SOE WHAT ?

A Communiqué From The SOE Forum

Contents:

THE INTERNATIONAL FORUM FOR GOVERNANCE OF STATE OWNED ENTITIES

www.thesoeforum.org

Represented by

Mr. Naceur Bourenane, Member, Advisory Council,

Our Statement at

'Etat actionnaire et la gouvernance des entreprises

*Au colloque organisé par l'**AFGE** en partenariat avec*
l'EIFRla Fédération Bancaire Française (FBF)

et avec le soutien de

l'Association Française des Investisseurs Institutionnels (af2i)
la Société Française des Analystes Financiers (SFAF)
l'Association Française de la Gestion financière (AFG)
l'International Corporate Governance Network (ICGN)
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BACKGROUND:

The SOE Forum (The short form of The International Forum for Governance of State-owned Entities) is an initiative of a few international experts in development economics, public policy and corporate governance to create a platform for sharing experience and knowledge, building capacity, rendering technical assistance and supporting policy reform relating to governance of SOEs (covering State Owned Banks and Insurance entities also). We believe that this is a singular international-level platform that fills a major gap for this key sector that accounts for over 25% of GDP in some important emerging economies and, which has also seen an increased role of the State post-global financial crisis.

This is a fledging initiative which will be grounded fully in the coming months with headquarters, likely in Asia or Europe. Currently its project office is located in India for reasons of cost and logistics and the presence of the Founder & Convenor, Dr.Y.R.K.Reddy.

THE PREMISE:

a) We believe that the <u>overall control and governance structure</u> is more important than the <u>ownership structure</u> (state-owned, family-owned, institutionally-held or widely-held), in ensuring the competitiveness and survival of companies. A type of ownership structure is not necessarily a guarantee for sustained success of any company.

b) We would like The SOE Forum to be ideologically neutral between continued state ownership of entities and wholesome privatisation. Its focus should be primarily on reforming the governance structures so that the enterprises are enabled to restructure, re-invent, transform and survive in the VUCA world with minimal loss of jobs or diminution of the value of the assets. We also believe that the current pace of slow movements in the reform or restructuring of the governance models will lead to huge losses in the jobs and the value of the assets resulting in massive sickness.

c) We believe that there is no universally applicable Structure / model to serve as a 'silver bullet' (such as a holding company / SPV for all state equity). As we have noted from the experience so far, the socio-political and economic structures and dynamics in each country will determine the workability and effectiveness of any such move. Consequently, unique customised models have to be evolved in each country to ensure that ownership, control and management roles are appropriately balanced and matching the local dynamic. This architecture could vary between strategic ownership and portfolio investment as also between banking, insurance and other state owned enterprises.

d) We believe that sharing experience and drawing lessons will help better design solutions tailored to the need of each country and industry. Issues raised today have been certainly tackled and addressed in some other regions and countries of the world. Knowing what were the solutions envisaged and those implemented and their results will help better protect SOEs against potential losses and destruction. They will help anchor better solutions favourable to clarifying the role of the State as a key shareholder and as regulator.

ISSUES FOR DEBATE:

In the current context, and based on the debate of today, we would like to flag three issues that may need debate both within the European region as well as internationally.

1. Whether the previous approaches which were incremental and weighed-in by those who have sunk cost (short term vested interest) will end up being too-little-too-late? Especially so in the context of highly disruptive technologies and newer business models along with increased globalisation of markets as well as the increasing measures for sustainable environment. As a corollary, whether the value of equity ownership by the employees (under ESOP) is under threat of rapid decrease against a hope of higher shareholder value?

2. Whether the asymmetry between varies types of investors relating to their goals and the time horizon for realising them will have an adverse implication for the attention to corporate governance mechanism and performance? We believe that some types of institutional investors have been increasingly resorting to arbitrage opportunities and short term returns while the employees, the State and some types of investors would be more intent on reliable corporate governance mechanism that yield longer term share holder value.

3. How far and under what conditions is extensive monetisation and securitisation of Sate-owned assets, as being advocated by some, valid? What would be the implications for countries where the fiscal deficits are already under stress? Will the liquidity arising from such measures encourage profligacy and create 'moral hazard' for the State?

NEW ISSUES IN TRADE CONTEXT – IMPLICATIONS FOR STATE OWNED ENTERPRISES

(A quick note for discussion among SOE fraternity by Ru Ding &Y.R.K.Reddy**)*

Many State Owned Enterprises (SOEs) in emerging markets (EME) may not have, as yet, gathered the full import of a mission-creep in the trade negotiations. It is feared by some that the Doha framework has been more or less given up and new issues are being raised beginning with the discussions at Nairobi and going further as potential derivative of the Trans-Pacific Partnership (TPP) Agreement / Negotiations. India's Commerce Minister has recently commented on this issue generally relating to the TPP.

The new issues being raised are fairly wide in canvas and include aspects relating to IPR state monopolies, subsidies and the material relationships between SOEs and the governments. In this context, it is worthwhile to look upon the debates relating to the Chinese SOEs, Indian SOEs, and the U.S. trade remedy actions in the WTO as a precursor to the emerging concerns and implications for other EME.[1]
The main legal issue is that whether the relationship between the government and the SOEs is such that the latter's activities are directly attributable to the government, and thus their activities are bound by obligations originally imposed on their government. In the context of the WTO law, this is the "public body" issue under the WTO's subsidy

[1]Of the two WTO cases on SOEs in EME, one is between the governments of China and the U.S. concerning Chinese manufacturing SOEs and Chinese state-owned commercial banks; and the other is between India and the U.S. on the National Mineral Development Corporation's sales of iron ore to downstream producers and also Steel Development Fund's loan to Indian producers. Refer to Appellate Body Report, *United States — Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, WT/DS379/AB/R (adopted Mar. 11, 2011) and Appellate Body Report, *United States — Countervailing Measures on Certain Hot-Rolled Carbon Steel Flat Products from India*, WT/DS436/AB/R (adopted Dec. 8, 2014).

rules, inquiring whether SOEs are "public bodies" that are providing/conveying subsidies to their downstream producers.***

The underlying concern is that special privileges and the relationship between the two distort prices. And thus SOEs could be a threat to fair competition. One perspective of this concern regards the special privileges enjoyed by SOEs, which are sometimes not available for competing private enterprises. For instance, privileged allocation of key resources to SOEs (coal, gas, power, water); underwriting of debt; privileged / concessional financing by government or its financial institutions; preferential purchases of output from one SOE to the other etc., could be contended as subsidies from governments to SOEs.

Another perspective of the concern is when SOEs are being used by the government as an intermediary to give subsidy to other producers and exporters. If a SOE is indeed recognised as a public body, it would be easy for the other countries to deem the transactions of the SOE with other companies as an actionable subsidy or a prohibited subsidy and initiate countervailing measures at their end. In the case of SOEs in countries like India it may be quite easy to hold the SOE as carrying out government's function (especially as the Supreme Court in India had held in several judgements that public corporations fall within the inclusive definition of "state" in the Constitution which implies that High Courts and Supreme Courts have power of judicial review)***. The matters do not become easy when the relationship between the SOE and the ministries are operationally close and easy to prove the public policy function of the SOEs.

Besides in the trade world, the SOE-related issues are also getting increasing attention in the investment arena. For example in the context of the investor-state dispute settlements, the question is when SOEs' activities are attributable to their government under bilateral or regional investment treaties. In the recently disclosed text of TPP, Article 17.3 (Delegated Authority)in the Chapter on SOEs has particular implications on this issue. There is however quite limited literature on this.

It is perhaps necessary for a debate amongst the SOE world-wide to understand the implications of the Nairobi talks and the TPP agreement for their adverse implications on competitiveness as well as the measures to be considered for restructuring their relationship with the government.

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****See for example Ru Ding, "Public Body or Not: Chinese State-Owned Enterprises" Journal of World Trade, Issue – 1, Volume 48, 2014.*

***** See for example: Report of the Law Commission of India on "The Article 12 of the Constitution and Public Sector Undertakings", 1992.*

A Key Event in which the Formation of The SOE Forum was Introduced by The Founder & Convenor