Forbes

Trade By State Owned Companies: Global But Is It Fair?

Alejandro Chafuen

October 31, 2019

I have witnessed many harsh debates during off-the-record meetings between policy leaders and advocates who value free-trade and globalization but where one side seeks exceptions for the "national interest" or to create a more levelled playing field. It's not all acrimonious, though. One topic on which I have seen consensus is the problem of state and quasi-state actors competing at par with the private sector. Many can profit from trade with state-owned enterprises (SOE) and other state actors, but is it just?

The principle that for centuries governed justice in contracts was that of "*volenti non fit injuria*": if the contract is voluntary there is no injustice. This also implied that prices were just if untainted by fraud, coercion or monopoly. A certain degree of knowledge by the parties was required as well (that is why a price set between a child and an adult can't always be considered just, even if both agree to it). Prices set in this manner were a pillar of "just price" theory.

How does this principle of justice apply to some of today's examples of international trade contracts by state actors? A contract between the figureheads of Vladimir Putin and Nicolás Maduro, for example, might very well be voluntary on their part but would likely require many involuntary actions by taxpayers and other players in their economy.

Companies totally or partially owned by states play a major role in the oil markets

Another factor that complicates the analysis of free trade is that many sectors of the economy today continue to lie in government hands. This is especially true in countries with little *de facto* division of power. Often only a handful of people, and sometimes even the executive alone, play a role in determining key aspects of multimillion-dollar contracts.

Oil is one sector dominated by state actors. Labeling as "free trade" a transaction between oil companies such as Petróleos de Venezuela (PDVSA) and Rosneft, or PDVSA and Petro China, is at best playing with words. PDVSA is controlled by the minions of Nicolás Maduro, Rosneft by those of Vladimir Putin (the Russian government controls 50% of the company), and Petro China and the China National Petroleum Corporation by Xi Jinping. In Saudi Arabia, the giant Saudi Aramco, the world's largest oil company, had $455.5 billion in revenue in 2017. It is controlled by Saudi Arabia's Ministry of Petroleum and Mineral Resources and the Supreme Council for Petroleum and Minerals. The largest producer in Africa, the Nigerian National Petroleum Corporation, is also a state-owned company. In Brazil we have Petrobras, in Mexico PEMEX, in Argentina the renationalized YPF… the list could go on and on. The reach of some of these companies goes beyond trade figures. R. Evan Ellis, now a member of the State Department's Policy Planning Staff, explained in a report released late last year that Chinese companies "control over 25% of Ecuadoran oil production on the ground, but per contracts using oil to repay loans to the Ecuadoran state, have a claim on almost all oil deliveries for export through 2024."

Countries with very low levels of corruption and high respect for rule of law, like Norway, also play a dominant role in their oil companies. The state owns 67% of Equinor (formerly Statoil), which operates in 36 countries. I suspect that their operations compare in transparency with those of major private oil companies and differ substantially from the operations of PDVSA or Lula's Petrobras!

The failure of World Trade Organization (WTO) treaties and agreements to make a proper assessment of the problem of state-owned companies has caused major imbalances and a huge image problem for free trade and its advocates, as they are seen as defending the indefensible.

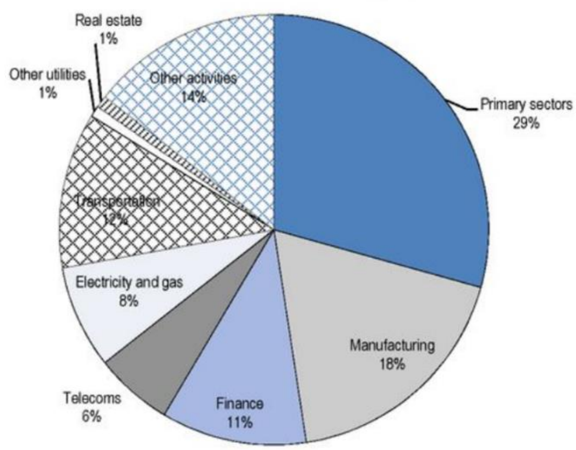
Some but not all industries key to the knowledge economy also experience the heavy hand of government. One example today is the integrated circuit (IC) market. Cato Institute, the most libertarian pro-free-trade think tank, called in a November 2018 study for disciplining China by issuing complaints with the WTO. The study summed up the potential consequences of Chinese government intervention in the IC sector: "(1) force the creation of market demand for China's indigenous semiconductor products; (2) gradually restrict or block market access for foreign semiconductor products as competing domestic products emerge; (3) force the transfer of technology; and (4) grow non-market-based domestic capacity, thereby disrupting the global semiconductor value chain."

The IC market is key to the data and communications sector. *The Economist* has published several articles stating that "data is the new oil." Some experts in markets for data and data technology disagree. Data is not "physical," it has less impact on the environment, it is not constrained by political borders, etc. But these disagreements regard the type of product rather than the power and relevance of the sector. This publication, Forbes.com, published a piece trying to show that data is not the new oil, but the author concludes: "Of course, data, like oil, is a source of power. And those who control it (think of Amazon, Alibaba, Facebook or Google) are establishing themselves as masters of the universe, just as oil barons did 100 years ago."

I have written previously of the competition for dominance in the 5G wireless communication market. Companies in this area also operate in a climate of heavy state regulation. The wireless spectrum today is like ports, highways and airports – an area where countless services are provided. Given the national security implications, I wrote in that piece, "major decisions today are made not by regular customers but by powerful government players and companies tied to government in one way or another. It is true that we, customers around the world, choose to buy an iPhone or a Huawei phone, and usually a carrier as well. But the biggest money – which is not necessarily associated with the best service – is made by large companies that are associates or quasi-associates of the state. This is not a pure 'free-market transaction.'"

Monetary policy is another area of government action which has a major impact on the global economy, creating changes that have little to do with free markets or a free economy. By keeping the value of their local currencies artificially low relative to the U.S. dollar and the Euro, some state actors can cause huge shifts in trade flows. In addition, from a moral point of view, one of the big problems with monetary and credit manipulation is that the general population does not "see" how it acts. They can see how the merchant increases the price of the products for sale, or how it becomes more difficult to export or import, but they do not see how money enters the market or how certain players get advance knowledge of government decisions.

Sectoral distribution of SOEs by employment: China (end-2015)



Although available data are insufficient to give an exact idea of the magnitude of the problem, estimates about the size of the state-owned sector exist. I am not aware, however, of any good estimate of the size of the quasi-state sector, the part of the private sector that receives privileges from states or SOE's. In the Organisation for Economic Co-operation and Development (OECD), an analysis of 34 developed countries showed that the share of SOE in GDP is relatively small, less than 3%, but as their studies show, "SOEs are highly concentrated in strategic sectors on which large parts of the private economy depend. Half of SOEs by value operate in the network industries (telecoms, electricity and gas, transportation and postal services)." Their indirect impact can be huge. Another OECD study in 2017, covering 40 countries, found that outside China there were close to 2,500 SOEs, but China alone has over 50,000.

The impact of governments through the activities of companies they control, directly or indirectly, can produce results that hamper productivity and justice in a free economy. The problem should not lead us to move to closed economies, but requires us to find better solutions to reduce the privileges and unfair advantages that “privileged” companies have in their operations.