Executive summary

This Policy Contribution assesses whether European competition law could be applied more directly to state-owned enterprises that create an unlevel playing field in Europe because of the support they receive from their home governments. This issue has become a priority for many European Union countries and for the European Commission, given its impact on European economic autonomy. Competition law may not be the appropriate tool for addressing the granting of illegal subsidies or other forms of support in third countries, but it could be more effective than previously thought in dealing with the distortive effect of state-owned entities on the EU internal market.

If state-owned enterprises are not resource-constrained or even profit maximising, they might be unconstrained by competitive pressures, therefore possessing a de-facto level of market power. By adapting existing antitrust theories of harm, such as predatory pricing, to fit the specific nature of SOEs, this Policy Contribution argues that it should be possible to add further tools to the EU’s toolbox. In any event, as part of its efforts to address the distortive effects on the internal market of foreign state ownership and subsidies, the European Commission should develop a coherent and proactive competition policy to provide guidance to the market.
1 Introduction

The distortive effects that foreign state-owned or state-supported companies can have on European markets and on the European Union’s economic autonomy are starting to worry policymakers. The focus tends to be on the links between the Chinese government and Chinese businesses. The Chinese government’s patronage of companies threatens European value chains and possibly also Europe’s critical infrastructure, according to the European Commission’s in-house think tank, the European Political Strategy Centre (EPSC, 2019). One of European Commission executive vice-president Margrethe Vestager’s new tasks is to develop tools and policies to address the unlevel playing field created by "the distortive effects of foreign state ownership and subsidies in the internal market" (Von der Leyen, 2019).

There has been a plethora of proposals from European governments and industry groups on how to address this unlevel playing field, including reforming trade-defence instruments, but few proposals have explored competition policy options in detail. Those that have looked at competition policy tended to focus on reforming European merger control, either to enable the creation of European champions or to screen foreign transactions more aggressively.

This Policy Contribution focuses on a different area of competition policy: how European abuse-of-dominance rules could address the anticompetitive effects of state support.

We first look at a pragmatic definition of companies benefitting from state support or state direction, and at the role of such companies in China, specifically how they enable Chinese industrial policy. We then review how competition law treats state-owned enterprises (SOEs), exploring market power and other key considerations, before touching on predatory pricing as a potentially fruitful theory of harm. We acknowledge certain challenges in enforcing competition rules against SOEs, notably sanctions. We conclude with recommendations on providing coherent guidance to the market.

2 Undertakings directed by the state: definitional issues

The Organisation for Economic Cooperation and Development 2015 Guidelines on Corporate Governance of State-Owned Enterprises (OECD, 2015a) define an SOE as a situation in which the state exercises legal ownership over an undertaking. This would include where the state

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1 See also the European Commission’s Joint Communication, EU-China - A strategic outlook (European Commission/High Representative, 2019) in which the Commission committed to finding means to "appropriately deal with the distortive effects of foreign state ownership and state financing of foreign companies on the EU internal market".

2 See for example the group of EU countries making up les Amis de l’Industrie (2018), BDI (2019), the German National Industrial Strategy 2030, presented on 5 February 2019 (BMWi, 2019), or the 2019 ‘Franco-German manifesto for a European industrial policy fit for the 21st century’ (BMWi/Ministère de l’Économie et des Finances, 2019). Proposals include increasing the international competitive capacity of EU firms, boosting public and private risk investment, focusing on capacity building in specific sectors, increasing Europe’s competence in digital markets, engaging in joint projects for key enabling technologies and flanking measures such as creation of a European sovereign wealth fund, increasing Europe’s economic diplomacy through coordination of EU and member-state trade and investment activities, and promoting European norms internationally.

3 See for example the 2019 joint proposals for modernising EU competition policy from the French, German and Polish governments (available at https://www.bmwi.de/Redaktion/DE/Downloads/M-O/modernising-eu-competition-policy.pdf), and Heim (2019).

4 This approach has some support, as expressed in a Dutch government non-paper of December 2019, which considers a range of options. See ‘Strengthening the level playing field on the internal market’, available at https://www.permanentrepresentations.nl/binaries/nlatio/documents/publications/2019/12/09/non-paper-on-level-playing-field/Dutch+nonpaper+on+Level+playing+field.pdf.
is the ultimate shareholder, where corporations are established through legislation, or where the state exercises an equivalent degree of control through golden shares or other legal stipulations.

However, a more pragmatic view is used by the European Commission (2017) in relation to China where it recognises that the division of companies into ‘private’ and ‘state-owned’ is too simplistic, especially as privately-owned companies might have close government links because of the strategic importance of the markets they are active in. Such companies might also assist in the execution of governments’ policy objectives (see for example Milhaupt and Zheng, 2015).

In this Policy Contribution, the expression ‘state-owned enterprise’ or ‘SOE’ is used to mean not only enterprise that are legally owned by the state, but also those that are effectively controlled or directed by the state, notably in pursuit of government policy.

3 The function of commercial Chinese SOEs in pursuing state policies abroad

The substantial role of SOEs in the Chinese economy gives the Chinese government an exceptional platform to exert control over its economy. Notwithstanding announcements from China that pro-market SOE reforms are imminent, developments have rather confirmed the use of SOEs to pursue non-market goals. The European Commission (2017) highlighted different ways in which the Chinese state uses SOEs to drive strategic policy goals. It cites the 2015 ‘Guiding Opinions of the Central Committee of the Communist Party of China and of the State Council on Deepening the Reform of State-owned Enterprises’ seeks to reinforce the role of state ownership of SOEs of a commercial nature “and to use such ownership for strategic economic goals decoupled from market rules”. Under this guidance, the performance of commercial SOEs will also be assessed “on their efforts to serve national strategies, safeguard national security and the operation of the national economy, develop cutting-edge strategic industries and complete special tasks”

These policies do not appear to be purely domestic. European Commission (2017) also noted the Chinese Government’s intention to maintain direct control over SOEs active in international markets, to which it would provide resources to aid such developments. There therefore appears to be a Chinese policy to foster the international competitive positions of certain firms, in order to serve the strategic goals of the country, notably to increase China’s international economic influence.

4 SOEs and competition law

When an undertaking carries out an economic activity, its ownership is effectively irrelevant to competition law analysis. Undertakings should not benefit from competitive advantage or immunity merely because they are government-owned (Fox and Healey, 2014). Competition law is therefore a powerful tool to address the activities of both domestic and foreign SOEs (OECD, 2015a), if they act in an anticompetitive manner.

There are, however, a number of important characteristics that differentiate SOEs from private undertakings. For example, SOEs can benefit from significantly fewer regulatory constraints, such as employment or environmental protection conditions, softer budget constraints or access to credit on preferential terms, and subsidies (OECD, 2018). The state can also allow national champions to have unrestricted growth in their national market, protected from the rigours of foreign competition (European Commission/High Representative, 2019). These advantages translate into significant international competitive advantages that private enterprises cannot benefit from nor match. Given globalisation, increasingly global markets and cross-border transactions, the effects on the competitiveness of markets in different jurisdictions can be broad-ranging (OECD, 2018). Competition law might therefore be interested in the effects of such advantages on market competition.

The European Commission and national competition authorities in Europe have applied competition rules to tackle the anticompetitive impact of SOEs, but that has been done mainly for European SOEs in a largely uncoordinated manner. Svetlicinii (2018) noted that there is little coherence or consistency in the approach of national European competition authorities to merger reviews involving Chinese SOEs. Furthermore, despite evidence of an increase in SOEs’ share of the economy generally there has been a marked decrease in the number of competition investigations and sanctions against these SOEs in Europe, and no European investigation has been opened against an SOE since 2014 (Schrepel, 2019).

It seems generally accepted that the strategic behaviour of state-funded or state-controlled enterprises could damage the functioning of the internal market. For the purposes of this paper, anticompetitive distortions are assumed to occur. However, more empirical work is needed to test those assumptions. It remains important for sound policy and for evidence-based enforcement to establish observable facts of market distortion and of abuse. Without such an exercise, any policy or enforcement solutions proposed might not address the underlying problems, might be disproportionate or might result in unintended consequences. When considering its competition prioritisation strategies, the European Commission’s competition directorate-general (DG Competition) should engage with other Commission departments and with EU countries in order to identify and assess market distortion. Particular scrutiny could be applied to those sectors that are explicitly linked to a third country’s international industrial policy. It would of course be incumbent on the Commission to carefully select cases where there is prima facie evidence of harm, in order to ensure that there can be no criticism on the basis of protectionism. Indeed, if enforcement is not based on valid competition law grounds (but rather intends to protect industrial champions or pursue strategic or industrial-policy goals), cases against foreign SOEs might result in non-tariff barriers to trade (OECD, 2018).

7 The OECD (2015b) defined the principle of competitive neutrality as being where “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.”

8 European national competition authorities have also been active in investigation abusive practices by European SOEs. See for example the Italian Ferrovie dello Stato discriminatory practices case (1990); the Norwegian SAS predatory pricing case (2005); the Romanian CFR Marfa refusal to deal case (2006); the UK Cardiff Bus predatory pricing case (2008); and the German Deutsche Post AG margin squeeze case (2012).
4.1 SOEs and market power
Antitrust enforcement can only occur if the undertaking under investigation possesses market power. The EU court in the United Brands and Hoffmann-La Roche cases defined market power as; “a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained on the relevant market by affording it the power to behave to an appreciable extent independently of its competitors, its customers and ultimately of its consumers”. The very fact that SOEs may benefit from access to state resources, or are subject to fewer financial obligations, can effectively cushion them from market pressures (which might indeed be the point of state involvement in the undertaking). The ability of SOEs to act in a manner that is unconstrained by competitive pressure would therefore be a critical factor in establishing market power; one could even argue that this could be a rebuttable presumption.

The impact of anticompetitive international SOE activity will primarily be on the competitive process, affecting competitors or customers (rather than any short-run consumer benefit in terms of, eg consumer prices), which might result in efficient competitors exiting the market (or not entering the market). Such a result is anathema to modern competition policy (Heim and Midoes, 2019). In this context, it would be logical for the Commission to focus on protecting the competitive process, as a proxy for long-run consumer welfare.

4.2 SOEs’ strategic incentives
Competition policy assumes that market players are economic entities seeking to maximise profits. SOEs, however, might prioritise strategic policy goals over profit-maximisation, and could be specifically required to do so by their government. As far as China is concerned, many SOEs appear to be established on the basis of carrying out government objectives, rather than correcting market failures (García-Herrero and Xu, 2017). Understanding the underlying strategic objectives of particular SOEs is therefore critical in appreciating whether they are acting as classic market participants or are (also) engaged in activities driven by strategic policy incentives.

Where a state’s industrial strategies include the use of SOEs to control or affect specific markets, the result might be to distort effective competition and force efficient rival firms out of that market. In fact, where an SOE’s obligation to the state is to deliver on industrial policy, the SOE might be tempted to actively engage in exclusionary practices in order to gain market share and/or ensure strategic autonomy. This would suggest adapting the usual analytical tools used to assess markets and anti-competitive conduct, in order to take into account the activities and specificities of SEOs and ensure the neutral enforcement of a consumer welfare standard (OECD, 2015).

4.3 Predatory pricing
Dominant companies are prohibited from engaging in pricing below marginal cost, which they can afford to bear, as this might drive competition from the market in the long term. This theory is particularly interesting in the context of SOEs because, as noted above, SOEs might not be bound by classic industrial organisation pressures. SOEs may be able to sustain losses – and to do so over long periods – with no need to seek recoupment of lost ‘profits’ in the post-predation period. The specificities of SOEs thus not only challenge the traditional notions of the relevant price-cost test, by which predatory pricing allegations should be measured, but also the ‘equally efficient competitor’ test given that the conditions of an SOE’s ‘competitiveness’ may effectively be set by its government.

In the Deutsche Post case\(^{11}\), the European Commission concluded that Deutsche Post’s medium-term pricing strategy was not in its economic interest. Rather than implying that Deutsche Post should have been seeking to earn a commercial margin, the Commission applied the logic that setting loss-making prices was irrational unless the loss was to be compensated for through higher prices elsewhere or at a later date. The Commission did not explicitly consider whether Deutsche Post was likely to be able to recoup the identified losses or where from. This makes sense, as an SOE might not intend to recoup incurred losses nor might they be acting in their rational economic interest, given that – depending on the case – the SOE could be prioritising an industrial strategy required by the state. Therefore, predation theory could be explored in the SOE context.

5 Challenges to enforcement of competition rules against SOEs

Of course, investigating and establishing competition abuses by non-EU SOEs in the EU market is unlikely to be straightforward. SOEs create practical challenges for competition authorities beyond competition policy orthodoxy. This includes accessing the necessary information to effectively review anti-competitive practices. SOEs might have less regard for the competition authorities and might even face pressure from their governments not to engage with competition authorities, notably where the SOE is embroiled in broader political issues. The EU Gazprom case clearly demonstrated how competition investigations can have geopolitical elements, given that the Russian state sought to obstruct foreign investigations of Russian strategic enterprises and prohibited Gazprom from replying to the information requests issued by the European Commission (OECD, 2018).

DG Competition has tools to address non-compliance, such as imposing fines for supplying inaccurate or misleading information. While such tools could be used more aggressively, they might not be sufficient. In a case in which a trading partner of the EU controls an SOE that does not comply with a Commission investigation, the matter could well be elevated beyond competition enforcement. For this reason, close coordination between DG Competition and DG Trade in such cases is warranted.

5.1 Sanctions and remedies

The topic of sanctions for anticompetitive practices by SOEs also needs reflection. In particular, calculating the appropriate level of fines following a violation might be difficult where an SOE’s turnover figures are not public, either because of the complex structure of the SOE or where access to the necessary information is being obstructed. In addition, the deterrent effect of fines might be limited if financial penalties are effectively paid from state coffers (or are ultimately passed-on to taxpayers).

Any company found to have abused their market power must, of course, cease the infringing activity. In order to ensure compliance, transparency requirements could be imposed on an infringing SOE active in Europe to ensure future pricing strategies are legal. Classic antitrust remedies are devised for traditional market participants but one could envisage broader tools in the case of SOEs. The Commission has some flexibility in fashioning acceptable solutions (such as requiring procurement in Europe contracts to take into account any history of market abuse or transparency in accounting), as long as these are effective and proportionate to ensuring a level playing field.

5.2 Market guidance

Drawing inspiration from past cases, the Commission could develop a more coherent policy on the specific challenges raised by SOEs, as discussed above. The Commission could fulfil its policy function by ensuring that European competition rules relating to SOEs are clear and well-understood, and by providing clarity to market participants through a range of soft-law instruments, including guidelines and guidance papers, informal guidance letters\(^\text{12}\), annual work plans and commissioned studies, which should show what practices undertakings should consider carefully. Issuing guidelines that address SOE market distortions will allow the Commission to hone its analytical tools to the specific characteristics of SOEs and provide clarity to the market about where its enforcement priorities lie. More coherent action by the European Commission relating to SOEs will be important to show that third-country government protection of SOEs will not be a shield against competition law enforcement.

6 SOEs and European industrial policy

Overall, the EU can seek to address the negative effect of SOE activity. Trade policy and trade defence actions under World Trade Organisation rules can be used to address the source of the problem, but to address the effects of the problem, the Commission might wish to consider competition law remedies if there is evidence of anticompetitive distortion.

The EU competition commissioner has broad discretion to prioritise cases and allocate resources, notably to ensure that competition actions are coherent and consistent with the EU’s stated policy goals. The 2018 Gazprom case is instructive: the European Commission investigated the Russian energy SOE because of concerns that Gazprom imposed, among other things, territorial restrictions and excessive pricing on its energy customers. The European Commission extracted commitments from Gazprom ensuring that customers had the ability to renegotiate long-term conditions in supply contracts, thereby increasing competition in the gas market. The Gazprom investigation also took place in the context of Europe’s policy imperatives of realising a true internal market for energy, and of ensuring competitive energy pricing.

The European Commission is seeking to adapt to new realities of global competition. It is considering means of plugging the enforcement gap relating to the unlevel playing field created by protectionist industrial policies of third countries through the activities of their SOEs. This is especially important given evidence of under-enforcement by the Commission (Schrepel, 2019). The paucity of realistic competition policy proposals to date does not reflect the significant role that competition policy can play as part of the range of European tools available to ensure a level playing field. The European Commission could exercise its competition powers more actively wherever the unlevel playing field distorts the internal market.

Opportunities exist to enhance the Commission’s decision-making, analytical and enforcement capabilities. The difficulties of addressing abusive SOE action cannot discourage competition authorities from their task of ensuring a level playing field for European markets, companies and consumers.

\(^\text{12}\) The Commission’s ‘Notice on informal guidance relating to novel questions concerning Articles 81 and 82 of the EC Treaty that arise in individual cases (guidance letters)’ is in the Official Journal C 101, 27 April 2004, pp 78-80. The notice sets out the conditions under which the Commission may issue informal guidance letters, which would be apposite given how particular the SOE issue is.
References:


OECD (2015a) Guidelines on Corporate Governance of State-Owned Enterprises, Organisation for Economic Cooperation and Development


