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# **CHAIR REPORT**

## GA6: ECONOMIC AND FINANCIAL COMMITTEE (ECOFIN)

## Evaluating the role of state-owned companies in the free market

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**Introduction**

State-owned companies are legal entities that are created by a government in order to engage in commercial activities on the government’s behalf. Their stocks are partially owned by a government entity, and the shares are operated through an operating license, allowing production-sharing contract with other entities on behalf of the government to generate revenue. The state-owned enterprises account for a considerable proportion of gross domestic product, employment, and assets in many countries. They have become important parts of social and economic policy in industrialized mixed economies and in developing countries, usually owning a stake in mineral, oil, and gas produced locally. Legally, most state-owned companies qualify as business entities, providing them with all the rights and responsibilities associated with them. This means that they are normally required to follow any laws and regulations governing the operation of their business type, and they can also be held liable for their actions. State-owned companies’ finance comes from the state budget or the commercial marketplace. In most countries, direct state support for SOEs occurs and is nearly always provided in compensation for public service obligations or other public policy objectives. The presence of SOEs in the global economy has grown strongly in recent years. Today they account for over a fifth of the world's largest enterprises as opposed to ten years ago where only one or two SOEs could be found at the top of the league table.

**Key Vocabulary**

SOEs are State-owned Enterprises.

POEs are Public-owned Enterprises.

Free-market economy is an economic system based on supply and demand with little or no government control.

Private Sector is the part of the national economy that is not under direct state control.

Public Sector is the part of an economy that is controlled by the state.

Operating license are document issued annually in order to legally and effectively conduct a business.

Commercial activities can be listed as sales or exchanges of goods or services for profit or for other business considerations.

ECOSOC is a permanent council of the United Nations; responsible for economic and social conditions. Economic and Social Council.

OECD is an acronym for Organization for Economic Cooperation and Development

**Focused Overview**

1)What is a state-owned company?

State-owned companies are enterprises formed by a government through legal means so that they can take part in activities of a commercial nature. State-owned enterprises are owned by the general public and the government agencies who exercise the ownership rights, and these ownership rights are answerable to the public. Every country has explicit ownership policies to define their objectives on the ownership.

• Ownership model: Most countries have either adopted a centralized model for state ownership, have established a central holding company for an important portfolio of SOEs, or have established a central coordinating agency, often charged with monitoring performance or coordinating governance practices across the SOE sector. Some countries have a highly decentralized system, with the ownership of SOEs being exercised by a multitude of line ministries and no coordinating agency in place.

• SOE creation and termination: Procedures for creating an SOE are set forth either in laws on the establishment of SOEs, or in the legal instrument establishing a specific SOE (i.e. legislation, decree, resolution, executive order, etc.). The procedures for terminating SOE ownership or divesting state shares are often of a similar nature. To create an SOE, governments need to provide a rationale for the need for state enterprise ownership (often to Parliament) when deciding to found a new SOE and, in some cases, are required to come up with a framework for operating the new business. To terminate ownership, governments usually have to demonstrate that the rationale for ownership no longer applies.

• Aggregate reporting: To facilitate transparency and disclosure, countries should form an aggregate reporting on SOEs.

2) State-owned companies’ role in free market economies

Companies in Public Sector get all possible financial support from the government even in adverse circumstances where financial health of the companies are not in good condition. SOEs are more dependent on debt and financial support from outside sources rather than equity, compared to POEs. With the creation of a competitive neutrality between private and publicly-owned businesses, efficiency throughout the economy can be achieved. Thus, by giving adequate attention to competitive neutrality, governments may minimize the risk of competitive activities being “crowded out” and promote their own private sectors’ development, job creation and growth. SOEs can incur a negative reputation by being exploited through corrupt dealings in several countries. When put to good use and managed well, SOEs can help spur economic growth and development. Available evidence suggests that the financial performance of many SOEs and their contribution to the state budget have improved in the past decade as a result of budgetary reforms, restructuring measures, improved governance practices, and exposure to greater competition and capital market discipline.

3) Role and Importance of SOEs

Despite extensive privatization, governments continue to own and operate

national commercial enterprises in such critical sectors as finance, infrastructure, manufacturing, energy, and natural resources. State-owned sectors in high-income countries, in major emerging market economies, and in many low- and middle-income countries have continued, and even expanded. Indeed, many SOEs now rank among the world’s largest companies, the world’s largest investors, and the world’s largest capital market players. In many countries, SOEs in strategic industries are increasingly viewed as tools for accelerated development and global expansion.

* Globally, in 2006 SOEs accounted for 20 percent of investment and

5 percent of employment (Robinett 2006).

* In less developed countries, SOEs produced about 15 percent of regional GDP in Africa, 8 percent in Asia, and 6 percent in Latin America in 2006 (Robinett 2006).
* SOEs remain central economic players in the major emerging markets of China, India, and the Russian Federation, even as the private sector share of GDP has risen over the years.
* In fragile and postconflict states such as Afghanistan, Iraq, Liberia, and others, SOEs play, and are expected to play, an important role in the transition to a sustainable economy.

**Major Parties Involved and Their Views**

OECD

The OECD Working Party on State Ownership and Privatization Practices is the only

international forum for government officials charged with the oversight of state-owned enterprises. The Working Party is responsible for the implementation of the OECD Guidelines on Corporate Governance of State-Owned Enterprises (the “SOE Guidelines”).

CHINA

A large sector of state-owned enterprises (SOEs) is well known as the hallmark of the Chinese economy. China has nearly halved the number of its state-owned enterprises - firms such as China Guodian Corporation, a major power generator, and Shenhua Group, a coal producer - in the past 15 years. But this does not mean its SOEs are becoming smaller. Instead, these merged corporate behemoths will soon start taking larger stakes in China's leading private companies, thereby increasing their centrality to the nation's economy. Beijing is using these titanic companies to develop a global network of infrastructure projects, such as China Harbour Engineering's Port City project in Colombo, Sri Lanka, that will increase its influence in dozens of countries. At the same time, its economy continues to grow, and the spread of its culture, films and TV shows is reaching new peaks.

RUSSIA

Government-linked companies have personalized ties to the state. Moscow is able to use these corporations for political ends: threatening gas supplies to keep European governments compliant, for instance, or directing energy revenue to finance military development. Russia's refusal to separate politics and markets has not led to any lessening of its influence in global politics. On the contrary, Moscow has pulled off the highest-profile annexation so far this century, in Crimea, and its intervention in the American presidential election has sent shock waves through U.S. politics.

THE WORLD BANK

The World Bank has published a toolkit in 2014, tackling the issue of Corporate Governance of State-Owned Enterprises. The toolkit provides an overarching framework for the corporate governance of state-owned enterprises (SOEs), along with the tools and information for making practical improvements. Drawing on global good practices, reform experiences, and a growing body of knowledge, the toolkit is designed to assist practitioners in creating, implementing, and monitoring SOE corporate governance reforms and in building the capacity to carry them out.

**TIMELINE of PAST SOE REFORMS**

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| --- | --- |
| **Date of Event** | **Description of Event** |
| 1970s and 1980s | Number of countries shows that, on average, SOEs have performed poorly relative to private fi rms, partly because multiple policy goals proved difficult to reconcile. |
| 1980s | Reforms have sought to improve performance by exposing SOEs to competition, imposing hard budget constraints, and introducing institutional and managerial changes. Many SOEs were commercialized and later corporatized into separate legal entities. |
| the 1990s and first few years of the 2000s | Both financial and nonfinancial SOEs were privatized through various means, including strategic sales, auctions, vouchers, management and employee buyouts, leases and concessions, and public stock offerings. |
| 2007–08 Global Financial Crisis | Led to turmoil in  the capital markets and reduced investor interest, these factors further slowed privatization and brought it to a near halt after 2008. Indeed, the crisis itself triggered new debates on the role of the state in the economy. |

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### **Possible Solutions**

In many countries, public enterprise or SOE laws are outdated and came into effect at a time when SOEs operated as vertically integrated enterprises with very little competition in the market. Many such laws have overlapping and sometimes contradictory provisions that lead to inconsistent and conflicting frameworks and undermine the accountability of the state, boards of directors, and management. So, SOE laws should be rewritten with the OECD and The World Bank guidelines in a way to ensure the competitive neutrality in the market.

### **Further Reading**

<http://www.oecd.org/corporate/Ownership-and-Governance-of-State-Owned-Enterprises-A-Compendium-of-National-Practices.pdf>

<http://documents.worldbank.org/curated/en/228331468169750340/pdf/Corporate-governance-of-state-owned-enterprises-a-toolkit.pdf>

**Bibliography**

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* Borroz, Nicholas. “Analysis | State-Run Economies Increasingly Adore the Free Market.” *The Washington Post*, WP Company, 29 Jan. 2018, https://www.washingtonpost.com/outlook/state-run-economies-increasingly-adore-the-free-market/2018/01/26/e1ae08b4-0212-11e8-bb03-722769454f82\_story.html.
* “State Owned Enterprise (SOE) - Overview, Purpose, and Examples.” *Corporate Finance Institute*, https://corporatefinanceinstitute.com/resources/careers/companies/state-owned-enterprise-soe/.