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Opinions

WTO Reform on State-Owned Enterprise Disciplines and Implications for Korea

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Background

The term “WTO Reform” was officially mentioned for the first time at the WTO General Council meeting in July 2017. Ever since, the discussion has revolved around the issues of WTO dispute settlement system, state-owned enterprises (SOEs), industrial subsidies leading to overcapacity, transparency, notification on domestic agricultural supports, forced transfer of technology, and digital economy. Among these topics, particularly three WTO Members – the United States, the European Union, and Japan – have been ardent supporters for fixing WTO subsidy rules. Together they have launched an initiative to strengthen trilateral cooperation for WTO reform on subsidy disciplines. Through a total of five joint statements so far they have shared concerns with regard to non-market-oriented policies and practices in some WTO Members and stressed the need for WTO reform, arguing that the current WTO subsidy rules need to be reinforced so that emerging economies like China cannot avoid their application. It is expected that the first draft proposal of these three Members will be produced by the end of this year at the earliest. Reportedly,

they will invite a limited number of like-minded countries first, and subsequently will make public the draft text as they intend to expand participation to all willing WTO Members.

The main focus lies in how to adequately address China's SOE subsidies under WTO agreements. For this purpose, it is necessary to take a look at the current WTO disciplines applicable to Chinese SOEs. The current law applies to: (i) where SOEs conduct commercial activities in terms of importation and exportation (Article XVII GATT); and (ii) where a government or public bodies grant subsidies to its domestic enterprises or industries (WTO Subsidies Agreement). This KIEP Opinion will focus on the second issue. It will be discussed whether Chinese SOEs can be seen as public bodies under the WTO Subsidies Agreement, and how effective the current rule is in addressing China's SOE subsidies. Further, it would be fruitful to look into SOE-related "WTO plus" elements in some of the recent regional trade agreements. For this, CPTPP Chapter 17 and USMCA Chapter 22 will be examined and compared with WTO subsidy rules.

Current WTO Subsidy Rules and Their Limits

While SOEs are emerging as a key player in the global economy, WTO law is revealing its limits. The WTO subsidy rules cannot get to the core of the SOE-subsidization problem. This is because they do not regulate situations where not the government but SOEs provide subsidies to private enterprises, unless the latter is demonstrated to be a "public body".[1] That demonstration, however, turns out to be quite burdensome given the recent Appellate Body findings in *US-AD/CVD (China)*, *US-Carbon Steel (India)*, and *US-Countervailing Measures (China)*. In these WTO cases, the Appellate Body adopted the so-called "government authority" test, and held that ownership or control by a government of an entity does not by itself make such an entity a "public body." Rather, that entity must possess, exercise, or be vested with governmental authority.

[1] In order for a government measure to be subject to the WTO Subsidies Agreement, it must be first established that such a measure constitutes a "subsidy" within the meaning of the same Agreement. In order to be categorized as a subsidy, one of the elements to be demonstrated is that there must a financial contribution by the government or a "public body." Since SOEs are not the government *per se*, they should fall under the "public body" category.

The government authority test has often been criticized for being too ambiguous and subjective, and for placing too much burden on the investigating authorities. Under the test, it is the investigating authorities' responsibility to prove that (i) it is a sustained and systematic practice that the entity is *de facto* exercising government authorities; (ii) the government exercises meaningful control over that entity; and/or (iii) activities or functions of the entity are generally classified as "governmental" in nature within the domestic legal system of the country under scrutiny. The United States criticizes that the government authority test too much narrows the meaning of the term, so it has become virtually impossible for the investigating authorities to prove that Chinese SOEs are public bodies; thereby the possibility of solving an SOE-subsidizing-private-enterprises problem within the current WTO discipline has become even lower.

Development of SOE Disciplines through RTAs

Against this backdrop the United States chose to step forward by including WTO-plus SOE disciplines in RTAs. For instance, the CPTPP[2] defines SOEs based on the government's ownership or control of an entity at hand. This runs contrary to the government authority test under the WTO Subsidies Agreement. More specifically, Article 17.1 of the CPTPP defines a state-owned enterprise as an "enterprise that is principally engaged in commercial activities in which a Party: (a) directly owns more than 50 per cent of the share capital; (b) controls, through ownership interests, the exercise of more than 50 per cent of the voting rights; or (c) holds the power to appoint a majority of members of the board of directors or any other equivalent management body."[3] Once determined as an SOE, such an entity becomes subject to a set of strict substantive and procedural obligations under the same Chapter, including non-discrimination and commercial consideration, the obligation not to use its monopoly position to engage in anti-competitive practices, transparency, and the obligation not to cause adverse effects or injury to the interests of another Party through the use of non-commercial assistance to SOEs.

The USMCA also defines SOEs based on government ownership and control. That is, for the purpose of Chapter 22 of the USMCA, a state-owned enterprise means "an enterprise that is

[2] Before announcing its withdrawal in January 2017, the United States was an active participant in the previous TPP negotiation, https://www.whitehouse.gov/presidential-actions/presidential-memorandum-regarding-withdrawal-united-states-trans-pacific-partnership-negotiations-agreement/ (last visited on November 29, 2019).

[3] https://www.mfat.govt.nz/assets/Trans-Pacific-Partnership/Text/17.-State-Owned-Enterprises-and-Designated-Monopolies-Chapter.pdf. (last visited on November 29, 2019).

principally engaged in commercial activities, and in which a Party: (a) directly or indirectly owns more than 50 percent of the share capital; (b) controls, through direct or indirect ownership interests, the exercise of more than 50 percent of the voting rights; (c) holds the power to control the enterprise through any other ownership interest, including indirect or minority ownership; or (d) holds the power to appoint a majority of members of the board of directors or any other equivalent management body."[4] The overall structure of the SOE definition is similar to that of the CPTPP. But there is a big difference here. In the case of government ownership of share capital of the entity, the CPTPP provides only for direct ownership by the government. Therefore where the government indirectly owns an entity through more than two of its state enterprises, that entity does not necessarily constitute an SOE subject to the CPTPP SOE Chapter. In contrast, under the USMCA even such indirect ownership falls within the scope of SOEs, as the definition explicitly states that a CPTPP Party can "indirectly own" 50 percent of an SOE's share capital. In this sense, it can be safely said that the USMCA has adopted a higher standard than the CPTPP (therefore "CPTPP plus") in defining SOEs and the scope of application for its SOE disciplines.

Possible WTO Amendments

The core of the ongoing trilateral discussion between the US, the EU, and Japan is how to define a "public body." There is a strong possibility that modification of Article 1.1(a)(1) of the WTO Subsidies Agreement will be proposed in a manner to expand the scope of a public body to include SOEs. While keeping the amendment of the treaty text to the minimum, addition of a new footnote on SOEs is most likely to happen. Also the proposal may include a list of specific elements which need to be taken into account in determining whether an SOE constitutes a public body. This would be directly contrary to the government authority test adopted by the Appellate Body, and more in line with recent developments on SOE definitions under the CPTPP and the USMCA. This Opinion also predicts that the joint proposal will suggest modification of the meaning of a public body to be broad enough to include not only activities that an entity formally engages in as a part of governmental function, but also activities that the

[4] Before announcing its withdrawal in January 2017, the United States was an active participant in the previous TPP negotiation, https://www.whitehouse.gov/presidential-actions/presidential-memorandum-regarding-withdrawal-united-states-trans-pacific-partnership-negotiations-agreement/ (last visited on November 29, 2019).

entity conducts in effect on behalf of the government. The proposal may possibly contain wordings similar to the CPTPP SOE definition or maybe, more ambitiously, that of the USMCA.

Implications for Korea

Article 4(3) to (5) of Korea's *Act on the Management of Public Institutions* define "public institutions" – a term equivalent to "public bodies" under the WTO Subsidies Agreement – as *including* (i) an institution that the Government holds at least 50 percent of the outstanding shares of; (ii) an institution that, with at least 30 percent of such outstanding shares, the Government secures *de facto* control over decision-making through the exercise of the power to appoint executive officers (which is similar to the CPTPP SOE definition up to this point); (iii) an institution that, through two or more of the above institutions, the government holds at least 50 percent of the outstanding shares; (iv) an institution that, through one or more than two of the above institutions, and with at least 30 percent of such outstanding shares, secures *de facto* control with at least 30 percent of such outstanding shares (which is similar to the USMCA SOE definition up to this point).[5] But the Act does not stop there. It even includes an institution that, *through one or more than two of the above institutions mentioned in (i) to (iv)*, the Government holds at least 50 percent of the outstanding shares or with at least 30 percent of such outstanding shares the Government secures *de facto* control over decision-making through the exercise of the power to appoint executive officers.

As can be seen above, the Korean domestic law reflects indirect ownership in defining public institutions in a similar manner as Article 22.1 of the USMCA. Moreover, the same law defines the public body to include all of its public corporations, quasi-governmental institutions, and other remaining forms of public institutions altogether.[6] In other words, Korea has already made the scope of public bodies broad enough in its domestic legal system. Further, one needs to bear in mind that SOE definitions in the CPTPP and the USMCA are limiting their scope of application exclusively to "an enterprise that is principally engaged in commercial activities." Although further discussion is needed as to the precise meaning of "principally," at this point it seems safe to say that only entities which are directly or indirectly involved in international

[5] http://www.law.go.kr/lsInfoP.do?lsiSeq=188522&urlMode=engLsInfoR&viewCls=engLsInfoR#0000 (last visited on November 29, 2019).

[6] *Act on the Management of Public Institutions*, Article 5(3).

trade will be subject to the SOE chapters under the CPTPP and the USMCA. That being said, while Korea has a total of 339 public institutions as of January 2019,[7] it is noteworthy that only a limited number of them are directly or indirectly[8] engaged in commercial activities relating to international trade. Therefore, with high probability, most of these entities would have already been subject to WTO subsidy rules well before the WTO amendment proposal by the US, the EU, and Japan. Thus even if the "public body" provision is to be amended to include SOEs in the sense of the CPTPP, it is not expected that there will be any 'radical' changes from a legal point of view. If the SOE definition in the USMCA is to be included in the WTO Subsidies Agreement, however, there can be a certain level of uncertainty. This is because while the USMCA accepts a government's indirect ownership as an element of SOEs, it does not provide for any detailed criteria as to how much ownership is required to be accepted as a case of indirect ownership. By not providing for the precise percentage required for indirect ownership in the definition, the USMCA SOE Chapter may carry some uncertainties in the future. For this reason, while Korea's *Act on the Management of Public Institutions* already reflects USMCA-plus level of public body definitions, it will still be necessary to take sufficient time and discuss the precise scope of indirect ownership if such ownership is proposed as an SOE definition under the WTO Subsidies Agreement.

Lastly, while only the threshold issue (i.e. whether SOEs are public bodies to which the WTO Subsidies Agreement can be applied) is addressed in this KIEP Opinion, there is a possibility that some of the substantive obligations similar to those under the CPTPP or USMCA SOE Chapter will be additionally proposed to be part of the WTO amendments. As briefly mentioned in the introduction, trilateral discussion between the US, the EU, and Japan is dealing with some other related issues as well – one of them being "harmful subsidies" or industrial subsidization leading to overcapacity. In this sense, in addition to proposing a modified definition of public body they will very highly likely propose a number of modifications to the substantive obligations to increase the effectiveness of the WTO subsidy rules against SOE-subsidization. Therefore, the overall impact of WTO subsidy rule modifications on our domestic industrial subsidization policy may vary, depending on what and how many substantive obligations are to be added through the WTO amendments.

[7] http://www.moef.go.kr/nw/nes/detailNesDtaView.do?menuNo=4010100&searchNttId1=MOSF_000000000-026683&searchBbsId1=MOSFBBS_000000000028 (last visited on November 29, 2019).

[8] These entities' granting subsidies to domestic industries which are engaged in international trade, including importation or exportation can be one example of such indirect involvement.

Concluding Remarks

The WTO reform may take a few years, but it is regarded to be the most important trial ever since the unsuccessful Doha Development Agenda (DDA) back in 2001 and may bring a significant change to the current multilateral trading system. Discussion on SOE disciplines was started primarily targeted at China; but once such amendment is successfully achieved, it will apply multilaterally within the WTO system and can have direct and/or indirect effects on Korea's domestic subsidization policy – relatively less so where the Government grants subsidies, but much more so where Korea' public institutions (public corporations, quasi-governmental institutions, and other remaining forms of public institutions) grant subsidies to domestic firms, based on their own decision and from their own budget.

Based upon the above findings, this Opinion suggests that the Korean Government closely monitor the ongoing trilateral discussion between the US, the EU and Japan. Further, before choosing Korea's positioning with regards to the WTO Reform on SOE disciplines, it will be crucial to prepare multiple scenarios for possible WTO amendments and go though comprehensive legal and economic pre-evaluation of possible outcomes, taking into account the advantages and disadvantages of joining such WTO amendment discussion and impact on our domestic industries. KIEP