Working Party of the Trade Committee

STATE-OWNED ENTERPRISES: TRADE EFFECTS AND POLICY IMPLICATIONS - ANNEX

Annex to OECD Trade Policy Paper No. 147

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ABSTRACT

With a growing integration via trade and investment, state-owned enterprises (SOEs) that have traditionally been oriented towards domestic markets increasingly compete with private firms in the global market place. Three principal questions emerge from the international trade perspective: (1) How important is state ownership in the global economy; (2) What types of advantages granted to SOEs by governments (or disadvantages afflicting them) are inconsistent with the key principles of the non-discriminatory trading system; and (3) What policies and practices support effective competition among all market participants? Using a sample of world’s largest firms and their foreign subsidiaries, this paper shows that the extent of state presence in various countries and economic sectors is significant. Moreover, many of the countries with the highest SOE shares and economic sectors with strong SOE presence are intensely traded. The potential for economic distortions is hence large, if some of these SOEs benefit from unfair advantages granted to them by governments—a allegation that is often raised in political and business circles. Existing information on such advantages is often either anecdotal or limited to individual cases. As a groundwork for future analysis and building on the existing information and literature, this paper presents a conceptual discussion of how potential SOE advantages can generate cross-border effects. It also describes several cases when actions of SOEs as well as advantages allegedly granted to them by governments have been contested as inconsistent with national or international regulations, albeit with varying degree of success. This may be partially explained by the fact that existing regulatory frameworks that discipline some forms of anti-competitive behaviour of SOEs have been designed with domestic objectives in mind or were conceived at times when the state sector was oriented primarily towards domestic markets. The survey of existing rules at the national, bilateral and multilateral levels presented in this paper is a first step in determining whether there is a need to fill any gaps and in finding the most constructive ways of doing so.

Keywords: international trade, international investment, state-owned enterprises, ownership, WTO, competition policy, competitive neutrality

JEL classification: F13, F14, F21, F23, G38

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A1. Annex 1: State sectors in the OECD area and the BRIICS—qualitative analysis

1. This part of the annex builds on existing OECD material, as well as data collected for the purposes of this project, and provides a broad overview of state ownership objectives, history, regulatory framework and policies across OECD and BRIICS economies, highlighting key commonalities and points of divergence. It aims to present general trends and to highlight differences among the individual countries and, as such, to provide insights into the role of SOEs in the domestic economies and, in particular, their international trade and investment activities.

A1.1 Objectives of SOE policies

2. The aims for state ownership have often been derived from some notion of market failure, be it the case of a natural monopoly, as in some segments of network industries such as electrical power or railways, or the case of public or merit goods and externalities, where the private sector may not supply an optimal level of a good due to inherent pricing challenges. Yet, if the state is able to regulate, distribute taxes and subsidies and contract private sector actors effectively, these market failures may not need to be addressed through direct state ownership (OECD, 2005a).

3. Other important reasons for state control pertain to the industrial, national security and fiscal policy objectives. Industrial policy considerations include supporting national champions in “strategic” sectors (e.g. French EDF in the power sector or Norwegian Statoil in the extractive industry), controlling the decline of senile industries (e.g. heavy industry in former transition economies) or preventing the collapse of services critical to the functioning of the economic or social system (e.g. large, distressed financial institutions during the recent crisis). Moreover, the state may be keen on retaining monopoly prices in some areas in order to boost its fiscal standing and use the revenues for subsidisation in other areas. Overall, there exists a variety in goals set for state ownership, examples of which are provided in Annex Box 1.

4. Given that regulatory frameworks are generally weaker, that financial markets can be less developed and that transaction costs to enforce contractual relationships can be higher in developing countries, there may be a stronger advocacy for state ownership of firms as vehicles to realise public goals in a development context. Indeed, many BRIICS economies have used state ownership in order to further their development goals.

5. For example, the Brazilian government states that all SOEs are obliged to leverage investments for the benefit of society and fulfil their “social function” (DEST, 2011). Yet, it remains undefined what this exactly implies for their governance. Also in China, India and Indonesia SOEs are to some extent considered an additional tool for the government in pursuit of its economic and development targets. However, the precise expectations for SOEs in achieving these broader policy aims remain somewhat unclear. Government policy towards SOEs in Russia, while not clearly defined, also seeks to fulfil general state functions, for example, in the areas of national security and social policy, as well as economic development and the re-structuring of the economy. The founding laws of state holdings and state corporations mention several objectives for industrial policy, including the modernisation of infrastructure, the diversification of the economy by attracting investments in high-technology sectors, innovation and the creation of large vertically-integrated structures in order to gain a competitive edge in international competition. Re-integration of research institutions and industrial enterprises is also frequently mentioned in public statements. In South Africa, SOEs are tasked with substantial responsibilities in realising the government’s “New Growth Path” framework, which includes improving transportation and power sector infrastructure and, more broadly, increasing employment. Thus not only statutory institutions, but also state-owned enterprises operating in a more or less competitive market, are often expected by BRIICS governments to carry some broader social and developmental role.
Annex Box 1. Examples of ownership objectives in selected OECD countries

- In **Finland**, “The State seeks to achieve an economic and societal overall result that is as good as possible” (2004 Decision in Principle on State’s Corporate Ownership Policy); “The economic overall result is the sum of the development in value of the shares owned and their annual dividend yield" (State Shareholdings in Finland, 2005, p. 4).

- In **Norway**, “The purpose of state ownership is to attend to the common good. As an owner, the State also expects these companies to take corporate responsibility and to uphold our basic values in an exemplary manner” (The State Ownership Report, 2005, p. 5).

- In **Sweden**, “The Government’s overall objective is creating value for the owners” (State Ownership Policy, 2006).

- In the **UK**, the overall objective of the Shareholder Executive is “to ensure that Government’s shareholdings deliver sustained, positive returns and return their cost of capital over time within the policy, regulatory and customer parameters set by Government, by acting as an effective and intelligent shareholder”.

**Source:** OECD (2007).

### A1.2 Historical and current trends in state ownership and privatisation

6. The Great Depression, financial crises and wars have intensified state interventionism in a number of OECD economies during the first half of the 20th century. Post-war reconstruction in Europe and Japan pushed a number of governments to intervene directly in the economy, either by nationalising or by founding state companies in the so-called “strategic” sectors, i.e. natural monopolies and large industrial corporations, mostly in the network services and banking segments (OECD, 2005a: 20).

7. In Turkey, Korea and Mexico direct state intervention was often based on development goals, while in former transition economies in Central Eastern Europe, such as, for example, Poland and the Czech Republic, significant numbers of SOEs persist as a legacy of the former system of central planning. In Norway state intervention was guided primarily by the desire to secure surplus wealth generated from petroleum and to shield the economy from currency appreciation, while in Finland a relatively large share of state-owned enterprises was located in manufacturing, mainly due to lack of private venture capital during the first decades of the country’s independence (Parker, 1998).

8. The perceived utility of state ownership has diminished drastically in many countries, in part as a consequence of the development of the capacity of many countries’ regulatory systems, as well as advances in technology and intensification of international trade and investment, which put a premium on flexibility and competitiveness. By the end of the 1980s, the fiscal burden of SOEs in the OECD economies reached significant levels, increasing pressure for reform.\(^1\) The UK was among the first countries to undertake large-scale privatisation starting in the 1980s. By mid-1990s virtually all OECD economies followed suit with large waves of privatisation, including the post-communist economies from Central and Eastern Europe that had just become OECD members. During that period OECD privatisation proceeds each year averaged around 0.3% of GDP (OECD, 2003). Since the end of the 1990s, the scope and size of public enterprises in OECD countries has slightly decreased, while the pace of privatisation has slowed from early stages of the reform period.

9. Today, a large variation in the degree of state presence persists in the OECD area, which ranges from negligible across-the-board in some countries to significant in some sectors in other countries.\(^2\) State interventions in the midst of the financial crisis had increased somewhat state equity holdings in a number

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1. An early wave of privatisation took place in the Federal Republic of Germany in 1950s and 1960s.

2. OECD’s *Product Market Regulation* database contains information on the “size of the public sector” and “scope of public enterprises” and points to high variation in these two indicators in the OECD area (latest year: 2008).
of OECD economies, mostly in the banking sector and, in some cases, in large manufacturing firms. Central government authorities in the United States owned no shares, whether listed or unlisted, prior to the 2008-09 crisis and, in the UK, public authorities also held very few shares (OECD, 2010a: 6). This has changed during the crisis, when both governments came into possession of equity shares (e.g. General Motors in the US and the Royal Bank of Scotland in the UK). This trend appears, however, to be short-lived and governments have already divested or have committed to divestment of accrued assets in the near future. The weakness of equity prices in the aftermath of the crisis has also stalled or slowed the corporatisation and privatisation processes of existing SOEs, holding back the stock-market introduction of unlisted SOEs as well as further divestment of listed SOEs in most countries. But high state ownership shares in the OECD must not reflect an unfinished privatisation process, but can also be a deliberate policy of the state. Currently the shares of equity holdings of some OECD governments exceed the equivalent of 20% of their countries' GDP, well above the OECD average of around 8% (OECD 2010a: 6).

10. Among the unlisted SOEs, public ownership declined over the same period, with strong reductions in a number of SOEs in Hungary, Czech Republic and Poland as well as reduced SOE portfolios in Denmark, Greece and Korea (Capobianco and Christiansen, 2011). This trend seems to reflect both further privatisation and a degree of consolidation, resulting from mergers of SOEs as a part of rationalisation process in some countries. Those few countries that increased their SOE ownership did so through corporatisation of an autonomous government body or a public service (e.g. Portugal, Sweden and Norway).

11. Whereas most SOEs in China and Russia stem from the period of a state-controlled planned economy, most of the other BRIICS established SOEs in order to aid industrialisation in light of a lack of private investment. In Brazil, SOEs became prevalent from World War II onwards. Initially established to secure investment, and further driven by national interest arguments, the country saw a second wave of SOE creation under military rule in the 1960s and 1970s (Pargendler, 2011). India, from 1948 onwards, operated a highly regulated and planned economy with heavy state involvement. Several SOEs were established and accounted for approximately 40% of India’s gross investment between 1986 and 1991 (Sáez and Joy, 2001). In Indonesia, lack of private entrepreneurship was a key motivation for the formation of SOEs following World War II. Furthermore, most former Dutch companies (both private and state-owned) were nationalised in the same period. In South Africa, several SOEs were formed to aid import substitution during the Apartheid era.

12. In all the BRIICS, there has been some reform with the aim of increasing the profitability and effectiveness of SOEs. In Brazil, since the mid-1980s efforts have been underway to bring under control the spending of loss-making SOEs and to improve their performance in general. Reform of the SOE sector in China failed to prevent more than two-thirds of industrial SOEs from running deficits in 1998. The poor corporate governance, red-tape and distortive policies have been addressed to some extent through further reform and streamlining over the last decade (Deng et al., 2011: 10) but breaking up state monopolies and oligopolies have been identified as key for further private sector development and state enterprise reforms (World Bank, 2012). In India, the government has classified SOEs with accumulated losses equal to, or greater than, their net worth as “sick SOEs”. A toolkit encompassing administrative frameworks and restructuring schemes has been employed to revive these, or they are being shut down. In Indonesia, SOE policy has been gradually directed towards a more market-based system since the late 1960s. Re-structuring of state enterprises, as well as industries, is a pronounced aim of the Russian government. In South Africa, a Presidential Review Committee on SOEs is currently working on recommendations regarding, among other things, further restructuring, introduction of accounting standards, and performance measurement.

3 Korea and Poland are the only two OECD countries where the number of listed SOEs increased between 2008 and 2009 (OECD, 2011a: 9).
13. While boosting short-term government revenue, privatisation of SOEs has also contributed to tackling the problem of loss-making SOEs. Across the BRICS, poorly performing SOEs have been among the first to be privatised. Prior to 1990, the Brazilian government primarily privatised firms under state control due to financial difficulties. Privatisation of SOEs was first centred on mining and manufacturing companies. The leading telecommunications firm, Telebras, was privatised in the late 1990s. In China, privatisation took place under the “grabbing the large and letting go the small” policy (zhua da fang xiao), commencing in 1994. By 1997 a majority of small SOEs had been privatised, while large SOEs were either converted into listed corporations or restructured. Indonesia has pursued privatisation with varying impetus since at least the 1980s. India’s reforms during the 1990s were focused on general market liberalisation and divestment from loss-making SOEs. In Russia, a wave of mass privatisation took place after the collapse of the Soviet regime in the first half of the nineties. In South Africa, a wave of privatisation took place in the first decade after the end of Apartheid, but in recent years reform has rather focused on improving SOE performance.

14. Whereas most of the BRICS have undergone more or less substantial privatisation and liberalisation of state controlled sectors, the momentum of these reforms has slowed, if not halted or in some instances even reversed, over the last decade. In Brazil, the 1999 devaluation crisis and the 2001 electricity shortage induced political concerns with respect to further privatisation. Subsequently, privatisation efforts came to an effective halt in the early 2000s. In China, privatisation undertaken in the 1990s ceased in the mid-2000s amid growing political emphasis on the state’s role in key sectors of the economy. In Indonesia, privatisation and commercialisation of SOEs have rendered most SOEs profitable, which together with constitutional guarantees for state involvement in some sectors and public demands for price administration of basic goods has reduced incentives for further privatisation. Russia saw a steady decline in state ownership during the 1990s, but with new regulation of strategic sectors and government take-overs privatisation has stalled, if not reversed between 2004 and 2008. New reforms and privatisation in Russia have been further hampered by the international financial crisis. In South Africa, the state is currently reviewing SOE policy with an activist perspective and strategic development objectives in mind.

15. Sectors in which SOEs remain prevalent in the BRICS are to some extent perceived as particularly important or strategic. In both Brazil and Indonesia, state control of strategic sectors and natural monopolies are constitutionally protected. In Brazil, the more recent constitution from 1988 has made private participation in protected sectors more difficult. Yet, different interpretations of the constitution have allowed privatisation (subject to some state regulatory control) of the telecommunications sector, and allowed private firms to operate on government concession, for instance in the distribution of electricity (both telecommunications and electricity being covered by the constitution’s protection of state control). The Indonesian constitution, dating back to 1945, granted the government rights to intervene in certain sectors and has been used as an argument for state control of companies in those parts of the economy.

16. India does not explicitly express a rationale for maintaining state control in particular sectors, albeit the SOE presence is relatively heavy in the sectors also identified as strategic by other BRICS. In Russia, several new laws were passed between 2004 and 2008 protecting what were deemed strategic sectors. Most prominently, the Strategic Investment Law came into force in 2008 listing 42 activities considered of strategic importance for the state, specifying the rules of engagement for foreign investors interested in these sectors. In South Africa, the nine SOEs governed by the Department of Public Enterprises are concentrated in three sectors deemed strategically important, these being mining and energy, manufacturing, and transport. In addition to sectors like resource extraction, energy, telecommunications and transport, all the BRICS countries maintain SOEs in the finance sector.

17. In addition to the consolidation of state ownership in strategic sectors in some BRICS, the financial crisis has also encouraged state intervention. This has contributed to an expansion of SOEs in recent years. In Brazil in the 2000s, SOEs have seen increased investment turnover, in particular through an increase in
state-owned minority shares (Lazzarini and Musacchio, 2011). In the case of the financial sector, large SOEs like the Brazilian Development Bank (BNDES) have increased dominance through injections of government capital in the wake of the financial crisis.4 In China, the financial crisis saw government spending disproportionally benefit the state sector to the detriment of private enterprises (Deng et al., 2011). In Indonesia, the number of SOEs has marginally increased since 2006. Interestingly, the number of corporations in which the government holds only a minority share has simultaneously decreased. The number of officially recognised SOEs in India has gradually declined over the last decade, while the capital stocks and net worth of SOEs has increased. While the wave of re-nationalisations of already privatised firms pre-dates the crisis in Russia (OECD, 2011b), the crisis has further delayed the implementation of privatisation plans. Furthermore, state’s support for the already dominant large state-owned banks (that did not face an immediate insolvency threat) and a wave of acquisitions performed by the two largest ones – Sberbank and VTB – have further bolstered the state’s presence in the banking sector. In South Africa, the financial crisis increased pressure on loss-making SOEs to restructure and may have contributed to closer state review of SOEs as well as apparently, in some cases, to new appointments in SOE-related political and corporate positions.

18. In all the BRIICS, SOEs that are largely profit-making have grown in size, and often made new acquisitions. Where SOE presence remains notable in the BRIICS, there has also in general been increased investment in these firms.

A1.3 Legal status and official definitions of SOEs

19. A firm’s legal form can be an important determinant of the quality of SOE governance. From a legal perspective, most OECD SOEs have the same status as private companies and are subject to national company law. The most common legal form for SOEs in the OECD area is “limited liability company”; this is followed, in second place, by “joint stock company” (OECD, 2005a: 36). There are, however, some statutory corporations with a distinct legal status provided by their enabling legislation (i.e. statutes). Statutory companies are more common among the BRIICS countries. Statutory as well as publicly-listed companies (or other corporate forms of companies) where the state owns a proportion of shares make out the two broad categories of SOEs usually reported.

20. Statutory companies exist in most of the BRIICS. Created by the state to fulfil some public purpose, the nature and ownership structure of such firms varies across several dimensions. They may be either fully or partially controlled by government at different levels (federal, state, municipal) and may or may not have other shareholders. State control may be determined not only by shareholder rights, but also by established legislation. In Brazil, for example, a handful of statutory companies, which have their budgets directly allocated by the Treasury, are classified together with other SOEs and overseen by the same government agency. Indonesia operates so-called “Perjans” that are non-profit agencies directly attached to a government department with the aim of delivering public services. These are gradually being phased out, and either converted into public companies or made into departmental agencies (Indreswari, 2006). Statutory corporations in Russia include so-called “State Corporations” that are government funded, non-profit enterprises tasked with promoting some public objective. Russia furthermore has “Unitary Enterprises”, which are entirely controlled by public authorities and all their assets are owned by the state at the federal, regional or municipal level. In South Africa, several “Parastatals”, usually created by

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4 BNDES is one of the largest federal financial institutions in Brazil. The bank received unique access to government funding in the wake of the financial crisis (OECD, 2011b). Subsequently, BNDES’ assets more than doubled between 2008 and 2010, while turnover increased by more than 50%. BNDES is tasked with facilitating economic development. Furthermore, as noted above, among its responsibilities is fostering the production of domestically produced goods earmarked for foreign trade and facilitating the internationalisation of Brazilian firms.
parliament, are SOEs. These remain loosely defined and their governance is not clearly specified. In both China and India, statutory companies or government agencies are not officially classified as SOEs by the respective governments.

21. Examples of statutory SOEs in the OECD include the Czech Republic where the main SOEs are governed by special statutory laws. In Korea, the government-owned companies and the government-invested companies are also subject to special category laws. A further harmonisation of the legal status of SOEs with either private or public companies would be helpful in allowing a more systematic use of corporate governance instruments and such efforts are being undertaken (OECD, 2005a: 37). For example, while two French power companies – EDF and GDF – were established as SOEs in the form of “Établissements Publics Industriels et Commerciaux” under special legislation, a 2004 law on public services in the gas and electricity sector changed their status to that of a limited liability company, thus, bringing them under general corporate law.

22. There are large discrepancies in reporting on the SOEs by national statistical offices and responsible ministries across the different countries. On average in the OECD countries, only 10% of SOEs are publicly listed, but wide variation persists with ratios significantly above the average in Norway, Greece, Italy, France and Finland, and below the average in Czech Republic, New Zealand and Poland (OECD, 2004 and 2011a). Yet, among OECD countries the share of public ownership tends to determine SOE status, the variation in this criteria is reflected in the results of the questionnaire assembled recently by the OECD Secretariat (OECD, 2011a). For example, the Ministry of Finance in Austria reports as SOEs all enterprises that have at least 10% of government ownership, including listed and unlisted enterprises and statutory corporations (Christiansen, 2011: 81). The Ministry of Finance in the Czech Republic only reports on majority-owned SOEs held by the central government and statutory corporations, excluding SOEs “in bankruptcy” and “in liquidation” from aggregate numbers (Christiansen, 2011: 84). In the case of Estonia, reporting covers SOEs operating as private limited companies and public limited companies, but only in cases where the state owns more than 50% of the capital; municipality-owned enterprises are excluded (Christiansen, 2011: 85). In terms of the average size of the actual government stake, there is a clear predominance of majority and full control: on average, almost three quarters of SOEs in the OECD area are fully or majority state-owned and there is relatively little variance among the OECD economies (OECD, 2005a: 33). In Australia, Belgium and Turkey, all SOEs are fully or majority state-owned.

23. Listed companies, where the government owns a specified proportion of shares, are officially considered to be SOEs in Brazil, Indonesia and Russia. In Brazil, the government needs to own more than half of the shares with voting rights in order for the company to constitute a “State Enterprise”. In Indonesia, any listed firm where the state owns more than half the shares is officially considered an SOE, so called “Perseros”. Russia, on the other hand, applies a condition of 100% ownership of shares by the state for a listed company (joint stock companies) to officially constitute an SOE. In all three countries,

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5 See Annex I.2. in OECD (2005) for a full overview of various legal categories used in the OECD area.
6 For a comprehensive overview of the differences in definitions of SOEs used by the reporting institutions, see Annex C in Christiansen (2011).
7 Almost all OECD economies hold around 60% to 90% of their SOEs as majority or fully state-owned firms (OECD, 2004: 20).
8 The specification of shares with voting rights is of importance, as Brazilian legislation allows firms to offer shares without voting rights.
9 This is the definition used by the National Statistical Office of the Russian Federation (Rosstat), while the data shared with the OECD by the Ministry of Economic Development for the purposes of completing Accession Review of the Russian Federation on Corporate Governance 2010 include information on joint stock companies with less than 100% government shareholding.
state-owned listed companies are subject to the same legal regime and requirements as their private counterparts.

24. In China, several government-owned enterprises were transformed into share-holding enterprises with the state as a majority owner. These companies are subject to the same public governance as non-listed SOEs. In India, majority ownership (more than 50% of shares, if listed) is a necessary, but not sufficient condition for SOE classification. So-called “Central Public Sector Enterprises”, have been created as government companies under the Companies Act, or as statutory corporations under specific statutes adopted by the Parliament. Similarly, in South Africa the list of state-owned companies supervised by the Department of Public Enterprises includes only nine SOEs. The South African government classifies only a limited number of other listed companies, where national or regional authorities possess a controlling share, as public enterprises. Hence, in the official treatment by the Chinese, Indian and South African governments is in many cases based on a combination of the company’s origin, current status and ownership stake.

**A1.4 SOE Regulation**

25. Listed SOEs in most economies are subject to national company law and, thus, need to comply with regular corporate requirements. There are nevertheless exceptions, whereby SOEs are subject to special laws, pertaining either to particular categories of SOEs or specific SOEs.\(^{10}\) The manner and channels through which Governments are seen to exercise their ownership functions over SOEs vary across countries.

26. SOEs in most OECD countries follow the same general rules for insolvency and bankruptcy as private companies.\(^{11}\) OECD SOEs are also subject to as stringent financial disclosure and transparency standards as private enterprises. In fact, in many OECD countries SOEs are subject to additional requirements (e.g. Poland, Denmark, Finland). Moreover, in an increasing number of OECD countries, even when SOEs are not listed or not subject to the company law, they are required to report to the same standard as listed companies (e.g. Sweden). Similarly, accounting and auditing standards apply to SOEs to the same extent they apply to private companies, while SOEs may also undergo additional controls carried out by specific state audit entities (e.g. Japan, Australia and UK).\(^{12}\)

27. The models for organisation of the exercise of ownership rights within the state administration also vary, and can be generally divided, as of 2005, into three broad categories: 1) *decentralised models*, where SOEs are under the responsibility of the relevant sector ministries, as for example in Finland; 2) *centralised models*, in which the ownership responsibilities lie within one main ministry (as in e.g. Belgium, Denmark or Poland), and 3) *dual models*, where the responsibility is shared between the sector ministry and the “central” ministry (e.g. in Mexico, New Zealand, Switzerland). While the dual model has been the most prevalent among OECD countries, recently undertaken reforms tend to move countries towards

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\(^{10}\) For a detailed repository of varying legal statuses of SOEs, see OECD (2005b).

\(^{11}\) Only three countries do not subject their SOEs to general insolvency and bankruptcy procedures (Belgium, Turkey and France), though there are some exceptions applied to some SOEs in the UK and Poland (OECD, 2004).

\(^{12}\) Additional specific reporting and control procedures have not always been effective in providing safeguards against incompliance with strategic orientation or prudent levels of risk among the SOEs. As a result, some countries adopted additional risk management tools, such as a “no surprise policy” in New Zealand, where the government should be informed in advance of any potentially contentious developments.
the centralised model (OECD, 2004: 26). Overall the regulatory frameworks governing the treatment of SOEs are still undergoing important changes with the view to improve the regulatory oversight.13

28. Some of the BRIICS economies have established dedicated government departments tasked with the oversight and management of SOEs along the lines of a centralised model. In China a set of State-owned Assets Supervision and Administration Committees (SASACs) have since 2002 been the state’s representatives in the management of SOEs. The State Council SASAC is organised as a separate ministry of the central government and oversees some 30 regional level SASACs. In India the Department of Public Enterprises (DPE) is responsible for the coordination of policies on CSPES as well as monitoring and evaluations the performance of public enterprises. In Brazil a separate department (Departamento de Coordenança das Empresas Estatais – DEST) under the Ministry of Planning, Budget and Management is responsible for the management and oversight of most SOEs. An exception are the SOEs in the financial sector which are overseen by the Central Bank.

29. South Africa and Indonesia operate some quasi-governmental bodies under separate ministries. The nine most prominent South African SOEs are under the management of the Department of Public Enterprises while so called “Parastatals”, tasked with more direct governmental objectives, lie under respective ministries (see section 1.3). Similar to South Africa, Indonesia’s “Perjans” (SOEs defined as social service agencies) are controlled by respective ministries depending on their area of operation. There is no single government department dedicated to the management of profit-seeking SOEs. These are regulated by a special act and the board is appointed directly by the President.

30. Russia can be seen to employ a dual model of SOE governance. The government’s ownership function in SOEs is executed by the Federal Agency for Government Property Administration (Rosimuschestvo) established in 2004. The agency operates under the Ministry of Economic Development and Trade and is tasked with the formulation of policies for government property. Sector-specific ownership policies are however delegated to respective ministries.

31. While explicit, targeted competitive neutrality frameworks (CNF) are still relatively scarce, many OECD economies use a combination of competition law, procurement policies and merger control rules to ensure that state-owned and private firms compete on an equal footing. For instance, in the European Union, Article 106 of the Treaty on the Functioning of the European Union (former Art. 86) subjects public companies to the European competition rules and empowers the Commission to sanction directly infringing companies or governments.14 Australia also has a specific competitive neutrality policy and is together with Europe often mentioned as an example in this regard.15

32. Many of the OECD economies have designed a set of specific objectives and performance indicators for their domestic SOEs in order to ensure effective use of capital, creation of value by the board and management and retention of acceptable levels of financial risk. These include both quantitative and qualitative targets that may apply either to the entire state portfolio, to certain sub-sectors of the portfolio.

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13 The OECD (2011a) took stock of recent regulatory changes regarding the governance of SOEs in the OECD area. For example, in Finland, the 2007 State Shareholding and Ownership Steering Act, transferring most SOEs to an ownership unit in the Prime Minister’s Office, is seen as instrumental in enhancing the separation of the ownership function from the regulatory oversight. In Poland, the draft bill aims to collect in one legal act all regulations on the treasury ownership functions that are currently contained in various laws.

14 Moreover, European state aid and subsidies regulations require the member states to notify the Commission if they plan to grant state aid to any company and this is subject to the Commission’s approval and the EU’s transparency directive requires separate accountability for commercial and non-commercial activities of public firms in order to reduce the scope for cross-subsidisation (Capobianco and Christiansen, 2011).

15 For more details on the use of CNFs in the OECD area, see Capobianco and Christiansen (2011).
(e.g. publicly traded companies), or to particular SOEs (OECD, 2008:15). For example, in France there is a set of diverse indicators that measure performance of the entire SOE portfolio, including operational and financial profitability and indebtedness sustainability. In the UK, on the other hand, a single quantitative portfolio-level target is used instead. Namely, the shareholder executive agreed to increase the value of six main businesses in the government's portfolio (constituting 76% of total sales in the portfolio) by GBP 1 billion within three years from 2007.16

33. There is also variation in terms of the type of performance-related requirements set for individual SOEs. For illustrative purposes, Annex Box 2 below provides a snapshot of goals set for postal services SOEs in three selected OECD countries. Some countries introduced a formal monitoring and review mechanism through so-called “management contracts” that set corporate objectives and require annual reports on performance, used for example in Australia, Belgium, France, Greece and New Zealand. To increase transparency, in some cases there are requirements for these to be submitted to parliament for approval (e.g. Australia). In some OECD countries such as Australia, Belgium and Canada, SOEs are also required to submit corporate plans, which set broad objectives covering a period from three to five years, as well as to provide progress reports on the state of their implementation. Despite a generally positive impact on performance and productivity of SOEs, the effects of performance contracts have nevertheless varied, depending on the nature of any wider SOE reform packages that were in place, and these contracts did not always ensure isolation from political interference.17

34. Importantly, most OECD economies do not allow outright subsidies or other forms of financial assistance to the commercial activities of SOEs and most subject their SOEs to the same regulatory framework and lending conditions as private sector companies. However, a few exceptions have been made to sustain loss-making SOEs or other government-controlled companies, either due to their large economic weight or their contribution to employment (OECD, 2010b).

Annex Box 2. Examples of mandates or objectives for similar SOEs (postal services) in different OECD countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Mandate or Objectives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royal Mail (UK)</td>
<td>“Our main aim is to be the most trusted delivery brand in the UK which provides the Universal Service for our customers the length and breadth of the country. We also want to be seen as the premier European and UK express parcel businesses, offering excellent customer service. The Group also wants to sustain and grow the Post Office commercially while maintaining its key role as part of the UK’s social and economic fabric.” (Annual Report 2010-2011, p. 27).</td>
</tr>
<tr>
<td>PostNord AB (Sweden)</td>
<td>“The group shall have a return on equity of 10 per cent over a business cycle, an equity/assets ratio of at least 35 per cent and at least 40 per cent of the net profit for the year shall be distributed to the owners.” (Annual Report State-Owned Companies 2010, p. 71).</td>
</tr>
<tr>
<td>Canada Post (Canada)</td>
<td>“Mandate: Universal service, affordable rates, frequent and reliable delivery, convenient access to postal services, secure delivery, community outreach and consultation, responding to complaints, reporting on performance.” (Canadian Postal Service Charter 2009) Goals for 2011: “We must be able to provide the quality service that Canadians expect and to remain relevant in the future. For 2011, our priorities are to achieve our financial imperatives and focus on opportunities for revenue growth in a challenging and uncertain economic environment.” (Annual Report 2010, p. 56).</td>
</tr>
</tbody>
</table>

35. Favourable tax or regulatory regimes, regulatory exemptions (e.g. either from bankruptcy or competition law) or in-kind benefits can be seen in this light, as they can distort the competitive landscape by lowering the cost base of affected SOEs. While a few OECD economies have reverted to the use of

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16 House of Commons, Committee of Public Accounts, *The Shareholder Executive and Public Sector Businesses*, 27.06. 2007.

17 For a detailed summary of the best practice and an overview of SOE performance management tools used in the OECD area, see OECD (2005a, 2010c).
such policies during the recent crisis, this trend seems temporary. In the long run, modernisation and privatisation are often the ultimate tools for dealing with underperforming SOEs in the OECD area, even thought the speed and scope of this process tend to vary across countries. For example, structural changes in the aviation sector in Europe, which has seen the decline in profitability of many of the former national champions, led to a sale of a controlling share to a foreign investor in some countries (e.g. Austrian Airlines and Swiss Airlines). Faced with the growing debt of its national postal service, the UK government introduced a Postal Services Bill 2010-2012, which enabled it to sell up to 90% of Royal Mail to private investors, including foreign ones, in order to attract capital. While often subject to political considerations, restructuring of unprofitable SOEs tends to be an effective option, provided that historical liabilities can be accommodated to help attract private investors.

A1.5 Outward orientation of SOEs

36. In terms of international trade and investment, it is difficult to point to explicit objectives of OECD governments to expand the activity of their SOEs abroad. This does not mean that the governments have no means of shielding an SOE or a national champion from foreign competition, helping them win important international contracts, or lowering the borrowing cost on the international markets, indirectly facilitating their expansion abroad. For example, the liberalisation of the EU’s internal market that enabled cross-border integration of utilities and network industries, including those owned by the government, has given rise to an occasional controversy (OECD, 2009: 3). It can be said that EU’s internal market liberalisation, also in the sectors with numerous national SOEs, may facilitate market consolidation, including through expansion of more successful SOEs to foreign markets and take-overs of their less successful private or state-owned rivals (e.g. EDF in the power sector or Lufthansa in the aviation sector).

37. Expansion and increased activity in international markets is a discernable trend with large SOEs from the BRIICS economies. Indeed, international expansion is a pronounced policy objective of several of the BRIICS governments. In China the government has pursued a “going out” policy encouraging Chinese companies to invest and acquire market share abroad. SOEs are seen as serving a prominent role in this process. The strategy was first implemented in 1999, with its pronounced objectives including promotion of exports of goods and services and fostering links of Chinese companies with well-known brands. Already in 2006, the government reported that some 30 000 enterprises had developed transnational business.18 Mergers and acquisitions (M&A) is the most important mode for Chinese’s firms’ international operations. Chinese SOEs’ M&A overwhelmingly target large objects aimed at gaining market shares, achieving synergetic effects and economies of scale, and securing what is perceived as strategic assets. The key objective cited for both government policy on “going out”, and for firms themselves, is the acquisition of natural resources. Both investment and M&A activities of Chinese firms is predicted by a government representative to increase rapidly over coming years.

38. The going out policy also guides the objectives of the central and regional SASACs in terms of oversight and, to some extent, management of state enterprises. Besides political pressure exerted on SOEs to expand abroad, the government has also focused on restructuring the bureaucratic system in order to facilitate and quicken the approval process for SOE ventures abroad. The Enterprise Research Institute of the State Council’s Development Research Centre is developing policy recommendations that entail improved coordination and reform of the management system of state-owned assets and the investment and financing system. Reform of SOEs is recommended with the aim of improving corporate governance and in order to preserve the value of state-owned assets abroad. Increased support to Chinese firms going abroad through finance and taxation, as well as through diplomatic, legal, technological and information services is also recommended. In sum, policies recommended to support the international expansion of

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Chinese firms, and in particular SOEs, is centred on i) improving the effectiveness of SOEs, ii) providing support through a host of broad-ranging policy and business areas (including taxation as well as diplomacy), and iii) moving away from micro-management of SOE operations and strengthening its overarching macro control. The “going out” policy and its likely future direction suggest that fostering SOEs international expansion is a government priority that entails extensive support policies.

39. In India, the government has its own scheme in place to promote the international expansion of SOEs. The Maharatna scheme applies to SOEs identified as national champions (called Navaratnas) with a potential for international growth. Indian SOEs classified as Navaratnas already enjoy privileges regarding capital expenditure, joint ventures, mergers and acquisitions, and regarding creation and investment in subsidiaries. Measures under the Maharatna scheme include increased operational autonomy with special regard to operations abroad. Indian SOEs’ foreign market participation is centred on the acquisition of natural resources and materials abroad. In 2010-11 the foreign exchange expenditure of five of the largest Indian SOEs exceeded foreign exchange earnings by almost USD 60 billion. By far the largest foreign exchange expenditure of Indian SOEs is the import of raw materials and crude oil. While the Indian government has an explicit aim of facilitating SOE expansion in international markets, the manner in which this is done seems to be more about relinquishing bureaucratic and political impediments than about offering privileged support.

40. In Indonesia, promoting SOEs internationally is a stated aim of the government for the strategic development of SOEs. One of the ways the government is trying to further the internationalisation of SOEs is through a restructuring of SOEs and their management. The approach entails the creation of overarching holding firms to manage SOEs. This model is based on the successes of Temasek in Singapore and Khazanah Nasional in Malaysia, whereby both of these countries hold SOEs with significant international presence. Hence, the Indonesian government is currently engaged in reforming SOEs with an aim of increasing their international activities.

41. In Brazil, international expansion of SOE activities is not officially declared as a public policy objective. Yet, a prominent example of an SOE that seeks to promote the internationalisation of Brazilian firms is the above mentioned Brazilian state-owned bank BNDES. BNDES receives its mandate from the federal government and has been explicitly tasked with encouraging Brazilian firm’s international operations. This includes both supporting export-oriented companies in Brazil, but also supporting Brazilian firms with operations and subsidiaries abroad. BNDES primarily offers support through provision of financing or raising capital via bonds or securities. BNDES benefits from unique access to relatively inexpensive government funding, something seen as an obstacle to private banks on the market, and seen to reduce the availability of private loans (OECD, 2011b). BNDES also helps Brazilian companies to identify opportunities for internationalisation and guides the structuring of Brazilian firms abroad. While this does not constitute a clear government policy of increasing SOEs presence abroad, it shows that internationalisation and trade of Brazilian firms is a policy priority. Furthermore, it provides an interesting case of how a state-owned bank can be employed as a tool in fulfilling internationalisation objectives for the economy.

42. In South Africa, while leading SOEs are active internationally, the government has not stated a clear ambition of advancing their international presence. Yet, leading South African SOEs like Denel and South African Airways do seek to engage in international markets.

43. In Russia, it is a stated objective of the government to increase the international competitiveness of SOEs. In particular, the guiding laws for state holdings and state corporations declare an aim of creating

19 Indian Oil Corp. Ltd., MMTC Ltd.; Bharat Petroleum Corp Ltd.; Mangalore Refinery, and Petrochemcicals; Hindustan Petroleum Corp. Ltd.
large and vertically integrated structures, in order to gain international competitiveness. While international expansion of SOEs is not an explicitly stated aim of Russian policy, the goal of increasing their international competitiveness appears to indicate an effort to facilitate their growth abroad. Furthermore, several of the large Russian SOEs like Gazprom and Sberbank have noticeably increased their international presence over the last ten years. Thus, also in Russia the increased presence of leading SOEs abroad is accompanied by an expressed political aim of facilitating international expansion.

44. In sum, government policies for internationalisation of domestic enterprises vary across the BRIICS, as do the approaches for attainment of such objectives. SOEs can be used as an instrument facilitating the expansion of domestic firms abroad, for example, through provision of financing in the context of the shallow financial markets characteristic of many developing countries (e.g. in Brazil). In some countries SOEs are actively encouraged to lead the process of internationalisation of domestic enterprises, such as in the case of China, where SOEs are prominent in the economy also more generally. In other countries, such as India, the most successful SOEs benefit from reduced bureaucratic impediments in order to allow growth in foreign markets.

A1.6 SOE sector in the OECD and BRIICS—summary

45. Overall, it is apparent that state sector is prevalent and important in the BRIICS and various OECD economies. Furthermore, the largest SOEs are often active internationally and engaged in trade, sometimes enjoying direct or indirect support from their governments. Where official data on SOEs are available from different countries, the definition and treatment of these differ significantly. Hence, the varying manifestations of state-owned companies and their sometimes divergent national classifications suggest the need for more transparency and development of comparable data sources, in particular with regard not only to key financial statistics in home markets but also to SOE trade and investment activities.

A2. Annex 2: State-owned enterprises in international markets—selected case studies

46. Given the heterogeneity of approaches to regulating SOEs’ activities at home and abroad, a case study approach provides a useful illustration of firms’ interactions in the international market place and helps shed light on issues encountered by governments, private firms and SOEs. In particular, case studies allow to demonstrate how the letter of law is applied in practice, what difficulties appear in legal enforcement (e.g. question of definitions), and to what extent the existing legal frameworks effectively level the playing field in mixed markets.

47. This part of the Annex looks at three selected cases: 1) an example of an international arbitration case between an SOE and a private firm under existing provisions in a bilateral investment treaty; 2) a WTO countervailing duties case against state-owned financial institutions providing credit to private firms at below-market rates; 3) and an example of the application of “national benefit” and “national security” tests under national investment laws. This line of work is likely to be continued in future OECD work on trade and investment of SOEs, in collaboration with BIAC, OECD Member States, and other OECD Committees to illustrate the ways of regulating SOEs’ behaviour in the international market place.

A2.1 Bilateral investment treaties and international dispute arbitration: the case Maffezini vs. Spain

48. The spread of Bilateral Investment Treaties (BITs) has been called “[s]ome of the most remarkable phenomena in international law” (Vandefelde, 2009: 3). Indeed, the exponential growth in the volume of cross-border investment from the 1980s on has been mirrored in the proliferation of BITs in the international arena, with ca. 2 500 BITs that have been concluded by the mid 2000s, involving more than 170 countries (Bubb and Rose-Ackerman, 2007). Broadly, BITs can be defined as “agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each other’s
territories by companies based in either country” and they generally cover the scope and definition of investment, rules on admission and establishment, anti-discriminatory clauses such as most-favoured nation treatment, national treatment and fair and equitable treatment as well as settlement proceedings in the event of an investment dispute (UNCTAD, 2004).

49. As such, BITs can provide a legal framework for the arbitration of disputes between SOEs and foreign investors, where the former exercise governmental functions. The case Maffezini vs. Spain is an example of an international investment dispute arbitration under the Argentina-Spain BIT, involving a private Argentinean investor and a Spanish SOE. The case has received considerable attention in the legal literature, for two principal reasons. First, it involves the application of the most-favoured nation (MFN) principle and illustrates the interconnectedness of different BITs among various jurisdictions. Second, it refers to the structural and functional tests of whether SOEs (or private firms) can be considered state entities.

50. In 1989, the Argentinean national Emilio Augustín Maffezini established in Galicia, northwest Spain, the firm Emilio A. Maffezini S. A. (EAMSA) for the production and distribution of chemicals. EAMSA was incorporated under Spanish law and the enterprise was undertaken in a joint venture with the Spanish majority state-owned firm Sociedad para el Desarrollo Industrial de Galicia (SODIGA) that subscribed to 30% of the capital, with Mr. Maffezini subscribing to 70% (Rosenberg, 2011). After receiving a loan from SODIGA as well as subsidies from the Spanish state, EAMSA purchased land and began to construct a chemical plant (Ripinsky and Williams, 2008). However, in light of growing and unforeseen project costs, partly related to environmental impact assessments, EAMSA was increasingly confronted with financial difficulties. In November 1991 a bank transfer of 30 million pesetas from Mr. Maffezini’s personal bank account to SODIGA was ordered by SODIGA’s representative in EAMSA. The transfer was processed, despite not being authorised by Mr. Maffezini. Finally, in March 1992 Mr. Maffezini instructed the discontinuation of EAMSA’s operations and laid off employees. After an ongoing disagreement between the two parties concerning financial liabilities, Mr. Maffezini filed on July 18th 1997 a request for arbitration against Spain at the International Centre for Settlement of Investment Disputes (ICSID).

51. Key elements in Mr. Maffezini’s claim were the following: First, all acts and omissions of SODIGA were attributable to Spain because of the firm’s status as public entity. Second, international rather than national (Spanish) jurisdiction could be invoked, based upon provisions of the Argentina-Spain BIT and, by way of the MFN clause in the latter, also provisions of the Chile-Spain BIT. Third, the failure of the joint-venture could mainly be attributed to SODIGA because its initial cost estimations and related counselling turned out to be largely unrealistic. Fourth, the bank transfer from Mr. Maffezini’s personal bank account to SODIGA was unauthorised by Mr. Maffezini.

52. The tribunal that has been established at the ICSID dismissed the claims that were related to SODIGA’s cost estimations. But the tribunal ruled that the transfer from Mr. Maffezini’s bank account represented a breach by Spain of its obligations under the Argentine-Spain BIT to protect investment (Article III(1)) as well as to grant a foreign investor fair and equitable treatment (Article IV(1)). Consequently, the tribunal awarded 30 million Spanish pesetas as amount of compensation to Mr. Maffezini, plus interests of more than 27 million Spanish pesetas.

53. However, the case is less known for the rules on compensation than for its considerations on jurisdiction (Radi, 2007). When the case was filed internationally by Mr. Maffezini at the ICSID, Spain argued that this arbitration lacked jurisdiction and that Mr. Maffezini should have resorted to Spanish courts, instead. This argument referred to Article X(2) of the Argentine-Spain BIT, according to which disputes have first to be submitted to courts of the jurisdiction of the host country. Only when the dispute continues and when no decision has been made by the domestic court after more than 18 months from the
initiation of proceedings, cases can be submitted to the ICSID dispute settlement mechanism. In its response the tribunal referred to the national treatment clause in Article IV(2) of the Argentine-Spain BIT that reads: “In all matters subject to this Agreement, this treatment shall not be less favourable than that extended by each party to the investments made in its territory by investors of a third country.”

54. The most-favoured treatment here referred to Chile-Spain BIT according to which investors are not obliged to first submit cases to courts of the jurisdiction of the host country, but can bring the dispute directly to international arbitration after a six months period of negotiations. Thus, the tribunal applied the less restrictive conditions of the Chile-Spain BIT.

55. Spain argued also that the arbitration at the ICSID was lacking jurisdiction because, following the ICSID Convention, the ICSID has jurisdiction only over investment-related disputes that arise “between a Contracting State and a national of another Contracting State” and henceforth has no jurisdiction to arbitrate disputes between two States or two private entities (ICSID, 2000). According to Spain, EAMSA, although majority-owned by an Argentinean national, was a Spanish juridical entity and had a separate and distinct juridical personality from its shareholder. Furthermore, Spain argued that SODIGA was a commercial corporation established under Spanish law and that its activities were by consequence of private commercial character and could not be attributed to the Kingdom of Spain. From the Spanish perspective, the dispute should therefore have been considered as a dispute between two commercial entities under Spanish law and not as a dispute between a foreign private entity and the Spanish state.

56. The tribunal dismissed these objections. It concluded that the investment in a Spanish company by an Argentinean in his personal capacity was covered by the broad definition of investment in Article I(2) of the BIT, which stipulates: “the term ‘investment’ means every kind of assets, such as goods and rights of whatever nature, acquired or made in accordance with the laws of the Contracting Party in whose territory the investment is made, and shall include, in particular though not exclusively, the following: shares in stock or any other form of participation in a company.”

57. With regard to the status of SODIGA, the tribunal largely followed the argumentation of the claimant that the company was not only state-owned, but that it was also state-controlled and operating with government objectives for the development of Galicia. The tribunal first followed a structural test that referred to firm ownership (ICSID, 2000; paragraph 77): “Here a finding that the entity is owned by the State, directly or indirectly, gives rise to a rebuttable presumption that it is a State entity. The same result will obtain if an entity is controlled by the State, directly or indirectly.”

58. Yet, in its decision the tribunal did not follow the rebuttable presumption principle and argued that firm ownership or control alone is not sufficient to define a state entity. It was argued that a functional test was necessary to determine whether firm operations are commercial or governmental in nature, where state entities undertake functions that can be classified as governmental. In this context, the tribunal underlined that following the functional test privately owned firms can be considered as state entities as well (ICSID, 2000; paragraph 80): “By the same token, a private corporation operating for profit while discharging essentially governmental functions delegated to it by the State could, under the functional test, be considered as an organ of the State and thus engage the State’s international responsibility for wrongful acts.”

59. Following these two tests, the tribunal held that SODIGA represented an entity of the Spanish State because the latter owned more than 88% of the firm’s capital (“structural test”) and because the firm carried out governmental functions of regional development (“functional test”).

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20 A rebuttable presumption means that it will stand unless the other party provides evidence to the contrary.
60. Altogether, the decision of the tribunal illustrates that BITs can sometimes provide a legal mechanism for arbitration in disputes between SOEs or private firms that are state-backed on the one side and fully commercial entities on the other, representing a tool for disciplining anticompetitive practices. In particular, this might be the case if the anti-competitive practices take place in the home state of the SOE and if the contested actions can be attributed to the host state as an act of the state. Also, the case illustrates some of the complications related to existence of overlapping agreements as well as the role of MFN clauses in this context.

A2.2. State-Owned financial institutions as credit providers: the dispute settlement case United States – Definitive Anti Dumping and Countervailing Duties on Certain Products from China

61. As argued in the main text of the paper in Section 5.4 on WTO Disciplines, while SOEs are in principle covered by WTO subsidy disciplines when they are subsidy recipients, the application of subsidy disciplines to SOEs as conveyors of subsidies may be more complicated. The first complication is related to the question whether SOEs can be considered public bodies. Second, in cases where the alleged subsidies by SOEs do not take the form of plain financial contributions, there is the question of whether providing inputs or other benefits can be treated as a subsidy. The dispute settlement case DS379 United States – Definitive Anti Dumping and Countervailing Duties on Certain Products from China described below is an example of these two aspects.

62. In response to increasing imports of two different kinds of pipe or tubes and a specific form of pneumatic off-road tyres from China the United States Department of Commerce (USDOC) found in 2007 that preferential loans to Chinese exporters constituted a subsidy to their exporting activity (USDOC 2007a; 2007b; 2007c). Several aspects of SOEs in China were considered, including the provision of intermediate inputs to private firms by SOEs at prices perceived to be below market prices and special access to land for SOEs. In response to countervailing measures imposed by the US, China requested consultations through the WTO in 2008. Consultation failed to facilitate an agreement and a panel was set up to review the case under the dispute settlement understanding. The panel report issued in October 2010 was subsequently appealed by China. A final report was adopted with modifications from the appellate body in March 2011.

63. In justifying and establishing countervailing measures the USDOC has applied a non-market economy status to China, where state involvement is seen to render domestic prices an inaccurate benchmark for market rate prices when calculating the rates of countervailing measures. A non-market economy (NME) status is important for calculating antidumping measures since it impacts the type of duty rates applied. The NME methodology is based on “factors of production” methodology, whereby the factors of production used by NME producers are identified and quantified. Price information from surrogate countries is used to construct a normal value of the imported product under investigation (India is the most common surrogate country used for China). The dumping margin—and consequently the anti-dumping duty rate—are then determined by comparing this normal value with the NME company’s export price to the United States. Besides the reference price used for the determination of the normal value, the second difference associated with NME status is that while all companies from market economy

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21 Imports of off-road pneumatic rubber tyres increased by some 30% from 2004 to 2006.
22 Consultation between members is the first stage of the WTO Dispute Settlement Mechanism where parties attempt to solve a contested issue bilaterally, consultation bring into effect the rules and proceedings laid down in the Dispute Settlement Understanding.
23 On the twenty five occasions that USDOC applied anti-dumping rates to both China and a market economy the average China country-wide rates were on average over 60 percentage points higher than comparable market economy rates (GAO AD Database).
countries are eligible for individually determined or weighted average anti-dumping duty rates, companies from China and other NME countries must pass a separate rates test to be eligible for such rates. This test requires NME companies to meet two criteria: they must demonstrate that their export activities are free from government control both in law and in fact. For companies that could not (or did not attempt to) pass the separate rates test, the USDOC calculates a country-wide duty rate, which is higher than for market economies.

64. Due to China’s non-market economy status the USDOC did not use Chinese interest rates to determine whether loans from state-owned commercial banks constituted a subsidy. The Agreement on Subsidies and Countervailing Measures (SCM Agreement) Article 14(b) stipulates that a potential benefit of a government loan is the difference between the cost of the loan given (by a government or public body) and the cost of a comparable loan the benefactor could receive on the commercial market. The panel and appellate body supported USDOC’s use of proxy interest rates in calculating the benefit of loans from state-owned commercial banks finding that the SCM agreement provides “sufficient flexibility to permit the use of a proxy in place of observed rates in the county in question where no “commercial” benchmark can be found” (WTO 2011a: 184).

65. A key issue was the status of state-owned commercial banks as public bodies. The SCM Agreement (Article 1) states that only benefits conferred from a government or public body can be considered a subsidy. The panel and subsequent appellate body supported the USDOC in considering state owned commercial banks as “public bodies”. The initial panel report interpreted “public body” (in article 1.1.(a)(1) of the SCM Agreement) to mean “any entity controlled by a government” (WTO 2011a, p. 124). Furthermore the panel had relied on the “everyday financial concept of “controlling interest” and hence approved USDOC’s approach of considering any company with a majority state share a public body (op. cit. p. 124) that underlined USDOC determinations of public body status in a number of other cases. The appellate body however overturned the panel’s definition of a public body and instead saw the term to mean an entity that is “vested with or exercises governmental authority” (op. cit. p. 132). Furthermore the appellate body found that government ownership is by itself not sufficient to prove that a body is vested with, or performing, a governmental function.

66. A US document investigating the links between the Chinese government and state-owned commercial banks in the context of a previous investigation was accepted by the appellate body as evidence for Chinese state-owned commercial banks constituting public bodies. It argued that state-owned commercial banks were public bodies based on: a near complete state-ownership in the sector; Article 34 of Chinese banking law stating that banks are obliged to carry out business upon the needs of the national economy and social development under the guidance of state industrial policies; evidence of state-owned commercial banks lacking adequate analytical and risk management skills, and; lacking information on the loan request and approval process (WTO 2011a: 134). As a result the appellate body upheld the determination of Chinese state-owned commercial banks to be public bodies as they were seen to be “meaningfully controlled by the government in the exercise of their functions” (op. cit. p. 136). They were therefore considered to be covered by the SCM.

67. The SCM Agreement defines a subsidy as any financial contribution, given by a government or public body (within the territory of the given member) that confers a benefit. Classifying state-owned commercial banks as public bodies in the case of this particular dispute is hence important as it categorised non-commercial loans from such SOEs as subsidies that may be sanctioned within the WTO framework. Yet, it should be mentioned that this does not mean that in the future China’s state-owned commercial banks will be automatically considered as public bodies. The burden of evidence will remain with the

24 Issues and Decision Memorandum for the Final Determination in the Countervailing Duty Investigation of Coated Free Sheet from the People’s Republic of China (Panel Exhibit CHI-93)
parties imposing countervailing measures especially as the characteristics of the sector, on the basis of which the government function was argued in the discussed case, are likely to evolve in the future.

A2.3 Treatment of SOEs in national investment provisions: Cases of Australia, Russian Federation and Canada

68. Given perceived strategic importance of certain assets to local communities or national economies at large, governments at times decide to limit or regulate foreign investment in such sensitive sectors or firms. The application of the so-called “national security” or “net benefit” tests and stricter approval requirements for investment in “strategic” activities are often used for this purpose, whereby the foreign investor has to prove that the investment will in fact benefit, and not endanger, local or national interests. If such tests are sufficiently transparent and non-discriminatory they can be a useful tool in the hands of governments to protect valued national assets, while encouraging competition and growth. However, if the criteria used are arbitrary, rules applied subject to changing political pressures and the review process non-transparent, such tests can prove welfare-reducing by preventing legitimate investment, be it by private or state-owned firms. Various countries use different frameworks and policy designs, with a varying degree of stricter provisions applied to SOEs. While a comprehensive review of such frameworks is beyond the scope of this annex the remainder of this section discusses the examples of Australia, Russian Federation and Canada.

69. In Australia the Foreign Acquisitions and Takeovers Act 1975 (FATA) allows the Treasurer, or his delegate, to review foreign investment proposals and decide, based on the recommendations from the Foreign Investment Review Board (FIRB), if they are in line with Australia’s national interest, or block them otherwise. While in the case of private foreign investor a prior approval is required only beyond certain monetary threshold of investment, e.g. above USD 244 million for non-US investor, any investment by foreign governments or their related entities requires a prior approval irrespective of the value of investment (FIRB, 2012).

70. Overall, the system is deemed effective in clearing foreign investment, including by SOEs (Conference Board of Canada, 2012; Norton Rose, 2012). Still, a heated public debate about the application of “national security” tests in the context of growing investment by foreign SOEs, as exemplified by the discussion of the review of the failed Rio Tinto-Chinalco deal, and increased political pressure to tighten the existing provisions for SOEs, may lead to revisions in FIRB’s policy in the future, in particular in natural resources, agricultural and agribusiness sectors (Norton Rose, 2012).

71. Russian Federation’s Strategic Investment Law of 2008, instituted by a presidential decree, lists sectors and entities that are considered strategic – mostly in the natural resources, defence, natural monopolies and media sectors – and in which foreign investment is limited and requires prior approval by a special governmental commission chaired by the Russian prime minister himself. Prior approval is required when a private foreign firm is to take “control” of a strategic entity and, in the case of a public foreign investor, a 5% share threshold applies. Moreover, a share above 25% by a public foreign investor is prohibited in strategic entities altogether (recently raised from a 10% threshold), and an acquisition above the same threshold in a non-strategic sector also requires prior approval under federal law. The Law also includes specific restrictions for transactions involving “subsoil strategic entities”, again with stricter provisions for SOE investment (approval required for a 5% or higher share).

25 The Federal Antimonopoly Service of the Russian Federation is charged with managing the applications by investors and passes them on to the government commission for a final decision. For a full list of strategic entities, see the government’s website: http://www.kremlin.ru/text/docs/2004/08/75174.shtml

72. The system has been perceived by some as legally vague and burdensome for foreign investors (Clifford Chance, 2012; Josefson and Kotlyachkova, 2012), even though the refusal rate of applications filed to the commission seems to be low: between 2008 and 2012, six out of 147 applications received by the commission were refused and 139 approved. It has been also noted that some foreign SOEs have encountered difficulties in investing in Russia, but it may be because many have been targeting the “strategic sectors” with stricter provisions and review process. Recent amendments to the law, however, have been seen as facilitating investment by both private and sovereign investors (e.g. Norton Rose, 2011).

73. In the case of Canada, the Investment Canada Act (ICA) specifies the conditions under which foreign investment is required to pass the “net benefit” test and has to satisfy the “national security” condition. In general, a direct acquisition of a Canadian business by a foreign business (i.e. taking a controlling share in a firm) is subject to review, when the book value of the acquired assets is C$ 344 million or more. The review process requires the company to submit necessary documentation to a review board, which then passes its recommendations to the Minister of Industry, who decides whether or not the deal meets the net benefit and national security conditions. In the case of the review of investment by SOEs under the ICA, an additional set of guidelines developed by the Ministry of Industry applies. The initial set of SOE Guidelines were developed in 2007 and included criteria against which the government reviews the investment by foreign SOEs, requiring in particular that the acquired business complies with Canadian corporate governance standards and that it continues operating on a commercial basis.

74. The SOE Guidelines have not necessarily led to disproportional blockage or dissuasion of investment by SOEs as opposed to investment by private firms. Although very few transactions have been disallowed under the ICA, those transactions have involved private-sector firms, while deals by foreign SOEs have been approved in the national resources sector. In a recent case a bid by a private investor in Canada’s potash industry was withdrawn by an Australian-based company after receiving a notice from the Minister of Industry that the current proposal was not likely to be of net benefit to Canada. That an alternative investment by a Chinese SOE was sought is illustrative in this regard (see Annex Box 3 below). However, in the light of a growing presence of foreign SOEs in Canada’s natural resources base, the government amended the SOE Guidelines in 2012. It has done so following the approval of two

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27 Altogether foreign investors filed 265 applications to FAS and 86 of them were not passed onto the government commission but returned to the applicants, either because of documents were incomplete (8 of them), because they were not subject to prior approval (7), or because the applicants recalled the application, having decided not to invest (32). All information was obtained by the OECD Secretariat from FAS via the Ministry of Economic Development.

28 A threshold is much lower if an acquisition involves a sensitive sector, e.g. a cultural industry, or a non-WTO member is pursuing the acquisition (usually C$5 million).

29 For example, Neylan (2008) argues that, in practice, it seems that the “net benefit” and “national security” tests enshrined in ICA have been more of a deterrent for SOE investment in Canada, rather than the SOE guidelines themselves due to a broad definition of net benefit and national security conditions.

30 For example the 2008 MacDonald Dettwiler deal in the satellite industry.

31 For example: China Investment Corp. 45% stake in Alberta oil sands project owned by Penn West Energy and a 5% stake in the company; Sinopec’s 9% share in Syncrude Canada, one of the oil sands industry’s top producers; acquisition of Harvest Energy by South Korea’s National Oil Company.

32 See for example, the speech by Prime Minister Harper from December 7, 2012; “In light of growing trends, and following the decisions made today [i.e. the approval of two acquisitions by foreign SOEs], the Government of Canada has determined that foreign state control of oil sands development has reached the point at which further such foreign state control would not be of net benefit to Canada.”
high-profile acquisitions of Canadian firms in the oil sector by Asian-based SOEs in December 2012.\textsuperscript{33} The government made an announcement that included revised SOE Guidelines with a few noteworthy changes, including the expansion of the definition of SOE to include the concepts of influence,\textsuperscript{34} a commitment to retain the current asset threshold requiring a net benefit review under ICA for SOEs (C$ 344 million) while increasing it to $1 billion in enterprise value for private sector WTO investors, a clear preference given to private investors over SOEs in the oil sand sector, and a commitment to carefully monitor foreign SOE investment throughout the rest of the economy.\textsuperscript{35}

As illustrated by the examples above, countries have tended to differentiate the application of “net benefit” or “national security” tests when clearing SOE investment. Often the asset thresholds triggering an investment review are lower for SOEs as are the maximum shares acquisition levels in some sectors. Sometimes, additional scrutiny or conditionality applies (e.g. SOE-specific guidelines). Still, despite a formal differentiation in legal requirements, to date the authors do not find evidence that SOEs have been systematically disadvantaged or barred from investing when such tests were applied. In fact, SOE investment has at times been perceived as better aligned with commercial and political objectives of the recipient country than that by its private sector rival. Recent developments in Canada suggest that this may, however, be changing and in some sectors a strong preference will be given to private firms and stronger scrutiny applied to foreign SOEs. Such additional review measures for SOEs are to provide recipient governments with further latitude to consider whether or not a control of a foreign state over an investing firm compromises the firm’s commercial considerations or privatisation objectives in the sector. Using the review process to increase transparency in investing firms’ operations and ensuring that commercial considerations are observed, e.g. through encouraging listing of shares at a local stock exchange, appears \textit{a priori} to be of benefit to the recipient country regardless of the ownership status of the investing firm. Definitions will nevertheless require clarity and rules will have to be applied in a transparent and consistent fashion to ensure legitimate investment is not deterred.

\textsuperscript{33} On December 7, 2012 the federal government announced its approval of both Malaysian-controlled PETRONAS’ proposal of a $6 billion acquisition of Progress Energy Resources Corp. and China National Offshore Oil Corporation’s (CNOOC) proposed $15.1 billion acquisition of Nexen Inc.

\textsuperscript{34} The new definition includes not only enterprises owned or controlled directly or indirectly by a foreign government but also entities that are \textit{influenced directly or indirectly} by a foreign government. In a related statement, the Minister of Industry indicated that he “will closely examine the degree of control or influence an SOE would likely exert on the Canadian business that is being acquired; the degree of control or influence an SOE would likely exert on the industry in which the Canadian business operates; and, the extent to which a foreign state is likely to exercise control or influence over the SOE acquiring the Canadian business. Where due to a high concentration of ownership a small number of acquisitions of control by SOEs could undermine the private sector orientation of an industry, and consequently subject an industrial sector to an inordinate amount of foreign state influence, the Government will act to safeguard Canadian interests”.

\textsuperscript{35} “(…) the Minister of Industry will find the acquisition of control of a Canadian oil-sands business by a foreign SOE to be of net benefit to Canada on an \textit{exceptional} basis only” (Industry Canada, 2012)
Production of potash is considered a strategic sector in Canada, and in particular in the Saskatchewan province. Over 50% of world’s potash reserves are located there, primarily in Saskatchewan, and Canadian firms account for the largest share of world’s potash production (30%) and global exports (36%), followed by Russia and Belarus. Due to high barriers to entry and high economies of scale, there are only few firms operating in the market, additionally organised in export cartels. The largest one – Canpotex – is located in Canada and sells potash outside of North America on behalf of the Canadian PotashCorp, Atrium of Canada, and U.S.-based Mosaic. PotashCorp, based in Saskatchewan, is Canpotex’ largest supplier and used to be a Crown corporation until the province divested all its assets in 1993. Together with another export cartel – Belarusian Potash Company, representing a Moscow-based Uralkali and Belaruskali of Belarus, these two export cartels account for 70% of global potash exports and strongly influence global prices. The activity of Canpotex and PotashCorp is an important source of local government revenues in Saskatchewan. Hence, it may not be a surprise that foreign investors’ actions seen as changing the position of either of these two firms may meet local opposition.

In August 2010 BHP Billiton - an Anglo-Australian mining giant, made a $38.6 billion hostile take-over bid for PotashCorp. The firm applied for approval under ICA and the “net benefit’ review was commenced. In the meantime, the Saskatchewan Government raised concerns that the bidding company would resign from providing potash to the global market through Canpotex and that this change would significantly hurt its tax revenues. Interestingly, in the meantime, PotashCorp’s management approached a Chinese SOE – Sinopec, in order to rally up an alternative bid for a higher price. The fact that the management supported the bid by a foreign SOE, while an investment by a private firm was being questioned under the “net benefit” review, suggests that the price for the bid and the retention of Canpotex dominated the considerations, and ownership was of secondary importance.

Sinopec eventually withdrew its bid in October 2010, allegedly as the price was too high. On November 3, 2010, the former Minister of Industry – Tony Clement, announced that he was not able to conclude that the BHP investment would "likely be of net benefit to Canada".

A3. Supplementary information on regulatory approaches dealing with anti-competitive cross-border effects of SOEs

A3.1 Competition law

76. The general purpose of competition law is to protect competition in the market place. The application of competition law to remedy anti-competitive behaviour of SOEs in a cross-border context requires fulfilment of several criteria (for key points see Section 5.1 in the main text). The concept of extraterritorial jurisdiction in competition cases and the so called effects doctrine “implies that domestic competition laws are applicable to foreign firms as well to domestic firms located outside the state’s territory, when their behaviour or transactions produce an “effect” within the domestic territory” (EC, 2012). Depending on how broadly the “effect within domestic territory” is interpreted, according to this doctrine, national antitrust law could in principle be applied to any type of anti-competitive behaviour by a foreign firm, including an SOE, whether it involves foreign presence or cross-border trade.

77. A first issue in competition cases against a foreign SOE is whether the anticompetitive conduct by a foreign SOE in their market might be shielded from jurisdiction by sovereign immunity as the action could be considered an act of the foreign State. Where foreign state immunity can be evoked, it means that “one State is not subject to the full force of rules applicable to another State; the doctrine bars a national court from adjudicating or enforcing certain claims against foreign States” (Gaukroderg, 2010). Traditionally sovereign immunity was considered very broadly, and referred both to immunity from jurisdiction (judging the actions of another State) and to immunity from execution (taking coercive measures against another

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36 See, for example, the Conference Board Report, 2010 or the speech by Brad Wall, Premier of Saskatchewan opposing the bid on October 21, 2010: http://m.theglobeandmail.com/globe-investor/premier-walls-speech-on-proposed-takeover-of-potash-corp/article1215903/?service=mobile [accessed last on 2 Nov 2012]

37 See, for example: http://m.theglobeandmail.com/globe-investor/sinochem-courts-backers-for-move-on-potash/article4326132/?service=mobile [accessed last on 2 Nov 2012].
state’s assets) (Gaukrodger, 2010). Yet, with increasing States’ involvement in commercial activities many jurisdictions began to apply a “restrictive” approach to immunity, where courts continue to recognise immunity for “sovereign” acts, but deny immunity for “commercial” acts with a view of protecting the legitimate expectations of business partners that engage in commercial transactions with foreign states. The “commercial exception” from immunity in the restrictive approach is now also set out in the UN Convention on Jurisdictional immunities of States and their Property, and is considered customary international law. Thus, SOEs will generally be subject to the competition laws of the host State both for jurisdiction and for enforcement against its assets in the host state (provided the assets relate to that commercial activity).

78. All this suggests that, provided certain criteria are fulfilled, private firms can attempt to seek a recourse from anti-competitive behaviour of foreign SOEs in their own jurisdictions (i.e. host state jurisdiction), which may be less intimidating, and formally easier (e.g. potential residency requirements) than trying to do so in the jurisdiction of an SOE or a third country. While seeking such recourse on the basis of a foreign antitrust law is in principle also an option, there may be specific requirements for demonstrating the case (e.g. sufficient size, sufficient impact on the foreign market, etc.) which may be harder to meet. The latter option can also in general be more challenging due to information asymmetries, inability to access evidence located abroad, higher transaction costs, as well as unfamiliarity with specificities of foreign legal systems.

79. The application of competition laws to SOEs, but also to private monopolies, is complicated because they will sometimes enjoy exemptions from national competition laws in their home states and will be protected from enforcement of decisions of foreign competition authorities. Enforcement of competition decisions in the domestic market of the host state or importing state is often possible but this will not generally have an impact on activities in third markets. Competition authorities in countries with large markets can have the clout to enforce their decisions with respect to foreign SOEs and force them to effectively change behaviour also in third markets. When this is not the case the problem of enforcement where the anti-competitive behaviour takes place in a third state jurisdiction, without proper competition laws and enforcement, remains.

A3.2 OECD Guidelines on Corporate Governance of SOEs

80. The OECD Guidelines on Corporate Governance of SOEs establish the core elements of a good corporate governance regime that helps minimising costs associated with state ownership. To the extent these costs may spill across borders and to the extent the Guidelines are applied on a non-discriminatory basis (e.g. their enforcement is not lessened for SOEs competing with foreign POEs), they can serve as an instrument of minimising unwanted cross-border effects of SOEs. They cover a broad range of legal and regulatory issues pertaining to SOEs, and are outcomes-based, focusing on corporate outcomes while giving individual jurisdictions freedom on whether and how to apply these.

81. While de jure the Guidelines apply equally to domestic and foreign firms operating in a given country, in line with the non-discrimination principle, it is an open question whether they could be effectively used by foreign firms operating in the market to ensure level playing against domestic players, including SOEs. Equally, it is not clear if the governments require their domestic firms to align their conduct with these guidelines to the same extent when they are competing abroad as when they are competing in the home market. As Capobianco and Christansen (2011) point out “it is not obvious that

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38 In some countries, such as, for example, the United States private enforcement of competition law is possible but more typically the pursuit of competition policy is the domain of competition authorities.

39 The key condition here is that SOEs are not exempted from the application of competition law (see Section 5.1 in the main text).
governments necessarily remain unwavering in their commitment to a level playing field when the playing field is located in a foreign economy. Issues of competition between countries as well as between enterprises may enter the calculation”. In other words, countries may be less inclined to use the principles enshrined in the guidelines when their enterprises are operating abroad or when foreign enterprises operating in their domestic markets attempt to use competitive neutrality framework provisions against domestic firms.

82. Another shortcoming in the cross-border context is that the OECD guidelines are non-binding. They, as an OECD recommendation, are a legal instrument with which all members must formally associate themselves and, in the case of accession to OECD, prove that they can credibly do so. Investment regulators are free to use them as a benchmark to assess the quality of potential investors. Yet, even among the OECD members, they remain “recommendations at a high aspirational level”, their implementation is not as consistent as of some other OECD instruments and they are generally not backed to the same extent by pressure from legislators, investors and stock exchanges (op. cit.). The non-binding and voluntary nature of the OECD guidelines suggests that, while they could be used as a useful tool for advocacy-oriented approach to minimising unwanted cross-border effects of SOEs among countries committed to the reform of the state sector, they fall short of providing binding multilateral rules as seen in international trade or investment agreements.

A3.3 Other domestic arrangements aimed at fostering competitive neutrality

83. The competitive neutrality framework (CNF) of Australia has been devised in addition to national competition law and provides a set of rules designed to ensure that government businesses operating in competitive or potentially competitive markets do not enjoy a net competitive advantage over the private sector because of their ownership. The key principles of Australian competitive neutrality are: taxation neutrality, debt neutrality, regulatory neutrality, commercial rate of return and that prices charged by SOEs reflect costs. Implementation is overseen by the National Competition Council and the Productivity Commission, and there is a special unit where companies can file complaints.

84. The CNF of Australia can be used by foreign firms to remedy some of the anti-competitive effects of SOEs. In fact, one of the few existing complaints filed does involve a subsidiary of the government-owned Meteorological Services of New Zealand Limited as a complainant against the state-owned Australian Civil Aviation Safety Authority’s.

85. In the European Union competitive neutrality is pursued through a set of special competition-law rules concerning interactions between government and private entities. Public companies fall under the scope of the competition law and are subject to rules on monopolisation and subsidies (Capobianco and Christiansen, 2011). The European Commission has the power to require national governments to apply competition rules to public companies and, in case of infringement, can require companies to stop the anti-competitive conduct and can impose fines. In the case of SOEs, if the anti-competitive behaviour is government-induced, the European Commission can require the government to stop such a practice. State aid rules cover both aid to private and public companies and include: capital injections, grants, tax reductions and tax holidays, reductions in social security costs and warranties. The selected types of state aid that are allowed have to be notified and approved by the European Commission, and the Commission has also the power to recover incompatible state aid (see Annex Box 4 for one example of a dispute over state aid in the EU context). In addition, the European transparency directive requires that commercial and non-commercial activities of public companies should have separate accounts (op. cit.). The EU has also strong EU-level public procurement rules.

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86. The supranational character of the European Union’s arrangement makes it particularly relevant for consideration in the discussion of disciplines on anti-competitive cross-border effects of SOEs. Its roots go back to the early stages of establishing a common market between the EU members—many of which had different traditions with respect to the role of the state in the economy—and as such the framework has been designed specifically to deal with cross-border competition issues. The EU’s arrangement can thus be seen as one of the most advanced frameworks dealing with anti-competitive cross-border effects of SOEs and POEs. Yet, its provisions bind only EU members and rules bearing on competition, state aid and transparency aim principally at underpinning the EU single market. Also, its advanced state cannot be seen in separation from other dimensions of deep economic and social integration in the EU. It is unclear to what extent it could realistically serve as a model for international competitive neutrality agreement involving a larger group of less integrated countries.

Annex Box 4. Dispute of EDF vs. European Commission concerning illegal state aid

Article 107(1) of the Treaty on the Functioning of the European Union prohibits state aid granted by member states or through state resources for the benefit of certain undertakings, or for the production of certain goods, if there is a possibility the aid may distort competition or have an adverse effect on intra-community trade. In order to assess if a measure adopted by the state vis-a-vis an SOE should be considered state aid, it has to be decided if the state was acting as a shareholder or a public authority. For this purpose a “private investor test” is applied: if the same measure would have been adopted under normal market conditions by a private investor in a situation similar to the state’s, the undertaking concerned is not considered to have received state aid, under the EC rules.

According to the European Commission (EC), in 1997 France waived a tax claim against the then wholly state-owned company Électricité de France (EDF) worth 888.89 million Euros at the time. In 2003, the Commission ruled that the waiver strengthened EDF’s competitive position vis-a-vis its peers and hence constituted improper state aid (Decision 2005/145/EC of 16 December 2003). The EC had argued that the state acts as a public authority, not a shareholder, when it uses measures that only a public authority can use, such as legislative or tax measures. EDF was ordered to pay 1.22 billion Euros after interest to the French state.

In 2009, EDF successfully appealed the EC ruling to the General Court - the European Union's second highest court, and the French state returned the money to EDF. The European Commission appealed the decision to the European Court of Justice. The final ruling came in June this year (case C-124/10 P), following a 15-year long dispute, when the court ruled in favour of EDF, allowing it to keep the money. The European Court of Justice rejected EC’s appeal on the grounds that the EC erred in law by refusing, simply because the measure was fiscal, to consider whether the French state had acted as a private investor: “The Commission erred in law by refusing, simply because the measure was fiscal, to consider whether the French state had acted as a private investor,” the Court of Justice said in its statement.

The European Court of Justice came to the conclusion that the sovereign nature of the measure does not preclude the applicability of the private investor test. However, the member state must show unequivocally that it considered the measure ex ante as an investment on market terms, and not as financial support by a public authority, and it cannot argue ex post that the measure has effects comparable with a hypothetical action of a private shareholder.

A3.4 WTO disciplines

A3.4.1 Ownership-neutral WTO rules applicable to SOEs

87. As a general principle WTO rules impose obligations on governments, as opposed to private or non-governmental entities or SOEs or STEs. The WTO obligations aim at protecting the trading conditions of economic operators engaged in international trade. Generally WTO rules do not distinguish between POEs and SOEs when it comes to protecting the expectations of economic operators with respect to access to markets. A few examples are provided in the remainder of this sub-section. However, there are some WTO provisions which specifically target actions by enterprises having a “special connection” with a government, e.g. state-trading enterprises (STEs), to avoid situations where State could deny responsibility for actions taken by the legally distinct entity of the STE that might distort international trade. See for instance sub-sections A4.4.3 and A4.4.4.
A3.4.1.1 National treatment

88. The principle of national treatment is a core element of the legal framework of the General Agreement on Tariffs and Trade (GATT, Article III). It requires signatory governments to treat imported goods equally to like domestically produced goods and has the consequence of protecting expectations of foreign producers supplying a market from behind-the-border barriers, including when their products compete with products of SOEs of the importing country or are procured or handled by SOEs. The same could be said about most-favoured nation (MFN) and other principles; countries cannot normally discriminate between their trading partners, independent of their ownership status.

3.4.1.2 Subsidies in goods trade

89. Subsidies belong to the list of key benefits granted historically to enterprises, including SOEs, by governments. The SCM Agreement disciplines apply in the same way to subsidies received by enterprises, whether private or state-owned. The SCM Agreement constitutes a set of rules that discipline the use of subsidies in industrial sectors but it does not apply to services industries. It sets out disciplines for different types of subsidies, and the remedies available to enforce those disciplines. In particular, subsidies which are contingent on export performance, or which are contingent on the use of domestic goods over imported ones, are prohibited. Other subsidies, while not prohibited, may be acted against if they cause adverse effects in international trade, and are thus deemed "actionable". Both prohibited and actionable subsidies may be challenged directly in the WTO dispute settlement mechanism (DSM). In addition to DSM, a country whose domestic industry is injured by imports that benefit from a subsidy granted by another country (actionable or prohibited) may, following an investigation by the importing country's authorities, impose countervailing measures. Such measures usually take the form of additional import duties, the level and duration of which are governed by the SCM Agreement.

90. While SOEs are covered by the above-explained WTO subsidy disciplines when they are subsidy recipients, the application of subsidy disciplines to SOEs as grantors of subsidies is more complicated. Namely, the SCM Agreement specifies that subsidies granted by "public bodies" are subject to WTO disciplines in the same way as subsidies granted by government authorities. Whether or not an SOE is subject to these disciplines will thus depend on whether it can be considered a “public body”. State-ownership is not a sufficient condition to make such a determination under the existing WTO rules (see also A2.2 and section A3.4.3.2 for more detail).

91. A recent stocktaking of the effectiveness of WTO subsidy disciplines by Horlick and Clarke (2010) suggests that the WTO SCM provisions have been successful in disciplining export subsidies, relatively less successful in disciplining import-substitution subsidies and largely failed to discipline so-called domestic subsidies, which are neither contingent on exportation nor on the use of domestic over imported goods, but might nevertheless have harmful trade effects.

92. A shortcoming of existing WTO subsidy disciplines in our context is that there are no equivalent subsidy rules for services. The SCM Agreement does not apply to trade in services and no specific disciplines have been developed yet for services subsidies. Such subsidies are subject to basic GATS disciplines, including the MFN obligation and, where relevant commitments exist, the national treatment obligation (see below). GATS Article XV mandates WTO members to negotiate with a view to developing

41 If a subsidy is determined to be prohibited, the country granting the subsidy will be directed to withdraw it without delay. In the case of actionable subsidies causing adverse effects, the granting country will be directed to take steps to remove the adverse effects, or withdraw the subsidy, within a reasonable period of time.

42 Nevertheless, subsidies granted to services and services suppliers are subject to some GATS disciplines, in particular the national treatment and the MFN obligations (see below).
multilateral disciplines addressing trade-distorting subsidies but the negotiations have not resulted in new disciplines yet.

93. The lack of subsidy disciplines in the services sectors is important for three reasons. First, many modern internationally active SOEs operate in services sectors (see Section 3 of the main paper). Second, goods and services provision are tightly linked in a number of ways: many of modern enterprises engage in production of both goods and services; services are often embodied in traded goods, and vice versa; and there are strong vertical links between goods and services sectors. Third, the expansion of the state sector related to government stimuli in the context of the financial crisis was strongly concentrated in services sectors such as, for example, financial services and real estate. All this means that services—an important sector with significant SOE presence—is not efficiently disciplined by existing WTO subsidy rules.

A3.4.1.3 Anti-dumping

94. SOEs may behave in ways that do not always align with commercial considerations, for example due to non-economic objectives they may assume, and this may be reflected in their pricing strategies at home and in foreign markets. Dumping, i.e. selling abroad below the “normal value” (generally, the market price of the good in the exporting country), may be one of the manifestations of such a behaviour. GATT Article VI, as developed in the “Anti-Dumping Agreement”, allows governments affected by dumping to defend their domestic industries by taking targeted anti-dumping measures in cases where imports from foreign producers—SOEs or POEs—are priced below the normal value and cause injury, or have the potential to cause injury, to a domestic industry producing the like product.

95. Anti-dumping measures usually take the form of additional import duties on the goods that are dumped. The level and duration of anti-dumping duties are governed by the WTO Agreement. The calculated margin of dumping limits the amount of additional duty that can be imposed, and its calculation may be more complicated in the case of products exported by SOEs. This is because in some cases margins of dumping are computed using production functions and profit margin concepts, which may be less relevant and reliable in the context of SOEs. In addition, in cases involving imports from so-called non-market economies (i.e. economies where state involvement is considered so high that domestic market prices cannot be treated as a reliable benchmark for what a normal value is), some countries use surrogate-country market prices to establish what normal value is to then calculate the anti-dumping duty rate, which further complicates the determination of the margin of dumping.43

A3.4.2 WTO provisions that allow exemptions of SOEs from the application of the WTO disciplines or commitments

A3.4.2.1 The GATS

96. Under the GATS, members undertake specific commitments by sector and by mode of supply. In sectors and modes where they undertake such commitments, members may protect national enterprises, including SOEs, in various ways. For instance, they can stipulate that the commitment will apply only to private entities. Alternatively, they may limit the number of service suppliers, refrain from granting national treatment or maintain some measures granting more favorable treatment to national entities.44 There is also no direct equivalent to GATT Article XVII on State Trading Enterprises in the GATS.

43 For example, U.S. Department of Commerce applies a “non-market economy” status to some countries, including China, and uses surrogate country prices to calculate the market price benchmark.

44 Some WTO members reserved the right to apply an additional government approval procedure for direct investments made by a foreign government-owned services provider while some others do not allow licenses to foreign government-owned services providers in certain sectors.
A3.4.2.2 The GPA Agreement

97. Some WTO members have agreed to further market opening in the area of government procurement (purchases of goods and services by public bodies for governmental purposes). Some SOEs can have both governmental and commercial functions. In that context, it is important to note that in negotiating GPA commitments, WTO members can, in their schedules to the Agreement, both list relevant SOEs and add qualifying provisions that limit the extent of their obligations (see also section A3.6).

A3.4.3 Explicit rules on State Trading Enterprises and other concepts closely related to SOEs

A3.4.3.1 State Trading Enterprises

98. WTO rules explicitly discipline some practices in which so-called State Trading Enterprises (STEs), some of which can but do not have to be state-owned, can be used by governments as vehicles to influence international trade. The idea here is that states cannot hide behind such STEs to avoid their WTO obligations. GATT Article XVII on STEs and the Understanding of the Interpretation of Article XVII of the GATT 1994, aim to discipline cases where the level of purchases or sales conducted by STEs is not based on economic principles but rather on political or political-economy considerations.

99. A difficulty with WTO rules on STEs has been the lack of clear definition of what STEs and state trading actually are. For example, the text of the original GATT Article XVII could suggest that state ownership is a sufficient condition for an enterprise to be considered an STE (see “State enterprise” in Annex Box 5). However, the WTO Understanding on the Interpretation of Article XVII of GATT 1994 (WTO Understanding thereafter) provides the “working definition” of STEs which states that they are “governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports”. The latter definition suggests that state ownership is neither a necessary nor a sufficient criterion for an enterprise to be considered an STE. Rather, STEs seem to be defined in terms of their actions or activities in the market, not in terms of ownership per se. However, it can be expected that ownership (by states) will influence choices of actions or activities of the concerned enterprises, thus bringing them within the scope of the WTO STE disciplines.

100. This lack of clear definition has had a number of implications. First, it has been, as stated by the WTO, “a serious handicap in the efforts to enforce the transparency obligation under Article XVII” (WTO’s page in STEs), as illustrated by the consistent lack of the members’ notification of STEs and their activities to the WTO Secretariat (Smith, 2006). The WTO reports though that compliance with the notification obligation has recently improved.

101. Second, while the WTO Understanding provides a “working definition” of an STE one could still argue which interpretation is the most useful one. For example, considering the letter of Paragraph 1.(a) of the original Article XVII (see Annex Box 6), it is not clear whether, and if so why, the “granting to the enterprise of exclusive or special rights or privileges” element (rights element) is interpreted in the WTO Understanding as a stronger criterion for state trading as compared to the “State enterprise” element

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45  WTO official website on STEs: [http://www.wto.org/english/tratop_e/statra_e/statra_info_e.htm](http://www.wto.org/english/tratop_e/statra_e/statra_info_e.htm).
46  (op. cit.)
47  Typical STEs as listed by the WTO’s Working Party on STEs include: statutory-, export- and regulatory marketing boards; fiscal monopolies; canalising agencies; foreign trade enterprises or boards/corporations resulting from nationalised industries (WTO, 2012).
(ownership element) (Annex Box 6). One hypothesis here is that this is because traditionally the WTO law tended to be ownership neutral. Yet, there exist exceptions where WTO texts do explicitly refer to state-ownership or similar concepts (see below). Arguably, making either of the two elements (rights or ownership) sufficient, when combined with the “resulting influence, through the enterprise's purchases or sales, on the level or direction of imports or exports” element (trade distortion element) could make the Article more effective, while not making ownership a sufficient requirement in itself.

102. Another explanation is that Article XVII, and now more clearly the Understanding on Article XVII, defines state-trading enterprises with reference to whether the STE is capable of controlling the concerned market because of the privileges and rights provided to the concerned enterprise by the government. The GATT/WTO disciplines are not based on ownership per se because STE disciplines based on (majority) ownership alone could easily be circumvented. For example, under WTO rules, an enterprise that is not majority-owned by government can nonetheless be considered an STE if it receives any rights or privileges that give it power in the market. This is not to say that ownership is not relevant or indicative but it is not determinative of whether an entity is a STE (under GATT Article XVII) or a public body (under SCM) or a monopoly under GATS.

103. Other ambiguities in Article XVII evoked in the literature include the interpretation terms “commercial considerations”, “customary business practice” and “enterprises of the other contracting parties” in Paragraph 1(b) (Smith, 2006). In addition, subsidisation, which is a highly relevant in the context of the state sector, is not elaborated on under Article XVII and trade-related subsidisation is instead disciplined by Article XVI, the SCM Agreement and different provisions of the Agreement on Agriculture (Qin, 2004). Finally, the relationship between the first and second sub-paragraph of Article XVII is unclear. For example, the first sub-paragraph of Article XVII prohibits STEs from any discrimination, while the second obliges STEs to respect commercial considerations, when it is generally accepted that discriminatory export price is a reasonable business practice. Some examples of dispute cases concerning STEs and GATT Article XVII are given in Annex Box 7.
Annex Box 5. GATT Article XVII

State Trading Enterprises

1. (a) Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in this Agreement for governmental measures affecting imports or exports by private traders.

(b) The provisions of subparagraph (a) of this paragraph shall be understood to require that such enterprises shall, having due regard to the other provisions of this Agreement, make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of the other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

(c) No contracting party shall prevent any enterprise (whether or not an enterprise described in subparagraph (a) of this paragraph) under its jurisdiction from acting in accordance with the principles of subparagraphs (a) and (b) of this paragraph.

2. The provisions of paragraph 1 of this Article shall not apply to imports of products for immediate or ultimate consumption in governmental use and not otherwise for resale or use in the production of goods for sale. With respect to such imports, each contracting party shall accord to the trade of the other contracting parties fair and equitable treatment.

3. The contracting parties recognise that enterprises of the kind described in paragraph 1 (a) of this Article might be operated so as to create serious obstacles to trade; thus negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles are of importance to the expansion of international trade.

4. (a) Contracting parties shall notify the CONTRACTING PARTIES of the products which are imported into or exported from their territories by enterprises of the kind described in paragraph 1 (a) of this Article.

(b) A contracting party establishing, maintaining or authorising an import monopoly of a product, which is not the subject of a concession under Article II, shall, on the request of another contracting party having a substantial trade in the product concerned, inform the CONTRACTING PARTIES of the import mark-up on the product during a recent representative period, or, when it is not possible to do so, of the price charged on the resale of the product.

(c) The CONTRACTING PARTIES may, at the request of a contracting party which has reason to believe that its interest under this Agreement are being adversely affected by the operations of an enterprise of the kind described in paragraph 1 (a), request the contracting party establishing, maintaining or authorising such enterprise to supply information about its operations related to the carrying out of the provisions of this Agreement.

(d) The provisions of this paragraph shall not require any contracting party to disclose confidential information which would impede law enforcement or otherwise be contrary to the public interest or would prejudice the legitimate commercial interests of particular enterprises.

Source: GATT/WTO.
Annex Box 6. Excerpts from the Understanding on the Interpretation of Article XVII of the General Agreement on Tariffs and Trade 1994

Members,

Noting that Article XVII provides for obligations on Members in respect of the activities of the state trading enterprises referred to in paragraph 1 of Article XVII, which are required to be consistent with the general principles of non-discriminatory treatment prescribed in GATT 1994 for governmental measures affecting imports or exports by private traders;

Noting further that Members are subject to their GATT 1994 obligations in respect of those governmental measures affecting state trading enterprises;

Recognizing that this Understanding is without prejudice to the substantive disciplines prescribed in Article XVII;

Hereby agree as follows:

1. In order to ensure the transparency of the activities of state trading enterprises, Members shall notify such enterprises to the Council for Trade in Goods, for review by the working party to be set up under paragraph 5, in accordance with the following working definition:

"Governmental and non-governmental enterprises, including marketing boards, which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports."

This notification requirement does not apply to imports of products for immediate or ultimate consumption in governmental use or in use by an enterprise as specified above and not otherwise for resale or use in the production of goods for sale.

(...)


Annex Box 7. WTO disputes involving state trading enterprises (STEs)

A prominent dispute at the WTO’s dispute settlement mechanism recalling GATT Article XVII on STEs is the Canada — Measures Relating to Exports of Wheat and Treatment of Imported Grain (DS276) case initiated by the US in 2002 (Smith, 2006). The complaint inter alia challenged Canadian exports of wheat which involved the Canadian Wheat Board (CWB), a mandatory marketing system for wheat and barley farmers of several Canadian provinces. The US claimed that that the export of wheat conducted by the CWB was inconsistent with Paragraphs 1(a) and 1(b) of GATT Article XVII on STEs. The WTO’s panel report and subsequently the WTO Appellate Body report rejected the claim that Canada had violated its obligations under Article XVII with respect to the CWB. Smith (2006) interpreted this decision as reflecting insufficient empirical evidence in support of the claim that the sales of the CWB took place on an anti-competitive and non-commercial basis. However, despite the fact that the panel's interpretation provided important clarification of the concept of "commercial considerations", the same author suggested that the case highlighted the imprecision of the wording of Article XVII with regard to commercial considerations, export subsidies or import barriers in the context of STEs, and that this undermines legal applicability of the article (op. cit.).
A3.4.3.2 WTO provisions which specifically refer to entities closely related to SOEs

“Public bodies” in SCM

104. While SOEs are covered by WTO subsidy disciplines when they are subsidy recipients, the application of subsidy disciplines to SOEs as grantors of subsidies may be more complicated. The SCM Agreement provides that its disciplines apply equally to subsidies involving financial contributions provided by governments or “public bodies”, and also to subsidies provided by private parties in certain circumstances. First, the question arises whether SOEs can be considered public bodies. The ruling in the Dispute Settlement case DS379 United States – Definitive Anti Dumping and Countervailing Duties on Certain Products from China (see also A2.2) suggests that SOEs cannot automatically be categorised as “public bodies” based on state ownership. To be considered a “public body” such an entity must be controlled by the government and exercise “governmental functions”. “The mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercise meaningful control over the conduct of the entity, much less that the government has bestowed it with governmental authority” (p. 318). Nonetheless it is clear that "under the SCM, if an entity is a public body, then its conduct is attributed directly to the State” (p. 309). Second, there is a question whether the provision of inputs or other advantages by a public body constitutes a financial contribution. Here, establishing a relevant market-based commercial benchmark for an input provided by an SOE can be more challenging especially in cases where the boundaries between commercial and public activities of SOEs are blurred.

SOE-related entities in the GATS

105. The GATS does not refer to state trading enterprises or state-owned enterprises, but contains two concepts which can potentially overlap with SOEs. Article I:3(b) of the GATS carves out from the scope of the Agreement “services provided in the exercise of governmental authority”. These services are defined as services which are “supplied neither on a commercial basis nor in competition with one or more service suppliers”. Hence, SOEs which do not supply services commercially and are not competing with other suppliers would benefit from this carve-out. However, SOEs which supply services on a commercial basis and/or are competing with other service suppliers fall within the scope of the GATS and are subject to its disciplines.

106. The GATS also contains disciplines regarding monopolies, which apply to both public and private monopolies. Under the GATS Article XVIII, Members must ensure that monopoly suppliers act in a manner consistent with members' specific commitments, as well as with the MFN obligation. Moreover, when a monopoly competes, either directly or through an affiliated company, in the supply of a service outside the scope of its monopoly rights and that service is subject to a member's specific commitment, that member must ensure that such monopoly supplier does not abuse its monopoly position in a manner inconsistent with those specific commitments.

A3.4.4 Some Actions of SOEs can be “attributed to” WTO Members or governments and thus become subject to WTO rules as if they were actions by governments

107. In certain circumstances, actions of SOEs can be attributed to WTO members or governments, subjecting them to the same WTO rules as governments are subject to. For example, the footnote to Article 4.2 of the Agreement on Agriculture explicitly extends the prohibitions against Members’ quantitative import restrictions to measures maintained by STEs. The Ad Note to Article XI, XII, XIII, XIV and XVIII provides that "throughout Articles XI, XII, XIII, XIV and XVIII, the terms "import restrictions" or export restrictions include restrictions made effective through state-trading operations.
108. More generally, under the GATT, the Japan - Semiconductor panel report (1988) had concluded that in certain circumstances, actions that appear *prima facie* to be private measures can nonetheless be considered as governmental measures when such actions are indirectly monitored and controlled by government which maintains incentives and disincentives in their regard. Under general international law, actions by non-State actors, including SOEs, could be qualified as governmental measures if there is sufficient evidence role of State.

**A3.4.5 WTO provisions which specifically refer to SOEs or STEs in the WTO Accession Protocols of China and Russia**

109. China’s WTO Accession Protocol of 2001 departs from the ownership-neutral philosophy of the WTO system (Qin, 2004) and relates in large part directly or indirectly to the country’s dominant state sector. While the protocol does not contain obligations on privatisation of SOEs it provides in paragraph 46 of the Working Party Report that China “…would ensure that all state-owned and state-invested enterprises would make purchases and sales based solely on commercial considerations, e.g., price, quality, marketability and availability, and that the enterprises of other WTO Members would have an adequate opportunity to compete for sales to and purchases from these enterprises on non-discriminatory terms and conditions. In addition, the Government of China would not influence, directly or indirectly, commercial decisions on the part of state-owned or state-invested enterprises, including on the quantity, value or country of origin of any goods purchased or sold, except in a manner consistent with the WTO Agreement.”

110. China’s WTO Protocol comprises several provisions that aim to rule out trade distorting effects of the Chinese state sector and that refer to market access commitments, obligations with regard to the liberalisation of trading rights or commitments on SOE subsidies and their notification (Qin, 2004). For instance, sectors where SOEs were enjoying monopoly rights, such as the banking sector, had to be opened to foreign competition; trading rights had to be extended from selected and mainly state-owned firms to all enterprises; export subsidies had to be phased out until the moment of accession, without benefitting from usual transition periods under the SCM Agreement; and the legal scope for domestic subsidies had considerably been reduced compared to other developing countries (op. cit.). Furthermore, since specific subsidies are actionable according to Article 2 of the SCM Agreement, section 10.2 of the China protocol underlines that subsidies which are predominantly targeted towards state-owned enterprises in terms of the number of recipients or the volume of subsidies are considered as specific subsidies. This SOE-specific provision, clearly addressing the issue of state ownership, is a departure from the otherwise ownership-neutral philosophy of the WTO.

111. Thus, China’s accession protocol can be considered a part of the WTO law with very strong disciplines dealing with anti-competitive cross-border effects of SOEs. Yet, some have expressed doubts as to whether these provisions have been effective in disciplining trade distorting effects of China’s SOEs. On the one hand some legal scholars and economists have emphasised that the far reaching commitments made by China under its accession protocol have had and continue to have important spill-over impacts for the quality of the rule of domestic economic law, arguably with WTO law having more impact on Chinese

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48 China made specific commitment to eliminate the central government’s subsidies to money-losing (SOE), one of the 24 subsidy programs notified to the WTO.

49 Whereas the protocol does not define SOEs, there exists a consensus among legal scholars that they comprise fully state-owned and state-controlled entities (Qin, 2004).

50 It should be noted that China’s accession protocol allows it to maintain exclusive trading rights for certain SOEs on the trade of certain goods listed in the annex. Also, China made commitments to refrain from treating some SOEs’ purchases as government procurements (paragraph 47 of the Working Party Report).
law than any other international law (Manjiao, 2012), and for the transition and liberalisation of the state-owned sector with potentially huge welfare effects for the society as a whole (Bajona and Chu, 2010).

112. On the other hand, some critics argue that the current legal framework has not sufficiently impeded trade-distorting policies that advantage Chinese SOEs. The main criticism is related not to the provisions of the accession protocol but to the fact that, in addition to being time-consuming, WTO dispute settlement procedures can also have diplomatic as well as commercial costs and might represent a suboptimal forum for foreign producers in a context where the ultimate owners of competitor firms—government bodies—are closely affiliated to other government bodies which act as regulators, principals of government procurement biddings, etc. (e.g. Potter, 2001 and Annex Box 8). The Chinese case might thus illustrate that state ownership confers additional challenges for the effectiveness WTO dispute settlement mechanism.

113. The Working Party Report on the WTO Accession of Russian Federation notes that Russia needs to ensure that its “state-owned and state-controlled enterprises that operate in the commercial sphere” and “enterprises with exclusive or special privileges with regard to conducting commercial activity” would, when engaged in commercial activity, “make purchases, which were not intended for governmental use, and sales in accordance with commercial considerations, including price, quality, availability, marketability, and transportation, and would afford enterprises of other WTO Members adequate opportunity in conformity with customary business practice, to compete for participation in such purchases or sales” (WTO, 2001: paragraph 46).

114. In the case of Russia, specific issues related to the operation of state-owned enterprises were also discussed during its accession negotiations, including pricing practices by SOEs that could be considered as either incompliant with “commercial considerations” requirement under Article XVII of GATT or “adequate remuneration” requirement provided for in Article 14(d) of the SCM Agreement (e.g. lower domestic prices of gas provided by Gazprom that may be a de facto subsidy to downstream industries). Still, most of the commitments were generic and reaffirmed the need for the Russian Federation to comply with existing WTO provisions, also in regards to SOEs. For example, the STE notification requirement was noted and Russia committed to notifying Gazprom as STE in accordance with Article XVII of the GATT 1994. It was also noted that Gazprom pricing practices will also have to comply with Articles XI, XVI of the GATT 1994 and the SCM Agreement. The only mention of state-owned firms in the Accession Protocol itself regards the banking sector, where the Protocol stipulates that “Russian authorities shall ensure that foreign banks established in Russia shall enjoy the same level of guarantee from the State for deposits as all other banks (including State-owned banks) and the same obligations as regards their participation in a possible deposit insurance mechanism.” (WTO, 2011: 46) While it is too early to tell to what extent the adherence to the general WTO acquis will allow foreign government to use DSM mechanism to discipline Russian SOEs, bearing in mind the experience with China so far, the prospects may be not particularly promising.
China has been involved as respondent in several disputes concerning SOEs. For instance, the case China – Publications and Audiovisual Products (DS363) initiated by the US challenged the granting or trading of distribution rights for a variety of cultural products mainly or exclusively to Chinese SOEs, which violated a number of WTO provisions such as GATT Article III (national treatment), GATS Article XVI (market access) or GATS Article XVII (national treatment). The three cases grouped under China – Measures Affecting Financial Information Services and Foreign Information Suppliers (DS372, DS373 and DS378) involved the Chinese state news agency “Xinhua News Agency”. The EU, the US and Canada claimed that conditioning the renewal of foreign financial information suppliers’ licenses on the prior signing of agent agreements with a branch of Xinhua, named China Economic Information Service represented a violation to several provisions under GATS. However, these three cases have not led to the establishment of a panel.

In the case China – Electronic Payment Services (DS413) the US argued that China UnionPay – (CUP) a Chinese entity which can be considered an SOE for the purposes of this paper – was granted exclusive market rights for electronic payment services for transactions in Renminbi. It was argued that this represented a discrimination of foreign electronic payment services providers who were limited to transactions in foreign currencies violating provisions under GATS Articles XVI (market access) and XVII (national treatment). The dispute was filed by the US against China, and Australia, Ecuador, the EU, Guatemala, Japan, Korea and India joined the claimant in the case (WTO, 2012).

This case related to China’s Services Schedule where China has undertaken certain commitments in respect of “all payment and money transmission services, including credit, charge and debit cards…” (WTO 2001) by December 11th 2006. Yet, long after this date has expired CUP continued to hold a strong position for different payment services transactions in Renminbi, and several multinational financial services corporations, most prominently Visa, complained about anticompetitive disadvantages they encountered in the Chinese market.

CUP was established under the approval of the State Council and the Chinese central bank People’s Bank of China (PBOC) in 2002 and cooperated with foreign credit card companies by providing dual-currency credit cards, where holders’ transactions in foreign currencies are handled by the partner whereas transactions in Renminbi are handled by CUP. Hence, foreign corporations could cooperate with CUP for foreign currency transactions, but the cards of foreign providers were required to carry the Yin Lian/UnionPay logo; cards had to be issued in the technical and security PBOC 2.0 standard; merchants and all terminal equipment in mainland China were required to accept CUP cards and to post its logo, whereas foreign providers had to negotiate contracts individually; and some Renminbi-denominated transactions could only be cleared by CUP (WTO 2012). The United States claimed that these requirements represented a violation of China’s national treatment and market access obligation under the GATS.

The WTO panel report was circulated in July 2012. It rejected –due to a lack of evidence--the claim that CUP represents an across-the-board monopoly supplier. However, the panel confirmed that CUP held a monopoly in relation to one particular type of transactions and that this was contrary to China’s commitments under Article XVI (market access). The panel also ruled that certain other regulatory advantages enjoyed by CUP as described above, represented a breach of China’s commitments under GATS Article XVII (national treatment).

Yet, some commentators highlighted the limitations of the dispute settlement procedure in this case. Given the market dominance of CUP and its close connections with the Chinese government, different multinational corporations did not actively cooperate with the United States Trade Representative (USTR) because of a possibility of retaliation in China’s market. It was difficult for the USTR to gather sufficient empirical evidence for its claims. And indeed, Visa which was among the main providers of information on anticompetitive advantages enjoyed by CUP, saw certain of its business activities in China blocked while the dispute was being settled, whereas some of its more timid private foreign competitors announced new co-operations with CUP (McGregor 2012). Arguably, a similar dynamic could evolve in a situation that involves purely private firms with important market shares only. However, it is questionable if CUP would have been in a similarly dominant position in the first place, and if it could maintain this position, if it has not been for its close ties to the government and the domestic legal system.

China has also been a major respondent in cases not related to state ownership. Between 2002 and 2011, it has been respondent to a total of 23 WTO cases and in 2009 it alone was respondent to more than a fourth of all WTO disputes during this year (Manjiao, 2012). During the same period it has been complainant of eight cases.

The case was joined by Australia, the EU, Japan, Korea and Chinese Taipei.

The case was joined by Australia, Ecuador, the EU, Guatemala, Japan, Korea and India.

Note: The question of CUP’s ownership status was not addressed in this dispute and the concept of SOEs is not found in the GATS.
A3.5 SOE provisions in preferential trade agreements and bilateral investment treaties

115. Parallel to the multilateral trading regime of the WTO, a plethora of preferential trade agreements (PTAs) exists that regulate trade on a bi- or minilateral basis. Having mushroomed since the early 1990s, currently 511 PTAs have been notified to the WTO Secretariat\textsuperscript{55} and a WTO member is on average party to some 13 PTAs. It is estimated that half of the world's trade takes place among PTA members and that some 16% is subject to PTA provisions that provide a preferential treatment relative to multilateral standards (WTO, 2011b). Predominantly, PTAs include regulations on tariffs or rules of origin.

116. Several countries with high SOE shares, such as China or India, actively pursue PTA-oriented policies (WTO, 2012). Also, many PTAs include specific provisions on SOEs as well as related regulations which can specify explicitly that provisions apply similarly to SOEs and to private firms, or they can provide exceptions for state enterprises or state monopolies (Solano and Sennekamp, 2006).\textsuperscript{56} It is hard to say in general whether these provisions improve upon the existing WTO provisions in terms of disciplining unwanted effects of SOEs, but many of the provisions aim to extend WTO provisions by requiring that state enterprises and state monopolies do not discriminate according to the country of origin of firms of a shared PTA.

117. In addition, numerous PTAs comprise provisions on services or on other “trade +” issues such as intellectual property rights, technical barriers to trade, investment issues or competition policies. Whereas these provisions might not directly be related to SOEs, they can set rules that strengthen competitive neutrality in specific areas and discipline anti-competitive behaviour or practices with regard to monopolisation; anti-competitive mergers; state aid and subsidies; or the application of domestic competition laws or policies (op. cit.). The Singapore-Australia free trade agreement is one example of an PTA with extensive references to competitive neutrality. The North American Free Trade Agreement (NAFTA) addresses potentially trade distorting effects of state enterprises and designated monopolies in its competition chapter, reflecting the notion that a party owning a state enterprise is arguably in a position to influence its market behaviour and, as such, that state enterprises with authorities mandated by the government should be obliged by the same obligations under the agreement as the government itself. Other U.S. PTAs with NAFTA-like obligations are agreements with Australia, Chile, Korea and Peru. Even more far reaching disciplines with regard to SOEs are contained in the US Singapore PTA that enhances transparency disciplines, prohibits direct government influence on SOEs, collusion and other anti-competitive activities and that foresees a progressive reduction in the number of SOEs. Against this

\textsuperscript{55} When accounting for PTAs in goods and in services separately. Some of these agreements are still under negotiation or not yet ratified, but a majority of 319 PTAS is in force.

\textsuperscript{56} For instance, the following PTAs have been identified by previous OECD trade policy research to contain provisions on state enterprises or state monopolies (Solano and Sennekamp, 2006): Albania – Bosnia and Herzegovina; Albania – Bulgaria; Albania – Croatia; Albania – Former Yugoslav Republic of Macedonia; Albania – Romania; Albania – Serbia and Montenegro; Albania – UNMIK (Kosovo); Algeria – EC; Australia – Singapore; Australia – US; Azerbaijan – Georgia; Bosnia and Herzegovina – Bulgaria; Bosnia and Herzegovina – Croatia; Bosnia and Herzegovina – Former Yugoslav Republic of Macedonia; Bosnia and Herzegovina – Moldova; Bosnia and Herzegovina – Serbia and Montenegro; Canada – Chile; Canada – Costa Rica; CariCom; CEFTA; Central America – Chile; Central America – Panama; Chile – EC; Chile – Korea; Chile – Mexico; Chile – US; Chinese Taipei – Panama; Colombia – Mexico – Venezuela; Croatia – EFTA; Croatia – Former Yugoslav Republic of Macedonia; Croatia – Moldova; Croatia – Serbia and Montenegro; EC – Jordan; EC – Morocco; EFTA; EFTA – FYROM; EFTA – Jordan; European Economic Area; Former Yugoslav Republic of Macedonia – Moldova; Former Yugoslav Republic of Macedonia – Romania; Former Yugoslav Republic of Macedonia – Turkey; Israel – Mexico; Israel – Romania; Korea – Singapore; Mexico – Uruguay; Moldova – Serbia and Montenegro; NAFTA; Romania – Serbia and Montenegro; Singapore – US; Trans-Pacific Strategic Economic Partnership.
backdrop, the current negotiations in the context of the Trans-Pacific Partnership are likely to reflect the U.S. approach aiming at a level playing field between SOEs and POEs.

118. Similarly, trade agreements of the EU mirror the principles of non-discrimination and commercial considerations and aim to discipline the direct or indirect influence of the state on firms’ decisions and strategies. The EU treaty Article 345 specifies that: “The Treaties shall in no way prejudice the rules in Member States governing the system of property ownership” and by consequent the EU’s definition of enterprises in international trade that are granted special or exclusive rights and privileges considers ownership not be a decisive factor alone, but focuses on state aid control in a broader sense as essential tool for competitive neutrality.

119. A number of PTAs comprise dispute settlement mechanisms that may represent alternative strategic venues for arbitration (Bush, 2007). Currently, 30% of the disputes at the WTO take place between members who are also parties to shared PTAs (WTO, 2011) but the availability of alternative dispute settlement mechanisms opens up the possibility for complainants of strategically filing SOE-related cases regionally or multilaterally, sometimes referred to as “forum shopping” (op. cit.) (see Marceau and Kwak, 2006).

120. Even though several PTAs include investment provisions, the major venue for the bilateral regulation of investment are bilateral investment treaties (BITs). Similar to PTAs, BITs have been proliferating dynamically and today more than 2 500 agreements involving at least 175 countries are in place (Bubb and Rose-Ackerman, 2007). Interestingly, BITs are mainly concluded between countries of different levels of development; less than 30% of BITs are signed between developing countries, 7% between developed countries, and the bulk between a developed and a developing country (Sachs and Sauvant, 2009).

121. BITs usually cover the definition and the scope of investment and comprise rules and procedures on admission and establishment, most-favoured and national treatment, compensation in a case of expropriation, transfer of funds and arbitration (UNCTAD, 2004). By contrast to the multilateral trading system which is intergovernmental in design, most of the BITs refer to both state-state and state-investor relations (op. cit.). An examination of the database on BITs provided by UNCTAD indicates for the countries with substantial SOE shares (as identified in Section 3) the following numbers of treaties: China (88 BITs), United Arab Emirates (46), Russia (43), Indonesia (52), Malaysia (36), South Africa (21), India (33), Brazil (8), Norway (15) and Thailand (37).

122. In many instances, BITs directly address issues of competition in countries with a considerable presence of the state sector and the US model BIT, having been released in a revised form in April 2012, is an example concerning this matter (Scissors, 2012). The model serves as an outline for BITs of the US with its partner countries and the United States Trade Representative (2012) and the US Department of State explicitly underline that the revised version of the model BIT aims, inter alia, to “...sharpen the disciplines that address preferential treatment to state-owned enterprises, including the distortions created by certain indigenous innovation policies”. The model BIT defines in its Article 1 a state enterprise as “an enterprise owned, or controlled through ownership interests, by a Party” and states in Article 2, Paragraph 2 that a party’s obligations under the BIT apply to these state enterprises. Furthermore, the

57 An exception in this regard can be services of general economic interest.

58 Yet, some PTAs like the EC-Chile agreement exclude competition-related aspects from the agreement’s dispute settlement and arbitration mechanism.

definition of “investment agreement” under Article 1 specifies that the agreement grants rights to the covered investment or investors in areas that are often dominated by SOEs, or more precisely:

- “with respect to natural resources that a national authority controls, such as for their exploration, extraction, refining, transportation, distribution, or sale;
- to supply services to the public on behalf of the Party, such as power generation or distribution, water treatment or distribution, or telecommunications; or
- to undertake infrastructure projects, such as the construction of roads, bridges, canals, dams, or pipelines, that are not for the exclusive or predominant use and benefit of the government.”

123. In addition, although not explicitly addressing the issue of state ownership, the US model BIT comprises several provisions that level the playing field with regard to a competing domestic state-sector and that refer, for instance, to national treatment (Article 3); most-favoured-nation treatment (Article 4); a minimum standard of treatment (Article 5); transfers (Article 7); performance requirements such as export requirements or local content clauses (Article 8); or transparency (Article 11). However, even in the case of this advanced model BIT, SOE-related provisions may fall short of effectively protecting investors in countries with important SOEs, such as China or India. Scissors (2012), for example, points out to insufficiencies with regard to the definition of state enterprises, transparency requirements or arbitral proceedings.

A3.6 Government procurement under the Government Procurement Agreement

124. Government procurement, i.e. the purchase by governments and state-owned enterprises of goods and services, accounts for a significant percentage of GDP (10-25%) and has a direct impact on the economy. In particular, open and transparent government procurement regimes directly strengthen governments' capacities to build developmentally significant infrastructure and to provide socially important goods and services (e.g. medicines) for citizens. In addition, in countries with a large state sector, public procurement can become an important vehicle for providing preferential treatment to domestic private and state-owned firms or for restricting market access to foreign firms. Hence, effective regulation on the national and international level in this area is also crucial for levelling the playing field for international trade and investment. There are public government provisions present in a plurilateral Agreement on Government Procurement (GPA) in the WTO, regional trade agreements like the North-Atlantic Free Trade Agreement (NAFTA, bilateral trade agreements like the U.S.-Colombia Free Trade Agreement or the EU-Mexico Free Trade Agreement, and domestic public procurement policies.

125. On the multilateral level, the Agreement on Government Procurement, concluded in 1994 and renegotiated in 2011 (see Anderson, 2012) is, to date, the only legally binding agreement in the WTO focusing on government procurement.60 The GPA is a plurilateral treaty signed by 42 WTO members that, as Parties, have rights and obligations under the Agreement.61 The Agreement commits members to certain core disciplines regarding market access, transparency, competition, and good governance in relation to the procurements that are specified in each Party's annexes to the Agreement, which cover goods, services, and capital infrastructure construction by public authorities. Each signatory has negotiated coverage through a positive list or other approach with the other signatories of the GPA, based on mutual reciprocity. Entities

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60 The revised GPA which was negotiated in 2011 will come into effect when formal acceptances have been received from two thirds of the Parties to the Agreement. In the meantime, the 1994 version of the Agreement remains in force.

61 A full list of GPA Parties is available at: [http://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm#parties](http://www.wto.org/english/tratop_e/gproc_e/memobs_e.htm#parties) [last accessed on 6 November 2012]. The membership of the Agreement is increasing, over time (see Anderson, 2012).
covered are listed in the GPA’s “Appendix I” for each Party, which is an integral part of the Agreement (see Article XXIV:12 of the 1994 Agreement), also referred to as each Party’s “schedule”. Signatories may withdraw entities from GPA coverage on the grounds that “government control or influence over it has been effectively eliminated”. Other signatories may object within 30 days of notification (Article XXIV:6). State-to-state disputes pursuant to the GPA are subject to the WTO dispute settlement system (based on Article XXII of the 1994 GPA), hence providing an enforcement mechanism, and there have been three trade disputes under the 1994 GPA so far. The GPA does not apply to every procurement of the covered entities, but only when the value of procurement is at or above a pre-defined threshold, which varies depending on the level of government (central government, sub-central and SOEs), and is not otherwise excluded.

126. As of today, none of the BRIICS countries are parties to the GPA; China is the only BRIICS country currently negotiating accession to the agreement, having been bound to do so by its WTO accession protocol. Russia is also bound by its WTO accession commitments to submit an offer to the GPA within four years from its accession to WTO. Not being bound by GPA provisions, BRIICS countries have at times used government procurement as means of providing preferential treatment to its firms, including domestic SOEs, and, more generally, shielding domestic enterprises from foreign competition. For example, SOE procurement has been seen as a means of partially restricting market access to the Chinese wind turbine industry (e.g. National Foreign Trade Council, 2010). China’s joining of GPA as the first BRIICS country would hence be an important stepping-stone, but also a challenge to the effectiveness of the agreement in regulating activities of a country with a large state sector (see e.g. Wang 2007; Wang 2009). For example, so far China has declined to offer any state enterprise for the GPA, but it is likely that it will have to commit to offering some (e.g. Wang 2009).

127. Some countries have pursued negotiations on government procurement disciplines in other international fora, principally regional and bilateral trading agreements. For example, government procurement, including SOE procurement, is currently discussed in TPP negotiations. Similarly many bilateral free trade agreements, such as U.S.-Colombia Trade Promotion Agreement’s, have government procurement chapters. Domestic policies in various countries also provide a varying degree of disciplines attached to different types of procurement. For example, the EU has agreed to common procurement rules in the water, energy, transport, and postal services sectors (EU Directive 2004/17/EC). Finally, the OECD Principles for Enhancing Integrity in Public Procurement identify elements of good governance throughout the procurement cycle, and the OECD Public Procurement Reviews help to establish best-practice.

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62 Central government entities are listed in Annex 1, sub-central government entities are listed in Annex 2, and other government entities (e.g. public utilities) are listed in Annex 3. For a list of entities proposed in each Annex by each GPA party, see: http://www.wto.org/english/tratop_e/gproc_e/appendices_e.htm#us [last accessed on 8 Nov, 2012]

63 A few earlier disputes took place under the GPA’s predecessor (Tokyo Round Code on Government Procurement); a list available here: http://www.wto.org/english/tratop_e/gproc_e/disput_e.htm [last accessed on 6 November 2012].

64 See here for a list of thresholds for each country; http://www.wto.org/english/tratop_e/gproc_e/thresh_e.htm
ANNEX REFERENCES


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