

**ERIA Discussion Paper Series****Disciplines on State-Owned Enterprises under the  
Trans-Pacific Partnership Agreement:  
Overview and Assessment**

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**Abstract:** This paper analyses the disciplines of state-owned enterprises (SOEs) stipulated in Chapter 17 of the Trans-Pacific Partnership Agreement (TPP). The introduction of the extensive disciplines on SOEs was led by the concern that SOEs are likely to disturb fair international competition regime by conducting business activities not depending on economic rationality and anticompetitive activities. Major provision of this chapter includes definitions and the scope of application, commercial considerations and non-discriminatory treatment, non-commercial assistance, and transparency. While Chapter 17 can be appreciated as the first comprehensive and detailed discipline on SOEs including that of the WTO-plus, it still has problems and remaining issues concerning the disciplines. Nevertheless, the very fact that the TPP includes specific rules for SOEs is appreciated as a first step towards disciplining them in the future.

**Keywords:** State-owned enterprise; Trans-Pacific Partnership (TPP); Commercial considerations; Non-discriminatory treatment; Non-commercial assistance; Transparency.

**JEL Classification:** F13; H25; K33; L32.

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## 1. Introduction

Bremmer (2011) depicts the rise of China and other state capitalist countries – those in which governments actively intervene in their economies for the stability of their countries and governments – since the 2000s and how they have come to confront the United States (US) and European countries that embrace traditional economic liberalism. State-owned enterprises (SOEs) are an important policy tool for state capitalist countries, and their remarkable growth in emerging economies can be observed, for instance, in the fact that China National Petroleum Corporation, Sinopec Group, and Industrial and Commercial Bank of China have been ranked among the top 10 companies in the Fortune Global 500 and the Financial Times Global 500 in recent years (cf. METI, 2015, pp. 506).<sup>1</sup>

While subject to state policies, SOEs enjoy a series of competitive advantages over their private-sector competitors. These include subsidies, soft loans, and credit guarantees backed by an abundance of government funding; preferential tax and regulatory treatment; and less-stringent corporate governance in terms of not being required to make short-term profits because they are state-owned. It has thus been pointed out that SOEs are prone to engage in economically irrational behaviour and anticompetitive business practices, thereby disrupting the order of fair competition in international markets (Capobianco and Christiansen, 2011, pp. 4–10). Since the early 2000s, there has been a series of cases in which such problematic behaviour and practices of SOEs have evolved into an international dispute or issue. Typical examples include a case filed with the World Trade Organization (WTO) over anti-dumping and countervailing duties investigations and imposition by the US, growing

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<sup>1</sup> China National Petroleum Corporation and Sinopec Group were ranked in the top third and fourth places, respectively, in the 2016 Fortune Global 500. China National Petroleum and Industrial and Commercial Bank of China were ranked sixth and ninth, respectively, in the Financial Times' 2015 Global 500.

concerns about irrational investment decisions regarding interests in mineral resources and exploration rights, and investment activities by sovereign wealth funds (Kowalski et al., 2013, pp. 16–17; METI, 2015, pp. 507–510). To sum up, it is concerned that SOEs are likely to disturb fair international competition regime by conducting business activities not depending on economic rationality (e.g. dumping and excessive investments) and anticompetitive behaviours.

Against this backdrop, it was inevitable that extensive disciplines on SOEs would be introduced during the negotiations for the Trans-Pacific Partnership (TPP) Agreement, which includes as its signatories a series of emerging economies that embrace state capitalism – Brunei Darussalam, Malaysia, Singapore, and Viet Nam. The application of the SOE disciplines to Viet Nam in particular has been seen as a potential test case for how to deal with China in the future. The US business community hoped strong rules would be introduced for SOEs, and a 2011 joint proposal put forward by the Coalition of Services Industries and the US Chamber of Commerce<sup>2</sup> became the basis for US proposals in the TPP negotiations.<sup>3</sup>

The objective of this paper develops preliminary analysis of the new SOE rules contained in Chapter 17 of the TPP Agreement. For this purpose, we begin our argument by outlining international economic rules in force governing SOEs such as the WTO Agreement in Section 2. Section 3 overviews the major disciplines of SOEs stipulated by Chapter 17 of the TPP Agreement. Section 4 develops an analysis of achievements and remaining issues in the chapter. Section 5 provides guidance for prospective parties to implement the SOE rules upon their accession to the TPP

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<sup>2</sup> See Coalition of Services Industries and the US Chamber of Commerce (2011). This report proposes that US TPP negotiators address the challenge of SOE issues in the way that the TPP commitments should include a package of addressing the practical market access and market distortion problems caused by government intervention in favor of SOEs and the actions of SOEs in the commercial market in the larger context of competitive neutrality.

<sup>3</sup> *Inside U.S. Trade*, 29 September 2011.

Agreement. Section 6 describes developments after the US withdrawal from the TPP Agreement, and the implication of the new accord concluded by 11 countries to the SOE rules. Finally, Section 7 concludes our arguments with overall estimation of new TPP SOE discipline and its implications for future trade negotiations.

## **2. International Economic Rules Governing State-Owned Enterprises**

Several trade agreements provide international rules governing SOEs. Under the WTO framework, the General Agreement on Tariffs and Trade (specifically, Articles III and XVII), the Agreement on Subsidies and Countervailing Measures (SCM Agreement), and the Agreement on Government Procurement impose some discipline on SOEs' discriminatory behaviour and governments' practice of providing unfair competitive advantages (subsidies and preferential regulatory treatment) to SOEs in the area of trade in goods. With respect to trade in services, the General Agreement on Trade in Services (GATS) (specifically, Articles VIII and XVI, the Annex on Telecommunications, and the Fourth Protocol on Basic Telecommunications) fulfils a similar role (Kowalski et al., 2013, pp. 78–92).

Meanwhile, obligations under bilateral investment treaties and investment chapters in free trade agreements (FTAs) – such as the principle of fair and equitable treatment and provisions for expropriation – would be applied, through the general international law principle of attribution, to SOEs acting with delegated government authority if they impinge on foreign investment. For instance, Article 9.2, paragraph 2(b) of the TPP Agreement has codified such disciplines to some extent. Regarding SOEs as investors, the Organisation for Economic Co-operation and Development

(OECD) Code of Liberalisation of Capital Movements allows host countries to regulate investment by foreign investors for security reasons, while the International Monetary Fund's Santiago Principles and the OECD Declaration on Sovereign Wealth Funds and Recipient Country Policies regulate sovereign wealth funds' strategic investment activities overseas (Kawase, 2014; Li, 2015).

Furthermore, recently concluded FTAs to which the European Union (EU) or the US is a party incorporate the General Agreement on Tariffs and Trade and/or GATS provisions, and their investment chapters regulate SOEs' anticompetitive behaviour (Kawase, 2014). Also, the extraterritorial application of domestic competition law is useful in regulating foreign SOEs' anticompetitive behaviour in the domestic market, as was the case with the European Commission's Statement of Objections sent to Gazprom in 2015, notifying the Russian firm of its alleged breach of EU competition law (Press statement by European Commission, Commission sends Statement of Objections to Gazprom for Alleged Abuse of Dominance on Central and Eastern European Gas Supply Markets, 2015).

However, this patchwork of existing rules is not enough to address concerns over the competition-distorting effect of SOEs. For instance, ensuring the transparency of corporate information, such as business description and financial information, is a prerequisite for regulating SOEs but is outside of the purview of the existing rules. Also, suppose a company has launched operations in a foreign country by making a direct investment there and competes with an SOE from a third country in that market (as in the case where a Japanese company competes with a Chinese SOE in the Association of Southeast Asian Nations market); even if the SOE's investment and operations are subsidized by its home country, it is difficult to determine the existence of and regulate such subsidies. The OECD (2015) calls for ensuring a 'level playing

field' between public- and private-sector companies as a corporate governance guideline for SOEs, but this is nothing more than a soft-law instrument and its effective enforcement is not necessarily warranted.

Chapter 17 of the TPP Agreement is counted on to fill such gaps. Section 3 provides an overview of the chapter's major provisions.

### **3. Overview of Chapter 17 of the Trans-Pacific Partnership Agreement**

#### **3.1. Definitions and the scope of application**

An SOE refers to an enterprise that is engaged in commercial activities in which a TPP party (i) directly owns more than 50% of the share capital, (ii) controls more than 50% of the voting rights, or (iii) holds the power to appoint a majority of members of the board of directors or any other equivalent management body. Chapter 17 is applicable not only to SOEs but also to designated monopolies, i.e. government- or privately owned enterprises designated by the government of a party as the sole provider or purchaser of a good or service. Privately owned monopolies designated as such before the TPP entered into force are excluded (Articles 17.1 and 17.2.1).

Certain types of organizations and their activities are provided with a blanket exemption from the application of the chapter. These include the performance of regulatory or supervisory activities and the conduct of monetary and related credit policy and exchange rate policy by a central bank or monetary authority (Article 17.2.2), the exercise of regulatory or supervisory authority by a financial regulatory body (Article 17.2.3), activities for the resolution of a failing or failed financial

institution (Article 17.2.4), government procurement (Article 17.2.7), and governmental functions (Article 17.2.8).

Also, a set of core obligations under the chapter (Articles 17.4, 17.6, and 17.10) does not apply to any service supplied in the exercise of governmental authority (Article 17.2.10).<sup>4</sup> Furthermore, sovereign wealth funds (Article 17.2.5) and independent pension funds and enterprises owned or controlled by them (Article 17.2.6) are also excluded from the application of the chapter, except for some provisions for non-commercial assistance (Articles 17.6.1 and 17.6.3).

In addition to the above exemptions, each party to the TPP can claim party-specific exemptions. First, the activities of SOEs or designated monopolies stated in each country's schedule of non-conforming activities (Annex IV) are exempt from the application of Articles 17.4 and 17.6 (Article 17.9.1, except for Japan and Singapore).<sup>5</sup> Second, subject to the condition that further negotiations will be commenced within 5 years of the date of entry into force of the TPP to narrow the scope of exemptions (Article 17.14 and Annex 17-C[a]), the sub-central SOEs and designated monopolies listed in Annex 17-D are provided with a blanket exemption from the application of Articles 17.4–17.6 and 17.10 (Article 17.9, except for Brunei and Singapore). Third, the obligation to ensure non-discriminatory treatment (Articles 17.4.1[b], 17.4.1[c], 17.4.2[b], and 17.4.2[c]) does not apply to purchases and sales made by SOEs and designated monopolies pursuant to measures set out in schedules of cross-border trade in services and investment non-conforming measures (annexes I and II) (Article 17.2.11). Lastly, Singapore has secured exemption from a set of core obligations under

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<sup>4</sup> A 'service supplied in the exercise of governmental authority' is defined as having the same meaning as the identical phrase in GATS Article I, paragraph 3(c) as well as in paragraph 1(b) of the General Agreement on Tariffs and Trade Annex on Financial Services under the framework of the WTO (note 11 to Chapter 17).

<sup>5</sup> See Willemys (2016, pp. 20–22) for an overview of country-specific non-conforming activities.

the chapter for SOEs owned or controlled by sovereign wealth funds, such as Temasek Holdings (Annex 17-E), whereas Malaysia has obtained exemption from the entire chapter for some activities of certain SOEs, such as those of a pilgrimage fund (Annex 17-F).

Other exemptions from specific obligations will be explained in the context of their relationships with the respective obligations.

### **3.2. Commercial considerations and non-discriminatory treatment**

A core obligation under Chapter 17 is to ensure that SOEs and designated monopolies act in accordance with commercial considerations in their purchase or sale of goods and services (Articles 17.4.1[a] and 17.4.2[a]). ‘Commercial considerations’ means the terms and conditions of purchase or sale of goods and services, such as price and quality, and other factors that would normally be taken into account in the commercial decisions of a privately owned enterprise (Article 17.1).

Parties are also obliged to ensure that SOEs and designated monopolies treat the goods, services, and enterprises of another party on a non-discriminatory basis (most-favoured nation and national treatment). Each party must ensure non-discriminatory treatment by its SOEs (i) between a good or a service imported from another party and a like good or a like service supplied domestically or imported from any other party that is not the one aforementioned (hereinafter referred to as a ‘third party’) or any non-party; and (ii) between a good or a service supplied by an enterprise established within its territory by investment from another party (‘enterprise that is a covered investment’) and a like good or a like service supplied in the relevant market in its territory by domestic enterprises or enterprises established by investment from any third party or non-party in purchasing goods and services. Also, each party must



guarantee non-discriminatory treatment by its SOEs (i) between an enterprise of another party and its domestic enterprises or enterprises of any third party or of any non-party; and (ii) between an enterprise established within its territory by investment from another party and enterprises established within its territory by domestic investment or investment from any third party or any non-party in the relevant market within its territory in selling goods and services (Articles 17.4.1[b] and 17.4.1[c]).

Parties are also obliged to ensure non-discriminatory treatment by designated monopolies in the same manner, with respect to their purchase and sale of goods and services on which they are allowed to have a monopoly (Articles 17.4.2[b] and 17.4.2[c]). In addition, designated monopolies are prohibited from using their monopoly position to engage in anticompetitive practices in any market in which they are not allowed to have a monopoly (Article 17.4.2[d]).

It should be noted that these provisions do not necessarily preclude SOEs and designated monopolies from purchasing or selling goods or services on different terms and conditions, including those relating to prices, or refusing to purchase or sell goods or services, provided that such transactions are in accordance with commercial considerations (Article 17.4.3).

However, the obligations under Article 17.4 are subject not only to the blanket exceptions and exemptions explained in (i) above, but also to those specific thereto. No provisions of Article 17.4 apply to any party with respect to temporary measures taken to respond to a national or global economic emergency (Article 17.13.1) or to any SOE or designated monopoly if its annual revenue from commercial activities was less than 200 million Special Drawing Rights (SDR) in any one of the three previous consecutive fiscal years (Article 17.13.5 and Annex 17-A). Meanwhile, as a partial exception or exemption, the obligation to ensure commercial considerations and non-

discriminatory treatment (Article 17.4.1) does not apply in the case where an SOE supplies financial services in support of trade or investment pursuant to a government mandate, provided that such services meet certain requirements, such as compliance with the OECD Arrangement on Officially Supported Export Credits (Article 17.13.2). Also, in the case where an SOE provides a public service pursuant to a government mandate (direct or indirect supply of a service to the general public, Article 17.1), the obligation to ensure commercial considerations does not apply (Article 17.4.1[a]), insofar as the SOE does not discriminate against any enterprise established by investment from another party (Article 17.4.1[c][ii]).

### **3.3. Restrictions on non-commercial assistance**

As explained in Section I, the ongoing concerns over SOEs centre on the competition-distorting effect of government assistance that is backed by an abundance of state-owned capital. More specifically, such government assistance is provided mainly in the form of financial assistance to SOEs, such as subsidies, loans, and credit guarantees, and Chapter 17 includes provisions that restrict this ‘non-commercial assistance’.

The chapter defines non-commercial assistance as ‘assistance to a state-owned enterprise by virtue of that state-owned enterprise’s government ownership or control.’ Here, ‘assistance’ means (i) direct transfers of funds or potential direct transfers of funds or liabilities, such as grants or debt forgiveness, loans, loan guarantees, or other types of financing on terms more favourable than those commercially available; or (ii) goods and services other than general infrastructure on terms more favourable than those commercially available. The term ‘by virtue of that state-owned enterprise’s government ownership or control’ refers to a situation where an SOE receives

materially favourable treatment as a subject of government assistance or where government assistance is available only to the SOE (Article 17.1).

### *3.3.1. Prohibition of adverse effects*

Non-commercial assistance provided to an SOE directly or indirectly by a party (including cases in which such assistance is provided by a non-SOE entrusted or directed by the government) or by its public enterprises or SOEs must not cause adverse effects to the interests of other parties with respect to the (i) production and sale of a good by the SOE, (ii) supply of a service by the SOE from the territory of the party into the territory of another party, and (iii) supply of a service in the territory of another party through an enterprise established in the territory of that other party or any third party by investment from the party (Articles 17.6.1 and 17.6.2). Meanwhile, adverse effects that the provision of a service by an SOE of a party may cause in the market of a non-party are subject to further negotiations within 5 years of the date of entry into force of the TPP Agreement on extending the application of Articles 17.6 and 17.7 (Article 17.14 and Annex 17C[a]).

Although Article 17.7.1 sets out seven types of adverse effects, they can be broadly classified into two categories. Adverse effects in the first category are those that arise in the form of displacing or impeding from its market imports or sales of a like good. Adverse effects are deemed to arise if a good produced or sold by a party's SOE that has received non-commercial assistance (i) displaces or impedes from its market imports of a like good from another party or sales of a like good produced by an enterprise established within its territory by investment from another party (Article 17.7.1[a]); (ii) displaces or impedes from the market of another party sales of a like good produced by an enterprise established within the territory of such other party by investment from any third party or imports of a like good of any third party (Article

17.7.1[b][i]); or (iii) displaces or impedes from the market of a non-party imports of a like good of another party (Article 17.7.1[b][ii]).

Adverse effects are also deemed to arise if a service supplied by a party's SOE that has received non-commercial assistance displaces or impedes from the market of another party a like service supplied by an enterprise of such other party or of any third party (Article 17.7.1[d]). A determination of such displacement or impediment is based on whether there is a significant change in relative shares of the market (Article 17.7.2).

Adverse effects in the second category arise in the form of significant price undercutting, price suppression, price depression, or lost sales. Such adverse effects are deemed to arise if a good produced or sold by a party's SOE that has received non-commercial assistance causes such effects (i) in its market as compared to a like product imported from another party or produced by an enterprise that is a covered investment from another party in its territory (Article 17.7.1[c][i]); or (ii) in the market of any non-party as compared to a like good imported from another party (Article 17.7.1[c][ii]).

Adverse effects are also deemed to arise if a service supplied by a party's SOE that has received non-commercial assistance causes such effects in the market of another party as compared to a like service supplied by an enterprise of such other party or of any third party (Article 17.7.1[e]).

### *3.3.2. Prohibition of injury*

When a party has an SOE that has invested in another party and provides non-commercial assistance to the SOE to help with the production and sale of a good in the market of such other party, the good produced and sold by the SOE may compete with a like good produced and sold by the relevant domestic industry of such other party (host country) in its market. In such a case, the non-commercial assistance provided to

the SOE must not cause injury or threat thereof to the host country's domestic industry (Article 17.6.3).

The term 'injury' here means material injury or threat of material injury to a domestic industry or material retardation of the establishment of such an industry (Article 17.8.1; see Article 17.8.5 for the definition of 'threat of material injury'). A determination of injury is based on the examination of various factors, including the volume of production by the SOE that has received non-commercial assistance, the effect of such production on prices for like goods in the host country's market, the impact on the domestic industry of the host country (e.g. decline in output, sales, and market share; negative effects on cash flow and inventories), and the causal relationship between the goods produced by the SOE and the injury to the domestic industry (Articles 17.8.2–17.8.4).

### *3.3.3. Exceptions and exemptions*

Again, there are exceptions specific to Article 17.6 apart from the blanket exemptions explained in Section 1. The economic emergency exception (Article 17.13.1) and exception for SOEs with an annual commercial revenue of less than SDR200 million (Article 17.13.5 and Annex 17-A), discussed in Section 2, are applied to make an exemption from all of the obligations under Article 17.6. Also, an enterprise located outside the territory of a party over which an SOE has assumed temporary ownership as a consequence of foreclosure in connection with defaulted debt or payment of an insurance claim by the SOE is outside the scope of application of Article 17.6 (Article 17.13.4).

A partial exemptions similar to the one discussed in Section 2 that exempts the supply of trade- or investment-related financial services from the application of Article 17.4 (Article 17.13.2) are provided for separately to make an exemption from the

prohibition of the supply of services causing adverse effects (Articles 17.6.1[b], 17.6.1[c], 17.6.2[b], and 17.6.2[c]) insofar as a party (host country) requires the local presence of another party's SOE that provides trade- or investment-related financial services in its territory (Article 17.13.3). Meanwhile, a service supplied by an SOE of a party within its territory is deemed not to cause adverse effects (Article 17.6.4). Furthermore, non-commercial assistance provided before the signing of the TPP Agreement or that provided within 3 years after the signing of the TPP Agreement pursuant to a law enacted or contractual obligation undertaken prior to the signing of the TPP Agreement are also deemed not to cause adverse effects (Article 17.7.5).

### **3.4. Ensuring transparency**

As often pointed out about Chinese SOEs, there is a general lack of transparency regarding the status of activities of SOEs. The US has included a transparency clause as part of SOE provisions under its FTAs, but the disciplines provided for in Chapter 17 are more detailed. Within 6 months after the entry into force of the TPP Agreement, each party must make a list of its SOEs and designated monopolies publicly available on its official website or provide it to the other parties (Articles 17.10.1 and 17.10.2). Also, upon request from another party, a party must provide information concerning a specific SOE or designated monopoly (e.g. the percentage of shares owned by the government, the government titles of any government official serving as an officer or member of the board, annual revenue and total assets over the most recent 3-year period) and information regarding any government policy or programme for non-commercial assistance (e.g. the form and amount of the non-commercial assistance and the names of the agencies providing the non-commercial assistance) (Articles 17.10.3–17.10.7).

Meanwhile, obligations under Article 17.10 are subject to the exceptions and exemptions discussed in Section 1 as well as to the exemption for SOEs with an annual revenue of SDR200 million (Article 17.13.5 and Annex 17-A). Measures listed in party-specific schedules (Annex IV) are exempted only from the application of Articles 17.4 and 17.6, with the exception of Brunei, Malaysia, and Viet Nam for which all or part of the obligations under Article 17.10 do not apply to specific items listed in their respective schedules (Notes 26, 27, and 30 to Chapter 17). Also, these three countries are provided with a grace period of 5 years from the entry into force of the TPP Agreement to undertake the obligations under Article 17.10.1, provided that they meet certain requirements (Notes 28 and 29 to Chapter 17).

## **4. Analysis and Assessment**

### **4.1. Expansion of disciplines**

Chapter 17 deserves appreciation as the first comprehensive and detailed disciplines on SOEs. First, regarding the obligation to ensure that SOEs and designated monopolies act in accordance with commercial considerations, similar provisions are set forth, for instance, in Article 12.3 of the US–Singapore FTA. However, the chapter goes further than existing FTAs in that it defines specific types of relevant markets and for each one sets out detailed non-discrimination obligations in trade in goods and services and in the treatment of any enterprise that is a covered investment (Articles 17.4.1[b], 17.4.1[c], 17.4.2[b], and 17.4.2[c]). These provisions partially overlap with, for instance, General Agreement on Tariffs and Trade Articles I and III.4, GATS Articles II and XVII, and the principle of non-discrimination and of fair and equitable

treatment under investment treaties, but are expected to be far more effective as they explicitly prohibit discriminatory behaviour by SOEs.<sup>6</sup>

As for disciplines on non-commercial assistance provided by SOEs, the SCM Agreement requires a complainant to prove the characterization of an SOE as a public body or establish the fact that the SOE has been entrusted or directed by the government with respect to the provision of non-commercial assistance (chapeau and item (iv) of Article 1.1(a)(1) of the SCM Agreement), and it is not easy to provide such proof as required by the Appellate Body of the WTO.<sup>7</sup> In this regard, the Chapter 17 can be seen as ‘WTO-plus’ by virtue of allowing disciplines similar to those under the SCM Agreement to be directly imposed on SOEs that provide injury-causing non-commercial assistance.

Most importantly, it is particularly noteworthy that the scope of disciplines on non-commercial assistance has been expanded to cover subsidies in trade in services and investment, which have been outside the purview of the WTO. Subsidies for the production, sale, and export of goods by domestic companies have been subject to the rules and disciplines of the WTO’s SCM Agreement. However, rules for subsidies in trade in services are under negotiation as part of the WTO Doha Round in accordance with the mandate provided in GATS Article XV, and the talks remains stalled. Rules for home country governments’ subsidies to overseas investments have been non-

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<sup>6</sup> These international agreements only regulate the behaviour of their parties, i.e. sovereign states, and are unable to directly regulate any act by SOEs. In order to apply any provisions under these agreements to an SOE, it must be proven separately that the SOE is an integral part of the government of the party in question or that the government of the party is involved in the discriminatory acts of the SOE.

<sup>7</sup> For instance, see Appellate Body Report, *United States – Definitive Anti-Dumping and Countervailing Duties on Certain Products from China*, pp. 282–322, WT/DS379/AB/R (11 March 2011) for the requirement for the proof of the former, and Appellate Body Report, *United States – Countervailing Duty Investigation on Dynamic Random Access Memory Semiconductors (DRAMs) from Korea*, pp. 108–116, WT/DS296/AB/R (27 June 2005) for that of the latter.



existent in the first place.<sup>8</sup> Chapter 17 is designed to address problems arising from the increasingly globalized business operations by SOEs in particular, in that it expands the scope of disciplines to include assistance to SOEs established by investment in a third party.

## **4.2. Problems and remaining issues**

At the same time, however, there is no denying that the disciplines provided in Chapter 17 have problems. The following paragraphs explain several issues that remain unaddressed.

### *4.2.1. Narrow scope of application and large number of exceptions*

First, in marked contrast with the SOE provisions under the US–Singapore FTA, Chapter 17’s definition of an SOE is very narrow and fails to cover enterprises that are effectively government-controlled (Willemyns, 2016, pp.12). Under the US–Singapore FTA, an enterprise in which the government has ‘effective influence’ and whose annual revenue or total assets is greater than 50 million Singapore dollars<sup>9</sup> and those in which the government owns a special voting share with veto rights relating to important matters, such as the appointment of directors and senior officers and the acquisition by any third person of shares therein, are a ‘covered entity’ and subject to the disclosure requirement (Articles 12.3.2(g) and 12.8.1 of the US–Singapore FTA). A ‘government enterprise’ subject to the other substantive obligations, including

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<sup>8</sup> The coverage of subsidy disciplines under investment treaties is limited to cases where the government of a host country – not of a home country – treats its domestic companies – not a foreign enterprise that is a covered investment – by giving subsidies in a discriminatory manner. Furthermore, investment treaties concluded in recent years tend to exclude subsidies from all or part of disciplines. The Investment Chapter of the TPP Agreement is no exception, exempting subsidies or grants from the obligations of most-favored-nation treatment and national treatment as well as from the prohibition of requiring the appointment of a person of a particular nationality to a senior management position (Article 9.11.6[b]).

<sup>9</sup> US\$36,752,550 as of 12 November 2017 (S\$1.00 = US\$0.735).

assurance for the SOE's conduct in accordance with commercial consideration, is defined as 'an enterprise in which that party has effective influence' (Articles 12.8.5 and 12.8.6 of the US–Singapore FTA). 'Effective influence' is deemed to exist, not only where the government owns more than 50% of the voting rights, but also even where the government owns 50% or less of the voting rights if it has the ability to exercise substantial influence over executive appointments or other important management decisions. Regarding the latter case, if the government owns more than 20% of the voting rights that constitute the largest block thereof, there is a rebuttable presumption that effective influence exists. Also, for the purpose of applying this 20% threshold, voting rights owned by the government are not limited to those directly owned by the government but include those owned by SOEs and enterprises owned by SOEs (Article 12.8.5 and Annex 12A of the US–Singapore FTA). These criteria enable the US–Singapore FTA to cover a far wider scope of enterprises compared to Chapter 17, which defines an SOE as an enterprise in which a government directly owns more than 50% of shares or voting rights (Article 17.1) and exempts SOEs with an annual revenue from commercial activities of less than SDR 200 million (Article 17.13.5 and Annex 17-A).<sup>10</sup>

In addition, the chapter provides for exceptions and exemptions, and it includes party-specific schedules that allow for a broad range of exceptions.

#### *4.2.2. Lack of disciplines on government ownership and involvement*

Chapter 17 includes no provisions that would require parties to reduce government ownership and involvement. In contrast, the US–Singapore FTA prohibits the exercise of government influence over decisions by SOEs (Article 12.3.2[e]). In addition, it includes a unilateral obligation requiring only Singapore to continue to reduce its

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<sup>10</sup> US\$147,010,200 as of 12 November 2017 (S\$1.00 = US\$0.735).

aggregate ownership in SOEs (Article 12.3.2[f]). An OECD study points out that stable ownership by a government (captive equity) absolves SOEs from pressure to pay dividends and fear of falling stock prices, and could become a source of anticompetitive activities and unfair competitive advantages (Capobianco and Christiansen, 2011, pp. 6–7).

#### *4.2.3. Lack of disciplines on preferential regulatory treatment*

According to the OECD study, sources of competitive advantages for SOEs are not limited to the non-commercial assistance restricted by Chapter 17, i.e. subsidies, but include preferential regulatory treatment (in disclosure requirements, environmental regulations, antimonopoly law enforcement, zoning regulations, etc.) and exemptions from bankruptcy rules (Capobianco and Christiansen, 2011, pp. 6–7). The chapter does not include adequate provisions to address these preferential measures. The principle of non-discrimination applies to SOEs' business activities but not beyond that, and the chapter has no provision regulating preferential regulatory treatment by a party of its SOEs over competing foreign enterprises. Also, while Article 17.5.2 prohibits administrative bodies from providing preferential treatment to SOEs by exercising their regulatory discretion, this does not apply, for instance, in the case where a specific law or regulation explicitly provides for an exemption applicable solely to SOEs.

With respect to covered investment assets, the obligations to ensure national treatment (Article 9.6) and the minimum standard of treatment (Article 9.6) under the Investment Chapter provide some disciplines if there is any regulatory discrimination between enterprises that are covered investments and SOEs of the host country. However, if such obligations are to be enforced through an investor–state dispute-settlement system, the scope of disciplines is confined to cases where such

discriminatory regulatory treatment has caused damage for which compensation can be claimed; the regulatory discrimination in question per se is not subject to the dispute-settlement procedure.

#### *4.2.4. Lack of disciplines for ensuring rational investment behaviour*

Chapter 17 exempts sovereign wealth funds entirely from its coverage and includes no provisions for ensuring rational investment behaviour by other SOEs. The obligation to act in accordance with commercial considerations is applied only with respect to purchases and sales of goods and services, and not with respect to investment behaviour (Articles 17.4.1(a) and 17.4.2[a]). In its *2015 Report on Compliance by Major Trading Partners with Trade Agreements*, the Ministry of Economy, Trade and Industry (METI) of Japan expressed concerns about the rationality of SOEs' behaviour in securing an interest in or acquiring companies holding an interest in mineral resources and raw materials (METI, 2015, pp. 507). How to address such concerns has been left to be dealt with in the future.

#### *4.2.5. Restrictions on non-commercial assistance and policy rationale*

In China, the presence of SOEs has been aggravating overcapacity problems in heavy industries such as steel, cement, and chemicals, and structural adjustment of such industries may require a degree of assistance to help them dispose of excess facilities and reduce workforce (EU Chamber of Commerce in China, 2016; Qi, 2014). Also, when assessed from the perspective of the need to address the problem of natural monopoly in network industries or of externalities in research and development, a degree of rationality is recognized in non-commercial assistance (Chang, 2007, pp. 8–14). However, Chapter 17 assesses the permissibility of non-commercial assistance based solely on its economic impact on the relevant market, giving no consideration to policy goals and the problem of externalities. Prompted by the awareness of such

problems, the need to make amendments to the SCM Agreement has been discussed in recent years, but the chapter has failed to respond to those concerns (Horlick and Clarke, 2016).

#### 4.2.6. *Challenges in enforcing restrictions on non-commercial assistance*

The provisions of Chapter 17 are enforceable through the designated dispute-settlement procedure. In particular, the wording of Articles 17.6 and 17.8 concerning non-commercial assistance is very similar to that of Articles 6 and 15 of the WTO's SCM Agreement. Therefore, a TPP dispute-settlement panel is expected to apply these provisions with reference to relevant precedents in WTO dispute-settlement decisions.

However, the settlement of a dispute over a subsidy involves the determination of facts based on an enormous volume of documentary evidence, including the determination of the existence of the subsidy, the calculation of the benefit to the recipient of the subsidy, and the assessment of injury and causal relationships. For example, extremely complex and voluminous panel reports were issued in two WTO disputes between the US and the EU over subsidies to Airbus and Boeing (about 800 pages from the US report and more than 1,000 pages from the EU report ) and in another dispute over US subsidies to upland cotton (more than 2,000 pages including parties' submissions and evidence documents).<sup>11</sup> The TPP dispute-settlement mechanism provides very limited secretariat function to support panel members (Article 27.6) and its procedures for collecting evidence for the determination of facts are simple compared with those provided for in Annex V of the SCM Agreement (Article 17.15 and Annex 17-B). It is questionable whether and to what extent the

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<sup>11</sup> See Panel Body Report, *United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint)*, WT/DS353/R (31 March 2011); Panel Report, *European Communities and Certain Member States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS316/R (30 June 2010); Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/ R (8 September 2004).

provisions similar to those under the SCM Agreement will be workable under the TPP framework.

#### *4.2.7. Effectiveness of disciplines on transparency*

Article 25 of the SCM Agreement requires that members notify the WTO of all subsidies, but this notification system does not function properly. In contrast, Chapter 17 requires parties to provide information on non-commercial assistance upon request from another party affected by the provision of such non-commercial assistance, rather than requiring unilateral notification. In this regard, the chapter has made some improvements on the SCM Agreement. However, since a country making such a request must explicitly show how the activities of the SOE in question and the non-commercial assistance thereto affect trade or investment between the two countries (chapeau of Articles 17.10.4 and 17.10.4), the country on the receiving side may refuse to respond if it finds any defects in the request. In the first place, if a non-commercial assistance in question is provided in secrecy, it would be difficult for other countries to identify which information should be disclosed with respect to the specific assistance measure.

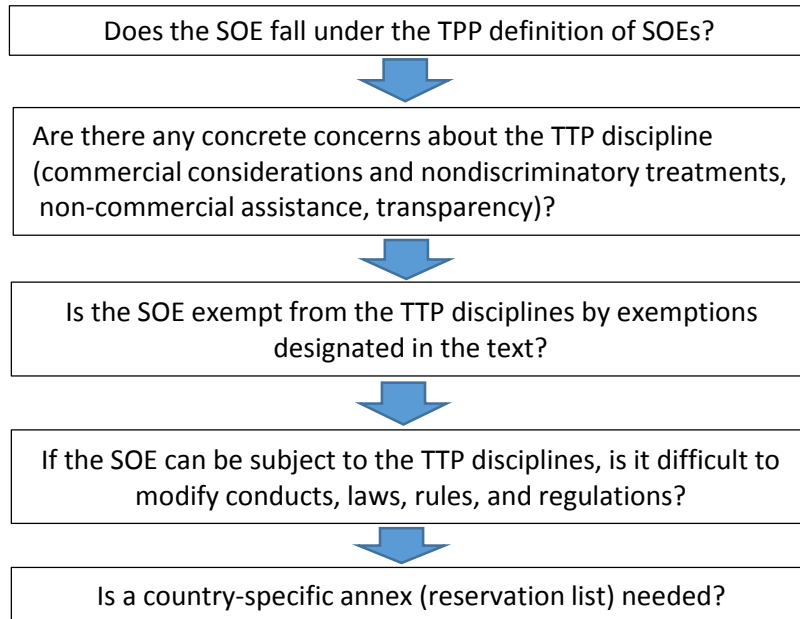
## **5. Implication for Future Parties to the Trans-Pacific Partnership: How to Prepare for the State-Owned Enterprise Rules**

While this paper has so far pointed out insufficiencies of the current Chapter 17 of the TPP Agreement, it by no means denies that the chapter is a giant step for effective international control over market distortion caused by anticompetitive behaviours of SOEs, and has significant implications for future parties to the TPP Agreement. Non-TPP ASEAN countries, such as Indonesia, the Philippines, and

Thailand, have shown their interests in joining the TPP Agreement even before its entry into force. It is obvious that Viet Nam's successful conclusion of the TPP Agreement, despite their difficulty in SOE reforms, brought a sense of impending crisis to the above-mentioned three countries that they might be left behind the larger global value chain to be available in the Asia-Pacific region. For these countries, Chapter 17 is a vehicle to transform their domestic economies into more efficient and market-oriented economies. Therefore, even after the US pulled out of the agreement, it is worth the prospective TPP parties' while to give a serious consideration to accepting the set of the rules.

Before joining the TPP Agreement, it would be useful for the prospective parties to simulate how to accept the rules in Chapter 17. The figure briefly summarises this process. First, it is important to probe whether a specific enterprise falls into the definition of an SOE that is described in Article 17.1. If the enterprise is not assumed to be an SOE, there is no need for further examination. Second, if the enterprise is assumed to be an SOE, it is necessary to identify a concrete concern that the enterprise finds it difficult to abide by with respect to commercial consideration and non-discriminatory treatment, non-commercial assistance, and transparency. At the same time, we must note that the SOE might be exempted from the disciplines designated in the chapter. Third, it should also be clarified whether the SOE can be subject to the disciplines and whether it is difficult to modify conducts, laws, rules, and regulations accruing to the SOE. Finally, the country-specific annex, or reservation list, is likely to allow the SOE to maintain the concerned behaviour and business practice as critical roles for fulfilling policy objectives. Yet, whether the reservation list is available or not depends on negotiations among parties.

### Flow Chart of the Examination of Trans-Pacific Partnership Discipline



SOE = state-owned enterprise, TPP = Trans-Pacific Partnership.

Source: Authors.

## **6. Trans-Pacific Partnership 11 and Its Impact on the State-Owned Enterprise Rule**

Despite its leading role in the TPP negotiation, the US officially withdrew from the TPP framework on 23 January 2017 with the presidential order of Donald Trump, then newly elected, who insisted that the TPP would not serve US interests. Since then, and despite US withdrawal, the other 11 parties have made tremendous efforts to maintain the fundamental framework of the TPP Agreement. These efforts resulted in the ministerial agreement on the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) on 11 November 2017 in Da Nang, Viet Nam<sup>12</sup>

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<sup>12</sup> Related documents are available at [http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/statement-declaration.aspx?lang=eng&\\_ga=2.239857219.1923031733.1510435660-1966312929.1510435660](http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/statement-declaration.aspx?lang=eng&_ga=2.239857219.1923031733.1510435660-1966312929.1510435660)



and the scheduled signature of the CPTPP on 8 March 2018 in Chile.<sup>13</sup> The new accord incorporates the text of the original TPP Agreement, and, once enforced, will suspend 22 items in the incorporated agreement, including intellectual properties protection and investor–state dispute settlement. The rest of the agreement remains unchanged. The November package does not indicate any major change to Chapter 17.

Having thus said, at the request of Malaysia, its party-specific schedule of non-conforming SOE activities in Annex IV of the TPP Agreement has been eventually included in these suspended items by consensus among all Parties for its suspension to take effect. Nevertheless, since Malaysia had already obtained ample exceptions to the SOE rules in the original TPP negotiation, the impact of this additional suspension would be limited as such suspension does not expand to other parties' non-conforming SOE activities. The 11 parties succeeded in reaching a conclusion on these unsettled items before their signature of the CPTPP.

## **7. Conclusion**

As we have observed, the TPP's disciplines on SOEs are very limited in their scope of application, with various exceptions, and in some areas they compare poorly to the US–Singapore FTA – one of the most recently concluded FTAs. Because of such limitations, Chapter 17 is not necessarily attached a high value in terms of its direct impact on competitiveness of SOEs in the contracting parties.

In particular, the SOE provisions, fraught with multiple weakness, fall far short of the initial expectations of the US, which, at the time of negotiations, was hoping to discipline China (Scissors, 2015). It is clear that the TPP disciplines on SOEs failed to

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<sup>13</sup> This information is obtained from official release of the Japanese government (in Japanese). [https://www.cas.go.jp/jp/tpp/naiyou/pdf/tokyo1801/180123\\_tpp\\_tokyo\\_gaiyou.pdf](https://www.cas.go.jp/jp/tpp/naiyou/pdf/tokyo1801/180123_tpp_tokyo_gaiyou.pdf)

reach the level that the US Congress and the US business community behind it had hoped for. In this context, Senator Orrin Hatch, chair of the US Senate Finance Committee since 2015, was concerned about such defects in the SOE chapter immediately after conclusion of the TPP negotiation in the fall of 2015, and called on the administration to take appropriate steps to address the concerns before ratification. Hatch believed that Washington should seek agreement, particularly with Viet Nam, on specific plans for the implementation of Chapter 17. To that end, he proposed that the US negotiate a bilateral consistency plan for the implementation of the SOE provisions, in the same way as it did with Brunei, Malaysia, and Viet Nam with respect to the implementation of the labour chapter of the TPP Agreement.<sup>14</sup> Although the anecdote in the US Congress seems irrelevant now that the US has withdrawn, it still shows eloquently the insufficiency of TPP Chapter 17 for the ultimate policy goal of achieving competitive neutrality in the Asia-Pacific region.

Nevertheless, some observers find Chapter 17 ground-breaking<sup>15</sup> and the fact that the TPP includes specific rules for SOEs is appreciated as a first step towards disciplining them (Larson, 2015). Also, given the politically sensitive nature of SOE issues, some believe that it was wise to take such a limited step (Elms, 2015). The SOE chapter will also serve to improve competitive environments in the Asia-Pacific region through other economic forum and trade negotiations.

The Regional Comprehensive Economic Partnership (RCEP), now under negotiation, comprises ‘ASEAN + 6’ countries. Some of these economies are of state capitalist in nature, such as China, India, Indonesia. For that reason, it is obvious that assurance of competitive neutrality in the region is very critical. As RCEP membership

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<sup>14</sup> *Inside U.S. Trade*, 20 November 2015.

<sup>15</sup> *Inside U.S. Trade*, 6 November 2015.

overlaps with that of the TPP/CPTPP, TPP Chapter 17 offers a template for an SOE chapter in RCEP. In other words, TPP-type rules on SOEs could prevail across the RCEP economies. On the other hand, the Asia-Pacific Economic Cooperation (APEC), which includes all 12 TPP parties, might find it difficult to adopt stringent SOE disciplines on economies across the board, since by nature it is suitable for setting soft rules and implementing cooperation based upon flexible and voluntary agreements. However, the importance of governing SOEs has been widely acknowledged to secure competitive and open business environments in the Asia-Pacific region.<sup>16</sup> Therefore, APEC is expected to promote further study and capacity building of SOE rules based on TPP Chapter 17.

Even though it is now heavily inclined to a bilateral approach, the US could take advantage of TPP Chapter 17 in its prospective trade negotiations. During the ongoing North American Free Trade Agreement (NAFTA) renegotiation, the US Trade Representative reportedly floated the idea of introducing a set of SOE rules similar to but stronger than TPP Chapter 17.<sup>17</sup> Also, the US and the Republic of Korea have already agreed to tackle implementation issues of US–Korea Free Trade Agreement, including potential renegotiation. Since comprehensive SOE rules are also missing in the US–Korea Free Trade Agreement, it may be a major topic in the forthcoming negotiations.

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<sup>16</sup> For examples of recent studies, see APEC (2016, 2017).

<sup>17</sup> *Inside U.S. Trade*, 27 October 2017. See also the official document published by the US Trade Representative (2017) that describes concise objectives of the NAFTA renegotiation regarding state-owned and control enterprises.

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