ *Id.* at 155.

³⁸ *Id.* at 158.

implementation of the policy and in the incorporation of competition principles in their laws, regulations, and policies. In addition to the draft NCP, the Indian government also proposed a Public Procurement Bill in 2012 that promotes transparency in public procurement and ensures the evaluation of bids in pre-disclosed criteria, among other measures that aim to create free competition in public procurement.

2.5 *Corporate Governance Reforms*

37. India has pursued other measures to promote competitive neutrality, including measures to improve the efficiency and transparency of SOE management. One of the ways in which India has tried to tackle the inefficiencies of SOEs, which has an indirect bearing on competitive neutrality, is the introduction of the Memorandum of Understanding (“MoU”) system in 1986, under which the SOE and the government negotiated a management contract annually to set out the performance targets to be achieved and the government support to be rendered in a particular year. This system provides greater transparency between the government and its enterprises and imposes greater accountability on the management of the SOEs. Another measure is the discontinuation of the preferential public procurement policy in 2008 which was mentioned earlier, which ensured fair competition between the public sector and private companies in public procurement.

2.6 *Privatization of SOEs*

38. Perhaps a more fundamental way of dealing with competitive neutrality issues is the privatization of SOEs. The best way to prevent the government from favoring its own enterprises through various fiscal and regulatory means is to reduce the number of government-owned companies. Despite the fact that the Malaysian government has declared that competitive neutrality is a presently unattainable objective for the country, Malaysia is one of the jurisdictions that have pursued, albeit somewhat halfheartedly, privatization of its SOEs. The Malaysian government launched the ten-year GLC Transformation Program in May 2004. The Putrajaya Committee on GLC High Performance was formed in January 2005 to drive the program. In July 2011, as part of the program, the government further identified 33 GLCs as ready for divestment, but did not identify them by name.³⁹ Under the plan to rationalize the portfolio of GLCs in Malaysia, the government would reduce its stake in some of these companies, list a few others, and sell the rest. For example, in the first quarter of 2012, Khazanah Nasional Berhad offloaded its stake in the national car company Proton to DRB-Hicom Berhad. In December 2012 Khazanah Nasional Berhad announced its intention to divest its IT company Time Engineering Berhad. However, progress has been slow and doubts began to emerge as to the government’s determination to pursue privatization. As of February 2013, less than half of the 33 GLCs have been divested.⁴⁰ Only 15 of the divestments had been completed when the target was to divest 24 of them between 2011-12. The lackluster performance of the divestment program is particularly worrying as evidence has shown that the substantial presence of the state sector in the various markets in the Malaysian economy crowds out private investment.⁴¹ In particular, it has been shown that when the market share of GLCs exceeds 50% to 60%, private investment drops significantly.⁴² It has been hypothesized that private firms may be reluctant to invest in sectors dominated by GLCs as they perceive that the playing field is stacked against them.

³⁹ Menon & Ng, *supra* note 31, at 7.

⁴⁰ *Id.*

⁴¹ *Id.* at 13.

⁴² *Id.*

3. Treatment of Asian SOE Foreign Investment by Host Countries

39. A number of issues arise when SOEs, be they from Asia or elsewhere, invest in a host country, especially when the SOE investor has received various kinds of advantages from its own government. Having received various kinds of advantages from its own government, which are often tied to its record in foreign investment, the SOE investor will not be competing with firms in the host country market on even terms. Aside from this competitive neutrality issue, which will be discussed below, host country governments have also reacted to foreign investments by SOEs from Asia, especially from China, with various kinds of concerns. One of the most common concerns is that of national security. This has scuttled a number of foreign investments by Chinese SOEs in the U.S. Examples include CNOOC's failed acquisition of Unocal in 2005 in the face of congressional opposition.⁴³ The Chinese telecom giant Huawei, which allegedly has close ties to the Chinese military, has also seen a number of acquisition attempts in the U.S. stymied. These include its failed attempt to acquire 3Com, a network equipment manufacturer, and 3Leaf, a cloud computing company.⁴⁴ In fact, American suspicion of Huawei is so strong that when Softbank acquired Sprint, a mobile service operator in the U.S., Sprint was required to undertake that it will not incorporate Huawei equipment into its network.⁴⁵ Suspicion of Chinese investment is not confined to the U.S. In Australia, China Minmetals' acquisition of OZ Minerals was subject to close scrutiny and was only approved after the acquirer agreed to divest a mine that was seen as being located in close proximity to sensitive locations.⁴⁶ And when Chinalco planned a USD19.5 billion investment in mining giant Rio Tinto, there were vociferous calls for government intervention until the deal was eventually abandoned.

40. One of the aspects of competitive neutrality that has so far received relatively little attention is the use of home country measures to assist firms in one country to make foreign investments. This is somewhat akin to the export cartel scenario in cartel enforcement. Many countries provide domestic firms a range of assistance, including financial measures such as preferential loans and loan guarantees and fiscal measures such as tax subsidy, to encourage them to invest abroad. These firms need not be SOEs, although in recent years, the issue has attracted the most attention with respect to foreign investments by Chinese SOEs. There is no question that these so-called "home country measures" distort the playing field by giving firms a competitive advantage in the markets in which they invest. It is important to consider what should be the correct response of the recipient country competition authority. First, the recipient country authority has a very limited range of options in responding to these "home-country measures". For one thing, foreign investment is often highly sought after and can make important contributions to the local economy, especially in developing countries. It may be political unfeasible for a competition authority to advocate against measures paid for by a foreign government to facilitate investment in its home country. Second, even if the authority is minded to do so, there is not much the authority can do apart from enforcement of anticompetitive conduct by the subsidized foreign firms. However, this is an incomplete solution as foreign firms that have benefited from home country measures may not perpetrate anticompetitive conduct. Even if they do, the penalty and remedies that the recipient country authority can impose on the subsidized foreign firm may not be able to nullify the advantage received. In this sense, home country measures for foreign investment are even trickier to deal with than export cartels. With export cartels, at least it is theoretically possible for the victim countries to bring enforcement action. The problem is usually that these countries lack the resources to do so. In the context of home country

⁴³ Ziad Haider, *China Inc. and the CFIUS National Security Review*, THE DIPLOMAT, Dec. 5, 2013, available at <http://thediplomat.com/2013/12/china-inc-and-the-cfius-national-security-review/1/>.

⁴⁴ *Id.*

⁴⁵ *Id.*

⁴⁶ Denny Thomas, *Update 1-China's Minmetals seals \$1.4 bln OZ Minerals deal*, Reuters, June 11, 2009, available at <http://www.reuters.com/article/2009/06/11/ozminerals-idUSSYD41832420090611>.

measures, there is not much the recipient country authority can do. It certainly cannot pursue advocacy to ask the donor country government to stop offering assistance. And thus probably the only viable option is to rely on the donor country authority to engage in advocacy. However, it is not clear why the authority would have the incentive to do so. Plus the authority would need to undertake a very difficult analysis of whether from the recipient country's perspective, it is better off without the subsidy even though there is a risk that the foreign investment may not take place without it. There is no clear solution to this situation. But it is nonetheless an important issue that needs to be explored.

4. Cutting-edge Issues in Competitive Neutrality

4.1 *The Pros and Cons of Privatization*

41. Having examined the core issues of competitive neutrality, such as state subsidy and regulatory preference for SOEs, the remainder of this paper will turn to some more cutting edge issues pertaining to competitive neutrality that have been relatively unexplored. As mentioned earlier, there are three levels of manifestation of competitive neutrality issues, the highest level of which is the choice of ownership by the state with respect to enterprises. In other words, under what circumstances are SOEs justified and under what circumstances are they not. This is a very complex and multifaceted issue, a complete treatment of which is beyond the scope of this paper. One aspect of this issue that has been discussed in the literature is whether private ownership is unequivocally superior to state ownership. Alexander Volokh reviews the existing theoretical literature and concludes that none of the prevailing models unambiguously predicts benefits from privatization.⁴⁷ In fact, one of the earlier models by David Sappington and Joseph Stiglitz concludes that whether assets are publicly or privately owned is irrelevant. Empirical studies likewise do not unanimously establish that privatization is superior. The success of privatization very much depends on the institutional environment and context. In particular, Volokh argues that the prevailing corporate governance regime and the quality of antitrust enforcement and other entry-promoting policies all play a role in the success of privatization. Ultimately, Volokh concludes that the strongest argument in favor of privatization is the depoliticization of firms, which helps to minimize undue political influence that often produces inefficient outcome.

4.2 *Treatment of SOEs in Competition Law Analysis*

42. Another emerging issue with respect to competitive neutrality is how to treat the relationship between the various SOEs of the same state in competition law analysis. To put it slightly differently, the issue is the extent to which SOEs under the same state should be deemed to be a single economic unit for competition law analysis. This issue arises in the merger review and the horizontal agreements context. In the former context, whether the single economic unit doctrine applies affects the size and the market power of the merging parties at issue. A merger may raise no competitive concerns if we only simply focus on the SOE at issue involved in the merger. However, competitive harm may arise if we treat the merger as one involving all the SOEs owned by that particular state. In the latter case, if the participants of a horizontal agreement are all SOEs, there is an argument that they constitute a single economic entity and are hence incapable of being parties to a horizontal agreement. This issue is especially relevant and current in recent years in light of the rise of state capitalism, particularly China, whose SOEs have been aggressively acquiring foreign firms. In responding to this challenge in competition law, Wentong Zheng proposes that competition law learns from trade law and examines how trade law determines whether a particular entity is state-owned or controlled by the state.⁴⁸ In the anti-dumping context, SOEs of a “nonmarket economy” are presumed to operate as one statewide entity. To overcome this presumption, the party must demonstrate

⁴⁷ Alexander Volokh, *Privatization and Competition Policy*, in *COMPETITION AND THE STATE* 15 (Thomas K. Cheng, Ioannis Lianos & D. Danny Sokol eds., 2014).

⁴⁸ Zheng, *supra* note 26, at 75.

that the government exercises no de jure and de facto control over the firm. In determining the absence of de jure control, the U.S. Department of Commerce examines whether formal laws, regulations, and enactments applicable to the firm at issue suggest a lack of formal control. In determining the absence of de facto control, the U.S. Department of Commerce examines the firm at issue has complete autonomy in the setting of its export prices, whether the firm has the authority to enter into agreements, whether the firm has autonomy in deciding the composition of its management, and whether the firm makes independent decisions on how its profits are dispersed. In the subsidy context, in determining whether a financial benefit emanates from a public body, the U.S. Department of Commerce considers: (1) government ownership, (2) government presence on the board of directors, (3) government's control over the entity's activities, (4) entity's pursuit of governmental policies and interests, and (5) whether the entity is created by statute. Competition law can enrich its analysis of the issue of the applicability of the single economic unit doctrine to SOEs in light of these approaches in trade law.

4.3 *Public-Private Partnerships*

43. A third more cutting-edge issue related to competitive neutrality is the determination of the public cost of capital in the context of public-private partnerships ("PPPs"), which are increasingly used worldwide in the construction and provision of infrastructure. In determining whether PPP or public provision should be adopted, the authorities usually make a determination that provision via a PPP provides the public with value for money as compared to public provision. The cost of public provision is captured through the public-sector comparator ("PSC"), which "estimates the hypothetical risk-adjusted cost if a project were to be financed, owned, and implemented by the government' in the most efficient manner possible by government."⁴⁹ PSCs ensure competitive neutrality by making sure that infrastructure projects are allocated to the most efficient provider. However, Richard Geddes argues that PSC systematically underestimates the public cost of capital by ignoring the fact that taxpayers are effectively captive equity holders of public infrastructure projects.⁵⁰ Captive equity "stems from the fact that public-sector residual claims are not separable from residency in the jurisdiction in which the taxpayer resides..., while private-sector residual claims are transferable at low cost on an equity market."⁵¹ In a way, taxpayers are required to provide risk-bearing services without compensation. The nontransferability of taxpayers' residual claims to public infrastructure projects also raises the public cost of capital by mandating very dispersed ownership. There is no way for ownership to be consolidated among taxpayers. It is well-understood that dispersed ownership leads to higher agency costs for the monitoring of management, hence raising the cost of capital. Non-transferability further means that the management of public infrastructure projects is not subject to the discipline of the capital markets through change of control. There is no threat of a corporate takeover or an ouster of management. This will inevitably lead to poorer management performance. Furthermore, non-transferability also means that there is no price transparency for public-sector residual claims, which studies have shown to increase the cost of capital. Geddes suggests that the systematic underestimation of the public cost of capital means that private providers of infrastructure are subject to an artificially inflated benchmark for evaluation of cost effectiveness. Geddes proposes that this can be dealt with through competitive neutrality measures or rebidding of concession to inject additional competition.

⁴⁹ R. Richard Geddes, *Competition Issues and Private Infrastructure Investment through Public-Private Partnerships*, in *COMPETITION AND THE STATE* 60 (Thomas K. Cheng, Ioannis Lianos & D. Danny Sokol eds., 2014).

⁵⁰ *Id.* at 61-67.

⁵¹ *Id.* at 63.