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## **Part A: Perspectives**

### **Is There a Resurgence of State Capitalism?**

*Y.R.K.Reddy*

*A perspective shared on 21<sup>st</sup> October, 2016*

1. At the beginning of this century, no one had perhaps ventured to predict that Public Enterprises (SOE) will become significant global players and shine in competitive terms of size, reach and performance. That they even can be a cause of worry for protagonists of free / liberalised markets. One would not have imagined an ONGC acquiring asset and stakes in distant lands and recognised as the most internationalised Indian firm or a Rosneft making a massive acquisition from Essar in India beating several private majors or a private giant reportedly trying to sell its fertiliser business to IFFCO.

2. For over three decades, in almost all countries including the “curtained”, good governance of SOE implied privatisation – and an unending saga of whether it succeeded, failed or created conditions for a reversal ( “publicization” or “re-nationalisation”, as some call it ). Yet, not only have they remained but seem to be thriving in many countries (as amply argued over the years by this author since 1998 in various for a of SCOPE). Going further, some like the Economist, referred to an IMF perspective and estimate that



arguably include all buildings, landed assets and sub-soil resources as the real treasures and part of the SEO ecosystem.

3. There is palpably renewed interest in this sector with more and more studies indicating their significant resurgence on the one hand and on the other, their potential challenges to market discipline. Studies, especially emanating from the EU region, indicate a significant growth worldwide among SOEs during the last 12 years or so. Some indications are as follows:

a) The number of SOEs (defined in the popular way as Government holding more than 50% stake) among Fortune 500 listed companies has increased from 9% in 2005 to 23% in 2014 (PwC study - 2015). Their presence, though wide-spread, is more dominant in petroleum, utilities and financial sectors. There has also been a strident growth in Sovereign Wealth Funds, 18 of which can be treated as SOEs – perhaps the massive SOEs. Most of these hold majority of their assets outside their countries (for example, 69% of Temasek Holdings` portfolio in 2014). They appear to be powerful as well as aggressive with stakes in both private and public assets across many countries.

b) A forthcoming publication from OECD (due in November 2016) states in the flyer that 22% of the world`s largest firms are now effectively under Government control and are expected to remain a critical constituent of the global economy and marketplace.

c) Another study (Max Buge et al of 2013) estimates that over 10% of the Forbes Global 2000 are State-owned with 50.01% or more stake owned directly or indirectly. As of 2011, they come from 37 countries with their joint sales amounting to \$3.6 trillion (which is more than 10% of the total sales of the 2000 firms – indirectly indicating their superior performance on this dimension). This exceeds the GDP of countries such as Germany, France or the UK and of course, India. The top countries with highest SOE presence among their top ten firms



(by a specified indicator) are: China, UAE, Russia, Indonesia, Malaysia, Saudi Arabia, India, Brazil, Norway, Thailand, Singapore, France, Ireland, Greece, Finland and Germany.

d) In a HBR article of 2014, it was stated that 73 Chinese companies were among the Fortune Global 500 in 2012 and 65 of them were SOEs. Russian SOEs account for over 50% of Moscow's Exchange value, while Petrobras in Brazil accounted for 38% of the largest stock exchange in Latin America ( before the recent scandals ).

e) There has been a popular expectation, in the context of years of devoted privatisation, that the SOEs would be the targets in M & A statistics. Belying this, recent research (mainly by Massimo Florio in 2014 & 2015) show that in a global sample of 13,475 deals, there were 1140 acquisitions by SOEs. Of these 450 were acquired from the private sector. Against this, 1034 cases were privatisations (with a lower cut-off of 25% Government stake to be treated as SOEs), while the bulk of the lot were accounted by private-private deals. Further, the data relating to cross-border deals reveals that out of 3,844 such, 163 were acquisitions of private companies by SOEs. Further studies have also claimed that this phenomenon is applicable to SOEs in the Banking sector also – they had competed effectively in the “markets of control”, acquired private entities out-bidding others and shored up their performances on multiple parameters, post-acquisition.

4. The causes of this significant resurgence are still rather speculative. However, some (like the author) seem to argue that the corporate governance movement has contributed significantly with domestic liberalisation and external trade liberalisation providing the ambience.

5. Alongside these positive developments for the SOE protagonists, there are emerging concerns and challenges. Some believe that this “State Capitalism” (as the Economist has caricatured on more than one occasion) might disrupt



the level-playing field and distort prices in the global markets. Global SOEs have the backing of their respective countries and often can be an instrument of their foreign and trade policy too. Thus, there is greater scrutiny on the material relationship between the State and the SOE that could result in trade disputes (Ru Ding & Y.R.K.Reddy). Further, the issue of corruption has assumed cross-border status and is threatening to evoke international and national laws as well as third-party claims. The issues of Internationalisation and Corruption in relation to SOEs have been the specific subjects of an important colloquium at the OECD on 19<sup>th</sup> October.

*PS: The research and perspectives such as the ones mentioned in the foregoing are important as there have been very few international level studies with comprehensive and systematic treatment of the firms under state control. However, there are constraints and definitional issues that must be kept in view. Illustratively, (i) there are several listed companies ( especially in Europe ) with far less than 50% Government stake, held directly and indirectly, but having an effective control over the firm. In fact, many believe, that there are cases where the State has been able to exercise effective control with as little as 10% stake in the absence of other block holders – thus raising the issue of the criteria to define an SOE. (ii) There are a huge lot of sub-national level legal commercial entities (state, provincial and municipality level) that are often excluded. For instance, 89% of all SOEs contributing to 62% of all SOE income are owned by municipalities. This figure (according to a PWC study 2015 and as of 2013) in Sweden is 74% of all SOEs owned by counties and municipalities accounting for 40% of all SOE revenues. As per one report, internationally, about 29% of the value of all SOEs is attributable to unlisted ones. (iii) Most of the SOEs world-wide are not listed on the bourses and hence the data is not fully, uniformly and publicly available.*



**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.<sup>1</sup>

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

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<sup>1</sup>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).



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.*



## **State-Owned Enterprises and Corruption – An International Perspective**

*Dr.Y.R.K.Reddy\**

Petróleo Brasileiro S.A. of Brazil popularly known as Petrobras, has been caught in a storm of corruption charges dragging with it the internationally popular President Dilma Rouseff, who has been suspended on 12 May, 2016 by the Senate is now to defend herself against impeachment by the Senate end of August. Along with her, several Ministers and the former iconic President Lula da Silva have also been indicted. Over 117 senior executives face charges. The Government of Brazil together with its financial entities own 64% of Petrobras. It should indeed have been a very unlikely candidate to be caught in corruption by many indicators that now seem so facile. It was lately ranked 28 among Fortune Global 500. It is the largest company by market capitalization north of the equator; a true state-controlled multi-national with assets in several countries in South America, North America, Africa, Europe and Asia; a signatory to the UN Global Compact and a recipient of prestigious awards for sustainability initiatives.

Petrobras also embraced outstanding corporate governance standards such as international listing; separation of CEO and Chairman; non-executive directors; board committees; regular financial and non-financial reporting; impressive disclosures; engagement of big four auditor; a dedicated Corporate Governance Officer and the like. But years of cronyism and cleverly packaged kick-back schemes ensured that about 16 companies received inflated contracts, which eventually passed the benefits to some individuals, the political party in power and its associates / nominees. While the kick-backs have been estimated by the company sources at about USD3-4 billion, the Audit Court put the figure at USD7.6 billion. Ironically, the Workers Party which has been the chief beneficiary, in this scandal nicknamed “car wash”, came to power on the back of socialism and fight against corruption.

In another part of the world, there has been a globally cited strong drive against corruption in the State-owned Enterprises with President Xi Jinping reportedly promising to clean up not only the “tigers” (the giants among them) but also the low flying “flies” in China. Since the beginning of 2014 over 115 C-Suite officials were reportedly named publicly for investigation, which include giants like Petrochina, China Southern Airlines and Sinopec. As per one report even two years ago, 10,300 officials have been probed for graft mostly involving engineering projects, purchasing and sales, real estate and international dealings. According to an official of the Supreme Peoples` Procuratorate, the fundamental issue reportedly is the relationship between political power and proper allocation of resources. Not surprisingly, surveys in other countries have also shown that public procurement as being at the centre of such corruption. Other studies such as those of the Organisation for Economic Co-operation and Development (OECD) indicate low standards of disclosures, conflicts of



interest, weak internal control environment as exasperating corruption in SOE some regions.

The issue of corruption in State-owned enterprises (SOE or public enterprises or Government Linked Companies or Parastatals as they are called in some countries) is not limited to the countries in the current limelight alone. It is wide-spread, admittedly more noticeable in the BRICS, where massive scandals have been reported in the energy, digital space, banking and defence segments.

Given the size and economic significance of the SOE in the global economy, there are intuitively appealing estimates as to how much could be saved by arresting corruption; how that could help mitigate fiscal pressures in stressed economies; and how the savings could contribute to eradication of poverty as also improvement in quality of nutrition, health, education among children, women and the extremely vulnerable - and eventually to meeting the Sustainable Development Goals (SDG).

According to the Paris based The SOE Forum ( [www.thesoeforum.org](http://www.thesoeforum.org) ) SOE represent over 25% of GDP in many important emerging economies; that more than 10% of the worlds' 2000 largest companies are SOE; about 25% of the top 100 multinationals are SOE; and that market cap of the listed SOE could be over 20% of the total. These numbers could indeed be much understated as they often exclude much of the financial sector and the sub-national entities, as well as those in which the State may have significant shareholding and indirect control. Further, not all state-owned commercial enterprises are corporatized and hence excluded from these estimates.

An OECD study of 2009 estimated the value of 2050 SOE in 25 member countries at US\$1.2 trillion accounting for about 15% of GDP. Another study estimated the sales of 204 SOE among the world's largest 1000 companies as about US\$3.6 trillion - more than the GDP of the UK or France. In some countries in the Middle-East & North Africa, Latin America and Central Asia they may represent more than 50% of GDP. Many SOE, including from China and India, have become global players with assets and investments in several countries and, at times, partnering with other firms. They seem to be concentrated in infrastructure, Banking and financial services, Oil & Gas.

Despite the lack of sufficient and validated data, it is obvious that the economic dimensions and implications of the SOE are extremely significant for the global economy and for the new aspirations of sustainable development. They are not only a sector whose efficiencies are often in debate but one that hosts significant corruption. According to an IMF Staff Discussion Note released in May, 2016, the cost of bribery – excluding the overall corruption of all kinds and their economic and social costs - appears to be between US\$1.5- US\$2 trillion per annum or about 2% of global GDP. SOE would account for a significant part of this “abuse



of public office for private gain” – as corruption has been defined. The SOE Forum states that fighting corruption in SOE can improve their competitiveness significantly, reduce dependence on the State exchequer, improve internal accruals for investments and protect jobs in the long run.

Corruption among public officials has been studied, categorized and described over the millennia but it is only in recent decades that it has been mainstreamed into global dialogue and attention. Consequently, there are now many protocols, task forces, agreements and alliances that are addressing the issue. There are several recommendations ranging from strong immediate punitive actions to long-drawn institution building and culture change. However, these are general in nature and not specific to SOE and hence an area that needs specific empirical study.

In the case of SOE, corruption perhaps is mostly collusive than facilitative or extractive (going by one typology). The facilitative type is often experienced in public service provision – some had euphemistically called it speed money or grease. In many developing countries, the low ranking government officials interacting with the public have been the face of this type of corruption. In many societies that have not focused on rights over the decades, this facilitative corruption has been so institutionalized as to become a social norm – a custom reflexively performed.

There is the extractive type too – that often is the cause of leakages in transmission of material benefits such as pensions, employment guarantee and the like. They also extend to systematic rents such as those demanded by Police, Municipal officials, Transportation authorities or those in-charge of recruiting temporary labour or providing small-time contracts. The Transparency International has studied these common corruption practices in many countries and has provided great insights.

Collusive corruption, the bane of SOE, occurs primarily when the insiders (management and / or the Directors) joining hands with outsiders (mainly politicians, government officials, powerful intermediaries or clients themselves) to abuse official power for their private gains directly or indirectly. This is strikingly evident in award of contracts (civil works, purchase of capital equipment, maintenance contracts, procurement of bulk materials etc.) in the case of manufacturing sector. In the Banking and development finance sector, advancing of credit for non-bankable projects / proposals and write-offs of non-performing loans, in part or full, are common results of such collusive actions.

There have been several suggestions and illustrative case studies for reducing the scope for corruption: Most prominent among these are (a) transparent e-procurement supported by a legislative framework (b) actively operating whistleblower mechanisms at the organizational as well as civil society levels (c) improved attention to internal control environment using modern systems and processes (d) empowering the stakeholders / civil society to obtain information (e) standards for more



detailed financial and non-financial disclosures and (f) invoking / building an ethical culture.

The power balance for implementing these is surely vested with the shareholding / administrative / responsible Ministries or where applicable, the Shareholding entities (designated national wealth funds, coordinating agencies, Special Purpose Vehicles etc.). The question arises, as to how these powers should be motivated to restrain themselves from unethical conduct in dealing with the SOE. They should be directed and controlled to provide the critical leadership for ethical conduct and give the strategic support to SOE they help govern – i.e., provide meta-good-governance. There being no silver-bullets to deal with this, each country must devise a compelling action-framework with political will – which in the end is creative action against odds! Making space where none seems to exist and acting strategically on it!

Even as these powers in many countries may be loath moving rapidly in that direction, they must note, among other known considerations, the increasing issue of “extraterritoriality” that includes aspects of corruption. Consequent to the global and regional cooperation under the aegis and with the active support of multi-lateral and bilateral bodies, corruption is no longer a private transaction or domestic / national issue. Other countries are indeed interested parties especially if there are trans-national transactions and bribery. Most countries have specific laws now that gives them wide-powers and makes the bribe-giver equally liable as bribe takers whether they are located within the country or elsewhere. They can even dispute tailor-making of contracts or grant of special dispensations that may indeed stretch the idea of corruption by far. There are also attempts to link corruption with abuse of human rights and social responsibility in some contexts and gain extraterritoriality jurisdiction. SOE must beware of this emerging gray area that, at its worst, may even see corruption in preferential treatments, monopolistic actions, lack of transparency and poor disclosures.

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*\*Not to be cited, as it is due to be published in Moral Cents, USA. An earlier version was prepared for the benefit of the Annual Conference of Vigilance Study Circle, Hyderabad, India.*



**Part B: Snippets:**

- i. The SOE Forum / FIGEP ( *Forum International pour le Gouvernement des Entreprises Publiques* ) has been registered as an association in France with the initial office-bearers of Y.R.K.Reddy, as Founding-President; Mr.Jean-Aymon Massie, as Working President; and Dr.Naceur Bourenane, as Secretary-General. The website [www.thesoeforum.org](http://www.thesoeforum.org) is being supported by Yaga Consulting Pvt Ltd, the current host for ACG.
- ii. The first meeting of The SOE Forum was held in Paris on 19<sup>th</sup> July, 2016 at the premises of TOTAL and was attended by:

Sara SULTAN	OECD
Jean Pierre QUARANTA	ORANGE
Stéphane ROSENWALD	RV CONSEIL
Christophe ROUX	Ingénieur Qualité
Jean-Alain TAUPY	(TOTAL)
Norbert TANGY	Ingénieur (EDF)
Eugène WOPE	AIRBUS
Jean-Aymon MASSIE	FIGEP/THE SOE FORUM
Naceur BOURENANE	FIGEP/THE SOE FORUM

- iii. Dr.Y.R.K.Reddy, has Led the 13<sup>th</sup> Program on Corporate Governance for Directors for SCOPE under the aegis of Department of Public Enterprises on 7-8<sup>th</sup> February 2016, along with Mr. Peter Greenwood, of the UK as the International resource.
- iv. IFC has initiated a pioneering joint project with the World Bank for developing a curriculum for training of Directors of SOE.
- v. The 14<sup>th</sup> Program on Corporate Governance for public sector directors by SCOPE has been announced for 1<sup>st</sup>-2<sup>nd</sup> December, 2016 at Delhi.