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Progress in TPP on Abuses of State Capitalism

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In President Obama's campaign for national and Congressional support of the Trans-Pacific Partnership Agreement (TPP), he has frequently mentioned the importance of establishing trade rules to sustain an open and competitive global economy. The unspoken risk is that China will lead a mercantilist race to the bottom based on subsidized national champion industries. The TPP chapter on State-Owned Enterprises (SOEs) is a vivid illustration of what he had in mind.

The new SOE rules, all enforceable through dispute settlement, create new obligations essential to avoiding abuses of state capitalism:

- SOE's must make commercial purchases and sales on the basis of commercial considerations, e.g. contracts go to lowest bidders without discrimination in favour of domestic companies;
- Subsidies to SOEs, e.g. below market-price raw materials or land for factories to a state-owned mobile phone company, cannot undercut or disadvantage foreign firms without risk of retaliation;
- Regulatory authorities cannot give preferential treatment to SOEs compared to foreign companies;
- TPP countries must publish complete lists of their SOEs and facts on government control and non-commercial assistance to SOEs;
- Enforcement remedies against SOEs will be provided for patent and trademark violations, e.g. injunctions and damages against an SOE making cars using stolen intellectual property.

As always, terms will be defined during implementation: What level of government control will be required? What asset levels in specific transactions will trigger the rules? What type and size of subsidies will damage foreign competitors? But this giant step forward will help prevent SOE's in TPP member countries such as Japan, Malaysia and Vietnam from unfairly competing with each other.

The impact of the rules will be strongest in Malaysia and Vietnam, where the state-controlled sector is so vast. Vietnam's economy is 38% controlled by SOE's. The 2013 WTO Trade Policy Review (TPR) of Vietnam described the "fundamental approach to state ownership as a mixture of renovation, preservation and expansion" hardly a prescription for reform. The financial difficulties in 2010 of the shipbuilding SOE (Vinashin) revealed the type of problems the SOE rules will tackle, namely lack of effective corporate governance and expansion beyond stated core activities.

In Malaysia, in 2013 subsidies of \$14.3 billion went to sectors such as petroleum, food, agriculture, fisheries and utilities. The WTO TPR in 2014 concluded the Malaysian economy "remains one of the most heavily subsidized in the region and in the world...[This includes] a concerted effort to build up 'government-linked companies' (GLC's) into regional champions." The GLCs employ 5% of the Malaysian work force and account for 36% of the capitalization of a major stock exchange ("Bursa Malaysia"). The TPP rules will give foreign firms injured by these subsidies a tool for curbing abuses.

As in the past, these SOE rules will become precedents for rules in other trade deals. For example, NAFTA rules on services, patents and trademarks laid the foundation for global (WTO) rules. The EU is now engaged in three sets of trade talks that could readily incorporate SOE rules.

In the TTIP negotiations the EU proposed rules on SOE's in July, 2014 and made them public in January, 2015. They call for non-discrimination by SOE's to investments, goods or services as well as 'high standards' of transparency and corporate governance. The transparency provisions mandate forthcoming responses to requests for detailed information about SOEs just as they do in TPP. U.S. leadership in the creation of SOE rules in TPP will add strength to the EU's proposal for such rules in TTIP.

The EU-Japan FTA talks, now in their 13th round, includes a section on competition policy that should encompass rules on SOEs equivalent in strength to the TPP, which Japan already has signed up to.

The EU-China BIT negotiations now underway could also deal with EU concerns about SOEs announced in the 2014 WTO TPR of China: "a strong degree of government intervention in the economy, resulting in a dominant position of state-owned enterprises, and unequal access to subsidies and cheap financing."

The application of the SOE rules in new trade agreements can also help curb the abuses of SOE giants beyond TPP in Russia, India, Brazil and especially in China. The U.S. hoped that when China accepted the free market rules of the WTO in 2001, it would reduce the role of enormous state-owned firms. But China's public sector still controls 40% of investment and two-thirds of its exports. China radically distorts trade and competition by subsidies to five of the ten largest public companies on the planet, including the world's largest bank and giants in oil, utilities, telecom and construction.

TPP-type SOE rules could be included in the U.S.-China Bilateral Investment Treaty (BIT) now under negotiation, as suggested by the U.S. Chamber of Commerce. The potential for new U.S. investment in China under this BIT gives the U.S. leverage to nudge China toward SOE restraints.

Consider China's track record: the U.S. Department of Commerce has found damage to U.S. steel from Chinese government subsidies to steelmakers, including below-market loans, low-cost electricity and land, and direct financial transfers. All but 5% of China's steel is made by SOE's. In the first half of 2015 China exported 27% more steel than in 2014. Most of this was sold in the U.S. at prices 25% below market. This is a global issue: China's steel production now equals the rest of the world combined.

Likewise, the U.S. solar panel industry was gutted by subsidized Chinese exports. Other U.S. findings against Chinese subsidies cover \$7.3billion of imports including thermal paper, pressure pipe, line pipe, citric acid, lawn groomers, kitchen shelving, oil country tubular goods, wire strand, steel grating, wire decking, magnesia bricks, seamless pipe, print graphics, drill pipe, wood flooring, steel wheels, steel wire, steel cylinders, wind towers and steel sinks.

China's competition law gives immunity to SOEs who break the law if the SOE's are 'vital' to the Chinese economy. China's SOEs are shielded by unpublished government budgets, internal instructions, oral directives and a law that can treat commercial information as state secrets. China has disclosed only a tiny fraction of subsidies to the WTO since 2001 despite rules that all must be disclosed.

Trade agreements are built on the assumption of free market competition based on supply and demand, quality and performance, the rule of law, and open, non-discriminatory regulatory procedures. But trade in the 21st century includes the growth of 'state capitalism', particularly in advanced developing countries where few of these assumptions apply. The steps taken in TPP to establish rules to govern SOEs acting in their commercial capacity will help sustain the global marketplace of fair competition at the high end so that others cannot prevail in an unfair race to the bottom.