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Serious threat to Asian economic model

by Martin Khor

The successful East Asian model of “state-driven capitalism” is being threatened by proposals in the TPPA trade agreement to remove possible advantages of state-owned enterprises.

Many articles and books have been published on the contrast and competition between the present Western and the Asian-style economic models.

Western countries are said to have the free-market model based on competition among private firms, with the government taking a hands-off approach.

East Asian countries are branded as practising “state capitalism” in which the government plays a major role in helping the local private sector and the state also fully or partially owns many enterprises.

The Western countries are increasingly attacking the Asian model, claiming that state-owned companies or state-aided commercial firms have an unfair advantage vis-à-vis the foreign firms competing with them.

In Asia, countries with a substantial role of the state include China, Malaysia, Vietnam and Singapore. Of course, in Japan and Korea their domestic firms grew to become world-beaters with the systematic backing of their governments.

For these countries, the so-called state capitalism (or in the case of socialist countries, market-oriented socialism) have worked well through industrial development and relatively high and sustained economic growth.

Some Western countries have been trying to curb or even eventually eliminate the Asian model of state-owned or state-aided capitalism.

Of course this is largely hypocritical because the American, European and Japanese agricultural sectors are highly subsidised and protected; many of their farms could not survive without massive state aid and high import tariffs.

Many of their banks and industrial firms are also subsidised in various ways, including through the recent multi-billion dollar bailouts in the wake of the recent financial crises.

This has not stopped these countries from attacking the Asian model. The latest attempt to curb this model is through the negotiations in the Trans Pacific Partnership Agreement (TPPA), a trade and investment treaty involving the United States, Canada, Malaysia, Singapore, Vietnam, Brunei, Peru, Chile, Mexico, Australia and New Zealand.

The TPPA contains an important section on State-Owned Enterprises (SOEs), championed by the U.S. and Australia.

The TPPA drafts are secret, so the text of the SOE section is not known. However, it can be anticipated that the section will contain disciplines to curb and shape the behaviour of three types of SOEs.

The recently concluded United States bilateral FTAs contain a competition chapter that deals with two types of SOEs. For example, the US-Peru FTA has disciplines on designated monopolies and state enterprises, and it is likely that the US will propose something similar in the TPPA.

That FTA says that government and private monopolies (designated by the government) shall act solely in accordance with commercial considerations, including with regard to price, quality, availability, transportation, when buying or selling the monopoly good or service.

They shall provide non-discriminatory treatment to investments, goods and services of other TPPA members, with respect to the purchase and sale of the monopoly goods and services. And they shall not use their monopoly position to engage in anticompetitive practices through their dealings with their parents, subsidiaries or other enterprises with common ownership in a non-monopolised market that adversely affect the investments of other countries.

State enterprises shall similarly provide non-discriminatory treatment in sale of goods or services to investments of other countries.

More importantly, the US and Australia are proposing a third type of SOE to be subject to disciplines. According to press reports, Australia has also introduced the principle of “competitive neutrality” to discipline the SOEs.

How this principle will apply can be anticipated from the Australian government’s competitive neutrality guidelines.

This is based on the concept of a “government-owned business”. The state-owned business enterprise which competes with private companies may obtain advantages, impeding the ability of the private sector to compete on equal terms.

According to the Australian guidelines, these advantages include exemptions from taxes; cheaper debt financing (because of the low-risk classification or government guarantees); absence of need to make a commercial rate of return; and exemption from regulatory constraints or costs.

To offset these advantages, the Australian guidelines cover how government businesses should pay taxes in full; pay back to the central government the difference in their loan costs vis-à-vis private sector loan costs; pay license fees equivalent to the central government; and ensure that they obtain a commercial rate of return.

It is likely therefore that the draft of the TPPA will have disciplines along the lines above on a third category of SOEs - government-linked business entities involved in commercial activities that compete with the private sector.

The proposed disciplines could be along the line that “advantages” enjoyed by government-linked businesses such as those mentioned in the Australian guidelines be disallowed. The implications for Malaysia, Vietnam and Singapore would be serious because their national economies are characterised by important roles of state owned enterprises or government linked companies.

The countries would have to move away from their successful development model and economic structure.

Moreover, SOEs have many functions including providing social services to the public, ensuring that poor and vulnerable groups are given special consideration.

This often means that SOEs cannot operate on solely commercial grounds; and that several of them depend on government subsidies and assistance, and there are also cross-subsidies in that the profitable aspect of an SOE may finance non-profitable (but socially important) activities. There is a danger that the TPPA section on SOEs will prevent or hinder the socially useful functions of SOEs.

The proponents of the SOE section argue that foreign companies are not able to compete fairly with SOEs. They want the TPPA to remove or reduce the “advantages” of the SOEs. But that could threaten the survival of the system that has helped propel the East Asian model, a creative and dynamically changing mixture of state and market.

The TPPA negotiations are still going on, and a text on the SOEs section is not yet final, so there is scope for the different views to be expressed.

Much is at stake, and it is important for more information to be made available on the negotiations, including on SOEs.

Author: Martin Khor is the Executive Director of the South Centre. Contact: director@southcentre.org.

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For more information, please contact Vicente Paolo Yu of the South Centre: Email yu@southcentre.org, or telephone +41 22 791 80 50.