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From industrial policy to competition policy: A discussion based on two debates[☆]

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ABSTRACT

The effectiveness and fairness of industrial policies are highly controversial topics in the academia both at home and abroad, which involve the basic proposition concerning the relationship of government and market. The governance mode of a well-positioned limited government plays an indispensable role in guiding economic transition and structural change, as well as correcting for market failures. Selective industrial policies are necessary, but they should be used in a prudent manner. Instead, marketization reform that provides the underlying institutional environment is more fundamental and crucial for sustainable economic development. Both theory and practice show that only a limited government can lead to an efficient market and provide effective industrial policies. China still has a long way to go towards a modern economic system, which calls for the transition from the use of industrial policies to the use of competition policies. Especially under the current severe internal and external environment, it is particularly necessary to accurately grasp the basic and fundamental nature of competition policy and the short-term and complementary feature of industrial policy as a reform principle. Only through such marketization reform can the ideal state of a limited government be approached so as to finally establish a modern economic system.

1. Introduction

China has made great achievements in the past 40 years of its reform and opening up. With a low-level starting point in 1978, it has realized tremendous growth and become one of the world's largest powers. Such achievements cannot be overpraised. However, it still faces many deep-seated problems, which are attributable to delays in the structural, institutional, and growth driver transition, namely, the transition from factor-driven to efficiency-driven and innovation-driven growth. Its growth rate experienced a sustained decline in the past 10 years, the root cause of which mainly lies in the lagging in terms of market institutional reforms rather than external and cyclical factors (Tian, 2019).

The decisive factors of achievements and the causes of problems should be carefully analyzed, rather than generalized. We must address differential factors according to the basic methodology of controlled experiments, rather than putting all factors together. Otherwise, it is impossible to find out the new factors that have driven China's rapid growth and what we have done right in the reform in the past 40 years.

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Over the past 70 years, the Chinese government has always been playing a powerful role, in which factors such as strong executive force and state governance ability, social stability, and dominance of state-owned enterprises in the market had already existed before the reform and opening up. When summarizing the reasons or factors for the great achievements in the reform and opening up, we should look for new emerging factors; otherwise, new factors that did contribute to the great achievements might be neglected and retrogression might occur. The stagnation of deep-level market reform, increasing government intervention in the economy in recent years, and the bottleneck in the private economy are manifestations of such problem. Mistakes, misunderstandings and misleading conducts do exist in terms of not only ideology but also practice.

In view of the experience and lessons, I have proposed a research method with “three dimensions and six features” to analyze and solve problems. The three dimensions, namely, “theoretical logic, practical knowledge, and historical perspective”, are indispensable. Without theoretical logical analysis, one may only see the obvious but not the underlying commonality, making it difficult to obtain general conclusions with universal significance. If we simply emphasize the theoretical logic, we are prone to ignore the reality and divorce our discussion from the reality, thus falling into formalism, dogmatism and metaphysics. We must, therefore, test theories or reform measures through “practical knowledge”. Still, only theory and practice are not enough because we should also be alert to short-sightedness, keeping in mind that short-term optimality is not necessarily long-term optimality and the two are often very different. Thus, the vertical and horizontal comparative analysis from a “historical perspective” should be highlighted. Only through the three dimensions can it be possible to ensure that the reform measures embody the “six features” of being “scientific, rigorous, realistic, pertinent, forward-looking, and thought-provoking”.

The reason why I emphasize the research method of “three dimensions and six features” is that many of the policy suggestions and reform measures proposed in China are not scientific or rigorous, which has affected the benign development of a balanced economy and the establishment of a modern economic system. In particular, many industrial policies and related reforms have hindered the market from playing a decisive role, thereby worsening the misallocation of resources (Huang, 2019). Industrial policies do have positive effects and are necessary to any country, but their different functions should be clarified carefully and their use is stage-dependent, which should not be generalized. For China that aims to establish a modern economic system, as highlighted by Huang, Liu, and Tian (2020) based on data-driven policy simulations, greater importance should be attached to the competitive neutrality and ownership neutrality policies recently proposed. Ownership neutrality policy can be seen as a manifestation of competitive neutrality.

This paper focuses on addressing the following two issues. First, how shall we regard the role of industrial policy? Second, why does China need competition policy, especially competitive neutrality policy, more urgently? To do so, I start the discussion by reviewing the two big debates on industrial policy in China.

2. The two big debates on industrial policy

There have been two major debates on industrial policy in China since the beginning of the 21st century. The first is the debate on the latecomer advantages and disadvantages in 2002. The second is the debate on industrial policy during 2016 and 2017. Both debates have addressed the issue of the proper positioning of a government. I did not participate in the first debate but had a lot of communication with Professor Xiaokai Yang in private. The second debate attracted more attention than the first one, aroused extensive interest of the society and media and triggered much thinking and comments in the economics academia. I participated in the second debate and wrote several articles. I believe that these two debates have played a very positive role in deciding on what path to follow for China's industrial policy and economic reform by clarifying many concepts and eliminating a bunch of misunderstandings.

In the first debate, Lin (2003) claimed that if the government policy induces enterprises to make full use of the comparative advantages determined by the factor endowment structure to choose industries at every stage of development, then the latecomer advantage can be fully utilized, the factor endowment structure can be quickly improved, and the industrial structure will steadily approach that in developed countries ‘at a trot’. I believe that Lin's statement is not wrong in itself, because especially in the early stage of factor-driven growth of a late-developing economy, the country is not totally self-reliant but can quickly access and master foreign advanced technology and management experience by simple imitation. However, it is undesirable to over-emphasize the importance of industrial policy but ignore that of the basic institutional environment for long-term growth and development. The transition from factor-driven to innovation-driven growth cannot be done by simple imitation, in which case latecomer advantages may disappear while latecomer disadvantages are likely to emerge.

Xiaokai Yang recognized the importance of the basic institution for long-term development, but it is also undesirable to ignore the importance of the imitation of technology and management in an early development stage as well as that of appropriate industrial policies. I had expressed such opinion to him during his debate with Lin and also at some academic seminars. I think both of their opinions are partially true, but they did not indicate all of the truth. Yang (2000) believed that the characteristics of successful economic development in the UK are that there is no industrial policy, and that according to the industrial policy of the early Japanese government, it had no exogenous comparative advantage in terms of production technology. But its late-developing private sector resisted the industrial policy of the government, thereby achieving an endogenous comparative advantage. This is justifiable in a certain sense, but in my point of view, an extremely important industrial policy that contributed to Japan's economic take-off was its utmost attention to the education industry, which brought about the endogenous comparative advantage of rapid development.

Yang (2000)¹ believed that using government monopoly plus technology and management imitation as substitutes for institutional reform is a kind of state opportunism, which is referred to by some economists as “curse to the latecomer”. By imitating technologies and management modes of developed countries, late-developing countries without the basic institution could realize certain achievements that developed countries have achieved. Saying so, he also affirmed that a latecomer could have some comparative advantage. However, in so doing, it will leave many hidden problems unresolved and even lead to the state failure in the long run. He was more concerned about the long-term problem. The situation facing China today proves that Yang's academic views were very forward-looking.

Lin and Yang seem to have opposite opinions on industrial policy. If we read their papers, however, they did not completely deny each other's views, but each emphasized one aspect and ignored the other. However, I believe that the accomplishment of many objectives often requires comprehensive governance, which means imitation, learning, and innovative institutional improvement are all indispensable.

In 2016, in the second debate, Lin still insisted on his point of view, while Zhang (2016) argued from the perspective of information economics that industrial policy is like betting, which generally cannot be accurate. Even if government officials are all honest in performing their duties without getting any private interest involved, industrial policies enacted by the government are not more desirable than decentralized decisions of entrepreneurs. He interpreted industrial policy as the planned economy wearing a vest. He basically (though not totally) denied the industrial policy. I think clear directions are as important as temporary strategies. We should not go to extremes in our discussions and conducts.

The debate between Lin and me about active government and limited government is an extension of the controversy over the pros and cons of industrial policy. Lin deemed an active government as any government excluding inactive and misconducting ones. A question here is whether the active government takes actions *ex ante* or *ex post*. If we define the active government as one with *ex ante* actions, it will become common phenomenon for good intentions to lead to bad outcomes, just like what happened in the planned economy, which was what Zhang concerned the most because of information asymmetry that causes distortion of incentives. The reason why industrial policies are often formulated by local governments instead of the central government is that the formers are more likely to obtain symmetric information. On the other hand, if a government is active in an *ex post* way, it nearly means that the government will not do anything wrong, which is basically a false proposition. So in my opinion, the core of the debate is not about whether the government needs to be active, but to *what extent* the government needs to be active. For example, Japan's policy on education industry played a crucial role in its economic take-off.

The causes of the said debates may be related to the scholars' professional background, academic literacy and training, and research paradigm. Specifically speaking, Yang followed the new classical economics, the inframarginal analysis, and the constitutional economics, Lin follows the neoclassical economics and his new structural economics, while Zhang follows the Austrian economics. The three schools of economics have different understandings of industrial policy and even different definitions of concepts, which are all reasonable to a certain degree, but are also biased or extreme in some way. I personally adhere to the theory of mechanism design, which not only fully respects the self-interested nature of individuals and the decisive role of competitive market but also aims to correct for various market failures through mechanism design or industrial policy. Essentially, mechanism design theory discusses the issue of how to make the goal of the country incentive-compatible with that of individuals in the presence of private information.

3. How to understand the role of industrial policy

When addressing the issue, we need to first clarify the definition. Many debates turn out to be a matter of different understandings of terms. Industrial policy is a very broad concept, and there are great differences in the focus, measures and theoretical basis of industrial policy in different countries. I shall give a general definition of industrial policy below. According to this definition, we can see the advantages, disadvantages and necessity of industrial policy, and when it is effective.

Industrial policies refer to policies of a country or a region that guide the direction of industrial development, including industrial structure policies, industrial organization policies, industrial technology policies and industrial layout policies, as well as other policies and regulations that have a major impact on the industrial development. Industrial policies can accordingly be divided into two categories: one is universal policies designed to promote the function of the market, that is, universal functional policies; the other is preferential policies supporting emerging industries and basic industries (called selective industrial policies). As such, we can know where the government should be active and where it should refrain from interference.

The general principle is that the first or second category of industrial policies should be formulated in consideration of the specific market failure. The selective industrial policies led by the state or local governments, to some extent, can be beneficial when there are market failures due to, for example, the presence of market power, asymmetric information, and externalities (such as infrastructure), short-term unprofitable strategic, forward-looking, emerging industries or industrial structure transformation, which can be reflected in three aspects: they can cultivate comparative advantage through the increasing returns to scale; can produce great social benefits based on the industrial externalities and prospective performance; can play an important role in national security and economic stability when it is risky or unprofitable for firms if not compensated. However, the difficulty is that government agencies formulating industrial policies also face information constraints and may be subject to additional incentive problems. As such, for any nation, especially for an economy where both the market and the government operate imperfectly, such as China in the development impetus

¹ His co-authored article, Sachs, Woo, and Yang (2000), also gives a similar view.

and institutional transformation, universal (first type) industrial policies (such as China's early rural reform and factor-driven development strategy) and selective (second type) industrial policies (such as preferential policies for high-speed rail and semiconductor) are both necessary.

Based on the above principle, Yang and Zhang mainly opposed the second type of industrial policies, and what they emphasized was that such industrial policy choice often brings adverse distortions in resource allocation, such as inefficiency and corruption. However, the problem is that they basically denied any positive effects of selective industrial policies. In my point of view, part of the industrial policy advocated by Lin is correct, especially the part stressing the government's compensation for positive externalities and assistance to improve the soft and hard infrastructure. Industries with positive externalities, such as education and basic infrastructure, would affect many other industrial policies, where I think governmental involvements are certainly necessary. However, Lin's problem is that in many discussions, he only emphasized the benefits of the second type of industrial policy, but almost did not discuss incentive distortions that may easily arise due to information asymmetry and ignored the first type, giving the impression of over-emphasis on the government's role even in the current context, which may evolve into the dominance of government over the market.

Indeed, China's industrial policy has always been characterized by strong direct intervention in the market, and the most significant feature is the direct intervention in the micro market (Jiang and Li, 2010). Over the past 10 years, with the government's administrative intervention in the micro economic activities of enterprises, it has been strengthened under the so-called "macro-control". Another prominent feature is trying to replace market mechanism with the judgment and choice of the government, which is manifested by the selection and support of specific technologies, products and processes in various industries. For example, in the *Catalogue for Guidance of Industrial Structure Adjustment (2013)* issued by the National Development and Reform Commission, the encouraged category covers almost all major industries and lists 539 products, technologies and processes in detail. *The Guidelines for the Current Priority Areas of High Technology Industrialization (2011)* also covers a wide range, embracing almost all secondary industries, and the selective support for products and technologies is also very specific. The third feature of China's industrial policy is to protect and support large state-owned enterprises, and restrict the challenges and competition from small and medium-sized enterprises to the market position of large state-owned enterprises. Such policies are often implemented on the excuse of making full use of scale economy, building large-scale enterprise groups with international competitiveness, improving market concentration and avoiding excessive competition. China's industrial policy with these characteristics has led to a series of problems.

From the perspective of mechanism design theory, since the government can hardly change the human nature of individuals and has little incentive to obtain relevant information concerning the market and economic men, ex ante industrial policies and measures based on limited information are indeed poorly designed on average and at great variance with the factual situation. Many empirical analyses show this point. Chen (2011) conducted a comprehensive empirical analysis on the effects of China's industrial policies, including the effects of industrial policies on resource allocation, industrial structure optimization and upgrading, industrial organization policies on economies of scale, industrial production efficiency, industrial technology policies on industrial technological progress rate, industrial technological innovation ability and industrial policies on promoting international competitiveness of China's industries, and industrial policies on regional industrial structure. The overall conclusion is that China's industrial policy has not fully achieved the expected effect. Based on the data of cities, industries and years, Chen, Poncet, and Xiong (2017) found that the establishment of export processing zones has no significant effect on the growth of urban exports, unless the supported industries are in line with local comparative advantages. Dai and Cheng (2019) and Xi and Han (2019) also showed that government subsidies and low interest rate loans reduce the total factor productivity and markup rate of supported enterprises in general.

These studies have shown that, good intention usually leads to bad outcomes, so the second type of industrial policy should be used with caution. The practice at home and abroad also demonstrates that industrial development is often driven by the market and private enterprises, such as China's Alibaba, Tencent, and Huawei, and this is the case especially in the United States. Of course, the second type of industrial policy is of necessity, as in some industries that are strategic, fundamental and forward-looking, especially the education, military and infrastructure industries featuring large investments, low short-term returns, and long construction periods. For example, China's current education provision is neither market-oriented nor universal, which is insufficient for building an innovative country. In sum, government policies in these regards are absolutely necessary regardless of as industrial policies or other institutional arrangements.

Since the beginning of this century, China's industrial policy has mainly focused on two tasks: (1) promoting the adjustment of industrial structure and (2) curbing over-investment and overcapacity in some industries, although its effect is not satisfactory. For a long time, industrial structure adjustment has been a major task and many industrial policies are formulated for this purpose in China. For example, *The Catalogue of Encouraged Industries, Products and Technologies (2000 revision)*, *Interim Provisions on Promoting Industrial Structure Adjustment*, and *Plan for Restructuring and Invigorating Ten Key Industries* all place industrial structure adjustment at an extremely important position and have achieved remarkable progress. China announced in 2010 that it would develop leading high-speed rail (HSR) technology, and now it has 60% of the world's HSR market. China's industrial policies in scientific and technological innovation have promoted rapid development in the core scientific and technological fields such as AI and 5G technology. By June 2019, the number of Chinese AI enterprises has exceeded 1200, ranking the second in the world. Currently, due to the trade frictions and deteriorating relations between China and the United States, in some key areas, China has launched a series of preferential industrial policies in cutting-edge science and technology and strategic emerging industries. For example, in the semiconductor and chip field, China launched a \$29 billion state fund for semiconductor development at the end of 2019.

Then, under the circumstances that an industrial policy may be beneficial, how it should be optimally designed becomes extremely important to avoid negative effects. The degree of information asymmetry determines the adaptive boundary of the first type and the second type of industrial policy. From the perspective of mechanism design, the implementation of an industrial policy is

Table 1

Fiscal expenditure structure by function of China (2008) and some OECD countries (2006) (%).

Source: Research Group of the Institute of Finance and Trade Economics, Chinese Academy of Social Sciences (2010).

Expenditure types	China	United States	France	Germany	United Kingdom	Japan	Three nordic countries	Three countries in transition
Basic government functions	20.81	29.03	20.7	19.99	23.1	19.8	18.37	22.6
Economic construction (economic affairs, housing and community facilities)	38.67	11.94	9.38	11.36	8.76	11.56	9.32	14.72
Social welfare	40.51	58.78	70.08	68.84	67.92	69.03	72.36	62.73

Note: The three Nordic countries are Sweden, Denmark, and Norway. The three countries in transition are Hungary, the Czech Republic and Poland.

actually a principal-agent problem under asymmetric information, that is, how to design the optimal mechanism (or rules) to solve the problems of adverse selection (hidden information) and moral hazard (hidden action) under the constraints of participation and incentive compatibility. If the problem of optimal design is not well addressed, it would lead to incentive distortion and inefficient resource allocation, and further bring a huge negative impact.

For example, to cope with the 2008 world financial crisis, the industrial policy for strengthening infrastructure construction² and expanding manufacturing investment has undoubtedly played an important role in preventing the sharp economic downturn. However, it has also produced a lot of incentive distortions, such as the phenomenon of striving for projects and competing for resources, and resulted in serious consequences such as over-investment, overcapacity, real estate bubbles and local debt defaults. At the same time, the excessive use of selective industrial policy while neglecting functional industrial policy and the lag in market-oriented institutional reform give rise to the “three over-emphases versus three under-emphases”, namely, “over-emphasis on the government versus under-emphasis on the market, over-emphasis on development versus under-emphasis on public service, over-emphasis on enriching the state versus under-emphasis on enriching the people”. As shown in Table 1, among China's fiscal expenditure, economic construction takes up the largest proportion whether in horizontal or vertical comparison, nearly 30 percentage points higher than OECD countries in the table, while social security expenditure is almost 30 percentage points lower than that in these countries. Hence structural imbalances have not been fundamentally reversed.

This government-led development mode may lead to many deep-seated problems. For instance, it causes the international community's denials of China's status as a market economy. If the United States and Europe pursued a strategy of encirclement and containment, it would seriously affect China's domestic economic development and its expansion in the world market. At the critical moment of entering the innovation stage, China should adopt neither industrial policies that encourage investment nor those that inhibit investment to cut overcapacity. Instead, China should adopt *structural institutional reform*, that is, the government should streamline administration and delegate power to the lower levels, create a level playing field, let the market supply and demand decide which enterprises should exit or enter the market, and let enterprises choose their paths and directions of development.

Only a well-positioned limited government can play an indispensable role in guiding economic transition and structural changes, as well as correcting for market failures. Selective industrial policies are also necessary, but they should be kept moderate and be used with caution because market-oriented institutional reform instead of industrial policy plays the key role in economic development. In issues about the positioning of the government and its relationship with the market, my viewpoints differ a lot from those of Lin. His view of an active government and an efficient market as two fully independent dimensions is problematic, because the proper positioning of the government endogenously determines whether the market is efficient. Thus, the positioning of the government is a critical factor, which affects the effectiveness of the market and industrial policies and the social norms. Both theory and practice reveal that only an appropriately positioned limited government that is capable, accountable, effective, and caring can lead to an efficient market, and the key is to reasonably define the governance boundary between government and market and between government and society.

To make it clear, in my definition of a limited government, “capable” mainly refers to the state's capacity to govern and the government's ability to execute; “accountable” means that the government should act within its scope of duty (mainly to maintain law and order and provide public service); “effective” refers to the efficacy and efficiency of government administration. These three points clarify the relationship between government and market, while “caring” properly addresses the relationship between government and society. Basically, the government should not interfere but delegate powers where self-organization, self-governing, and self-service of society are possible. Currently, the society only plays a minor role. A truly “caring” government needs to solve problems of negative externalities or caused by opportunity inequality, such as wide income gap, to meet the people's growing desire

² According to the “Information on the 4-Trillion Investment” issued by the National Development and Reform Commission of China, the RMB 4 trillion is invested in various key areas including: (1) the construction of affordable housing such as low-rent housing and shantytown renovation, which cost about RMB 400 billion; (2) the construction of infrastructure and livelihood projects such as water, power, road, gas, housing, which cost about RMB 370 billion; (3) major infrastructure construction such as railways, highways, airports, water conservancy and urban power grid transformation, which cost about RMB 1.50 trillion; (4) health, education, culture and other social undertakings, which cost about RMB 150 billion; (5) energy conservation, emission reduction and ecological engineering construction, which cost about RMB 210 billion; (6) independent innovation, structural adjustment and technology transformation, which cost about RMB 370 billion; (7) post-disaster recovery and reconstruction, which cost about RMB 1 trillion. In addition, driven by the central economic stimulus plan, the cumulative investment of local governments actually exceeded RMB 20 trillion.

for a better life. The guarantee of reliable sources allocated to livelihood, old age care, medical service, housing, and education is what the people truly expect and the duty of a limited government that is capable, accountable, effective, and caring, which comes down to the design of the optimal incentive mechanism or institution. Only in this way can we better solve the problems of efficient allocation of resources, industrial structure adjustment, optimization and upgrading, and promote industrial technology innovation.

4. Why does China especially need competition policy?

When it comes to competition policy, there are many different views. In order to reduce ambiguity, it is necessary to give a definition first. In [Motta \(2003\)](#)'s book, *Competition Policy: Theory and Practice*, competition policy is defined as "the set of policies and laws which ensure that competition in the marketplace is not restricted in such a way as to reduce economic welfare." In short, it is the sum of policies to protect and promote market competition; that is to say, it aims at anti-monopoly and encourages competition. Its purpose is to ensure the smooth operation of the competition mechanism, so that the market can play a decisive role in allocation of resources, and special policies for non-competitive situations such as cartel, joint venture, merger, vertical contract, predatory pricing, exclusionary conduct and price discrimination can be formulated. As such, in the environment of market economy, the definition of competition policy is clear and more substantive, which can be regarded as a category of universal industrial policy. Competition policy also plays an important role in the design of economic institution, the formulation of economic policy and the promotion of economic development. Competition policy is the most important component of national economic policy system. In the critical stage of economic development, competition policy can facilitate transformation and boost economic development. The formulation of competition policy depends on the corresponding economic institution or policy, the stage of economic development and the coordination with other policies, especially with industrial policies. In order to make clear which of competition policy and industrial policy is more dominant, we must first know which policy should be given priority in the current stage of China's economic development.

During the 40 years' history of China's reform and opening up, China has indeed launched many industrial policies, some of which have been successful while others not. We must identify clearly what has contributed to the success of these policies. Basically, the success in some of the selective industrial policies is largely because of simultaneously implementing more inclusive economic institution and the first type of industrial policies, including completion policy so as to enhance the market competition function.³ It is precisely due to the marketization reform and competition policy that are directional and universal, and the increasing regional competition, that local selective industrial policies are successful. That is to say, the success of the second type of industrial policies depends on China's reform and opening up, deregulation and decentralization, and the inclusive economic institution and competition policy so that the market can play a more important fundamental role. In particular, under the fierce competition among local governments of China, sensible local governments would readily cooperate on the implementation of the first type of industrial policies for the success of the second type of industrial policies.

In this sense, the success of the Chinese economy does not reside in how many selective industrial policies were implemented, but should be owed to the increased number of competition policies under the market-oriented reform and the transition from an over-intervening omnipotent government to a maintenance-and-service-oriented limited government. In this process, the role of market in resource allocation has undergone great but progressive changes. Before the reform and opening up, China implemented a planned economy; when the reform just started, it featured the dominance of central planning with the market acting as a supplement, which was then transformed into the unification of planning and market. The Third Plenary Session of the 14th CPC Central Committee then proposed to build a socialist market economy and let the market play a fundamental role; the Third Plenary Session of the 18th CPC Central Committee proposed to let the market play a decisive role in resource allocation; this is a gradual reform and transition. As proved by the practice of the reform, the achievements are earned under a relatively fair, open, and progressively improving competitive environment that includes various forms of ownership. The continuous improvement of the environment has also led to the booming of private economy.

The development course of China's competition policy, according to [Li \(2018\)](#), can be roughly divided into two stages: 1978–2008 and 2008–2016, which have produced major law and regulation respectively to promote competition policy. One is the *Anti-Monopoly Law* issued in 2008 and the other is the *Opinions on Establishing A Fair Competition Review System in the Construction of Market System* (hereinafter as "Opinions"), released by the State Council on June 14, 2016, which stipulates the main contents of fair competition review system, including review objects, methods, standards, exception provisions and safeguard measures. Various principles have been clarified in the "Opinions" for those such as under what circumstances is the priority of competition policy or industrial policy, how to coordinate competition policy and industrial policy, whether to adopt a more strict merger policy, whether the firm should be allowed to engage in exclusionary practices, whether price discrimination will cause anti-monopoly concerns, and what constitutes "unfair" price competition, etc. For a detailed interpretation of the "Opinions", see [Li \(2018\)](#).

Facing the future, the key then lies in how to promote the competition policy to play a greater role in China's economic development, how to implement fair competition review system, make it coordinate various economic policies, and advance fair market competition. For this reason, China should stick to the path of reform and opening up in line with the goal of developing a modernized economy, as proposed at the 19th CPC National Congress. To this end, it should carry out institutional and structural reforms

³ For example, the industrial policy concerning the development of automobile industry seems successful in terms of the fact that China became the largest automaker in the world since 2009. Based on the National Bureau of Statistics of China (NBSC) firm-level data, [Zhang and Tian \(2020\)](#) showed that it is market competition that significantly improved the aggregate TFP growth rate in China's automobile industry.

based on the principle of competitive neutrality and ownership neutrality to create a level playing field for state-owned enterprises, private enterprises, and foreign enterprises, let the market truly play a decisive role in resource allocation, and realize the smooth transition from factor-driven to efficiency-driven and finally to innovation-driven development. Otherwise, it could not effectively cope with this round of economic growth slowdown. As pointed out by the Meeting of the Political Bureau of the CPC Central Committee on April 29, 2019, the main reason for this round of economic downturn is structural and institutional. This also relates to some of my debates with Lin about whether the reason for the economic downturn is mainly structural and institutional or cyclical and external. Of course, the analyses of both sides are well-founded and do not completely negate each other, but the main point in our debate is which is the determinant factor. Especially at present, the external strategic environment that China faces is undergoing profound changes, especially the growing uncertainty brought about by the changes in the China-U.S. relations and the spread of the pandemic in the world, and the deep-seated problems and contradictions inside China are also increasing. Where to go and what to do are still extremely important historical choices for China. We should accurately grasp the marketization reform orientation of foundational and fundamental competition policy and short-term and complementary industrial policy, take the full implementation of competition policy as an important driving force of economic structural reform and the establishment of a unified, open, competitive, and orderly market system as the goal, realize the fundamental position of competition policy, and strengthen the principle of competitive neutrality.

First of all, the fair market competition mechanism can help eliminate the distortion in resource allocation that involves state-owned enterprises, so that the market can truly play a decisive role and the government plays a proper but not excessive role in resource allocation. Of course, we should note that every country needs certain state-owned enterprises and selective industrial policies, especially in industries that provide public goods related to people's livelihood and the security and stability of the country. However, in other competitive industries, the principle of competitive neutrality shall hold. This is also, to a large extent, a key to determining whether China's market economy status can be recognized by other countries, especially the United States and European countries. China should not blindly expand, strengthen and optimize state-owned enterprises, but should pay more attention to improving business environment for all types of enterprises.

Second, expanded opening up can push forward the progress of the reform. For now, China is in need of further reform and greater opening up. After entering the deep-water zone, it is difficult to make every step forward relying on the domestic pressure only, so the driving force of opening up becomes more important. Zero tariffs, zero barriers, and zero subsidies together with strengthened intellectual property protection and a business environment featuring fair competition are becoming the goals and priorities of global economic trade. This reflects not only the requirement of the domestic market integration but also the trend of economic globalization and world market integration. Though it is difficult to realize the said "three zeros" in the short term, it should be the direction of efforts and could be approached gradually and orderly. To be realistic, the competitive edge relying on government subsidies and barriers built on tariffs can by no means sustain in the long term but will rebound on China instead of winning itself an advantage over other countries. Therefore, China should establish a competitive and open market environment with order, or weigh and consider the opening of the market based on its effects on the progress of the reform, which is beneficial to the sustainable development of China's economy.

Third, in the face of unilateralism and protectionism, China must pursue free trade and free competition policies around the world to enhance the consistency of domestic and foreign policies and create a friendly external environment. One cannot talk about free competition and national treatment on the one hand but establish barriers on the other. Currently, China is in urgent need of Free Trade Agreements (FTAs). It should accelerate the negotiation or escalation of major multilateral and bilateral FTAs, including those between China and Europe, between China and the United Kingdom, between China and Japan, between China and South Korea, and RCEP (Regional Comprehensive Economic Partnership), and should actively explore the feasibility of joining the CPTPP (Comprehensive and Progressive Agreement for Trans-Pacific Partnership) (Table 2).

Of course, China still has a long way to go before fully establishing a modernized economy in which market plays a decisive role in resource allocation. So, how can China achieve this goal? Besides necessary selective industrial policies, functional industrial policies and competitive neutrality policies are needed more urgently. This then calls for a limited government that advocates competition policies rather than an active government that advocates preferential industrial policies and interferes everywhere. In fact, the boundaries of an active government's behavior are infinite and unbounded, whereas those of a limited government that is capable, accountable, effective, and caring are clearer and bounded. To build a modern market economy, the relationship between government and market must be well defined.

Once again, government, market and society are not independent from one another. An efficient market economy and a well-organized society are based on the proper positioning of the government. Lincoln, one of the greatest presidents in the American

Table 2

China's free trade agreements.

Source: Ministry of Commerce of the People's Republic of China.

China-Mauritius	China-Maldives	China-Georgia	China-Australia
China-South Korea	China-Switzerland	China-Iceland	China-Costa Rica
China-Peru	China-Singapore	China-New Zealand	China-Chile
China-Pakistan	China-ASEAN	The Mainland and Hong Kong/Macau Closer Economic Partnership Arrangements	China-ASEAN ("10 + 1") upgrade
China-Chile upgrade	China-Singapore upgrade	China-Pakistan phase II	

history, made a succinct summary: “The legitimate object of government, is to do for a community of people, whatever they need to have done, but can not do, at all, or can not, so well do, for themselves—in their separate, and individual capacities. In all that the people can individually do as well for themselves, government ought not to interfere.”

The report of the 19th CPC National Congress provides an accurate description of how to build an inclusive market economy and modernize the national governance system and governance capacity. The report proposes to “concentrate on improving the property rights system and ensuring the market-based allocation of factors of production, so that property rights act as effective incentives. We should ensure free flows of factors, flexible prices, fair and orderly competition, and that business survival is determined by competition”. Meanwhile, “The government needs to transform its functions, further streamline administration and delegate powers, develop new ways of regulation and supervision, and strengthen its credibility and administrative capacity, building itself into a service-oriented government able to satisfy the needs of the people.” These two points basically correspond to the behavioral characteristics of a limited government that is capable, accountable, effective, and caring. In sum, the improvement of economic inclusiveness and sustainability, state coercion by the rule of law, government executive power and social harmony requires that the government per se should return to the basic functions of order maintenance and service provision.

5. Conclusion

The governance mode of a well-positioned limited government plays an indispensable role in guiding economic transition and structural change, as well as correcting for market failures. Selective industrial policies are necessary, but they should be adopted in an appropriate and prudent manner. Market-oriented reform that provides the basic institutional environment is more crucial for sustainable economic development. The modern economic system basically features a limited government that is capable, accountable, effective, and caring, plus an efficient competitive market. Of course, this is the ideal goal, the benchmark or the reference system, but one can only do better through learning from and comparing with the best. China is still far from the goal of establishing a modern economic system, which I believe poses the requirement of transiting from the use of industrial policy to the use of competition policy. Indeed, such a transition and reform is particularly necessary under the current severe internal and external environment.

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