State-owned enterprises: Good governance as a facilitator for development

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Abstract

State-owned enterprises (SOEs) are in many developing economies the sole providers of key public services, such as water, electricity, transportation, telecommunications and postal services. They generally also account for major shares of other parts of the urban economy. Ensuring that they are competitive and efficient is therefore crucial for economic development, public service delivery and the downstream competitiveness of the broader enterprise sector. When governed transparently and efficiently, SOEs can correct market failures, improve public service delivery and even play a role in creating fairer, more competitive markets.

However, SOEs need to establish strong governance practices in order to maximise their contributions to development. In particular, it is important that SOEs have well-defined objectives, professional and independent boards of directors, and clear lines of accountability for their performance. Furthermore, SOEs can be particularly at risk for corruption and they often operate in sectors with high potential environmental impacts. Ensuring that SOEs respect their legal obligations, apply good standards of responsible business conduct, and ensure economic objectives that take into account the environmental and social objectives of development, are important elements of policy coherence.

Many countries have taken steps to improve the governance and performance of their SOE sectors, often taking as a benchmark the OECD Guidelines on Corporate Governance of State-Owned Enterprises (“SOE Guidelines”). This Policy Coherence for Development report provides an overview of some of the main policy tenets encouraged by the SOE Guidelines to maximise SOEs’ contributions to sustainable growth. OECD is actively supporting these measures, including via regional networks advising on good practices for SOE governance reform.

What is policy coherence for sustainable development?

Policy coherence for sustainable development (PCSD) is an approach and policy tool for integrating the economic, social, environmental and governance dimensions of sustainable development at all stages of domestic and international policy making. Its main objectives are to increase governments’ capacities to:

- Identify trade-offs and reconcile domestic policy objectives with internationally agreed objectives.
- Foster synergies across economic, social and environmental policy areas.
- Address the spillovers of domestic policies.
What is at stake? Overview of policy coherence challenges and development impacts

State-owned enterprises play an important role in national and international economic activity...

State-owned enterprises (SOEs) are assets that the government manages on behalf of citizens. Ensuring that these assets create value for society and are managed professionally and transparently is a cornerstone of sound public governance and a precondition for creating trust in governments and markets.

Sound governance of SOEs is important for development for a number of reasons. First, in many developing economies, SOEs are the sole providers of public services (e.g. water and electricity provision, telecommunications and postal services). Secondly, bearing in mind that many developing economies have largely agrarian economies, SOEs regularly account for between 25% and 50% of the urban economy. Thirdly, in economies with less developed private sectors, SOEs can be an important source of employment and job training for the local population. These factors combined make the efficient and competitive operations of SOEs paramount importance to economic development.

Making SOEs perform efficiently – and on equal footing with private enterprises – is crucial for economic growth and development. When SOEs are mismanaged, they waste public resources, channel funds away from productive activities, and ultimately hinder development. But when they are governed transparently and efficiently, they can correct market failures, improve public service delivery and play a role in creating fairer and more competitive markets.

In developed economies, SOEs play a more restricted economic role. A recent study of OECD-area SOEs shows that they account for as much as 10% of economic activity, but in general their share of the economy is much lower, with SOEs accounting for 2.5% of national employment on average. SOEs are, however, highly concentrated in infrastructure and other network industries and in some cases also the financial sector (OECD, 2014b). Together, the network industries (telecoms, electricity and gas, transportation and other utilities, including postal services) account for about half of all OECD SOEs by value and 60% by employment share. For an illustration of SOEs’ sectoral distribution in the OECD area, see below figure.

...and fulfil a number of public policy functions ...

The public policy functions accorded to SOEs vary widely across countries, often reflecting their level of development and the role accorded to the state in the economy. Even in advanced economies with robust private sectors and recent histories of SOE privatisation, SOEs continue to perform important public policy functions, including:

- The delivery of public services (for example universal mail delivery) where direct ownership is deemed more

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**Figure 1. Sectoral distribution of SOEs, by company value (total OECD)**

![Sectoral distribution of SOEs](image-url)
efficient or reliable than contracting such services out to private operators;

- The operation of “natural” monopolies, for example in the public utilities sector, where direct state ownership is deemed more feasible or efficient than regulation of privately-owned monopolies;

- Supporting broader strategic goals in the national interest, such as maintaining certain sectors under national ownership (for example oil and gas, and some defence industries).

Historically, many low income countries have created SOEs as part of broader strategies to develop nascent industries or to establish new sectors with no existent private-sector led economic activity. As countries grow beyond low-level income levels they often carry a legacy of SOEs, the more successful of which may now have become viewed as “strategic” or even “national champions” (such as many of the flag carriers still operating in the aviation sector, even among advanced economies). When establishing new sectors in a developing country, governments are usually not concerned with fine-tuning corporate efficiency or safeguarding the competitive landscape. However, as emerging economies approach mid-income levels, and as private companies enter the sector, their policy makers become alert to the need to find a proper balance between public and private sector commercial activity, and to consider privatisation.

Large state-owned sectors in developing economies at comparatively high income levels are sometimes a legacy of historical reliance on state intervention to drive economic activity or to develop nascent industries. In some cases they are also a legacy of political decisions that direct state ownership is more efficient, more equitable – or indeed more feasible – than creating incentives for private investment. The experiences of Brazil, China, India, Singapore and South Africa in using SOEs as vehicles of national development strategies and industrial policy are explored in a recent OECD report (OECD, 2015). SOEs may also be created to fulfil the three public policy functions set out above: to provide public services, to operate and prevent abuse of natural monopolies; or to secure strategic national interests.

It is an open question whether public policy goals are best achieved through continued state ownership of enterprises. On the one hand, if governments do not hold SOEs to high standards of governance and transparency, then they can become inefficient and less able to achieve their public policy objectives. On the other hand, in economies with weak market regulations and in the absence of a viable private sector, privatisation might actually lead to a worse development outcome – particularly for SOEs that embody monopoly elements or provide essential public services. Regardless of whether SOEs are to be privatised or remain under state ownership, they must be governed efficiently and transparently.

...but their performance is hindered by governance challenges.

SOEs face a number of particular governance challenges that can hinder their ability to perform efficiently, create value, and contribute to economic development. Many of these challenges stem from the fact that the accountability for an SOE’s performance is often dispersed across the public administration and among different state bodies with inherently different policy interests. SOEs may need to serve several different political masters, with confused and non-transparent lines of accountability. This can allow excessive and politically-motivated interference in SOEs’ decision-making; or it can leave a vacuum, with passive ownership and limited oversight, increasing the risk that corporate insiders will advance their own interests rather than those of the enterprise and the general public. SOEs and their employees can also be at particularly high risk for soliciting or receiving bribes.

A further layer of complexity is added by the fact that SOEs are often tasked with multiple – and sometimes conflicting – policy objectives; for example operating profitably alongside private companies while delivering public services. Ensuring that SOEs can deliver on these multiple objectives efficiently, and without distorting competition, can be a challenge. At the level of the state, particular attention needs to be given to avoiding market distortions by ensuring that market regulations, such as those bearing on competition and procurement, apply equally to SOEs and their private competitors. It is also important to ensure that any subsidies to SOEs are calibrated to the actual costs of fulfilling well-defined public policy objectives, to avoid market distorting cross-subsidisation of SOEs’ commercial activities.
What has been done and what is to do? Improving the governance of state-owned enterprises

OECD Guidelines on Corporate Governance of SOEs: The international standard for SOE reform

In a context of growing scrutiny of public sector activities and pressure on fiscal budgets, many countries around the world have begun reforming the way in which SOE sectors are organised and governed, often taking as a benchmark the OECD Guidelines on Corporate Governance of State-Owned Enterprises (“SOE Guidelines”). The SOE Guidelines were first developed in 2005 and provide advice to governments on how they should manage their ownership responsibilities to ensure that SOEs perform efficiently and create value for society.

Since their development, the SOE Guidelines have been widely used in both OECD and emerging market economies as a benchmark to guide reforms to SOE ownership and governance arrangements.

Many countries around the world have made efforts to bring ownership practices more in line with their aspirational standards, for example by taking steps to better co-ordinate ownership responsibilities within the state administration, to improve transparency and accountability through reporting on SOE activities and performance, and to bring SOE board practices more in line with best practice corporate standards.

The SOE Guidelines offer advice regarding SOEs’ legal and regulatory framework, the organisation of the state ownership function as well as the governance of individual SOEs (e.g. calling for the establishment of independent and professional boards of directors). The box below provides an overview of their overarching principles.

The following sections explore in greater detail some of the policy areas encouraged by the SOE Guidelines, to improve the efficiency of SOEs and maximise their contribution to economic growth and development, notably: clarifying SOE objectives; strengthening operational autonomy through independent boards; separating ownership and regulatory functions; maintaining a level playing field with private companies; and encouraging responsible SOEs that contribute to sustainable development. It ends with a discussion of some issues to consider when

Box 1. OECD Guidelines on Corporate Governance of State-Owned Enterprises

The OECD Guidelines on Corporate Governance of State-Owned Enterprises offer guidance and good practices to help governments manage their responsibilities as “owners”, so that the SOEs they oversee operate efficiently, transparently, and on a level playing field with private companies. First developed in 2005 and updated in 2014-15, they are the world’s internationally-agreed standard for sound SOE governance. The Guidelines include recommendations to the following effect:

• Governments are encouraged to clearly evaluate and disclose the policy rationale that motivates state ownership of enterprises and subject these to recurrent review.

• The state is well advised to act as an informed, professional, and active owner; and to allow SOEs full operational autonomy to achieve their defined objectives. The establishment of a central ownership entity, not responsible for regulating SOEs, can help clarify the responsibility for state ownership within the state administration;

• When SOEs undertake activities in the marketplace, it is important that they compete on a level playing field with private enterprises, and that their commercial activities face market-consistent financing conditions;

• Where SOEs are listed or otherwise have non-state investors among their owners, all shareholders should be treated equitably and have equal access to corporate information;

• It is in the interest of both SOEs and their state owners to ensure that SOEs observe high standards of responsible business conduct, and that the state’s expectations of this are clearly communicated and disclosed;

• SOEs are encouraged to observe the same high standards of accounting, disclosure and audit as listed companies. Government accountability for state ownership can be reinforced through the publication of an annual aggregate report on the size and performance of the state’s SOE portfolio;

• SOE boards can most effectively carry out their functions of strategic guidance and monitoring of management when they have the authority and competence to do so. SOE boards are encouraged to act with integrity in the best interest of the SOE and to be held accountable for SOE performance.
determining whether to transition from a state-owned enterprise to a privatised or partially-privatised company.

**Clarifying SOE objectives**

One of the commonest reasons for an SOE’s underperformance is that it is tasked with multiple, unclear, or even contradictory, objectives. Without clearly defined objectives, and clear lines of accountability for meeting them SOEs can quickly become subject to politicisation, or face conflicting tasks from various parts of the public administration, thereby threatening their efficiency. Contradictory objectives might include, for example, expectations that SOEs operate profitably on a commercial basis, while also delivering on recurrent or ad hoc policy objectives.

A first step to improving SOE efficiency and performance is to clearly define their commercial and public policy objectives, and to ensure that any public policy objectives are adequately and transparently compensated by the state budget. These might include, for example, the delivery of defined public services. Other ad hoc policy objectives, such as dividend distributions that reflect temporary fiscal needs rather than SOE performance, should be avoided.

Evaluating and disclosing the objectives of SOEs must begin with an identification of the enterprises under state ownership, and the rationale for their public ownership. This process is underway in a number of emerging economies. For example, South Africa established a Presidential Review Committee on State-Owned Enterprises in 2010 to undertake an extensive review of the national SOE sector and make recommendations to improve SOE efficiency and maximise their contributions to South Africa’s broader developmental goals (South Africa Presidential Review Committee on State-Owned Entities, 2013). Many of the post-transition economies have also begun cataloguing their national SOE sectors and clarifying the objectives of different categories of SOEs, in part to evaluate the suitability of their continued state ownership.

SOEs’ objectives should reflect a coherent view of their role, including the impact of their activities on wider stakeholders and policy objectives. This means identifying not only the direct objectives of SOE activities, but also potential synergies where SOEs can indirectly support other policy objectives (e.g. the Sustainable Development Goal targets for universal access to water (6.1) or energy (7.1)), or spillovers where their activities could potentially undermine other policy objectives. Dialogue with wider stakeholders can make an important contribution to this. Identifying these linkages early, and where necessary including them transparently in SOEs objectives, can reduce potential sources of tension between SOEs and governments, and avoid pressure for later ad-hoc interventions.

**Box 2. Clarifying SOE objectives to efficiently deliver developmental mandates: Example from Singapore**

The government of Singapore has been, since its international independence in 1959, among the most active users of SOEs as a tool for development. Singapore is widely cited as a success story, but the success was not based solely on SOEs. The early governments of Singapore sought to emulate earlier (and contemporary) experiences of Japan and Korea in attracting large amounts of foreign direct investment (FDI) as a source of international integration, knowledge transfers and much-needed jobs. However, unlike those countries, the government of Singapore was unsure if a domestic industrial sector – in a city that had previously existed almost exclusively as an entrepot trading station – would evolve rapidly enough to serve as an equal partner to the foreign-owned companies. It decided that the state should fill the gap and act as Singapore’s largest owner of commercial enterprises.

Arguably one main reason that the Singaporean model was so successful was that it did not burden its SOEs with multiple objectives. Their role in the development of certain sectorial activities was clearly defined, and other essential elements of early industrialisation (such as providing health care and affordable housing) were taken care of by the government alone. The latter point is particularly important: the continued industrialisation of Singapore did at times seem threatened by a lack of housing that was affordable to industrial labourers. The government repeatedly addressed the issue through the provision of subsidised homes financed by the public purse. Good corporate governance also played a role: the establishment and development of Temasek as an industrial holding company helped sustain the development-focus of the SOE sector by emphasising the need for professional management and boards, providing the SOE boards with sufficient autonomy to get on with their job; and by ensuring that the ownership of SOEs has been clearly separated from their regulation.

Strengthening operational autonomy through independent boards

SOEs need to have sufficient operational autonomy to achieve their defined objectives without political interference. This is a central tenet of the SOEs Guidelines, which call for governments to avoid interfering in the day-to-day management of SOEs, and to allow independent and professional SOE boards to fulfil their functions of setting strategy and supervising management.

Effective and professional boards play a vital role in ensuring the operational autonomy of SOEs. They act as an intermediary – as well as a buffer – between the ownership entity and SOEs’ executive management, and are a critical link in the chain of agents involved in SOE governance. SOE boards need to be held accountable for SOE performance and the state needs to communicate its expectations as an owner in a structured manner. Appropriate safeguards are necessary to ensure that boards do not become conduits for political interference – or indeed be sidestepped by direct government intervention in SOE management – at the expense of SOE performance or commercial viability.

A stocktaking of national practices for board composition and functioning found that, in most OECD countries, SOEs that operate in a largely commercial manner have established boards of directors, with roles and responsibilities that are clearly defined by law and in line with those of private companies. However, a persistent challenge in some countries is that boards are often circumvented by direct government intervention in SOE management, for example by ministerial appointments of executive management or the use of “instructions” by the state to direct corporate decisions (OECD, 2013a). This is also a challenge in many developing economies.

Despite these challenges, a trend towards more professional SOE boards can be seen in many developing economies. For example, starting in 2008 China established boards of directors in most central (state-level) SOE corporate groups, to increase their operational autonomy (OECD, 2014a). India developed “Guidelines on Corporate Governance for Central Public Sector Enterprises” in 2007, which include principles for the composition of boards of directors and the role of SOE boards’ audit committees (OECD, 2014a). In 2010, the government of India established a new category of SOEs, “Maharatna”, to grant the boards of certain large enterprises greater operational and financial autonomy from the government (OECD, 2014a).

Separating ownership and regulatory functions

Another important element to improve SOE efficiency and performance is to clearly identify which part of the public administration is responsible for exercising the state ownership function. It is considered good practice to establish an ownership entity responsible for developing the government’s ownership policy, representing the state as owner, and reporting to the public on SOE performance. This promotes government accountability for SOE performance and can help avoid lax oversight by the state. An ownership entity can also help shield SOEs from political interference by ensuring that the state’s expectations as an owner are communicated in a structured, transparent and regular manner to SOE boards.

The establishment of an ownership entity can also be useful in separating the exercise of the state ownership function from other government functions influencing SOEs’ conditions, such as market regulation or safety and consumer protection regulation. Separation of functions is important to avoid situations in which a single part of the state is tasked with implementing potentially conflicting objectives, such as ensuring the commercial success of a state-owned company, while promoting fair competition with its private competitors. Such a situation would occur, for example, if the government (as a regulator) attempts to shield its state-owned telecoms operator from competition in a previously monopolised sector that has since been opened to new market entrants. Such actions would benefit the state-owned incumbent operator but run counter to the government’s objectives of promoting greater competition in the telecoms sector. This example highlights the importance of policy coherence and the need to implement a whole-of-government approach when defining the relationship between SOEs, the ownership entity, and the different parts of the state that can influence SOEs’ operations. Furthermore, the establishment of independent regulatory bodies, such as competition authorities, is considered good practice when SOEs engage in competition with other enterprises.

Many countries around the world have commenced reforms towards a greater centralisation of the state ownership function:

- China established a centralised ownership entity, the State-Owned Assets Supervision and Administration Commission (SASAC), in 2003.
- The Philippines passed the Government-Owned and Controlled Corporations (GOCC) Governance Act in 2011, which led to the creation of a dedicated commission to examine the performance and organisational structures of GOCCs (OECD, 2014a).

1. India’s central SOEs (“Central Public Sector Enterprises” by national nomenclature) are accorded different levels of financial autonomy based on their status as “Miniratna”, “Navratna” or “Maharatna”, a categorisation based broadly on their financial performance, net value and level of internationalisation. The “Maharatna” status is granted to certain large and internationally active “Navratnas”, and gives their boards the power, among others, to make investment decisions up to a certain threshold without explicit government approval.
• South Africa’s Department of Public Enterprises was established in 1994, with oversight responsibility for some of the country’s most economically significant SOEs.

As a general principle, SOEs engaged in activities in the marketplace should face the same regulatory treatment as other companies. This can be achieved by incorporating SOEs using the same legal form as private enterprises or, if this is not feasible, by ensuring that SOEs’ legal and regulatory framework approximates as much as possible that of private enterprises, notably in the areas of creditors’ rights, transparency and disclosure requirements and the roles and legal responsibilities of boards. The SOE Guidelines specifically call for SOEs’ legal and regulatory framework to allow creditors to press their claims and initiate insolvency procedures, in order to ensure that SOEs are not shielded from those market forces that inform sound business decisions in the private sector.

Some countries have opted for the development of SOE-specific codes and guidelines to approximate the governance and disclosure requirements that regulations place on private companies.

• Morocco adopted a corporate governance “code of good practices” for SOEs in 2011, which explicitly draws on the standards established in the SOE Guidelines. The code, which SOEs are required to implement on a “comply-or-explain” basis, outlines the functions and responsibilities of SOE boards and their committees, and calls for SOEs to strive towards the implementation of the same accounting and auditing standards as listed companies (Moroccan Ministry of Economy and Finance, 2012).

• India’s 2007 “Guidelines on Corporate Governance for Central Public Sector Enterprises” outline requirements relating to SOE board composition, the role of the audit committee and disclosure (OECD, 2014a).

• Pakistan’s 2013 “Public Sector Companies (Corporate Governance) Rules” outline rules for SOE board composition and independence and require SOEs to disclose financial information in line with the International Financial Reporting Standards (The Gazette of Pakistan, 2013).

Maintaining a level playing field with private companies

One major area of concern for policy makers is how to ensure that when both SOEs and private companies operate in the same sector, they compete on a level playing field (i.e. that SOEs do not face any financial, regulatory or operational advantages – or disadvantages – purely as a result of their state ownership). When the competitive conditions of all enterprises are based purely on their ability to create value (and not on the public or private status of their owners), then goods and services are produced by those entities that can do so in the most efficient manner, leading to optimal resource allocation in the broader economy (OECD, 2012a).

As highlighted in the previous CODE report: “Competition Law and Policy: Drivers of Economic Growth and Development”; competition can be an agent for poverty reduction and sustainable development. Poor consumers spend a greater share of their income on basic provisions such as utilities than wealthier consumers. A lack of competition can make these more costly or unaffordable, and potentially contribute to increasing poverty.

Box 3. Establishing a state ownership entity: An example from Vietnam

In Vietnam, the government has established the “State Capital Investment Corporation (SCIC)” whose role is to represent the state shareholdings in the enterprises. In other words, its function is to centralise or integrate the ownership function and clearly separate it from (other) regulatory and policy functions carried out by line ministries.

SCIC is a special economic organisation of the state, operating under the Law on State Enterprises and other relevant laws. It was established in 2005, having functions and responsibility mandated in law, and commenced operations on 1 August 2006. It is entirely owned by the state and is chaired by the former Vice Minister of Finance. It is organised as a financial holding company. The SCIC receives and represents state equity ownership in enterprises where the state owns shares.

The stated objectives were to speed up the SOE privatisation and reform, to split regulatory functions from business functions, to enhance effectiveness of the management and investment of state assets and capital, and to promote the introduction of the best practices of corporate governance.

Maintaining a level playing field can be particularly difficult to implement when SOEs are tasked with delivering on public policy objectives, such as ensuring universal postal or telecommunications services. In such cases, SOEs might not be adequately compensated for their public policy activities (e.g. if their other, profitable activities are expected to internally subsidise their loss-making public obligations), and this could put them at an undue competitive disadvantage. Conversely, they might be over compensated, thus effectively benefiting from unintended subsidisation of their competitive activities. As discussed above, clearly identifying the costs of public policy activities, and ensuring that related funding arrangements do not distort the competitive landscape, is therefore central to maintaining a level playing field. There are many other important aspects to maintaining a level playing field, discussed in detail in OECD (2012a). They include, for example, ensuring that both debt and equity financing for SOEs’ commercial activities is obtained at market rates, and that SOEs do not face preferential treatment in public procurement.

Although a level playing field between SOEs and private companies is an important element of efficient markets, it is (understandably) not always an immediate policy priority for low income countries where there is no viable private sector with which to compete. In such cases, SOEs have indeed been used as vehicles to develop nascent industries, and benefitted from extensive state support to do so. However, when such countries reach middle income levels of development, they need to assess the policy trade-offs inherent in keeping such enterprises under state ownership, and notably the extent to which their continued state support might crowd-out private sector activity. The OECD’s Factsheet on competition and growth highlights the role of competition in moving out of the “middle-income trap”. Once the initial growth or catch-up phase has stabilised, competitive markets are essential to facilitate moving from middle-income to higher-income status, especially when the sources of “easy” input factors start to run dry (OECD 2013c).

**Encouraging responsible SOEs that contribute to sustainable development**

SOEs, like private companies, should respect the rights of stakeholders – including employees, creditors, and communities affected by their operations – and abide by relevant national laws. They also have a reputational interest in implementing high standards of responsible business conduct and ensuring that they make positive contributions to the communities in which they operate. This is of particular importance when SOEs operate in sectors with high potential environmental impacts and/or health and safety concerns for employees, such as in the extractive industries.

Beyond the reputational benefits for individual enterprises – which are arguably no different than for private companies – governments have an obligation to ensure that the enterprises under their purview abide by the same international conventions and norms to which the governments themselves adhere. By striving to be seen as “good corporate citizens” SOEs can send an important signal to the rest of the business sector. Given the importance of responsible business conduct for achieving the sustainable development goals worldwide, it is important that policymakers create an enabling environment – including through market structures and governance arrangements – for SOEs to systematically integrate environmental, social, and ethical standards. In the domain of responsible business conduct, this would include respecting the standards outlined in the OECD Guidelines for Multinational Enterprises (“MNE Guidelines”) and other relevant international instruments. While the MNE Guidelines are voluntary from the point of view of companies, they were developed by 42 adhering governments who agreed to promote their implementation by enterprises operating within their borders. Holding SOEs to those standards is an important element of policy coherence.

Responsible SOEs can also play a role in fighting corruption and thereby contribute to cleaner and better-functioning markets. In many countries, SOEs operate in sectors at high risk for corruption, such as the extractive industries (oil and gas, mining, forestry), defence, and energy. Many SOEs are also exposed to risks of corruption as a result of their governance arrangements. As a result they can be particularly at risk for engaging in corrupt practices, such as soliciting or receiving bribes. According to recent research detailing concluded cases of foreign bribery in 17 jurisdictions since the 1999 entry into force of the OECD Anti-Bribery Convention, 27% of foreign public officials that received bribes were SOE employees. The bribes they received accounted for 80.11% of the total value of bribes paid. Their roles within the SOEs ranged from CEO or President to management and lower-level employees (OECD, 2014d).

Bribery and corruption hinder development by channelling resources away from productive activities, distorting competition and ultimately discouraging investment (OECD, 2011b). Corruption in the public sector can also create pervasive distrust in the government, ultimately undermining the functioning of markets and discouraging long term investment. Because SOEs often operate in sectors at high risk for corruption, it is crucial that governments take action to prevent corrupt practices involving the enterprises under their purview, and notably to ensure that SOEs do not solicit, receive or act as intermediaries for bribery.

**Considering the transition from state to private ownership**

As a growing number of emerging economies approach middle-income levels (and as policy makers consider what steps to take to avoid the “middle income trap”), their SOE...
reform priorities will evolve. The issue of maintaining a level playing field moves to the forefront, as does the fear that the state may be crowding-out more productive private activities. In this situation governments usually take steps to identify the SOEs for which there remains an overriding public interest in continued state ownership. Other SOEs which are active in competitive (or potentially competitive) markets are then typically divested. SOEs that are inherent monopolies, but where the rationale for state control has evaporated, are typically opened to private participation through public-private partnerships or joint ventures. This process is already well underway in some emerging economies such as China and India, and others will follow. OECD countries have a wealth of experience to share with their partners in the developing world on this subject, having gone through similar transformations in earlier decades.

- A 2009 report on the privatisation experiences of OECD countries sheds some light on the different regulatory issues that policy makers should consider when deciding whether and how to privatise their state-owned companies (OECD, 2009).

- Where privatisation is undertaken in tandem with the introduction of competition in a previously monopolised sector, it is of paramount importance to ensure adequate competition regulation and enforcement mechanisms. Without proper competition frameworks in place, the privatised SOE, now free from government oversight, may abuse its market position, leading to economic inefficiencies and exploitative behaviour which are detrimental to consumers and market participants.

- In cases where the SOE undertakes activities with natural monopoly characteristics (i.e. where, owing to economies of scale, it is more efficient for one firm to undertake a given activity) it is important to establish an effective sectoral regulator both to protect consumers and to maintain minimum standards of service delivery and quality. In such cases, the contractual and funding arrangements related to the public service obligations should be established before privatising.

Finally, many governments opt for partial privatisations, for example by listing SOE minority shares on stock exchanges. In countries with well-developed capital markets, partial listings are often undertaken to attract additional financing, and also to subject SOEs to higher governance and transparency standards, thus helping to improve SOE accountability and performance (without relinquishing state control). In countries with less robust capital markets, partial listings of SOEs can be a means of promoting the development of national stock exchanges.

In sum, whether partial or full privatisation of SOEs is the most effective and efficient route to improve their performance and achieve broader economic goals depends on a country’s level of development, the quality of its public sector governance, and the regulatory environment in which SOEs operate. Whatever the level and scope of privatisation being considered, it is important that policy makers carefully evaluate and address the related governance and regulatory issues with a view to ultimately ensuring efficient markets and quality public service delivery.
Where do we go from here? What can the OECD do?

Supporting national reform efforts for better governance of SOEs: OECD’s global engagement

The OECD hosts the world’s only forum where SOE practitioners exchange good practices and information on how to implement effective governance reforms to improve SOE performance. The OECD Working Party on State Ownership and Privatisation Practices is open to non-member participation. It currently brings together the 34 OECD member countries as well as government representatives from 11 emerging economies for biannual meetings in Paris. The interest among the OECD’s partner countries in taking part in this exchange of good practices has grown rapidly in recent years and is expected to continue growing.

The implementation of the SOE Guidelines will be a key focus of OECD’s work with developing economies in the coming decade. During extensive consultations for the 2014-15 update of the SOE Guidelines, over 30 countries outside of OECD membership contributed their experiences with implementing SOE reform, helping to ensure the continued relevance and usefulness of the SOE Guidelines for countries at different levels of development.

In addition to inviting developing countries to join its Paris-based activities, the OECD supports national reform efforts through dedicated regional, peer-learning networks active in Asia, Latin America, the MENA region and Southern Africa, which work to identify common challenges to SOE governance and share good practices for reform. Information about the Southern Africa SOE Network is provided as an example in the box below. Information on the OECD’s support for SOE governance reform can be found at the following link: www.oecd.org/daf/ca/soemarket.htm

Coherent policies for state-owned enterprises

State-owned enterprises are important: they account for a large share of economic activity in many developing economies, and in some OECD countries as well. Because a large proportion of SOE activity is in the network industries (telecoms, electricity and gas, transportation and other utilities, including postal services), SOEs play an important role in providing the infrastructure and essential services needed to support sustainable and inclusive development. The two previous Policy Coherence for Development (CODE) reports looked at Competition Law and Policy and at Responsible Business Conduct. The lessons of those reports – that competition and responsible business can both be enablers and drivers of sustainable growth and development – also apply to SOEs.

SOEs can play a direct role in national strategies for economic development, e.g. when they are used to foster new sectors. And because of the scope of their activities, SOEs are essential to achieving the wider economic, social, and environmental objectives set out in the Sustainable Development Goals. This is particularly the case in Southern Africa, where SOEs are key players in large cross-border infrastructure projects which are crucial to realising regional integration goals and to overcoming what is considered to be the continent’s top development challenge.

Box 4. Promoting SOE governance reforms in Southern African economies

State-owned enterprises (SOEs) are one of the largest sectors of the economy in many African countries, and are important contributors to national development processes. SOEs provide citizens with access to vital services such as water, electricity, health, sanitation and transportation. The competitive position of the private sector-led economy, including small and medium-sized enterprises, is also heavily dependent on the services and infrastructure provided by these firms. Regionally, SOEs are key players in large cross-border infrastructure projects which are crucial to realising regional integration goals and to overcoming what is considered to be the continent’s top development challenge.

However, a number of distinct challenges remain for improving SOE efficiency in the region, including under-performance of SOEs which results in poor returns on invested government capital, and, in many cases, ongoing government subsidies. SOEs tend to be fraught with outdated governance and inconsistent ownership practices. Better governance arrangements can lead to more effective institutions and accountability mechanisms. This in turn can make a positive contribution to development.

The SOE Network for Southern Africa provides a forum for policy makers to discuss these and other common challenges to SOE governance in the region and to agree on priorities for reform. The Network was launched in 2007 and brings together policy makers and practitioners from the member economies of the Southern Africa Development Community (SADC). One of the main undertakings of this Network to date has been to develop regional guidelines for SOE governance and ownership. These guidelines, which were made public at a meeting in Lusaka, Zambia in November 2014, are expected to serve as a point of inspiration and a benchmark for SOE reform across the Southern Africa region for years to come.


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case for those SOEs which provide essential services, which have a disproportionate impact on the poor.

The importance of SOEs in the economy, and their potential to affect other policy outcomes, makes it important that they are efficient, well-governed, and that governments maximise their value for society. The OECD Guidelines on Corporate Governance of SOEs can help support these objectives, by guiding reforms to SOE ownership and governance arrangements, with better co-ordination within state administrations, and improved transparency and accountability. The governance arrangements and objective-setting stages described in the Guidelines can also contribute to ensuring coherence between SOEs’ activities and governments’ wider objectives, by identifying policy linkages and synergies, and setting objectives transparently which maximise SOEs’ contribution to sustainable development.
References


OECD (2013b), Factsheet on Competition and Growth, OECD Competition Committee, Paris.


