

The Treatment of State Enterprises in the WTO & Plurilateral Trade Agreements

Kirk Haywood

Emerging Issues Briefing Note (3)
March 2016



The Commonwealth

The Treatment of State Enterprises in the WTO & Plurilateral Trade Agreements

Kirk Haywood¹

BACKGROUND

Going back to the time of the foundation of the international trading system during the Havana Convention, disciplines on state enterprises have been a feature of the international trading system. Policymakers have always been trying to balance two competing interests. On the one hand is the impulse to correct certain market failures through direct intervention in the marketplace through an enterprise that they can direct to achieve government's policy goals, and on the other hand is the recognition that these enterprises can become an unsustainable drain on the public purse and become themselves a source of market instability.

The extent to which countries strike this balance, and their success at using these instruments differs. Some, such as Canada, has been able to successfully use to state enterprises to play a role in developing traditional agricultural sectors. Others, such as Singapore, have been able to use it to develop modern service sectors and drive innovation. Many others have not been able to successfully use state enterprises and the result has been a drain on the public purse.

It cannot however be said that this is the heyday of the use of state enterprises. In the 1990s and 2000s many state enterprises were privatized. One cannot find any evidence showing that state enterprises is a more pressing priority than the distortions caused by restrictions around goods, services, investment or intellectual property.

Nevertheless, state enterprises has spectacularly re-emerged on the trade agenda as an area in which disciplines are seen by a very important section of the trade rule making community as something needing to be addressed. The Transpacific Partnership contains rules on state owned enterprises and these rules are being introduced into the Trade in Services Agreement and so we are already beginning to see a dissipation of these rules into the trading system.

This policy brief will sketch the evolution of disciplines on State Enterprises from the WTO to plurilaterals and reflect on what this may mean for trade rulemaking going forward.

STATE ENTERPRISES UNDER THE WTO

The General Agreement on Tariffs and Trade (GATT) 1947 introduced the first multilateral rules on state enterprises. There, the parties decided to regulate "State

¹ Adviser, Trade Competitiveness, Commonwealth Secretariat. The views expressed are personal.

Trading Enterprises” (STEs). The basis for including rules was the recognition that a Member could avoid complying with their commitments by simply establishing an enterprise, clothing it with the appearance of being a private enterprise, but then use this enterprise to circumvent their commitments.

Article XVII of the GATT requires that if a Member establishes or maintains a state enterprise, wherever located, or grants to any enterprise, formally or in effect, exclusive or special privileges, then such an enterprise shall, for its exports or imports, act in accordance with two principles (1) non-discriminatory treatment and (2) commercial considerations.

The first point to note is that the phrase state enterprise is misleading, as the obligations apply not only to a state enterprise but also to any enterprise, public or private, which has been granted special privileges by the state. Such special privileges could include for example where a private company is granted an import monopoly. Where such an enterprise exists then its two obligations with respect to its purchases and sales are to first, to comply with the most favoured nation (Article I) and national treatment (Article III) provisions, and secondly to ensure that in those purchases and sales it acts solely in accordance with considerations of price, quality, availability, marketability, transportation and other conditions of purchase or sale. The obligation to act in accordance with commercial considerations does not mean that STEs should act in the same way as a private company in every respect, but rather that with respect to a specific transaction, the STE uses a commercial basis for decision making.² To monitor these activities, Members agreed on a transparency mechanism whereby notifications would be provided of the imports and exports of these entities.

What was still not clear from the GATT 1947 is to which entities specifically these two disciplines of non-discrimination and acting in accordance with commercial considerations applied. To clarify this during the Uruguay Round negotiations members adopted the *Understanding on the Interpretation of Article XVII*. The Article XVII Understanding clarified which activities must be notified:

Governmental or 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 Understanding added an important clarification on the concept of STEs by qualifying STEs as only those whose activities are trade distorting. This clarification arguably narrowed the concept of state enterprises as under the GATT 1947 it applied to all state enterprises whether trade distorting or not.

In addition to the clarification in the Understanding, the WTO Agreements also introduced obligations concerning STEs in a wide range of other instruments. Footnote 1 to Article 4.2 of the Agreement of Agriculture for instance prohibits

² *Canada- Wheat Exports and Grain Imports*

quantitative restrictions, minimum prices, discretionary import licensing and non-tariff measures maintained through STEs. The Declaration on Export Competition³ adopted at the 9th Ministerial Conference required, among other things, the establishment of an annual dedicated discussion during the June meeting of the Committee on Agriculture (CoA). The discussion is structured around a report prepared by the Secretariat and updated annually based on Members notifications to the CoA, the Working Party on State Trading Enterprises (STEs) and responses to a questionnaire. The first report, *Export Subsidies, Export Credits, Export Credit Guarantees or Insurance Programmes, International Food Aid and STEs*⁴. was discussed at the 2014 June meeting of the CoA.

One area that Members attempted to strengthen under the WTO system was the transparency mechanism around STEs. They devised a standard questionnaire that Members were required to use to provide biennially to notify the activities of their STEs to the Working Party on State Trading Enterprises. This transparency mechanism provided some clarification as to the scope of activities that STEs are involved in. Members identified a wide range of activities undertaken by STEs but these can be broken down into five broad categories of activities:⁵

- Controlling or undertaking imports or exports;
- Issuing licences or permits for imports or exports;
- Determining the domestic sales prices of imports;
- Administering the multilaterally or bilaterally agreed quotas, tariff quotas or other restraint arrangements or other import or export regulations; and
- Enforcing the statutory requirements of an agricultural marketing scheme and/or stabilization scheme

What was clear from these notifications was that the overwhelming majority of STEs were involved in the agriculture sector and that most were in fact marketing boards. What is also interesting is that there seems to be no instance where a member has notified a private enterprise, perhaps because of the focus on state enterprises.

³ WT/MIN(13)/40

⁴ G/AG/W/125

⁵ G/STR/4

Table 1: Notified STEs

Member	Notified Entity
Bangladesh	No Notification
Belize	No Notification
Botswana	Notification that no STEs exist
Cameroon	No Notification
Canada	Canadian Dairy Commission, Canadian Wheat Board, Freshwater Fish Marketing Corporation, Provincial And Territorial Liquor Control Authorities
China	25 entities various agricultural products
Grenada	Grenada Cocoa Association
India	14 entities on agricultural products, minerals and oils
Indonesia	BULOG (rice)
Jamaica	Jamaica Commodity Trading Co (fertilizer)
Kenya	Notification that no STEs exist
Mauritius	Agricultural Marketing Board (7 tariff lines)
Mozambique	Notification that no STEs exist
Nigeria	Notification that no STEs exist
Pakistan	Notification that no STEs exist
Sri Lanka	No Notification
St. Kitts & Nevis	Notification that no STEs exist
Tanzania	Notification that no STEs exist
Zambia	Notification that no STEs exist

Source: WTO Notifications

Finally, in Article XVII(4) of the GATT, Members included a reference to future negotiations. They noted that “negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce [serious obstacles caused by the operation of STEs] are of importance to the expansion of international trade.” The Interpretive Note to this article clarifies that negotiations may be on tariffs or on any other mutually satisfactory arrangement consistent with the provisions” of the GATT. This article does not contain a mandate for further negotiations, merely an acknowledgement that such negotiations are of importance. It is also useful to note that even if it did, such negotiations would be limited to STEs as WTO-defined, limited to goods STEs and on the obstacles caused by the operation of STEs, rather than the STEs themselves.

STATE ENTERPRISES IN PLURILATERALS

In the Trans Pacific Partnership Agreement (TPP), the participants concluded a chapter on State-Owned Enterprises (SOEs). Apart from the change in the name of the covered enterprises, it is important to determine the exact scope how the discipline has changed. This is because as TPP's domestic ratification in the United States has stalled until at least a new President takes office in 2017, the USTR has begun to propose that these disciplines enter into other agreements, starting with the Trade in Services Agreement (TiSA). As this concept begins to spread, it therefore requires an assessment of what entities are covered by these disciplines.

Just as in the WTO, state ownership of a private enterprise involved in trade is not prohibited. The SOE Chapter instead seeks to regulate the conduct with respect to such entities. The focus on entities is a peculiar one from the perspective of how trade chapters are usually negotiated, the result is that the SOE chapter is a hybrid discipline which applies to both goods and services, and has rules covering non-discrimination, anti-competitive behaviour, as well as marginally touching on the question of intellectual property rights and finally creating what in practice looks like an SOE trade remedy.

SCOPE OF THE CHAPTER

The first thing to note is that the Chapter applies to two entities equally; "state owned enterprises" and "designated monopolies". State owned enterprises are any enterprise that is firstly, government owned or controlled and secondly, principally engaged in commercial activities. Government owned or controlled means that the government owns or controls more than 50% of the shares or that it has the power to appoint the majority of the board of directors. Commercial activities are those that focus on profit making and involving the production of a good or service for sale to a consumer in some market at a price determined by the enterprise. Not covered by this definition therefore are government-owned not for profits or those operating on a cost recovery basis.

This is somewhat an expansion of the WTO approach by moving the focus away from only those government enterprises involved in international trade, and including enterprises involved in any commercial activity- i.e. even if it is trading wholly domestically. Furthermore, and critically, the expansion includes services SOEs. This is an important expansion as many SOEs are in the service sector. At the same time as the discipline has been expanded to include these categories, on the other hand it has been narrowed by this focus on profit-oriented enterprises. Under the WTO provision even socially oriented or not for profit STEs, once they have the power to influence trade flows, would be included in the discipline, while in the case of the TPP it would not be.

Designated Monopolies is the other concept in the SOE Chapter. Designated Monopolies are of two kinds, either government owned or publicly owned. Government-owned monopolies is any government-owned monopoly that is

established, designated or authorized at any time- before or after the agreement enters into force. Private monopolies are those that are established, designated or permitted after entry into force of the TPP. Key to understanding the scope of the entities covered will be an understanding of the phrase “established, designated or authorized”. If a private entity establishes itself as a monopoly in a given sector is that enough? If government permits a private monopoly to continue to exist, has it “authorized” it? These concepts are not yet clear and so it is difficult to delineate the true scope of the private monopolies to which discipline applies. It may be broad or narrow and then the question becomes how can government ensure such a monopoly complies with the discipline of this chapter. If conceptually, the chapter was meant to reduce government involvement in trade, and then in this regard, it asks governments to become even more involved.

A common theme throughout the chapter is that it is subject to a whole range of exclusions at many different levels. The range of many of these exclusions are so extensive that, when combined with questions around the overall trade distorting impact of SOEs, raises questions as to the commercial rationale for this Chapter. For instance the full exclusions from the Chapter are:

- SOEs with turnover below 200 million SDR (approximate USD\$275,000,000 at the time of writing) in any of the previous three years with respect to the core substantive obligations of non-discrimination and non-commercial assistance as well as transparency;
- Government Procurement;
- Independent pension funds;
- Actions for addressing failing/failed financial service suppliers;
- Actions of financial service regulators (government and private) from exercising regulatory/supervisory functions;
- Central banks performing regulatory/supervisory actions or monetary/credit/exchange rate policy; and
- Responses to national or global economic emergency.

Where an SOE or Designated monopoly does fall within the ambit of the chapter there are five relevant disciplines:

1. Ensure the entity acts in accordance with commercial considerations;
2. Non-discrimination in Purchases and Sales;
3. Prohibition Against Anti-Competitive Practices;
4. Transparency/Notification Requirements; and
5. Non-Commercial Assistance Remedy

COMMERCIAL CONSIDERATION

SOEs and designated monopolies engaging in commercial activity must act in accordance with “commercial considerations” in trade in goods/services. “Commercial considerations” under the TPP is broader than the similar WTO obligation. Not only does it include the WTO definition, but it also has been defined

in the agreement as equating to those factors that a privately owned enterprise in the same industry would also take into account.

On the one hand this introduces some flexibility. It means for instance that SOEs or designated monopolies need not act solely toward a profit making function. For instance if in a given sector the normal business practice is to include non profit-maximizing factors into decision-making, then a SOE falling under these disciplines could do the same.

On the other hand however, what is not clear is whether the standard is for a business in the same industry in the same country, or whether the standard can also include reference to the practice in some other country. The latter seems very possible as if the entity is a monopoly, then there would be no other domestic standards of comparison.

NON-DISCRIMINATION IN PURCHASE/SALE OF GOOD OR SERVICE

For the purchase or sale of both goods and services, SOEs and designated monopolies must provide national treatment and most favoured supplier treatment to enterprises of any TPP country. This applies even if that enterprise is based in a non-TPP country as there is no requirement that it applies only to companies geographically located in a TPP country as well as TPP enterprises based domestically (once these are covered investment).

RESERVATIONS & EXEMPTIONS TO COMMERCIAL CONSIDERATIONS AND NON-DISCRIMINATION

As with the exclusions on scope, these disciplines are subject to a wide range of limitations that temper their ambition. The first is that, unlike the WTO discipline, these two disciplines are not absolute. Reservations can be made to either discipline, in an annex of non-conforming measures. It is true that this is a negative listing, but if one considers not the format of the schedule but the substance of the fact that carveouts are being allowed where none was before, then this is a counterbalancing step against the expansion of the discipline to service sectors.

In addition to reservations to the disciplines, there are a wide range of exclusions included, too many to mention here. A few of the key ones are:

- These obligations do not apply to trade finance, outward investment finance, and finance under the OECD Arrangement on Officially Supported Export Credits provided by an SOE once these are not intended to displace commercial financing and are offered on terms no more favourable than the same services in the commercial market.
- SOEs can act on non-commercial considerations to fulfil a public service mandate.

- Designated Monopolies can act on the basis of non-commercial considerations where their designation allows. However they must nevertheless act consistently with the non-discrimination requirements.

TRANSPARENCY DISCIPLINES

The agreement contains reasonably detailed disciplines on transparency. They provide various requirements for TPP members to provide information on the SOEs that they have as well as the information on how the state party influences their governance through information on any government appointees, share ownership (including special shares), immunities as well as any non-commercial assistance. Although not as sharp as the other disciplines, they nevertheless will be an important source of information to monitor the implementation of the obligations.

However, as with other disciplines, the baseline transparency discipline is subject to a range of exceptions. All three Commonwealth members in the TPP have taken some derogation or reservation to elements of this provision. Brunei has permanently carved out its sovereign wealth fund, the Brunei Investment Agency⁶, from all transparency disciplines. Additionally, Brunei, along with Singapore and Malaysia have secured various transitional periods from the obligation to identify its SOEs. This provides in practice a transition period for all transparency disciplines as if the other member states do not know the SOE's that a state has, then it cannot request information on those SOEs.

COMPETITION DISCIPLINES

There is a requirement that each Party ensures that its Designated Monopoly, i.e. a government or private monopoly, does not engage in “anti-competitive practices” in market segments other than that segment in which it has the monopoly. This seeming prohibition is more emphatic than that which is found in the Competition Policy chapter, as the latter does not require a Party to constrain firm conduct, only adopt and maintain the laws that do.

However, a footnote to the provision makes it clear that this provision can be complied with either through enforcement or implementation of:

1. national competition laws and regulations
2. economic regulatory laws and regulations or
3. “other appropriate measures”.

In practice this provides considerable domestic policy scope as it demurs to domestic measures.

⁶ As has Malaysia and Singapore to varying degrees in Annexes 17-E and 17-F

Non-Commercial Assistance Remedy

The agreement introduces disciplines analogous to trade remedies that apply specifically in relation to SOEs with respect to either goods, cross-border trade in services or investment. There are two kinds of disciplines:

1. Adverse Effects to Interests

Under the first kind of discipline, Parties are prohibited from giving support that causes “adverse effects” to “interest”. Examples of prohibited support include equity injections, liabilities forgiveness and better than market rate loans. The concept “adverse effects” is subject to detailed illustration and includes:

- Displacing or impeding of domestically produced like goods or imports of like goods. Displace or impede includes, but is not limited to, cases where there is a significant change in the relative market share. Negotiators provided detailed rules on the concept of significant change in relative market share. However this is just a subset of displace or impedes, and one could expect that over time this concept would be subject to further elaboration;
- Significant price undercutting, price suppression, price depression or lost sale. The concept is not defined beyond including “price undercutting” shown through comprising SOE and non-SOE like goods. However this definition is not exhaustive. This provision would seem to circumscribe SOEs from taking advantage of certain market share strategies; and
- Displacing or impeding of like services from anyone else in that market.

2. Injury to Domestic Industry Discipline

The agreement also contains a prohibition against causing injury to a domestic industry of another member by the assistance provided to any SOE in the production or sale of goods which have like goods produced and sold by that other Party’s domestic industry. This discipline adopts the concept of injury from anti-dumping and modifies it to a SOE context. The requirements are that there is:

- a. Direct or indirect non-commercial assistance to its SOE in another Party;
- b. that SOE is a covered investment in that other Party;
- c. the support is for production and sale of a good in the other party;
- d. a like good is produced and sold in the other Party by domestic industry of the other Party;
- e. support causes injury to domestic industry.

Just as with the disciplines, this remedy is subject to various carveouts. Some of the more significant are:

- NCA given before signing or 3 years after on an enacted law or obligation prior to signing will not violate NCA discipline because it is deemed not causing adverse effects.
- Initial capitalization of an SOE.
- Services supplied domestically are exempted from having an adverse effect.

- Entities owned or controlled by an independent fund except certain non-commercial assistance obligation applies to enterprises owned or controlled by the fund that get any non-commercial assistance or is used as a vehicle for non-commercial assistance.
- Sovereign Wealth Funds except if it provides or is used to provide certain NCA.

DOMESTIC POLICY IMPLICATIONS

State-Owned Enterprises (SOEs) are common policy instrument throughout the Commonwealth. They are used across the spectrum of members from the smallest island economies in the Pacific to the largest developed economies for both domestic and international trade. What varies is the intensity of their use as SOEs are often used far more widely in larger emerging economies with the resources to do so, and less so in smaller economies, especially those who have undertaken structural reform.

In the first foray into SOE disciplines, the TPP has created a flexible framework for its SOE disciplines. Given the varied nature of the regulatory systems involved in the negotiation of the TPP this is not surprising. While avoiding an outright prohibition on SOEs or indeed strictly constraining their activities the TPP nevertheless does provide some restrictions on their activities.

For countries outside of the TPP process, the developments in the TPP do matter if the TPP does what its proponents claim and ‘write the rules for trade in the 21st century’. Given the shared regulatory frameworks among Commonwealth countries, and the varying approaches and stages at which they exist in using SOEs as policy tools, this is an area where members can leverage the experiences across the Commonwealth as members try to balance competing regulatory objectives around not just state owned enterprises, but also around the competition policy and the treatment of monopolies.

The Trade Competitiveness Section

The Trade Competitiveness Section provides technical assistance to Commonwealth member countries in four areas, namely market access; export development; export of services; and trade facilitation, in order to exploit opportunities offered by international trade. The Section works with government ministries, agencies, regulators and their stakeholders to provide assistance to develop their trade competitiveness. Areas of recent intervention include national trade policy formulation, export strategies, aid for trade strategies, competitiveness implications of trade agreements, trade facilitation and gendering trade policy.

Commonwealth Secretariat
Marlborough House, Pall Mall
London SW1Y 5HX
United Kingdom

thecommonwealth.org