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Opening Up and Competitive Neutrality: The International Experience and Insights for China

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对外开放与竞争中性：国际经验及对中国的启示

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SUMMARIES AND PRESENTATIONS
总结与报告

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OPENING UP AND COMPETITIVE NEUTRALITY: THE INTERNATIONAL EXPERIENCE AND INSIGHTS FOR CHINA

INTRODUCTION

GUO Kai and Alfred Schipke[1]

As China shifts from high-speed to high quality growth while aiming to control corporate leverage, it has become even more important to ensure that resources are allocated efficiently and irrespective of ownership-type (state-owned, private, foreign, or domestic) or company size.

Creating such an environment of “competitive neutrality” is challenging and has been the focus of a number of countries and international organizations. Australia, for example, conceived the concept of competitive neutrality in the late 1980s and the Organization for Economic Cooperation and Development in 2011 identified eight building blocks that govern such a strategy. While the terminology might differ across countries, the overarching aim is to create a level playing field for all market participants.

Recently, the Chinese authorities have put competitive neutrality to the top of their reform agenda, and in the 2019 Report on the Work of the Government (March), Premier Li Keqiang stressed “We will follow the principle of competitive neutrality, so that when it comes to access to factors of production, market access and licenses, business operations, government procurement, public biddings, and so on, enterprises under all forms of ownership will be treated on an equal footing”.

[1] Editors and conference organizers, People’s Bank of China and International Monetary Fund.

Hence, this conference reviewed international experience and determined how it could apply to China. Conference participants also assessed existing developments, discussed the authorities' reform plans, and identified areas for future work.

The event brought together international and domestic experts, staff from the People's Bank of China, the National Development and Reform Commission, the Ministry of Finance, the Ministry of Commerce, the State-Owned Assets and Supervision and Administration Commission, the State Administration for Market Regulation, financial sector regulators, the Organization for Economic Cooperation and Development, the World Bank, the IMF, academics, as well as private sector representatives.

This volume includes contributors' bios, short summaries, and the respective presentations. A Chinese translation is available at http://www.imf.org/external/country/CHN/rr/chi/.

Opening Remarks

Chen Yulu[1]

Today, as the seventh high-level conference jointly sponsored by the People's Bank of China (PBC) and the IMF successfully opens, on behalf of the PBC, I would like to express a warm welcome to all of the distinguished guests attending the conference and opening ceremony. The topic of this conference is openness and competitive neutrality. Together, we will explore and share the beneficial experience of various countries in implementing competitive neutrality and the implications such experience can offer China. This topic has important significance as a reference for the further deepening of China's magnificent undertaking of opening and reform. I will now discuss two viewpoints of this topic, integrating relevant details from the financial sector:

First, the high-level openness of China's financial services industry to the outside is now entering a new phase of historical development. Financial industry reform is an important link in China's new pattern of reform and opening. For many years, increasing the level of openness of the financial services industry has been an important safeguard that has enabled the achievement of sustainable, healthy development of China's economy and finance, and is an important principle that the country will consistently uphold. At the Boao Forum for Asia in April 2018, President Xi Jinping announced "we will significantly broaden financial market access and we have every intension to translate them into reality, sooner rather than later". Subsequently Yi Gang, governor of PBC, declared the specific measures and a timetable for further increasing the level of openness of the financial services industry.

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[1] Chen Yulu is a Deputy Governor of the People's Bank of China.

Most of these measures are now in place, and there has been a series of new developments in the opening of the financial services industry: first, market access in the banking, securities, and insurance industries has been completely opened up, with full-ownership operations to be realized by 2021. The scope of operations has expanded, including substantial expansion of the scope of operations of foreign-owned banks, and the discontinuation of individual restrictions on the scope of operations of foreign-owned securities companies and insurance agencies.

Second, access restrictions have been lifted for corporate credit information and credit rating services, bank card clearing and nonbank payment services, and we have begun offering national treatment to foreign capital.

Third, steady advances have been made in the bidirectional opening of capital markets, the level of openness of the bond markets has increased, supporting accounting, tax and trading systems have been perfected, the interconnection and interworking of domestic and foreign stock markets have been deepened, crude oil futures denominated in renminbi have been introduced targeting international investors, and offshore traders have been introduced into the trading of futures for iron ore and other commodities. Currently, foreign-owned financial institutions are responding positively to the steps taken to open the financial services sector, notable progress has been made in the area of market access and operations in China of foreign institutions, and the Chinese stock markets and bond markets have been incorporated into major international indices.

The door that China has opened will continue to open increasingly widely, and the pace of promoting high-level openness will not falter. In the next stage, on the requirement for heightened openness, we will continue to promote the openness of the financial services industry, with a primary focus on the successful completion of four tasks: first, continuing to ease restrictions on shareholding ratios, forms of incorporation, shareholder qualifications, and scope of operations of foreign-owned financial institutions, urgently revising the relevant laws and regulations, processing foreign capital access applications as quickly as possible, ensuring that opening measures already announced are put in place as quickly as possible, and continuing to study further easing of restrictions on entry by foreign-owned financial institutions.

Second is transforming the idea of opening to the outside, transitioning from an opening model that relies on individual case approvals to a management model of national treatment and negative list management prior to entry, to achieve systemic and institutional openness.

Third is further streamlining government functions and delegating authority, improving the business environment, promoting the bringing of various systems into line with international standards, and promoting a switch from approvals before the fact to reporting after the fact for a greater number of matters.

Fourth is establishing and improving a supervisory framework and financial infrastructure compatible with an open financial services industry and strengthening macroprudential management and the coordination of financial supervision to effectively guard against and defuse financial risk.

We sincerely welcome foreign-owned financial institutions and offshore investors to actively participate in opening China's financial services sector to create even more opportunities for commercial cooperation and achieve mutual benefit and joint development.

Second, the reform and opening of China's financial services industry must reflect the principle of competitive neutrality. In this year's Report on the Work of Government, Premier Li Keqiang indicated that "We will follow the principle of competitive neutrality, so that when it comes to access to factors of production, market access and licenses, business operations, government procurement, public biddings, and so on, enterprises under all forms of ownership will be treated on an equal footing." From the perspective of conditions in the financial field, the PBC and other financial regulatory agencies have consistently emphasized equal treatment of all types of market principals and striven to put the principal of competitive neutrality into practice, to treat all market principals equally. From the perspective of financial market access, our goal is to realize equal treatment of all types of market principals in the state-owned and the private economy. As the opening of the financial services industry progresses, we will also further reduce restrictions on market access and operations of foreign capital, to achieve equal treatment of domestic and foreign capital. From the perspective of the availability of financial services, in the past year, the PBC has introduced a series of policy measures to target the increase in operating difficulties and the exacerbated financing problems some private enterprises encountered, including "three arrows shot together," and including the strengthening of "precision drip irrigation," to enable the allocation of credit between private and state-owned enterprises to become more balanced. From the perspective of financial supervision, our goal is to achieve supervisory neutrality, to maintain equal treatment without regard for a financial institution's ownership structure, institution type, industry, or market, and carry out uniform supervision in accordance with the relevant regulations.

We also recognize that to truly implement the principle of competitive neutrality will not be an easy task, urgently requiring governmental departments to establish and perfect the legal and institutional frameworks and adopt corresponding implementation and supervision mechanisms. In the course of putting competitive neutrality into practice, various countries have come up with many effective approaches. I'm confident that today's conference will aid us in learning widely from the strongpoints of others, actively drawing on the best practices of various other countries and integrating the realities in China, to continually optimize the business environment, promote truly fair competition among enterprises of all ownership structures, stimulate the inherent vitality of all types of market principals to a greater extent, and promote high-quality economic and financial development in China.

Opening Remarks

Changyong Rhee[1]

Ladies and Gentlemen,

Good morning!

It is my great pleasure to welcome you to the Seventh High Level PBC-IMF Joint Conference, which this year focuses on "opening up and competitive neutrality". As Deputy Governor Chen Yulu mentioned in his speech, competitive neutrality is now on top of the authorities' reform agenda and we are glad to bring together Chinese policymakers, international and domestic experts, and academics to discuss this important topic.

After four decades of rapid growth, China is transitioning from high-speed to high-quality growth. This is much needed, especially because the economy has in the past relied too much on credit-driven stimulus. And associated with increasing leverage was a deterioration in the efficiency of credit allocation.

The government has rightly recognized these challenges and launched a multiyear campaign at the end of 2017 to stabilize the debt-to-GDP ratio and implemented measures to reduce financial sector vulnerabilities. This process might warrant constant recalibration of policies and needs the support of structural reforms to ensure resources are channeled to the most productive firms, whether state or private, domestic or foreign owned.

In this context, "competitive neutrality" is a useful framework to guide reforms. As premier Li emphasized in the 2019 Government Work Report," when it comes to access to factors of production, public biddings, and so on,

[1] Changyong Rhee is Director, Asia and Pacific Department, International Monetary Fund.

enterprises under all forms of ownership will be treated on an equal footing." Creating such an environment of "competitive neutrality" has been the focus of several countries and international organizations. As we will hear today first hand, the concept of competitive neutrality was first applied by Australia;the Organization for Economic Cooperation and Development identified eight building blocks that govern such a strategy in 2011. While the terminology might differ across countries, all aim to create a level playing field for all market participants.

China has made progress on SOE reform and opening up. In recent years, the government has reduced overcapacity and the number of zombie firms, and improved SOE governance. The perception of implicit guarantees for SOEs, however, remains widespread, allowing SOEs to finance themselves more cheaply than their private counterparts. Such an advantage is reflected in both the pricing of bank credit and bond issuance. And signs suggest that China's deleveraging campaign has had a much larger impact on private companies. While the government has announced a series of measures to support private lending, they need to go hand-in-hand with structural reforms.

Further opening up can also contribute to competitive neutrality. Ensuring that foreign entities can access the Chinese market on an equal footing will not only improve the allocation of resources but support economic growth. The newly passed foreign investment law is an important step toward further opening up and fair treatment of foreign investors, but detailed supporting legislations and implementation will be crucial.

In today's conference, we will review the international experience and discuss how it could apply to China. The conference will allow us to take stock, discuss the authorities' reform plans, and identify areas for future work.

I wish you a successful conference and fruitful discussions.

Thank you.

SESSION I

THE CONCEPT OF COMPETITIVE NEUTRALITY: THE INTERNATIONAL EXPERIENCE

Competitive Neutrality in Australia

Michael Brennan[1]

It is a great privilege to talk about Australia's experience with competitive neutrality policy. Australia made significant gains in the 1980s by reforming and opening up the tradeable sector: floating the Australian dollar, introducing foreign banking competition, and unilaterally reducing tariff protection.

By the early 1990s, an important policy goal was to inject greater competition into the non-tradeable sector. The policy response was our National Competition Policy, which sought to extend competition as a general principle across the breadth of the economy. In the private sector, this meant a pattern of industry reviews identifying barriers to competition in individual industries.

In the public sector, it involved a suite of reforms to state-owned enterprises (SOEs), including structural reform and corporatization of government-owned business activities; extension of the anti-competitive conduct legislation to include government-owned businesses; a national access regime, to provide third-party access to monopoly infrastructure (much of it publicly owned); and a competitive neutrality framework to govern competition between government businesses and private sector competitors.

Australia is a federation, and many of the SOEs in need of these reforms were owned by state governments. So, the policy had to be enacted through agreement between the national and subnational (i.e., state) governments.

To a large extent, this reflected a shared understanding of the importance of these reforms for national prosperity. Many states saw the case for SOE reform in its own right.

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[1] Michael Brennan is the Chair of the Productivity Commission, Australian Government

But it was also recognized that the economic “dividend” from these reforms would flow mostly to the national government as increased GDP and higher corporate and personal income tax collections.

As such, a key part of the architecture was that the national government would make competition payments—financial incentives —to states which advanced the competition reforms in full, with states’ progress assessed by an independent “umpire” called the National Competition Council.

SOE reform involved defining some commercial activities and structurally separating them from the core operations of government. It often then involved creating a corporate entity with an independent board, giving the entity a commercial objective, subjecting it to general corporate law, and requiring things like publication of a corporate plan and audited annual financial statements

The unifying goal of all these measures was to give SOEs an “arms’ length” relationship to government. This helped create the environment in which the competitive neutrality framework could operate to good effect.

That framework stipulates the usual things: charge prices that fully reflect costs, tax neutrality, debt neutrality, and regulatory neutrality (in part, ensuring SOEs are subject to the same regulation as private competitors and ensuring regulatory separation. In the past, SOEs which literally regulated aspects of the industry in which they operated). It also required that SOEs achieve a commercial rate of return.

Tax neutrality can be achieved by making SOEs formally subject to tax or having them pay tax equivalent payments to the tier of government which owns the SOE (reflecting the taxes that would be payable to a different level of government), or even by imputing these taxes in the prices charged.

Debt neutrality is achieved in two ways. Some SOEs (including many owned by the national government) borrow directly from the market, with their own credit rating. Many of our states use a more centralized approach, where the central borrowing authority issues debt on behalf of the public sector, and then lends to its internal “clients”—including both the general government sector and the SOEs.

The SOEs then pay a charge back to government reflecting the difference between the semi-government rating and what would be their own standalone credit rating given their financial metrics.

Overall, a good competitive neutrality framework involves a combination of ex-ante and ex-post elements. The ex-ante elements are the policies governing the operation of SOEs: how they access finance, the taxes they pay, government requirements of them to deliver commercial returns. The ex-post elements are the sanctions for noncompliance, both the application of the general competition law and the existence of a complaint handling function, from which private entities can seek some redress

Australia's system rests heavily on the ex-ante component. Other jurisdictions have placed more emphasis on competition law to drive competitive neutrality.

The system is also enforced by multiple "umpires":

· the Australian Competition and Consumer Commission enforces general competition law (which applies with equal force to corporatized SOEs).

· the National Competition Council had responsibility for determining states' compliance with the Competition Policy and their eligibility for incentive payments.

· The National Competition Council also regulates applications for third party (i.e., private sector) access to essential infrastructure.

· And the Productivity Commission (my entity) handles complaints about competitive neutrality from private sector entities (and each state has its own competitive neutrality complaints handling body).

In the Australian experience, another set of umpires is often overlooked, but is vitally important in delivering competitive neutrality in practice. These are the various finance ministries (often treasuries in our system) that perform shareholder function over SOEs.

These have been important in constantly reminding SOEs of the need to fulfil their commercial charter—to plan rigorously, drive out costs, and pay a dividend; also to stick to their core business.

Where equity is too weak, and an SOE runs at a persistent loss, it is effectively a disguised subsidy to the SOE's customers—arguably less transparent than if the government paid the subsidy directly through the budget.

A further reflection is that SOE reform need not require privatization. Australian governments (national and state) have indeed sold many former SOEs, particularly once they were fully immersed in competition with private businesses. But from the outset of the National Competition Policy in 1995, it was very clear that there was no requirement on the states or the national government to privatize.

This begs the question: if efficient, focused, competitively neutral, and arms' length SOEs are the ultimate goal, what is the optimal sequence of reforms to get there?

In Australia, a lot happened at once, reflecting the spirit of the times and the national government's preparedness to pay financial incentives. Could a more sequential approach work? Perhaps so; it could be for example that debt neutrality would be a good starting point, from which other changes could flow.

Every circumstance will be different, but some basic principles include:

the need to build broad support across levels of government (if necessary through financial incentives),

the need for a mix of ex-ante and ex-post measures, and

having a strong shareholder focused on commercial return will be a very important complement to the formal rules of competitive neutrality.

Opening Up and Competitive Neutrality：The Case of Sweden

Thomas Östros[1]

Thanks for this opportunity to share my experience in governing state-owned enterprises. I am currently Executive Director at the IMF, representing the eight Nordic-Baltic countries. I have previous experience as Minister in Swedish Governments for 10 years, first as Minister for Fiscal Affairs then as Minister for Education and Science, and finally as Minister for Industry and Trade. In the latter, I was responsible for managing the Swedish State Company portfolio.

The Swedish state company portfolio contains 47 wholly and partially owned companies in the sectors of basic industry/energy, telecom, services, property, finance, consumer goods, infrastructure, and transport. Two of them are listed on the Swedish Stock Exchange. State-owned companies represent strong brands and play an important role. Several started out as public enterprises within government agencies or state monopolies. Today, most of these enterprises operate in fully competitive markets. It is important that they are profitable, efficient, and take a long-term approach. The government has partial ownership of Telia, the leading telecom company in the Nordic Baltic region. That is, of course, a legacy of the previous monopoly that the state had in telecom services, now fully competitive market.

The state has full ownership of Vattenfall, an energy company operating in Sweden, Germany, the Netherlands, Denmark and the United Kingdom. The company LKAB, an international high-tech minerals group and world

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[1] Thomas Östros is Executive Director at the International Monetary Fund and represents the Nordic and Baltic countries in the Executive Board. The presentation is based on the author's own experience and on the Swedish Government's Annual Report for State-Owned Enterprises

leading-producer of processed iron ore products for steel production, is also fully owned by the Swedish state. Sometimes state-owned enterprises can be a legacy of a financial crisis. When I was Minister for Industry and Trade the state was a large owner in one of the largest banks in Northern Europe, Nordea. That was a legacy of the financial crisis in Sweden in the early 1990s, when the state had to take over ownership to save the bank. The Swedish state sold Nordea bank a few years ago.

The most important objective for the ownership of state-owned companies is to promote long-term sustainable value growth. The government has its mandate from the Swedish Parliament to actively manage state-owned enterprises to ensure long-term value performance.

The state's company portfolio is estimated to be worth close to SKr600 billion (about $65 billion. Around 135,000 people are employed in a state-owned company. The government receives about SKr20 billion in dividends per year, almost as much as the annual cost of the universal child benefit program for every child in Sweden.

The Swedish Government's investment strategy principles largely follow the OECD Guidelines on Corporate Governance of State-Owned Enterprises. The international standards are intended to help the state avoid making the mistakes of passive ownership or intervening excessively as an owner. Investments teams analyze the companies' business environment, challenges and risks, and adopt financial targets and dividend policies.

It is fundamental to separate the state's ownership function and the its role as a regulator of the markets. This is made certain in the organization of government, where responsibilities for sector-specific legislation typically are separated from those involved in the management of state-owned enterprises.

Both national and European Union law prohibits the state to subsidize state-owned companies, be it by directed lending with subsidized interest rates or by direct state aid to individual companies. This gives a strong legal basis for competitive neutrality. Anyone can challenge a perceived subsidy by reporting it to the competition authorities on the national or European Union level.

The boards of state-owned companies are responsible for setting the company's overall strategy and for taking important strategic decisions. One of the most important responsibilities for the owner is to nominate highly qualified board members. The board of a state-owned company should possess a high level of expertise relevant for the company's challenges.

Setting the financial targets for the companies is essential. It safeguards the creation of value, which is the core objective. It focuses the Board and Management on working towards long-term, ambitious, and realistic goals. The owners can control the risks by keeping financial risks at a reasonable level. Clarifying the cost of capital is the natural starting point for achieving capital efficiency. And for the owner to ensure dividend yield through sustainable and predictable dividends, of course, is key. And it is the owner's responsibility to measure, track, and evaluate profitability, efficiency, and risk in a structured manner.

It starts with a calculation of the company's cost of capital, which is the expected return an investor can obtain for an alternative investment with the same risk and duration. Then a capital structure target is set to achieve a balance between risk-taking and efficient capitalization in the companies. The aim is to set the optimal balance between equity and borrowed capital to keep the company's cost of capital as low as possible. A profitability target is set where the cost of capital is used as the floor. The dividend policy gives the company guidance on how much of a company's profit should be payed in dividends.

In my view, transparency is extremely important. To be responsible for state-owned companies, as I was as Minister for Industry and Trade, is very interesting, but also tough. Everyone has a view on how state-owned companies perform and behave. Everyone wants profitable companies, but often have reasons for why, in their specific case, the state-owned company should make an exemption for them. It is especially challenging when state-owned companies go through structural changes, with layoffs of workers and closing of factories and plants. This is why it is so important with life-long learning opportunities and strong social safety nets provided by the public sector. To be able to keep the goal of value creation and neutrality, we need guidelines and, not least, transparency. To provide citizens and markets regular reporting is of utmost importance as a foundation for continuous monitoring evaluation of the companies' operations and established goals. In Sweden, the government also reports annually to the parliament, where it provides an account of management of the state-owned companies in the past year and the value of the portfolio.

The Swedish policy for management of state-owned companies has been guided by several international guidelines, including OECD guidelines, the Global Compact, Agenda 2030, and United Nations guiding principles on business and human rights. A sound and healthy work environment, respect for human rights, and decent working conditions are fundamental. The companies should be role models in achieving gender equality. They should reduce climate and environmental impact. They should act in accordance with high business ethics and active prevention of corruption. There should be no abuse of the special status that being a state-owned company may entail.

To reach financial and other targets, active ownership means that the owner must keep abreast of company developments and have regular follow-up meetings with the chairman and the chief executive officer. Financial, public policy, and sustainability targets are monitored. Professional and transparent governance of state-owned companies is essential to reach the goal of competitive neutrality and it can contribute to the overarching goal of sustainable growth and prosperity for a country and its citizens.

The Concept of Competitive Neutrality —the International Experience: An OECD Perspective

Antonio Capobianco[1]

State-owned enterprises (SOEs) are important elements of many national economies. They frequently operate in sectors on which businesses depend for their operations and competitiveness, for example transportation, other public utilities, and finance. SOEs are also increasingly active internationally, which has led to renewed concerns in recent years about whether their operational conditions in home markets might adversely impact "fair" competition with companies abroad. Ensuring that SOEs operate on a level playing field with privately owned enterprises—and demonstrating that they do so—is important for promoting competition, avoiding protectionism, and maintaining an open international trade and investment climate.

The largest SOE portfolios in absolute terms are in emerging market and post-transition economies

According to the OECD's The Size and Sectoral Distribution of State-Owned Enterprises (2017), the central governments of countries in the sample area are the full or majority owners of 2,467 commercially-oriented enterprises, together valued at over $2.4 trillion and employing over 9.2 million people. For aggregate analysis, the sample area excludes China, since its SOE portfolio is significantly larger than that of all other contributing countries combined. In comparison to the sample area, China has a far bigger SOE portfolio in

[1] Antonio Capobianco is a Senior Competition Expert with the OECD Competition Division and is currently the Acting Head of the division.

absolute terms: the central government is a full or majority owner of over 51,000 enterprises, together valued at $29.2 trillion and employing approximately 20.2 million people. This is followed by Hungary (370 SOEs), India (270 SOEs), Brazil (134), the Czech Republic (133), Lithuania (128), Poland (126) and the Slovak Republic (113).

SOEs are highly concentrated

SOEs in the sample area are highly concentrated in the network industries and the financial sector. Together, the electricity and gas, transportation, telecoms, and other utilities sectors account for 51 percent of all SOEs by value and 70 percent by employment. The financial sector accounts for 26 percent of all SOEs by value, making it the largest individual sector by this measure. The sectoral distribution of the Chinese SOE portfolio differs somewhat to that of the sample area with the financial sector accounting for over half of all Chinese SOEs by value and 11 percent by employment. The manufacturing, electricity and gas, transportation and primary sectors each account for over 5 percent of all Chinese SOEs by both value and employment, with the primary and manufacturing sectors accounting for the largest proportion of SOE employees (29 percent and 18 percent , respectively).

Fully incorporated entities are the predominant corporate form

In the sample area, fully incorporated entities (that is, those incorporated according to company law) are the predominant corporate form, representing 92 percent of all SOEs by value and 84 percent by employment. Among those fully incorporated entities, about half by value are listed on national stock exchanges. Statutory corporations (that is, those incorporated according to enterprise-specific legislation) are a much less common corporate form, accounting for only 8 percent of all SOEs by value and 16 percent by employment. These findings appear to differ significantly from those of the previous edition of the data collection exercise, which found that statutory SOEs accounted for 21 percent of all SOEs by value and 42 percent by employment. However, this most likely does not indicate a significant corporatization initiative, but rather the fact that many countries have excluded statutory enterprises that perform a primarily public policy or administration function and that are not engaged in economic activities in the marketplace from the current data collection exercise.

Listing on stock exchanges could indicate a changing landscape of state involvement in the corporate economy

In addition to their portfolios of full- and majority-owned enterprises— considered SOEs for this exercise— a number of governments in the sample area also maintain significant minority shareholdings in listed companies. While not considered SOEs per se, these minority-owned entities can nonetheless provide useful insights into the changing landscape of state involvement in the corporate economy. The countries in the sample area (excluding China) have minority shareholdings in 134 listed companies valued at $912.3 billion and employing 2.8 million people. Among all listed entities with a degree of state ownership exceeding 10 percent, state majority shareholdings are relatively more prevalent in the electricity and gas, primary, financial, and other utilities sectors. State minority shareholdings are relatively more prevalent in the telecoms, manufacturing, real-estate, and transportation sectors, possibly reflecting efforts to relinquish or significantly reduce state control in these sectors.

Competitive Neutrality can help level the playing field between SOEs and privately owned enterprises

Competitive neutrality is quickly becoming a top priority for economic policymakers across the world because the relative importance of state ownership has changed in recent decades. Two areas of reform in particular can help strengthen competitive neutrality and make sure enterprises maximize their contribution to domestic growth: competition policy and governance of state-owned enterprises. Governance frameworks for SOEs ideally should empower the state to use its responsibility as an enterprise owner to make those enterprises more competitive, efficient, and transparent.

OECD countries have a wealth of experience to offer in this area—and we know from that experience what are the key principles for a sound competitive neutrality policy:separating ownership from regulation, to ensure there are no conflicts of interests between the state's role as owner, shareholder, and policy maker;

ensuring SOEs operate in the same legal and regulatory environment as private competitors;

· ensuring high standards of transparency and disclosure where SOEs combine economic activities with public policy objectives;

· making sure SOEs face debt and equity finance conditions consistent with the rest of the market; and

· ensuring transparent and non-discriminatory public procurement processes.

According to OECD research (Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business, OECD 2012) sound competitive neutrality frameworks should be based on the following building blocks:

1.Streamlining government business—either in terms of its structure or corporate form—can have an impact on the playing field.

2.Identifying the costs of any given function and developing appropriate cost allocation mechanisms promote transparency and disclosure.

3.Government business activities operating in a commercial and competitive environment should earn rates of return like comparable businesses.

4.Where the performance of public policy functions is required by government businesses, adequate, transparent, and accountable compensation should be provided.

5.To ensure competitive neutrality, government businesses should operate, to the largest extent feasible, in the same tax and regulatory environment as private enterprises.

6.Debt neutrality remains an important area to tackle if the playing field is to be levelled.

7.To support competitive neutrality, procurement policies and procedures should be competitive, non-discriminatory, and safeguarded by appropriate standards of transparency.

SESSION II

COMPETITIVE NEUTRALITY: STOCKTAKING

Competitive Neutrality: A Summary of Current Conditions

MO Wangui[1]

The Communist Party of China (CPC) Central Committee and the Chinese government have made continuous efforts to create a policy environment characterized by competitive neutrality. They put great emphasis on creating conditions for entities of various types to participate in market competition on an equal footing. The "Decision on Some Issues Concerning the Establishment of the Socialist Market Economy" of 1993 stipulates that the state should create conditions for economic entities under all forms of ownership to participate in market competition on an equal footing, and to treat enterprises of various types in the same way. The 15th CPC National Congress report in 1997 states to continuously encourage and guide individual economy, private economy, and other forms of non-public economy. In 2003, the Third Plenum of the 16th CPC Central Committee states to vigorously develop the non-public economy, and encourage non-public sector of the economy to expand and grow stronger.

In recent years, President Xi Jinping (also general secretary of the Communist Party of China Central Committee), Premier Li Keqiang, Vice Premier Liu He, and the PBC Governor Yi Gang had emphasized on multiple occasions that enterprises under all forms of ownership should be treated equally in accordance with the principle of competitive neutrality. Since the outset of reform and opening-up, the Chinese government has implemented a series of policies and measures to promote open, fair and just competition, and made great achievements. This can be seen from two sets of statistics. The first one shows that the share of state-owned enterprises in the Chinese economy has

[1] MO Wangui is Deputy Director General, Research Institute, the People's Bank of China.

declined. From 2000 to 2017, shares of state holding industrial enterprises in corporate assets, operating revenue, and total profit declined by 37, 27, and 32 percentage points, respectively. Currently, private enterprises contribute more than 60% of GDP. The second one shows that the tax treatment of foreign-funded enterprises and private enterprises is more preferential than that for state-owned enterprises. Foreign-funded enterprises have enjoyed, over a considerable period of time, since the reform and opening-up, preferential treatment in taxes and other areas. From 2008 to 2017, the operating revenue of state-owned enterprises declined by approximately 6 percentage points, but their share of tax revenue declined only about 2 percentage points, meaning that the relative tax burden for state-owned enterprises is higher.

Further efforts could be made in four aspects to improve the policy environment of competitive neutrality.

First, the shedding of non-commercial businesses from state-owned enterprises has not been sufficient. Some state-owned enterprises have taken on non-commercial businesses, and the losses incurred have markedly weakened their efficiency. The stripping of this non-commercial burden would be an important future direction for allowing state-owned enterprises to participate in market competition fairly.

Second, liberalization in the service sector is inadequate. The OECD services trade restrictiveness index, published in December 2017, showed that China has higher indices in 19 services sector areas than the average indices of 44 countries, including financial services, information technology services, and cultural and entertainment sectors.

Third, some policies and measures designed to support the development of the private economy have not been fully implemented. The government has rolled out many policies and measures, but deviations exist during the implementation process of certain policies. Large gaps still exist in terms of equal protection of property rights, equal participation in market competition, and equal access to factors of production.

Fourth, there is room for improvement in financial services. The loans private enterprises receive from banks are still not comparable with their contribution to the economy. private enterprises have less accessibility to financial resources than state-owned enterprises. An important cause is that the vast majority of private enterprises are small or micro-enterprises, which have problems including a short life cycle, incomplete disclosure of information, flawed corporate governance, as well as higher risk. Since last year, the People's Bank of China, as the leading agency, has introduced a series of policy measures to address this issue, and have improved the credit allocation between private and state-owned enterprises, further improvement could be expected in the future.

(The above represents the author's viewpoint and does not represent the position of the agency he works for.)

Using Fair Competition Reviews to Actively Promote Establishment of the Competitive Neutrality Principle

YANG Hongfeng[1]

Distinguished guest, ladies, and gentlemen:

I am pleased to be participating in this conference to jointly explore the issue of competitive neutrality with all of you. For some time recently, competitive neutrality has become a hot topic in various discussions about reform and development of the Chinese economy. I will integrate my work experience to focus on three points of understanding.

I. The competitive neutrality principle is a real requirement for the Chinese economy to develop to a specific stage

The Chinese economy has now entered the stage of high-quality development, and the competitive neutrality principle needs to be established, whether to deepen internal reforms or to increase the level of openness to the outside. From the perspective of deepening internal reforms, in recent years, China's market environment has generally improved, but the problem of unfair competition remains in some industries and regions, and some market principals routinely receive unfair treatment with respect to market access, operations, and exit mechanisms, characteristics that are unfavorable to sustainable and healthy economic development.

Last year, the Central Economic Work Conference put forward the need to "look to reform for development." To deepen market reform and focus on resolving

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prominent problems that constrain the operation of market mechanisms, it is imperative that competitive neutrality be made the focus of key breakthroughs. In accordance with the principle of competitive neutrality, deepening the reform of systems and mechanisms in such areas as market access, factor acquisition, business operations, and procurement, and building the stage for fair competition for enterprises of all ownership types, will further release the dividends of reform, stimulate market vitality, and inject important new energy into high-quality development.

From the perspective of increasing the level of openness to the outside, promoting the transformation from opening based on the free flow of goods and factors to opening based on rules and systems is the new trend and new characteristic of the new era of opening to the outside. With the deepening of economic globalization, competition among nations will no longer be limited to competition for products and services, but will increasingly include competition for market rules. Countries with fairer, more transparent, and more predictable market rules will take the lead in international competition. To promote comprehensive, high-level openness to the outside, it is necessary to establish the principle of competitive neutrality, proactively come into line with international rules, reform and perfect the relevant legal frameworks, enhance and stabilize enterprise confidence and expectations, reduce institutional inconsistencies, and appropriately respond to trade friction, to create a good external environment for high-quality development.

II. Establishing the principle of competitive neutrality will require bringing things into line with international practice while maintaining a footing in domestic conditions; we must also avoid "absolutism"

Bringing things into line with international practice means proactively aligning our rules with the internationally-accepted rules of competition. After decades of development, a relatively complete system of rules has taken shape for competitive neutrality. In particular, the OECD has published a series of reports in recent years that have clarified standards in eight areas, providing an important guide and reference for countries to implement competitive neutrality. Despite differences in the focal points and demands of various countries, the basic concepts and principles are the same. China should proactively bring its rules into line with the rule standards that have been widely accepted internationally, and implement competitive neutrality at a high level.

Maintaining a footing in domestic conditions means that we must earnestly analyze prominent problems in the current development of the economy that violate the principle of competitive neutrality, and institute targeted reforms for some of them. For example, regarding market access, we must comprehensively implement negative list management to realize "admitting all but those who are prohibited." In market supervision, we must perfect impartial supervision systems to ensure supervision neutrality. In protections for property rights, we must clean up regulations that are unfavorable to the protection of property rights, to achieve equal protection under the law. In natural monopolies, we must implement the separation of operations from sales networks, and comprehensively push competitive businesses toward the market. In state-owned enterprises, they should be pushed toward mixed ownership by allowing entry by a greater number of non-public sector entities. And in taxation and finance, we must implement inclusive tax, credit, and subsidy policies, to resolve the problems of the limited availability and high expense of financing for private enterprises and medium, small, and micro enterprises.

Avoiding "absolutism" means acknowledging that competitive neutrality is not utterly and absolutely "neutral." Even Australia, which was the first country to propose competitive neutrality, did not push all public products and services into the market; rather, they permitted these goods and services to be provided in a non-market manner, and provided public enterprises with reasonable non-commercial subsidies, while also allowing public enterprises to use their own advantages and inherent strengths to achieve success in market competition. China must also guard against "absolutism" and the "cookie-cutter" approach in its implementation of competitive neutrality. On one hand, in fields where the market fails or it is difficult to develop the role of market mechanisms, appropriate government intervention will still be required, the boundaries between government and the market must be scientifically defined, and we must clarify fields and scope of exceptions to the application of competitive neutrality. On the other, we must truly achieve neutrality and encourage all types of enterprises to participate fairly in market competition. There can be neither discrimination against private or foreign enterprises, nor discrimination against state-owned enterprises. In international trade and international negotiations, we must resolutely oppose discriminatory regulations and practices that target state-owned enterprises, to prevent the generation of a new unfairness problem.

III. Using fair competition reviews to promote the establishment of the principle of competitive neutrality

In June 2016, the State Council printed and distributed the Opinion Concerning the Establishment of a Fair Competition Review System in the Development of Market Systems, which made comprehensive arrangements for the establishment and implementation of fair competition reviews. This was a key step in China's establishment and reinforcement of the fundamental role of competition policy, and has important significance for perfecting the socialist market system and promoting high-quality economic development.

The fair competition review system requires the government sector to perform reviews in strict accordance with standards before the fact when introducing policy measures that involve market economic activities, to prevent exclusion or restriction of competition. The review standards consist of eighteen items in the four areas of market entry and exit, the free flow of goods and factors, impact on production and business costs, and impact on production and business conduct, and, in a manner of speaking, these standards lay out a "negative list" for government conduct. Many of the review standards directly reflect competitive neutrality requirements. For example, "the setting of unequal market access and exit conditions for operators of different ownership types is not permitted," "implementation of discriminatory pricing and subsidy policies for imported goods and services is not permitted," and "restricting the entry of imported goods and services into the local market is not permitted." From this perspective, fair competition reviews are an important starting point and effective means for the implementation of the principle of competitive neutrality.

This year's Report on the Work of the Government refers to "reforming and perfecting the fair competition review system, and accelerating the cleanup of various regulations and practices that impede unified markets and fair competition." In the next stage, the State Administration for Market Regulation will collaborate with the relevant departments to earnestly implement the arrangements of the Party Central Committee and the State Council, and will successfully carry out fair competition review work and promote the establishment of the principle of competitive neutrality from three angles.

First, in accordance with competitive neutrality requirements, we will arrange for the cleanup of provisions of existing policy measures that impede the development of private enterprises or violate the principle of consistency for domestic and foreign capital, to conscientiously create an institutional environment of fair competition.

Second, centered on key areas of concern to market principals, including market access, government procurement, and public bid invitations and tenders, we will strictly review incremental government documents to prevent violations of the principle of competitive neutrality.

Third, we will further reform and perfect the fair competition review system. In accordance with competitive neutrality requirements, we will draw on advanced foreign experience, bring rules into line with internationally accepted rules, and perfect the scope, standards and operating procedures for the reviews, in order to more effectively protect fair competition and optimize the business environment.

Thank you!

Competitive Neutrality and Neutral State-Owned Enterprises: Theory and Evidence

NIE Huihua[1]

Presenter: NIE Huihua (Deputy Dean of the National Academy of Development and Strategy and Professor at the School of Economics, Renmin University of China)

Today's presentation, Competitive Neutrality and Neutral SOEs: Theory and Evidence, can be addressed in three areas: starting with the rationale for state-owned enterprises (SOEs) in China, and moving on to whether the discriminatory practices observed are based on type of ownership or size, before concluding with a discussion of the feasibility of having so-called "Neutral SOEs."

Competitive neutrality and the role of SOEs

Competitive neutrality refers to the principle by which a government treats all companies equally, enabling SOEs and private enterprises (foreign enterprises included) to compete on a level playing field. According to a widely accepted definition by OECD, competitive neutrality "implies that no business entity is advantaged (or disadvantaged) solely because of its ownership."

The key issue in competitive neutrality is achieving the ideal mix of SOEs and private enterprises in the market. Ideally, a market would be close to achieving competitive neutrality if most or all SOEs were eliminated. For China, the most hotly debated issues are whether SOEs are necessary in the

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first place and, subsequently, whether they compete on equal footing with private enterprises. Hence, the rationale for SOEs is an important question to address, theoretically and practically.

Competitive neutrality presupposes two preconditions: first, there is a market in place, in which different types of players—all well-established and functioning—engage in transactions based on market rules. Second, the market functions properly; in other words, there are no market failures. As these conditions are not always met in the Chinese context, there is a case for SOEs.

I believe there are three parts to the raison d'être of SOEs in China.

First, SOEs set the stage for the creation of markets. There can be no market economy without the infrastructure (the physical conditions) or the market entities (persons, natural, and legal). The term infrastructure here includes services such as ground leveling, water and electricity access, roads and bridges, telecommunications, and financial services. The government is the main provider of infrastructure, channeling capital through investment and financing platforms as well as SOEs. This is because governments are in control of key resources and can use centralization to their advantage in enabling large-scale undertakings.

SOEs also play a role in shaping market entities. Specifically, the government starts by creating the market through setting up an SOE that runs like a monopoly. The government then breaks up the monopoly SOE into several entities that compete against each other or allows private and foreign enterprises to compete against the SOE, thus triggering a process that eventually gives rise to a competitive market. For example, the evolution of the telecommunications industry in China is the result of this type of policy approach.

Other typical examples in this regard include the Shokusan Kogyo strategy (boosting production and promoting industry development) during the Meiji Restoration in Japan (circa 1870), steel and shipbuilding industries in Korea, as well as textile and plastic industries in Taiwan.

Second, SOEs also ensure the proper functioning of the market. Market failures occur when one encounters imperfect competition, information asymmetry, externalities, or issues pertaining to public goods. These failures can be corrected to a certain extent through government interventions to limit the impact on resource allocation. In situations where one finds imperfect competition, externalities, or public goods issues, SOEs can serve as vehicles of government interventions to address market failures and promote competitive neutrality.

Third, SOEs can help China catch up with more developed economies. As competition in a globalized world takes place between countries, a company run like a monopoly within its national borders can nevertheless be a competitive player in the world market. As the level of globalization differs across countries, developing economies are at a disadvantage. Given this asymmetry in global competition, it is natural that development-oriented governments provide support to their companies (SOEs) to catch up with more developed economies and to play a leading role in certain industries. As long as we acknowledge that competition between countries is ultimately about national interests (one example of this is “America First”), there can be no perfect competitive neutrality among companies in the global marketplace, since more authoritarian countries have a strong incentive to use national power to buttress “sovereign enterprises” for them to compete on the world stage.

Subsidies for SOEs and Private Enterprises

Despite the minority view among some foreign journalists that only publicly listed SOEs are subsidized, publicly listed companies in China—SOEs and their private counterparts alike—are both recipients of considerable amounts of subsidies. The amounts received and the shares of companies (both issuers of A-shares) receiving subsidies from 2007 to 2017 are documented in Table 1.

Table 1. Subsidies Received by SOEs and Private Enterprises

Year	Total Amount (RMB billion)		Share of Companies Subsidized	
	SOE	Private	SOE	Private
2007	19.883	4.3651	0.781	0.839
2008	88.5	6.7496	0.866	0.892
2009	24.514	6.4389	0.926	0.925
2010	32.922	14.016	0.924	0.951
2011	46.026	18.536	0.943	0.965
2012	60.713	19.246	0.963	0.967

2013	61.271	20.728	0.964	0.973
2014	75.789	23.31	0.975	0.977
2015	93.422	29.323	0.975	0.986
2016	93.905	36.156	0.976	0.98
2017	76.059	50.047	0.861	0.92

Source:

The similar proportions of subsidized companies indicate that nearly all publicly listed companies in China, SOEs, and private enterprises alike, are recipients of government support. Further econometric analysis revealed that the larger a company, the more likely it is to receive subsidies. In light of these data, what is commonly considered discrimination based on ownership is, to a large extent, discrimination based on size, with the latter being essentially motivated by the pursuit of lower prices and hence inevitable in any market economy.

Looking Ahead: Feasibility of Neutral SOEs

An instrument of national governance, SOEs are more commonly used by development-oriented governments due to limited resources and ease of use. However, this does not preclude private enterprises from playing a role in governance strategies.

As governments strive for competitive neutrality, SOEs can and should become neutral enterprises in the sense that SOEs exist to enable the market, ensure its proper functioning, and help the country catch up with competition, instead of competing for limited resources against their private counterparts. Several preconditions must be met before there can be neutral SOEs: the relevant laws and regulations should not favor SOEs, SOEs should be run in a way that maximizes social utility, and interactions between SOEs and the government should be closely monitored.

Applying Competitive Neutrality in Corporate Financing in China

Sarwat Jahan and Kenneth Kang[1]

In China, implementing principles of debt and regulatory neutrality can eliminate market distortions and promote a more efficient allocation of credit. For state-owned-enterprises (SOEs), these high-quality reforms include removing implicit guarantees, increasing banks' risk weights on corporate loans with implicit guarantees, rationalizing subsidies, hardening SOEs' budget constraints, and accepting defaults of SOEs. Proactive, market-friendly measures can also be taken to level the playing field in support of small and medium-sized enterprises. These reforms can be carried out sequentially to allow smooth transition to more market-oriented resource allocation.

The Status of Competitive Neutrality in Financing

1.State-owned-enterprises (SOEs) tend to benefit from lower cost of capital due to higher credit ratings based on implicit guarantees. The credit ratings of SOEs in China often overstate firms' underlying financial health because of the perceived implicit guarantees. Comparing the two credit ratings of each corporate (with and without factoring in implicit guarantees), SOEs are estimated to have credit ratings about two to three notches higher than comparable privately-owned enterprises. As a result, SOEs benefit from interest rates that are estimated to be 150–200 basis points lower than those paid by their private sector peers for bonds with similar maturities (GavekalDragonomics 2018). Even after controlling for additional factors (such as the type of credit bond, industry, and trading year), SOEs typically pay over 100 basis points

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less in borrowing costs than private firms with the same financial conditions such as leverage, profitability, and size (Zhang and Wu 2019).

2.SOEs continue to receive a large share of credit allocation due to their prevalent and persistent implicit guarantees. SOEs enjoy implicit support on several factor inputs such as land, credit, and natural resources. Overall the implicit support to SOEs in recent years has declined to below 3 percent of GDP, but a considerable part of the implicit support is related to credit allocation. Banks are more inclined to lend to SOEs, as they are perceived to be less risky and shielded from defaults. Implicit guarantees also boost the profitability of SOEs; adjusting for the estimated implicit support, SOE return on equity fell from an average of 8 percent to about −1.3 percent during 2011–15 (Lam and Schipke 2017).

3.Financial regulatory tightening, while needed to support China's de-risking, has had the unintended consequence of constraining credit to private corporates. Small and micro enterprises (SMEs) were hit particularly hard from the contraction in shadow banking, an important source of financing for the private sector. The intended outcome of channeling credit to private corporates through the banking sector did not happen, as banks opted to continue lending to less risky SOEs. As a result, financing conditions tightened for privately-owned enterprises, and their default numbers increased.

Applying the Principles of Competitive Neutrality to Corporate Financing

4.To boost the prospects for the private sector, the authorities have adopted competitive neutrality as a mandate. In the 2019 Plan for National Economic and Social Development, the authorities committed to "follow the principle of competitive neutrality—enterprises under all forms of ownership will be treated in equal footing". For this year, they also announced several specific measures for credit allocation towards the private sector.

5.The first step in establishing competitive neutrality would be to separate SOEs that should compete with privately-owned enterprises. The authorities launched an initiative to divide non-financial SOEs into three categories—social, strategic, and competitive firms. Although classification was completed in 2017, no information has been released. The first step to level the playing field is to release a publicly available list of the SOEs with their category. This classification will ensure that identified SOEs will not be exempt from the rules that apply to privately-owned enterprises.

6.Dismantling implicit guarantees would require careful sequencing of reforms. Implicit guarantees have biased credit to SOEs by lowering the cost of capital and shielding SOEs from defaults, which contradicts the principle of debt neutrality (OECD 2012a,b). Unwinding these guarantees, however, should only occur after appropriate conditions are in place including: accepting more defaults through hardening SOEs budget constraints, rationalizing subsidies, and implementing a comprehensive system-wide plan with legal and institutional insolvency frameworks for exiting zombie firms and restructuring viable firms. Equally important would be to internalize that nonviable firms should not be in operation only to reach employment and growth targets.

7.Removing implicit guarantees to SOEs would have spillovers on the fiscal sector. The exit of local SOE "zombies" will have fiscal implications for local governments that rely on local SOEs for economic and social spending, raising the need to address the gap between local government revenue and expenditures. Comprehensive reforms of the social safety net will help soften the impact of exiting zombies on local employment. Reforming the "hukou" for greater labor mobility can also help. Opening more sectors to privately-owned enterprises can also support employment.

8.The removal of implicit guarantees can also adversely affect the financial sector in the near term. Any change to the perception on guarantees could lead to a sudden repricing of risk and disruptive withdrawals—such as by retail investors from investment products exposed to SOEs. Even a gradual reevaluation of expected returns, including the possibility of retail investors taking principal losses, may create uncertainty and trigger capital flight. To address these risks, the financial sector will need to be reinforced to remain resilient (IMF 2017). To prepare banks for the removal of implicit guarantees, risk weights could be increased on loans to corporates that currently receive implicit guarantees, to mitigate the underpriced risk to the banks. Additional options include building liquidity buffers, strengthening oversight, and reducing reliance on short-term funding.

High-quality Reforms Targeted to SOEs

9. **Hardening budget constraints through enforcing the dividend payout policy can also improve allocation of resources.** The authorities have directed central SOEs to increase their dividend transfer to the fiscal budget to 30 percent of profits by 2020. But at about 7 percent, more effort is needed to harden the budget constraints. These funds should also be channeled to the general budget, rather than transferred to weaker SOEs, to enhance corporate discipline.

10. **A rationalization of subsidies is also necessary to ensure efficient allocation of resources.** The authorities have been successful in gradually reducing subsidies since 2015 for both SOEs and privately-owned enterprises. However, more needs to be done as SOEs receive relatively more subsidies than POEs who are typically smaller is size which can lead to market distortions. Moreover, even with subsidies, a quarter of SOEs in 2015 remained loss making, possibly because they received subsidies to continue their support of government policies (Lardy, 2019).

11.**To strengthen market discipline, defaults, if they occur, should be tolerated.** Despite the recent increase in the number of SOE defaults in the last quarter of 2018, the total default rate compared to privately-owned enterprises remains small. Only through market-based defaults and resolution would investors start to properly price credit risks without the influence of implicit guarantees, and the government would be able to establish a reputation for allowing market forces to work.

Strengthening Legal and Institutional Reforms

12.**The Enterprise Bankruptcy Law (2007) generally follows best international practices but is not very concise with many gaps,** leaving it subject to uneven interpretation and implementation. As a result, the law does not provide adequate guidelines for many complex problems in insolvency, a growing problem given China's deadline to resolve zombies by 2020. The authorities' initiative to form a committee in June 2019 to draft the amendments to the existing law is a welcome step. The amendments to law should focus on providing greater clarity and details on:

- the scope of the law's application,
- the conditions for bankruptcy, and
- bankruptcy procedures.

Along with reforming the law, enhancing the capacity of the judiciary to handle insolvency cases is needed. An effective application of the amended law will also help prevent unwarranted interventions in bankruptcy proceedings that could prevent the start of eligible cases.

13. "TEMASEK-style" reforms can be an alternative approach to enhance the performance of SOEs. Restructurings of firms have not been entirely market-based in China, with restructurings done through mixed ownership between public and private or mergers with stronger SOEs. Alternate methods could be a Singapore style "Temasek" where a governing body holds shares in state firms, giving the body autonomy while requiring they operate as efficiently as the private sector.

A Multi-Pronged Approach to Support the Private Sector

14.A level playing field can be created by reducing the barriers to entry and ensuring that all corporates have the right to operate in every sector of the economy. The authorities recently announced opening up of the financial sector, elderly care, education, and health care to the private sector. This is a welcome step and could be extended to other state-dominated service sectors such as logistics and telecommunications. Breaking up administrative monopolies can also enhance private sector entry. The Company Law can ensure that no government entity may use industrial policies or regulations to restrict access by privately-owned enterprises.

15.Uniform application of laws can also help establish regulatory neutrality. For example, the Commercial Bank Law does not differentiate corporates based on ownership. Although the same law applies, bank officers are often more reluctant to lend to private enterprises because of the higher probability of defaults, as opposed to SOEs which are perceived to be less risky. To address this bias, the Commercial Bank Law can protect bank staff who have exercised proper due diligence when extending a loan, by dropping the "lifelong accountability" to bank staff for a loan default by a private enterprise if proper due diligence has been followed.

16.Channeling credit in a market-oriented manner can eliminate the need for targeted lending. The authorities have announced several quantitative targets to allocate greater credit towards the private sector at lower cost. Instead, a more efficient allocation of resources can be achieved by removing bottlenecks and distortions. For SMEs, market-oriented policies include:

· fostering the use of movable collateral (such as inventory and accounts receivables), which may require amending or formulating a new law on security interest;

· expanding risk-based lending to SMEs based on potential profitability;

· improving credit reporting mechanisms such as credit bureaus and public credit registries—for example, a specialized credit bureau that could run credit ratings for "small enterprises."

· Using state-owned/development banks to expand credit to SMEs—successful cases involve clear mandates, sound governance, clear performance criteria, risk-based loan pricing, and so on; and

· developing specific capital markets targeted at SMEs.

The Way Forward

17.Concerted efforts to promote debt and regulatory neutrality to create a level playing field will improve the allocation of corporate credit. Implementation of the high-quality reforms will need to be sequenced appropriately. Equally important will be to ensure that policies are market-oriented so that they are durable and not circumvented, leading to a more efficient allocation of resources. Policies here would include removing implicit guarantees given to SOEs, increasing banks' risk weights on corporate loans with implicit guarantees, rationalizing subsidies, hardening SOE budget constraints, and accepting SOE defaults. Improving allocation of credit can also be achieved by enhancing support to privately-owned enterprises and SMEs under expanded coverage of competitive neutrality, such as by removing barriers to entry, considering alternative forms of collateral, and applying laws uniformly.

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LUNCH KEYNOTE

The Economics of China's New Era[1]

Justin Yifu LIN[2]

With the age of Western global dominance coming to an end, it is China's time to shine. The potential is certainly there, but to realize it, President Xi Jinping will have to confront serious challenges, from domestic supply-side reforms to expanding international responsibilities.

In his opening speech at October's 19th National Congress of the Communist Party of China (CPC), President Xi Jinping argued that China had "crossed the threshold into a new era." He then pledged to build a "great modern socialist country" that is prosperous, strong, democratic, culturally advanced, harmonious, and beautiful by mid-century, led by an empowered CPC, but open to the world.

These are bold aspirations, though if anyone is in a position to deliver them, it is Xi, now widely regarded as the most powerful Chinese leader since Mao Zedong. But the specifics of Xi's plan remain unclear. What will it take for China to modernize effectively in this new era?

Out with the Old?

The era may be new, but one of the trends that will define it is already well under way: China's dual-track transition from a planned to a market economy. Continued progress on this front is vital to boost stability, capitalize on comparative advantages, and spur rapid socioeconomic development, paving

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1 https://www.project-syndicate.org/onpoint/the-economics-of-china-s-new-era-by-justin-yifu-lin-2017-12?utm_source=Project%20Syndicate%20 Newsletter&utm_campaign=4528768fd1-op_newsletter_2017_12_1&utm_medium=email&utm_term=0_73bad5b7d8-4528768fd1-93569489

2 Justin Yifu Lin, Dean, Institute of New Structural Economics, Peking University

the way for deep institutional reform.

Since the transition began in 1978, China has taken important steps, including to liberalize employment-generating industries like manufacturing and to implement rural reforms. Yet, given that the country's leaders have always placed a high priority on stability, they have taken an incremental approach while maintaining many of the interventionist policies typical of a planned economy, including protecting and subsidizing large state-owned enterprises (SOEs).

In the early years of the transition, the capital-intensive SOEs that China's government was propping up defied the country's comparative advantages and would not have been able to survive in a competitive open market. Thanks to China's rapid growth and accumulation of capital, however, many of those SOEs have now become viable.

The time has come to eliminate distorting subsidies and protections. Only with such a change, alongside deep and ongoing institutional reforms, can Xi reach his stated goal of allowing markets to play a "decisive role" in resource allocation—critical to the modern economy he aims to build.

The Never-Ending Growth Story

In many ways, China is already on a strong footing. Over the last 38 years, the country's GDP has grown at a rate of 9.6%—an unprecedented feat. And the economy still has considerable growth potential.

As it stands, there is a wide gap between per capita income in China, an upper-middle-income country, and in the developed economies. This gap represents the difference in labor productivity, and thus points to opportunities for growth-enhancing technological innovation and industrial upgrading.

Already, China is at the global frontier in some industries, such as high-speed rail, renewable energy, and household appliances. Securing a leading position in other advanced industries—such as e-commerce and mobile devices, which have short product cycles and require substantial human capital—will be vital to enable the country to continue to thrive. Fortunately, the country faces no shortage of local talent, and it boasts a massive domestic market for new products.

So far, China has not managed to capitalize fully on these assets and continues to lag far behind the West in terms of the quality—and, thus, the price—of the products it manufactures. Yet, if the country can close this gap, it has the potential to achieve 8% annual economic growth.

Other economies have shown that it can be done. China's per capita GDP (in purchasing power parity, or PPP, terms) in 2008 was 21% that of the United States— the same ratio registered by Japan in 1951, Singapore in 1967, Taiwan in 1975, and Korea in 1977. All those economies maintained an 8%–9% growth for another 20 years after that point, and they didn't even have the option, as China does, to take advantage of human-capital-intensive industries with short production cycles.

Some have argued that the blind pursuit of GDP growth is a risky game, claiming that the challenges China now faces are the result of its prolonged and rapid economic expansion. Yet India has been growing more slowly than China for decades, and faces more severe pollution, income inequality, and corruption. In short, as long as potential allows, it makes little sense for developing countries not to pursue a high growth rate.

The Reform Tightrope

Of course, this does not mean that China should be reckless. Turning potential into reality requires the right conditions on both the supply and demand sides. If China is to fulfill its potential sustainably, supply-side innovation policies should be complemented by demand-side efforts.

Growth can be supported on the demand side through exports, investment, and consumption. At a time of plummeting annual export growth—from 16.5%, on average, from 1978 to 2014 to below zero in 2015-2016—many are pointing to consumption as the next key driver of Chinese growth, arguing that it is more sustainable than investment.

But higher consumption hinges on higher incomes, which depend on higher labor productivity. And higher labor productivity demands constant technical innovation and industrial upgrading. Without investment, there can be no innovation or upgrading, much less income or consumption growth.

Given this, the country should be focusing not on replacing investment with consumption, but on improving the efficiency of investment, so that it supports the productivity growth, job creation, and wage gains needed to sustain domestic consumption. This will require, among other things, that China address supply-side imbalances, including excessive leverage and overcapacity.

At the same time, China's leaders must pay close attention to the needs and expectations of the emerging middle class. Xi has made it clear that his vision is to be carried out by a powerful CPC, which should "resolutely oppose all statements and actions that undermine, distort, or negate" its leadership or the Chinese socialist system. If the CPC is to maintain the popular legitimacy needed to underpin its authority, reform efforts must be people-oriented, focused on meeting the public's rising expectations regarding living standards, environmental quality, transparency, governance, and freedom of speech.

Clouds Beyond the Borders

Of course, China is not reforming its economy in a vacuum. And there is no shortage of challenges confronting the global economy. Twenty-six years after its economic bubble burst, Japan is still struggling to secure strong growth or escape deflation fully. The European Union seems finally to be emerging from its own slump, which began with the 2008 economic crisis, but the recovery remains fragile, with GDP growing at about 1%, on average, and unemployment still high. While the United States is doing somewhat better, its GDP is growing at just 2% per year, and neither the International Monetary Fund nor the World Bank expects it to reach 3% before 2020.

A key reason for this state of affairs is that developed countries have consistently failed to pursue difficult but necessary structural reforms. Politicians know that structural reforms are necessary to enhance long-term competitiveness; but they fear the political repercussions of the short-term impact on investment, employment, and consumption. In times of slow growth and mounting unemployment, however, such reforms only become more difficult.

In Japan, Prime Minister Shinzo Abe established structural reforms as the third "arrow" of Abenomics (the first two being fiscal stimulus and monetary easing). Yet, after five years, the third arrow remains in the quiver, and annual GDP growth stands at just 1%. I fear that long-term sluggishness like what Japan is experiencing might afflict a larger number of developed countries.

None of this will be good for political stability. In the United Kingdom, the vote for Brexit was followed, a year later, by an unexpected loss for the Conservative Party in a snap election. Donald Trump's victory in the 2016 U.S. presidential election shocked the world. German Chancellor Angela Merkel is struggling mightily to form a coalition government.

Faced with an anemic recovery, mounting unemployment, and rising inequality, electorates in developed countries will naturally vote for change. China needs to gird for it—and for the uncertainties that follow. What it must not do is panic. Staying calm and pursuing smart, forward-looking policies is the best way to ensure that China does not get caught in the crossfire of international upheaval.

Putting America First

This is particularly true with respect to the United States, which, despite its ongoing retreat from global leadership, remains the single biggest international player—and China's single most important economic partner. If China is to achieve the "great rejuvenation" of the Chinese nation that Xi seeks, its leaders will need to avoid conflicts—including trade disputes—with the United States, by leveraging economic complementarity.

In China, per capita income is about one-fourth that of the United States in PPP terms, and about one-seventh nominally, while average labor productivity is low. This makes it less likely that the US and China will compete directly in, say, high-value-added, high-tech, and capital-intensive industries. So, unlike the European Union and Japan, China is seldom locked in international competition with the United States, because Chinese exports to the United States are mainly low value-added goods (a point that U.S. President Donald

Trump seems unable to understand).

In fact, not only do the comparative advantages of the United States and China rule out direct competition; the market of one actually enables the other to make the most of its own strengths. For US companies, China's market—the world's largest, in PPP terms, contributing over 30% of the global market's annual expansion—is too lucrative to pass up. Given that America's largest firms are often the biggest donors in US elections, U.S. policymakers have a strong incentive to maintain, and deepen, economic ties with China.

It will not be all smooth sailing for the bilateral relationship—far from it. The US has lately been feeling threatened by China, whose international influence is expanding in lockstep with its economy. But whatever geopolitical rivalries emerge should not be allowed to undermine the mutually beneficial bilateral trade relationship. This makes it all the more critical for China to continue to upgrade its economy and realize its growth potential. Only by ensuring that it is indispensable to American business can China remain on friendly economic terms with the United States, even as political challenges, including those rooted in the continued growth of China's geopolitical clout, inevitably emerge.

A Global Governance Reset

Make no mistake: China is right to seek and assume a larger global role. It is by far the world's largest economy by PPP, and it will become the largest economy in nominal terms before 2030. It is only reasonable that China's growing economic clout should be accompanied by greater influence over global governance.

The current international order has contributed to relative peace and stability since it was created at the end of World War II. Yet it has been dominated by the Western countries that created it. It has not only served these countries' interests before all others; it has also championed their approaches to development and governance.

Very few developing countries have succeeded within this system. In 1960, there were 101 middle-income economies; by 2008, only 13 of them had reached high-income status. Worse, since 1945, only two of the world's

200-odd developing economies—Taiwan and Korea—have ascended from low-income to high-income status. (If all goes according to plan, China will become the third by 2025.)

No developing economy, except perhaps one that is economically and geographically close to Western Europe, can succeed by adhering to the advanced economies' development prescriptions. That is why a new kind of development thinking is needed, one that takes into account the lessons of those, from the four "Asian Tigers" to China itself, that have succeeded precisely by ignoring the development strategies pushed by the West.

In the 1950s and 1960s, developing countries were told repeatedly that, to raise incomes and labor productivity to the level of the developed world, they needed to achieve the same level of industrialization. So, rather than continuing to export agricultural produce and minerals, and import modern manufactured goods, many dove head first into the deep water of automobile, steel, and equipment manufacturing. Some never resurfaced.

In the 1980s, when that import-substitution strategy had proved a failure, developing countries were told that the problem lay in the fact that they were not full market economies. They must, according to the neoliberal logic of the so-called Washington Consensus, immediately roll back government intervention, and pursue privatization, deregulation, and trade liberalization.

But the most successful developing economies are those that rejected these prescriptions. Japan and the four Asian Tigers pursued labor-intensive, small-scale traditional manufacturing, instead of import substitution. China adopted its gradual, dual-track approach to the transition from planned to market economy. Vietnam and Cambodia, two more Asian countries that have achieved stable development, also resisted the conventional neoliberal wisdom.

A similar trend can be seen in Eastern Europe. In Poland and Slovenia, large, non-privatized SOEs contribute nearly 30% of GDP, no lower than the ratio in China. Uzbekistan and Belarus, the best economic performers among the ex-Soviet countries (aside from the three Baltic states), also rely on non-privatized firms.

There is no one-size-fits-all development strategy. Successful countries think about what they can do well with what they have, and create conditions to scale up those industries. That is what China has done, and what it, as an increasingly central player on the international stage, must help enable other developing countries to do, too.

Xi's Belt and Road Initiative, which promises massive infrastructure development in Eurasia and Africa, is an ideal vehicle for this. And, beyond the BRI, China can use its engagement in countries all over the world to spread a new and viable set of development and governance ideas. China has a clear interest in their success: bringing about prosperity in the developing world would be the best way for Xi to achieve what he, and now the CPC, call the "Chinese Dream" of individual achievement and national greatness.

SESSION III

THE WAY FORWARD

The Way Forward

Michael Buchanan[1]

Over the past two decades, China achieved strong growth through massive accumulation of capital inputs, technology catch-up, and reliance on low labor costs due to favorable demographics. Going forward, growth will naturally trend slower.

· Growth was exceedingly high even when compared to countries with exceptional growth paths (such as Japan, Korea, or selected Nordic countries). This comes from technological catch-up and accumulation of capital supported by high savings rates.

· The admission of China into the World Trade Organization helped provide a global market for its products, mostly manufacturing goods, supported by favorable demographics and low labor costs.

· Growth would naturally trend slower as China reaches middle income, with diminishing rewards from technological catch-up and a diminishing pool of inexpensive labor.

Our growth estimates, while slower, still suggest outperformance compared to even the most exceptional cases. Some upside could be gained from China's innovation drive supporting specific sectors in the new economy but, overall, the country needs structural reforms to reap benefits.

Given the steady decline in the savings rate, it is more critical for China to increase investment efficiency.

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· Previously, high domestic savings supported a high investment rate.

· On a flow basis, the investment rate had been high for a while but not quite so high on a stock basis. Even today, room remains for catch up, especially in social infrastructure, such as health care and education.

· However, credit-driven investment has not always flowed into the right areas. Excessive investment in certain sectors has led to overcapacity and declining corporate profitability.

· Incremental returns to investment declined. This decline was less an issue earlier given ample funding sources. But now, with the current account balance shrinking, domestic funding will be more challenging and China may need to rely more on foreign capital.

· While the move from a sizeable current account surplus to a small deficit is not a radical shift, this trend will likely persist in the long term, which would imply that investment efficiency would become increasingly more important.

The main factor for weakening investment efficiency was resource misallocation and this resulted in lower total factor productivity growth and higher credit intensity.

· By not allowing efficient firms to grow, potential gains in productivity were lost.

· By allowing inefficient firms to grow, they required more financial resources for less output, so credit intensity deteriorated.

· On top of that, the government's high growth target implied more output and required credit, pushing debt higher.

The way to improve resource misallocation requires not only opening up to more competition, but also leveling the playing field for private companies.

· State-linked enterprises, because of implicit guarantees, command a large amount of credit and assets, even though they generate lower returns than private enterprises.

· To help release resources to more productive sectors of the economy, there needs to be:

— More credit support for domestic private firms: This is partly due to state-owned companies crowding out the private sector.

— Broader state-owned enterprise (SOE) reforms: Besides the government focus on mixed-ownership reforms, there exist the need for an orderly exit of non-viable firms that use up valuable resources.

— A relook at existing industrial policies to encourage more market-based competition: Earlier industrial policies promoted specific industries. This tended to occur through a "selection" process that picked a winner (or largest firm) rather than through "competition". This has encouraged a "race to be the biggest", helped by subsidies and easier access to financing biased towards SOEs.

Besides opening up to local private firms, allowing more competition from foreign companies operating in China can also help.

· China will continue to open up its economy to foreign investors. Directionally, this is unlikely to reverse.

· Allowing foreign firms more market access will help encourage competition. Uncompetitive Chinese firms are fundamentally not viable so perpetual government funding and subsidies will eventually become too expensive, with only truly competitive firms succeeding.

· Foreign firms have often cited obstacles to operating in China, with unfavorable treatment and limits on expansion.

· China is taking concrete steps to answer international investor concerns with the new foreign investment law and by shortening the negative list. Progress was made in opening up the financial sector, particularly on reducing equity cap restrictions.

However, more work is required to address the perception that government-related agencies are partial to domestic firms.

· More safeguards for intellectual property: Prevent forced technology transfers, allow freedom for local partners, suppliers, and IT vendors. Policies tend to be top-driven and enforcement, especially by local governments, is more difficult to monitor.

· Government policies are often perceived to be guided by broader strategic outcomes by the state rather than rule-based laws: As such, policy and regulation varies frequently from tight to tolerance, posing uncertainty on foreign firms

· New foreign investment law: This was a further step towards more opening up, but it was passed quickly with broad terms. This leaves considerable discretion in the hands of government agencies, with uncertainty about the implementation and rules. In addition, earlier concerns of foreign investors, such as the national security review, were yet to be fully addressed. Premier Li announced at the Boao Forum that regulations supporting the foreign investment law were likely to be completed this year. These will be crucial to watch.

China also needs move forward with reforms in areas other than in opening up, given that economic reforms are interlinked.

· SOE reforms that allow the permanent exit of non-viable firms need to be supplemented by:

· Financial sector reforms: Strengthen banks' balance sheets and improve bankruptcy procedures to allow orderly exit of weaker SOEs.

· Fiscal reforms: Increase local governments' fiscal sustainability and reduce their reliance on large SOEs for social goals, such as employment and tax revenue. The use of property tax was discussed in the National People's Congress in March but, implementation will be a key challenge.

· Social reforms: Hukou reforms can improve the mobility of workers and help them find jobs in thriving new firms and industries. These could include new economic sectors that are thriving, including technology and the service sector, and help support changing household needs.

The reform task may seem challenging, but China has made progress on structural reforms. Policymakers also appear more coordinated.

· Favorable domestic and external conditions over the past two years have provided a window for China to accelerate reforms—including supply-side—addressing financial risks and improving environmental control measures.

· More challenging tasks are still to come. New challenges are also emerging, such as household debt, which remains low but has risen sharply in recent years.

· Reducing the household and corporate tax burdens are positives for rebalancing, but creates a delicate balance between fiscal support and sustainability.

China is rebalancing its economy towards slower but safer and more balanced growth. Implementing its reforms agenda and allowing markets to play a more decisive role will help guide its success.

· For now, deleveraging may have taken a backseat to the stabilization of growth. However, the broad policy direction towards de-risking the economy remains unchanged. And the key challenge is to engineer steady growth and reduce longer-term risks at the same time.

· The debt-to-GDP ratio is expected to increase in 2019. This is not a big cause of concern, especially viewed over a longer period. It is challenging to expect China's debt-to-GDP ratio to fall or even stay flat while it undergoes reforms to address structural issues. The slower increase in the last two years provides cushion for a slightly higher increase this year.

· China still has policy buffers: human capital still has room to catch up to developed markets productivity gains are still to be had from reforming state-owned sectors, and the financial deleveraging campaign of 2017 and 2018 has reduced the most acute financial risks.

· However, policy space is steadily dwindling as the current account surplus narrows, foreign exchange reserves decline, and household and fiscal debt burdens rise.

· Government has given encouraging signs that it remains committed to its overall policy direction. It is hoped that it will stay the course, bear the cost of reforms, increase competition, and fix resource misallocation.

China-Specific Issues in Implementing Competitive Neutrality

MA Jun[1]

Let me touch upon a few China-specific issues related to state-owned enterprises (SOEs) and competitive neutrality.

First, why are governments, especially local governments in China, eager to run and create many SOEs? Part of the problem is institutional, which has roots in the fiscal space of the Chinese government.

Local governments in China do indeed run many SOEs. But local government officials have very mixed feelings about them. They consider SOEs inefficient but still want to keep them and even create more SOEs, because they rely on the SOEs to do many things beyond governments' fiscal means. For example, local governments received a lot of unfunded mandates from high-level governments, such as reducing poverty within several years and decreasing air pollution by 25 percent within a few years. But local governments do not have enough money, and private enterprises are unlikely to contribute to these unprofitable projects, and hence local governments rely on the SOEs to carry out many of these tasks. This creates an incentive for local governments to set up more SOEs and, as the root cause of this issue, cannot really be resolved within in the current system.

Second is implicit entry barriers against private enterprises. These barriers are implicit because, according to the Negative List for Market Access, private enterprises are actually allowed to enter almost every single sector, including

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the oil sector, hospitals, schools, and financial sectors. In reality, however, it is very difficult for private enterprises to get a license or to operate in many sectors. For example, they can enter the oil sector, but it's difficult for them to get crude oil, because crude oil is monopolized by three SOEs, or to sell refinery oil products because all the gas stations are monopolized by three SOEs.

Likewise, private enterprises are allowed to run hospitals, but it is difficult for them to get doctors. Many doctors are eager to obtain professional titles (e.g., equivalent to professor or associate professor, and so on), but such titles are only available in public hospitals. Moreover, private hospitals are not well covered by insurance and therefore customers are not coming in. None of these are legal entry barriers on the negative list, but they are effective barriers to entry for private enterprises.

Third is implicit guarantees for SOEs. In reality, SOEs are the most likely firms to be bailed out when they fail, for reasons related to financial or social stability. This creates a perception of lower credit risk for SOEs, compared with private enterprises with the same financials. Some complain that the financial cost of SOEs is much lower than private enterprises, and the main reason is not direct government subsidies but implicit guarantees.

All that said, a few options may be able to mitigate these problems. One is that the very high levels of the government need to commit very strongly to implementing competitive neutrality. Currently, the one-line statement on competitive neutrality in the Government Work Report is not sufficient to be translated into effective action. It needs to be lifted to the Central Party Committee level in a formal document such as the "Opinions on Comprehensive Deepening of Economic Reform" by the 3rd Plenary Session of the 18th Party Congress.

The second thing that can be done is a serious survey on what are the implicit barriers against private enterprise entry. These barriers exist in many laws and regulations and internal practices. But be prepared to take five years to clean most of them up. When China was entering the World Trade Organization, hundreds of rules and regulations were rewritten because it had a strong commitment from the very top level to be in compliance with the WTO. China needs to replicate this kind of effort to abolish or rewrite hundreds of rules and regulations and to set up important legal precedents against the violators of competitive neutrality. For example, we should allow some private enterprises to sue certain agencies for discriminating against them.

Another critical effort is needed to scale back higher-level government mandates for lower-level governments. Higher-level governments should not be asking local governments to do things beyond their fiscal means, and they should stop local governments from creating new SOEs at discretion. The creation of new SOEs needs to go through a legal process, for example, local parliament to rectify the establishment of a new SOE.

The government should also develop a plan for SOEs to exit competitor industries, which was a plan 6 years ago at the 3rd plenary session of the 18th Party Congress but has not been done. In fact, SOEs have expanded into many competitive industries in the past few years.

Achieving Competitive Neutrality in China

Nicholas R. Lardy[1]

The concept of competitive neutrality was first advanced in Australia more than 20 years ago, and the Organization for Economic Cooperation and Development (OECD) began studying and promoting this concept almost a decade ago. Essentially, competitive neutrality means that any action taken by a government should have a similar effect on both private and state enterprises. One OECD study of the concept is summarized under the following points:

· State-owned enterprises (SOEs) providing public services should be given fair and transparent compensation, and commercial operations of SOEs should be separated from their responsibilities for public services.

· State and private firms should enjoy equal tax, supervision, and government procurement treatment.

· The state should not provide implicit or explicit guarantees of SOE borrowing. Exemption from debt repayment is equivalent to a subsidy.

· The state as a shareholder in an SOE should require the same rate of return as it would get on a commercial investment. Injecting state capital into SOEs while not demanding a commercial rate of return is a form of subsidy.[2]

Chinese policy has long emphasized that the state should protect the ownership rights and legal interests of all enterprises, regardless of their ownership

[1] Nicholas R. Lardy is Anthony M. Solomon Senior Fellow, Peterson Institute for International Economics.

[2] Zhang Chunlin. 2018. “Competitive Neutrality for SOEs Can Help China at Home and Abroad.” Caixin, October 16.

status, allowing them equal use of factors of production and to openly and fairly participate in a competitive market. But Chinese practice has fallen short of these ideals. This paper explores some of these shortfalls and suggests policies that would form an essential part of any serious effort to implement competitive neutrality in China.

The first and perhaps most obvious dimension in which China's current economic policy falls short of competitive neutrality is the huge share of loss-making state firms. Data from the Ministry of Finance (Table 1), reveal that over the past decade about two-fifths of all state companies are loss-making, meaning that they can't fully cover their cost of capital. Losses of about RMB500 billion prior to the global financial crisis tripled to about RMB1.5 trillion by 2017. Moreover, in many cases it appears that these money-losing firms are relieved of paying taxes and perhaps contributions to social insurance funds. Their true losses may be larger than shown in Table 1.

Since the losses of state firms roughly tripled between 2008 and 2017 while roughly two-fifths state firms remain loss-making, it seems that a large subset of state firms is persistently losing larger and larger amounts. These loss-making firms continue to operate by borrowing more and more funds to cover their losses and to have the funds to pay the interest on their outstanding borrowings from state banks. These mechanisms violate the competitive neutrality principles of equal treatment in taxation and not guaranteeing borrowing of state firms.

A second dimension in which China's current economic policy falls short of competitive neutrality is that the state as shareholder does not demand that state enterprises earn the same return as it would get on a commercial investment. Figure 1 shows that the return on assets of state industrial firms has since the late 1990s persistently lagged the returns of private firms and that the gap has increased since the global financial crisis. In recent years, the return on assets of private firms has been two-and-a-half to three times the returns earned by state companies. Perhaps some loss-making state firms included in Table 1 are public service firms that are required to provide services at less than cost and receive subsidies that offset the resulting losses.

The situation of state industrial firms (Figure 1) is quite different. Few public service firms operate in this universe; rather, these firms are mostly in manufacturing, where state firms generally are not required to sell at less than cost of production to meet social objectives. Thus, there is a second clear violation of competitive neutrality—the state provides capital to industrial SOEs but does not require these firms to generate a commercial rate of return.

More evidence that conditions of competitive neutrality do not exist in China is reflected in Figures 2 and 3. Figure 2 shows one of the more common metrics of enterprise creditworthiness—the share of a firm's profits is required to pay interest on its outstanding debt. Commercially oriented banks presumably would be less willing to lend and/or would charge higher interest rates to firms in which interest payments absorb a relatively large share of profits. As is clear from Figure 2, the average creditworthiness of state and private industrial firms diverged after the global financial crisis so that by 2017 private firms were more than twice as creditworthy, on average, as state firms.

Figure 3 shows that in the early years of this decade, private firms, indeed, received a much larger share of bank credit than state firms, consistent with the hypothesis that commercially oriented banks would lend larger amounts to more creditworthy firms. But after 2013, with no improvement in their creditworthiness, the share of new bank loans going to state firms soared, and bank lending to private firms collapsed. It appears that the state began to provide at least an implicit guarantee of borrowings by state companies from state banks, again another violation of the principle of competitive neutrality.

To offset their loss of access to bank credit, private firms turned increasingly to shadow banks. This involved two violations of competitive neutrality. First, since interest rates charged by nonbank financial institutions are typically several times those charged by state banks, private firms were no longer able to compete with state firms on a level playing field. Second, starting in 2017, the authorities sought to slow the growth of credit to reduce the financial risks associated with a high level of debt relative to GDP. And they focused their efforts on shadow banking, the less well-regulated portion of China's financial system. While this made sense from a macroprudential perspective, the collateral damage is that private firms were increasingly squeezed out as the growth of shadow bank lending slowed and then shrank in absolute terms (Figure 4). Again, government action had a differential effect on private and state firms, a clear violation of the principle of competitive neutrality.

Figure 5 further underscores the preferential access of state firms to credit, showing that the number of state-controlled firms continues to expand while, as their access to bank and non-bank credit collapsed, the number of private limited liability companies grew more slowly in 2016 and then fell noticeably in 2017.[3] Despite the large number of loss-making state companies, exit via bankruptcy is limited. In 2017, Chinese courts adjudicated fewer than 7,000 bankruptcies.[4] Even if all these cases involve state-owned firms, the share of loss-making state firms subject to bankruptcy is less than 5 percent annually. The absence of significant exit plus the formation of some new state firms means the universe of state-owned firms continues to expand.

Similarly, money-losing state-owned firms are not required to either sell assets to offset their losses or be acquired by another firm that could potentially make more productive use of the state firm's resources. As Table 2 shows, only around 7,000 merger and acquisition transactions occurred in each of the past two years. In value terms these transactions are tiny. The assets of state nonfinancial firms at the end of 2017 stood at RMB185 trillion.[5] If all of the merger and acquisition transactions involve takeovers of state firms, the magnitude of the assets involved is only about one-half of one percent of the assets of state nonfinancial firms.

Figure 6 reflects another dimension in which competitive neutrality is absent—while entry by private firms into manufacturing has long been relatively liberalized, substantial regulatory barriers remain to entry of private firms in services. The share of investment by state firms in services is relatively

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3 The focus here is on private firms organized as limited liability companies. Undoubtedly thousands of small startup, registered private companies fail and go out of business simply by exiting. With no formal creditors involved there is no need for a legal bankruptcy process when these firms exit. Private firms organized as limited liability companies are much larger. For example, these firms account for only a little over one-tenth of all private firms but a disproportionately large share of the profits of private firms. Thus, they are more likely to have formal creditors.

4 Supreme People's Court of China. 2018. "Press Conference Briefings on the Adjudication of Enterprise Bankruptcy." March 6.

5 Ministry of Finance. 2019. 2018 China Fiscal Yearbook China State Finance Magazine, p. 356. Beijing.

elevated and shows no downward trend, meaning the state has not liberalized the terms of entry for private firms for almost a decade. Private investment in services is concentrated in traditional services such as wholesale and retailing, restaurants, and hotels, all domains that the state opened to private investment decades ago. Investment by private firms in financial services and information transmission, software, and information technology is far more limited. The restrictions on access of private firms reduce competition and likely contribute to the very low return on assets of state firms in services (see Figure 1).

Discussion by Chinese leaders of adopting the principle of competitive neutrality is an encouraging sign. If implemented it likely would put China on a path to higher growth, near its potential of 8 percent a year, or slightly more.[6] Achieving competitive neutrality would be challenging and require:

· market-oriented allocation of financial resources, meaning at a minimum ending the implicit state guarantee of borrowing by state companies,

· imposition of hard budget constraints on state enterprises,

· elimination of obstacles to merger and acquisition activity,

· facilitation of bankruptcy for chronic money-losing companies, and

· liberalization of access of private firms to service industries.

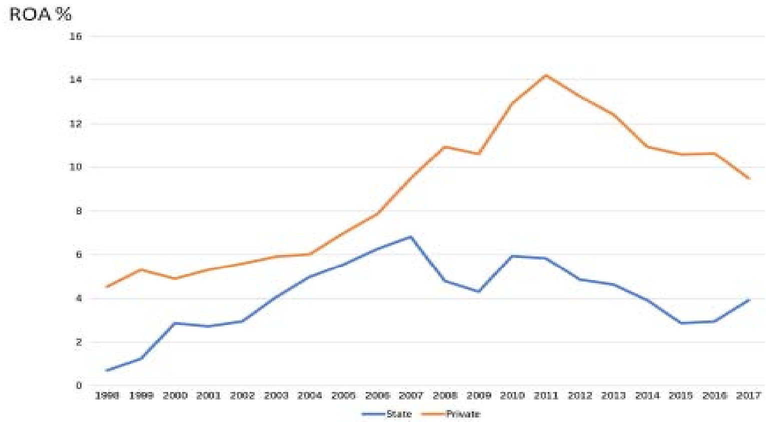
Table 1. Huge Share of Loss-Making State Firms, 2008–17

Year	Loss-making share (percent)	Number of Loss-making Enterprises (Hu)	Losses: Amount (billions of RMB)	Losses: As a share of GDP (percent)
2008	39.5	43,500	507	1.6
2009	37.1	41,200	394	1.1
2010	35	39,900	392	1.0
2011	35.1	47,700	613	1.3
2012	35.5	52,200	855	1.6
2013	35.6	55,200	860	1.5
2014	36.1	58,100	1,086	1.7
2015	37.2	62,100	1,342	2.0
2016	37.1	64,600	1,466	2.0
2017	36.9	69,000	1,445	1.8

Source: Ministry of Finance.

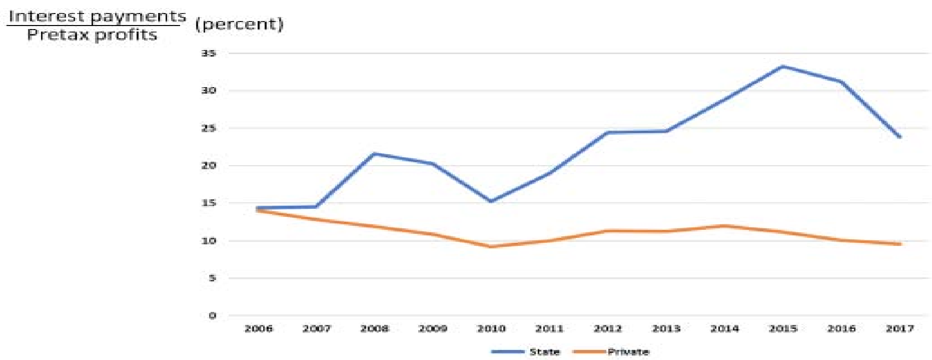
6 Nicholas R. Lardy. 2019. The State Strikes Back: The End of Economic Reform in China? Washington: Peterson Institute.

Figure 1. Diverging Returns of State and Private Industrial Enterprises After 2007



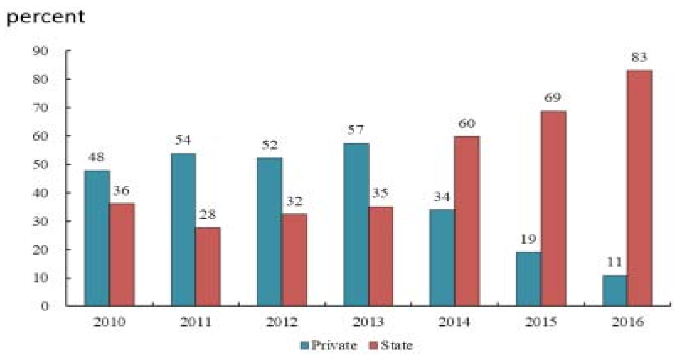
Source: National Bureau of Statistics.

Figure 2. Private Industrial Firms Are More Creditworthy



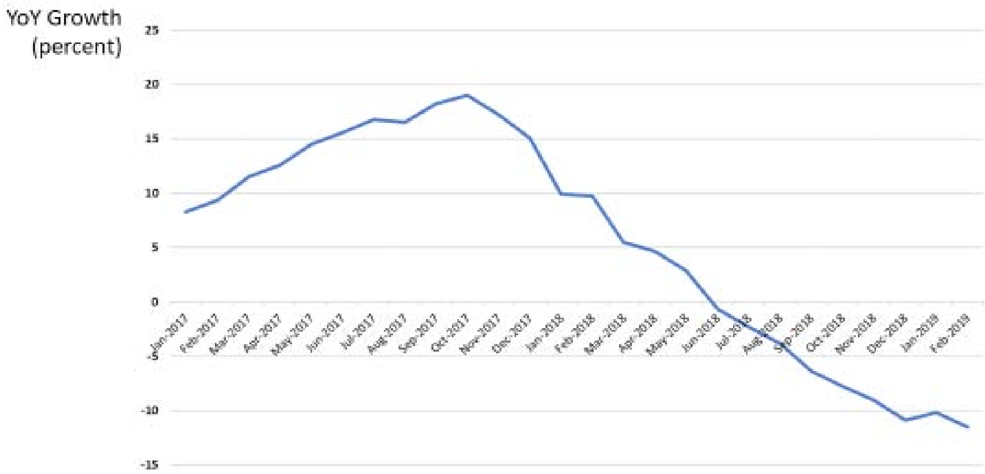
Source: National Bureau of Statistics.

Figure 3. Misallocation of Loans to Nonfinancial Enterprises After 2013



Source: China Banking Society.

Figure 4. Collapse of Shadow Finance Further Squeezes Private Firms, January 2017–February 2019



Note: Shadow finance = sum of entrusted loans, trust loans and bankers' acceptances.
Source: People's Bank of China.

Figure 5. Only Private LLCs are Subject to Financial Discipline

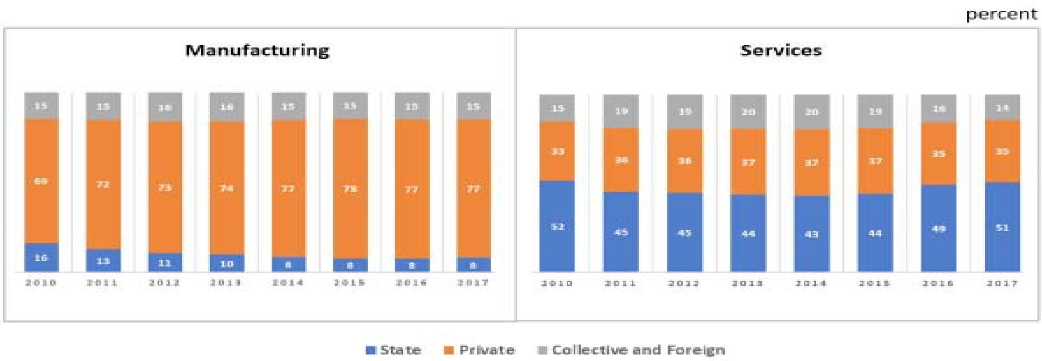
LLCs = limited liability companies
Source: National Bureau of Statistics.

Table 2. Limited Domestic Mergers and Acquisitions, 2007–18

Year	Number of transactions	Value (billions of RMB)
2007	1,078	326
2008	1,668	519
2009	1,559	577
2010	1,797	663
2011	2,063	725
2012	1,079	506
2013	1,583	480
2014	1,915	871
2015	2,887	1,547
2016	2,938	1,490
2017	6,689	1,568
2018	7,234	1,362

Source: Wind Financial Information.

Figure 6. Continued State Domination of Services Investment, 2010–17



Source: National Bureau of Statistics.

Mainstreaming the Competitive Neutrality Principle in China: The Way Forward

ZHANG Chunlin[1]

It is a great honor to participate in this important conference on competitive neutrality. My sincere thanks to the People's Bank of China and IMF for their kind invitation.

The importance of competitive neutrality to China

The World Bank has been advising China on mainstreaming the competitive neutrality principle since early 2014, shortly after the closure of the Third Plenum of the 18th Central Committee of the Communist Party of China, in which the party adopted a program of comprehensive reforms. Competitive neutrality is important to China in two ways.

First, in spirit, competitive neutrality is the same "equal competition" that China has advocated since 1993, when it decided to transform into a market economy while maintaining state ownership, that is, a "socialist market economy". How could it be possible? The socialist market economy concept the CPC adopted in 1993 has two cornerstones. One is the transformation of state-owned enterprises (SOEs) into market participants that are independent commercial entities, that is, modern corporations, with the state acting only as shareholder; the second is to ensure that the government creates conditions to "allow enterprises of all ownership types to compete equally", which requires that the government treats them equally. It is easy to see that the notion of "socialist market economy" will fall apart if the government fails to treat

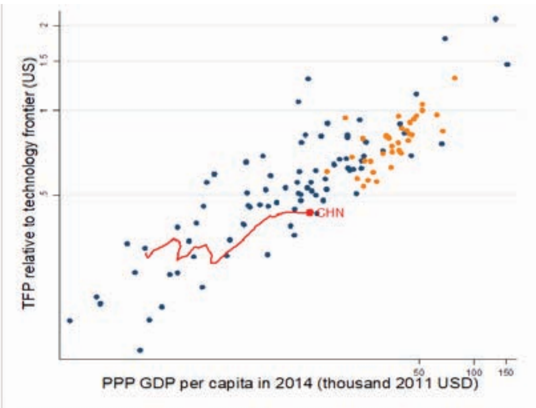
[1] ZHANG Chunlin is Lead Private Sector Development Specialist, The World Bank Group.

SOEs and non-SOEs equally.

China needs competition today more than ever before. It is widely recognized that its future growth hinges on a transformation of its growth model into one that is increasingly innovation-driven and productivity-led. More specifically, growth must rely less on accumulation of production factors and more on the efficiency of their use, which is typically reflected by total factor productivity (TFP). As a developing economy, China's TFP is still a long way from the global frontier (Figure 1), suggesting significant potential for catch-up growth. TFP growth can be generated in essentially three ways, all of which depend on the competitiveness of the market: (i) reallocation of factors of production into sectors and firms with higher productivity; (ii) improvement of firm performance; (iii) entry of firms with higher productivity and exit of those with lower productivity.

This explains why the Government of China in recent years has emphasized that competition policy must be given a "more fundamental" position in economic policy making. It is obvious that, given the importance of competition to economic efficiency, any policy that distorts competition has the potential to undermine China's own objective to transform its growth model. As such, arguing that China is entitled to maintain anti-competitive industrial policies because other countries have done so misses the whole point: such policies undermine China's own growth.

Figure 1. China's TFP suffered a slow down recently and is still a long way from the productivity frontier



Source: The Development Research Center of the State Council and the World Bank. 2019. *Innovative China: New Drivers of Growth*. Forthcoming.

Reforms necessary to achieve competitive neutrality

What must be done if China is to mainstream the competitive neutrality principle? As will be discussed later, more work is required before a complete answer to this question can be made. Nonetheless, existing knowledge already suggests some broad areas where changes are likely to be necessary to achieve competitive neutrality. They include:

· Regulatory reform to ensure equal treatment between SOEs and non-SOEs, especially regulatory enforcement and removal of implicit entry barriers.

· Reform of the state capital management system to impose a requirement of market rate of return to commercial SOEs.

· Elimination of privileges enjoyed by SOEs in access to and cost of finance.

· Clean-up of explicit and implicit subsidies and preferential policies that confer undue competitive advantage on SOEs.

· Adequate, transparent, and accountable compensation for public policy functions performed by SOEs per government instructions.

A closer look at state capital management

State capital management deserves special attention, for two reasons. First, soft equity capital finance to SOEs—namely, equity capital supply that does not require a rate of return on par with the prevailing rate in the market—offers cheaper finance to SOEs than they can find in the market and therefore enables them to undercut their competitors. As a result, non-SOEs are disadvantaged in competitions such as bidding for projects and land and application for commercial loans, even before they enter the playing field. Second, at any given leverage ratio, the amount of state equity capital invested in SOEs determines the size of their total assets on their balance sheets, an indicator of the amount of economic resources that have been allocated to SOEs. The potential crowd-out implication is clear: at any given point of time, the more resources are allocated to SOEs, the less is left for non-SOEs.

This is why the competitive neutrality principle requires SOEs operating in a commercial and competitive environment to "earn rates of return like comparable businesses". A similar rule was adopted in the Comprehensive Progressive Trans-Pacific Partnership agreement, which states that equity capital provided to SOEs should not be "inconsistent with the usual investment practice, including for the provision of risk capital, of private investors".

The overall situation in China points to urgent need to harden the budget constraint in terms of equity finance of SOEs. As Figures 2–4 show, state owner's equity in nonfinancial SOEs has kept increasing since 2007, despite a declining average return on equity; the return on equity gap between industrial SOEs and non-SOEs has widened since 2007, while SOE shares in industrial assets and revenue have stabilized in recent years and increased year over year in 2017, for the first time since 1998. There are significant variations across sectors and enterprises that must be noted: some SOEs perform better than others, and the average numbers reflect the fact that poor performing SOEs do not exit the market in as timely a fashion as their non-SOE counterparts. Nonetheless, the overall picture is one of increasing supply of soft equity capital to SOEs.

What does it take to ensure competitive neutrality in terms of equity finance? It may require at the least the following:

· Targets for return on state capital invested in SOEs that are appropriately defined, that is, with full consideration of industry context and defined over a relevant period of time.

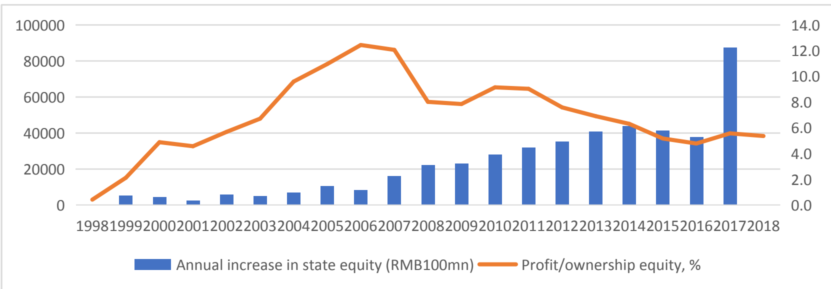
· Clarity of responsibility: what entity is responsible for return rate of how much state capital?

· Readiness for orderly exit of those entities who fail to meet the requirement.

· Simultaneous implementation of the competitive neutrality principle at other frontiers (such as compensation for public policy functions) to ensure no loophole is left.

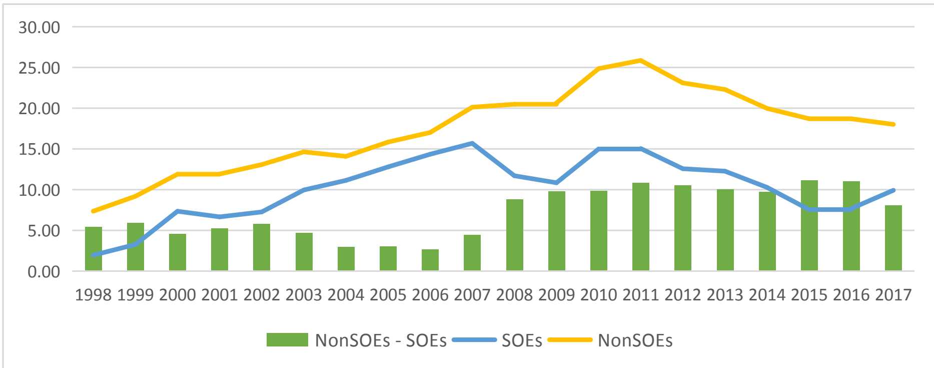
However, before figuring out how to make their competition equal, it is always important to ask why to keep SOEs competing with the private sector. In principle, if an economic activity can be carried out by non-SOEs, the state does not necessarily need to be involved in it, given its limited resources. This suggests that more fundamental reform actions must be considered. One is to exercise control over the growth of the total state equity capital invested in SOEs. Another is to withdraw state capital from SOEs operating in "non-strategic" sectors either completely or at least from controlling shareholder's position. This is essentially the reform agenda known in China as "strategic adjustment of the layout of state capital" that has been established since 1999 with moderate progress of implementation.

Figure 2. Annual increase in state equity in nonfinancial SOEs (left) and return on equity (right), 1998-2018



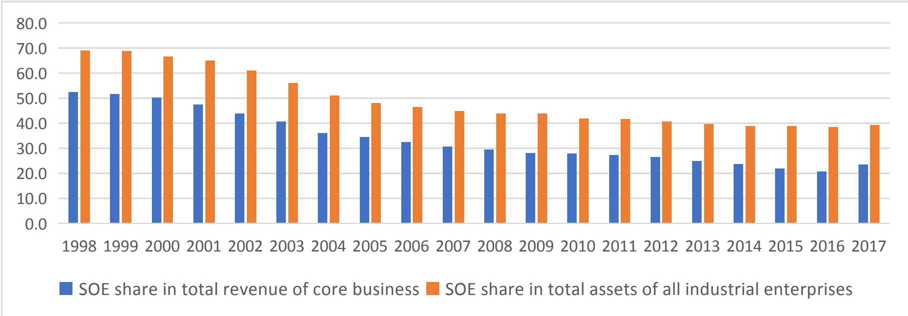
Source: China Fiscal Yearbook, various years.

Figure 3. Return on equity of industrial SOEs and non-SOEs, % and percentage points, 1998-2017



Source: National Bureau of Statistics website.

Figure 4. SOE share (%) in total assets and revenue of all industrial enterprises (above cutoff scale)



Source: National Bureau of Statistics website.

Immediate next steps

Back to the subject of this session, what is the way forward to implement the competitive neutrality principle in China? Or what are the immediate next steps? The World Bank has proposed two:

The first is to develop a "competitive neutrality standard". Unlike World Trade Organization rules, competitive neutrality is a guiding principle advocated internationally with no codified legal rules. It is up to every country to interpret it and turn it into an enforceable framework. Given the uniqueness of China's SOE sector, it would be advisable for China to develop a "competitive neutrality standard" that fits its particular situation at home and its changing role in the global economy. The competitive neutrality standard should aim to define in specific and enforceable terms exactly what government actions can be regarded as a violation of the competitive neutrality principle. It should be applicable to domestic market competition as well as aligned with China's role and commitments in the global economy.

The second is to conduct a competitive neutrality gap analysis, namely, benchmarking existing government regulations, policies, and practices against the "competitive neutrality standard". Building on the ongoing reform efforts of the fair competition review, the analysis should be oriented to the formulation of a reform action plan for the State Council to endorse. The gap analysis could involve three analytical steps covering all relevant areas:

· Identification and description of government actions that may distort competition (for example, specific tax rules that authorize exemptions from the general tax rules to selected enterprises).

- Assessment of the neutrality of the government actions to competition, or the extent to which the government actions under review confer an undue competitive advantage on any actual or potential market participant (for example, how tax exemption offered to selected enterprises distorts or is likely to distort competition).

- Proposing reform recommendations (for example, whether the rule of tax exemption should be abolished or revised).

SESSION IV

OPENING UP

China's Financial Opening

GUO Kai[1]

On the opening of the financial services industry, our overall direction is full equity ownership and full licensing. Currently, Standard & Poor's has entered the China market and UBS Group and Credit Suisse have increased their holdings in joint-venture securities houses to 51 percent and are slated for 100 percent holdings in the future. On the opening of financial markets, after the renminbi was added to the special drawing rights (SDR) , foreign official departments received approval to invest in China's interbank bond market and foreign institutional investors subsequently received approval to enter. At present, foreign investors can invest in Chinese stock markets, bond markets, and the foreign exchange market. China A-shares have been added to the MSCI index, and the Chinese bond market has been incorporated into the Bloomberg Barclays Index. In 2018, despite notable volatility in the renminbi exchange rate, capital inflows of about $100 billion to $120 billion were realized.

However, China's financial opening continues to face many problems and challenges. First, systemic, institutional opening has yet to take shape. In the opening of the financial services industry, the problems of fragmentation and patchwork-style opening are present, with the existence of various types of reviews and approvals in the opening process, so that even when senior levels have already announced that an area has been opened, foreign-owned institutions either find it difficult to enter the market and obtain the relevant licenses, or they obtain licenses through case-by-case appeals. While this sort of opening may appear to resolve foreign demands, it fails to achieve comprehensive opening. To realize comprehensive opening in China, we must

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transition from the positive-list model to a negative-list model, formulating streamlined negative lists and clarifying the entry expectations for foreign capital to achieve equal treatment of all types of institutions. The opening of financial markets has the problem of "pipeline"-style opening, with primary investment channels including qualified QFIIs, RQFIIs, QDIIs, RQDIIs, SH-HK Stock Connect, and Bond Connect. The pipeline approach was reasonable in the past, as it enabled us to increase our ability to control capital flows. However, the parallel existence of an excessive number of channels complicates opening arrangements. Rules should be made uniform, merging items of the same type to the greatest extent possible, to achieve comprehensive, coordinated opening.

Second, by deciding the level of openness based on the level of supervision, the supervisory framework has been unable to adapt to the demands of opening. Supervision pressures are often alleviated by setting excessively high entry thresholds. In fact, the degree of openness should not be restricted by the level of supervision; rather, the level of supervision should be increased based on the requirements for opening, and the phenomenon of using access as a substitute for supervision should change.

Third, opening places greater requirements on the institutional framework, such as accounting standards, bankruptcy law, information disclosures, and central bank communications. If supporting measures are incomplete, foreign investors will find it difficult to understand our legal framework and policy intentions, and will be faced with the problem of an open door that they are unable to enter. A more friendly framework must be formulated to achieve competitive neutrality and treat all market participants equally, conducting administration based on business type and risk status, and avoiding discrimination based on ownership structure.

Finally, we must ensure that all measures are truly put into place and implemented. We have published many documents and made many declarations, but in the end, we must accelerate the implementation of these measures.

Opening Up and Competitive Neutrality: The International Experience and Insights for China

HE Dong[1]

Thank you for the opportunity to participate in this conference. In my remarks today I will focus on "Opening Up the Financial Sector, Competition, and Stability". I will address the following questions: (1) What is the relationship between liberalization of trade in financial services and cross-border capital flows? And (2) How should we ensure that increased competition in the provision of financial services will help us reach a "frontier" of efficiency and stability so that the financial sector effectively serves the real economy?

At the outset, it is useful to clarify what we mean by "opening up the financial sector". While a common definition is elusive, it can be usefully thought of as including the following two components: liberalization of trade in financial services and liberalization of capital flows.

Consistent with the General Agreement on Trade in Services (GATS) of the World Trade Organization, trade in financial services can be defined as the supply of financial services by foreign service providers to domestic consumers through different modes of supply, namely cross-border provision, consumption abroad, commercial presence, and presence of natural persons.. Liberalization of trade in financial services entails progressive removal of limits on market access and national treatment. National treatment requires

[1] HE Dong is Deputy Director, Monetary and Capital Markets Department, IMF. These remarks represent my personal views only.

that the same conditions of competition are applied for both domestic and foreign firms in the market. Market access requires that conditions of market access are stipulated appropriately. Conditions on market access may include measures which restrict specific types of legal entity and limitations on the percentage of foreign capital participation or shareholding.

In comparison, liberalization of capital flows means the progressive removal of restrictions on the ability to trade financial assets between residents and non-residents. According to the IMF Institutional View, capital flow liberalization is generally more beneficial and less risky if countries have reached certain levels or "thresholds" of financial and institutional development. While countries with extensive and long-standing measures to limit capital flows are likely to benefit from further liberalization, there is no presumption that full liberalization is an appropriate goal for all countries at all times.

As for the distinction between capital flows and the financial services through which capital is transferred, the following can be noted: "Observers often fail to recognize that financial services liberalization does not necessarily imply capital account liberalization, with the consequence that liberalization in financial services trade may be held back for fear of its implications for the capital account."[2]

Recall that under the GATS, financial service agreements distinguish between a number of subsectors or types of activities, including lending and deposit taking, participation in securities issuance and trading, and so on. Financial services trade also differ in the "modes of supply': cross-border provision of services and the presence of a foreign establishment. The GATS encourages progressive liberalization and allows differential liberalization commitments across different financial services and modes of supply.

In general, it's useful to note that even fully free trade in financial services does not require full capital account liberalization. Putting it differently, liberalization of services trade is consistent with the existence of certain

[2] Masamichi Kono and Ludger Schuknecht. 2000. "How Does Financial Services Trade Affect Capital Flows and Financial Stability?" In The Internationalization of Financial Services: Issues and Lessons for Developing Countries, edited by Stijn Claessens and Marion Jensen, Kluwen Law International.

restrictions on capital movement. This is because the freedom of cross-border capital flows matters differently for different types of activities or modes of supply. Typically, cross-border provision of services requires a higher degree of capital flow mobility than the presence of a foreign establishment.

To use a concrete example: suppose a U.S. asset manager, let's say BlackRock, is interested in providing services to Chinese investors to buy exchange traded funds (ETFs). If it sells U.S. registered ETFs directly to Chinese investors, that would require the freedom by Chinese investors to convert renminbi into U.S. dollars and buy units of U.S. based funds, that is, free convertibility of the renminbi for portfolio investments abroad. However, if BlackRock sets up shops in China and establishes BlackRock ETFs for Chinese investors to invest in local assets, that would not require a high degree of renminbi convertibility for portfolio investments, but only the ability for BlackRock to do direct investments and convert and repatriate its earnings back into U.S. dollars from time to time.

Having said this, it must be recognized that an orderly and well-sequenced liberalization of capital flows is necessary for an emerging economy like China to truly benefit from progressive liberalization of trade in financial services. But the two processes can proceed at somewhat different speeds. Indeed, I would argue that given the current low level of foreign participation in the Chinese financial system, faster liberalization of financial services trade would contribute to a more efficient and stable domestic financial system through increased competition and diversity of service suppliers, skill and technology transfer, better risk management practices, and more transparency and information. This would thereby pave the way for an orderly liberalization of cross-border capital flows.

Considerable literature analyzes financial stability risks associated with large and volatile capital flows, and how macroprudential policy should be used to increase resilience against such risks.[3] I will not dwell on those issues today. Instead, I will focus on the implications of liberalization of financial services

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[3] See IMF. 2017. "Increasing Resilience to Large and Volatile Capital Flows—The Role of Macroprudential Policies." IMF, Washington, DC.

trade for stability. What is the relationship between increased competition in the provision of financial services and financial system stability?

In general, competition in banking and financial services is good for society, provided that prudential regulation and supervision are adequate, and there exists an effective exit mechanism through which failing firms can be weeded out.[4] Through a process of "the fittest survives the natural selection", competition promotes economic efficiency, and financial service is no exception. But we need to take into account how competition affects financial stability, as finance is a confidence game and the financial system can be more fragile than other economic sectors.

Banking is a multi-product industry, and there are many frictions and barriers to entry that make competition in banking imperfect. In retail banking, switching costs, reputation, and branch networks act as entry barriers. In corporate banking, established relationships and asymmetric information are relevant frictions that explain why the market for small and medium-sized firms remains local. In wholesale and investment banking, competition is at the international level and market-based, so it may be fierce even if the market is concentrated.

Owing to behavior biases, increased competition in the financial system may lead to more fragility. For example, competitive markets tend to oversupply credit by relaxing lending standards and extending it to both good and bad risks, reinforced by consumers' tendency toward overborrowing, particularly when risk appetite is strong and the price of risk is low. Competition may also intensify risk taking by eroding the franchise value of incumbent institutions and diminishing incentives to monitor loans and maintain long-run relationships with borrowers.

It is thus plausible to expect a hump-shaped relationship between competition and stability with an intermediate level of competition being optimal for stability (Vives 2016, 227). We can call such a point an adequate level of competition. Starting from a monopoly regime, an increase in competition is

[4] Xavier Vives. 2016. Competition and Stability in Banking. Princeton, NJ: Princeton University Press.

beneficial because it spurs productive efficiency and innovation. A continued increase in competitive pressure may lead to a point where the benefits balance with higher fragility, and further increases beyond that point could lead to "excessive competition".

In this context, notably, the Chinese financial system is probably quite far from reaching the optimal level of competition, in that it is ranked one of the lowest among the G20 economies in to financial services trade. Importantly, it lacks an effective exit mechanism for failing institutions and such institutions might have been competing "excessively" in a gamble for resurrection.

As the financial sector is opened up, how should the regulatory authorities take into account increased competition when designing and implementing prudential policy? Is there a case for coordinating competition and prudential policies?

Indeed, competition policy that eases entry, and increases contestability, may have to be accompanied by tougher prudential requirements (Vives 2016). In a more competitive environment, the solvency requirement has to be strengthened. This is because increased competition for funds aggravates coordination problems of investors, makes runs more likely, and it reduces the charter value of banks enticing them to take more risk. Thus, it will be wise for the Chinese authorities to strengthen the capital positions of banks, particularly small and medium-sized banks, when opening up the financial sector to greater foreign competition.

More broadly, there is a case for deploying macroprudential policy instruments to correct competitive excesses that result in a buildup of financial vulnerabilities. For example, a long housing boom may reduce default rates on residential mortgages. Competition among mortgage lenders may induce them to underestimate the probability of a housing bust. In such a case, there may be the case for the prudential regulator to intervene and impose a floor on the risk weights attached to mortgage loans. This is a case of prudential objectives overriding competition objectives.

European Chamber of Commerce: Some Considerations

Charlotte Roule[1]

Based on the experience of its 1,600 member companies all over China, the European Chamber of Commerce in China maintains a constant dialogue with Chinese authorities. While members have a wide range of concerns, the three most pressing relate to market access barriers, the incoming Foreign Investment Law and the need for competitive neutrality:

1.Market access, which remains an issue for members due to both direct and indirect barriers.

Direct barriers chiefly exist through China's various negative lists. The 2018 revision of the negative list did expand market access, but:

· the 48 items on the list remain too restrictive; and

· the Free Trade Zone negative list used to pilot opening up is no longer practical; for example, oil exploration is now open to foreign investment, but only in the Free Trade Zones which might not prove possible (is anyone drilling in Pudong?).

Given China's 40 years now of good results under opening up, and as a mature economy, one could question the need for such pilots.

Under indirect barriers, even industries whose businesses are not on the negative list still face barriers to market access. Taking just two examples:

· Many financial institutions that can now increase shareholdings or establish

[1] Charlotte Roule is Vice President of the European Chamber of Commerce in China.

wholly-owned foreign enterprises (WOFEs) have very limited access to needed licences (e.g., cross border custodial service licences). Some may have received these, but the regulations themselves have not been changed.

· China must do more than provide a few examples—it must ensure equal and fair access and treatment.

· Foreign construction service providers can set up shop, but they are restricted to four very niche services they can provide, hence their less than 0.25 percent market share.

These direct and indirect barriers must be removed if we want to see real opening up and a subsequent surge of meaningful investment.

2.The recently passed Foreign Investment Law

China has attempted to address the issues mentioned above and improve the level of openness and fairness in the market through the recently passed law. However, the European Chamber is uncertain about how this will happen in reality.

· First, the European Chamber is concerned that the investment law was rushed through as part of the negotiations with the United States. The comment period was short and irregular and the time to review stakeholders' input was limited.

· Second, we maintain our position that there should be no legal distinction between domestic and foreign companies, except for specific things like national security. The very nature of the legal distinction perpetuates unequal treatment and discrimination.

· Third, the Foreign Investment Law will become effective next January, so we are eager to monitor implementation and interpretive documents that will come out. Local governments will be responsible for ensuring that promises for fair and equal treatment are realized and that prohibitions on forced tech transfers are upheld.

3.SOEs and competitive neutrality

It is good to hear that the Chinese authorities intend to realize competitive neutrality between state-owned enterprises (SOEs), Chinese private-owned enterprises and foreign enterprises (POEs and FIEs), but this contrasts with what we observe as a trend, which is that the state-owned economy is gaining, not losing, prominence. Until SOEs look and act like market players as in open markets, China will remain a half-opened economy, in that private firms will be unable to enter markets dominated by SOEs.

SOE reform in China has proceeded much differently than it did in Europe: Privatization and liberalization in the 1990s and early 2000s has shifted towards consolidation and strengthening, leading to oligopolies and monopolies that crowd out the private sector—foreign and Chinese alike.

The European Chamber recently surveyed its members on SOE effects. Unsurprisingly, a majority (70%) reported that SOEs were present in their sector. Among these:

· 18% said SOEs control more than 50% of sectoral market share.

· The largest presence was noted in financial services, education, information technology, and telecoms, and civil engineering and construction. Notably, however, these breakdowns reflect the ones used for European Union Chamber of Commerce in China membership, meaning that sectors such as rail, steel, mining and so on are not represented.

· Of those that noted SOE presence in their sector:

· 39% described their sector as, "a market where SOEs have unfair advantages, but other market actors can still meaningfully compete".

· More worryingly, 19% described it as a "de facto SOE monopoly/oligopoly with marginal opportunities for private firms".

We then asked our members about 10 areas, such as access to cheap financing, access to licenses, or preferential treatment for public procurement, where SOEs or POEs might hold government-granted advantages over the other: Seven areas saw a majority give the advantage to SOEs.

· The lowest number reporting that SOEs held the advantage was 42%.

· In none of the ten areas did more than 6% of members think that POEs held an advantage over SOEs.

Finally, when asked to describe their outlook regarding the relationship between the private and state-owned sectors over the next two years:

· only 20% said the private sector will gain opportunities at the expense of the state sector;

· while 41% considered the opposite likely.

Conclusion

From the European Chamber's perspective, it is imperative that China accelerate its reform agenda to deal with the reform deficit that has built up over the years.

Removing nominal barriers to market access is not enough. A truly level playing field in an open market where SOEs are stripped of their special treatment is needed to maintain economic development and counteract rising tensions.

Foreign companies are not looking for special treatment in China. European businesses participate in a wide range of highly competitive markets on a level playing field and embrace the challenge of an open field. We simply hope that we can add China to the list of such markets sooner, rather than later.

Tax Neutrality, Efficiency, Innovation, and R&D

Era Dabla-Norris and Grace Li[1]

1.The focus of this note. Creating a level playing field for firms irrespective of their ownership structure, nationality, and size in order to achieve a more efficient allocation of resources and bolster productivity is an important ambition of Chinese policy makers. While this encompasses a range of complimentary regulatory reforms and competition policies, one pertinent aspect relates to the design of tax policy. This note briefly discusses, in turn, the rationale for tax neutrality in policy design; considerations associated with taxation of state-owned-enterprises (SOEs) vs. other firms in China; and research and development (R&D) incentives, where there is an economic rationale for deviating from tax neutrality to boost productivity and long-term growth.

Desirability of tax neutrality

2.Tax policy should aim at leveling the playing field across firms. Tax systems should strive for neutrality and not tilt the playing field across different types of firms. The principal of tax neutrality, one of the eight building blocks of the OECD's concept of competitive neutrality (OECD 2012), implies that firms' investment and employment decisions are made on their economic merits and not for tax reasons. This can maximize production efficiency and lead to higher growth.[2]

[1] Era Dabla-Norris is Division Chief, and Grace Li is Senior Economist, Fiscal Affairs Department, International Monetary Fund.

[2] The note abstracts from competing neutrality concepts in the context of international tax, such as capital export neutrality and capital ownership neutrality, and associated policy implications (see IMF 2014, Annex VII).

3.Tax incentives often reflect strategic choices of governments. In China, as in many other countries, deviations from tax neutrality reflect strategic government choices. Preferential tax incentives—any special tax provisions granted to qualified investment projects or firms that provides favorable deviation from the general tax code—may be necessary to improve market outcomes that are inefficient or unfair and correct for strong externalities (such as in R&D). For instance, firms may fail to account for the spillovers its activities will have on other businesses or the economy more broadly—a situation the tax code can remedy with subsidies or taxes depending on the sign of the externality.

4.Differences in tax treatment of firms can lead to resource misallocation, lower productivity, and growth. International experiences suggest that when incentives are targeted at a specific industry, sector, or even firm, they create an unlevel playing field and risk reallocating resources from more productive uses to less productive ones. Even if tax rules are uniformly applied, distortions can be created by the disparity in tax treatment across firms (IMF 2017). For instance, differences in tax treatment of assets could lead to too much capital in industries that are tax-preferred and too little capital in industries that are tax-disadvantaged. The resulting misallocation of capital reduces output.

Similarly, the debt preference of the tax system, whereby interest expenses are tax deductible but not the return on capital, creates an advantage for those firms that have easy access to debt (that is, those with large fixed assets), putting them at a competitive advantage over other firms.[3] This so-called debt-equity bias can also lead to overleveraging and increase financial fragility risks (IMF 2016a). Finally, preferential tax treatment for small firms can result in resource misallocation if more productive firms choose to stay small in order to remain below the eligibility threshold, creating a "small business trap". Improving the design of a tax system can thus help to level the playing field across firms by encouraging more productive firms to grow.

5.Tax policy reforms in recent decades have enhanced the efficiency of

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[3] From an international tax perspective, profit shifting through interest could be used for tax avoidance, putting multinationals at an advantage over purely domestic firms (IMF 2014).

China's tax system, but evaluating the impact of recent tax cuts would be important. Since the mid-1990s, a uniform income tax applies to all domestic enterprises, irrespective of ownership. The enactment of the 2008 Enterprise Income Tax Law further harmonized taxation across domestic and foreign-funded enterprises (Brondolo and Zhang 2016). A series of value-added tax (VAT) reforms have been implemented to move towards a broad-based VAT. Recent tax cuts enacted in China to stimulate the economy appear to be a move in the direction of providing more targeted incentives for certain sectors and firms. Tax measures include VAT cuts for the manufacturing, construction, and transportation sectors[4] and corporate income tax cuts for small and medium enterprises (SMEs),[5] among others. Evaluating the impact of these measures would be important to ensure that the differentiated tax cuts for specific sectors and preferential rates for SMEs stimulate growth without distorting the allocation of resources in the economy.

Tax treatment of SOEs vs. other firms

6.Even if tax rules are uniformly applied, distortions to investment decisions and resource allocation can be created by the different characteristics of SOEs and other firms. For instance, SOEs continue to dominate certain strategic sectors in the economy, including power and gas, construction, and services such as telecommunications. Many of these sectors benefit from tax incentives in the form of tax holidays or reduced tax rates for new investment, which could indirectly favor SOEs in the form of an implicit subsidy (Figure 1). Preferential credit access and implicit credit guarantees also tilt credit allocation towards SOEs, exacerbating debt bias and indirectly rendering them tax-favored. For instance, SOEs remain significantly less profitable than private firms and are more reliant on debt (Figure 2).

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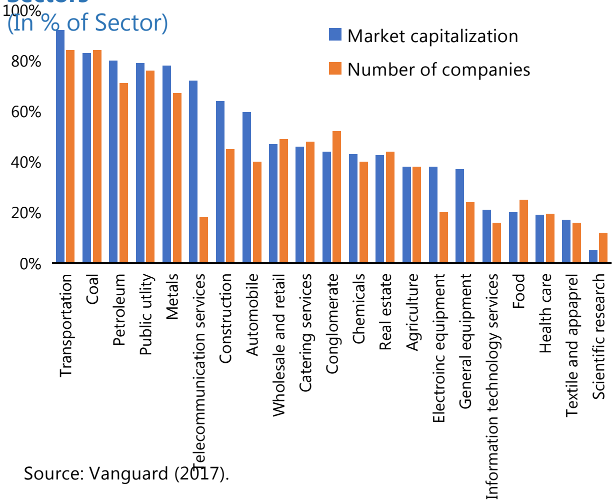
[4] Measures include reducing the current VAT rate of 16 percent in manufacturing and other industries to 13 percent; lowering the rate in transportation, construction, and other industries from 10 percent to 9 percent; and, maintaining the 6 percent rate on all other items.

[5] Small businesses enjoy half the corporate income tax rate, with the upper limit of taxable annual income raised from RMB0.5 million to RMB 1.0 million.

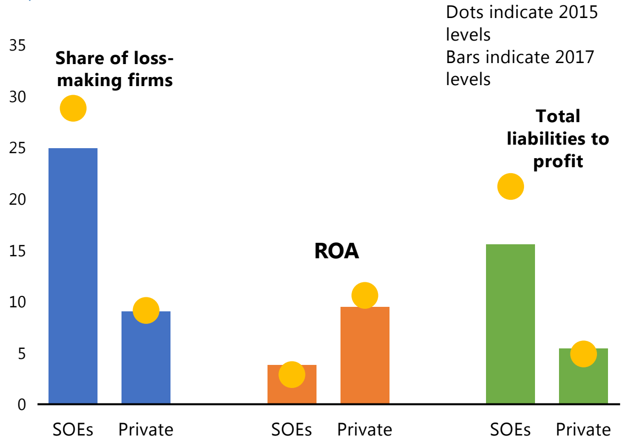
Figure 1. SOE Dominance in Specific Sectors
(In % of Sector)



Source: Vanguard (2017).

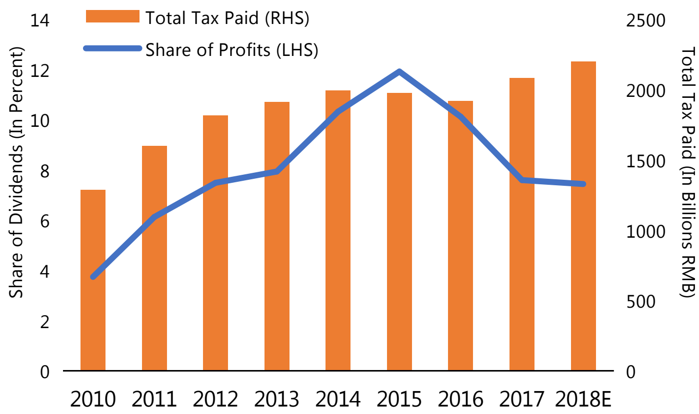
7.Taxes may not be perceived as costs by SOEs, suggesting that the tax burden on private firms should not be too distorting. Recent research finds that SOEs in China have a lower behavioral response to taxes in terms of leverage and investment decisions than other firms (Fuest and Liu 2015). This suggests that SOEs do not perceive taxes as costs and have an advantage that their decisions are not distorted by taxes. A related issue is that SOEs pay taxes as well as after-tax profits (dividends) to the government. In recent years, taxes paid to the government by SOEs have increased while dividends have declined, providing suggestive evidence that SOEs view them as substitutes (Figure 3). If taxes are not perceived as costs (that is, they are perceived as a substitute for dividends), there should be no wage and investment response to tax changes. Tax costs, however, will still be reflected in after-tax earnings for privately owned enterprises, suggesting that any distorting tax de facto is likely to advantage SOEs. One implication from the perspective of competitive neutrality is to ensure that the tax burden on private firms is not excessive compared to that for SOEs.

Figure 2. State-owned and Private Enterprises Compariso
(In percent)



Source: IMF staff estimates.

Figure 3. Share of Dividends and Tax Paid to the Government by Central SOEs



Source: Ministry of Finance.

Design matters for efficiency and effectiveness of R&D

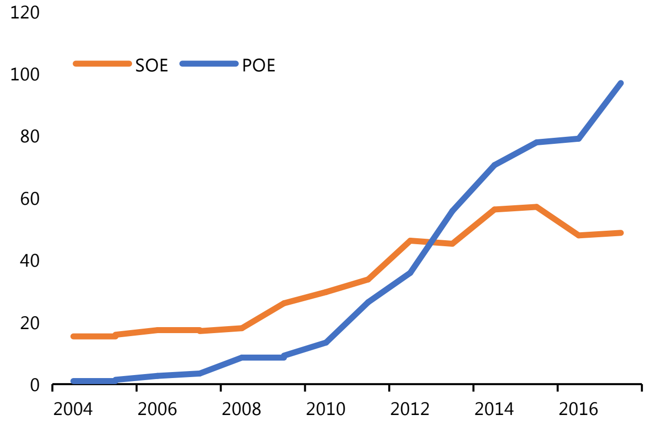
8.There is an economic rationale for deviating from tax neutrality in providing well-designed tax incentives for R&D and innovation to correct for externalities. This can help boost productivity and support growth prospects (IMF 2016b).6 The design of tax incentives, however, is critical, to get the

[6] IMF analysis finds that private firms in advanced and emerging economies would need to invest 40 percent more in R&D, on average, to account for the positive knowledge spillovers they create to the wider economy. This investment in R&D could lift GDP in the long term in those countries, and globally as a result of international technology spillovers (IMF, 2016).

best value for money. For instance, by providing incentives for innovation, patents may reduce the need for tax incentives. However, patents can hamper technology diffusion. Similarly, tax incentives that are available to all firms (or sectors) that invest in R&D provide a level playing field, as all private R&D activities get equal treatment. Private sector R&D decisions, however, may not adequately address the complex knowledge spillovers associated with R&D, requiring more targeted support. International experiences suggest that R&D input-related incentives (such as those related to actual spending on R&D) and tax credits offer superior design features than those for R&D outputs, such as intellectual property regimes. Moreover, targeting incentives to small and new firms is more effective in promoting R&D investments than for other firms.

9.Innovation has long been considered as key for development in China, with R&D spending increasingly led by the private sector. China has become a major R&D power in the world, with R&D spending accounting for around 2 percent of GDP in 2014. The government relies on both direct R&D spending and tax incentives to support research activities. Most R&D, however, is financed by firms, and only a small fraction comes from the government budget, and even less from foreign and other sources (OECD 2017). Further, R&D spending by the private sector now outpaces that by SOEs (Figure 4). The Chinese government recently increased its super deductions for R&D and a range of preferential incentives (from tax credits to reduced tax rates) are being provided for SMEs and firms in high-technology sectors. Promoting the efficiency and effectiveness of these incentives is crucial, and a key challenge is to ensure that R&D policies do not inordinately favor domestic companies over foreign firms or create an unlevel playing field.

Figure 4. R&D Investment in China (by firm ownership)
(In Billions RMB)



Source: National Bureau of Statistics.

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CONCLUDING ROUNDTABLE

Position Paper on Competitive Neutrality

Alan Beebe[1]

Introduction

The concept of competitive neutrality has recently begun to enter public discourse in China. In October 2018, PBC Governor Yi Gang told G20 International Banking Seminar attendees that China was considering treating state-owned enterprises in line with the principles of Competitive Neutrality.[2] In the 2019 Government Work Report, Premier Li Keqiang promised to "follow the principle of Competitive Neutrality" on factors of production, market access, business operations, and government procurement.[3]

The American Chamber of Commerce in the People's Republic of China welcomes the Chinese government's embrace of the concept, likewise embraced by the Organization for Economic Cooperation and Development and the United Nations Conference on Trade and Development. In principle, competitive neutrality has the potential to address many long-standing structural issues that contribute to an unlevel playing field for foreign companies—such as subsidies, overcapacity, market access restrictions, intellectual property protection, and onerous cybersecurity laws. Furthermore, it will benefit the entire economy and domestically-owned private enterprises.

What is competitive neutrality?

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[1] Alan Beebe is President of American Chamber of Commerce in China.

[2] See https://www.scmp.com/economy/china-economy/article/2168676/can-chinese-state-firms-compete-fairly-beijing-claims.

[3] See http://english.gov.cn/premier/speeches/2019/03/16/content_281476565265580.htm.

Competitive neutrality means that all market participants—state-owned, privately-owned, and domestically or foreign-owned—compete on a level playing field, free from excessive advantages due to their ownership or nationality.4 While certainly not true of all state-owned enterprises (SOEs), the fact is that due to their favorable status and implicit government guarantees, SOEs hurt market competition. In the Chinese context, any discussion of competitive neutrality must also acknowledge the privileges and advantages extended to domestic private companies, particularly in strategic sectors such as technology.

Implementing competitive neutrality requires a narrowly drawn foreign investment "negative list", to which China has previously committed, and assurances that national-security-related rules and restrictions are narrowly tailored and not used to promote industrial policy objectives. Along these lines, competitive neutrality provides a framework for ensuring that (1) SOEs, private, and foreign-owned firms face the same set of operating rules, and (2) that SOEs do not enjoy any competitive advantages (or suffer competitive disadvantages) as a result of their relationship with the state.[5]

AmCham China's Position on Competitive Neutrality

We believe that policies should place all enterprises in China on a level playing field. Implementing competitive neutrality is especially important given the growing challenges of the U.S.-China commercial relationship and questions being raised internationally about the relatively broad market access enjoyed by Chinese companies overseas, compared to the restricted market access for foreign-owned or foreign-invested enterprises in China.

As the world's second largest economy with a huge population base (over 1.3 billion people) and rapidly growing middle class (over 400 million people), China is the largest and fastest growing market in the world for many products and services. To be globally competitive, American producers and service providers must be able to compete in the China market. According to the 2019 China Business Climate Survey Report of February 2019, 62 percent of

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[4] See https://www.oecd.org/competition/competitive-neutrality.htm.

[5] See http://www.oecd.org/daf/competition/46734249.pdf.

respondents ranked China as their first or one of their top three priorities in global investment plans, despite concerns over the Chinese economy, indicating the importance U.S. companies place in the China market.

This is why, in principle, AmCham China welcomes the embrace of competitive neutrality. A complete, transparent, and sustained commitment to competitive neutrality and a level playing field for the foreign-owned and domestically owned private sector will benefit the entire economy, not just foreign-owned enterprises.

However, despite rhetorical commitments to these principles, China's economy requires systemic structural reform to ensure creation of a truly level playing field. AmCham China member companies face longstanding, persistent business challenges and an increasingly uncertain operating environment. Our members have been consistent for many years in expressing shared concerns over China's state intervention in the economy, restrictive market access policies, intellectual property rights violations, pressure to transfer technology, and an often opaque and discriminatory regulatory environment.

An Unlevel Playing Field

Below are select examples of how an unlevel playing field for foreign companies in China impacts AmCham China member companies.

Subsidies and overcapacity

China provides significant subsidies, including for agriculture, aluminum/steel, and key industries identified under Made in China 2025 (new advanced information technology, automated machine tools and robotics, aerospace and aeronautical equipment, maritime equipment and high-tech shipping, modern rail transport equipment, new-energy vehicles and equipment, power equipment, agricultural equipment, new materials, biopharma and advanced medical products). These subsidies distort domestic and global competition in favor of Chinese national champions and have led to industrial overcapacity in multiple sectors, often harming or placing their foreign competitors at a severe disadvantage in both the domestic and foreign markets.

Market access restrictions

China maintains market access restrictions in key industries that contribute to the unlevel playing field. Similar restrictions are largely absent in the U.S. market. For example:

· Agriculture: Foreign investment in important agricultural sectors, including biotech crop breeding, genetically modified seed production, and commercialization, is prohibited.

· Automobile: Foreign companies must form a joint venture with a Chinese partner. Foreign equity in production of passenger and commercial vehicles is capped at 50 percent, and the number of joint ventures per investor is also capped. Foreign equity caps, in place since China initiated its reform and opening, are not scheduled to be removed until 2022.

· Government procurement: Despite some progress, China still has not submitted an acceptable offer to fulfill its commitment to accede to the WTO Agreement on Government Procurement, 18 years after joining the World Trade Organization.

· Telecommunications: Foreign firms are subject to 50 percent ownership caps, even in those value-added telecommunications sectors in which foreign investment is permitted, such as cloud computing.

· Legal services: Foreign law firms cannot hire Chinese lawyers to practice Chinese law.

Intellectual property

China maintains numerous laws, regulations, policies, and standards that either provide insufficient protection of critical technology, or expressly require the transfer of technology/intellectual property as a precondition for market access, such as the requirement in some sectors to form a joint venture with a domestic Chinese company in order to operate in the Chinese market. According to AmCham China's 2019 Business Climate Survey Report "a lack of sufficient (intellectual property) protection" remains the main challenge dissuading companies from increasing innovation in China. Despite recent amendments to the Anti-Unfair Competition Law on trade secrets, sufficient protection of trade secrets for foreign-owned firms in China has been a longstanding challenge. In the media and entertainment industry, for instance, internet piracy remains a significant challenge because of insufficient copyright protection and weak penalties.

Cybersecurity and the digital economy

China's information and communications technology sector and digital economy is among the most dynamic globally, but it is also one of the most restrictive. Chinese laws restrict cross-border data flows and the free movement of information, require data localization, and create the potential for foreign technologies to be discriminated against in favor of domestically-produced technologies through a variety of means, including licensing and standards requirements. In an increasingly digital global economy, China's restrictive information and communications technology policies affect a wide range of industries, including automotive, banking, education, express delivery, health care, and insurance.

For example, in the banking sector, restrictions on cross-border transfers of basic bank and financial data, typically allowed to move freely across borders in other developed countries, create significant compliance burdens and costs for foreign-invested banks. In the insurance industry, current regulations give priority to non-specific "secure and controllable" IT hardware and software products, creating the potential for foreign technologies to be discriminated against in favor of domestically produced technologies, while also creating interoperability challenges with the global operations of foreign-invested insurance firms.

Recommendations to Ensure an Environment of Competitive Neutrality

Continued advocacy for a level-playing field is important to AmCham China members. In the 2019 Business Climate Survey Report, close to half (47 percent) of our members would like to see the U.S. government advocate more strongly for a level playing field. To promote its creation, we recommend that:

- Foreign investors be provided treatment no less favorable than the best treatment offered to any domestic Chinese company, whether state-owned, state-controlled, or privately-owned.

· Laws and regulations, enforcement activities, approval processes, procurement preferences, and other requirements that treat foreign entities less favorably than domestic firms be eliminated.

· Market openings be implemented in more sectors, beginning with those sectors in which China's previous commitments have yet to be implemented, to achieve a more balanced investment relationship. If Chinese businesses can make an investment in the United States, U.S. companies should be able to make the same investments in China.

· The Chinese government substantially narrow its foreign investment negative list, bringing it in line with those in other advanced economies.

· National security reviews and "secure and controllable" technology requirements be narrowly applied and not used for economic protectionism or in support of industrial policy.

· The Chinese government reduce overcapacity, provide a full accounting to the WTO of all subsidies and eliminate those that are non-WTO compliant, and remove other policies that promote unfair competition.

About AmCham China

The American Chamber of Commerce in the People's Republic of China is a non-profit, non-governmental organization whose membership comprises more than 3,300 individuals from 900 companies operating across China. The chamber's nationwide mission is to help American companies succeed in China through advocacy, information, networking and business support services. With offices in Beijing, Tianjin, Dalian, Shenyang and Wuhan, AmCham China has more than 50 working groups, and holds more than 250 events each year.

Government Support and Credit Markets

Shaun Roache[1]

From the perspective of an economist working at a credit ratings agency, I was particularly interested in the frequent theme of pricing and access to credit during the discussion. This appears to be among the most important issues in ensuring competitive neutrality. IMF work suggesting that Chinese government-related entities issuing offshore debt enjoyed a higher final credit rating and lower costs of debt funding than might be justified based on standalone credit profiles was unsurprising.

Indeed, S&P Global Ratings has published detailed global methodology on why and how government-related entities can benefit from extraordinary government support. I noted that the difference between a standalone credit profile and a final rating can be substantial and depends, in part, on the local currency rating of the supporting government, which may be a local government, and the likelihood of timely and sufficient intervention. In turn, this likelihood reflects the link between the government-related entities and the government, such as ownership or explicit guarantees, and the role that the government-related entity plays in delivering on the government's policy objectives.

Our discussions clearly suggested that the perception of government support was a particularly important issue for China. First, there is a long track record of government financial support for borrowing corporates, especially state-owned enterprises, which is reflected in low default rates. History matters because it strengthens the market's conviction that government support will

[1] Shaun Roache is Chief Asia-Pacific Economist, S&P Global Ratings.

be forthcoming during times of stress and this will be reflected in the cost of debt. Second, the government's wide-ranging economic and social objectives often rely on the execution of specific policies by state-owned enterprises. This also strengthens the perception that these companies will be supported even if their financial performance deteriorates.

While much of the discussion centered on the cost of funding, I raised the issue of access to funding, particularly during periods of market stress. In particular, issuance of speculative-grade debt during such periods can become prohibitively expensive. When access to funding completely shuts down for some issuers, this can exacerbate funding pressures and amplify stress in certain sectors on the economy. In contrast, for issuers with speculative-grade standalone credit profiles but a final rating that may be investment grade, allowing access to the market, the advantages of perceived government support can be extremely high. In this sense, simply comparing the average cost of funding may understate the benefits and distortions provided by government support.

Legal Challenges for SOEs Governance - International Experience

Rhoda Weeks-Brown[1]

General Considerations

The ultimate objective of reforming state-owned enterprises (SOEs) is to build a more efficient relationship between the state and its assets—a relationship that helps minimize misallocation of resources, clarifies the separation of roles within the government and within the SOEs themselves, and that is fully sustainable over time.

As we know from experience around the world, reforming SOEs is easier said than done. The legal and institutional framework is critical. But as with most reforms, it is not enough simply to have the right framework in place; it is also necessary to ensure its consistent and effective implementation. How do you build the government and public support needed, overcome vested interests, overcome competing priorities, and overcome political pressures, all with a view to ensuring success of the reform agenda?

These remarks address four areas that have legal implications and are critically important in this context: (i) treating SOEs like similarly situated private companies; (ii) conversely, ensuring there is appropriate governance and fiscal discipline to deal with the uniqueness of state ownership; (iii) having in place a strong and properly implemented insolvency and corporate restructuring

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1 General Counsel and Director, Legal Department, IMF. The views expressed in this note are views of the author and do not necessarily represent the views of the IMF, its Executive Board or IMF management.

regime that applies to SOEs as well; and (iv) using communications as a strategic tool to build political consensus to move SOE reforms forward.

Competitive Neutrality and Uniformity of Treatment

A lot has already been said at this conference about competitive neutrality; it is useful to look more closely at the OECD's definition of the term.

"Competitive neutrality occurs when no entity operating (or with potential operations) in an economic market is subject to undue competitive advantages or disadvantages." This means in practice that the legal and regulatory framework for SOEs should ensure a dynamic, level playing field in the marketplace when SOEs undertake economic activities. In other words, the same rules of the game should apply to all commercial businesses regardless of their ownership. As a simple example, where SOEs are incorporated as joint stock companies, a modern company law, generally applicable to SOEs as well as to private entities, is a key building block of a sound SOE legal framework.

Interestingly, we can see an analogy here to the uniformity-of-treatment principle that has long guided how the IMF deals with its member countries. This principle does not require that the IMF treat all members identically. But it requires that the IMF's policies and other decisions that differentiate among members be justified based on the application of criteria that are relevant to the power being exercised.

For companies operating in a market, the analogy would be that differences in treatment must be justified by factors relevant to that group of companies or industries as a whole, and not simply based on the state's ownership.

Applying this analogy, the following principles of competitive neutrality seem particularly relevant for China:

· Competitive neutrality implies that SOEs should earn a market consistent rate of return, meaning a rate comparable to what is earned by similar firms within the same industry. If government businesses were not required to earn a commercial rate of return, they would be able to undercut competition by factoring lower profit margins into their pricing.

· Tax neutrality was also emphasized in earlier discussions in this conference: government-owned businesses should bear a similar tax burden as private sector competitors.

· Similarly, SOEs should operate, to the maximum extent feasible, in the same regulatory environment as private enterprises. If there are regulations for a sector, it is not appropriate for the objective served by those regulations to carve out a company simply because it is state-owned.

· There is also the issue of debt neutrality: SOEs and other government businesses should pay the same interest rate on debt obligations as a private enterprise in similar circumstances. Governments should ensure that the commercial activities of SOEs and government businesses do not benefit from outright subsidies or subsidized finance. But even when this is done, cases also arise where, mainly because of perceived lower risks, SOEs can still obtain cheaper finance in the market than is available to private firms.

· Another key component of a level playing field is the equitable treatment of shareholders and other investors. Where SOEs are listed companies or otherwise include non-state investors among their owners, the state and the enterprises should recognize the rights of all shareholders and ensure shareholders' equitable treatment and equal access to corporate information.[2]

Unique SOE-Specific Governance and Fiscal Risks

The discussion above argues that SOE commercial activities should be subject to the same rules as other companies. It is important also to recognize, however, that public ownership matters. Sticking with the IMF uniformity of treatment analogy, that principle also requires that the IMF tailor policy advice (e.g., in the context of surveillance) to countries' specific circumstances, so similarly situated members would be expected to have similar policies recommended in light of those circumstances.

Looking at SOEs, one could see how differential treatment (special governance

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[2] See, on this and SOE governance in general, the OECD Guidelines for SOEs, https://www.oecd-ilibrary.org/docserver/9789264244160-en.pdf?expires=1555338779&id=id&accname=ocid195787&checksum=6A1FF3FA769C671D9CCA3B06A5E3E160

rules) would be justified to address unique issues arising from the government's ownership role, including safeguards to avoid political interference, enhance the performance of the state as an owner, and promote fiscal discipline.

Corporate governance safeguards—one category of these rules is SOE-specific corporate governance safeguards:

· Non-commercial activities—State-owned enterprises, unlike private companies, often perform public service functions. One of the most challenging issues for competitive neutrality arises where SOEs that operate in a competitive environment are required to carry out non-commercial activities in the public interest.

· The legal framework must ensure that commercial activities and related budgets are clearly demarcated from non-commercial activities and their costs. And companies should be adequately and transparently compensated for non-commercial activities with public funds in a way that avoids market distortions. If SOEs are under- or over-compensated for public service obligations, then it tilts the playing field.

· More generally, multiple objectives can be problematic. We know it is early days yet, but China is to be commended for taking steps to transfer social responsibilities from SOEs directly to the government.

Rationale for state ownership—It is also important for governments to regularly evaluate the rationale for state ownership and the underlying SOE mandates. The state exercises ownership of SOEs in the interest of the general public, ultimately to maximize value for society through efficient allocation of resources. Too often, however, there are broad and not well delineated mandates that open the door to conflicting interests in the management of the SOE.

State's role as owner—The state should act as an informed and active owner, ensuring SOE governance is carried out transparently and accountably, with a high degree of professionalism and effectiveness. The legal instrument to perform such a role may vary: e.g., some countries have SOE umbrella laws (Afghanistan, Brazil, Ghana,) or ownership policies (Bhutan, Colombia, Jamaica) to ensure proper division of labor within the government.

To complement the efforts of these institutional arrangements, governments have also pushed for rules and codes to enhance integrity in the management of SOEs. The most common address conflicts of interest, through codes of corporate governance and ethics (Chile, Pakistan, Peru).

Minimizing fiscal risks—The IMF's Fiscal Transparency Code (2018) emphasizes the importance of fiscal risk management and provides principles on disclosure of information about public finance. A few key principles that should be reflected in the legal and institutional framework for SOEs include:

· Strong fiscal risk oversight by the Ministry of Finance. An explicit legal mandate to the ministry for monitoring the fiscal risks of SOEs (such as subsidies and quasi-fiscal activities), with necessary powers (such as collecting information on the financial performance of SOEs) can strengthen the fiscal oversight of SOEs.

· For example, Ukraine set up a fiscal risk management unit in the Ministry of Finance to monitor and analyze SOE fiscal risks; Afghanistan focused on strengthening the fiscal risk oversight mandate of the Ministry of Finance, including by granting it veto powers for decisions that may give rise to significant fiscal risks.

· Integration with the budget process. Any transfers to SOEs made through the budget, together with government guarantees and the cost of public service obligations, should be correctly estimated and disclosed in the budget documents. The budgetary and public debt legal framework should include effective mechanisms to capture and oversee fiscal risks, including clear rules and procedures on inflows (such as profit transfers to the government) and outflows (such as capital injections to SOEs), and budgetary limits on public debt and guarantees.

Safeguards in state guarantees. A further important element is to ensure adequate safeguards and uniform procedures for the issuance and management of state guarantees, including to require cost-benefit analyses and to monitor contingent liabilities, with a view towards preventing excessive risk taking and placing government money where is most needed.

Phasing out implicit support. Direct and indirect support (such as subsidies) should be removed or disclosed, as appropriate, to prevent resource misallocation and an uneven playing field with private firms.

In China, the IMF recommended phasing out implicit support (land use, credit, input prices, fiscal support) reducing entry barriers to markets currently monopolized by SOEs (such as the oil sector and telecom), and having non-viable firms default and exit if market forces warrant, with fiscal support aimed at affected workers.

Insolvency of SOEs and Chinese Insolvency Reforms

Critically, level-playing-field considerations apply throughout the lifecycle of SOEs, including at the time of their exit.

Addressing SOE Insolvency

Application of the insolvency regime to SOEs is one of the foundations of competitive neutrality: if SOEs are not subject to insolvency law, or if SOEs are de facto protected from the insolvency regime, there is no market discipline, and SOEs can accumulate losses and engage in unfair competition against private companies. Exit problems cannot be solved without the application of insolvency law.

Zombie SOEs give the debate another angle: because SOEs often avoid insolvency thanks to the fiscal or financial support of the state, these firms continue to operate even though unviable. This can have a huge macroeconomic impact: SOEs tend to absorb financial resources that could be allocated to productive firms, crowding out private enterprises. In essence, productive firms may fail because of the unfair competition of SOEs, while SOEs survive by increasingly absorbing resources from the state.

The conclusion is that SOEs should be subject to the same insolvency regime as private companies, and local governments and courts should enforce the regime fairly and neutrally. Unviable SOEs would be liquidated. But importantly, distressed but viable companies should be restructured and kept going.

Also important, companies often need operational restructuring to address operational inefficiencies, not only debt (financial) restructuring. Debt restructuring by itself cannot solve the problem if there are dominant operational inefficiencies. Many countries need a legal framework that facilitates this kind of restructuring. According to best international practice, SOEs should be subject to the general insolvency regime, which affords ample opportunity for reorganization. There may be limited exceptions to the application of the general insolvency law, based on the special functions of particular enterprises (for instance, strategic companies in the defense sector, or basic infrastructure operators). In these cases, continuity of essential services or activities is guaranteed, but the special insolvency regime should encourage changes in management, capital and organization to increase efficiency.

China's reforms

On paper, China's Enterprise Bankruptcy Law (adopted in 2006) follows the international standard set by UNCITRAL and the World Bank, applies to SOEs, and covers both reorganization and liquidation. This said, the system lacks detailed secondary rules in key areas, and some of the basic principles have sometimes been misinterpreted.

An important development is that the authorities have been taking steps to advance the reform agenda:

China has created specialized bankruptcy courts (starting in 2007, but mostly between 2014–2017). There are now 92 bankruptcy courts, which are part of the state administration and thus not controlled by the local governments.

A recent analytical paper, Going Bankrupt in China,3 has a very positive assessment of this reform. It finds that the use of specialized courts "brought faster resolution of financially distressed SOEs and led local private firms to invest more, thus potentially mitigating resource misallocation in Chinese credit markets." The overall conclusion was that the use of these specialized bankruptcy courts "favored the transition from a state oriented to a market-based insolvency regime, at least when it comes to local government influence

[3] Li, Bo and Ponticelli, Jacopo, Going Bankrupt in China. 2019. SSRN: https://ssrn.com/abstract=3251570 or http://dx.doi.org/10.2139/ssrn.3251570

in insolvency resolution of local SOEs.”

Other more specific findings about the use of these specialized courts include an increase in total bankruptcy filings and in SOE filings in specialized bankruptcy courts, shorter resolution times for cases filed in specialized courts than in regular courts, more qualified judges in the specialized courts, and a decrease in the share of zombie SOEs in cities that have introduced specialized courts, compared to other cities.

Given this positive experience, it is encouraging that the authorities have indicated that other reforms of the enterprise bankruptcy law remain a policy objective. The list of important issues identified for reform includes the following, all of which should be helpful to SOEs in need of restructuring:

· Professionalization of insolvency administrators: development of the insolvency profession is crucial for the efficiency of the system.

· Allowing reorganizations under a “debtor in possession” approach: in theory, the debtor may remain in possession under Chinese law, as in Chapter 11 of the US Bankruptcy Code. In practice, however, there are obstacles for this solution. If the debtor in possession regime is implemented effectively, reorganizations would be more attractive for companies, which increases the possibilities of early (and therefore more successful) resolution of distress.

· Enforcing the “absolute priority rule”: currently, it is frequent that compositions or reorganization plans allow shareholders to retain value while creditors suffer heavy losses. The strict enforcement of this rule could have a huge impact on SOE insolvency, as it could result in the transfer of ownership of distressed SOEs to private investors (as the state could not retain any stake in the reorganized enterprises without the creditors’ consent).

· Introducing pre-packaged reorganizations: this would allow creditors and debtors to negotiate out of court and submit reorganization plans for quick confirmation by the court. In other countries, this has proven to be a very efficient way of resolving companies, and with the speed of the process itself providing a further incentive to move towards restructuring.

Communications as a Strategic Tool for SOE Reforms

Significantly, Premier Li Keqiang recently announced that creating a level playing field for all companies is an important policy objective to ensure a better allocation of resources, whether the firms are state-owned, private, domestic or foreign.

Key now is for the government to communicate carefully and strategically about this important objective, domestically and abroad.

Careful communication is more than just public relations: it can be a powerful strategic tool to build understanding and support for reform efforts, and this in turn can enhance the effectiveness of those efforts—once implementation actually begins to take shape. If people understand what is being done and how it benefits them, they are more likely to be supportive.

The converse is also true: in today's world, it is very hard to have a successful wide-impacting reform plan without careful, layered, and targeted communications.

Conclusions

Reforming SOEs is easier said than done but there are legal solutions that can help government iron out vested interests, competing priorities, and political pressures.

Equal treatment of companies, and adequate governance and fiscal discipline coupled with an effective insolvency regime, are what China should continue to focus its reform agenda on. There are undeniable benefits in properly designing and adequately implementing these three legal solutions to build a more efficient relationship between the state and its assets.

Yet ensuring that Government properly and timely communicates its intention, including of moving reforms forward to minimize misallocation of resources and make SOEs sustainable over time, is a critical component for success of the reform effort.

Some observations on SOE reform

GUO Kai[1]

I have several takeaways.

First, competition neutrality has provided us with a framework to move forward on SOE reform. In the past, all we have is vague language on fair competition and equal treatment. Today, there have been discussions on tax neutrality, regulation neutrality, debt neutrality and so on, which can become concrete steps for governments to take. This is a good sign that competitive neutrality is a potentially implementable way to lay a level playing field for all firms.

Second, SOE is not a new issue, it's a legacy issue. To address legacy issues, one should refrain from the simplistic approach of just introducing market and let everybody compete. There are a series of issues that have to be addressed at the same time, so it won't be easy.

And I actually have to remind everybody: 20 years ago, China's SOE problem was much more pronounced and problematic than today. Twenty years ago, there were much more SOEs, and their contributions to the economy, employment, and market distortion in the markets were much bigger than today. Now, the SOE problem becomes a more prominent issue probably because China has grown much bigger. But if you look at China alone in the long-term framework, the SOE issue is being addressed.

As China is and will be a socialist country, I think we need to take SOEs as a given, and we shouldn't assumed that it will go away. Encouragingly, Sweden's case shows that, if you have enough transparency, accountability and good

[1] GUO Kai is a Deputy Director-General of the International Department of the People's Bank of China.

management, SOEs in those competitive sectors can be as competitive as private companies, and won't compromise a level playing field.

But it's also complicated. The question is where do we start to achieve competitive neutrality.

Third, more transparent and strict fiscal discipline may be a good starting point. In the last round of China's SOE reform around the time of the 1997-1998 Asian Financial Crisis, we started by tightening the lending criteria for banks, and therefore hardening the budget constraints on SOEs. As a result, those unsustainable, loss-making SOEs could no longer have a way out by borrowing, and the government had to sell them. If they can find a way to turn around, it's OK. If they die, then they die. That's how we privatized or liberalized hundreds of thousands of SOEs at that time.

Going forward, we don't have to go into another crisis in order to reform SOEs, and I think maybe the starting point could be more transparent and strict fiscal discipline. This way, central and local governments cannot subsidize SOEs without sufficient justifications, and will no longer have the incentive of setting up new SOEs as borrowing vehicles to do things that should have been done on budget. That could kill some of the soft budget constraints from the fiscal side.

On the central bank part, enough discipline should be put in place both in terms of lending and the capital market, in particular the bond market. Ratings should reflect risks of companies. For companies failing to meet their obligation, it would put some discipline on them from the financial side by allowing their borrowing cost to reflect underlying risks .

If we can tighten both financial and fiscal sides of how SOEs can get soft subsidies, I guess that would provide some impetus for them to transform their business models.

For those commercially competitive sectors, if both fiscal and monetary parts are tightened, they have to get the right rate of return in order to survive in market competition. If they're really in the sectors that are not supposed to be profitable, like national security or some of the social functions that still need to be carried out by SOEs, then there should be explicit transfers from government.

As the discussion went on, I felt more hopeful on the prospect of SOE reform. It won't be quick, and it may take a lot of hard work, but I'm hopeful that we can achieve some success by getting competitive neutrality right.

BIOGRAPHIES

CHEN Yulu

Deputy Governor
The People's Bank of China

CHEN Yulu was born in 1966 and received a PhD degree in Economics. He became Deputy Governor of the PBC and Member of the CPC PBC Committee in 2015.

2011 to 2015	President, Renmin University of China
2010 to 2012	President, Beijing Foreign Studies University
2005 to 2010	Vice President, Renmin University of China
2002 to 2005	Dean, School of Finance, Renmin University of China
1997 to 2002	Executive Associate Dean, School of Finance, Renmin University of China
1992 to 1997	Assistant Director, and then Associate Director, Department of Finance, Renmin University of Chin

GUO Kai

Deputy Director-General, International Department
The People's Bank of China

GUO Kai is Deputy Director-General of the International Department of the People's Bank of China. His main responsibilities include United States, United Kingdom, G20 and IMF issues. Mr. Guo holds a PhD degree in Economics from Harvard University and worked as an economist at the IMF before joining the PBC. His research interest includes the Chinese economy and international finance.

HUANG Yiping

Chair Professor and Deputy Dean, National School of Development
Peking University

Huang Yiping is Jin Guang Chair Professor of Economics and Deputy Dean of the National School of Development and Director of the Institute of Digital Finance, Peking University. In October 2018, he was appointed by the IMF as a member of its External Advisory Group on Surveillance. He served as a member of the Monetary Policy Committee at the PBC during 2015-2018. Currently, he is a Research Fellow at the Financial Research Center of the Counselors' Office of the State Council. He also serves as Chairman of the Academic Committee of China Finance 40 Forum, and a member of Chinese Economists 50 Forum. He is Editor of the China Economic Journal and an Associate Editor of the Asian Economic Policy Review. His current research focuses on financial reform and fintech. Previously, he was a policy analyst at the Research Center for Rural Development of the State Council, senior lecturer of economics at the Australian National University, and Managing Director and Chief Asia Economist for Citigroup.

Justin Yifu LIN

Dean, Institute of New Structural Economics
Peking University

Justin Yifu LIN is Dean of the Institute of New Structural Economics, Dean of the Institute of South-South Cooperation and Development, and Professor and Honorary Dean of National School of Development at Peking University. He was the Senior Vice President and Chief Economist of the World Bank, 2008-2012. Prior to this, Mr. Lin served for 15 years as Founding Director and Professor of the China Centre for Economic Research (CCER) at Peking University. He is Councilor of the State Council and a member of the Standing Committee, Chinese People's Political Consultation Conference (CPPCC). He is the author of more than 20 books including Beating the Odds: Jump-starting Developing Countries; Going Beyond Aid: Development Cooperation for Structural Transformation; The Quest for Prosperity: How Developing Economies Can Take Off; New Structural Economics: A Framework for Rethinking Development and Policy; Against the Consensus: Reflections on the Great Recession; and Demystifying the Chinese Economy. He is a Corresponding Fellow of the British Academy and a Fellow of the Academy of Sciences for the Developing World.

LIU Shijin

Vice Chairman, China Development Research Foundation
Vice Director, Economic Committee of the CPPCC National Committee

LIU Shijin is Vice Chairman of the China Development Research Foundation, Vice Director of the Economic Committee of the CPPCC National Committee, and former Vice Minister of the Development Research Center of the State Council. His research fields include macro-economics, industrial development, and economic system reform. He is the leader and author of a series of research achievements, such as Traps and High Walls: Real Challenges and Choices for China's Economy and Forming a New Normal of Growth in Reform. He participated in drafting the report of the Third and Fifth Plenary Sessions of the 18th Central Committee of the CPC, and also the report of the 19th National Congress of the CPC. He is a member of the Expert Committee for China's 13th Five-Year Plan and the National Committee on Climate Change. He has won the Sun Ye-fang Prize for Economic Science and the top prize for China's development research.

MA Jun

Director, Center for Finance and Development
National Institution of Financial Research, Tsinghua University

MA Jun is Director of the Center for Finance and Development, Tsinghua National Institute of Financial Research. He is also a member of the Monetary Policy Committee of the People's Bank of China (PBC), Special Advisor to the Governor of the PBC, Chairman of the Green Finance Committee of the China Society for Finance and Banking, and Co-chair of the G20 Green Finance Study Group. Before joining Tsinghua University, he was the Chief Economist at the Research Bureau of the PBC from 2014 to 2017. Prior to that, he worked for 13 years at Deutsche Bank, where he was Managing Director, Chief Economist for Greater China, and Head of China and Hong Kong Strategy. From 1992-2000, he worked as public policy specialist, economist and senior economist at the International Monetary Fund and World Bank. From 1988-1990, he was a research fellow at the Development Research Center of China's State Council. Dr. Ma received his Ph.D. in Economics from Georgetown University in 1994.

MIAO Yanliang

Chief Economist
State Administration of Foreign Exchange Investment Center

MIAO Yanliang currently serves as Chief Economist of State Administration of Foreign Exchange Investment Center, the organ that manages China's forex reserves. He joined in 2013 as Senior Advisor to then Administrator YI Gang and as Head of Research for SAFEIC before being promoted to his current position in May 2018. He formulates global macro views for the world's largest reserve manager and leads the efforts in building a top-notch research platform. The research group he led and rebuilt was voted and recognized as SAFEIC's first ever "best team." As Chief Economist, he also advises the senior management of PBC/SAFE on a range of economic and policy issues. Before joining SAFE, he was an economist with the IMF for six years where he worked on emerging markets and then the euro area crisis including as policy coordinator for the Portugal program. Before joining the IMF, he visited the Bank of Israel as a special assistant to Governor Stanley Fischer and taught economics at the Woodrow Wilson School of Princeton University. Mr. Miao is recognized as a member of the China Finance 40 Forum and a "Young Global Leader" of the World Economic Forum in 2016. He publishes widely on global macro and occasionally as a columnist for Project Syndicate. He holds a PhD, MA, and MPA from Princeton University, and an MA in economics from Fudan University.

MO Wangui

Deputy Director–General, Research Institute
The People's Bank of China

MO Wangui is the Deputy Director-General of the Research Institute in the PBC. He graduated from Fudan University with a PhD in Economics. His main research areas include macroeconomics, international finance, and financial reform. He has led several key research projects including A Comparative Study of Two Major Global Financial Crisis (Monetary and Financial Perspective) and played a leading role in a joint research project by the finance ministries and central banks of the BRICS countries. He also participated in the drafting of many important documents including the reform and development plans of the financial industry during the 11th, 12th and 13th Five-Year Plan periods, documents of the National Financial Working Conference, and the overall plan for reform of rural finance. He has published over 30 research papers in journals such as Journal of Finance Research.

NIE Huihua

Professor and Executive Deputy Dean, National Academy of Development and Strategy
Renmin University of China

NIE Huihua is Professor of Economics and Executive Deputy Dean of the National Academy of Development and Strategy (NADS), Renmin University of China. NADS is one of the top twenty-five think tanks in China. Professor Nie is an expert in organizational economics and political economy in China. His recent research focuses on corruption, collusion between local governments and firms, and coal mine accidents in China. He has published a number of scholarly articles in well-reputed journals including the Review of Economics & Statistics, the Journal of Comparative Economics, Economics Letters, and the China Economic Review. He was the recipient of the China National Program for Support of Top-notch Young Professionals in 2013, and won the China National Excellent Doctoral Dissertation Award in 2008. Professor Nie contributes regularly to the media on current economic, social, and political issues, and his interviews have appeared on the New York Times, the Financial Times, NPR, CCTV, and Xinhua News Agency.

YANG Hongfeng

Deputy Director-General, Price Supervision and Anti Unfair Competition Bureau
State Administration for Market Regulation

YANG Hongfeng is Deputy Director-General of the Price Supervision and Anti Unfair Competition Bureau of the State Administration for Market Regulation (SAMR). Prior to that, he was Deputy Director-General of the Market Department of the State Administration for Industry and Commerce (SAIC) and Head of the China Advertising Association (CAA). He has served as spokesman on behalf of SAIC on CCTV's 3.15 Consumer Rights Day several times. He has participated in writing books concerning market and advertising regulation as well as e-commerce supervision, and has been engaged in drafting several laws and regulations. He graduated from China University of Political Science and Law in 1988.

ZHU Jun

Director-General, International Department
The People's Bank of China

ZHU Jun is Director-General of the International Department of the People's Bank of China, a role she assumed in 2015. Before that, Ms. ZHU has held a variety of positions in the International Department since 1997, including Director of the Research Division since 2006 and Deputy Director-General of the International Department since 2009. She worked in the Governor's Office between 1993 and 1997 before moving to the International Department. Ms. ZHU worked in the BIS as a secondee in 1999, and returned to the BIS as an Economist from 2003 to 2005. Ms. Zhu graduated from Peking University with a Bachelor's degree in Economics in 1989, and received her Master's degree in Economics from Peking University in 1993.

Alan Beebe

President
American Chamber of Commerce in China

Alan Beebe is President of the American Chamber of Commerce in China based in Beijing. He has more than 25 years of industry and management consulting experience in Asia, including over 15 years in mainland China.

As President, Alan oversees all Chamber advocacy, programs, partnerships, and insights to support the business growth of nearly 900 foreign corporations from across industries, including most of the U.S. Fortune 500. Over the past year, he has led major advocacy initiatives related to market access, cybersecurity, Made in China 2025, China's NGO law, and structural imbalances in US-China trade and investment.

In 2018, he launched AmCham China's Technology & Innovation Initiative, focused on the business and policy implications of disruptive digital technologies– such as artificial intelligence, blockchain and cloud computing–for U.S. companies in China.

Prior to joining AmCham China, Alan held various senior executive positions in China with EY, IBM, and management consulting firms AT Kearney and PRTM. He also led a Beijing based start-up for five years, the China Greentech Initiative, which merged in 2014 with the Paulson Institute, founded by Hank Paulson.

Alan has advised a wide range of corporations and global investors on investing and operating in China, including global private equity firms, high technology companies, energy related companies, and major state-owned and private Chinese enterprises.

He holds a Master's degree from Yale University in International Relations and a Bachelor's degree in Business Administration and Computer Science from the University of Nebraska-Lincoln in the United States. He is on the Board of Advisors of the Yale Club of Beijing, and in that capacity promotes academic and cultural exchanges between the United States and China. He speaks Mandarin fluently and reads and writes Chinese.

Alan was born and raised in Omaha, Nebraska.

Michael Brennan

Chair
Productivity Commission, Australian Government

Michael Brennan is Chair of the Productivity Commission.

Previously Michael was Deputy Secretary, Fiscal Group, in the Federal Treasury with responsibility for budget policy, retirement incomes, commonwealth-state relations, social policy and infrastructure financing.

Before that, he was Deputy Secretary, Economic in the Victorian Department of Treasury and Finance. Michael has worked as an Associate Director in the economics and policy practice at PricewaterhouseCoopers and as a senior adviser to Treasurers and Ministers for Finance at the State and Federal level.

Michael holds a Bachelor of Economics (Hons) from the ANU.

Michael Buchanan

Senior Managing Director, and
Head, Strategy & ANZ
Temasek International Pte Ltd

Michael Buchanan joined Temasek in December 2012 and is currently Joint Head, Portfolio Strategy & Risk Group and Head, Strategy. In addition, he is Head, Australia & New Zealand.

Michael was most recently the Chief Asia-Pacific Economist at Goldman Sachs, Hong Kong, where he was responsible for the firm's economic, forex, and rates views on the region. Prior to this role, he was the Co-Director of the Global Macro & Markets Research Group responsible for broad macro-trading strategy as well as long-term thematic research on the future of the global economy and shorter-term cyclical work on the major economies. Michael was also previously the Senior Emerging Markets Economist of Goldman Sachs, based out of London.

Antonio Capobianco

Acting Head
OECD Competition Division

Antonio Capobianco is a Senior Competition Expert with the OECD Competition Division and is currently the Acting Head of the division. In this position, he is responsible for the proceedings of the OECD Competition Committee and for all other competition work streams of the division. Over the years at the Competition Division, Mr. Capobianco has coordinated a series of OECD projects and work streams, including the development of the 2009 Guidelines for Fighting Bid Rigging in Public Procurement and the related OECD Council Recommendation of 2012, the work on transparency and procedural fairness, on SOEs and competitive neutrality, and most recently he has been leading the work on international enforcement co-operation. He has authored numerous Background Notes of the Secretariat on a variety of competition law enforcement and policy topics.

Prior to joining the OECD in 2007, Mr Capobianco was a Counsel in the Competition Department of WilmerHale LLP, based in Brussels. He also spent three years with the Italian Competition Authority. Mr Capobianco authored several articles on antitrust issues published in major international law journals specialized in competition law and co-authored textbooks on Italian and European competition law and economics. He regularly speaks at international conferences on antitrust and regulation issues. Mr. Capobianco graduated in law at the L.U.I.S.S. - Guido Carli in Rome and holds LL.M. degrees from the Law School of the New York University and from the Institute of European Studies of the Université Libre de Bruxelles.

Sally Chen

Resident Representative for Hong Kong SAR
International Monetary Fund

Sally Chen is the IMF's Resident Representative for Hong Kong SAR, covering financial market developments in the Greater China region. Additionally, in this capacity, Sally engages with academia, think tanks, media and market participants as she coordinates the Fund's outreach in Hong Kong. Sally has been with the Fund since 2010, having previously worked in the Strategy, Policy and Review Department and on the U.S. and Spain desks. Her research focuses on macro-financial linkages, including global liquidity, financial cycles, and the modalities and impact of debt deleveraging. Prior to joining the Fund, Sally was an economist with BNP Paribas Asset Management and the Federal Reserve Bank of New York.

ERA DABLA–NORRIS

Division Chief
Fiscal Affairs Department, International Monetary Fund

Era Dabla-Norris is a Division Chief in the IMF's Fiscal Affairs Department. She is currently working on issues pertaining to tax reforms and their macroeconomic impacts, structural reforms and productivity, gender and the future of work, demographic change and fiscal dynamics, and sovereign debt. Since joining the IMF, she has worked on a range of advanced, emerging market, and low-income countries. Ms. Dabla-Norris has published widely in several fields of economics, including macroeconomic modeling, international economics, public finance and economic development. Ms. Dabla-Norris received her M.A. in Economics from Delhi School of Economics and a Ph.D. in economics from the University of Texas at Austin. Ms. Dabla-Norris has been a contributing member of the Global Councils of the World Economic Forum.

HE Dong

Deputy Director
Monetary and Capital Markets Department, International Monetary Fund

HE Dong is Deputy Director of the Monetary and Capital Markets Department of the International Monetary Fund. His work has focused on central banking, global financial stability analysis, monetary and macroprudential policies, and fintech. Prior to joining the IMF in October 2014, He Dong was Executive Director at the Hong Kong Monetary Authority, responsible for managing the Research Department and for directing research and policy advice on issues relating to the maintenance of monetary and financial stability and the development of financial markets. He was also Director of the Hong Kong Institute for Monetary Research, responsible for leading the institute's research activities. He joined the World Bank through the Young Professionals Program in 1993 and was a staff member of the IMF during 1998–2004. Dong He holds a doctorate in economics from the University of Cambridge. He has published extensively on monetary policy and financial market issues.

Sarwat Jahan

Senior Economist
Asia and Pacific Department, International Monetary Fund

Sarwat Jahan is a Senior Economist in the IMF's Asia and Pacific Department, where she is working on China. Since joining the IMF, she has worked on a range of countries with IMF-supported programs including Sri Lanka, Myanmar, and St. Kitts and Nevis. She was also in the IMF's Strategy, Policy and Review Department, where she worked on policy papers and guidance notes, as well as developed toolkits focusing on frontier and developing economies and small states. Her research work focuses on several cross-country issues including monetary policy, growth strategies, debt restructurings, openness of the capital account, financial inclusion and development, and challenges facing small states. Prior to joining the IMF, she worked at the World Bank evaluating country strategies in Brazil, Georgia, India, and Peru. She also taught at Tufts University. She holds an undergraduate degree in Economics from the University of Dhaka and a Ph.D. in Economics from Cornell University.

Kenneth Kang

Deputy Director
Asia & Pacific Department, International Monetary Fund

Kenneth Kang is Deputy Director in the Asia and Pacific Department of the International Monetary Fund, covering economies in Northeast Asia, including China, Hong Kong SAR, Korea, and Mongolia. Previously, he worked on a range of countries, including Italy, Japan, the Netherlands, as well as the euro area, and served as the IMF's Resident Representative in Korea during 2003–06. He has a Ph.D. from Harvard University.

Nicholas R. Lardy

Senior Fellow
Peterson Institute for International Economics

Nicholas R. Lardy is the Anthony M. Solomon Senior Fellow at the Peterson Institute for International Economics. He joined the institute in March 2003 from the Brookings Institution, where he was a senior fellow from 1995 until 2003. Before Brookings, he was the director of the Henry M. Jackson School of International Studies at the University of Washington, from 1991 to 1995. From 1997 through Spring 2000, he was the Frederick Frank Adjunct Professor of International Trade and Finance at the Yale University School of Management. He is an expert on the Chinese economy. His most recent book is The State Strikes Back: The End of Economic Reform in China? (Peterson Institute 2019).

Thomas Östros

Executive Director, International Monetary Fund

Thomas Östros is Executive Director at the International Monetary Fund and represents the Nordic and Baltic countries in the Executive Board.

Thomas Östros has served as the Minister for Fiscal Affairs and Deputy Minister of Finance between 1996–1998. 1998–2004 he was the Minister for Education and Science and 2004-2006 he served as the Minister for Industry and Trade. From 2006–2011 he served as the Deputy Chairman of the Committee on Industry and the Deputy Chairman of the Committee on Finance in the Swedish Parliament. Before assuming the position at the IMF, Thomas was the Managing Director of the Swedish Bankers' Association.

Thomas Östros holds a Degree in Public Administration and a Fil. lic. in Economics from the University of Uppsala.

Martin Raiser

Country Director for China and Mongolia, and Director for Korea
World Bank

Martin Raiser is the World Bank's new Country Director for China and Mongolia, and Director for Korea starting March 1, 2019. Mr. Raiser is leading a team that is managing one of the World Bank's largest loan portfolios and directs an extensive analytical and advisory program with China and Mongolia, and a growing knowledge partnership with Korea.

Mr. Raiser holds a doctorate degree in Economics (summa cum laude) from the University of Kiel, Germany, and degrees in Economics and Economic History from the London School of Economics and Political Sciences. Mr. Raiser worked for the Kiel Institute of World Economics and the European Bank for Reconstruction and Development, where he was Director of Country Strategy and Editor of the Transition Report. Since joining the World Bank in 2003, Mr. Raiser held positions as the Country Manager in Uzbekistan, Country Director for Ukraine, Belarus and Moldova, Country Director for Turkey, and most recently Country Director for Brazil.

Changyong Rhee

Director
Asia and Pacific Department, International Monetary Fund

Changyong Rhee is the Director of the Asia and Pacific Department at the IMF, where he oversees the Fund's work on the region, including its lending operations and bilateral and multilateral surveillance of economies ranging from China, Japan, and India to the Pacific Islands.

Prior to joining the IMF in February 2014, Mr. Rhee was Chief Economist of the Asian Development Bank (ADB); Secretary General and Sherpa of the Presidential Committee for the 2010 G-20 Seoul Summit; Vice Chairman of the Financial Services Commission (FSC) and Chairman of the Securities and Futures Commission of Korea; professor of economics at Seoul National University and the University of Rochester. He has also been a frequent policy advisor to the Government of Korea, including in the Office of the President, the Ministry of Finance and Economy, the Bank of Korea, the Korea Securities Depository, and the Korea Development Institute.

Mr. Rhee has published widely in the fields of macroeconomics, financial economics, and on the Korean economy. He holds a Ph.D. from Harvard University and an undergraduate honors degree from Seoul National University, both in economics.

Shaun Roache

Managing Director and Chief Economist
Asia-Pacific, S&P Global Ratings

Shaun Roache is Chief Asia-Pacific Economist at S&P Global Ratings. Based in Singapore, he leads the economic research agenda and serves as the primary spokesperson on macro-economic matters across the region.

Before joining S&P Global Ratings, Shaun was the Macro Strategist and Lead Economist at Temasek, a Singapore sovereign wealth fund, covering China, Japan, and emerging markets. Before that, Shaun held various roles with the International Monetary Fund in both Washington, D.C. and Hong Kong, with responsibility for capital market surveillance, economic forecasting, and outlooks.

Shaun holds a Ph.D. in Economics from Birkbeck College, University of London and a bachelor's degree in Economics from Queen's University Belfast.

Charlotte Roule

Vice President of the European Chamber of Commerce in China
Chief Executive Officer, ENGIE CHINA

Charlotte Roule is Vice President of the European Union Chamber of Commerce in China and Chief Executive Officer of ENGIE CHINA.

She joined ENGIE China back in 2016 initially as COO, Head of Business Development and Innovation. In line with ENGIE's strategy and values, she promoted and developed there clean energy (mainly solar and electrical mobility) as well as energy efficiency. ENGIE China now operates directly 6 joint ventures in these areas, covering design and engineering, development and operations.

Before working in China, Mrs. Roule was based in Cheshire, UK, where, jointly with her team, she's been developing the largest onshore underground gas storage of the country. Prior to this, she served as VP, Audit and Risks and VP, HR in Storengy, ENGIE's affiliate dedicated to underground gas storage, based near Paris.

Mrs. Roule is a member of the Jinan Mayor's International Economic Consultation Committee. She also acts as mentor of the Board of the Women in Renewables Asia (WiRA) organization.

She is also external trade advisor to the French Government.

Alfred Schipke

Senior Resident Representative for China
International Monetary Fund

Alfred Schipke is the IMF Senior Resident Representative for China. In this capacity, he provides policy advice, leads the analytical work of the office, engages with academia, think tanks, and the media, and coordinates the IMF's training and technical assistance in China. Previously, he was a division chief in the Asia and Pacific Department, where he coordinated the work on fast growing low-income countries in South-East Asia (Frontier Economies) and led missions to Vietnam. and the Western Hemisphere Department in charge of the Latin Caribbean and Eastern Caribbean Currency Union (ECCU) divisions. He is Research Professor at National School of Development, Peking University, and also teaches international finance at Harvard Kennedy School. He has authored and edited several books and articles.

Rhoda Weeks–Brown

General Counsel
Director of the Legal Department, International Monetary Fund

Rhoda Weeks-Brown is General Counsel and Director of the IMF's Legal Department. She advises the IMF's Executive Board, management, staff and country membership on all legal aspects of the IMF's operations, including its lending, regulatory and advisory functions. Over her career at the IMF, she has led the Legal Department's work on a wide range of significant policy and country matters. She has written articles and many IMF Board papers on all aspects of the law of the IMF and co-taught a Tulane University seminar on that topic.

Ms. Weeks-Brown has also served as Deputy Director in the IMF's Communications Department, where she led IMF communications and outreach in Africa, Asia and Europe; played a key role in the transformation of the IMF's communications strategy; and led IMF strategic policy communications on key legal and financial topics.

Ms. Weeks-Brown has a J.D. from Harvard Law School and a B.A. in Economics (summa cum laude) from Howard University. Before joining the IMF, she worked in Skadden's Washington DC office. She is member of the Bar in New York, Massachusetts and the District of Columbia and a member of the Supreme Court Bar. Ms. Weeks-Brown serves on the Board of TalentNomics, Inc., a non-profit organization focused on developing women leaders globally.

ZHANG Chunlin

Lead Private Sector Development Specialist
The World Bank Group

ZHANG Chunlin is a Lead Private Sector Development Specialist in the Finance, Competitiveness and Innovation Global Practice of the World Bank Group. His current work focuses on state-owned enterprises reform; the Belt and Road Initiative; innovation, entrepreneurship, and competition. Zhang Chunlin joined the World Bank in 1999 and worked in the Bank's Beijing Office (1999–2008) and Pretoria Office (2009—2015). He is the author of a number of World Bank analytical and advisory products, such as"China's New Round of SOE Reform: Managing State Capital and Leveling the Playing Field" (2017). Before joining the World Bank, he was Division Director in the Department of Enterprise Reform of the State Economic and Trade Commission of the Chinese government. Chunlin Zhang studied economics in Nankai University and Peking University in China and obtained his Ph.D. from the Graduate School of China Academy of Social Sciences.

ZHANG Longmei

Deputy Resident Representative for China
International Monetary Fund

ZHANG Longmei, is the IMF Deputy Resident Representative for China. Previously, she was a China economist in the Asia and Pacific Department based in Washington D.C., where she focused on macroeconomic forecasting, broader China rebalancing and issues on high savings. Before working on China, she worked on regional issues in the Asia Pacific, and published research in a wide range of areas, including long-term growth/ middle-income trap, macroprudential policies, corporate leverage, and capital flows and asset prices. Prior to that, she worked on the Philippines, focusing on macro surveillance and labor market issues. She also worked on Romania, engaged in IMF program negotiations and reviews. Ms. Zhang is a Young Global Leader of the World Economic Forum. She holds a Ph.D. in Economics from Goethe University Frankfurt.

PRESENTATIONS

Australian Government
Productivity Commission

Competitive neutrality
竞争中立

The Australian experience 澳大利亚的经验

Presented by 演讲人

Michael Brennan
博立楠

Chair主席

24 April 2019

Economic reform in Australia
澳大利亚的经济改革

2

- Opening up the tradeable sector
  开放贸易型产业
- More competition in the non-traded sector
  在非贸易型产业中引入更多竞争
  - National Competition Policy 国家竞争政策

Elements of competition policy 竞争政策的成分

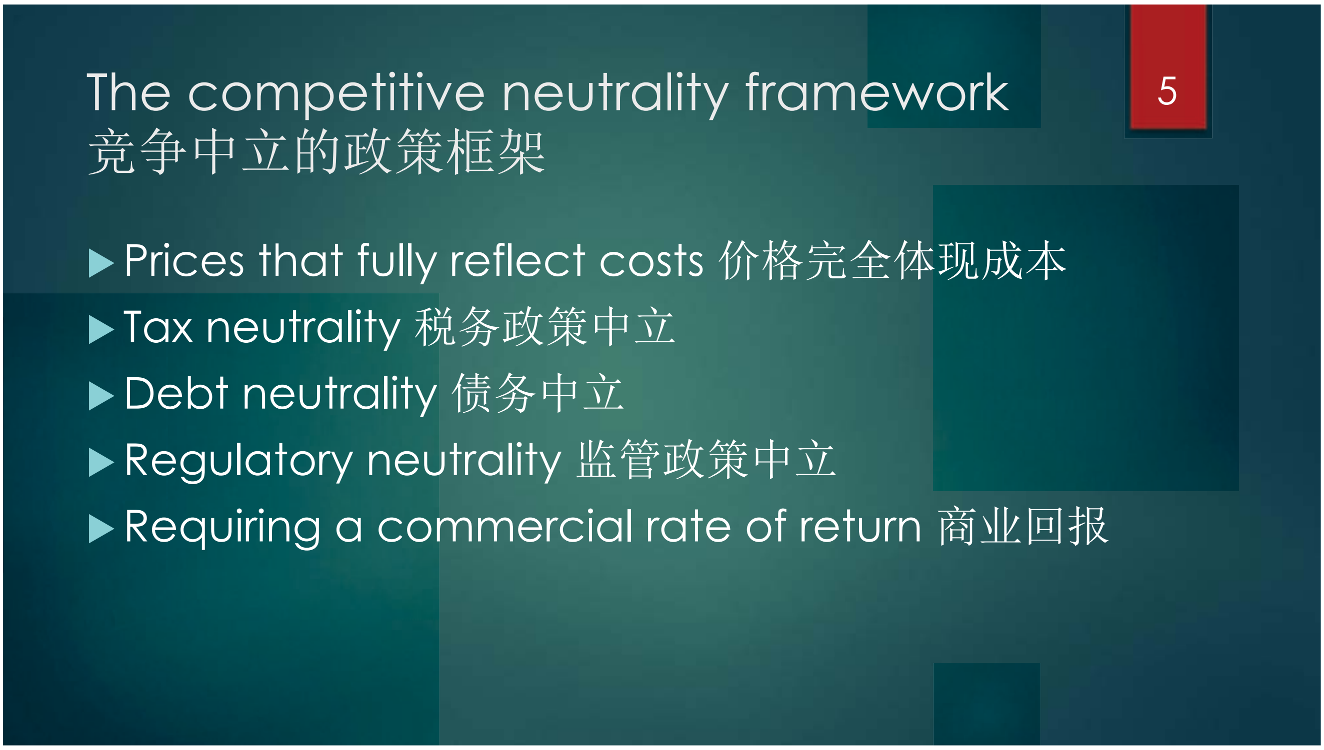
3

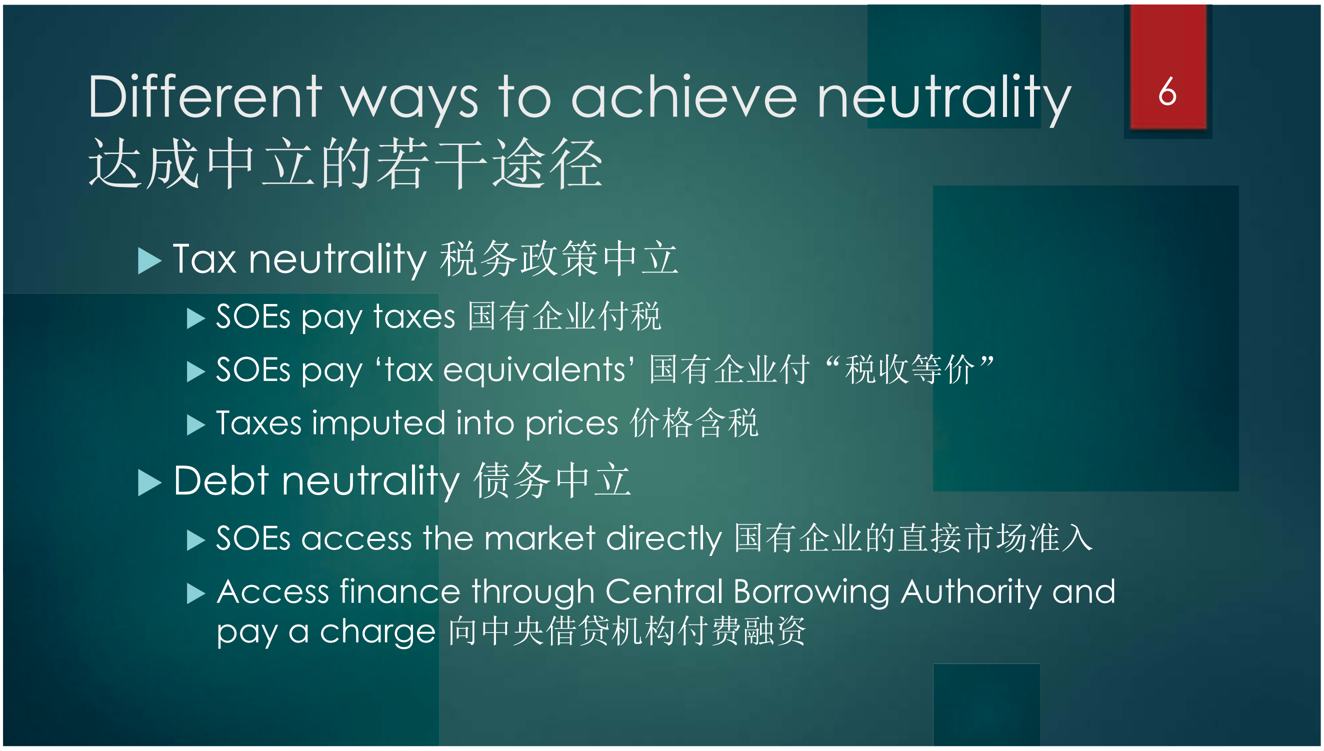
- Private sector 企业
  - Reviews of individual industries 产业情况回顾
- Public sector 政府
  - Structural reform of SOEs 国有企业的结构性改革
  - Extending competition law to SOEs 国有企业扩入竞争法的适用范围
  - National access regime 全国性的准入政策
  - Competitive neutrality framework 竞争中立政策框架

Support for competition reform 支持竞争政策改革

4

- Policy enacted through ***agreement*** between levels of government
  在各个层级的政府间达成***合议***，制定政策
- Shared acceptance of the need for reform
  就改革的重要性达成共识
- Financial incentives from central to sub-national governments
  联邦政府对州政府给与财政奖励


The competitive neutrality framework
竞争中立的政策框架
5
Prices that fully reflect costs 价格完全体现成本
Tax neutrality 税务政策中立
Debt neutrality 债务中立
Regulatory neutrality 监管政策中立
Requiring a commercial rate of return 商业回报


Different ways to achieve neutrality
达成中立的若干途径
6
Tax neutrality 税务政策中立
SOEs pay taxes 国有企业付税
SOEs pay 'tax equivalents' 国有企业付“税收等价”
Taxes imputed into prices 价格含税
Debt neutrality 债务中立
SOEs access the market directly 国有企业的直接市场准入
Access finance through Central Borrowing Authority and pay a charge 向中央借贷机构付费融资


Reflections 反思
7
Combination of ex ante and ex post measures 事前和事后措施结合
Many ‘umpires’ 众多裁判
Competitive neutrality less well developed where Government funds services 在政府资助服务时，竞争中立发展不理想
SOE reform and competitive neutrality do not have to mean privatisation 国有企业改革和竞争中立，并不必然意味着私有化
Political challenges are always a factor 政治难题永远存在

INTERNATIONAL MONETARY FUND

Opening Up and Competitive Neutrality

Seventh High Level Joint Conference People's Bank of China and IMF

Thomas Östros, Executive Director
Nordic-Baltic Constituency
Beijing April 2019

SYSTEM BOLAGET
AKADEMISKA HUS
apl
SAS
almi
DRAMATEN
SEK
OPERAN
SWEDESURVEY
VATTENFALL
GÖTA KANAL
Ecolabel
Miljömärkning Sverige
Visit Sweden
AB BOSTADSGARANTI
SVENSKA SPEL
Telia Company
SOS Alarm
ARLANDABANAN INFRASTRUCTURE
postnord
apoteket
green cargo
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SPECIALFASTIGHETER
Industrifonden
SVENSKA SKEPPSHYPOTEK
VOKSENÅSEN
Swedfund
SVEVIA
NORRLANDS FONDEN

[redacted]

Objectives and expectations

"The Government has a mandate from the Riksdag (the Swedish Parliament) to actively manage state-owned enterprises in order to ensure optimal long-term value performance and, where applicable, that specifically adopted public policy assignments are duly performed."

"To promote long-term sustainable value growth in state-owned enterprises, sustainable business is integrated into corporate governance. State-owned enterprises should thus serve as role models in the area of sustainable business and otherwise act in a manner that generates public confidence."

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Key principles for state ownership

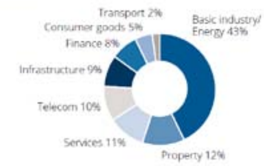
- Transparency
- Active ownership
- Professionalism
- In good order

The state bears a substantial responsibility to be an active and professional owner. The Government's overall objective is for the companies to create value and, where applicable, ensure that specifically adopted public policy assignments are duly performed.

Ministry of Enterprise and Innovation

Portfolio overview

Portfolio value
Per sector



State's company portfolio[1]
Estimated value, SEK bn

Gender distribution[3]

Board chairs and directors, proportion of women/men
49%/51%

Board chairs, proportion of women/men
48%/52%

Dividends, SEK bn
20.2

Dividend yield
3.6%

Number of employees[2]
135 000

1) Portfolio value adjusted for transactions.
2) Around 135 000 people are employed by state-owned enterprises, including associates.
3) Gender distribution refers to wholly and partially state-owned enterprises.

[redacted]

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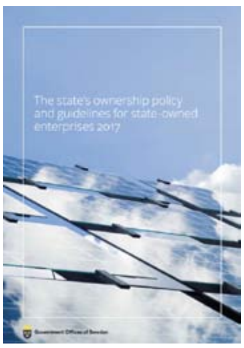
An active and professional owner



Active ownership
Active ownership within the framework of the state's ownership policy

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[redacted]

Separation of the state's ownership function and role as regulator

In order to avoid conflicts of interest and to achieve an efficient investment management, responsibilities for sector-specific legislation typically reside with divisions other than those involved in the management of state-owned enterprises.

Examples

Apoteket	Ministry of Health and Social Affairs	Ministry of Enterprise and Innovation
Vattenfall	Ministry of the Environment and Energy	
Samhall	Ministry of Employment	

Ministry of Enterprise and Innovation

The law requires competetive neutrality

- For all EU (including EEA) member states specific provisions of EU law bearing on competitive neutrality apply to all undertaking regardless of ownership.
- The European Commission is responsible tor enforcing EU regulation on competitive neutrality
- The National Competition Authority is also bound by EU regulation

Beijing | April 2019

Directors of state-owned enterprises

"… ensuring public **confidence** in the operations…"

"The board is responsible for ensuring that companies in which the state has an ownership interest are managed in an **exemplary manner**…"

"**Sustainable business** is an important issue for the state as owner and it is essential that the board has the capacity to work strategically in this area."

" … utmost **integrity** and the ability to safeguard the best interests of the company."

"To be considered for a directorship, the candidate must possess a **high level of expertise** relevant to the company's business operations, business development, industry expertise, financial matters, sustainable business or other relevant areas."

Excerpts from the state's ownership policy 2017

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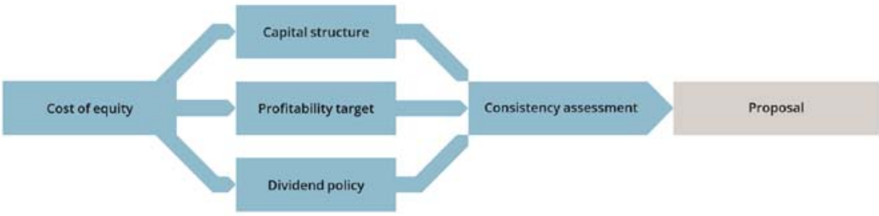
Purpose of financial targets

- Safeguard the creation of value, with the board and management working towards long-term, ambitious and realistic goals
- Keep financial risk at a reasonable level
- Achieve capital efficiency by clarifying the cost of equity
- Ensure dividend yield for the owner through sustainable and predictable dividends that take the company's future capital requirements and financial position into account
- Measure, track and evaluate profitability, efficiency and risk level in a structured manner

Method for setting financial targets



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Do not waste taxpayer’s money!

- The owner’s cost of equity is an important basis for setting financial targets.
- The owner’s cost of equity ultimately determines whether the state, in its capacity as owners, receives reasonable compensation at market level for the risk taking involved in company ownership.
- If the returns to the owner is systematically below the cost of capital it basically means the destruction of value for the state as an owner.

Beijing | April 2019

Transparency

- **Guidelines for reporting**
  - Transparency and professionalism overarching principles
  - Sustainability reporting
  - Foundation for continuous monitoring and evaluation of the companies' operations and established goals

- **Annual report state-owned enterprises**
  - The Government submits an annual communication to the Riksdag. The communication provides an account of management of the state-owned companies in the past year and the value of the portfolio
  - Account of goals and target achievement

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Compliance with international guidelines

"These efforts are guided by international guidelines, Agenda 2030 and global goals for sustainable development." *(The state's ownership policy 3.4.1)*

For the state in its capacity as owner, it is particularly important that state-owned enterprises work towards the following:

• A sound and healthy work environment, respect for human rights and good and decent working conditions.
The enterprises should be role models in the efforts to achieve gender equality and work actively with gender equality in operations. The enterprises should also take aspects of diversity into account and foster an inclusive culture.
• Reduced climate and environmental impact
• High standards of business ethics and active prevention of corruption
• To otherwise ensure that there is no abuse of the special status that being a state-owned enterprise may entail
• Responsible conduct in relation to taxes

Source: The state's ownership policy 2017

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Tracking targets

Investment team
-Continuously keep abreast of company developments
-Follow-up meetings with relevant company departments to discuss current status

Owner dialogue
-Regular follow-up meetings with the chairman and the CEO
-Monitoring of performance in relation to financial targets, public policy targets, and sustainability targets
-Request additional measures when targets are not met

Annual report state-owned enterprises

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Constant structural change – Protect the workers, not the jobs

The public sector can facilitate structural change by investing in people

- High quality education for all
- Build bridges for people between jobs
  - Life long learning
  - Active labor market policy
  - Unemployment benefit systems

Beijing | April 2019

Thank you.

Thomas Östros

Office of the Nordic-Baltic Constituency
700 19th St. NW, Washington, D.C. 20431

Standard financial targets

	Purpose	Examples of targets
Capital structure	▪ To keep the company's financial risk at a reasonable level given its operating risk, legal requirements etc. ▪ Optimise the value with an efficient capital structure ▪ Ensure that the company is financially resilient	▪ Debt-equity ratio ▪ Equity-assets ratio ▪ Net debt / EBITDA ▪ Interest coverage ratio
Profitability target	▪ To ensure that the owner receives reasonable compensation for the risk-taking, the return should exceed the cost of capital over time ▪ A target scenario for the company that is both ambitious and achievable	▪ Return on operating capital ▪ Return on equity ▪ Operating margin
Dividend policy	▪ To ensure that the owner receives predictable and sustainable dividends over time ▪ To clarify the owner's stance regarding profitability, future investments, and sector maturity	▪ Proportion of net profit that should be used for dividend payments

Ministry of Enterprise and Innovation

7th High Level Joint Conference
People's Bank of China & IMF
Beijing, 24 April 2019

THE CONCEPT OF COMPETITIVE NEUTRALITY – THE INTERNATIONAL EXPERIENCE

AN OECD PERSPECTIVE

Antonio Capobianco
Acting Head of Division
OECD Competition Division

OCDE
DES POLITIQUES MEILLEURES POUR UNE VIE MEILLEURE

Background on the SOE dataset

- Third edition of a recurrent review of the characteristics of national state-owned enterprise sectors, by the Working Party on State Ownership and Privatisation Practices.
- Covers 40 countries, mainly in the OECD area but also, for the first time, Argentina, Brazil, China, India and (partially) Saudi Arabia.
- Examines the size of SOEs – by company value and employment – and their distribution by sector and corporate form.
- Also examines state minority shareholdings in listed companies, including an inventory of individual enterprises.

Definition of "SOE" uses the scope of applicability of the *OECD Guidelines on Corporate Governance of State Ownership Enterprises*, which is based on entities' corporate forms, commercial orientation and degree of state ownership and control.

2

Snapshot of main findings

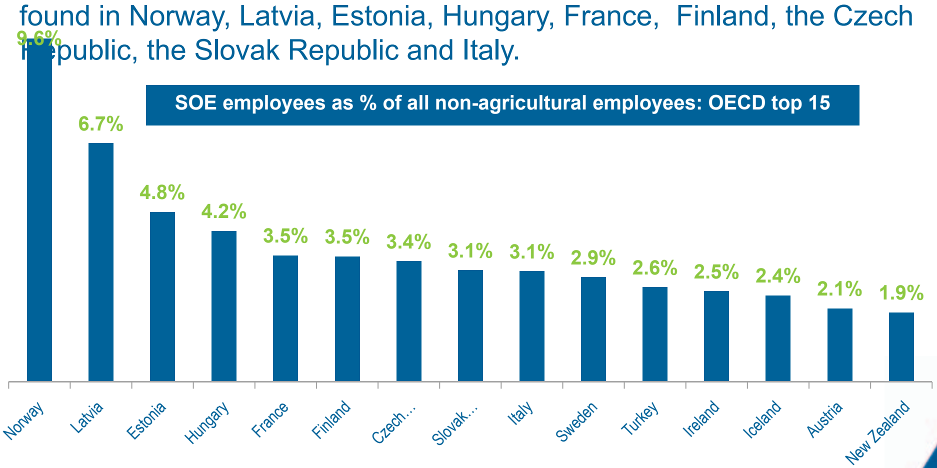
- Taking China aside for a moment, governments in the sample area are the full or majority owners of **2 467 commercially-oriented enterprises** valued at USD 2.4 trillion and employing over 9.2 million people.
- In China alone, the central government owns **51 000 SOEs**, valued at USD 29.2 trillion and employing approximately 20.2 million people.
- China is the largest SOE sector by number of SOEs. followed by Hungary (370 SOEs), India (270), Brazil (134), the Czech Republic (133), Lithuania (128), Poland (126) and the Slovak Republic (113).
- Governments in the sample area (outside of China) hold **minority shareholdings** in 134 listed companies valued at USD 912.3 billion and employing 2.8 million people. While not considered SOEs *per se*, minority shareholdings can provide insights into the changing landscape of state involvement in the corporate economy.

Source: OECD (2017), *The Size and Sectoral Distribution of State-Owned Enterprises*, OECD, Paris. Note: Figures exclude China.

3

SOEs represent on average 2-3% of national employment in OECD area

Among OECD countries , the largest SOE sectors **as a percentage of employment** (a more useful comparison than by absolute values) are found in Norway, Latvia, Estonia, Hungary, France, Finland, the Czech Republic, the Slovak Republic and Italy.



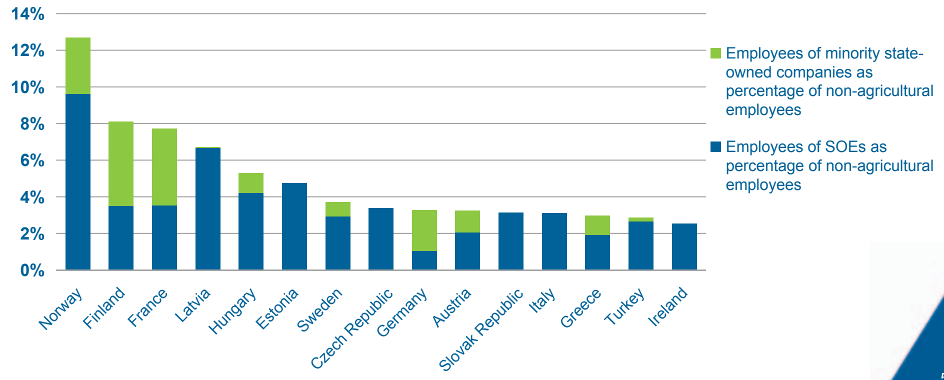
Source: OECD (2017), *The Size and Sectoral Distribution of State-Owned Enterprises*, OECD, Paris. Note: Figures exclude China.

4

Employment share rises when minority shareholdings are included

When the analysis is expanded to include **minority-owned listed companies**, employment share rises considerably in some countries (e.g. Norway, Finland and France). Germany and Greece replace Iceland and New Zealand in the league table.

Employees of SOEs and state minority-owned companies as % of national employment: OECD top 15



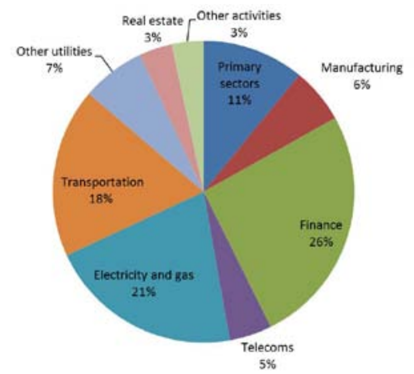
Source: OECD (2017), *The Size and Sectoral Distribution of State-Owned Enterprises*, OECD, Paris. Note: Figures exclude China.

5

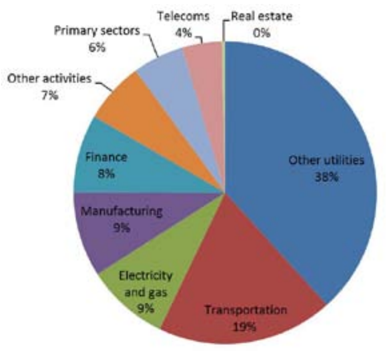
SOEs are highly concentrated in the network industries

The electricity and gas, transportation, telecoms and other utilities sectors account for 51% of all SOEs by value and 70% by employment. Finance is the largest individual sector, at 26% of SOEs by value.

Sectoral distribution of SOEs by value



Sectoral distribution of SOEs by employment

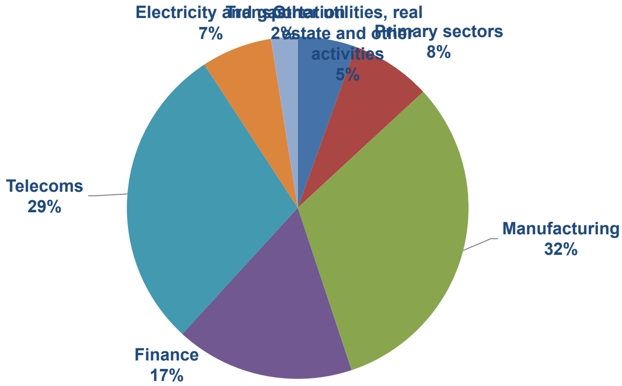


Source: OECD (2017), *The Size and Sectoral Distribution of State-Owned Enterprises*, OECD, Paris. Note: Figures exclude China.

6

State minority shareholdings

Most **state minority-owned companies** by value are found in the manufacturing sector (32%), followed by telecoms (29%) and finance (17%). Minority shareholdings could indicate intent to relinquish state control in these sectors or temporarily shore up failing companies.



Source: OECD (2017), *The Size and Sectoral Distribution of State-Owned Enterprises*, OECD, Paris. Note: Figures exclude China.

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Importance of SOEs in modern economies

The world's largest 10 SOEs in the business (year 2012-13 - USD billion)

Global rank*	Company	Sector	Domicile	Market value	Sales	Assets
1	ICBC	Banking	China	237.3	134.8	2813.5
2	China Construction Bank	Banking	China	202.0	113.1	2241
8	Agricultural Bank of China	Banking	China	150.8	103.0	2124.2
10	PetroChina	Oil & Gas	China	261.2	308.9	347.8
11	Bank of China	Banking	China	131.7	98.1	2033.8
17	Gazprom	Oil & Gas	Russia	111.4	144	339.3
20	Petrobras	Oil & Gas	Brazil	120.7	144.1	331.6
26	Sinopec-China Petroleum	Oil & Gas	China	106.9	411.7	200.0
29	China Mobile	Telecom	Hong Kong	213.8	88.8	168.7
30	ENI	Oil & Gas	Italy	86.3	163.7	185.2

***Source*: OECD (2014); *Forbes 2000**

8

SOEs are going global – A few facts

- 22% of the world's largest 100 firms are state controlled companies – this is the highest percentage in decades
- SOEs operate in sectors important to international supply chains, such as public utilities, manufacturing, metals and mining, and petroleum
- There has been a surge of SOE-led international M&A activity observed over the last 10 years
- These trends are likely to continue in the foreseeable future

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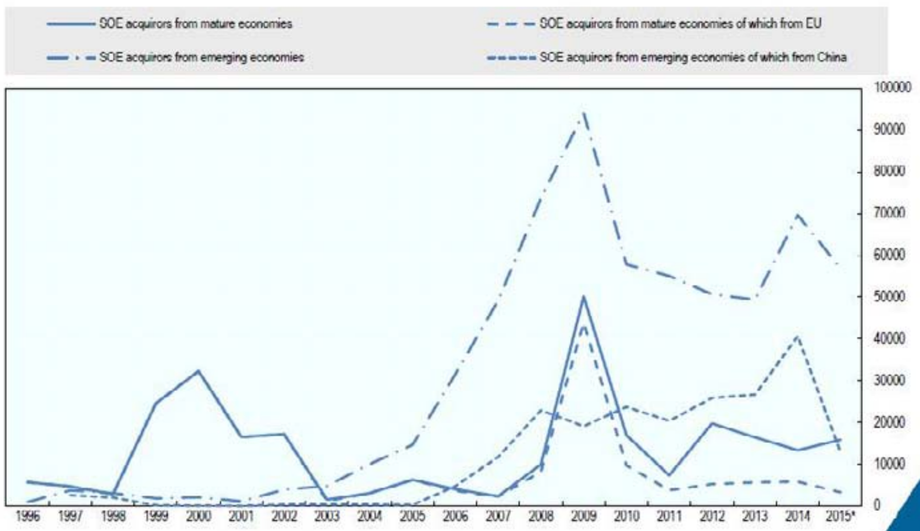
SOEs as targets and acquirers of IM&A by deal value (USD million), 1996 - 2015



Source: Author calculations based on Dealogics IM&A data, 2015

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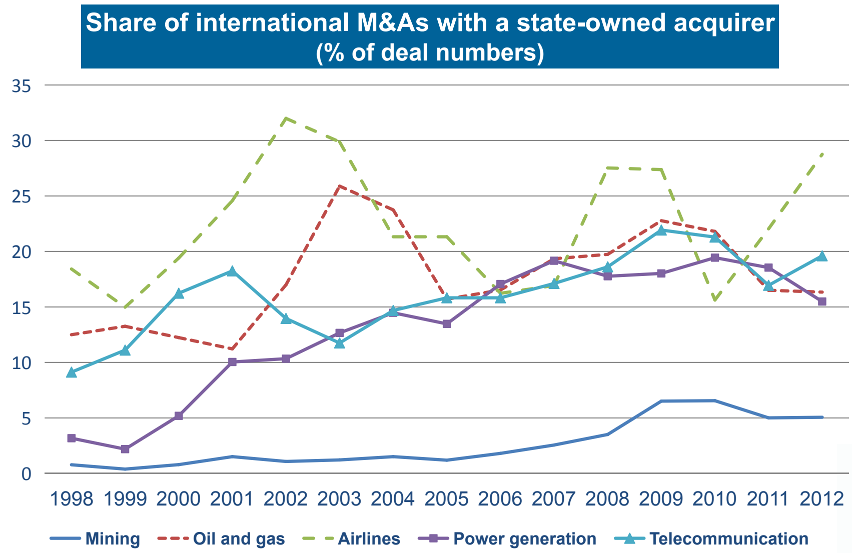
SOEs international M&A by sector



Source: OECD (2014), OECD (2014), Corporate Governance Working Paper No. 14

11

Concerns about the internationalisation of state-owned enterprises

SOEs may induce their government owners to grant them certain advantages, ranging from:

- Privileged market position
- Soft loans
- Outright subsidies
- Regulatory exemptions
- Fiscal advantages
- State backing
- No bankruptcy

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SOE as global competitors – Some perceived concerns

- SOEs may not always operate on a level playing field
- Compensation and special advantages granted by governments in return for public policy obligations at home can have harmful spill-overs effects
- Asymmetric contestability in home markets for foreign competitors

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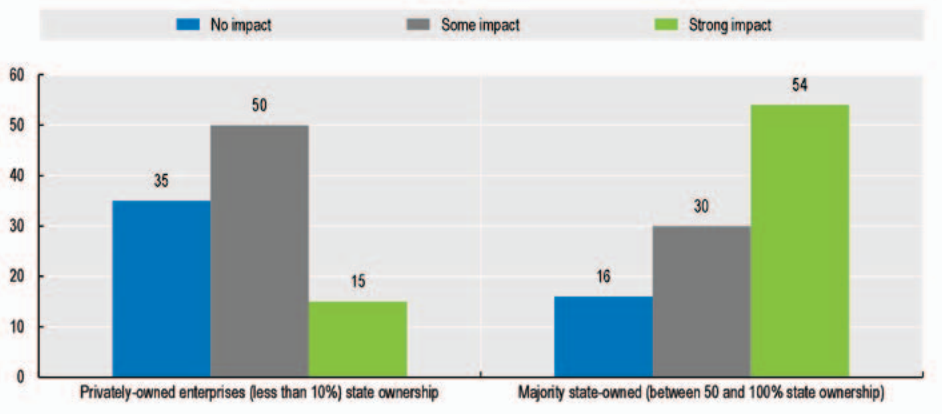
Business perceptions concerning preferential treatment granted to foreign competitors



1. Preferential treatment is defined as government measures or actions, which affect costs or prices of commercial enterprises and which are extended only to certain specific enterprises or groups of enterprises.
2. Own government is defined as the government of respondent's country of headquarters.

Source: OECD Business Survey on State Influence on Competition in International Markets.

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Competition issues arising from SOEs

Why do we worry?

- Many SOEs provide products and services in competition with private sector businesses, or in areas where private sector businesses could potentially compete.
- Anticompetitive harm may be even greater when caused by SOEs, due to the privileges conferred upon them and the high reliance of customers on their goods/services
- Public policy goal may be pursued through SOE, but to be balanced against consumer welfare loss due to competition harm
- Could SOE purpose be achieved through less competition-restrictive means through:
  - → Competition enforcement
  - → Regulatory intervention

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Competition issues arising from SOEs

Competition concerns arise where SOE has:

a. **Incentives** to behave anti-competitively
   - SOEs not necessarily profit-maximising entities.
   - Looking for economies of scale and scope: more concerned about expanding sales and revenues even if raise costs and do not generate profits
   - Sense of immunity, government protection and assistance

b. **The ability** to behave anti-competitively
   - Deep pockets and no bankruptcy
   - Softer budget constraints because of (a) the possibility of infusion of government cash; and (b) cheaper financing due to perceived gov't guarantees;
   - Enjoy a number of privileges …

Consequence: Un-level playing field and risk of competition distortions between state-owned and privately-owned rivals

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Application of competition law to SOEs: *General principles*

⇒ SOEs may harm competition and consumer welfare in the same way (or more) as private enterprises

⇒ Competition laws should, and generally do, apply to both private and state-owned enterprises, subject to limited exceptions

Essential features of competition law:

Ownership neutral & **Nationality neutral**

It applies to any entity that engages in economic activity ***regardless of*** its ownership or legal form.

It applies to any economic activity with anti-competitive effects in the jurisdiction ***regardless of*** nationality or place or establishment

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Application of competition law to SOEs: *Exemptions and defenses*

Exemptions*: formal exclusion from the law*

- SOE may be formally exempted/immune from the application of competition rules, usually when provide general public services (postal services, railways, heath care, etc.)
- Exemptions should be accompanied by proportionate and appropriate regulation to minimize risks of market distortions.

Defenses*: exclusion of liability on a case-by-case basis*

- State action defense: no antitrust liability if challenged conduct (whether by SOE or private enterprise) is determined by lawful public measures
- Strict interpretation and conditions (case law):
  - Must result from clearly articulated, affirmative state policy and active state supervision (US); must be required by the state with no room for autonomous action or appreciation (EU)

Consequences*: overall enforcement is barred or limited (e.g. lower fines)*

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Competitive Neutrality Frameworks: *Australia*

In 1995, the government adopted a unified National Competition Policy, which included a competitive neutrality framework to ensure SOEs and private companies were competing on a level playing field:

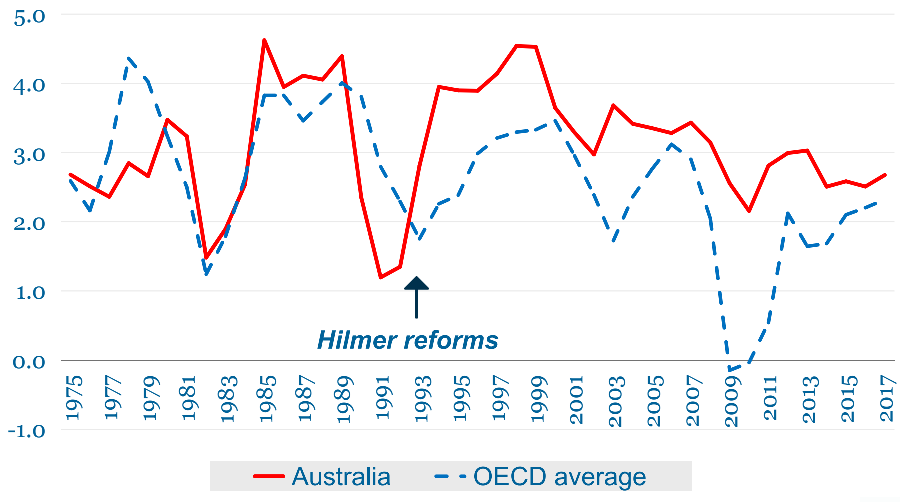
- corporatising all SOEs
- reforming anti-competitive legislation
- structural reforms
- privatization of SOEs.

Australia's "experiment" with competitive neutrality was a landmark achievement in its journey of economic modernisation.

Australian SOEs now perform better, are more transparent and more accountable.

Public services are provided to consumers at better quality and better prices.

Competitive Neutrality Frameworks: *Australia*



Note: Gross domestic product (expenditure approach) – annual growth rare, three-years moving average.
Source: OECD statistics, National accounts, 1.Gross domestic product (https://stats.oecd.org/)

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Competitive Neutrality Frameworks: *Other jurisdictions*

- European Union - with state aid and transparency rules
- Scandinavian countries - competition laws preventing all market participants from receiving competition-distorting public support
- Italy and Spain - competition agencies have been given the power to challenge in court any regulations that distort competition and the level playing field.

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Competitive Neutrality Frameworks: *Some key principles*

- Separating ownership from regulation, to ensure there are no conflicts of interests between the state's role as owner, shareholder and policy maker
- Ensuring SOEs operate in the same legal and regulatory environment as private competitors;
- Ensuring high standards of transparency and disclosure where SOEs combine economic activities with public policy objectives;
- Making sure SOEs face debt and equity finance conditions consistent with the rest of the market.
- Ensuring transparent and non-discriminatory public procurement processes.

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Competitive Neutrality Frameworks: *The building blocks*

1. Streamlining government business – either in terms of its structure or corporate form – can have an impact on the playing field.

2. Identifying the costs of any given function and developing appropriate cost allocation mechanisms promote transparency and disclosure.

3. Government business activities operating in a commercial and competitive environment should earn rates of return (ROR) like comparable businesses.

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Competitive Neutrality Frameworks: *The building blocks*

4. Where the performance of public policy functions is required by government businesses, adequate, transparent, and accountable compensation should be provided.

5. To ensure competitive neutrality government businesses should operate, to the largest extent feasible, in the same tax and regulatory environment as private enterprises.

6. Debt neutrality remains an important area to tackle if the playing field is to be levelled.

7. To support competitive neutrality, procurement policies and procedures should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency.

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Concluding remarks

- The concept of SOE encompasses a broad range of entities united by the common feature of government control.
- Due to their privileged position SOEs may negatively affect competition and should be subject to similar competition rules as private enterprises.
- It is important to ensure that SOEs public service responsibilities are consistent with a level-playing field.
- Enforcing competition rules against SOEs presents enforcers with particular challenges.
- Developing a domestic competitive neutrality framework deliver better performing, more transparent and more accountable SOEs.
- Competitive neutrality ensures that public services are provided to consumers at better quality and better prices, by entities that do it best – be it government or private actors

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State-Owned Enterprises as Global Competitors: A Challenge or an Opportunity? (OECD, 2016)

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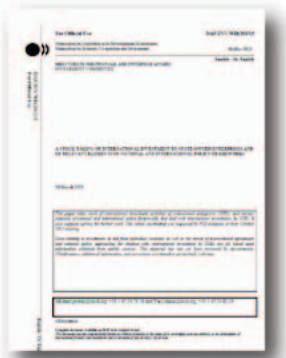

A Stock-Taking of International Investment by State-Owned Enterprises and of Relevant Elements of National and International Policy Frameworks, Background Report (OECD, 2013)

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State-Owned Enterprises: Trade Effects and Policy Implications, Working Paper (OECD, 2013)

Competitive Neutrality: Maintaining a Level Playing Field between Public and Private Business, Publication (OECD, 2012)

State-owned enterprises and the principle of competitive neutrality (OECD, 2009)

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Competitive Neutrality: A Summary of Current Situation

MO Wangui

Research Institute, People's Bank of China

1 The Chinese government has been committed to creating a competitive neutral policy environment

- **1.1 Attach great importance to creating conditions for all kinds of entities to participate in market competition on an equal footing**

1.1 Attach great importance to creating conditions for all kinds of entities to participate in market competition on an equal footing (continued)

- **Decision on Several Issues Concerning the Establishment of Socialist Market Economy System, 1993**: The basic framework of the socialist market economic system has been established, and the principle of common development with public ownership as the main body and various economic components has been put forward. It also puts forward that **the state should create conditions for all kinds of ownership economies to participate in market competition on an equal footing and treat all kinds of enterprises equally**.
- **Report of the 15th National Congress of the Communist Party of China, 1997**: Non-public economy is an important part of our socialist market economy. **We should continue to encourage and guide individual, private and other forms of non-public economy.**
- **3rd Plenary Session of the 16th CPC Central Committee, 2003:** Vigorously develop non-public economy; Encourage conditional non-public economy to expand and grow stronger.
- **Since 2018**, top leaders of the Chinese government have repeatedly stressed that all kinds of enterprises with ownership should be treated equally in accordance with the principle of "competition neutrality".

1.1 Attach great importance to creating conditions for all kinds of entities to participate in market competition on an equal footing (continued)

- **Speech by General Secretary Xi Jinping at the Symposium on Private Enterprises on November 1, 2018**:
  - Again, he emphasizes that **the status and role of non-public economy in China's economic and social development has not changed**. We have not wavered in encouraging, supporting and guiding the development of non-public economy. We are committed to creating a good environment and providing more opportunities for the development of non-public ownership economy. Our policies remain unchanged!
  - **Create a fair competition environment.** We should break through all kinds of "rolling curtain doors", "glass doors" and "revolving doors". We should **create a fair competitive environment for private enterprises in terms of market access, approval, operation, bidding and civil-military integration, and create sufficient market space for the development of private enterprises**. Private enterprises should be encouraged to participate in the reform of state-owned enterprises. We should **promote the transformation of industrial policies from differentiation and selectivity to inclusiveness and functionality, clean up policy documents that violate fair, open and transparent market rules, and promote anti-monopoly and anti-unfair competition law enforcement.**

1.1 Attach great importance to creating conditions for all kinds of entities to participate in market competition on an equal footing (continued)

- **Premier Li Keqiang:**
- **Executive Meeting of the State Council on December 24, 2018**

  According to the principle of competition neutrality, enterprises under all forms of ownership and large and medium-sized enterprises are treated equally in terms of bidding and land use.

  Unless otherwise stipulated, the minimum registered capital and the share structure restriction shall be abolished for private investment in the fields of resource development, transportation and municipal administration.
- **Report on Government Work of 5 March 2019**

  We should adhere to the principle of "two unswerving" and encourage, support and guide the development of non-public economy. **According to the principle of competition neutrality, all kinds of ownership enterprises are treated equally in terms of factors acquisition, admission, operation, government procurement and bidding.** We should build a new type of cordial and clean connection between government and business, improve the communication mechanism between government and enterprises, stimulate entrepreneurship and promote the development and upgrading of private economy.

1.1 Attach great importance to creating conditions for all kinds of entities to participate in market competition on an equal footing (continued)

- **Vice Premier Liu He:**
- On September 17, 2018, during the research on scientific and technological innovation in Shanghai, he emphasized that:

  We will continue to treat state-owned and private economies equally, treat small and medium-sized enterprises equally, strengthen the protection of property rights and intellectual property rights, and strive to create a good environment for the development of enterprises.
- Governor Yi Gang of the People's Bank of China:
- At the G30 International Banking Seminar in 2018, he emphasized that:

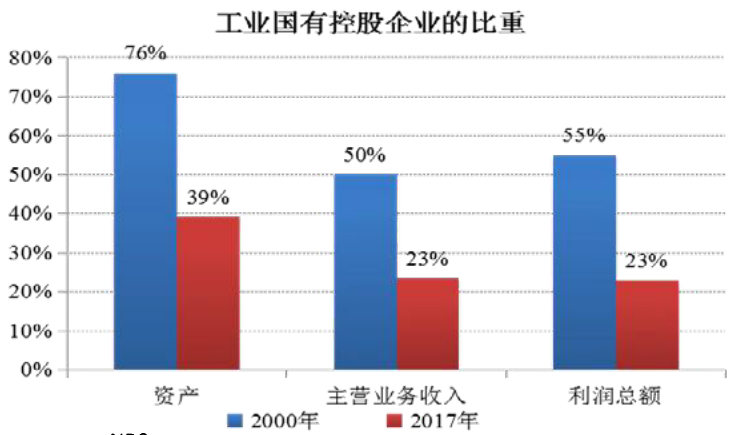
  In order to solve the structural problems in China's economy, we will **speed up domestic reform and opening-up**, strengthen the protection of intellectual property rights, and consider **treating state-owned enterprises with the principle of "competition neutrality"**. We will **vigorously promote the opening up of the service sector**, including the financial sector.

1.2 Put forward a series of policies and measures to promote open, fair and just competition

- Taking the **Anti-monopoly Law** as an example, China has implemented it for 10 years, which has promoted the formation of a unified, open and orderly market system, and protected the legitimate rights and interests of consumers and operators. **For implementation of competition policy**:
- In 2015, the CPC Central Committee and the State Council issued "Several Opinions on Further Promoting the Reform of Price Mechanism", putting forward "gradually establishing the basic position of competition policy", establishing a top-level design for the implementation of competition policy, and defining the basic direction and overall requirements.
- In 2016, "Opinions on Establishing a Fair Competition Review System in the Construction of Market System" was issued, which provides another important path and tool for the implementation of competition policy, enriching the connotation of China's competition policy, improving the system and improving the mechanism.
- The Anti-monopoly Committee of the State Council attaches great importance to the revision of the Anti-monopoly Law and includes it in its work plan.

1.3 Measures proved to be quite effective

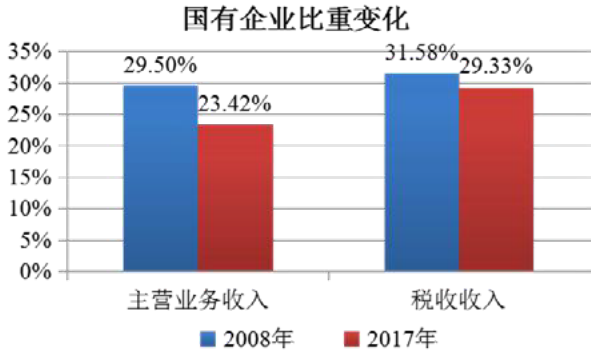
- The share of foreign and private enterprises in China's economy has been increasing. From 2000 to 2017, their share of assets, primary revenue and profit increased by 37 pp, 27 pp and 32 pp respectively. Currently, private enterprises contribute more than 60% of GDP.



source：NBS

1.3 Measures proved to be quite effective (cont'd)

- Foreign-funded and private enterprises enjoyed preferential treatment in tax and other areas, even more preferential than that of SOEs.
- Foreign enterprises has enjoyed preferential treatment in tax and other areas since the reform and opening up.
- From 2008 to 2017, SOE's share of primary revenue has down 6 pp, while the share of tax only fell 2pp.



Source: NBS, China Tax Yearbook

2. Areas where competitive neutrality should be strengthened

- **OECD: Competitive Neutrality: Maintaining a level playing field between public and private business (2012)**

Priority areas	Details
Streamlining the operational form of government business	the extent to which SOE's commercial and non-commercial activities are structurally separated.
Cost identification	Identifying the costs of SOE's commercial activity from non-commercial activities.
Commercial rates of return	If SOEs earn rates of return equivalent to that of private sector in comparable businesses.
Public service obligations	If SOEs get transparent, reasonable and adequate compensation when they provide public services.
Tax neutrality	If SOEs and other enterprises get equal tax treatment
Regulatory neutrality	If SOEs are subject to the same/similar regulatory treatment as private businesses
Debt neutrality	If SOEs benefit from preferential access to finance
Public Procurement	If procurement policies and procedures are competitive, non-discriminatory and maintain high standards of transparency

2.1 non-commercial businesses of SOEs were not fully separated

- Research indicated that some SOEs have taken non-commercial businesses which lead to losses and weaken SOEs' efficiency.
- Separating SOEs' non-commercial business is of key importance as it helps level the playing field for SOEs.
- **Guideline to deepening SOE reforms: the way to realize competitive neutrality.**

"Push forward SOE reform by dividing them into commercial enterprises and public-services enterprises. Defining SOE's functions and dividing them into different categories to achieve goals including reform, development, regulation, accountability and evaluation.

2. Areas where competitive neutrality should be strengthened

- **2.2 Greater openness is needed in the service sector.** OECD STRI showed, China's scores in 19 sectors out of 22 are above average (total 44 countries including all OECD countries and 9 EME countries), such as financial services, IT services and entertainment sector.

  The way forward: realize equal treatment to all market players irrespective of ownership. Restrictions on foreign ownership and business scopes will be removed as opening up further promoted.
- **2.3 Some policy measures supporting private enterprises were not adequately implemented.** Policy deviation exists. There is still a big gap in terms of same protection of property rights, fair market competition and equal use of production factors.

2.4 further improvement is need in financial service sector

- **Credit allocation:** According to incomplete statistics, private enterprises account for about 25% of the outstanding bank loans, while their contribution to economy is more than 60%. Credit allocation is not comparable with their contribution to economy.
- **Policy support:** Since last year, PBC has introduced a series of policy measures to address private enterprises' financing and operational difficulties, such as targeted RRR cut, TMLF, central bank lending and discount, establish supportive instruments for corporate bond issuance. Those measures are targeted and have contributed to a more balanced credit allocation between private enterprises and SOEs.

2.4 further improvement is need in financial service sector (cont'd)

- **The way forward：**
- Keep following the principle of equal treatment to all types of enterprises, continue to guide financial institutions to strengthen financial support to private enterprises in a market consistent approach, and better serve the real economy.
- Achieve regulatory neutrality. Regulations should be consistent and neutral irrespective of ownership, institution, sector, and markets.

THANKS

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Competitive Neutrality and Neutral SOEs: Theory and Evidence

Huihua NIE

Professor and Executive Deputy Dean
National Academy of Development and Strategy at RUC

2019. 4. 24

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Roadmap

- **Theory: why does China need SOEs?**
- **Evidence: ownership or size discrimination?**
- **Conclusion: will there be "neutral SOEs" ?**

2

Theory

- Competitive neutrality: fair competition and equal treatment of all enterprises without discrimination.
- Australia (1995): Competitive neutrality requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership.
- OECD (2011): Competitive neutrality implies that no business entity is advantaged (or disadvantaged) solely because of its ownership.

3

Theory

- Relationship between SOEs and POEs is at the core of competitive neutrality.
- Ideally, if there were no SOEs, competitive neutrality might had realized.
- The most contentious issue in China is the need for SOEs. Can POEs and SOEs compete on an equal basis?
- The need for SOEs is both theoretical and practical issues.

4

Thoery

Industries	SOE dominated	SOE needed	SOE not needed
Policy of competitive neutrality	SOEs run by the government	Law and regulation published to ensure fair competition	SOEs withdraw from the market

- Prerequisites for competitive neutrality： 1) the market already exists; 2) there is no market failure.

5

Theory

- The need for SOEs
- 1) To develop market economy
- Infrastructure is the fundamental facilities of market economy, which can be provided by the government.
- Authorities can first develop a market by setting up SOEs, and then promote competition by dividing SOEs into several competitive entities or introducing private and foreign capital.
- Examples： The Japanese Industry Breeding and Business Initiating Policy during Meiji Restoration, Steel and shipbuilding industry in Korea、 textile and plastic industry in Taiwan.

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Thoery

- 2) To correct market failures
- Market failure usually occurs due to imperfect competition, information asymmetries, externalities, or public goods. Government intervention can correct market failures to the extent.
- Examples: telecom, power and postal industry

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Thoery

- 3) To achieve catch-up
- The nation is the basic unit group of global competition. In this sense, SOEs of monopoly power can be competitive. Emerging countries tend to push forward catch-up by providing strong support to enterprises (SOEs).
- If nation interest takes precedence over everything (e.g. America First), global competition cannot be truly neutral.

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Thoery

Industries	SOE dominated	SOE needed	SOE not needed
Policy of competitive neutrality	SOEs run by the government	Law and regulation published to ensure fair competition	SOEs withdraw from the market
The role of SOEs	Developing market economy, correcting market failures and achieving catch-up; Industries related to national security	High-end manufacturing and services	Perfectly competitive industries

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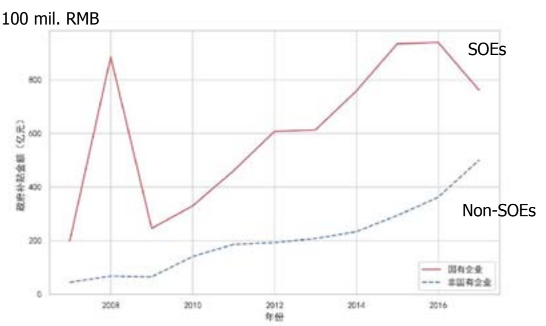
Evidence

——Subsidies: SOEs vs. POEs

✧ **Both listed SOEs and POEs have received large fiscal subsidies.**

Year	Subsidy (Bil. RMB)	
	SOEs	Non-SOEs
2007	19.883	4.3651
2008	88.5	6.7496
2009	24.514	6.4389
2010	32.922	14.016
2011	46.026	18.536
2012	60.713	19.246
2013	61.271	20.728
2014	75.789	23.31
2015	93.422	29.323
2016	93.905	36.156
2017	76.059	50.047



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Evidence

——Proportion of enterprises received subsidies: SOEs vs. POEs

✧**Almost all of listed SOEs and POEs have received fiscal support.**

Year	Proportion	
	SOEs	Non-SOEs
2007	0.781	0.839
2008	0.866	0.892
2009	0.926	0.925
2010	0.924	0.951
2011	0.943	0.965
2012	0.963	0.967
2013	0.964	0.973
2014	0.975	0.977
2015	0.975	0.986
2016	0.976	0.98
2017	0.861	0.92

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Evidence

——Ownership discrimination vs. size discrimination?

✧ Empirical analysis suggest that large firms can get easier access to fiscal subsidies.

✧Based on listed companies data, ownership discrimination is essentially size discrimination.

✧Size discrimination is essentially price discrimination, which cannot be avoided in reality.

✧"All competition is discriminatory."——Alchian & Allen，1972，*University Economics*

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Evidence

表 1 政府补贴的绝对值与总资产对数和员工人数对数的回归分析

	(1) 补贴金额	(2) 补贴金额	(3) 补贴金额	(4) 补贴金额	(5) 补贴金额	(6) 补贴金额
总资产的对数	0.254***	0.259***	0.277***			
	(7.93)	(6.54)	(6.53)			
员工人数的对数				0.147***	0.134***	0.145***
				(5.22)	(4.44)	(4.87)
国有股占比		-0.384*	-0.433**		-0.350*	-0.417*
		(-1.93)	(-1.98)		(-1.75)	(-1.87)
企业固定效应	YES	YES	YES	YES	YES	YES
年份固定效应	NO	YES	NO	NO	YES	NO
年份×行业固定效应	NO	NO	YES	NO	NO	YES
控制变量	NO	NO	YES	NO	NO	YES
聚类方式	Firm	Firm	Firm	Firm	Firm	Firm
样本个数	16612	16030	16030	16593	16013	16013

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Conclusion

- SOEs can be used as a tool of state management.
- SOEs can be and should be neutral. The role of SOEs should be limited to developing market economy, correcting market failures and achieving catch-up.
- The prerequisite for "neutral SOEs". SOEs do not enjoy any preferential treatment of regulation and supervision.

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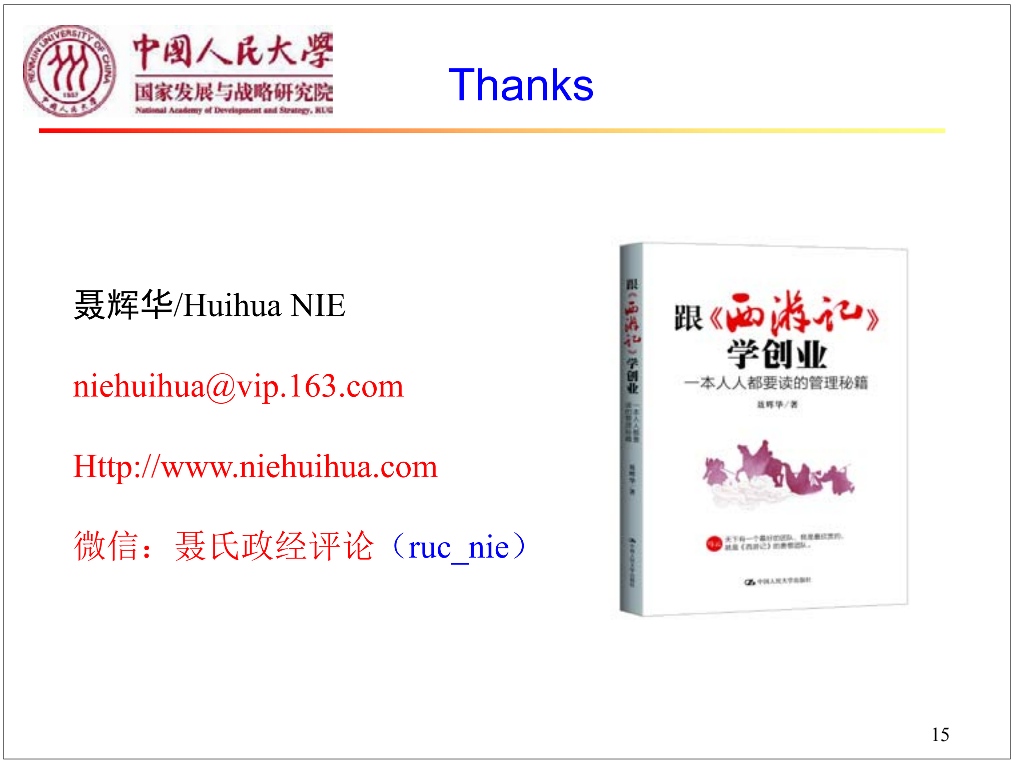
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Thanks
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跟《西游记》学创业
一本人人都要读的管理秘籍
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Seventh High Level Joint Conference
People's Bank of China and International Monetary Fund

Applying Competitive Neutrality in Corporate Financing in China

Kenneth Kang and Sarwat Jahan

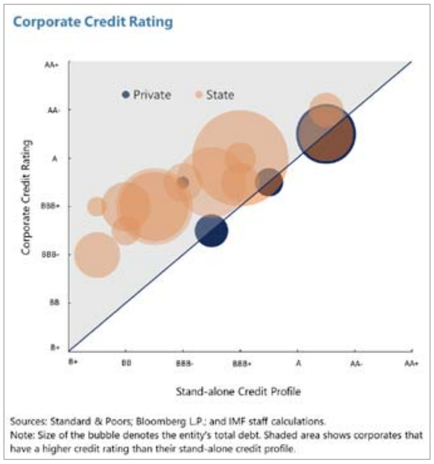
Asia-Pacific Department
International Monetary Fund
April 24th, 2019

Roadmap

- Situation with Competitive Neutrality in Financing
- Applying the Principles of Competitive Neutrality in Financing
- The Way Forward

Implicit guarantees provide SOEs an advantage in financing …

SOEs have higher credit ratings due to implicit government guarantees.



Benefits to SOEs:

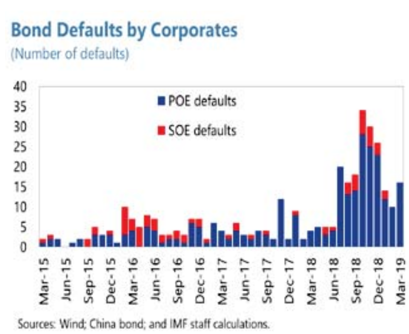
- ❑ SOEs pay 100 bps less in bond pricing compared to private firms with similar financial conditions. *Zhang and Wu (2019)*
- ❑ SOE return on equity would have fallen from an average of 8 percent to about −1.3 percent during 2011–15 without implicit support. *Lam and Schipke (2017)*

I. Situation with Competitive Neutrality | II. Applying Competitive Neutrality | III. The Way Forward

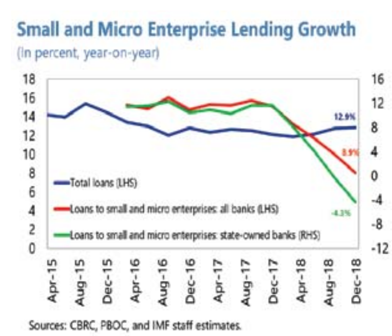
3

… and also inflates the credit worthiness of SOEs.

SOEs seem to be insulated from defaults

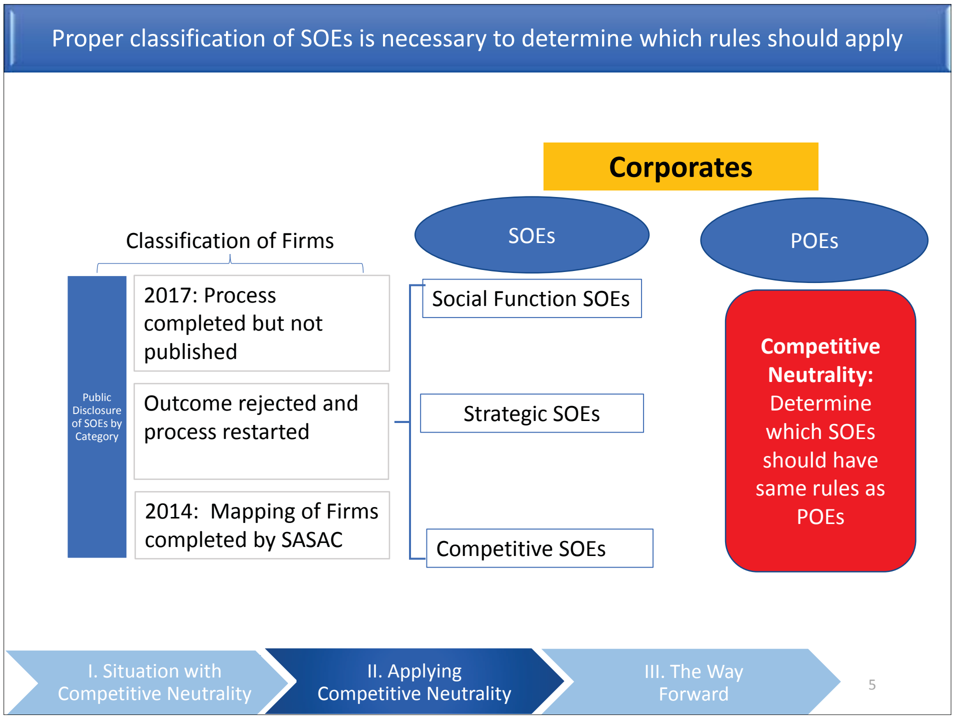


Perception of SOEs being less credit risky adversely impacts SMEs.



I. Situation with Competitive Neutrality | II. Applying Competitive Neutrality | III. The Way Forward

4


Proper classification of SOEs is necessary to determine which rules should apply
Corporates
SOEs
POEs
Classification of Firms
Public Disclosure of SOEs by Category
2017: Process completed but not published
Outcome rejected and process restarted
2014: Mapping of Firms completed by SASAC
Social Function SOEs
Strategic SOEs
Competitive SOEs
Competitive Neutrality: Determine which SOEs should have same rules as POEs
I. Situation with Competitive Neutrality
II. Applying Competitive Neutrality
III. The Way Forward
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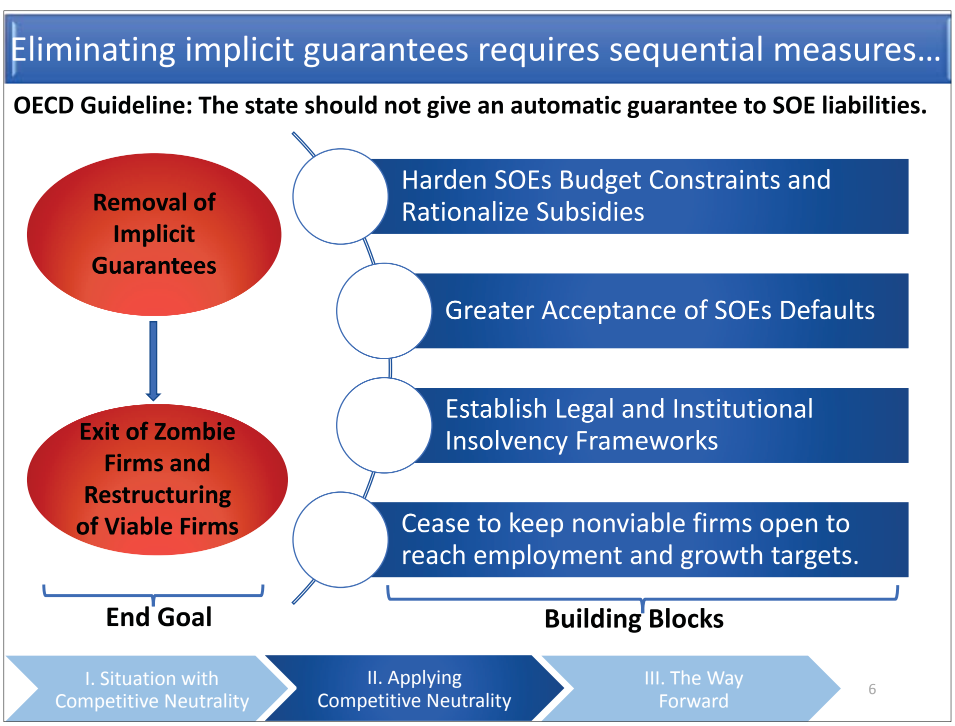

Eliminating implicit guarantees requires sequential measures…
OECD Guideline: The state should not give an automatic guarantee to SOE liabilities.
Removal of Implicit Guarantees
Exit of Zombie Firms and Restructuring of Viable Firms
End Goal
Harden SOEs Budget Constraints and Rationalize Subsidies
Greater Acceptance of SOEs Defaults
Establish Legal and Institutional Insolvency Frameworks
Cease to keep nonviable firms open to reach employment and growth targets.
Building Blocks
I. Situation with Competitive Neutrality
II. Applying Competitive Neutrality
III. The Way Forward
6

… which can also eliminate spillovers in other sectors.

Removal of Implicit Guarantees

FISCAL

Pressure on LG for revenues & employment

Mitigating Policies

- Address the gap between local government revenue and expenditures.
- Reduce local governments' reliance on local SOEs for spending.
- Open up more sectors to POEs and provide greater support to SMEs generate employment.
- More comprehensive social safety net and "hukou" reform

BANKING

Repricing of Risks

Mitigating Policies

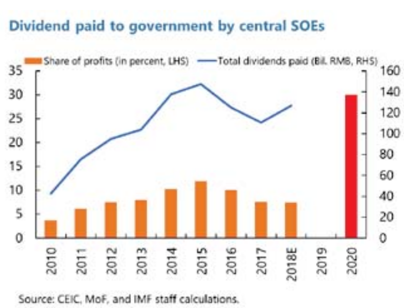
- Build up liquidity buffers.
- Strengthen oversight.
- Raise capital requirements.
- Reduce risks from creditor runs by lengthening maturities and reducing reliance on short-term wholesale funding

I. Situation with Competitive Neutrality | II. Applying Competitive Neutrality | III. The Way Forward

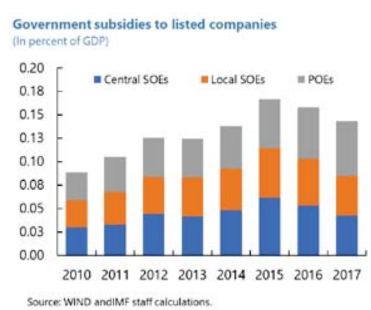
7

High-quality reforms will require hardening budget constraints for SOEs

Hardening Budgets Constraints



Rationalizing Subsidies



I. Situation with Competitive Neutrality | II. Applying Competitive Neutrality | III. The Way Forward

8

Legal and institutional framework also needs strengthening

Legal Framework

Enterprise Bankruptcy Law (2007)

✓ Follows best international practices…

⊗ but concise with many gaps…

⊗ does not have adequate guidelines for many complex problems in insolvency.

➢ Planned amendments need to focus on
- the scope of the law's application,
- the conditions for bankruptcy,
- bankruptcy procedures;
- and improving and reorganizing the system.

Institutional Framework

Viable and Non-viable Firms

✓ Significant exit of central zombies…

⊗ but limited market-based restructurings…

⊗ and issue of local government zombies are yet to be addressed.

➢ TEMASEK Style Reforms (Singapore):
- governing body that holds shares in state firms,
- giving SOEs autonomy, and
- requiring they operate as efficiently as the private sector.

I. Situation with Competitive Neutrality | II. Applying Competitive Neutrality | III. The Way Forward

9

There are multi-pronged ways to support the private sector

Measures to Support POEs

✓ Opening-up state-dominated services sector:
financial sector; elderly care; education and health care (2019).

➢ Opening-up all service sectors.

➢ The Company Law to ensure no industrial policies or regulations can restrict the access by POEs.

➢ The Company Law to prevent "lifelong accountability" for a POE loan default.

Greater Support for SMEs

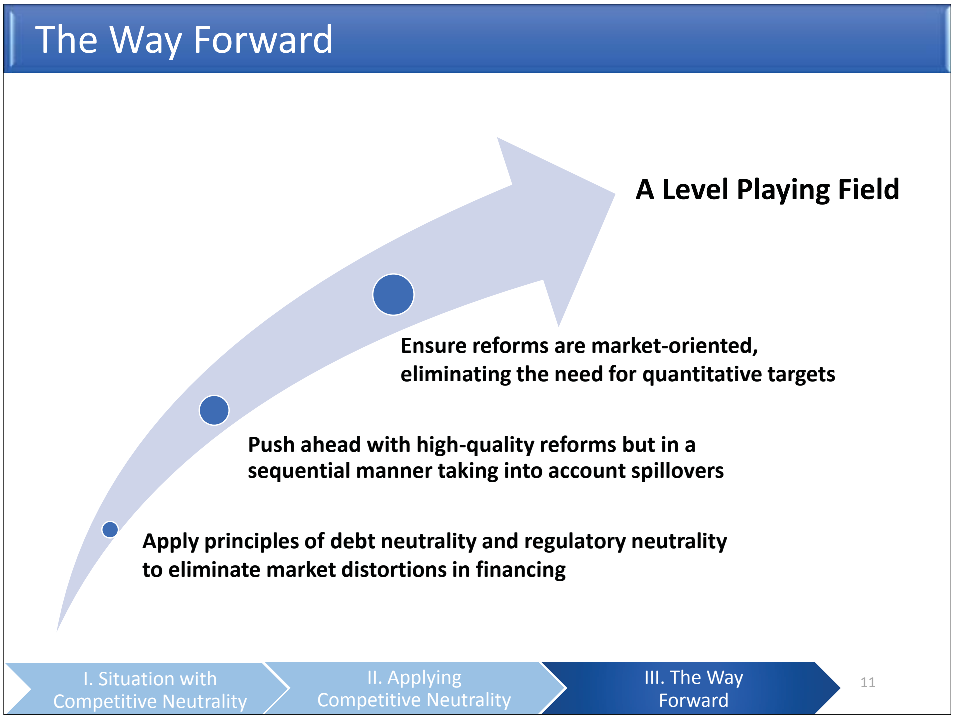
✓ Proactive measures for SMEs

⊗ Quantitative targets on quantity and price of credit.

➢ Greater use of market-based tools for credit flow
- ❖ Use of movable collateral which requires revision/new law on security interest
- ❖ Specialized credit bureaus for SMEs
- ❖ Specific capital markets targeted at SMEs (e.g., Korea has KONEX)

I. Situation with Competitive Neutrality | II. Applying Competitive Neutrality | III. The Way Forward

10


The Way Forward
A Level Playing Field
Ensure reforms are market-oriented, eliminating the need for quantitative targets
Push ahead with high-quality reforms but in a sequential manner taking into account spillovers
Apply principles of debt neutrality and regulatory neutrality to eliminate market distortions in financing
I. Situation with Competitive Neutrality
II. Applying Competitive Neutrality
III. The Way Forward
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INTERNATIONAL MONETARY FUND
THANK YOU

TEMASEK

Way Forward

Michael Buchanan

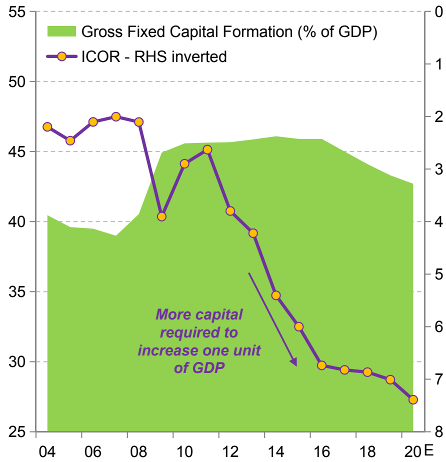
24th Apr 2019

Improving Investment Efficiency More Critical Now as Savings Rate Decline

Earlier high investment rate, while less efficient, was less of a concern given high domestic savings (bank deposits). As the current account shrink, funding will become more of a challenge.

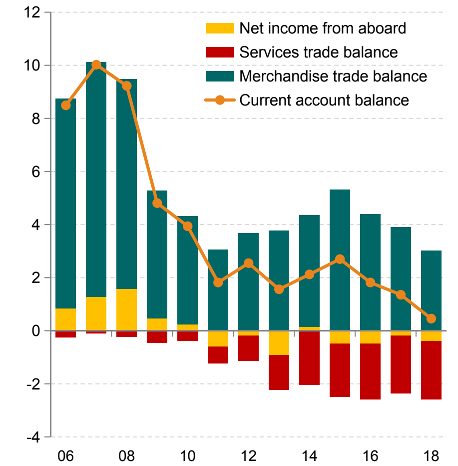
ICOR[1] deteriorating

(Units)



Current account shrinking

(% of GDP)



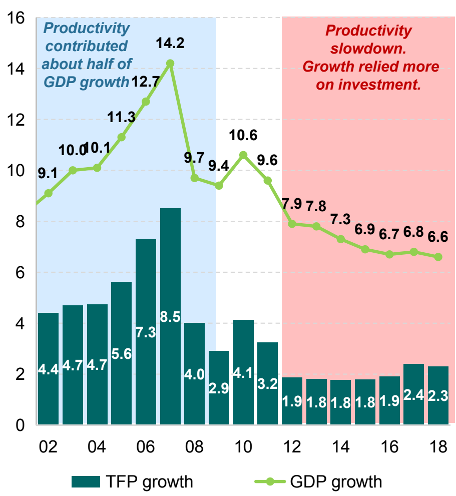
1. ICOR or Incremental Capital Output Ratio is the additional capital required to increase one unit of output.
Source: CEIC, Haver Analytics,

TEMASEK *Co-Confidential* 2

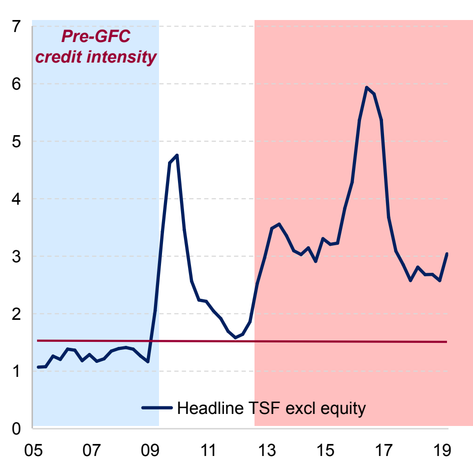
Resource Misallocation Resulted in High Credit but Low Productivity Growth

Productivity growth yet to show signs of sustained improvement. More credit required to hit the government's high growth target amidst higher credit intensity. Fixing misallocation helps release resources to more productive sectors.

TFP[1] growth vs GDP growth



Credit Intensity of Growth[2]



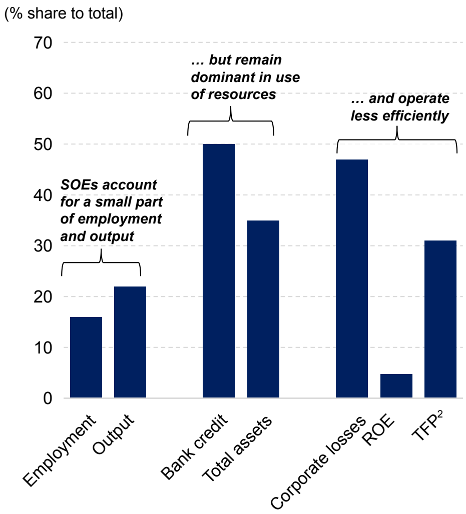
1. Total factor productivity measures the additional growth in output after allowing for extra labour and capital inputs
2. Credit intensity of growth measured by the ratio of 12mth avg of credit growth by 4 quarter avg of nominal GDP growth
Credit intensity as of Q1 2019, TFP as of 2018. Source: CEIC, Haver Analytics, Wind. Penn World table, Temasek estimates

TEMASEK *Co-Confidential* 3

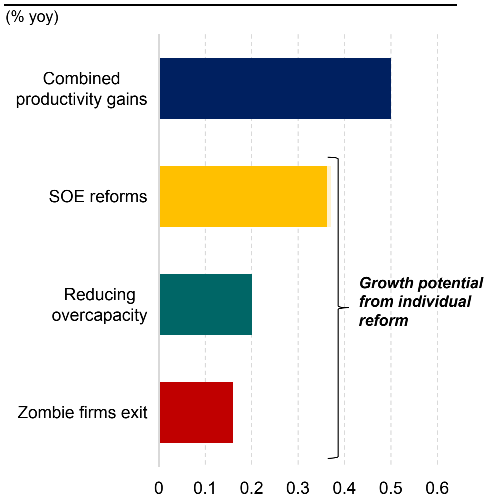
A "Fair Playing Field" Needs More Than Just Opening Up

SOEs dominate resources but are less efficient. Industrial policy tend to be through a process of selection rather than competition. This encourages "race to be biggest" with subsidies biasing towards SOEs.

Key statistics for SOE[1]



Still scope for better growth potential from higher productivity gains



1. SOE's share in total unless otherwise stated. Sample period as of end-2015 where data are available.
2. TFP as a ratio compared to POEs.
Source: IMF fiscal monitor 2017

TEMASEK 4

Allowing Foreign Firms More Market Access Will Also Encourage Competition

Perpetual government funding and subsidies to domestic firms that are non-viable will eventually become too expensive and only genuinely competitive firms will succeed

Foreign firms common-cited obstacles

- Ownership cap for overseas investors
- Restricted access to specific sectors
- Limited expansion opportunities with red tape

What has been done

- Opening service sectors such as the financial sector
- Reducing foreign equity cap
- Shortening of negative list for foreign investment

What more is needed

Intellectual Property Safeguards

- Prevent forced technology transfers, freedom of choice in JV partners and IT vendors

More predictable policy and regulatory environment

- Policymaking often guided by broader strategic outcomes of the government rather than rule-based law .
- Policy and regulation vary frequently from tight to tolerance, most through window guidance than in writing, posing as more uncertainty on foreign firms

Enforcement of new Foreign Investment Law

- Rules to address violations to anti-competitive behavior with greater transparency
- Compel local government to comply with protection of foreign investors
- Greater enforcement measures and penalties for infringement

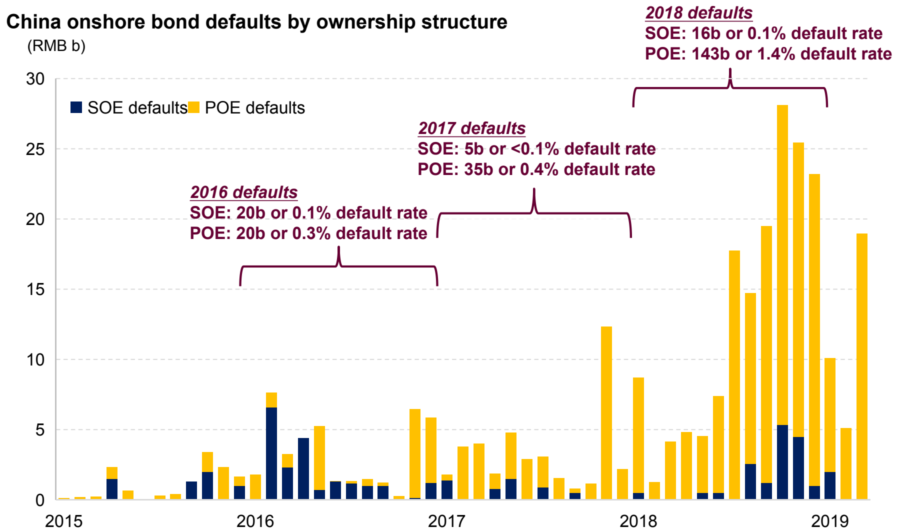
TEMASEK

Co-Confidential

5

POEs Bearing The Brunt of Earlier Efforts to Address Financial Risks

2018 onshore bond defaults came mostly from POEs. The financial tightening efforts squeezed POEs liquidity given that POEs have more limited access to official bank loans.



1. *Excludes financial institution bonds from commercial banks, policy banks, insurance companies and securities companies. Includes defaults on corporate bonds , medium-term notes and commercial paper. Also include defaults on bonds with put options.*

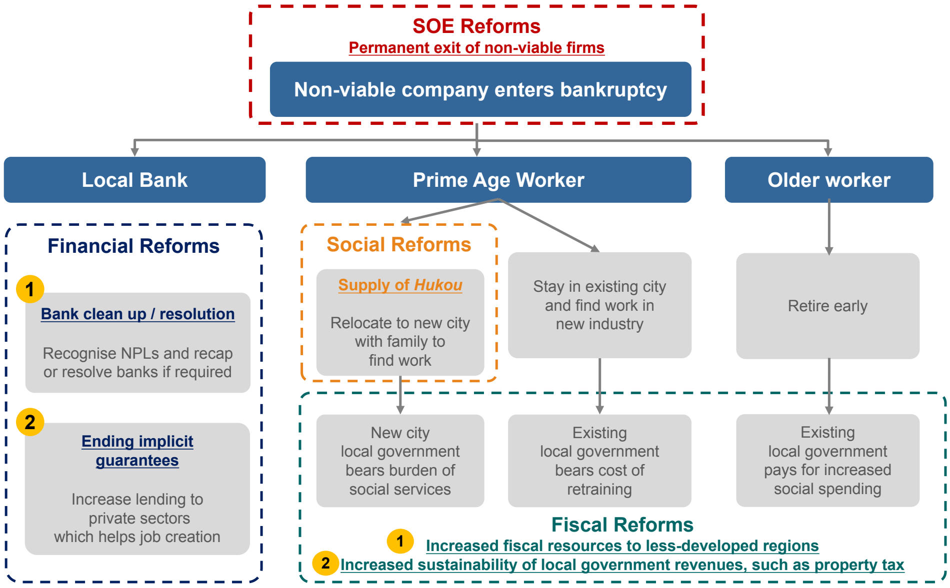
Source :Wind

TEMASEK

6

Other Reform Areas Help Supplement Efforts to Promote Competition

Financial sector reforms help strengthen bank's balance sheet and improve bankruptcy procedures.
Fiscal reforms to increase local government revenue sustainability, as they rely on large SOEs for social objectives.



TEMASEK CO-CONFIDENTIAL 7

Progress in Addressing Macro-Imbalances While Challenges Remain

China has made progress in broad areas. Further reforms, while critical are tough and risk market volatility and instability concerns. The government understand this and are calibrating policy to prevent sharp slowdown.

Macro-areas	Key progress so far	What more is needed	Short-term and Long-term Outlook
Financial	• Curb off-balance sheet and non-loan credit financing through **MPA and AMP rules**(1) • **Debt** accumulation slowed	• Control the pace and impact on **housing debt**, which remains low but has risen sharply over recent years	• **Policy fine-tuning:** Tightening is relaxed at the margin, suggesting more balanced risk to growth • Further reform effort might result in **higher volatility in market**, particularly as support from the external environment starts to fade • Long-term, further reforms will: 1) **Help economic rebalancing** 2) **Improve productivity** 3) **Stabilize debt trajectory**
Fiscal	• **Debt-swap** as more transparent means of financing local govt spending • **Tax and fee cut package** to stimulate economy and help pay cost of rebalancing	• Balance between **fiscal deficit** and **tax cuts** • Reduce reliance on property market and **land sales** • Address **central-local fiscal responsibility**	
External	• More flexibility in **exchange rate** • Eased **capital outflow pressure**	• Navigate potentially more **global protectionist policies**	
Structural, market, and resource allocation	• Reduced **overcapacity** • **Credit policies** directed at real economy, private and small enterprises	• Remove **implicit guarantees** • Allow **non-viable firms** to exit • **Tolerate slower growth**	

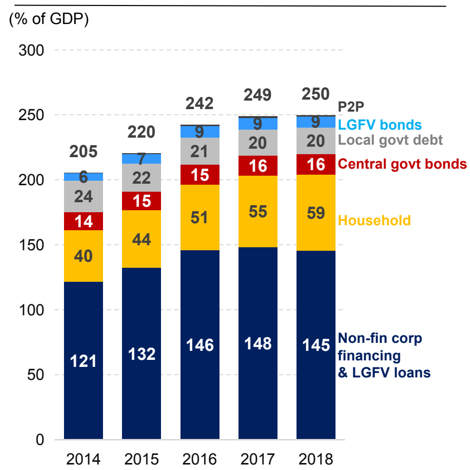
Note: (1) MPA : Macro-prudential assessment framework AMP: Asset Management plan

TEMASEK CONFIDENTIAL 8

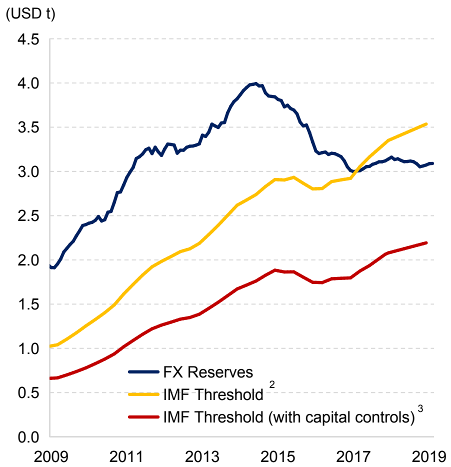
Slower Increase in Debt-To-GDP to Provide Some Cushion

Challenging for China's debt to GDP ratio to fall or stay broadly unchanged while it undergoes reforms. At same time, earlier buffers will continue to dwindle.

Total domestic non-financial debt to GDP ratio[1]



FX reserves and IMF reserve adequacy thresholds



1. Given local government debt swap, LGFV loans are unable to be identified from available data. LGFV loans identified for debt swap would have been classified under local government debt
2. 30% of short-term debt, 20% of other liabilities, 10% of broad money and 10% of exports. This metric does not include imports as it is mostly financed by external liabilities which should raise short-term debt as already included in this IMF threshold metric.
3. Weight of broad money is reduced to 5%
Source : CEIC , Wind, IMF ARA

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Agenda

- **Appendix**

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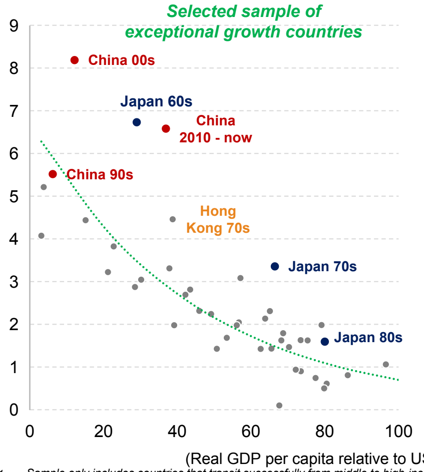
Retain Relatively optimistic assumptions on growth

China exceptional growth can be explained mainly by technology catch-up and massive accumulation of inputs. Growth would naturally trend slower, as rewards from catch-up in technology and pool of labour diminish. Further productivity gain must rely more on human capital advancement and technology sophistication.

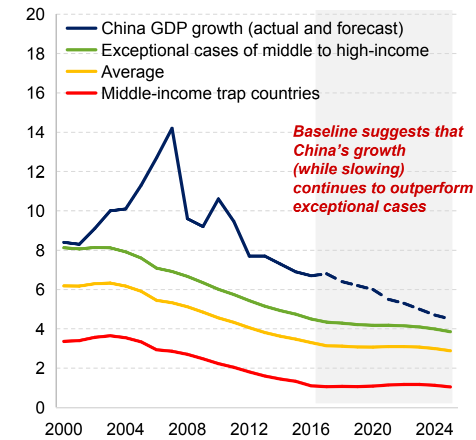
Labour productivity growth was exceptional

(Labour productivity growth relative to US)



Baseline expects China to continue outperform

(% yoy)



1. *Sample only includes countries that transit successfully from middle to high-income*
2. *Includes "East Asia" miracle countries i.e. Japan, South Korea, Hong Kong, Singapore and Nordic countries (Finland, Sweden, Norway , Denmark) and also Germany*
3. *Based on ADB definition on Middle-income trap countries (i.e. Brazil, Jamaica, Peru, Jordan , South Africa, Malaysia, Venezuela etc.)*

Source: UN population, World Bank, Haver Analytics. Overall sample consist of 32 countries.

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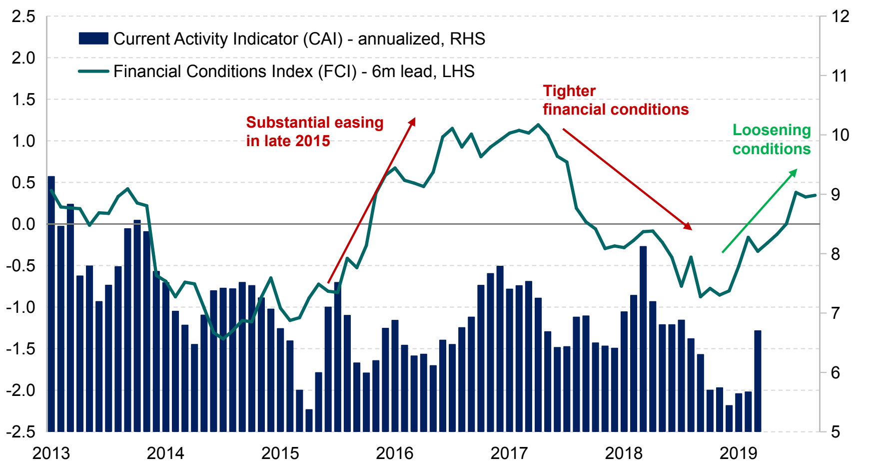
Sequential growth to continue due to earlier loosening of FCI

Financial Conditions Index (FCI) vs. Current Activity Indicator (CAI)

(Standard deviations from 2010-2017 average) (% annualized)



Data as at Mar 19. Source: CEIC , Bloomberg, Haver

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Withdrawing Implicit Guarantees

One of the most important and difficult of China's reform challenges.
There is no "best practice" blueprint that China can follow and implementation will introduce uncertainty.

Implicit guarantees crowd out loans to private sector and misprice credit risk, contributing to misallocation of resources, low productivity and slowing growth

Roadmap

1 Supporting policies
- Strengthen banks' balance sheets and resolution mechanisms
- Improve financial system disclosures (e.g. cross-guarantees)
- Clarify and improve corporate bankruptcy procedures
- Bolster social safety nets, human capital spending (e.g. re-training)

2 Gradually introduce more risk
- Allow non-viable SOEs to exit
- Distinguish between "old" and "new" guarantee regimes
- Tolerate more defaults for creditors under the "new" regime

3 Financial safety nets
- Active role by central bank to prevent emergence of systemic risks
- Distinguish between liquidity and solvency

Challenges

What could go wrong

Rising uncertainty about credit risk and run on wholesale bank funding given opaque exposures, cross-guarantees and liquidity mismatches

Escalate into solvency and banking crisis

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Reform Dividend Take Time to Materialise

Pace of execution varies across different reform areas, given inter-linkages and feedback loop

Key areas	Macro implications
SOE reforms − Privatisation of state-owned assets − Alignment of incentives between management and shareholders	Greater efficiency/innovation in SOEs to potentially drive growth
Urbanisation and social reforms − Some relaxation of *Hukou* system but migrant workers remain largely marginalised − Healthcare reforms	Greater social safety net and legal protection to encourage home ownership and support consumption growth over time
Capital market reforms − Further capital account opening at a measured pace	Freer flow of capital could potentially prevent asset bubbles and allow for cheaper financing
Fiscal reform − Implementation of property tax	Greater sustainability in local government revenue supports infrastructure spending

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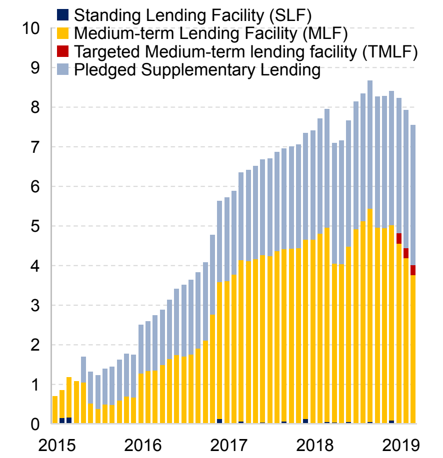
Limited incremental monetary policy easing

Net injection of liquidity has been slowing.
Further easing may be more targeted

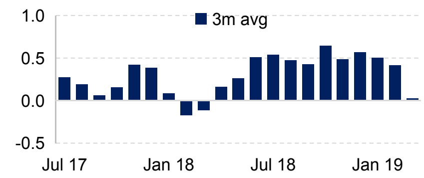
PBOC lending facilities[1] outstanding amount

(RMB trillion)



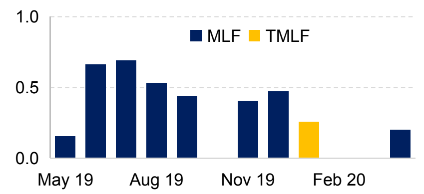
PBOC net injection of liquidity, ex-FX intervention[2]

(RMB trillion)



Maturing MLF/TMLF

(RMB bn)



1. PBOC lending facilities are aimed at injecting liquidity to commercial banks with relatively cheap funding. MLF (3.3%) and TMLF (3.15%) funding are mostly conditional on bank lending to private sectors or SMEs. This helps to achieve policy objective of supporting credit demand in these sectors.
Source: CEIC , Wind

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Key easing measures so far

Monetary policy

- 4 RRR cuts in 2018 and 1ppt RRR cut in 2019
- Lowered RRR criteria for banks with higher share of loans for “inclusive finance”
- Created Targeted MLF
- Expanded MLF collateral to include SME loans and AA-rated bonds
- Central banks bills swap to swap bank’s perpetual bond with central bank bills

Reduced Corporate VAT tax burden

- Lowered VAT tax rate from 11%/17% to 10/16% in May 2018 and further reductions to 9%/13% in Apr 2019
- Allowed VAT tax rebate for advanced manufacturing and R&D etc.
- Exempt VAT tax for SMEs with revenue below RMB100k (prev. 30k)

Personal income tax cuts

- Personal income tax (PIT) taxable income threshold raised from 3500RMB to 5000 RMB
- Expansion of personal income tax deductibles (e.g. education, medical, mortgage)
- Consumption boost measures such as car and household appliance subsidy (e.g. local government subsidy to NEVs)[1]

Infrastructure investment

- State-led infrastructure investment to increase
- Fiscal channel largely through off-budget spending (e.g. local government special bonds) with local government told to accelerate issuance of special local government bond

1. Car and household appliance subsidy unless permanent, will likely to bring forward purchases in the future

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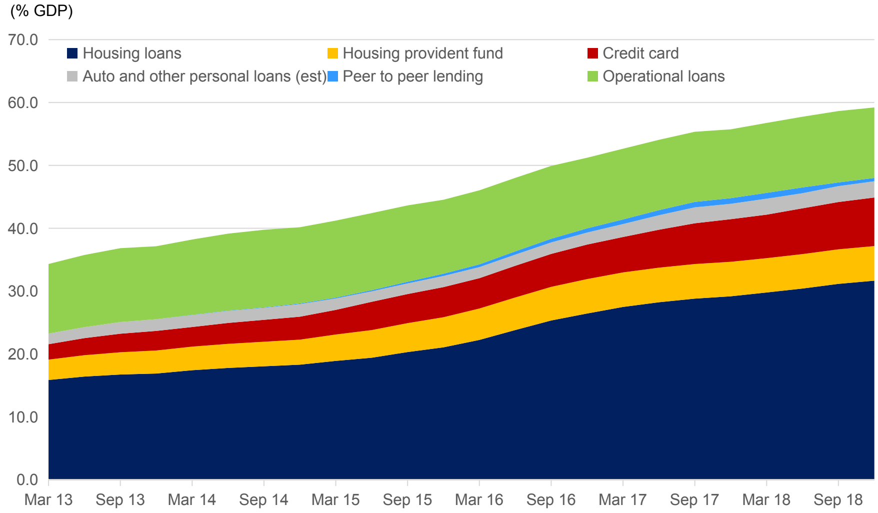
Rise in China household leverage largely driven by housing-related debt

Our estimate of adjusted household debt to GDP ratio had risen from ~37% to ~59% in the last five years, with housing-related debt contributing to nearly 17ppt or 75% of the increase

Household debt to GDP[1]



1. Data as of Q4 2018. We assume nearly 60% of peer to peer lending is attributed to household borrowings.
Source: CEIC

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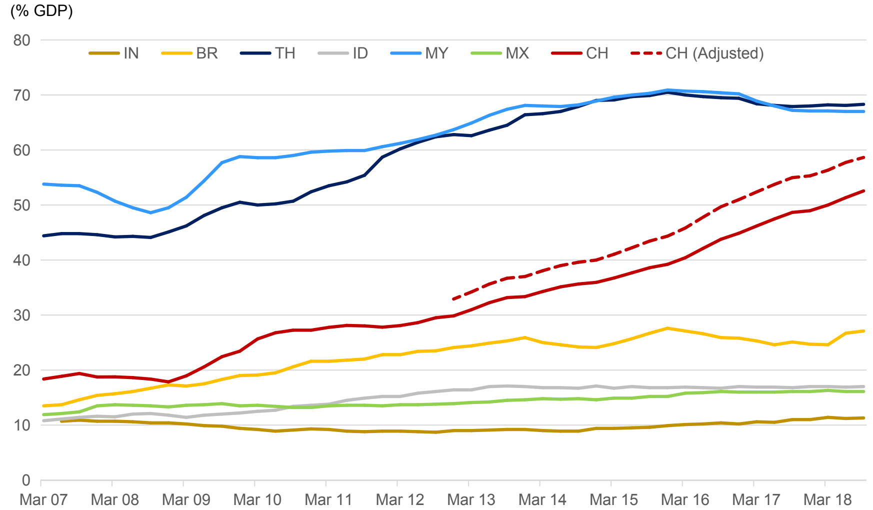
China household debt to GDP had risen much faster than most other EMs…

Compared to most other EMs, China's household debt to GDP ratio is high and continues to rise

Household debt to GDP[1]



1. Data as of Q2 2018. Data from BIS household debt statistics for all countries other than China
Source: Haver, CEIC, BIS

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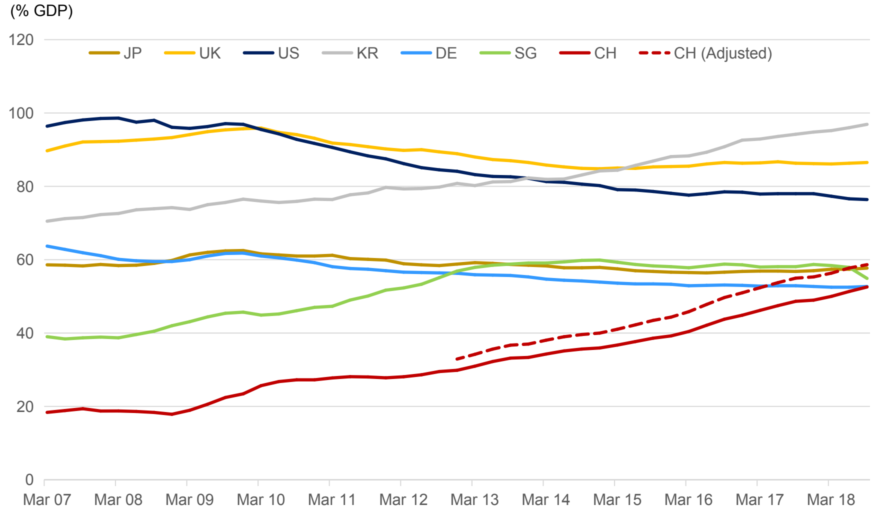
…but remains lower than most other DMs, implying room for increase

China's household debt to GDP still much lower than US, UK and Korea

Household debt to GDP[1]



1. Data as of Q2 2018. Data from BIS household debt statistics other than China
Source: Haver, CEIC, BIS

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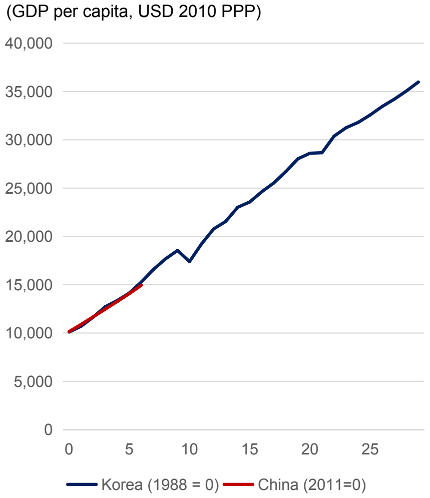
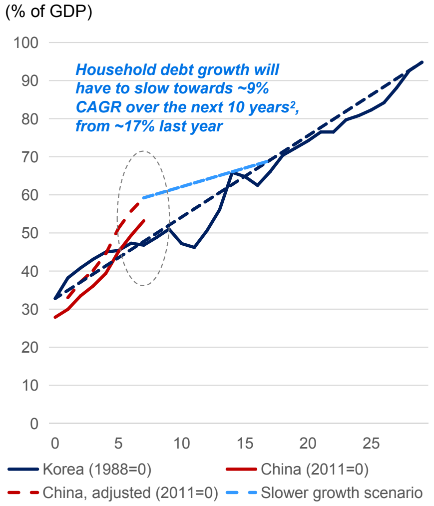
But China's household debt growth has to slow from its recent pace

China's household debt level has even exceeded Korea, a DM with highly leveraged households, at a similar stage of development in terms of GDP per capita

China's stage of development comparable to Korea in 1994[1]



Household debt to GDP



1. Based only on GDP per capita on a PPP basis
2. Assuming an average 7% nominal GDP growth over the same time horizon
Source: OECD, CEIC, Haver, BIS

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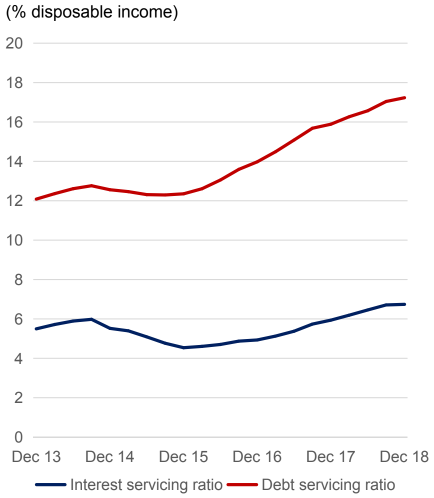
Debt servicing ratio has risen

On aggregate, debt servicing has shaved off merely an additional ~5% of disposable income since late 2015

Debt and interest servicing[1] ratios (excluding P2P)



Key assumptions

1. **Housing loans from banks**
   - *Rates: Weighted avg housing loan rate*
   - *Tenor on outstanding loans: 10y*
2. **Housing loans from Housing Provident Fund**
   - *Rates: Weighted avg housing loan rate*
   - *Tenor on outstanding loans: 10y*
3. **Operational loans**
   - *Rates: Weighted avg general loan rate*
   - *Tenor on outstanding loans: 5y*
4. **Auto and other personal loans**
   - *Rates: Benchmark 1-5y lending rate*
   - *Tenor on outstanding loans: 3y*
5. **Credit card loans**
   - *Rates: Benchmark 1y lending rate*
   - *Interest only on 50% of outstanding borrowings*
6. **Income assumption**
   - *Disposable income per capita x total population*

1. Interest rate times loan outstanding
Source: CEIC, Haver

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PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

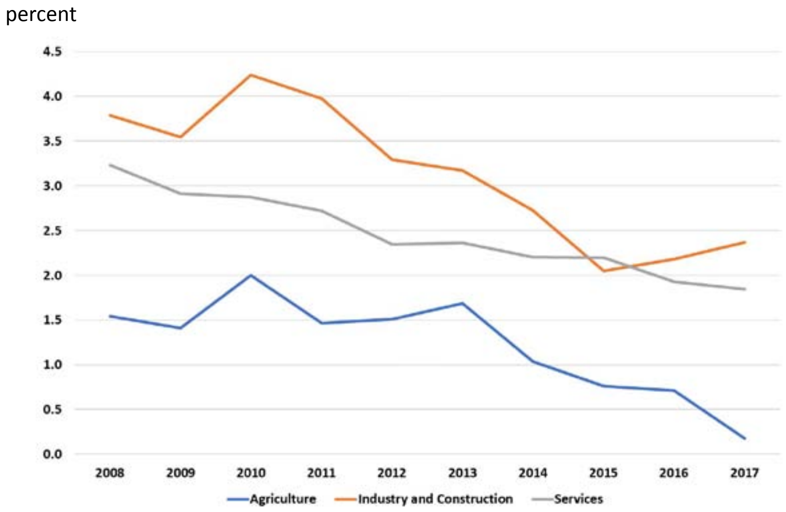
Achieving Competitive Neutrality in China

Nicholas Lardy
Anthony Solomon Senior Fellow
Peterson Institute for International Economics

IMF and PBOC Conference on Opening Up and Competitive Neutrality, Beijing, April 24, 2019

1

Low and Declining Returns on SOE Assets, 2008-17



Source: Ministry of Finance.

2

Huge Share of Loss-Making State Firms, 2008-17

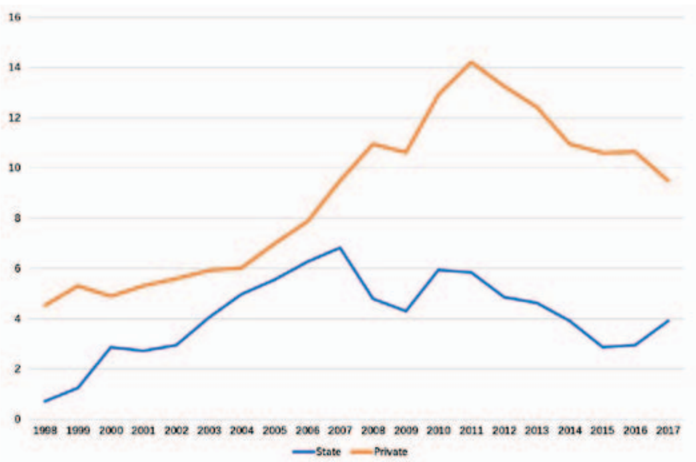
Year	Loss-making share (percent)	Number of Loss-making Enterprises (Hu)	Losses: Amount (billions of RMB)	Losses: As a share of GDP (percent)
2008	39.5	43,500	507	1.6
2009	37.1	41,200	394	1.1
2010	35	39,900	392	1.0
2011	35.1	47,700	613	1.3
2012	35.5	52,200	855	1.6
2013	35.6	55,200	860	1.5
2014	36.1	58,100	1,086	1.7
2015	37.2	62,100	1,342	2.0
2016	37.1	64,600	1,466	2.0
2017	36.9	69,000	1,445	1.8

Source: Ministry of Finance.

3

Diverging Returns of State and Private Industrial Enterprises After 2007

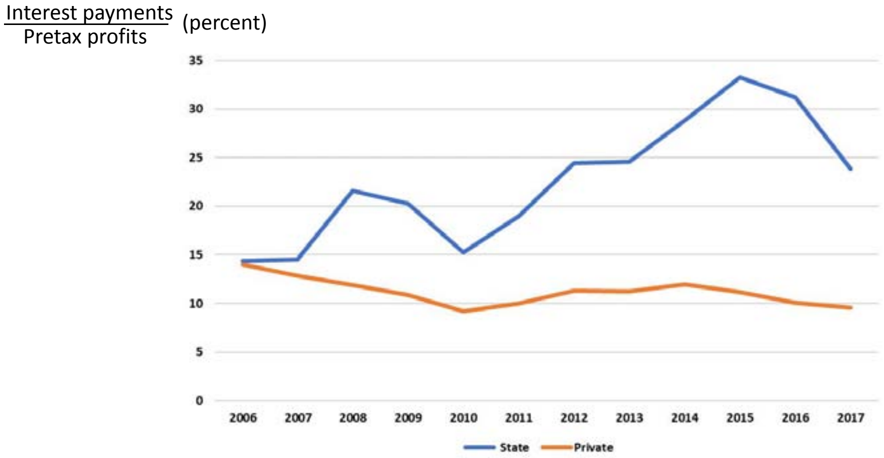
ROA %



Source: National Bureau of Statistics.

4

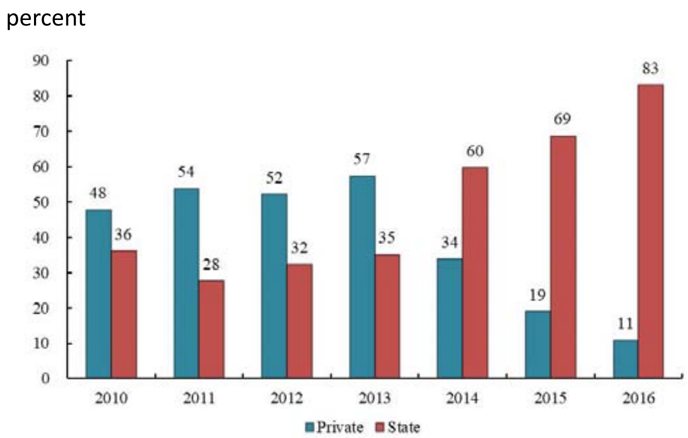
Private Industrial Firms Are More Credit Worthy, 2006-17



Source: National Bureau of Statistics.

5

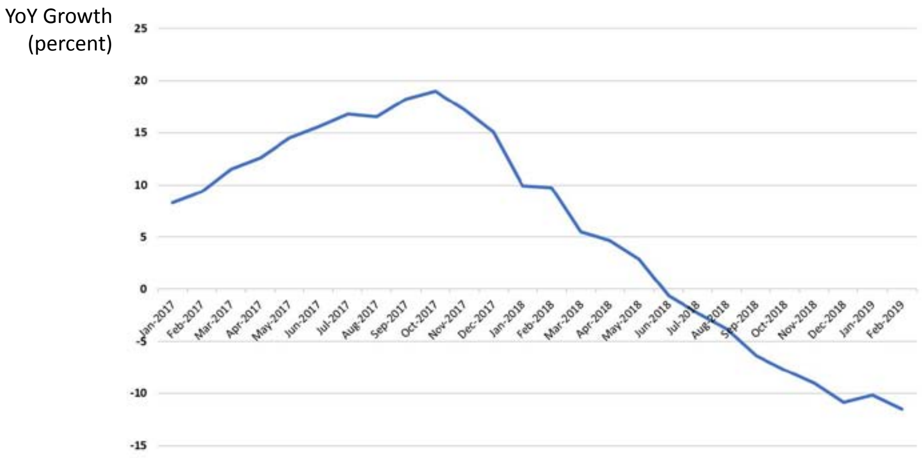
Misallocation of Loans to Nonfinancial Enterprises After 2013



Source: China Banking Society.

6

Collapse of Shadow Finance Further Squeezes Private Firms, 2017 – Feb 2019



Source: People's Bank of China.

Note: Shadow finance = sum of entrusted loans, trust loans and bankers' acceptances.

7

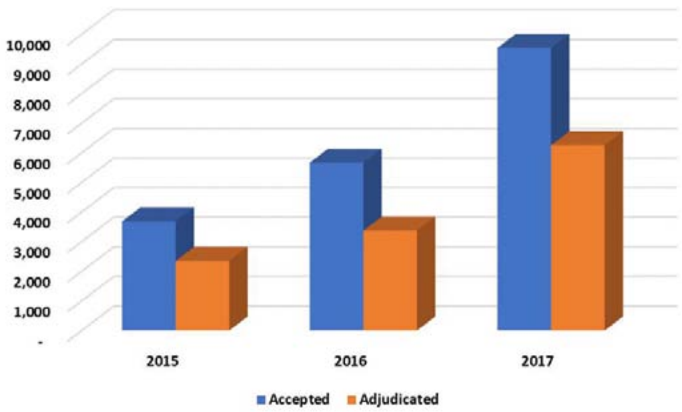
Limited Domestic Mergers and Acquisitions, 2007-18

Year	Number of transactions	Value (billions of RMB)
2007	1,078	326
2008	1,668	519
2009	1,559	577
2010	1,797	663
2011	2,063	725
2012	1,079	506
2013	1,583	480
2014	1,915	871
2015	2,887	1,547
2016	2,938	1,490
2017	6,689	1,568
2018	7,234	1,362

Source: Wind Financial Information.

8

Tiny Number of Enterprise Bankruptcy Cases, 2005-17

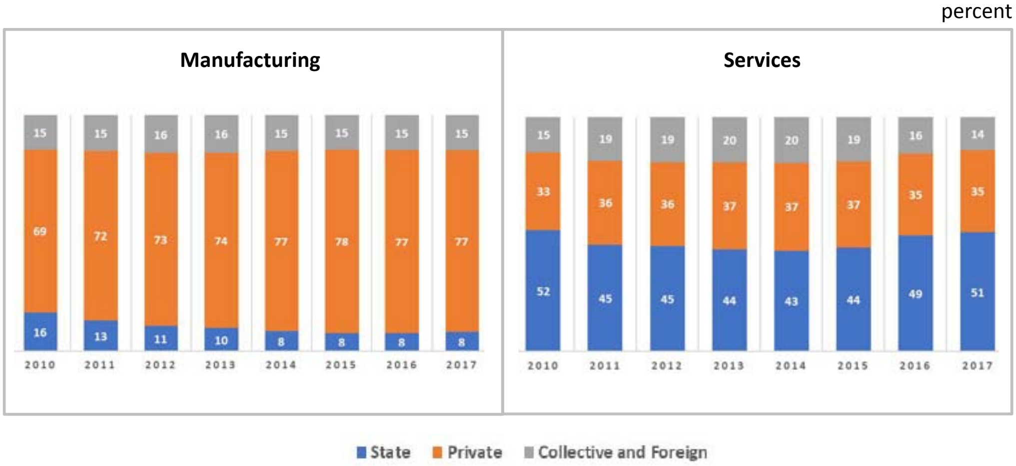


Source: Supreme People's Court.

9

Continued State Domination of Services Investment, 2010-17

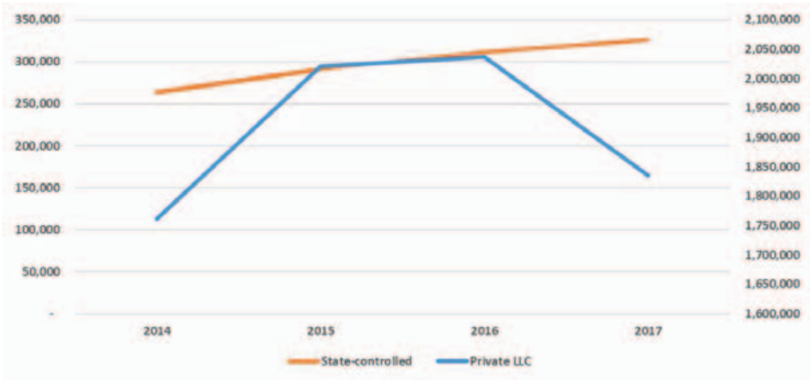
percent



Source: National Bureau of Statistics.

10

Only Private LLCs Are Subject to Financial Discipline



Source: National Bureau of Statistics.

11

Recommendations

- Require market-oriented allocation of financial resources
- Impose hard budget constraints on state enterprises
- Eliminate obstacles to mergers and acquisitions
- Facilitate enterprise bankruptcy
- Liberalize access of private firms to service industries

12

Mainstreaming the Competitive Neutrality Principle in China: the Way Forward

WORLD BANK GROUP

Chunlin Zhang
Lead Private Sector Specialist
Finance, Competitiveness and Innovation Global Practice
April 24, 2019，Beijing

04/24/2019

The spirit of CN principle is the same "equal competition" advocated in China for decades

China, 1993, Decision on Socialist Market Economy.	• The state must create conditions to allow enterprises of all ownership types to compete equally, and for the government to treat them on equal terms.
Australia, 1996, Commonwealth Competitive Neutrality Policy Statement	• Government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership.
China, 2013, Decision on Deepening Reform	• The state must ensure enterprises of all ownership types use factors of production on equal terms, and participate in market competition on open, fair and equal terms.
OECD, 2015, Note by the Secretariat on Competition Policy and Competitive Neutrality	• .... all enterprises, public or private, domestic or foreign, face the same set of rules, and where government's contact, ownership or involvement in the marketplace, in fact or in law, does not confer an undue competitive advantage on any actual or potential market participant.

04/24/2019 PBOC/IMF 2

The World Bank has advised China to mainstream the CN in recent years

以 “竞争中性原则” 确保国企民企公平竞争

2014年02月11日 04:14 21世纪经济报道 我有话说

Using "Competitive Neutrality" principle to ensure equal competition between SOEs and private firms: Chunlin Zhang interview with 21st Century Economic Herold. Feb. 11, 2014

China's New Round of SOE Reform: Managing State Capital and Leveling the Playing Field

Draft for Consultation
Not for Distribution and Quotation

August 2, 2017

China:

Applying Competitive Neutrality Principles
To Level The Playing Field Across Markets

- Lessons from International Practice -

May 2016

Mainstreaming the Competitive Neutrality Principle in China

The World Bank

January 10, 2019

04/24/2019 PBOC/IMF 3

Competition is of more fundamental importance for growth model transformation

China's future growth hinges on TFP, which suffered slowdown recently and is still a large distance to productivity frontier

Note: Line indicates China's TFP at various levels of per capita GDP. OECD countries in orange.
Source: World Bank "New Drivers of Growth" Report, 2019

And TFP growth comes from three sources, all dependent on the competitiveness of the market

Total factor productivity

- Reallocation of factors across sectors and firms (between-firm);
- Improved firm performance (within-firm);
- Entry of high productivity firms and exit of low productivity firms (selection)

04/24/2019 PBOC/IMF 4

Achieving CN in China may involve actions in multiple frontiers

- **Regulatory reform** to ensure equal treatment between SOEs and non-SOEs, esp. regulatory enforcement, implicit entry barriers.
- Reform of the **state capital management** system to impose a requirement of market rate of return to commercial SOEs.
- Elimination of privileges enjoyed by SOEs in **access to, and cost of, finance**.
- Clean-up of **explicit and implicit subsidies and preferential policies** that confer undue competitive advantage to SOEs. (Attempt made in 2014 – Directives of Guofa [2014] 62, MOF[2014]415)
- Adequate, transparent, and accountable **compensation for public policy functions** performed by SOEs per government instructions.

04/24/2019 PBOC/IMF 5

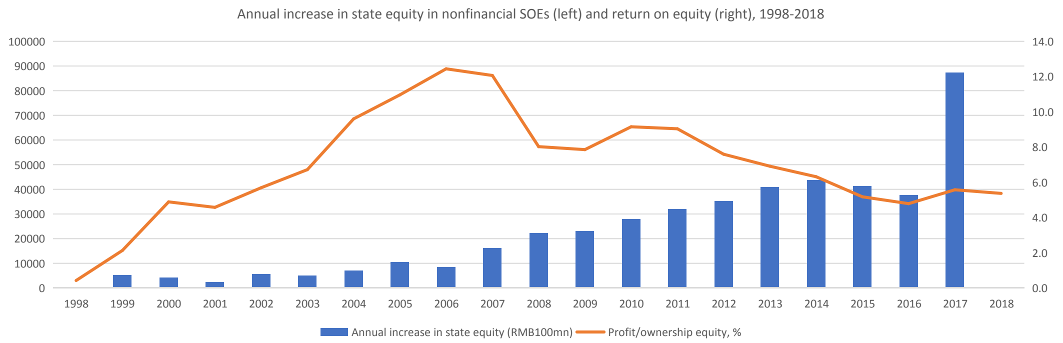
State capital management deserves special attention

- Soft equity capital finance to SOEs enable them to **undercut their competitors**, before entering competitions such as bidding, land allocation, access to loans.
- Given leverage ratio, the amount of state equity capital invested in SOEs determines the size of their total assets, with **potential crowd-out implications**.
- CN requires SOEs operating in a commercial and competitive environment "earn rates of return like **comparable businesses**".
- Similar rule was adopted in CPTPP: equity capital provided to SOEs should not be "inconsistent with the **usual investment practice**, including for the provision of risk capital, of private investors".

04/24/2019 PBOC/IMF 6

The overall picture in China points to urgent need to harden the budget constraint… (1/3)

State owner's equity in non-financial SOEs has kept increasing since 2007 despite declining ROE.

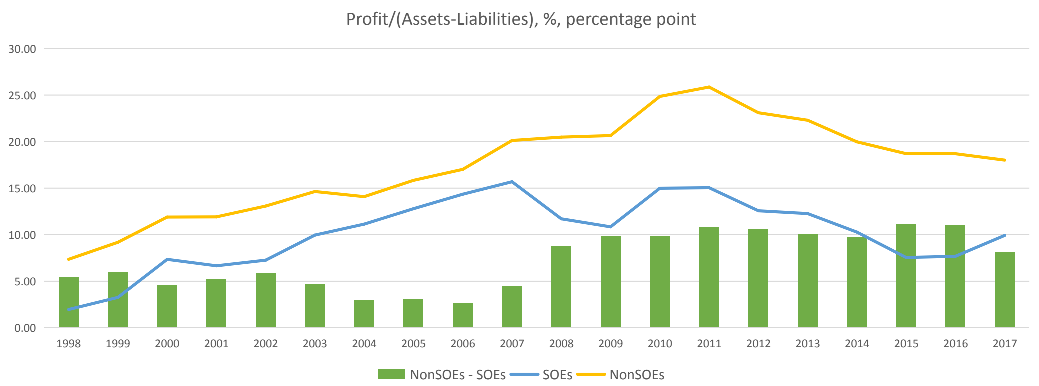


Source: China Fiscal Yearbook.

04/24/2019 PBOC/IMF 7

The overall picture in China points to urgent need to harden the budget constraint… (2/3)

ROE gap btw industrial SOEs and non-SOEs has widened since 2007



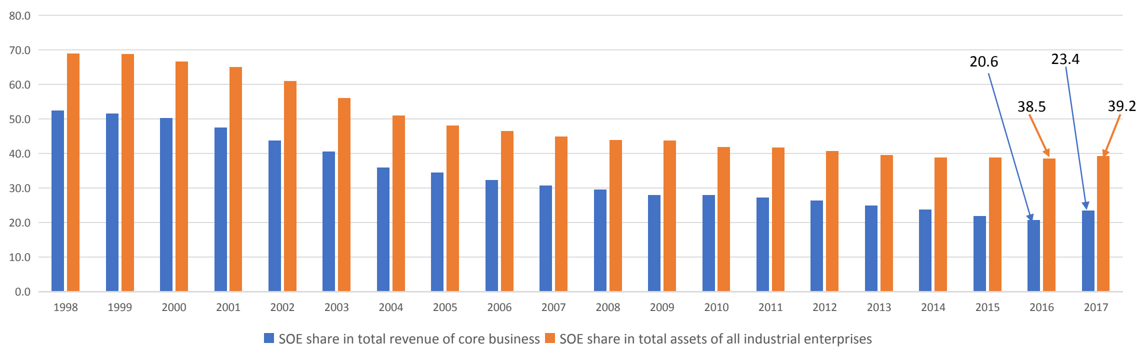
Source: National Bureau of Statistics website.

04/24/2019 PBOC/IMF 8

The overall picture in China points to urgent need to harden the budget constraint… (3/3)

Yet, SOE shares in industrial assets and revenue have stabilized in recent years and increased yoy in 2017, for the 1st time since 1998

SOE share (%) in total assets and revenue of all industrial enterprises (above cutoff scale)

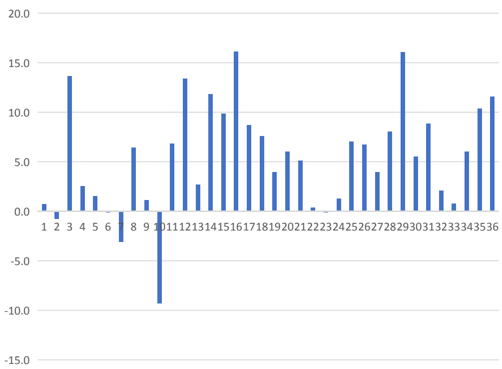


Source: National Bureau of Statistics website.

04/24/2019 PBOC/IMF 9

…Although important variation exists across sectors and enterprises

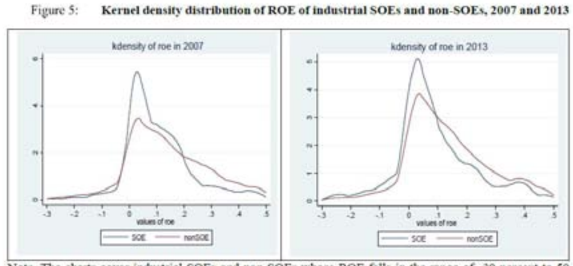
Profit/equity (%), non-financial SOEs, 2016, by sector



Source: China Fiscal Yearbook.

In the industrial sectors, SOE performance varies across firms, and more SOE assets are stuck in poor performing firms than non-SOEs

Figure 5: **Kernel density distribution of ROE of industrial SOEs and non-SOEs, 2007 and 2013**



Note. The charts cover industrial SOEs and non-SOEs whose ROE falls in the range of -30 percent to 50 percent. The 2007 sample comprises 17,192 SOEs and 120,127 non-SOEs, while the 2013 sample has 18,902 SOEs and 228,967 non-SOEs.
Source: (Ma, 2017).

Source: World Bank team calculation using data of National Bureau of Statistics.

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What does it take to ensure CN in equity finance to SOEs?

- Appropriate (industry, time period) **targets** for return on state capital invested in SOEs.
- Clarity of **responsibility:** what entity is responsible for return rate of how much state capital?
- Readiness for orderly **exit** of those who fail to meet the requirement.
- Simultaneous implementation of CN at **other frontiers** (e.g. compensation for public policy functions) to ensure no loophole.
- But before anything, need to ask why compete with the private sector:
  - if an economic activity can be carried out by non-SOEs, why should the state devotes its limited resources to invest in it and compete with non-state investors?
- More fundamental reform actions must be considered:
  - Overall **control** over the growth of the total state capital invested in enterprises.
  - **Withdrawal** of the state from SOEs operating in "non-strategic" sectors, to be defined, either completely or at least from controlling shareholder's position.

04/24/2019 PBOC/IMF 11

What are the immediate next steps to implement the CN principle?

- Develop a "**competitive neutrality standard**".
  - Unlike WTO rules, CN is a guiding principle advocated internationally with no codified legal rules.
  - China is unique in terms of its SOE sector.
  - Advisable to have its own "standard" to define in specific and enforceable terms exactly what government actions can be regarded as not neutral to competition.
- Conduct a **competitive neutrality gap analysis** -- a benchmarking of existing government regulations, policies and practices against the "neutrality standard".
  - Building on the ongoing reform efforts of fair competition review.
  - Oriented to the formulation of a reform action plan for the State Council to endorse.
  - Could involve three analytical steps covering all relevant areas:
    - Identifying government actions that may distort competition.
    - Assessing the neutrality of the government actions to competition.
    - Proposing reform actions.
- However, to be effective, the implementation of CN principle needs to happen on the basis of a **re-positioning of the role of state capital** in the economy ("strategic adjustment of the layout of the state sector") .

Source: "Mainstreaming the Competitive Neutrality Principle in China", World Bank (unpublished), January 10, 2019

04/24/2019 PBOC/IMF 12

中国金融开放

The Opening-up of China's Financial Sector

Kai GUO
郭凯

金融开放成效显著
Significant progress has been made

- 银行业、证券业和保险业：放宽市场准入、扩大业务范围

  Banking, securities and insurance: liberalize market access, expand business scope
- 企业征信、信用评级服务、银行卡清算和非银行支付：给予外资国民待遇

  Credit investigation, credit rating, bank card clearing and settlement, non-bank payment: national treatment for foreign institutions
- 推进资本市场双向开放

  Further open up the capital market

2

开放举措得到积极响应
Opening-up measures are well received

- 外资机构市场准入和在华展业取得明显进展

  Remarkable progress has been made in terms of market access and business operation

- 中国股市、债市被纳入主要国际指数

  China A share and CNY-denominated Chinese bonds have been included in major international indices

3

下一步考虑
The way forward

- 继续推动全方位的金融业对外开放，确保各项措施真正落地实施

  Open up across the board and make sure the measures are properly implemented.

- 转变开放理念，过渡到准入前国民待遇加负面清单管理模式，实现系统性、制度性开放。

  Aim at rule-based and systematic open-up by moving gradually to the approach of pre-establishment national treatment and negative list.

4


下一步考虑
The way forward
❑ 改善营商环境，提高政策制定透明度
Improve the business environment and increase transparency in policy making
❑ 将扩大开放与加强监管密切结合，有效防范和化解金融风险
Greater open-up will go hand in hand with better financial regulation, in order to effectively mitigate and dissolve financial risks
5

Opening Up the Financial Sector, Competition, and Stability
金融对外开放、竞争、与稳定

1

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国际货币基金组织 何东

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Joint PBC-IMF Conference on “Opening Up and Competitive Neutrality”

Questions to address 要回答的问题

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1) What do we mean by “opening up the financial sector”? 金融对外开放的内含是什么？

2) What is the relationship between liberalization of trade in financial services and cross-border capital flows? 如何理解金融服务贸易开放与资本账户开放的关系？

3) How to ensure that increased competition in the provision of financial services will help achieve a “frontier” of efficiency and stability? 如何理解竞争与稳定的关系？

The meaning of "Opening Up" 金融对外开放的含义

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1) **金融服务贸易的开放**

- "Trade in financial services" can be defined as the supply of financial services by foreign service providers to domestic consumers through four different modes of supply: Cross-border provision, Consumption abroad, Commercial presence, and Presence of natural persons. 外国服务供应商给本国居民通过跨境提供、国外消费、商业存在和人员流动等方式提供的金融服务

2) **资本账户的开放**

- The ability to trade financial assets between residents and nonresidents 本国居民和外国居民之间进行资产交易

Liberalization of Financial Services Trade 金融服务贸易开放的含义

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1) **金融服务贸易的开放**

- General requirements: the most favored nation (MFN) clause and the transparency requirement 一般要求:最惠国条款和透明度要求
- Specific commitments: market access; and national treatment 具体承诺：市场准入与国民待遇
- Market Access covers all measures which limit 市场准入包括的措施限制了
  - The number of service suppliers 服务供应商的数量
  - Total value of transactions 交易总额
  - Total number of services operations 服务操作的总数
  - Total number of employees 员工总数
  - Types of legal entity 法人类别
  - Percentage of foreign capital participation or shareholding 外资参股比例

Liberalization of Financial Services Trade and Liberalization of Capital Flows 金融服务贸易开放与资本账户开放的关系 (I)

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1) “Observers often fail to recognize that financial services liberalization does not necessarily imply capital account liberalization, with the consequence that liberalization in financial services trade may be held back for fear of its implications for the capital account.”

不要因为担心资本流动的冲击而不开放金融服务贸易。观察人士往往没有认识到，金融服务自由化并不一定意味着资本项目自由化，这导致，因为担心对资本项目的影响，金融服务贸易自由化进程受阻。

2) Liberalization of services trade is consistent with the existence of certain restrictions on capital movement 金融服务贸易在资本流动受到管制的情况下仍然可以相当程度的开放

- The freedom of cross-border capital flows matters differently for different types of activities or modes of supply 对跨境资本流动的影响取决于金融服务贸易开放的方式
- Typically, cross-border provision of services requires a higher degree of capital flow mobility than the presence of a foreign establishment 通常来讲，跨境提供比商业存在对资本流动的影响要大一些

Liberalization of Financial Services Trade and Liberalization of Capital Flows 金融服务贸易开放与资本账户开放的关系 (II)

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- An orderly and well-sequenced liberalization of capital flows is necessary for an emerging economy like China to truly benefit from progressive liberalization of trade in financial services 充分获得金融服务贸易开放的益处要求有序地开放资本账户
- But the two processes can proceed at somewhat different speeds 但这两个过程不一定需要完全同步
- Given the current low level of foreign participation in the Chinese financial system, liberalization of financial services trade at a faster speed would contribute to a more efficient and stable domestic financial system, through increased competition and diversity of service suppliers, skill and technology transfer, better risk management practices, and more transparency and information, thereby paving the way for an orderly liberalization of cross-border capital flows

鉴于中国目前对金融服务贸易限制较多，开放程度较低，在资本账户大幅度放开之前有很大的空间可以开放金融服务贸易，通过竞争和技术转移，以促进国内金融业效率的提高和金融市场的发展

Competition and Stability 竞争与稳定的关系 (I)

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- In general, competition in banking and financial services is good for society, provided that prudential regulation and supervision are adequate and there exists an effective exit mechanism through which failing firms can be weeded out 竞争促进稳定，但前提是有效的审慎监管和良好的退出市场和倒闭机制

- Competition is a main source of economic efficiency and financial service is no exception 竞争是效率的源泉，金融业也不例外

- But we need to take into account how competition affects financial stability as finance is a confidence game and the financial system can be more fragile than other economic sectors 但金融有其特殊性，过度竞争会导致脆弱性

Competition and Stability 竞争与稳定的关系 (II)

8

- Owing to behavior biases, increased competition in the financial system may lead to more fragility 在风险偏好强烈的情况下，过度竞争会导致过度借贷和高杠杆
  - Competitive markets tend to oversupply credit by relaxing lending standards and extending it to both good and bad risks, reinforced by consumers' tendency toward overborrowing, particularly when risk appetite is strong and the price of risk is low

    竞争激烈的市场往往会放松贷款标准、将贷款范围从好的风险扩大到坏的风险，从而导致信贷供应过剩，在风险偏好强劲、风险价格较低的情况下，消费者过度借贷的倾向会得到强化。

  - Competition may also intensify risk taking by eroding the franchise value of incumbent institutions and diminishing incentives to monitor loans and maintain long-run relationships with borrowers

    竞争还可能会侵蚀现有机构的专营权价值，降低监管贷款和维持与借款人长期关系的激励，这也会加剧风险承担

Competition and Stability 竞争与稳定的关系 (III)

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- It is plausible to expect a hump-shaped relationship between competition and stability with an intermediate level of competition being optimal for stability 竞争与稳定的关系是非线性的，适度竞争最有利于稳定
  - Starting from a monopoly regime an increase in competition is beneficial because it spurs productive efficiency and innovation 在垄断的情况下增加竞争是有益的，因为它促进生产效率和创新
  - Continued increase in competitive pressure may lead to a point where the benefits balance with higher fragility 竞争压力的持续增加会到达一个效率和脆弱性的临界点
  - Further increases beyond the point could be costly 超过这一临界点，继续增加竞争，则形成过度竞争。
- It is useful to note that the Chinese financial system is probably quite far from reaching the optimal level of competition, given that it is ranked one of the lowest among the G20 economies in terms of openness to financial services trade. Importantly, there lacks an effective exit mechanism for failing institutions 中国的金融系统很有可能还远低于竞争的最佳水平。但中国银行业某些方面似乎存在过度同质化的竞争，并缺乏有效的退出机制。

竞争政策与稳定政策的协调

10

- How should the regulatory authorities take into account increased competition when designing and implementing prudential policy? Is there a case for coordinating competition and prudential policies 有必要加强竞争政策与审慎政策的协调
- Indeed, competition policy that eases entry, and increases contestability, may have to be accompanied by tougher prudential requirements. In a more competitive environment the solvency requirement has to be strengthened 竞争越激烈，审慎标准就应该更高，资本充足率也应该更高
- More broadly, there is a case for deploying macroprudential policy instruments to correct competitive excesses that result in a buildup of financial vulnerabilities 用宏观审慎工具纠正竞争带来的一些顺周期问题
  - E.g., there may be the case for the prudential regulator to intervene and impose a floor on the risk weights attached to mortgage loans after a long housing book 监管当局为房贷风险权重设置一个下限
  - This is a case of prudential objectives overriding competition objectives 在某些情况下审慎目标致上


End of Presentation 发言结束
11
THANK YOU FOR YOUR ATTENTION
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European Chamber Perspective on China's Future Opening up and Reform

Charlotte Roule
Vice-President
European Chamber

www.europeanchamber.com.cn

1. Market Access: direct and indirect barriers
2. Foreign Investment Law
3. SOEs and Competitive Neutrality
4. Conclusion

2

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Conclusion

It is imperative that China accelerate its reform agenda to deal with the reform deficit that has built up over the years. China invests widely in areas in Europe that are still not open to European companies in China. This asymmetry is increasingly gaining attention in European capitals friction.

Removing nominal barriers to market access as well as improving the regulatory framework are both needed.

A truly level playing field in an open market means that SOEs no longer receive special treatment. Such treatment not only disadvantages the private sector but also makes it more difficult for SOEs to invest abroad as they will not be seen as purely market players.

Foreign companies are not looking for special treatment, they are looking for equal treatment in a more open, transparent market.

3

Tax Neutrality, Efficiency, Innovation, and R&D

PBC AND IMF JOINT CONFERENCE ON OPENING UP AND COMPETITIVE NEUTRALITY

APRIL 24, 2019

Era Dabla-Norris
International Monetary Fund

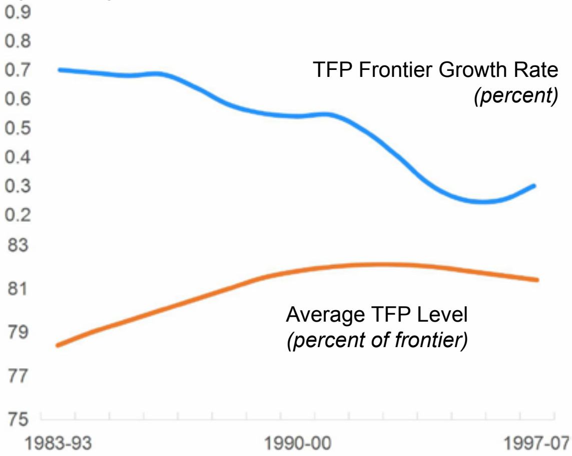
Why is Tax Neutrality Desirable?

- Tax systems should strive to be **neutral** so that investment decisions are made on their economic merits and not for tax reasons.
- Tax incentives and exemptions can have large efficiency costs.
  - Incentives targeted at specific sectors, locations, or firms can create an unlevel playing field.
  - Even if tax rules are uniformly applied, differential tax treatment across firms (e.g., by asset type, source of financing) can distort investment decisions.
- This can lead to misallocation of resources in the economy, lower aggregate productivity and growth.

How Can Tax Policy Boost Productivity?

- By pushing out the technology frontier and supporting growth (encouraging R&D and innovation)
- By narrowing the productivity gap between firms (reducing resource misallocation)

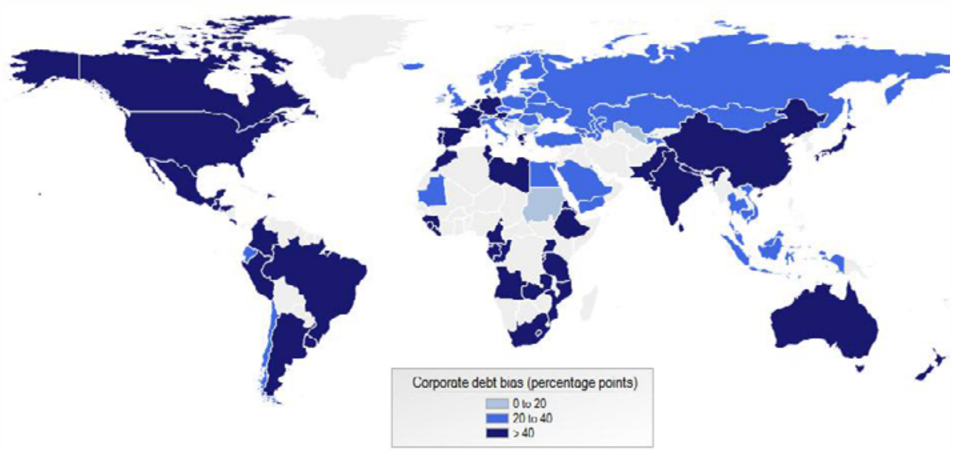
Advanced economies: Stochastic Frontier Analysis, by Country-Sector



Source: Dabla-Norris and others (2015)

Tax Disparity Across Sources of Financing Creates a Debt Bias

Corporate debt bias is high in many countries

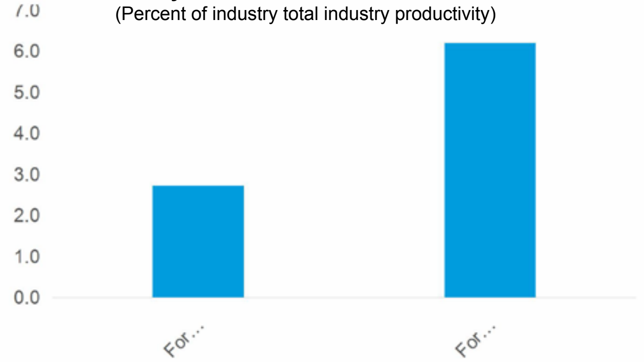


Sources: Oxford University Center for Business Taxation; and IMF staff estimates.
Note: Debt bias is the effective marginal tax rate (EMTR) on equity financed investment minus the EMTR on debt financed investment (percentage points).
Data as of 2016 or latest available.

Debt Bias Affects Firm's Investment Decisions

- Corporate debt bias distorts financing choices, affects the cost of capital, and investment decisions.
- Evidence suggests that higher debt bias raises macro-stability risks and can lower allocation efficiency.

Reducing debt bias could significantly raise resource allocation efficiency in more R&D-intensive industries
(Percent of industry total industry productivity)

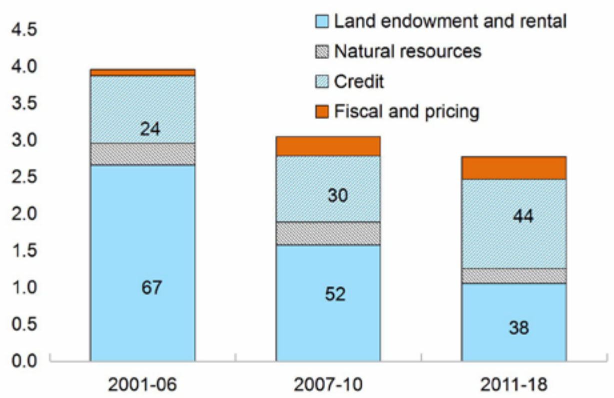


Source: Oxford University Center for Business Taxation, Brown and Martinsson (2016), and IMF staff estimates
Note: Debt bias is measured as the EMTR on equity financed investment minus EMTR on debt financed investment. Evidence from a sample of advanced economies.

INTERNATIONAL MONETARY FUND 5

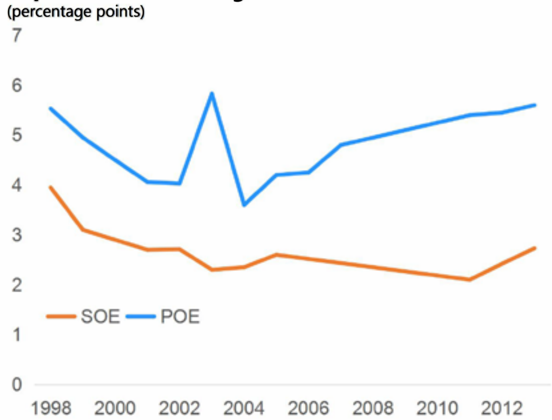
Preferential Access to Credit for SOEs in China May Reinforce Debt Bias

Preferential credit access now accounts for bulk of implicit sup
(in percent of GDP)



Sources: CEIC, WEO, Lam and Moreno-Badia (2019), and Lam and Schipke (2017)
Note: 1/ Numbers in the bar chart refer to the share of total implicit support.

Imputed debt financing rates are lower for SOEs
(percentage points)

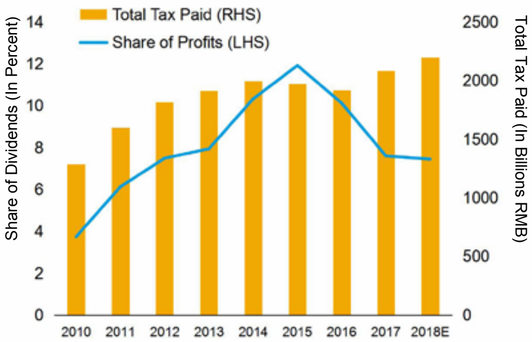


Source: Alvarez, Chen, and Li (forthcoming).

INTERNATIONAL MONETARY FUND 6

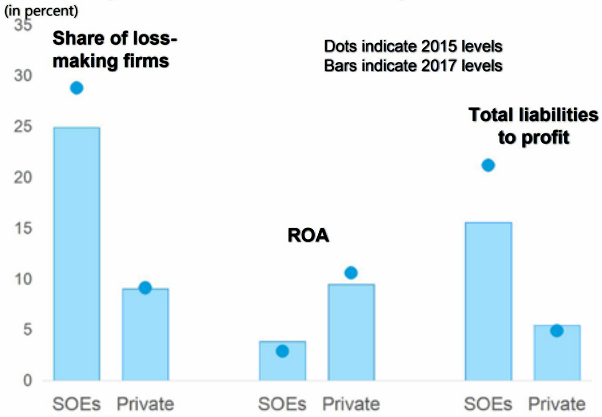
Dividends Paid by SOES and Overall Profitability Have Declined

Despite increasing taxes paid by central SOEs, dividends paid to the government have declined



Source: Ministry of Finance.

SOEs carry more debt but remain less profitable
(in percent)

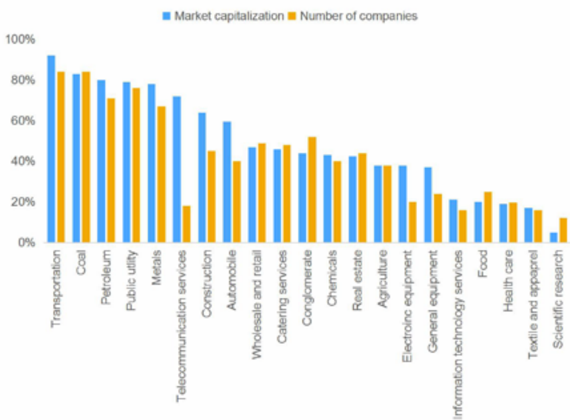


Source: IMF staff estimates.

Tax Incentives and Exemptions Targeted to Specific Sectors Can Indirectly Favor SOEs

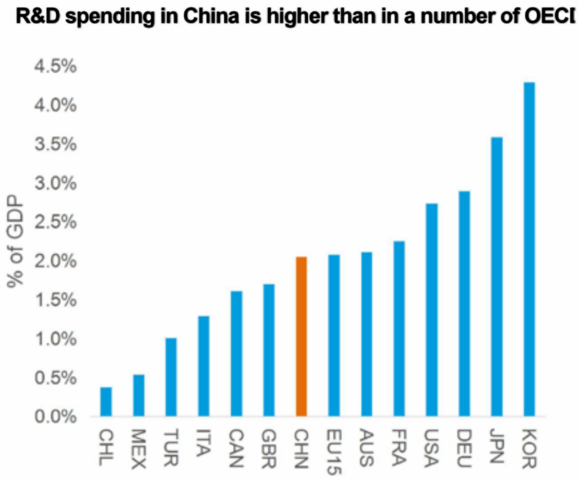
- SOEs in China dominate in certain strategic sectors (e.g., telecom, power and gas, transportation, information technology).
- To the extent these sectors benefit from temporary tax exemptions and reduced tax rates, this can represent an "implicit subsidy".

SOEs dominate in certain industries in China
(percent of industry)

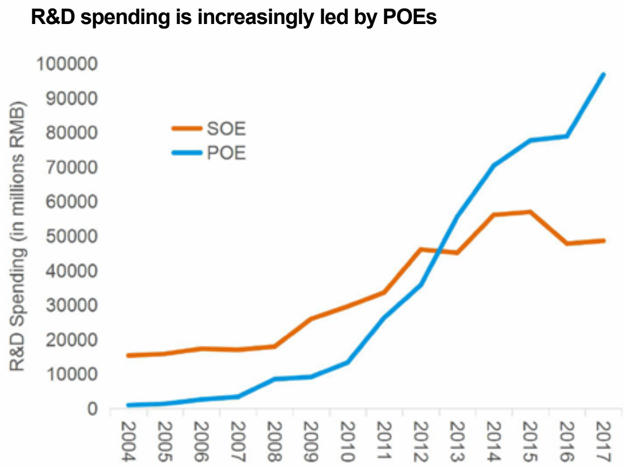


Source: Vanguard (2017).

China Has Become a Major R&D Power, with Increasing Private Sector-led Innovation



Source: OECD (2017).



Source: CEIC.

INTERNATIONAL MONETARY FUND 9

International Experiences Suggest that Efficiency and Effectiveness of R&D Tax Incentives Depends on Design

- Economic rationale for deviating from tax neutrality in providing tax incentives for R&D and innovation to correct for externalities and support growth.
- Tax incentives to all firms (or sectors) that invest in R&D provide a level playing field, but private R&D decisions may not adequately address complex knowledge spillovers associated with R&D .
- R&D input-related incentives and tax credits offer superior design features than those for R&D outputs, such as intellectual property (IP) regimes.
- Targeting incentives to **small** and **new** firms more effective in promoting R&D investments than for other firms.
  - ►Reduce the tax burden for SMEs by providing refundable R&D tax incentives, but avoid creating a small-business trap.

INTERNATIONAL MONETARY FUND 10

Thank You

Some Cross-Country Examples of R&D Incentives

Australia	Small firms: 45% refundable R&D tax credit Large firms: 40% non-refundable R&D tax credit (capped)
US	Regular: 20% R&D tax credit on increment Simplified: 14% R&D tax credit on increment
China	150% R&D super deduction 15% reduced CIT rate for high-tech firms
Germany	No tax incentives R&D subsidies: can be 25 -50 percent of R&D costs

Selected Country Examples Of Design of R&D Incentives

Name	Type	Novelty	Target	Cash refund	Carry over	Application	Evaluation
R&D Relief (UK)	volume enhanced allowance	new to world	size	yes	cf	online; one-stop; refund within year	yes (gov.)
Skattekreditordningen (DK)	volume tax credit	new to firm	liquidity	yes	no	online; one-stop; refund next year	planned
SkatteFUNN (NO)	volume tax credit	new to firm	size	yes	no	online; One-stop; refund within year	yes (gov. & acad.)
Jeune Entreprise Innovante (FR)	volume tax credit	new to world	size/age	yes		paper; pre-approval < 3 months, immediate refund	Yes (gov.)
WBSO (NL)	volume payroll withhold. tax credit	new to firm	implicit size, explicit age	n.a.	n.a.	online, one-stop; pre-approval < 3 months; immediate refund	yes (gov. & acad.)
R&D Tax Credit (IE)	incremental / volume tax credit	new to world	No	yes	cb & cf	online, one-stop, refund within year	yes (gov.)
SR&ED (Canada)	volume tax credit	new to world	size, local firms	yes	cb & cf	online; one-stop, decision < 120 (365) days	Yes (gov. & acad.)

INTERNATIONAL MONETARY FUND 13