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Taming Big Brother: G20 Push to Reform SOEs

By Amalina Anuar

Synopsis

Attempts to reform global trade rules on state-owned enterprises (SOEs) should balance improving markets and development needs, but geopolitical rifts in the global trading system could obstruct progress.

Commentary

THE VISIBLE hand of the state can significantly influence markets, and state-owned enterprises (SOEs) are no exception. As global heavyweights, government-owned, controlled or linked multinational enterprises constitute an estimated 25% of the Global Fortune 500. Concomitantly, pressure to discipline SOEs is mounting.

The longstanding push for SOE reform gained added traction with the recent communique by Business 20 (B20), the G20's informal business interest group. It advocated for the "significant limitation and/or elimination of policies that accord preferential treatment to SOEs". To level the SOE-private enterprise playing field, the B20 recommends that a tweaked multilateral trading regime should proscribe actions ranging from cheap financing to debt relief and other forms of market-distorting non-commercial assistance, i.e. assistance granted on the basis of ownership.

New Rules

World Trade Organisation (WTO) SOE-related rules already proscribe non-commercial assistance. They also mandate notifications on what SOEs exist domestically and how they are treated, including on non-commercial assistance received. Compliance, however, has lagged.

The B20's clarion call for stricter SOE rules amplifies that of certain countries trying to

bridge these regulatory gaps. India supports any potential Japanese-led bid for stricter SOE rules in the proposed Regional Comprehensive Economic Partnership (RCEP). In September 2018, the European Union, the United States and Japan proposed more transparent reporting on SOE numbers and reducing market-distorting SOE benefits.

The new free trade arrangement known as the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP) likewise aims for higher standards in SOE disciplines, with US lawmakers previously designing the pact with an eye towards exporting its standards into other arrangements. Having adopted the CPTPP SOE chapter nearly wholesale, the US-Mexico-Canada Agreement (USMCA) has similar ambitions.

CPTPP rules more narrowly define SOEs, such as more than 50% government ownership/control of shares. They apply only to SOEs earning more than 200 million SDRs (roughly USD276 million), and cover trade in goods and services. While it circumscribes non-commercial assistance for international SOE operations and production of goods, it grants exemptions for economic emergencies and public goods provision.

Aiming High

As rules are vehicles for broader agendas, what do more transparency and less non-commercial assistance aim to achieve?

Some main goals are incentivising SOEs to become more innovative and competitive. Curtailing preferential treatment would bar SOEs from operating even when unprofitable, culling these so-called “zombie firms” and reducing unfair competition. For international businesses, this could equalise operating terms in economies such as China.

Meanwhile, improving transparency and understanding of SOEs’ impact on trade in goods and services allows for more informed rulemaking and could reduce violations of the WTO’s national treatment principle, wherein all enterprises should receive equal treatment regardless of origin or ownership.

Development Dilemmas in Asia Pacific

However, broadly stringent rules on SOEs could dampen development for many, even if the main target is China. So what is the impact of these tightening moves on the Asia Pacific economies where SOEs have played defining roles in the region’s growth over the years?

Constraints on non-commercial assistance could hamstring the development of certain industries. The East Asian growth story would have looked much different, for instance, had non-commercial assistance been barred, with SOEs present everywhere from Malaysian palm oil to Korean steel.

A deeper and broader SOE discipline may also affect international development partnerships, depending on how non-commercial assistance is circumscribed and exemptions for SOE activity abroad are made.

The World Bank, amongst others, has pinpointed infrastructure as critical for economic growth. In the smorgasbord of infrastructure projects under China's Belt and Road Initiative (BRI), according to the American Enterprise Institute, SOEs carry out nearly 70% and 95% of BRI investment and construction respectively.

Considering that many such SOEs enjoy non-commercial assistance — and that several BRI-participating SOEs would be inoperable without this assistance — eliminating such assistance could leave a question mark hanging over the fate of some BRI development projects.

Uphill Battle

Ultimately, updating the multilateral rulebook must balance between meeting development needs and reducing market impediments, whether from state or private enterprises. Otherwise, attempts to strengthen the multilateral trading system, from the B20 or elsewhere, will only erode it instead.

However, several challenges dim such prospects. First, it is difficult to build consensus among the diverse membership and interests represented in the WTO. China, for instance, maintains that it has already established competitive neutrality, i.e. a level playing field between private and state enterprises.

Some developing countries have signed on to SOE reform rules — e.g. CPTPP members Vietnam, Malaysia, Brunei and Singapore. However, significant carve-outs in these agreements and absent SOE clauses in many FTAs worldwide indicate that developing countries are generally not on board with stricter SOE rules, even if opposition is not vocal. Meanwhile, the US has broadly complained about development-based exemptions to WTO rules and their abuse.

Second, trade tensions, including the SOE debate, fall under the larger banner of US-China geopolitical rivalry. There is a longstanding disagreement on which economic model — state or liberal capitalism — should constitute the foundations of the rules-based trading order.

Any consequences for the BRI and the race for infrastructure-based geostrategic influence are side-effects of this ageless clash of capitalisms and China's delay in meeting its accession terms satisfactorily, including in SOE notifications and transitioning to a market economy.

Talking Trade

Yet while multilateral progress may stall, SOE rules in plurilateral and regional trade agreements can be tightened. Ensuing effects on China may be indirect. The use of poison pill clauses in the USMCA and future US trade agreements, which discourage participating countries from entering trade agreements with non-market economies like China, could put pressure on Beijing to further reform lest it be isolated from trading partners.

Third, Trump's abhorrence for actual or perceived losing could make compromise

tough. Yet flexibilities for development and domestic political-economy considerations could help China's reformists, while unrelenting external pressure could make its hardliners more resistant to valid reform attempts — especially if China seemingly loses face and capitulates to others.

Balanced SOE rules could bring benefits vis-à-vis development and improved markets. However, changing trade rules without addressing underlying geopolitical tensions will not lay the foundations for an inclusive, sustainable global trading regime or make them less vulnerable to power politics.

Greater dialogue between some of the multilateral trading system's largest economies is important for all stakeholders; reaching a new trade consensus is even more so. The fate of global trade depends on it.

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