# The Promotion of Competitive Neutrality by Competition Authorities

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# Foreword

Building on the 2021 OECD Recommendation on Competitive Neutrality, this paper describes the main types of distortive measures jurisdictions may adopt and the tools available to competition authorities in order to address them.

Section 2 of the paper focuses on how competitive neutrality may be distorted in six fields: the competition law framework, which may include exclusions that benefit certain companies and may be enforced in a discriminatory manner; the regulatory framework, which may grant some market players preferential market access or special terms for operating in the market; public procurement legislation and processes, which may favour SOEs, domestic bidders or incumbents (and, in some cases, SMEs); public support, which may grant unfair financial advantages to selected companies; exclusive and special rights – usually granted for the provision of public services – which may create undue advantages in the way beneficiaries are selected, the rights and privileges that are attached to the public services, and the compensation paid; and state activism, in particular, the creation or favouring of national champions.

Section 3 of the paper focuses on the tools that competition authorities have to address competitive neutrality violations in these fields. In essence, authorities have three sets of tools.

The first set of tools are those aimed to stop legislative and administrative acts that distort competitive neutrality. The extent of competition authorities' powers varies across jurisdictions. Competition authorities may act as direct enforcers (directly removing the anti-competitive act) or they may challenge the act before a court (which can then remove it).

The second set of tools allows competition authorities to review legislation and provide advice to government on potential competition implications of legislation and reform initiatives. This is typically done in one of three ways: mandatory regulatory impact assessments, in which the assessment is conducted as part of the policy making process; ad hoc assessments of laws and regulations, in which an analysis is carried out on a case-by-case basis, in relation to both proposed and existing laws and regulations; and market studies or sector inquiries, which are large scale resource-intensive exercises in which competition authorities only engage if there is some prima-facie case for concern.

The third set of tools are those dealing with the control of public support measures. Most competition law regimes around the world do not contain specific provisions to address public support measures and so most competition authorities have a limited role in enforcement. Still, some authorities may rely on more general powers allowing them to intervene against anti-competitive state interventions. In addition, some competition authorities have specific advocacy roles in relation to subsidies, set out in legislation. Finally, competition authorities may support governments by drafting guidelines for public bodies, issuing opinions, and taking on a monitoring function.

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# 1 Introduction

Competitive Neutrality is defined as a 'principle according to which all [e]nterprises are provided a level playing field with respect to a state's (including central, regional, federal, provincial, county, or municipal levels of the state) ownership, regulation or activity in the market'.[1] State actions that benefit some enterprises over others may distort competition and undermine fair and open markets.

The OECD Recommendation on Competitive Neutrality was adopted on 31 May 2021,[2] and establishes a set of principles that promote a level-playing field among competitors and prevent situations where the state grants advantages to certain entities selectively, distorting competition within a market. It encourages Adherents to:

- Ensure that the legal framework applicable to markets in which enterprises currently or potentially compete is neutral and competition is not unduly prevented, restricted or distorted. This includes having a competitively neutral competition law, maintaining competitive neutrality in the enforcement of competition law, bankruptcy law, and the regulatory environment, and establishing open, fair, non-discriminatory, and transparent conditions of competition in public procurement.
- Preserve competitive neutrality when designing measures that may enhance enterprises' market performance and distort competition. This includes, avoiding offering undue advantages that distort competition and selectively benefit some enterprises over others, limiting compensation for any public service obligation placed upon an enterprise so that it is appropriate and proportionate to the value of the services, and adopting structural and governance rules for state-owned enterprises that do not provide them with an undue advantage that distorts competition.

In short, all competitors should be subject to the same rules and state actions should not give selected enterprises a competitive advantage over others. Competitive neutrality is essential for countries to ensure the effective use of their resources and to reap the benefits of competition. This includes the entry and expansion of more productive firms and exit of inefficient firms, leading to lower prices, more choice, better quality products and services and ultimately economic growth and development.

Building on the 2021 OECD Recommendation on Competitive Neutrality, this paper describes the main types of distortive measures jurisdictions adopt and the tools available to competition authorities in order to promote competitive neutrality.

Section 2of the paper focuses on how competitive neutrality may be distorted in six fields: (0) the competition law framework and enforcement; (0) the regulatory framework; (0) public procurement; (0) public support; (0) special and exclusive rights; and (0) state activism, and in particular, the creation of or preference for national champions.

Section 3then examines the enforcement and advocacy tools competition authorities may use to address these competitive neutrality concerns and thus contribute to enhancing competitive neutrality in their jurisdictions. In essence, the paper outlines (0) tools to stop anti-competitive legislative and administrative acts; (0) tools to support governments in the design of regulation and reform; and (0) tools to control public support measures. Section 4concludes. Annex A includes a table in which the competition authorities' tools identified in section 3are matched with competitive-neutrality distortions outlined in section 2

# 2 Competitive-neutrality distortions

## Neutral competition law framework and enforcement

To ensure competitive neutrality, competition law must apply to all enterprises and be enforced in a non-discriminatory manner, irrespective of their ownership, nationality, legal form, or the sector in which they operate, unless overriding public policy objectives require otherwise. Competitive neutrality in the context of state-owned enterprises (SOEs) was already explored in the Global Forum on Competition (GFC) roundtable in December 2018.[3] The main findings of this roundtable are summarised in Box 2.1.

### Box 2.1. Neutral competition law and enforcement in the context of SOEs

The 2018 GFC roundtable on Competition law and SOEs reached the following conclusions:

- Behaviour of SOEs engaging in economic activities in competitive markets should be subject to competition law enforcement in the same way as the behaviour of privately owned competitors.
- Competition authorities face a number of different challenges when investigating SOEs' behaviour. Calculating the appropriate measure of costs, determining if the SOE constitutes an undertaking or not, assessing its degree of independence from other SOEs, and deciding who exercises control over it, could be problematic due to SOEs' state ownership and control.
- Competition authorities' treatment of SOEs and private entities throughout investigations seems to be largely the same. However, competition authorities may need to adapt their tests and analyses to account for the fact that SOEs might pursue multiple objectives, some of which are not driven by profit maximisation.
- The choice of the appropriate sanctions for SOEs and for private entities can sometimes differ. Determining the appropriate sanction or remedy for an anti-competitive behaviour of an SOE is important to ensure an effective degree of deterrence.
- In a number of jurisdictions, SOEs benefit from legal exemptions, which prevent a neutral competition law enforcement system. Such exemptions include SOEs operating based on a statutory monopoly, and exemptions for government entities.
- A competitive neutrality framework is necessary to complement competition law enforcement to achieve a level playing field. Under competition law, competition authorities can only investigate anti-competitive behaviour by SOEs, but have no (or limited) powers to remove the advantages (or disadvantages) that SOEs might enjoy from the state, which are often the reasons why they can behave anti-competitively. In these cases, agencies can engage in advocacy, but may have no binding powers.

Source: OECD (2018), Executive summary – Roundtable on Competition Law and State-Owned Enterprises. https://www.oecd.org/daf/competition/competition-law-and-state-owned-enterprises.htm.

## *Specific ways in which competitive neutrality can be affected*

### *Neutral scope of competition laws*

In OECD jurisdictions and around the world, the scope of competition law typically covers any 'person' or 'undertaking' engaged in an economic activity, regardless of its ownership, source of financing, legal status, place of business or nationality (OECD, 2015[1]). Where no economic activity exists, competition cannot be distorted.[4]

In principle, a law that applies to all entities conducting an economic activity is competitively neutral, provided that no unjustified exclusions apply. Certain exclusions – especially those that are wide in scope – result in a non-neutral legal framework as they favour certain types of companies over others. Exclusions of competition law can be classified as exemptions[5] or defences:

- Exemptions exclude certain practices or entities from competition law. They imply that a public-policy objective is prioritised over competition. Exemptions may apply, for instance, to restrictive agreements concluded in industries in which government sees some strategic interest: airline alliances, for example, may seek antitrust immunity from the US department of transportation in order to 'coordinate their fares, services and capacity.'[6] Certain mergers may also be exempted from merger control by the minister in charge, if government interests are at stake, like in Hungary, where merger control exemptions can be granted to mergers involving state assets or companies (OECD, 2015[1]). Export cartels are explicitly or implicitly exempted from cartel law in various jurisdictions (OECD, 2019[2]). Exemptions may be automatically granted or an application may be required, and the competition authority may or may not be involved (OECD, 2015[3]).

Exemptions distort the playing field, as they may be granted to certain agreements (e.g. alliances) as opposed to others (e.g. mergers) in the same market, or to some sectors (e.g. air transport) as opposed to others (e.g. rail transport). In addition, they preclude any analysis of the effects of a particular merger or business practice. In competition enforcement proceedings, this would incorporate both potential competition harms and efficiencies passed on to consumers (for conduct that is not considered per se illegal).

- Defences are claims raised in courts by antitrust defendants in order to prove that even if competition law is applicable, it should not be enforced in that case. The so-called 'state action' or 'state compulsion' defence is the most commonly invoked one, although seldom successful. The defence involves economic actors claiming that their anti-competitive conduct was ordered by the state, leaving them no margin of discretion. For instance, an infrastructure operator or a professional board may adopt self-serving restrictive measures by relying on their powers to regulate and control access to the infrastructure or profession respectively.

Under the Spanish competition law, an undertaking may invoke the regulated conduct defence if its restrictive conduct was in fact required by a law.[7] Similar rules apply at national level in several EU Member states (such as Bulgaria, Germany, Hungary and Romania) and other OECD jurisdictions such as Canada and Chile (OECD, 2015[3]).

### *Neutral enforcement of competition laws*

Even if the legal framework is competitively neutral, competition authorities may face difficulties applying it neutrally. For instance, a few years ago, the head of Colombia's competition authority opposed the merger between Avian (a state-owned carrier) and ACES (another carrier). The President of Colombia bypassed the head of the authority and the head resigned (Fox and Healey, 2014[4]). The *Siemens-Alstom* case, in the EU, also illustrates how competition authorities may face calls from policymakers to authorise

a deal, for instance, due to the involvement of so-called national champions.[8] The calls may also go in the opposite direction, demanding more enforcement. For instance, currently, competition authorities are facing calls from both policymakers and the general public to act in relation to certain conduct by large digital companies (Jenny, 2021[5]).

In order to ensure that competition law is applied neutrally, the independence of the competition authority is key. The more independent an authority is, the lower the risk of influence by external actors in general and by the government in particular. The issue of competition authorities' independence was discussed at the GFC in 2016.[9]

## Regulation

The legal and regulatory framework can distort competitive neutrality, both in substance and application. This may mean that some competing enterprises (such as public, domestic or foreign enterprises, for example) are subject to different regulatory frameworks. Alternatively, when the same framework applies, some enterprises may be exempted from specific provisions through exclusions or through decision maker discretion. This may result in some market players having preferential market access or enjoying special terms for operating in the market. Unless there is an overriding public policy objective (that is transparent, proportionate and periodically reviewed),[10] the regulatory framework should be competitively neutral.

The OECD Competitive Neutrality Recommendation specifies that 'competing enterprises should be subject to equivalent rules irrespective of their ownership, location or legal form' and that 'enforcement should be non-discriminatory'.[11]

This section will consider aspects of both sector-specific and horizontal regulatory frameworks, which may distort the level playing field.

### *Specific ways in which competitive neutrality can be affected*

#### *Sectoral laws and regulations*

Sectoral laws and regulations can distort competitive neutrality on a specific market through selective application of licensing regimes, reporting requirements, other operational requirements and price regulation. Laws and regulations may also create conflicts of interest and grant exclusive or special rights to certain enterprises and this is discussed in section 0.

This section sets out how licensing and operational requirements in sectoral regulations can be distortive, citing examples identified by the OECD in its Competition Assessment and Competitive Neutrality Review projects.

#### *Licensing and other operational requirements*

Laws and regulations may require enterprises to obtain a licence to operate in the market. Qualification requirements could include minimum standards, which, along with the authorisation process itself, could result in significant costs for businesses.[12] There may be legitimate reasons for a licensing regime, yet competitive neutrality issues may arise if selected enterprises are exempted from some or all licensing or operating requirements,[13] or if there is discrimination in the application of requirements because of decision maker discretion. Enterprises could be fully or partially excluded from requirements because of their status, for example as SOEs, previous monopolists or incumbents. In some jurisdictions, regulatory bodies may have discretion as to whether they impose certain qualification requirements or grant the licence.

### *Exemptions for certain enterprises, notably SOEs*

Provisions granting certain enterprises exemptions from various regulatory requirements that apply to other enterprises may reduce entry costs, operating costs or administrative burdens (such as operational licence requirements) of favoured firms compared to other market participants. These provisions have the potential to distort competition in the relevant sectors, resulting in discrimination and privileging certain market players over others.

Examples of such barriers and specifically those favouring SOEs, have been identified in OECD reports:

- In Romania, a legal provision imposed licensing requirements on private operators if providing certain port services (such as pilotage or towing) but not on state-owned providers (port authorities) (OECD, 2016[6]).[14]
- In Myanmar, the OECD identified a broader exemption in the maritime sector, extending beyond licensing requirements. Government ships benefited from an exemption from the legislation governing the sector, the Merchant Shipping Act, which included the requirement to obtain an operating permit (OECD, 2021[7]).

In these situations, state-owned market players have a competitive advantage in the market, as they do not need to obtain an authorisation or meet the relevant requirements that apply to other market participants. The OECD recommends all operators be subject to the same administrative and legal requirements when performing the same services in competition. This could mean ensuring that all competing firms are subject to the same regulatory requirements or alternatively simplifying the licensing process and/or requirements for all market players, ensuring equal treatment. (OECD, 2016, pp. 176,180[6]), (OECD, 2020, p. 45[8]).

### *Grandfather clauses*

The OECD has also identified several examples of grandfather clauses where incumbents are treated differently to new entrants. This could occur, for example, when governments introduce new environmental regulations that require new firms to make significant investments, and that exclude application to incumbents or that provide for very long transition provisions. Adherence to the standards may be a prerequisite to obtaining a licence. The OECD has identified the following examples of grandfather clauses:

- In the Philippines, a truck age limit was enforced for new entrants but not for incumbents. This meant that new applicants wanting to use trucks over a certain age would not be granted a licence, but incumbents using old trucks could renew their licence (OECD, 2020, pp. 65-66[9]).
- In Greece, new legislation required new trucking companies to prove the existence of a parking place to obtain a licence for road transport, while incumbents operating prior to the new law were only encouraged (through financial incentives), but not required, to obtain a parking place (OECD, 2014, pp. 226-227[10]).

In these situations, incumbents are given a competitive advantage in the market, as they do not need to meet the standards required of new entrants. Such situations raise costs for some enterprises but not others and makes market entry more difficult.[15]

### *Decision maker discretion*

Legislation that sets out the procedures or requirements for obtaining a licence may provide the decision maker with a large amount of discretion. This could include broad subjective requirements where the decision maker uses their personal judgment and opinions to make a decision, require further documents

or impose additional criteria, as they see fit. In addition, the decision maker may ultimately have discretion to grant the licence, despite the applicant satisfying the relevant criteria. Such situations can be exacerbated by a lack of recourse to outside appeal processes for applicants. In Tunisia, the OECD found that the authorisation process for hypermarkets and supermarkets involved a significant degree of authority discretion (OECD, 2019, p. 31[11]). In relation to hypermarkets, the relevant authority could issue an opinion on the applicant's authorisation request (which was then subsequently considered for approval by another body) based on the 'economic, social and environmental impact of the project'. The OECD found that there were no clear and precise evaluation criteria for this assessment.

Significant discretionary power can lead to arbitrary standards in decision-making, meaning successful applicants may not be the most efficient, but the ones that are best able to navigate the complex process (OECD, 2019, p. 78[11]).[16]

#### *Horizontal legal and regulatory framework*

Some market players may be excluded from horizontal laws and regulations. This could also include the application of competition law (see section 0) and tax law obligations (see section 0).

In some jurisdictions, SOEs may not be subject to ordinary company laws due to their different legal forms or lack of corporatisation. They may instead be required to abide by internal government rules and procedures. This means that they may not be subject to the same regulatory framework as private enterprises operating on the same market. In some jurisdictions, SOEs may be exempted from certain horizontal legislation including insolvency and bankruptcy laws.[17]

## Public procurement

Public procurement refers to the purchase by public entities of goods, services and works.[18] Competition is a relevant dimension to public procurement, given that more competitive tenders help achieve value for money.

Distortions of competitive neutrality in public procurement can occur both at the level of the legal framework and at the level of tender procedures. The legislation or the tender terms may specify requirements that disadvantage certain types of companies as sellers/suppliers or procurers/buyers.

The OECD Recommendation on Competitive Neutrality encourages countries to establish open, fair, non-discriminatory, and transparent conditions of competition in government procurement processes in order to ensure that no enterprise, regardless of its ownership, nationality, or legal form is granted any undue advantage. Similarly, the OECD Recommendation on Public Procurement encourages countries to treat bidders, including foreign suppliers, in a fair, transparent and equitable manner, taking into account Adherents' international commitments.

This section focuses on how countries have approached discrimination by ownership and nationality, and then assesses other types of discrimination.

### *Specific ways in which competitive neutrality can be affected*

#### *Discrimination by ownership: favouring SOEs*

The OECD Guidelines on Corporate Governance of SOEs indicate that, '[w]hen SOEs engage in public procurement, whether as bidder or procurer, the procedures involved should be competitive, non-discriminatory and safeguarded by appropriate standards of transparency'.

Where long-established SOEs are involved, their incumbency advantages may be such that the entry of competitors in public procurement processes is effectively impeded.

The main risk from a competitive neutrality perspective is that SOEs are favoured as bidders. Numerous jurisdictions have developed and implemented public procurement policies to ensure a level playing field for SOEs and other market participants. These rules specify under which conditions SOEs are allowed to participate as suppliers (OECD, 2018[12]).

However, some countries grant or have granted more favourable treatment to SOEs. For instance, in the Philippines, SOEs have been found to have a number of advantages when participating in public procurement. Unlike private companies, SOEs are not required to register with the Philippine Government Electronic Procurement System. In addition, the government and SOEs can simply enter into a simplified 'agency-to-agency' contract under the flexibility granted by the Government Procurement Reform Act, and so avoid the general requirement for a public tender (OECD, 2020[8]).

From the perspective of SOEs as procurers, in the past, some countries have reported disadvantages associated with public procurement procedures for SOEs – mainly due to the more complex and lengthy bidding processes as compared with private sector companies (OECD, 2018[12]). Whether or not national procurement rules are limited to the general government or are also extended to procurement by SOEs differs between countries.

### *Discrimination by nationality: favouring domestic companies*

Competitive neutrality in public procurement may also be distorted by rules and tender design that privilege domestic over foreign companies. The OECD has developed a taxonomy of measures affecting government procurement that provides a classification system for different measures, policies, and procedures that can impact cross-border government procurement. The taxonomy focuses on whether and how country measures affect foreign suppliers that wish to access the market of government contracts.[19]

The taxonomy covers explicit and implicit measures and practices that may result in loss of market opportunities for foreign companies:

- The explicit measures directly reduce or prevent foreign companies' access to a government procurement system. For instance, in Argentina, the public administration has an obligation to award public-works contracts to national construction companies. A company is considered national if it has a legal address in Argentina and 80% of its staff is located in the country. International bids may take place only if a Minister authorises so (OECD, 2019[13]). Viet Nam and Malaysia also maintain restrictions requiring international bidding only when relevant domestic supply is not available (OECD, 2018[14]).
- Implicit measures do not expressly target foreign bidders, but may, indirectly or potentially, affect cross-border procurement. These measures or practices may not be restrictive de jure but in their application they may prevent access to procurement by foreign firms. For instance, in India, in order to evaluate the consultant's key professionals, experience in the region (number of projects in the region) may be a criterion and bidders must have achieved work of any nature with some national public entity listed (Gourdon, Bastien and Folliot-Lalliot, 2017[15]).

### *Other discriminations*

Public procurement rules and practices may also discriminate against other types of companies. Two particularly important ones from a competition perspective are new entrants and small and medium

enterprises (SMEs). (Iossa, 2019[16]) has argued that the incumbency advantage may constitute an important obstacle to competition in public procurement. Previous OECD work has confirmed that SMEs' share of public procurement contracts is often lower than their share of the market, for instance, in terms of value added or turnover (OECD, 2018[17])

New entrants and SMEs may face discrimination where public procurement rules/practices:

- Impose excessive financial constraints – which benefit companies with extensive financial resources over SMEs – or excessive prior experience requirements – which benefit incumbent companies and impede the participation of companies with little or no experience.
- Choose suppliers through procedures that are not fully open, rendering more difficult the participation of companies that are not already in the market (Sánchez-Graells, n.d.[18]).[20]
- Establish unnecessarily complex public procurement rules and procedures and use non-standardised bidding documents impede broad participation from potential competitors (OECD, 2018[12]).[21]
- Lead to the use of excessively large lots, which make it difficult for SMEs to participate in procurement processes.[22]

In some instances, governments favour SMEs and implement explicit public procurement measures to support them, such as dedicated financial instruments and preference programmes. In the Philippines, the Government is asked to procure at least 10% of its total purchases from duly registered cooperatives and another 10% from SMEs (OECD, 2018[14]). In South Africa, the bidding process goes through a selection which promotes and favours SMEs (OECD, 2018[14]).

This is in a context in which governments are increasingly using public procurement as a strategic governance tool for promoting inclusive and sustainable growth, including to increase the participation of SMEs in public procurement (OECD, 2018[17]). For instance, it was shown that, in Japan, 40% of SMEs 'would have exited the procurement market but for the government's set-aside program, which devotes half of the procurement budget to SMEs' (The World Bank Group, 2020, p. 28[19])

Given the role of competition in achieving value for money in the context of public procurement, it is important that governments carefully consider whether measures to promote public-policy objectives are justified. Among others, governments should evaluate the impact of the measure in the prices paid by public purchasers and compare it with the value obtained as regards the public-policy objective pursued. They should also assess how effective is the measure in achieving the desired objective and whether there are less distortive alternative measures.

## Public support measures

The OECD Recommendation on competitive neutrality asks adherents to uphold competitive neutrality when designing public support measures 'that may enhance an [e]nterprise's market performance and distort competition'.[23] Some enterprises may receive direct or indirect financial advantages from the state. Such public support benefits typically include direct grants, loans, loan guarantees and state investment in capital, at conditions not in line with market principles, as well as favourable tax treatment, grants and goods or services provided by governments at favourable prices.[24] Public support measures may be implemented to address market failures, foster innovation, promote foreign investment, and encourage positive externalities (environmental protection and sustainability goals), development of key industries or geographical areas or to pursue other industrial policy goals. Defensive industrial policy may mean that measures are used to support failing firms or industries that are considered 'national champions' or somehow essential to the economy. The OECD Recommendation calls for adherents to 'avoid offering

undue advantages that distort competition and selectively benefit some [e]nterprises over others', but acknowledges situations 'where achieving an overriding Public Policy Objective requires an exception'. [25]

Such public-support measures are often referred to as 'subsidies'[26] or 'state aid'. The concept of 'state aid' originates in the EU and is linked to the functioning of the EU internal market.[27] It is useful to consider this concept as the EU is one of the few jurisdictions that has a specific regime to control public support measures within the competition law. In the EU, state aid is defined as 'an [economic] advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities'.[28] Competitive neutrality is at the core of this concept.

In the following section, we focus on specific public-support measures that selectively favour certain firms, giving them a competitive advantage over others. This does not capture measures that treat all enterprises equally (for example, general subsidisation of inputs), which may also create inefficiencies or distort the international market.

### *Specific ways in which competitive neutrality can be affected*

Public support measures can distort the market and change how markets operate. They can distort the competitive process and create inefficiencies by protecting or providing advantages to specific enterprises. This is especially likely where the objective of the subsidy is not simply to correct a market failure or when the amount of aid granted is excessive, compared to the goal. Subsidies can be particularly damaging when they are used to support inefficient or failing enterprises, preventing their takeover, restructure or exit from the market or when they support specific sectors over others, preventing economic transitions. As explained by the OECD, 'the exit of firms and their replacement by entry and expansion of other firms in the market is an important driver of efficiency, productivity and growth. Selective state intervention can un-level the playing field and soften competition' (OECD, 2020, p. 17[20]). The expectation of subsidies (i.e. to help firms in financial difficulties) may also distort inefficient enterprises' incentives to improve in terms of quality, pricing, innovation and efficiency. The incentives of efficient firms may also be reduced 'if they expect that their resulting competitive advantage will be offset by the granting of an aid to their rivals' (OECD, 2010[21]). When an enterprise is granted a subsidy that is disproportionate, it may be encouraged to 'divert resources to strengthen its position in the market, with potentially distortionary effects on competition' (OECD, 2020, p. 19[20]). Support measures could also lead to predation by the supported firm. Depending on the dynamics of competition, such measures may drive out more efficient enterprises from the market, and thus shift 'production towards less efficient units, thereby increasing total production costs and/or lowering the quantity of output produced' (OECD, 2010[21]).

OECD and World Bank projects have highlighted the following types of public support measures and their potential implications for competitive neutrality.

#### *State loans and guarantees*

If some enterprises have access to more favourable terms for debt and equity financing (such as below market interest rates for loans, lower due diligence requirements, explicit or implicit state guarantees or below market guarantee fees) they will have (artificially) lower costs compared to their competitors (or potential competitors). Preferential financing terms can distort 'incentives and lead to excessive indebtedness and misused resources' (OECD, 2021, p. 72[22]), while also crowding out access to more efficient competitors.[29]

This is often particularly a concern for SOEs as financing by state owned institutions or private institutions may be distortive without measures to ensure comparable market conditions.[30] The OECD has explained that 'Even when funding is obtained from private lenders and granted on commercial terms, creditors

assuming an implicit state guarantee is in place on an SOE's debts can lead to artificially low funding costs for SOEs and distort the competitive landscape' (OECD, 2021, p. 72[22]).[31]

The OECD has highlighted several examples of state loans and guarantees distorting the playing field in its work. Vietnamese SOEs, for example, reportedly borrow from commercial banks on favourable terms because of their SOE status or because of the assumption that they will be guaranteed (OECD, 2020, p. 181[23]). In the Philippines, the OECD found that the legislation provided for the possibility of state guarantees for the SOE operating in the postal sector but that in practice, the SOE in question had never benefited from this advantage (OECD, 2020, p. 48[8]). In Montenegro, the OECD reported that loss-making SOEs receive privileged access to financing from the government and international development banks. It found that this especially disadvantages SMEs (OECD, 2021, p. 673[24]).[32]

### *Tax treatment*

Tax laws and regulations granting selected enterprises financial advantages (for example, tax relief or tax exemptions) can distort competition and affect competitive neutrality. In some instances, certain categories of firms may receive special treatment, for example foreign firms. The World Bank identified that foreign firms were the main recipients of tax incentives in Serbia as a result of efforts to attract foreign direct investment (World Bank, 2019, p. 10[25]). In other cases, SOEs or private enterprises carrying out public service obligations (PSOs) may receive more favourable tax treatment as a form of compensation (see section 0). In the Philippines, the problem of SOEs (called Government Owned and Controlled Corporations (GOCCs)) having tax exemptions was highlighted in the Philippine Development Plan as a competitive neutrality issue.[33] This possible advantage for SOEs in the Philippines was also highlighted by the OECD in relation to the SOE PHLPOST operating in the postal sector and which was exempted it from several categories of taxes, including taxes and duties on imported equipment, taxes on financial obligations, capital gains tax and local government imposts and fees (OECD, 2020, p. 51[8]).[34]

All enterprises should receive equal tax treatment in relation to their commercial activities. If certain enterprises, such as SOEs are not subject to the same tax treatment as private competitors, any advantage should be neutralised through, for example, the payment of equivalent dividends to government.

### *Preferential access to public land and facilities*

Certain market players may receive inputs (for example, land, energy or water) on more favourable conditions or prices than other market players. This indirect state support reduces costs for supported firms and may enable or motivate them to inefficiently drive out competitors. In general, certain enterprises in a competitive market should not have access to special rates or conditions for production inputs. Rates should be reflective of the market.

The *OECD Competitive Neutrality Reviews: small-package delivery services in ASEAN* found, for example, that relevant SOEs in several member states had preferential access to state-owned land, which was often 'assigned under long-term leases at nominal rates' (OECD, 2021[22]). [35] The *OECD Multi-dimensional review of Viet Nam* identified discriminatory access to land and specifically zoning reassignment. The OECD explained that 'all land in Viet Nam is state owned, but land rights can be granted to firms and individuals. A SOE wishing to expand will generally be provided with land free of charge. Foreign-invested companies in prioritised sectors may enjoy similar privileges. Conversely, according to discussions with private sector representatives during the preparation of this report, domestic private enterprises have no access to such favourable treatment' (OECD, 2020, p. 181[23]).[36]

## Special and exclusive rights

A state may grant special or exclusive rights to both public and private enterprises. An 'exclusive right' typically refers to a monopoly or sole right of an enterprise to produce certain goods or provide certain services.[37] The definition of 'special rights' is less straightforward. In the EU, the generally accepted definition of a 'special right' involves limiting the performance of a certain activity to a restricted number of enterprises or providing selective advantages that affect the ability of other enterprises to perform an activity. [38] The grant of special rights often involves discretion and subjective criteria. Like exclusive rights, special rights 'involve the creation of some sort of limited, closed class' (Jones and Suffrin, 2016, pp. 597-598[26]).

One of the reasons for granting an exclusive or special right may be for the provision of public services. Public services are generally identified as basic services that a government considers should be generally accessible. In the EU, such services are referred to as 'Services of General Interest' (SGI);[39] when they are carried out in return for payment they are called Services of General Economic Interest.[40] The provision of public services typically involves granting a single provider a 'public service obligation' (PSO), that is, an obligation to provide such services under stipulated conditions. It is common for SOEs to carry out PSOs but they may be also be carried out by private enterprises.[41] PSOs are common in certain sectors such as utilities (electricity, gas and telecoms), post, passenger transport (bus and rail) and health (OECD, 2012, p. 51[27]). They are often imposed as part of the liberalisation process (Jones and Suffrin, 2016, p. 588[26]). Universal service obligations (USO) are a sub-set of PSOs and usually involve a minimum level or standard of service, which must be provided to all consumers wherever they may be located and despite the relative cost of providing the service (i.e. including areas where providing the service is uneconomic). They are common in regulated industries, notably where there are natural monopolies and where there is a need to ensure accessibility. While several enterprises could carry out a USO, countries tend to designate a single enterprise, either through direct appointment or public procurement procedures and normally for a set amount of time.[42]

As previously noted by the OECD, 'almost all countries compensate undertakings (public or private) which deliver public service obligations alongside their commercial activities. Compensation methods vary depending on the country, the type of public service and the entity delivering such service'.[43] Compensation may be through direct transfers, capital grants, reimbursements (ex-post and ex-ante), budget appropriations and state aids or subsidies. Where user charges partly fund public services and the government, driven by equality considerations, sets below-cost tariffs, compensation will support the difference. Compensation is usually set in advance by a sector regulator or public authority, pursuant to methodology set out in laws and regulations (OECD, 2012, p. 51[27]). Where there is no direct compensation, the PSO provider receives indirect compensation through 'above-cost regulated rates and residual monopoly rights'.[44] In the EU, special considerations apply for public services under the state aid regime (see section 0).

### *Specific ways in which competitive neutrality can be affected*

Granting an exclusive right or discriminating between enterprises can limit market entry, create undue advantages or disadvantages and thus distort competition. This section considers how competitive neutrality can be distorted through the example of public service obligations (which as mentioned, involves the grant of an exclusive or special right).

Competitive neutrality distortions can arise on three levels[45]:

- Selection of the public service operator;
- Privileges and powers attached to the public service;

- Compensation for the public service.

### *Selection of the public service operator*

Public service providers are usually selected through direct appointment or procurement processes. To avoid competitive neutrality distortions, there should be a competitive selection process. Competitive tendering can ensure value for money in procurement. If there is no competitive selection process, the PSO may not be awarded to entity best equipped to provide the service, and the terms of the award may be worse (e.g. with inflated prices) relative to a competitive outcome.

### *Privileges and powers attached to the public service*

A public service operator may be granted a monopoly over a market (an exclusive right) or it may be granted special rights (for example, legal or regulatory advantages). This could distort the market where the right is granted (if it is or could be a competitive market) as it may make market entry difficult or impossible. Uncertainty as to the scope of exclusive rights may also deter potential competitors from entering the market if they do not understand the exact scope of the exclusive right. If the special rights or benefits are extended to other markets where the public service operator competes, or could potentially compete with other enterprises, the rights holder could have an unfair advantage in those markets.

In some jurisdictions, the grant of a special or exclusive right may be challenged if it leads the right holder to infringe competition law.[46] The following actions have been considered illegal (Jones and Suffrin, 2016, pp. 620-622[26]):[47]

- **Creating an inability to meet demand.** The state may grant a monopoly to an enterprise to provide goods and services so that no other enterprise can enter the market. If, because of the monopoly's setup, through exercising its exclusive rights, the enterprise cannot meet demand, the measure granting this right may be found to infringe competition law.[48]
- **Creating a conflict of interest**. If the state grants an enterprise who offers goods or services on a market, a special right to undertake regulatory functions in that market, this could create a conflict of interest. This has been found to be abusive in the EU when the state grants a holder of an exclusive right regulatory functions, which would enable it to affect competitors in a downstream market.[49]
- **Extending a dominant position to a neighbouring market.** When the state grants rights that extend a dominant position to a neighbouring market, the EU has considered this to be abusive 'as such'.[50]
- **Creating pricing abuses.** A grant of an exclusive right may allow an enterprise to impose unfair prices or engage in price discrimination (i.e. towards competitors in favour of its own services).

In addition to infringing abuse of dominance provisions, the EU courts have further found that the creation of inequality of opportunity and distorted competition is sufficient. The courts have held that the effect of a state measure on market structure is important. A state measure that creates 'inequality of opportunity' leading to distorted competition has been found to be sufficient to infringe Article 106(1) in relation to abuse of dominance, by showing potential anti-competitive consequence but without the need to show an abuse (Jones and Suffrin, 2016, p. 622[26]). Other cases have included breaches based on refusal to supply and 'automatic abuse', where the mere creation of monopoly rights (notably the extent of those rights) was considered an infringement without the need to identify an abuse.[51]

There may be legitimate public policy objectives behind protecting public service providers from competition rules. Some jurisdictions may have specific legislative exemptions that allow governments to grant special or exclusive rights, for example in the form of public service obligations that may infringe

competition law in order to achieve public policy objectives such as the provision of essential services.[52] Exemptions for public services may also be found in free trade agreements.[53]

### *Compensation for the public service*

Compensation for a public service may be distortive if the PSO provider is over or under compensated (directly, or for example, indirectly through high or low regulated tariffs). Public service compensation should be limited to what is appropriate and proportionate to the value of the service.

The delivery of public services may be accompanied by price regulation, especially in the case of USO and services provided under monopoly.[54] Price regulation may affect competitive neutrality when for example, the mechanism used to calculate the rates is not fair and transparent, it specifies minimum rates and if price regulation extends to competitive markets (OECD, 2021, p. 67[22]).

Overcompensation can create inefficiencies in the provision of the public service and can give the provider a competitive advantage in other markets. This could occur if PSO compensation is used to cross-subsidise the provision of goods or services in markets where it competes with other enterprises. It may enable the PSO provider to engage in below cost pricing in other markets and thus exclude competitors. Enterprises carrying out PSOs should be subject to high standards of transparency, account separation and disclosure around cost and revenue structures to avoid cross-subsidisation.

At the other end of the spectrum, inadequate compensation can disadvantage the PSO provider in other markets and influence its overall viability. The OECD noted that in several member states of the Association of Southeast Asian Nations (ASEAN), SOEs were providing delivery services to the state, often as part of their public service obligations, but did not receive adequate compensation for such services (OECD, 2021, p. 55[22]).

## State activism

States may also distort competition through activism.[55] State activism includes a wide range of, sometimes subtle, ways in which governments can participate in and influence markets: e.g. golden shares[56] and shareholder's activism, investments by sovereign wealth funds, political involvement in strategic deals,[57] joint technological or industrial initiatives, public-private partnerships for infrastructure, administrative hardship or ease on certain industries.[58] These measures may be adopted for investment purposes only, or as part of government's industrial policy to protect or stimulate a selected company or industry (OECD, 2015[3]).

An extensively debated aspect of state activism is the creation or favouring of national champions through political involvement in strategic deals. The OECD Competition Committee held a roundtable in 2016, which dealt with the State's involvement in mergers, in the broader context of public interest considerations in merger control.[59] The roundtable found that States' may become involved in mergers in several ways (OECD, 2016[28]):

- They may influence how takeovers of national companies by foreign ones are structured. The takeover of the French company Alstom by the United States conglomerate General Electric was structured to fit conditions set by the French government.
- Governments may block deals through sectoral regulation. While transparent and neutral regulatory reviews of mergers are not a concern for competitive neutrality, regulatory measures specifically aimed at protecting national champions are. For instance, in the past, the Spanish

government adopted a regulation aimed to prevent the takeover of national energy firm Endesa by the German firm E.ON.; a measure which was annulled by the European Court of Justice (OECD, 2009[29]). The regulation obliged E.ON., among others, to maintain Endesa's brand, keep in Endesa's group the companies owning electricity assets outside Spain, and continue using Spanish coal (European Commission, 2006[30]). E.ON.'s abandoned its bid on Endesa. This is by no means the only case in which an unjustified restriction has taken place to protect a firm from foreign takeover.

- Deals may also be blocked based through foreign investment screening, which review investments based on national interest or national security considerations. Only since 2018 have more than half of the 37 OECD countries put in place a cross- or multi-sectoral investment screening mechanism, compared to less than a third a decade earlier. This drive continues. In the first half of 2020, France, Japan and the United States implemented reforms (unrelated to the COVID-19 pandemic). Additional countries, including Austria, Czech Republic, Finland, Germany, Italy, Korea, Lithuania, the Netherlands, New Zealand and the United States, are preparing to or have recently adopted new policies or reforms that are unrelated to the pandemic. Denmark, Sweden and the United Kingdom have officially announced reforms, and Ireland was consulting on the merits of introducing an FDI screening mechanism in May 2020 (OECD, 2020[31]).The foreign investment assessment, i.e. the assessment to examine proposals by foreign investors having regard to the national interest or national security, is rarely conducted by the competition authority with some exceptions, like Poland (Svetlicinii, 2008[32]). Competition authorities are sometimes consulted by the bodies conducting the assessment however (e.g. in Canada).
- Governments may take part in the merger control process. As explained in section 0, in many jurisdictions (for example France, Germany, Italy, Netherlands, Spain, Portugal, the United Kingdom), the government (usually the minister for the economy) has the power to intervene in merger control. Such intervention is often ex post (i.e. it follows the competition authority's own assessment) based on public interest clauses which allow the competition authorities' decision to be overruled. There are a few examples among the OECD Members (e.g. Canada, Hungary and Israel) where intervention does not take a form of an ex post decision. In these jurisdictions, certain transactions can be exempted through the competition authorities' assessment (ex ante exemptions). The factors on which the state's intervention can be based vary significantly, including considerations that go from general ('overriding public interest', 'economic policies of the government', 'interest of major significance to society', 'benefits to fundamental strategic interests', 'industrial development', 'international competitiveness',) to more sector specific (e.g. 'media plurality', 'stability of the financial system', 'employment', 'national security', 'protection of public health', 'protection of the environment', 'promotion of technical research'). Countries which allow such intervention in the law do not always use this power in practice. The case-related practice in OECD Members suggests that external intervention in mergers is exceptional and limited to certain sectors and markets. Experiences show that OECD Members are more likely to introduce public interest clauses limited to certain strategically important sectors, especially defence, media, energy and financial markets (OECD, 2016[28]).

## Key takeaways

### Neutral competition law framework and enforcement

The fact that a competition law applies, in principle, to all undertakings is not sufficient to ensure competitive neutrality. Exemptions – especially those that are wide in scope – can be distortive. Exemptions may be granted to certain agreements (e.g. alliances) as opposed to others (e.g. mergers) in the same market, or to some sectors (e.g. air transport) as opposed to others (e.g. rail transport).

Even where the competition law framework is completely neutral, competition authorities may face difficulties applying it neutrally. Competition authorities may face calls from policymakers to adopt a more lenient or a stricter approach regarding certain conducts or mergers. Competition authorities' independence is key to ensure that competition law is applied neutrally.

**Regulation**

To prevent competition distortions, all enterprises competing in the same market should be subject to the same requirements under sectoral laws and regulations and horizontal frameworks, irrespective of their ownership, location or legal form.

Provisions should be applied equally and in a non-discriminatory manner. Regulations should be enforced with 'equal rigour, appropriate deadlines and equivalent transparency with regard to all current or potential market participants'.

**Public procurement**

Distortions of competitive neutrality in public procurement can occur both at the level of the legal framework and at the level of tender procedures. There is a risk that SOEs and domestic companies are favoured as bidders over fully private and foreign companies. New entrants and SMEs may face discrimination, for instance, through the imposition of excessively burdensome requirements.

**Public support measures**

1. There may be legitimate reasons for jurisdictions to grant subsidies and implement a range of public support measures. The OECD Recommendation on Competitive Neutrality acknowledges situations 'where achieving an overriding Public Policy Objective requires an exception'.

2. Competition concerns should however be integrated into the design and grant of public support measures to preserve competitive neutrality. State support should be based on clear, objective and non-discriminatory criteria and not on the identity of the enterprise that receives it, except for emergency measures. Like for all measures that restrict competition, transparency, proportionality and periodic review are key.

3. Given the particular risks for SOEs, the Recommendation on Competitive Neutrality recognises that SOEs 'may be subject to more stringent specific rules which limit the provision of government support to such entities'.

**Special and exclusive rights**

The rules for selecting a public service operator, the attached rights and privileges and the rules on how to determine the level of compensation for the public service provision can create undue advantages and in turn distort competition. Some key considerations for the provision of public services include the selection of the public service operator, compensation for the public service and privileges and powers attached to the public service.

**State activism**

States may also distort competition through State activism and, notably, through the creation or favouring of national champions. This can occur when governments influence how takeovers of national companies by foreign ones are structured, when they unduly block deals through sectoral regulation or foreign screening mechanisms or when they become involved with merger control.

# 3 Competition authorities' tools to address distortions

The ways in which jurisdictions tackle competitive neutrality violations vary.[60] Some have adopted a comprehensive competitive neutrality framework (Australia), while others have adopted specific competitive neutrality provisions to address competition distortions (Denmark, Finland, Norway, Spain, Sweden and the United Kingdom). In some jurisdictions, competitive neutrality principles are set out in the Constitution (e.g. Brazil, Chile, Mexico, Peru, and Russia) (OECD, 2015[33]) and in others at a legislative or even case-law level. This section focuses on competition authorities' tools to fight competitive neutrality violations. Indeed, this type of violation may account for a significant part of the work carried out by competition authorities.[61] In other jurisdictions, certain competitive neutrality provisions may be enforced by other bodies, but this is outside the scope of this paper.

## Actions to stop anti-competitive legislative and administrative acts

Competition authorities often have tools allowing address legislative and administrative acts that distort competitive neutrality. They may use these tools to fight against an anti-competitive regulatory framework (section 0), public procurement (section 0) or special and exclusive rights (section 0). At the legislative level, generally authorities can only act against secondary legislation (e.g. regulations, ministerial orders). The control of public support is addressed in section 0.

The extent of competition authorities' powers to act against legislative and administrative acts violating competitive neutrality greatly varies across jurisdictions. Competition authorities may act as direct enforcers (directly removing the anti-competitive act) or they may challenge the act before a court (which can then remove it).

### *Competition authorities as direct enforcers*

In some jurisdictions, authorities have the power to sanction public bodies that adopt anti-competitive acts and even to remove such acts. In Peru, Indecopi can 'engage in the ex-post review of regulations of secondary legislation issued by any other public entities such as municipalities and ministries (secondary legislation, such as decrees, municipal ordinances, agreements and resolutions) in relation to their illegality or unreasonableness' and can order their removal, through an administrative resolution. Failure to comply can result in fines of up to USD 25 000 (OECD;IDB, 2018, p. 83[34]). A number of authorities in Central and Eastern Europe can also prohibit anti-competitive acts and fine public bodies, as explained in Box 3.1.

## Box 3.1. Enforcement powers against public bodies in central and Eastern Europe

### Latvia

Since 2020, in Latvia, the competition law prohibits public administrative bodies (i.e. the state, local governments and SOEs) from violating competitive neutrality by unduly restricting or denying the private sector an opportunity to operate on the market. Where the Competition Council preliminarily identifies a possible violation, it can initiate negotiations with the relevant body. If the negotiation is unsuccessful, it may impose disciplinary sanctions on SOEs of up to 3% of their turnover.[1]

### Lithuania

The Lithuanian competition law provides for a duty on public administration entities to ensure competition. Article 4(1) provides that 'In carrying out the assigned tasks related to the regulation of economic activities within the Republic of Lithuania, public administration entities must ensure freedom of fair competition'. Article 4(2) provides that 'Public administration entities shall be prohibited from adopting legal acts or other decisions which grant privileges to or discriminate against any individual undertakings or their groups and which give or may give rise to differences in the conditions of competition for undertakings competing in a relevant market, except where the difference in the conditions of competition may not be avoided when meeting the requirements of the laws of the Republic of Lithuania.'

The competition authority can pass 'resolutions' against decisions and laws of public administrative bodies that distort the market through different treatment of certain market players. In 2014, the Competition Council found that the Vilnius City Municipality breached their duty to ensure freedom of fair competition by granting privileges to certain enterprises in the taxi services market. The municipality established its own taxi company, 'Vilnius veža' and granted it various privileges (including subsidies) that distorted competition. Powers aimed at controlling anti-competitive state interventions may also specifically include state aid or subsidy control.

### Russia

The Federal Antimonopoly Service of the Russian Federation (FAS) can conduct an investigation against state authorities that 'issue regulatory legal acts that adversely affect competition'. Examples of these acts include 'the introduction of restrictions on the creation of business entities in any economic sector, the establishment of unreasonable requirements for business entities, the introduction of restrictions on the free movement of goods, the prioritisation of access to information to certain economic entities and the creation of discriminatory conditions.' The FAS can issue fines and disqualify infringing officials for up to three years (Tsyganov and Atanasian, 2020, p. 20[35]).

### Ukraine

In Ukraine, article 15 of the competition law prohibits anti-competitive actions by the state towards state or private firms. This may include prohibiting or impeding new market entry, creating unfavourable or discriminatory conditions for some market players, or granting certain entities or groups of entities benefits or other advantages that place them in a privileged position in relation to competitors. The Ukrainian competition authority can issue decisions aimed to remove or amend the unlawful act.

Note: [1] See: https://webgate.ec.europa.eu/multisite/ecn-brief/en/content/new-framework-competition-law-latvia-against-competition-distortions-created-public.

Sources: Latvian, Lithuanian, and Ukrainian competition laws; (Tsyganov and Atanasian, 2020, p. 20[35]).

In the EU, under article 106 of the Treaty on the Functioning of the European Union (TFEU)[62] the Commission can take action against state measures that amount to an existing or potential infringement of treaty provisions, including those on competition law, for example, anti-competitive agreements (Article 101) and abuse of dominance (Article 102). The Commission may address binding decisions to Member States and has done so in the past. For instance, in the case *Portuguese Airports,* the Portuguese public airport authority 'applied a seemingly uniform system of quantity discounts which was so constructed that it gave larger discounts to Portuguese airlines than to others' (Jones, Sufrin and Dunne, 2019, p. 553[36]). This was considered to infringe article 102 TFEU, in conjunction with article 106 TFEU, and Portugal was directed to terminate the discrimination.[63] In addition, the European Commission can adopt legislation (Directives) to ensure the application of article 106. However, it has used the power to legislate relatively rarely (Craig and De Búrca, 2011[37]). Where it has used it, it has proven contentious with EU Member States (Jones, Sufrin and Dunne, 2019[36]).

In some jurisdictions, enforcement against anti-competitive public procurement measures is particularly prolific. Only in 2012, the Russian FAS investigated 594 petitions 'related to unreasonably restricting participation in bidding and to violating the procedures for determining the winner' and 322 to 'creating advantageous conditions for participating in bidding' (Fox and Healey, 2014[4]). In Lithuania, the competition authority often deals with cases in which municipalities award contracts to SOEs without a competitive process. For instance, in 2020, the Lithuanian competition authority found that out of the 43 intercity bus routes in Lithuania operated by private and municipal companies, only one was selected through a competitive process. The Lithuanian Transport Safety Administration (LTSA) had extended the other 42 contracts in 2018, favouring incumbents over new entrants. The competition authority considered that this breached competition law, fined LTSA and obliged this entity to terminate the contracts and organise competitive procedures (OECD, 2021[38]). In the Czech Republic, the competition authority must ensure 'open and free competition among public procurement suppliers' and 'the selection of the most suitable bid in a transparent manner without discrimination of tenderers' in the context of transport services (OECD, 2021, p. 8[39]).

### *Competition authorities' as indirect enforcers*

In other jurisdictions, competition authorities do not have the power to rule directly on whether a rule or act is competitively neutral. However, they may challenge specific acts before a court so the latter annuls it. For instance, in Sweden the Stockholm District Court may, upon a petition by the Swedish Competition Authority, prohibit certain conduct by the state, a municipality or a county council (OECD, 2015[33]). The Spanish National Commission on Markets and Competition (CNMC) can challenge regulations[64] and anti-competitive acts of public administrations that harm competition and which are considered unreasonable or disproportionate (International Competition Network, 2019[40]). It has done so, for instance, in the context of public procurement. In 2014, the CNMC challenged an act by the Government of Catalonia, which established that the geographic proximity of the company to the purchaser had to be taken into account as an evaluation factor in certain purchases. The competition authority considered that this distorted competition, as it reduced the ability of bidders that were further away to compete for the tender. Following the challenge, the Government of Catalonia decided to eliminate the restriction and the proceedings were closed (Comisión Nacional de los Mercados y la Competencia, 2016[41]).

The Italian Competition Authority (AGCM) has the power to take action against a public administrative body in relation to a distortive legal provision. The AGCM must issue an opinion and if the relevant administration fails to comply within 60 days, the AGCM has 30 days to lodge an appeal.[65] The AGCM has used this power to monitor the implementation of liberalisation reforms. It appears that the 'authority has not only experienced resistance at the local level towards the opening up of markets to competition, but even a tendency for the reintroduction of restrictions that had previously been removed at the national level, as local authorities tend to favour incumbent firms because either these undertakings are directly or

indirectly owned by them or they represent issues that are important to the local electorate' (Tonazzi and Pacillo, 2020[42]). The AGCM has, for example, used its power to 'discourage local health authorities from using historical expenditure as a criterion for the allocation of the public budget, given that the use of this criterion would inevitably give an advantage to incumbent providers at the expense of new and potentially more efficient accredited providers' in the Calabria region.[66]

In China, the State Administration for Market Regulation (SAMR) can investigate administrative monopolies, declare their illegality, and make suggestions to government agencies, but cannot adopt measures to stop the illegal conduct. The conduct can only be stopped by the agency carrying out the conduct and its superior agency (see Box 3.2).

### Box 3.2. China's rules on administrative monopolies

In China, administrative monopolies refer to 'government (administrative, judicial, or legislative) restrictions or distortions of competition in any field, where the market could play a role' (Zhang and Wu, 2019, p. 719[43]) In 2008, China adopted a competition law, the Anti-Monopoly Law (AML) that, along with anti-competitive practices and merger control, regulates administrative monopolies.

The AML devotes its chapter 5 (articles 32 to 37) to administrative monopolies. Article 32 prohibits that enterprises be required to purchase or use products from specific suppliers only. Article 33 aims to ensure free trade across regions, 'outlawing discriminatory measures in various forms' like 'unequal inspection standards for local and non-local products' or the establishment of licensing requirements or other barriers 'intended to block the entry of non-local products.' Article 34 aims to ensure competitive neutrality in public procurement, prohibiting the adoption of 'protectionist bidding procedures' like discriminatory assessment criteria. Article 35 forbids discriminating against non-local enterprises, for instance, hindering that they make investments or establish subsidiaries. Article 36 prohibits measures which lead companies to 'engage in monopolistic conduct.' Finally, article 37 bars the adoption of anti-competitive regulations (Ip and Kwok, 2017, pp. 557-558[44])

The SAMR can investigate administrative monopolies, declare their illegality, and make suggestions to government agencies so they address the illegality. However, the SAMR cannot adopt measures to stop the illegal conduct. The conduct can only be stopped by the agency carrying it out and its superior agency (Zhang and Wu, 2019[43]).

From 2008 to 2018, the two competition agencies responsible for applying the articles during that period – the National Development and Reform Commission (NRDC) and the State Administration of Industry and Commerce (SAIC) – had concluded 193 cases. Out of these, 62 were publicly available – they deal with all categories of infringement, but only one of them concerned the unequal treatment of non-local enterprises (article 35). The cases focus on the protection of consumer, such as situations involving 'the supply of natural gas, electricity, water and telecommunication services' (Zhang and Wu, 2019, pp. 721-723[43])

Note: * The SAMR consolidated resulted from the merger of the three competition authorities previously existing in China, the NDRC, the SAIC, and the Ministry of Commerce (MOFCOM).
Source: (Ip and Kwok, 2017[44]); (Zhang and Wu, 2019[43])

### *Key takeaways*

The extent of competition authorities' powers to act against measures violating competitive neutrality greatly varies across jurisdictions:

- Some competition authorities can directly remove anti-competitive acts and even fine public bodies (generally SOEs) and public officials.
- In other jurisdictions, competition authorities do not have the power to rule directly on whether a regulation or act is competitively neutral and they can only challenge acts before a court.
- Some competition authorities are able to address not only administrative acts, but also secondary legislation (e.g. regulations, ministerial orders).

## Support in the design of regulation and reform

Competition authorities may have a role in reviewing legislation and providing advice to government on potential competition implications of legislation and reform initiatives. The OECD Recommendation on Competitive Neutrality encourages adherents to maintain competitive neutrality in the regulatory environment by carrying out competition assessments that identify and revise existing or proposed regulations that unduly restrict competition.[67]

### *Competition assessment tools*

The associated analysis can be done using 'competition assessment' tools. The OECD defines 'Competition assessment' as 'a review of the competitive effects of public policies including consideration of alternative and less anti-competitive policies' (OECD, 2019, p. 6[45]) (See Box 3.3).

### Box 3.3. OECD Recommendation on Competition Assessment and Checklist

In December 2019, the OECD revised its Recommendation on Competition Assessment, which was first adopted on 22 October 2009. The Recommendation 'calls for Adherents to identify existing or proposed public policies that unduly restrict competition and to revise them by adopting more pro-competitive alternatives. It also recommends that Adherents establish institutional mechanisms for undertaking such reviews'. The implementation of the Recommendation is supported by the OECD Competition Assessment Toolkit, which sets out 'options and good practices on eliminating barriers to competition based on Adherent's experiences' (OECD, 2019, p. 3[45]). According to the checklist, further competition assessment should be conducted if a piece of legislation answers 'yes' to any of the following questions:

Limits the number or range of suppliers

This is likely to be the case if the piece of legislation:

- grants a supplier exclusive rights to provide goods or services
- establishes a licence, permit or authorisation process as a requirement of operation
- limits the ability of some types of suppliers to provide a good or service
- significantly raises the cost of entry or exit by a supplier
- creates a geographical barrier to the ability of companies to supply goods, services or labour, or invest capital

Limits the ability of suppliers to compete

This is likely to be the case if the piece of legislation:

- limits sellers' ability to set the prices of goods or services
- limits the freedom of suppliers to advertise or market their goods or services
- sets standards for product quality that provide an advantage to some suppliers over others or that are above the level that certain well-informed customers would choose
- significantly raises the costs of production for some suppliers relative to others, especially by treating incumbents differently from new entrants

Reduces the incentive of suppliers to compete

This may be the case if the piece of legislation:

- creates a self-regulatory or co-regulatory regime
- requires or encourages information on supplier outputs, prices, sales or costs to be published
- exempts the activity of a particular industry or group of suppliers from the operation of general competition law

Limits the choices and information available to customers

This may be the case if the piece of legislation:

- limits the ability of consumers to decide from whom they purchase
- reduces the mobility of customers between suppliers of goods or services by increasing the explicit or implicit costs of changing suppliers
- fundamentally changes the information required by buyers to shop effectively

Various competition authorities (such as Canada, Indonesia, South Korea and Mexico) have created toolkits or guidelines inspired by the OECD checklist.[68]

Note: See, OECD, Recommendation of the Council on Competition Assessment, OECD/LEGAL/0455.
Source: (OECD, 2019[46]), reproduced from (OECD, 2021, p. 144[7])

While competition assessment considers factors that extend beyond competitive neutrality, the tools can be used to assess competitive neutrality distortions. More targeted reviews can also focus specifically on competition neutrality issues, such as the recent OECD competitive neutrality review of the ASEAN small package delivery sector.[69]

The following section sets out the types of competition assessment tools that competition authorities may use and, where available, provides examples where these tools have identified competitive neutrality concerns.

### *The role of competition authorities*

Competition assessments may be carried out by competition authorities pursuant to specific powers or obligations or as a part of their general advocacy functions (direct or indirect models). The use of competition assessment tools may vary in terms of timing (before or after the regulation comes into force) and the type of intervention (for example, whether or not the opinion or recommendation is binding or non-binding). Powers may also depend on the level of regulation (for example, in some jurisdictions, competition authorities have specific powers in relation to administrative regulations or review is limited to national regulations).[70]

Competition authorities are well-placed to conduct competition assessments, given their technical capacities. It can be particularly valuable to involve both the competition authority, which has the knowledge of how markets work, and any relevant government departments or sector regulators, which have the sector and technical knowledge. Competition authorities should thus be encouraged to take on this role and to work with the public authorities that have the technical knowledge behind the laws and regulations. Where there is no express power or duty on competition authorities, public authorities should be encouraged to consult with competition authorities when drafting legislation.

The OECD has identified three main ways adherents conduct competition assessments within the policy development process and two ways they are used outside the policy development process.[71] The following section will consider the three main three main ways of conducting competition assessment within the policy development cycle, specifically:

- Mandatory regulatory impact assessments
- Ad hoc assessment of laws/regulations
- Market studies/sector inquiries

### *Mandatory regulatory impact assessments*

In some jurisdictions, either the competition authority or the authority developing the policy (or both)[72] carry out mandatory competition or regulatory impact assessments (with competition considerations) as part of the policy making process. This involves 'screening proposed policies and measures and is part of the formal policy development process' (OECD, 2014, p. 32[47]). In South Korea, the Korea Fair Trade Commission (KFTC) receives regulations from the Prime Minister's Office that are subject to an overall Regulation Impact Assessment. The KFTC then carries out a competition assessment and provides recommendations.[73] In 2016, China introduced its Fair Competition Review System (FCRS), a compulsory ex-ante review system that aims to 'address restrictions on competition imposed by administrative bodies and by anti-competitive laws, regulations and directives' (Fox and Healey, 2019, p. 202[48])[74]. The FCRS requires 'policy making authorities at central, provincial and local levels to review all new and existing policy measures, regulations and rules to ensure they do not have an unnecessary impact on market competition, particularly to support the creation of a national market' (Fox and Healey, 2019, pp. 202-203[48]). The review is carried out with regards to standards on 'market entry and exit', 'free movement of goods and production factors', 'standards that affect production and operating costs' and 'standards that affect activities of production and business operations'. [75] While the screening is carried out by public authorities and not the competition authority, the competition authority does have administrative powers in relation to the enforcement of the mechanism. In Japan, government ministries and agencies carry out competition assessment through a checklist 'when a regulation is established, amended or abolished' as part of an overall Regulatory Impact Analysis organised by the Ministry of Internal Affairs and Communications. The JFTC supports the competition assessment by providing advice to ministries and agencies through the process and designed the checklist used by the agencies (OECD, 2018, p. 84[49]).

### *Ad hoc assessment of laws/regulations*

This is not a screening tool but may be carried out on an ad hoc and discretionary basis, usually in relation to both proposed and existing laws and regulations (OECD, 2014[47]). The OECD has explained that this type of assessment 'usually has influence by presenting good arguments that convince policy and decision makers, rather than engaging in formalistic or adversarial processes' (OECD, 2014, p. 33[47]). Box 3.4 provides some examples of ad hoc regulatory assessments undertaken by competition authorities that have identified competitive neutrality distortions.

### Box 3.4. Ad hoc assessment by competition authorities – competitive neutrality issues

#### Serbia

In 2016, the Commission for Protection of Competition of the Republic of Serbia (Commission) issued an opinion on a draft amendment to the Law on Public Utilities, using its advocacy functions to highlight competitive neutrality concerns. (Rakić, 2020, p. 15[50]) has explained that the Commission 'stressed the importance of providing equal conditions for all participants in the public utilities market'. It highlighted the possible negative impact of creating a statutory monopoly and set out its concerns in relation to the proposal of the Ministry of Construction, Transport and Infrastructure. The Ministry acknowledged the Commission's comments and amended the draft law.

#### Costa Rica

In Costa Rica, the Comisión para Promover la Competencia (COPROCOM) undertook a study and issued an opinion on a directive by the National Treasury on public procurement, which favoured public enterprises. COPROCOM considered that this created an uneven playing field and disadvantaged private providers who could supply the same services at a lower price. The directive was revoked following the advocacy efforts of COPROCOM (OECD, 2020, p. 77[51]).

#### Latvia

In Latvia, the competition council regularly identifies anti-competitive regulatory provisions and makes recommendations to prevent competitive distortions. In 2020, for example, it issued 42 opinions on regulatory framework proposals. In 2016, it successfully prevented a legislative amendment that planned to entrust the provision of dog-chipping services to the state (to inspectors from the Food and Veterinary Service). The Competition Council had noted that the private sector could provide the service.[76]

Source: (Rakić, 2020, p. 15[50]), (OECD, 2020, p. 77[51]), Competition Council Republic of Latvia, Annual Report 2020, https://www.kp.gov.lv/en/media/9134/download, Competition Council, Republic of Latvia, Competition protection in Latvia: year 2016 in numbers and facts, 3 February 2017, https://www.kp.gov.lv/en/article/competition-protection-latvia-year-2016-numbers-and-facts

*Market studies/sector inquiries*

Large scale, public discretionary assessments are usually described as market studies or investigations (OECD, 2014, p. 33[47]). Such studies can be used to identify competitive neutrality restrictions, analysing the impact of existing policies. The OECD has explained that given their resource intensive nature, authorities only tend to embark on such large scale studies when there is a prima facie cause for concern. There are usually no formal powers to force change and so sector studies usually have an impact by influencing the policy process while some are specifically aimed at increasing sector expertise to prepare the authority for possible enforcement action (OECD, 2014, p. 33[47]).

Several jurisdictions have explicitly identified or set out to identify competitive neutrality concerns through market studies and have used this information to advocate for change. Box 3.5 provides some country examples.

### Box 3.5. Identifying competitive neutrality issues through market studies

Several jurisdictions have explicitly identified or set out to identify competitive neutrality concerns through market studies and have used this information to advocate for change.

- **Spain**: In Spain, the competition authority undertook a competition assessment in relation to postal market reforms. The authority had been particularly concerned with 'the benefit that Correos, the ex-state owned postal service, had in obtaining contracts for the universal postal service and for providing postal services to public bodies' (OECD, 2014, p. 18[47]).
- **Chinese Taipei**: In 2019, the Chinese Taipei FTC published research on Regulations of the Renewable Energy Industry under Competition Law. As part of its study, it considered the competitive neutrality implications of Taiwan Power Company's involvement in the market (Fair Trade Commission, 2020[52]).
- **Mexico**: In Mexico, the Instituto Federal de Telecomunicaciones (IFT) conducted a 'Study on Barriers to Competition and Competitive Neutrality Caused by Public Entity Regulations and Procedures in the B&T Market Sectors'. According to its 2016 programme of work, the aim of the study into the broadcasting and telecommunications (B&T) market was to 'assess regulatory restrictions and regulations of municipalities and states or any other requirement (or process) to deploy and use the infrastructure necessary to provide B&T services nationwide'. It set out to assess 'the restrictions imposed by public entities, mainly federal agencies that have a say in the design of procedures through telecommunications platforms and/or specific applications where there are times when this design is not neutral to technology, and can constitute an obstruction to competitive neutrality and cause user costs that can be avoided'.
- **Kazakhstan:** In 2014, the agency for competition protection conducted a market study on precious stones. It found that one enterprise had an exclusive right to undertake expert assessments on precious stones exported outside the Eurasian Economic Union. It recommended the government reconsider the Law 'On Precious Stones and Metals' to improve competition in the market. The government subsequently changed the law 'eliminating the identified market barrier' (OECD, 2016, p. 74[53]).

Source: (OECD, 2014, p. 18[47]), (OECD, 2019, p. 14[54]) (Fair Trade Commission, 2020[52]), (OECD, 2016, p. 74[53]), IFT, Annual Work Program AWP 2016, page 35. (ift.org.mx)

### *Challenges*

Competition assessments can be resource intensive and so authorities need to be adequately funded to carry out this task. In addition, a major challenge highlighted by competition authorities is that their opinions or recommendations resulting from the various competition assessment tools are often non-binding. This means that the relevant body may not take the advice or comments of the competition authority on board and that they are not held accountable for this decision (through disciplinary action or an ability to challenge the decision in court). Healey has commented that transparency of government action following regulator advice/opinion 'would significantly improve current models for competition policy and for mandated advocacy' (Healey, 2019, p. 68[55]). In Norway, for example, the Norwegian Competition Act empowers the Norwegian Competition Authority to identify distortive effects of public measures, suggest alternatives and require a response from the responsible public body.[77]

Despite the non-binding nature of their interventions, various competition authorities have recorded a positive impact of their advocacy efforts. In Mexico, for example, the Commission has estimated that 'approximately 70% of its regulatory opinions have had a positive impact on regulation, notably in key sectors such as financial institutions and services, airport services, milk powder standards, and transportation network companies' (OECD, 2020, pp. 152-253[56]). Lithuania has noted that 77 % of their comments were 'taken into account by legislators' (OECD, 2021, p. 9[38]).[78]Success rates appear to increase when authorities are explicitly asked by another public body to provide their opinions. In Italy, the AGCM may give opinions on draft legislation at its own discretion or following the request of relevant government authorities or in some cases, at the request of the prime minister.[79] The AGCM monitored its success rate in advocacy interventions over a two-year period, covering 2018 and 2019. It found that the result of its advocacy was positive in 70% of cases on opinions on draft laws and regulations (OECD, 2021, p. 16[57]). The AGCM noted that its success rate increases when it was given pursuant to a request from a state body (81% overall, with an 85% success rate when requested by the central government and 77% when requested by the local government) (L'Autorità Garante della Concorrenza e del Mercato, 2020, p. 11[58]).

### *Support in the design of public procurement legislation and processes*

Competition authorities may provide support to public bodies in the context of procurement as well. Notably, they may assist legislators and public purchasers to reduce barriers to entry and limit discriminatory measures ensuring that new entrants, SMEs and foreign bidders can participate in tenders.

Although consultation with competition authorities is often not mandated, authorities may be able to offer their assistance ex officio or if the legislature or a public body requests it. For instance, in Brazil, CADE can provide comments from a competition perspective on proposed legislation if it deems it appropriate or if requested by a public body. It can also provide comments in the context of public-procurement procedures. It has done so in the past – for instance, in May 2020, CADE expressed its concerns about an executive order authorising the National Social Security Institute to contract state-owned companies in the information technology market without a bidding process (OECD, 2021[59]). In Spain, the competition authority can analyse whether public procurement legislation and processes distort competition and issue reports with its conclusions – it has done so on several occasions.[80]

In some countries, the bodies that receive recommendations from the competition authority must provide a reply. This is the case of Peru, where the competition authority can issue measures aimed at promoting competition, including lifting barriers to competition. In 2018, Indecopi provided a recommendation to the Ministry of Economy and Finance and Peru's Government Procurement Supervisory Agency concerning the modification of the Public Procurement Law and the Public Procurement Regulation, which resulted in amendments in both pieces of legislation. Indecopi has also issued some recommendations concerning the design of specific procurement processes (OECD, 2021[60]).

Competition authorities may also promote competitive neutrality in tender processes by helping build the capacity of public-procurement officials. Many competition authorities already train procurement officials on competition law and policy, and have guidelines on how to design tenders. Competition authorities should make sure that these trainings and guidelines cover competitive neutrality. Increasing procurement officials' familiarity with competition can have additional benefits beyond promoting competitive neutrality, like preventing and detecting bid rigging more effectively.

Co-operation between competition authorities and public purchasers may be formalised in memoranda of understanding. The OECD's experience with in-country projects shows that formal co-operation agreements between competition and procurement authorities are useful in clarifying what can be required and expected from each body. Such agreements set the terms of inter-institutional co-operation and mutual support, and the conditions and channels of communication, including for exchanging information, sharing of evidence and providing investigation support (OECD, 2020[61]).

### *Key takeaways*

The OECD Recommendation encourages Adherents to maintain competitive neutrality in the regulatory environment by carrying out competition assessments. Competition assessments may take the form of mandatory regulatory impact assessments, ad hoc assessment of laws/regulations and market studies or sector inquiries.

Involvement of the competition authority varies among jurisdictions yet competition authorities are well placed to conduct competition assessments, given their technical capacities. Competition authorities may conduct them pursuant to specific powers or obligations or as a part of their general advocacy functions (direct or indirect models). Alternatively, competition assessments may be carried out by other government departments or bodies, often in consultation with or following guidance issued by the competition authority.

While competition assessments may be resource intensive and are often not binding, authorities have found that they are an effective advocacy tool. Success rates appear to increase when jurisdictions are explicitly asked by another public body to provide their opinions.

In the context of procurement, competition authorities may assist legislators and public purchasers to reduce barriers to entry and limit discriminatory measures by: offering their advice in legislative processes and tenders; building the capacity of public-procurement officials; and releasing guidelines on how to design public procurement processes.

## Control of public support measures

As highlighted in section 0, most competition law regimes around the world do not include provisions to address public support measures and so most competition authorities have a limited role in enforcement. Few jurisdictions outside the EU have subsidy control regimes. The EU has adopted a state aid regime that involves both an ex ante screening procedure and an ex-post assessment mechanism and targets subsidies that distort the internal market. Any state aid should be proportionate and appropriate and the Commission undertakes a 'balancing test' (See Box 3.6). The regime is implemented by the European Commission and the EFTA Surveillance Authority.

## Box 3.6. State Aid in the EU

According to Article 107(1) of the TFEU state aid is defined as an advantage in any form conferred on a selective basis to undertakings by national public authorities. Undertakings which are engaged in an economic activity are not authorised to receive state aid unless the aid is authorised by the European Commission, as provided for in Article 108 TFEU.

### Ex ante and ex post mechanisms

*Ex ante mechanism* - In line with Article 108 TFEU, Member States are required to inform the European Commission in advance of any plan to grant state aid. Implementing new state aid without notification leads to such state aid being considered 'unlawful' and the European Commission may request the Member State to suspend such aid, or to take all measures necessary to recover such aid from the beneficiary.

*Ex post mechanism* - The European Commission also has the power to review existing state aid, that is aid granted to an undertaking by a Member State prior to such Member State's accession to the European Union. The European Commission may at any stage find that, due to changing market conditions, such state aid is no longer compatible with the common market and has to be terminated.

### Economic assessment in EU State Aid Control: balancing test

The Commission undertakes a balancing test to determine whether the distortive effects of the aid outweigh the positive effects. This considers a set of economic principles and asks three key questions:

1. What is the objective of the aid? (the relevant market failure). Is it a well-defined objective of common interest?

2. Does the aid address the relevant market failure or another objective? Is it appropriate (incentive effect) and proportionate?

3. Does the positive impact of the aid outweigh the distortions to competition and trade?

This balancing test helps to prevent inefficient use of taxpayers' money and maximise benefits for society (European Commission, 2021, p. 7[62]).

The Commission will assess compliance with the treaty and horizontal and sectoral state aid guidelines. Horizontal guidelines cover topics such as regional state aid, research and development and innovation, rescue and restructuring aid, environmental protection and energy, training and employment of disadvantaged and disabled workers. Sectoral rules cover certain sectors or industries such as fisheries and aquaculture, shipbuilding, rail and road, maritime, air transport, broadband networks, films and other audio-visual works and agriculture, forestry and rural areas.

### General Block Exemption

The Commission has a General Block Exemption Regulation (GBER) for state aid. This sets out certain categories of state aid (and relevant conditions and maximum amounts) that do not need to be approved by the Commission. In 2019, 95.5% of new state aid measures fell under the GBER. There is also a separate block exemption for aid for agriculture, forestry and rural areas.

A *de minimis* regulation, exempts small aid amounts (up to €200 000 per undertaking over a three year period).

Source: (OECD, 2015, p. 10[1]); (European Commission, 2021[62]); https://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf.

Similar regimes exist in regional trade blocs such as the WAEMU (see Box 3.7) but the EU regime remains the most extensive.

### Box 3.7. State Aid in the West African Economic and Monetary Union (WAMEU)

In 2002, the WAEMU adopted community rules, including a regulation on state aid (No. 4/2002/CM/UEMOA) and a directive (No. 1/2002/CM/UEMOA) on transparency in financial dealings between member States and either SOEs or international or foreign organisations (UNCTAD, 2020, p. 17[63]). The WAEMU also has directives on public procurement and public services (Molestina, 2019, p. 51[64]) According to (Molestina, 2019, p. 51[64]), 'most of the regional cases brought to the Commission concern state aids or other state imputed behaviour. 'This has been attributed to the lack of a culture of supranationality (UNCTAD, 2020, p. 16[63]).

The WAEMU provides for both ex ante and ex post state aid control, which is exercised by the Commission. Article 5 of the State Aid regulation prohibits 'any aid granted by a State or through State resources in any form whatsoever which distorts or may distort competition by favouring certain undertakings or the production of certain goods'. The regulation sets out a list of aid that is 'compatible with the common market' (Article 3) as well as the types of aid, which are prohibited (Article 4) (UNCTAD, 2020, pp. 13-15[63]).

Note: The West African Economic and Monetary Union (WAEMU) is comprised of eight member states – Benin, Burkina Faso, Côte d'Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo and was established by the Treaty Establishing the West African Economic and Monetary Union, signed in Dakar on 10 January 1994.
Source: (UNCTAD, 2020[63]), (Molestina, 2019[64]).

The EU has pursued a subsidy policy with candidate and neighbouring countries and various competition authorities in these jurisdictions have similar powers to the European Commission in relation to state aid.[81]

### *Public service obligations*

Public support rules are also relevant in the context of compensation for PSOs. The OECD has previously explained that 'most jurisdictions have developed clear and transparent parameters/rules for public service compensation to ensure the compensation is fair and to guarantee sufficient accountability of the calculation of the PSO compensation. Compensation standards or benchmarks and generally stipulated by law (for example, in the EU, New Zealand, Poland and Turkey) but they can also be set out in case law' (for example, EU, Bulgaria and Romania) (OECD, 2015, p. 8[1]). In some jurisdictions, competition authorities may be able to take action against excessive compensation for public services.

In the EU, overcompensation for public service obligations can amount to state aid. As mentioned, the European Commission has the power to prevent distortive state aid through its gatekeeper role or to challenge state aid that was not notified to the Commission. The Altmark decision,[82] set out four cumulative criteria under which compensation for SGEI, the EU equivalent of public services, does not amount to (unlawful) state aid see Box 3.8. The European Commission has expanded on these criteria in its 'Communication on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest'. Where all the *Altmark* criteria are not met, the Commission will analyse the compensation under the state aid rules.

### Box 3.8. EU: The Altmark case - when compensation for public services can amount to state aid

The Altmark ruling draws the line between warranted and distortive compensation schemes.

The European Court of Justice established four cumulative criteria under which SGEI compensation does not amount to (unlawful) state aid:

(i) the recipient undertaking must have public service obligations to discharge, and the obligations must be clearly defined;

(ii) the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner;

(iii) the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations and

(iv) where the undertaking which is to discharge public service obligations is not chosen pursuant to a public procurement procedure, the level of compensation needed must be determined on the basis of an analysis of the costs of a typical well-run company.

Source: Reproduced from (OECD, 2015, p. 9[1]). See Case C-280/00, Judgment of 24 July 2003, Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht, ECLI:EU:C:2003:415.

Outside specific state aid frameworks, some authorities may also have powers to take action against anti-competitive state interventions (usually those by local and provincial governments) and targeted behaviour can include distortive public support measures. These powers usually relate to issues of local protectionism (including of SOEs) (see also 0).In Russia, the FAS exercises some power over state aid through its Department on Control over State Authorities as state aid can be granted when provided for in government legal acts but in other cases, authorisation is required by the FAS.[83]

In addition, authorities may have or could develop a role to independently monitor and advise on public service compensation. This would help ensure that compensation is proportionate and appropriate. Competition authorities may be able to investigate whether public service operators are being correctly compensated. Poland, for example, has used surveys to determine whether compensation is adequate.[84] Similarly, the Bulgarian competition authority issued an opinion about a legislative provision allowing compensation for a passenger transport provider for its obligation to provide discounts to certain categories of customers.[85]

Through their regulatory roles, some competition authorities have specific powers and tools to address potential issues in compensation of PSOs. In Australia, the ACCC is able to conduct an assessment on whether the postal services provider, Australia Post cross-subsidies its competitive services with its revenue from its 'reserved services' that is, its services provided under a statutory monopoly.[86] Australia Post has obligations under the postal regulation to provide the necessary information to the ACCC[87] and, until 2016, the ACCC issued a yearly report assessing cross-subsidisation by Australia Post. This information collection and monitoring function is one of the three responsibilities of the ACCC in relation to the regulation of postal services.[88] In Spain,[89] the CNMC has supervisory powers over the postal sector market and may verify Correo's (the designated operator) accounts to ensure that costs and revenues have been correctly allocated. Correos is required to separate its PSO and other services through analytical accounting. Correos is required to submit 'a calculation of the net cost of the PSO for validation

each financial year'. In April 2020, CNMC required Correos to resubmit its accounts 'after it wrongly charged revenues and expenses of certain services as part of the USO'. (OECD, 2021, p. 56[22]).[90]

### *General advocacy role of competition authorities*

Public support measures can distort the market, changing how markets operate. The involvement of competition authorities is thus very important. Some competition authorities have specific advocacy roles in relation to subsidies, set out in legislation. In the Dominican Republic for example, 'the National Commission for the Defence of Competition can analyse 'the effects on the conditions of competition of subsidies, State aid or incentives granted to public or private undertakings, charged to public resources, and shall proceed, where appropriate, to request the public authorities, by means of a reasoned recommendation report, to abolish or modify such subsidies, as well as to adopt any other measures conducive to the restoration of competition'[91]' (UNCTAD, 2021, p. 11[65]).Under the Spanish competition law, the CNMC, can issue reports on state aid measures, make proposals to public bodies with the aim of protecting competition and issue annual reports on state aid granted in Spain.[92] Even without a specific role, competition authorities can use their general advocacy powers to advocate for pro-competitive public support measures. Depending on the institutional context, there may be scope for competition authorities to have a role in identifying distortions from state interventions (i.e. expected impact on market structure) and designing support measures that minimise competition concerns, through their advocacy powers (OECD, 2020, pp. 15,18[20]). Competition authorities can support governments by drafting guidelines for public bodies, issuing opinions and taking on a monitoring function. On a sectoral level, distortive public support measures could be identified by carrying out market studies and competitive neutrality reviews. Box 3.9 provides some examples of how competition authorities have used their advocacy role in relation to public support measures.

#### Box 3.9. Advocacy roles of competition authorities around the world in relation to public support measures

**Japan**

In 2016, the Japan Fair Trade Commission (JFTC) released guidelines on 'the Concept of Public Support for Revitalization in view of Competition Policy'. The guidelines set out three key principles that should be considered when providing public support (1) subsidiarity, (2) minimum necessity and (3) transparency.[93] The guidelines were a result of a 'Study Group on Competition Policy and Public Support for Revitalization', which assessed market distortions arising from public support for certain enterprises. UNCTAD has explained that the JFTC's guidelines are cross-industry and cross-sectoral 'that incorporate some factors of which supporting organizations should be aware in view of competition policy, when providing public support, in order to minimise the influences on competition of public support for revitalization' (UNCTAD, 2021, p. 11[65]).

**Latvia**

Latvia has used its advocacy role to prevent anti-competitive legislation, including those containing public support measures, by assessing the compatibility of draft legislation with the competition law and by issuing objections and proposals to parliament. In 2016, the Competition Council of Latvia advocated against amendments to tax legislation (VAT) that favoured public organisers of cultural events over private organisers.

**Spain**

The CNMC can issue 'State aid reports on public aid schemes, which include recommendations to the public authorities to preserve effective competition in the markets' (UNCTAD, 2021, p. 11[65]). The CNMC has done so in the past, for instance, in the context of measures aimed at the air and maritime transport. The CNMC also has legislative power to release annual reports on national state aid. The annual report typically includes statistical information about the aid granted (e.g. whether it increased over the past year, the type of aid), and summaries of new legislation, case law and the initiatives of the CNMC in the field of State aid. The CNMC also has a database with the aid measures granted in Spain.

Sources: Japan: https://www.jftc.go.jp/en/pressreleases/yearly-2016/March/160331.html; Spain: https://www.cnmc.es/ambitos-de-actuacion/promocion-de-la-competencia/ayudas-publicas; https://www.cnmc.es/ambitos-de-actuacion/promocion-de-la-competencia/otros-informes-ayudas-publicas Guidelines : https://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines_files/160331.pdf, Competition Council Republic of Latvia https://www.kp.gov.lv/en/article/cc-through-advocacy-timely-prevents-anti-competitive-amendments-vat-law (UNCTAD, 2021[65]).

Governments should also seek out the advice of competition authorities when designing state aid measures. In response to the COVID-19 crisis, many jurisdictions have enacted rescue and stimulus packages. The OECD has highlighted that in order to prevent long-term harm to markets, competition considerations should be respected in the design of public support measures (OECD, 2020, p. 17[20]). Their involvement in the current crisis is considered especially necessary given the extent of state intervention (and thus potential extent of long-term harm and distortions) in response to the COVID-19 crisis (Maximiano, 2021[66]).[94] In the context of COVID-19, the OECD has explained that the involvement of competition authorities may 'be particularly relevant in the case of bailouts, equity assistance programmes and exit strategies from governmental measures. Ensuring that the role of the state is competitive neutral and that firms are able to operate in a level playing field is paramount for a successful implementation of state support measures' (OECD, 2020, p. 16[20]). Competition authorities can help identify markets where state intervention would be most harmful.

(Maximiano, 2021[66]) suggests competition authorities prioritise actions in relation to public support measures on markets where they have gained past experience (for example, through market studies or previous enforcement actions) and the prioritisation of data-driven advocacy efforts. This gives the competition authority the much-needed credibility required for government (decision maker) buy-in and makes it more likely that they will be consulted during the design phase.

The OECD's paper on *The Role of Competition Policy in Promoting Economic Recovery* sets out possible advocacy considerations for competition authorities in the context of the COVID-19 crisis. Some of the key takeaways are summarised in Box 3.10. In crises, like the one of COVID-19, which may require urgent decision-making, the OECD argues that even if an in-depth analysis may not be possible, streamlined assessments can consider the relevant economic principles and thus minimise distortive outcomes.[95]

### Box 3.10 Some key takeaways for competition advocacy in the design of state support measures

The following are possible proposals that competition authorities may consider when discussing the design of state support measures with decision makers:

- Screen and prioritise those state interventions that might merit competition advocacy. Elements to consider might include the amount of aid, market concentration, market power of the potential beneficiary or the existence of significant barriers to entry.
- Identify the specific market failure in need of correction, and the extent to which the measure is likely to correct it.
- In relation to the Covid-19 pandemic, advocate for the collection of evidence showing that businesses receiving support were not in prior financial trouble.
- Discuss, identify and/or propose less competitively distortive alternatives that still allow the policymaker to achieve the same goal.
- Advocate for the inclusion of claw-back mechanisms to ensure ex-post that support is proportionate.
- When state support implies competition distortions, consider advocating for conditions, such as divesting some activities or committing to refrain from using the support measure to engage in exclusionary behaviour.
- Advocate for the inclusion of flexible exit strategies, in order not to perpetuate state support beyond the necessary.
- Propose transparency of support and the availability of ex-post assessment mechanisms to limit circumstances where such support has no economic justification.

Source: Adapted from (OECD, 2020[20])

### *Key takeaways*

Few competition law regimes have specific provisions that address public support measures. Most competition authorities thus have a limited role in enforcement. Some authorities may rely on more general powers allowing them to intervene against anti-competitive state interventions (usually those by local and provincial governments) to act against anti-competitive public-support measures. In addition, some competition authorities have specific advocacy roles in relation to subsidies, set out in legislation.

Public support rules are particularly relevant in the context of compensation for PSOs. Most jurisdictions have developed clear and transparent parameters/rules to ensure compensation for public services is fair and to guarantee sufficient accountability. In some jurisdictions, competition authorities may be able to take action against excessive compensation for public services.

Where competition authorities do not have a formal role in relation to public support measures, they can support governments by drafting guidelines for public bodies, issuing opinions, and taking on monitoring functions. On a sectoral level, distortive public support measures can be identified by carrying out market studies and competitive neutrality reviews.

# 4 Conclusion

The principle of competitive neutrality supports competition, optimising the use of resources, increasing productivity and driving economic growth. By promoting the entry and expansion of more productive firms and the exit of inefficient firms, consumers enjoy lower prices, more choice, better quality products and services and more innovation.

State intervention can disrupt market dynamics and soften competition in a number of ways. Competition authorities should thus be aware of the unintended consequences of state intervention on markets and how they can best promote the principle of competitive neutrality.

Building on the OECD Recommendation on Competitive Neutrality, this paper sets out some areas where competition authorities should be particularly attentive.

- **Competition law framework and enforcement**. To ensure competitive neutrality, competition law must apply and be enforced in a non-discriminatory manner to all enterprises, unless overriding public policy objectives require otherwise. Governments and competition authorities should be particularly attentive to exemptions, which may unjustifiably exclude certain companies from the application of competition law. Existing exemptions should be regularly re-assessed to see whether they are still justified and proportionate.
- **Regulatory framework**. Some market players (including public, private, domestic, and foreign enterprises) may be subject to different regulatory frameworks or, when the same framework applies, they be may exempted from specific provisions. This may result in some market players having preferential market access or enjoying special terms for operating in the market. To prevent competition distortions, all enterprises competing in a market should be subject to the same requirements under sectoral laws and regulations and horizontal frameworks, irrespective of their ownership, location or legal form.
- **Public procurement**. Legislation and tender terms may establish requirements or processes that favour specific types of companies, like SOEs or domestic businesses, hurting the value for money obtained by citizens. Jurisdictions should avoid unjustified discriminations; where measures are adopted to support certain companies (such as SMEs) on public-policy grounds, they should be carefully considered in terms of their effectiveness and their potential distortions to competition.
- **Public support measures**. These are understood as financial advantages provided by the state to enterprises, on conditions that are not in line with market principles. Competition concerns should be integrated into the design and grant of public support measures to preserve competitive neutrality. Like for all measures that restrict competition, transparency, proportionality and periodic review are key. Given the particular risks for SOEs, jurisdictions should consider subjecting them to more stringent specific rules which limit the provision of government support to such entities.
- **Grant of exclusive and special rights**. The rules dealing with these rights, specifically for the provision of public services, can create undue advantages and in turn distort competition. Jurisdictions should, first, select public service operators through an open, fair and transparent bidding process. Second, jurisdictions should adopt fair and transparent public service

compensation standards to ensure compensation is limited to what is appropriate and proportionate and to ensure accountability. Third, jurisdictions should ensure that any exclusive right is clearly defined and limited to the public service obligation or reconsider the need for exclusive rights.

- **State activism**. Notably by creating or favouring of national champions through political involvement in strategic deals. This can occur, for instance, when governments influence how takeovers of national companies by foreign ones are structured, when they unduly block deals through sectoral regulation or foreign screening mechanisms or when they become involved with merger control.

Competition authorities have, in essence, **three sets of tools to promote competition neutrality in these fields**. The **first set of tools** involves those **allowing competition authorities to act against legislative and administrative acts** that distort competitive neutrality. The extent of these powers greatly varies across jurisdictions. In some, competition authorities can directly remove anti-competitive acts and even fine public bodies (generally SOEs) and public officials. However, in other jurisdictions, competition authorities do not have the power to rule directly on whether a regulation or act is competitively neutral and they can only challenge acts before a court. Thanks to the binding effect of either the authority's or the court's decision, these tools can be particularly effective to promote competitive neutrality.

The **second set of tools** include those allowing competition authorities to **review legislation and contribute to reform initiatives by providing advice** to government on their potential competition implications. Competition authorities are well placed to conduct competition assessments, given their technical capacities – they can conduct them pursuant to specific powers or obligations or as a part of their general advocacy functions. Competition assessments are typically done in one of three ways: mandatory regulatory impact assessments, in which the assessment is conducted as part of the policy making process; ad hoc assessments of laws and regulations, in which an analysis is carried out on a case-by-case basis, usually in relation to both proposed and existing laws and regulations; and market studies or sector inquiries, which are large scale resource-intensive exercises in which competition authorities will only engage if there is some prima-facie case for concern. Although competition authorities' recommendations are often non-binding, various authorities have reported a positive impact of their advocacy efforts.

The **third set of tools** are those dealing with the **control of public support measures**. Although most competition law regimes around the world have a limited role in enforcement, some authorities can rely on more general powers allowing them to intervene against anti-competitive state interventions (usually those by local and provincial governments). The EU is one of the few exceptions having adopted a state aid regime that involves both an ex ante screening procedure and an ex-post assessment mechanism. For most competition authorities their primary role as regards public support is advocacy. Competition authorities can, for example, support governments by drafting guidelines for public bodies that set out competition considerations.

In general terms, given the limited enforcement powers of most competition authorities in the context of competitive neutrality, it is indispensable that authorities engage with governments and administrations to convince them of the benefits of competition and support them in designing a competitively neutral framework. This will promote access to better and cheaper products and services, and, ultimately, economic growth.

# Annex A. Tools identified for different types of competitive-neutrality violations

| Competitive-neutrality violation | Specific ways in which competitive neutrality can be affected | Examples of tools used by competition authorities |
|---|---|---|
| Non-neutral competition law | Scope of competition law<br>Enforcement of competition law | - General advocacy, especially so jurisdictions (i) carefully consider whether an exemption is necessary before establishing it and, where it has already been established, whether, it is still justified and proportionate; and (ii) ensure the independence of the competition authority |
| Non-neutral regulation | Sectoral laws and regulations<br>Licensing and other operational requirements<br>Horizontal legal and regulatory framework | - Enforcement (for secondary legislation), either through the direct removal of anti-competitive rules or challenging them before courts<br>- Competition assessments, in particular, impact assessments, discretionary assessments, and market studies/sector inquiries<br>- General advocacy |
| Non-neutral public procurement | Discrimination by ownership (SOEs)<br>Discrimination by nationality (domestic bidders)<br>Other discriminations (SMEs and new entrants) | - Enforcement, either through the direct removal of anti-competitive rules and acts or challenging them before courts<br>- Competition assessments, in particular, impact assessments, discretionary assessments, and market studies/sector inquiries<br>- General advocacy, including providing support in the design of legislation and procurement processes, building the capacity of procurement officials and signing memoranda of understanding with public purchasers |
| Distortive public support measures | State loans and guarantees<br>Preferential tax treatment<br>Preferential access to public land and facilities | - Enforcement, either through a specific state aid regime or general rules against anti-competitive practices<br>- Specific advocacy powers, for example, to make non-binding requests that subsidies be abolished or modified or to issue reports on granted state aid<br>- General advocacy, for instance, by drafting guidelines and issuing opinions<br>- Competition assessments to identify distortive measures |
| Distortive special and exclusive rights | Selection of the public service operator<br>Privileges and powers attached to the public service<br>Compensation for the public service | - Enforcement, by ensuring that the selection process is not anti-competitive and removing or challenging the grant of exclusive and special rights that result in competition infringements<br>- Enforcement to take action against excessive compensation for public services<br>- Competition assessments, in particular, impact assessments, discretionary assessments, and market studies/sector inquiries<br>- General advocacy |
| Other distortive state activity | State activism | - General advocacy. In the context of state activism, to support the competition authority's independence and to ensure that competition concerns are considered when the government intervenes through any mechanism. In the context of internal restrictions, to promote the elimination of such restrictions |

Source: Prepared by the OECD Secretariat based on the information included in this paper

# Endnotes

[1] See OECD, Recommendation of the Council on Competitive Neutrality [OECD/LEGAL/2021].

[2] The Recommendation results from significant analysis and discussions of the OECD Competition Committee since 2004. In the context of the Global Forum on Competition, particular aspects of competitive neutrality have been addressed on three occasions: in 2018, in the roundtable on 'Competition Law and State-Owned Enterprises'; in 2010, in the roundtable on 'Competition, State Aids and Subsidies'; and in 2009, in the roundtable on 'Competition Policy, Industrial Policy and National Champions'. Furthermore, the OECD Competition Committee and its Working Party no. 2 have discussed aspects of competitive neutrality on several occasions, including a 2015 roundtable on the subject, as well as a 2020 session on 'the Role of Competition Policy in Promoting Economic Recovery'.

[3] See https://www.oecd.org/daf/competition/competition-law-and-state-owned-enterprises.htm.

[4] Activities that belong to the core of sovereign government functions, such as judicial and police functions, are not economic. For instance, India's Competition Act excludes from the definition of enterprise and, hence, from the scope of competition law 'any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.' Political and economic choices evolve, so the qualification of a state prerogative may change over time in a given jurisdiction, and across jurisdictions.

[5] In this section, in line with previous OECD documents, 'exemption' refers to the fact that an entity or an activity may not be subject to competition law. The term can also be used in a different sense and refer to an exemption granted by a decision by the competition authority. For instance under Article 101(3) of the Treaty on the Functioning of the European Union, the Commission can 'exempt' notified agreements between companies from the prohibition of Article 101(1) prohibiting restricting agreements.

[6] With the idea that alliances may achieve important transport policy goals, and are worth authorising despite their anti-competitive effects. For more information, see: https://www.transportation.gov/policy/aviation-policy/competition-data-analysis/alliance-codeshares.

[7] Article 4(1) of Law 15/2007.

[8] In that case, the Commission found that 'barriers to entry (investment and technical capabilities, requirement for a track record) were very high, particularly so in the EEA' and, on that basis, 'concluded that sufficient entry was unlikely in the foreseeable future, and potential competition would thus be an insufficient competitive constraint on the merged entity' (European Commission, 2021, p. 12[76]). As result, it prohibited the transaction. Subsequently, calls emerged to relax merger control rules to promote the creation of European champions.

[9] See https://www.oecd.org/competition/globalforum/independence-of-competition-authorities.htm.

[10] OECD Competitive Neutrality Recommendation, OECD/LEGAL/0462, page 3.

[11] OECD Competitive Neutrality Recommendation (II) 1 (b).

[12] This is especially the case when administrative procedures lack transparency. The OECD has defined administrative burdens as: 'The costs involved in obtaining, reading and understanding regulations, developing compliance strategies and meeting mandated reporting requirements, including data collection, processing, reporting, storage, but NOT including the capital costs of measures taken to comply with the regulation, nor the costs to the public sector of administering the regulations' (OECD, 2015, p. 219[69])

[13] This could include, for example, asset requirements and specialised staffing or experience requirements.

[14] Both public authorities and private operators were eligible to provide port services (such as pilotage or towage services) yet only private operators were required to obtain a licence from the Ministry of Transportation.

[15] The OECD recommends equal treatment of incumbents and new entrants.

[16] In Tunisia, the OECD recommended to 'reduce the discretionary power of the competent authorities to approve a hypermarket or a shopping centre project by publishing application guidelines and an evaluation grid with clear and transparent evaluation criteria' (OECD, 2019, p. 78[11]). Clear and transparent evaluation criteria minimises differential treatment of applicants and thus promotes a level playing field.

[17] In the *OECD Competitive Neutrality Reviews: small package delivery services in ASEAN*, the OECD noted that in some ASEAN member states, SOEs are not exempted from insolvency rules but in practice they 'are effectively shielded from insolvency procedures due to soft budget constraints' (OECD, 2021, p. 70[22]). In another instance, the OECD found that 'legislation exempts SOEs from liability to execution, which means that their assets cannot be taken away, either by execution of a judgement, debt or insolvency' (OECD, 2021, p. 70[22]). It recommended that SOEs should be subject to bankruptcy and insolvency rules. It explained that 'In case of operational losses from commercial activities, governments should refrain from transferring additional funds to SOEs, unless done so according market terms. Any considerations with regard to public-service obligations and their funding should be dealt with separately' (OECD, 2021, p. 70[22]).

[18] See https://www.oecd.org/gov/public-procurement/.

[19] The OECD taxonomy of measures affecting trade in government procurement processes is available at: https://doi.org/10.1787/5bfb44c3-en. To further assist countries in assessing their procurement regimes, the OECD has mapped the taxonomy against international good practices (the WTO Government Procurement Agreement and the UNCITRAL Model Law on Public Procurement).

[20] The OECD Recommendation on Public Procurement encourages purchasers to provide an adequate and timely degree of transparency in each phase of the public procurement cycle and allow free access, through an online portal, for all stakeholders, including potential domestic and foreign suppliers, civil society and the general public, to public procurement information.

[21] The OECD Recommendation on Public Procurement encourages Adherents to have in place clear and integrated tender documentation that is standardised (where possible) and proportionate.

[22] The OECD Recommendation on Fighting Bid Rigging in Public Procurement stipulates that procurement authorities should 'whenever possible, allow bids on certain lots or objects within the contract, or on combinations thereof, rather than bids on the whole contract only. For example, in larger contracts look for areas in the tender that would be attractive and appropriate for small and medium sized enterprises' (OECD, 2012[72]).

[23] See 2 of the OECD Recommendation.

[24] See 2(a) of the OECD Recommendation. In 2019 in the EU, the most common aid instrument was direct grants (62.8%) followed by 'tax exemptions, reductions, deferrals' (30.7%) (European Commission, 2021, p. 25[62])**.** In the EU, 80% of the 2019 state aid spending,[24] was allocated to 'environmental protection and energy savings' (51%), 'research and development including innovation' (10%), regional development (8.5%) and sectoral development (8.1%) (European Commission, 2021, pp. 17-18[62]).

[25] 2(a) of the OECD Recommendation.

[26] Given the ability of public support measures to distort the international playing field, trade law and specifically WTO agreements address certain public support measures granted by member governments. The WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), for example, covers the use of certain subsidies by Members, possible challenges through the WTO dispute settlement mechanism and the countervailing measures Members can take when the foreign subsidy distorts their domestic market. Under the SCM Agreement, a 'subsidy' exists where there is a financial contribution by a government or public body that confers a benefit (Article 1 SCM Agreement). To be a prohibited or actionable subsidy under the agreement, it must also be 'specific' (Article 2 SCM Agreement). This means that it is only available to a certain enterprise, industry or group of enterprises or industries within the jurisdiction of the granting authority.

Outside the WTO rules, free trade agreements (FTAs) may contain specific rules in relation to subsidies or state aid.[26] In 2019, François-Charles Laprévote undertook a 'mapping exercise of the competition-related provisions of 267 free trade agreements (FTAs) included in the World Trade Organization's (WTO) Regional Trade Agreements (RTA) database' (Laprévote, 2019, p. 3[74]) for the OECD Global Forum on Competition's session on *Competition provisions in trade agreements*. He found that over 90% of the FTAs in force had specific competition provisions or chapters on competition policy (Laprévote, 2019, p. 5[74]). Laprévote found that approximately 43% of the FTAs reviewed included provisions that related to the regulation of subsidies or state aid. He explained that the provisions varied in relation to '(i) their scope; and (ii) the type of obligation they impose upon the parties' (Laprévote, 2019, p. 17[74]). (Mattoo, Rocha and Ruta, 2020, p. 534[75]) explain that state aid provisions in FTAs 'typically aim at limiting any negative effects of state aid on the economic conditions of the other party'.

They explain that other state aid related commitments relate to transparency, the 'requirement that state aid not affect trade between parties' or that it 'threaten to distort competition'.

In addition, certain jurisdictions are considering additional measures to address competitive neutrality issues stemming from foreign subsidies. On 5 May 2021, the EU adopted a proposal for a regulation on foreign subsidies distorting the internal market. The proposed regulation followed an EU white paper on levelling the playing field as regards foreign subsidies, adopted on 17 June 2020. The proposed regulation seeks to address the perceived regulatory gap in the control of foreign subsidies and aims to ensure a level playing field by addressing such market distortions. Under the proposal, the European Commission will apply a regulation, which sets out two ex-ante notification regimes and a general screening tool. These tools address 1. Concentrations, 2. Public procurement and 3. Other market situations, where there is a selective financial contribution by a non-EU government conferring a benefit on an undertaking that is carrying out an economic activity in the internal market (a foreign subsidy). See, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market https://ec.europa.eu/competition-policy/system/files/2021-06/foreign_subsidies_proposal_for_regulation.pdf European Commission, Foreign subsidies, https://ec.europa.eu/competition-policy/international/foreign-subsidies_en.

[27] The 'internal market' of the EU is 'a single market in which the free movement of goods, services, capital and persons is assured, and in which citizens are free to live, work, study and do business'. See, https://eur-lex.europa.eu/summary/chapter/internal_market.html?root_default=SUM_1_CODED%3D24.

The Commission recently undertook an evaluation of the state aid rules and 'concluded that overall, the rules were fit for purpose but would be amended in some areas, to reflect the objectives of the European Green Deal – the EU's climate action plan, and its industrial and digital strategies' (House of Commons Library, 2021[67]).

[28] https://ec.europa.eu/competition/state_aid/overview/index_en.html.

[29] See also, OECD (2021), "Measuring distortions in international markets: Below-market finance", *OECD Trade Policy Papers*, No. 247, OECD Publishing, Paris, https://doi.org/10.1787/a1a5aa8a-en. The Trade and Agriculture Directorate (TAD) at the OECD has identified and measured government support in industrial sectors. This work provides new evidence on the scope and scale of measures such as below-market lending to SOEs and private firms alike.

[30] Further examples can be found in (OECD, 2021, p. 73[22]), i.e. Australia's debt neutrality charge.

[31] If a country provides a state guarantees on SOEs' commercial loans, it may creates the perception that SOEs are low-risk borrowers and gives them access to favourable loan conditions (OECD, 2021, p. 73[22]). It is important to recognise that in some markets, SOEs may under commercial terms have access to easier terms given their lower default risk when, for example, private companies are significantly smaller.

[32] In order to preserve competitive neutrality, enterprises' relations with financial institutions should be based on commercial terms. State loans and guarantees 'should be provided at arm's length; subject to appropriate due diligence, and reflective of market interest rates without the influence of an implicit or explicit state guarantee' (OECD, 2021, p. 75[22]). The OECD has

suggested that guarantee fees could be imposed on an advantaged enterprise, to ensure that any benefit gained from artificially lower funding costs, compared to what enterprises would face in comparable circumstances is neutralised. Governments should also ensure 'clear reporting and transparency requirements for debt obligations and financial assistance to SOEs, including for state loans and guarantees' (OECD, 2021, p. 74[22]). This can ensure that any lower cost of capital can be accounted for in other corrective mechanisms.

[33] https://pdp.neda.gov.ph/wp-content/uploads/2017/01/PDP-2017-2022-07-20-2017.pdf page 247

[34] The OECD considered that some of these exemptions appeared to be justified because of the specific obligations of the SOE. For example, in relation to capital gains tax due to the requirement on the SOE 'to remit at least 50% of their annual net earnings as cash, stock or property dividends to the National Government' (OECD, 2020, p. 51[8]). Although the OECD recommended a review of the exemptions, it acknowledged that case-by case exemptions may also be justified for SOEs with a public service obligation that is not directly funded (OECD, 2020, p. 51[8]). Where tax exemptions relate to compensation for PSOs, the same general principles (i.e. that they are limited and proportionate to the PSO) should apply, along with the requirement for separate accounting.

[35] See also (OECD, 2020, p. 181[23])

[36] In the *Competitive Neutrality Review*, the OECD recommended that governments revise the rental agreements with SOEs for public land and facilities to reflect market conditions, with possible exceptions for public service providers (where the resources are strictly related to the PSO). It recommended governments assign land and facilities through a competitive tendering process that avoids favouring SOEs and that governments increase transparency through disclosure of existing agreements. (OECD, 2021, p. 76[22]).

[37] In a questionnaire of (Fox and Healey, 2014, p. 780[4]) 26 authorities answered that their competition statute covers 'entities to which a state has granted special or exclusive rights or privileges' (9 respondents said no).

[38] See, for example, Article 4(3) of Directive 2014/25.

[39] The EU does not use the term 'public services' but refers to 'Services of General Interest' (SGI), which are 'services that public authorities of the EU member countries classify as being of general interest and, therefore, subject to specific public service obligations. They can be provided either by the state or by the private sector' (European Commission, n.d.[71]). There are three categories: Services of general economic interest (SGEI), Non-economic services and Social services of general interest (SSGI) (which can be classified as economic or non-economic). See, https://ec.europa.eu/info/topics/single-market/services-general-interest_en

[40] SGEIs include services such as postal services and are economic in nature. They are 'basic services that are carried out in return for payment'. They are subject to competition rules unless a specific derogation (such as 106(2) TFEU) applies. See, https://ec.europa.eu/info/topics/single-market/services-general-interest_en

[41] Public service obligations for SOEs are often set out in the legislation establishing the SOE or in sectoral legislation (OECD, 2021, p. 47[22]). The OECD recommendation does not consider whether certain activities are best performed by private enterprises or SOEs but highlight that when SOEs provide public services, good governance principles and structural separation are key.

[42] See, (OECD, 2021, p. 53[22])

[43] Some countries (Australia, New Zealand and Israel) reported that they do not usually compensate public service operators. They are funded by user charges and costs are incorporated into the cost structure of the company (OECD, 2012, p. 51[27]).

[44] (OECD, 2021, p. 53[22]).

[45] See, DAF/COMP (2015) 8/Final, page 8.

[46] In relation to the undertaking that has been granted the special or exclusive rights. In the EU, member states cannot adopt actions concerning 'public undertakings' or enterprises with special or exclusive rights (including private enterprises) that would force, lead or induce the enterprise to infringe competition law, most notably abuse of dominance provisions.

[47] In some cases, several different abuses have been identified.

[48] This would be in contravention of Article 102(b) TFEU 'limiting production, markets or technical development to the prejudice of consumers'. EU case examples include Case C-41/90 *Hofner v Macroton* [1991] ECR I-1979 and Case T-556/08,*Slovenska Posta* EU:c:2015:189.

[49] See, for example, the cases of Case C-18/88, *GB-Inno-BM SA* [1991] ECR I-55973 and Case C-49/07 *MOTOE* [2008] ECR I-4863.

[50] See, for example, Judgement of the Court of Justice of 17 July 2014, case C-553/12 P. The EU Court of Justice held that an EU country infringes Article 106(1) TFEU if its action conferring special or exclusive rights results in a circumstance in which the 'benefited' company is led to abuse its dominant position only by exercising its granted right. As such, the Court concluded that it is not necessary to find that an abuse has occurred, but only that an encouragement to commit the abuse is available.

[51] See, for example, Case C-320/91 *Corbeau* [1993] ECR I-2533.

[52] In the EU, there is an exemption for 'services of General Economic Interest' under Article 106(2), which provides that 'undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject … to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them'. A similar provision is found in the West African Economic and Monetary Union (WAEMU) Treaty. See, Articles 88-89 of the WAEMU Treaty and Article 6 of Regulation No. 2/2002/CM/UEMOA (UNCTAD, 2020, p. 15[63]).

[53] Laprévote explains that 'a number of FTAs—especially though not exclusively EU-style agreements—contain public service exemptions' (Laprévote, 2019, p. 20[74]). These provisions 'allow the parties to exclude from the scope of the competition rules public enterprises and enterprises entrusted with special or exclusive rights or with the 'operation of services of general economic interest or having the character of a revenue-producing monopoly,' to the extent that the application of the competition rules would hamper the performance of that service' (Laprévote, 2019, p. 18[74]).

[54] When rates are regulated, they should reflect actual costs and account for any additional public funding (OECD, 2021, p. 55[22]).

[55] State activism is also described, to varying extents, as state entrepreneurship, state capitalism or state interventionism.

[56] Golden shares are a type of share that provides governments with special powers and veto rights in fully or partially privatised companies.

[57] For example through the creation of national champions, ex nihilo or through mergers.

[58] Some may actually qualify as subsidisation or be taken through regulation, others may be more sui generis.

[59] See https://www.oecd.org/daf/competition/public-interest-considerations-in-merger-control.htm.

[60] The work undertaken by the GFC, the OECD Competition Committee and its Working Party no. 2 on competitive neutrality is addressed in footnote 2.

[61] For instance, in Romania, in 2019 33% of the RCC's investigations 'targeted anti-competitive actions of the public administrations' (OECD, 2020, p. 5[68]).

[62] Article 106 TFEU deals specifically with member states actions in relation to 'public undertakings' or to enterprises, which are granted special or exclusive rights (including private enterprises). Member states should not enact measures that permit an infringement of treaty provisions, including under competition law. For example, the granting of exclusive rights that forces or leads an enterprise to abuse its dominant position. 106(2) lays down an exemption for companies entrusted with the operation of services of general economic interest. These companies are exempted from rules on competition if their application would obstruct, in law or in fact, the performance of the tasks assigned to them.

[63] Decision 1999/199/EC of 10 February 1999 relating to a proceeding pursuant to Article 90 of the Treaty (IV/35.703 - Portuguese airports).

[64] The CNMC can challenge regulations and ministerial orders, but not laws.

[65] Section 21bis of the law no.287 of 10 October 1990 (Competition and Fair Trading Act).

[66] See the AGCM opinion to the Calabria region in 2014 (n.AS1181) (Tonazzi and Pacillo, 2020[42]).

[67] OECD Recommendation on Competitive Neutrality, 1(c)(iii).

[68] In Mexico, COFECE 'has also adopted a Guide for the Assessment of Regulation from a Competition Perspective (Guía para la Evaluación de la Regulación desde la Óptica de Competencia) which includes the principles set out in the OECD Competition Assessment Toolkit'. See, https://www.cofece.mx/wp-content/uploads/2017/11/Herramientas_CompetenciaEconomica_vf250815.pdf#pdf

[69] The OECD *ASEAN Competitive Neutrality Reviews of the small package delivery services sector* (SPDS) identified and assessed legislation and policies affecting competitive neutrality in the SPDS sector and proposed recommendations where appropriate. It focused on the SOEs active in the sector and addressed their advantages and disadvantages.

[70] The range of legislation that can be reviewed may vary. In Mexico, for example, legislative review by CONAMER (the national council for regulatory improvement) is limited to national and federal regulations, whereas state and local regulations are more difficult to spot and not systematically subject to [regulatory impact assessments] RIA and cumulative impact assessments (CIA)' (OECD, 2020, p. 152[56]).

[71] In 2014, the OECD undertook an implementation review of its 2009 Competition Assessment Recommendation. The implementation report, *Experiences with Competition Assessment*, set out the various competition assessment tools of Adherents. The report showed that the recommendation and toolkit were 'very successful in promoting competition assessment processes' (OECD, 2019, p. 3[45]).

[72] Findings in the OECD *Report on the Implementation of the 2009 OECD Recommendation* (Experiences with Competition Assessment) found that little involvement of the competition authority may limit the effectiveness of the review. 'As the involvement of the competition authority increases, the perceived effectiveness of the process also increases' (OECD, 2014, pp. 37-38[47]).

[73] See, Annual Report on Competition Policy Developments in Korea, 2019, https://one.oecd.org/document/DAF/COMP/AR(2020)19/en/pdf page 7. Article 63 (1) of the MRFTA and the Guidelines for Review of Anti-competitive Regulations under Article 63 of the MRFTA.

[74] Fox and Healey explain that 'the policy confirms that where there is a conflict between competition and industrial policy in the rule making process, competition policy should generally prevail' (Fox and Healey, 2019, p. 202[48]) yet there are exceptions. For example, according to Article 3(4) 'to qualify for an exemption, policy makers need to show that these measures are indispensable for achieving the policy and that any restraint is not serious. The exempted restraints must be assessed annually' (Fox and Healey, 2019, p. 203[48])

[75] See translation of the FCRS provisions (from West-Law China), reproduced in (Lyu, Buts and Jegers, 2019[73]).

[76] Competition Council, Republic of Latvia, Competition protection in Latvia: year 2016 in numbers and facts, 3 February 2017, https://www.kp.gov.lv/en/article/competition-protection-latvia-year-2016-numbers-and-facts

[77] OECDM Working Part No.2 on Competition and Regulation, Independent sector regulators-Note by Norway, 2019, https://one.oecd.org/document/DAF/COMP/WP2/WD(2019)29/en/pdf, page 3.

[78] Lithuania, for example, 'examined 482 draft legal acts and submitted comments regarding 241 of legal acts adopted in 2020'.

[79] Where legislation has the direct effect of conferring exclusive rights in certain business areas. See, Law no.287 of 10 October 1990 (Competition and Fair Trading Act), section 22.

[80] The reports are available at: https://www.cnmc.es/ambitos-de-actuacion/promocion-de-la-competencia/contratacion-publica.

[81] Countries wishing to join the EU are required to set up state aid control mechanisms in order to comply with EU rules before accession. The Republic of Serbia, for example, has introduced a legal framework for state aid control and has set up a Commission for State Aid Control, whose powers regarding state aid mirrors those of the European

Commission. It has a Department for State Aid Control (an 'independent organizational unit within the Ministry of Finance') which is tasked with carrying out 'specialist, administrative and technical activities for the Commission' and is also in charge of aligning national legislation with the EU instruments.

State Aid regimes have also been implemented in EU neighbouring countries thanks to commercial and regional integration agreements. Ukraine, for example, has state aid obligations under the EU-Ukraine Association Agreement. The Antimonopoly Committee of Ukraine (AMCU) has powers in state aid monitoring and control under the Ukraine Law 'On State Aid to Economic Entities' (OECD, 2020, p. 19[70]). In 2019, for example, Ukraine reported that it made amendments to this law, amongst others, in order to bring it in line with EU acquis on state aid. The AMCU is in charge of 'taking decisions on computability or incompatibility of state aid for competition and on the termination and refund of illegally received state aid' (OECD, 2020, p. 19[70]).

The UK was subject to the EU state aid regime when it was part of the EU. It is now establishing an independent subsidy control framework. In June 2021, it released its Subsidy Control Bill, which proposes that the Competition and Market Authority (CMA) have subsidy control functions and provides for the establishment of a subsidy advice unit within the CMA. See, https://publications.parliament.uk/pa/bills/cbill/58-02/0135/210135.pdf

[82] See Case C-280/00, Judgment of 24 July 2003, Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH, and Oberbundesanwalt beim Bundesverwaltungsgericht, ECLI:EU:C:2003:415.

[83] Federal Law No. 135-FZ of July 26, 2006 'On Protection of Competition' (as amended in 2021) | Федеральная Антимонопольная Служба - ФАС России (fas.gov.ru)

[84] 'In line with the Act on Public Transport in Poland, the operator is entitled to compensation if it proves that the revenue resulting from the concessionary fares does not exceed the costs incurred in providing the public transport services. In 2010 the Polish competition authority conducted a survey among entities in charge of land transportation services at central, regional and local levels. The results indicated that the amount of compensation was adequate and that it covered only the cost for providing the services with a reasonable profit' (OECD, 2015, p. 9[1]).

[85] 'In its Decision 542/15.05.2013 the Bulgarian competition authority issued an opinion regarding the provisions of the Ordinance for the transportation of passengers and the conditions for travelling by trolley bus (electric bus that draws power from overhead wires) in the town of Vratsa. The ordinance obliges the trolley bus transportation companies to offer additional discounts on season tickets for certain categories of passengers. In return for this obligation, the companies received compensation from the municipal budget, calculated on the basis of the issued tickets. The authority argued that the granting privilege to a company to compensate it for a legally imposed obligation is not a deviation from the principle of competitive neutrality, provided that there is no overcompensation' (OECD, 2015, p. 9[1])

[86] ACCC (2014), Tests for assessing cross-subsidy, https://www.accc.gov.au/system/files/Tests%20for%20assessing%20cross-subsidy_0_0.pdf

[87] Postal Services Legislation Amendment Act 2004

[88] See, https://www.accc.gov.au/regulated-infrastructure/postal-services/accc-role-in-postal-services#information-collection-and-monitoring-for-cross-subsidy The ACCC also has a role in assessing price notifications and conducting inquiries into disputes about bulk mail services.

[89]https://www.cnmc.es/en/ambitos-de-actuacion/postal/contabilidad-analitica-spu and www.cnmc.es/en/node/379846.

[90] See, https://www.cnmc.es/en/node/379846

[91] Dominican Republic, General Law No. 42-08 on the Defence of Competition (16 January 2008), article 15, Official Gazette No. 10458 (January 2008).

[92] See, Spanish Competition Law, Article 11(1) and (2).

[93] See: https://www.jftc.go.jp/en/pressreleases/yearly-2016/March/160331_files/160331_3.pdf

http://awa2017.concurrences.com/IMG/pdf/japan.pdf

[94] See, also, The Role of Competition Policy in Promoting Economic Recovery, OECD 2020.

[95] (OECD, 2020[20]) provides the example of the EU Temporary framework, which adapts the state aid provisions to the COVID-19 crisis.

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