

## CHAPTER 10

# State-owned enterprise, Subsidies

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### STATE-OWNED ENTERPRISE, SUBSIDIES

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#### 1. *BACKGROUND OF THE RULES*

The movement of state-owned enterprises and subsidies have been covered in the Report in Compliance until now,<sup>1</sup> but for the products such as steel and aluminum market-distorting subsidies are granted under national capitalism, excessive capital investment is made by state-owned enterprises' action lacking economically rational, and so-called "zombie" enterprises, that should essentially exit the market, survive by subsidies, consequently causing overcapacity issues.

Thereby, unreasonably cheap products influx excessively into other countries, and it adversely affects healthy development of industry.

Under such situation, new disciplines related to market-distorting subsidies and the behavior of state-owned enterprises that are the root cause of the problem have been established in EPAs concluded by Japan.

The 21st century type rule contributes to the elimination of unfair competition conditions caused by the behavior of certain state-owned enterprises lacking economic rationality and to the unlimited subsidies that do not take into account market conditions. From the viewpoint of ensuring a level playing field in the future, it is important that such disciplines is to be spread worldwide. By introducing such disciplines in bilateral EPAs, etc., it may be able to standardize the prohibition of market distorting measures.

In Japan's EPA/FTA, in order to ensure free trade and investment, when a state-owned enterprise or designated monopoly company purchases or sells products or services, it is stipulated that shall act in accordance with commercial considerations and that it shall provide national treatment to an enterprise of another party.

Regarding the subsidies, it stipulates the prohibition, notification, and consultation of specific subsidies.

The following is the outlines of disciplines on state-owned enterprise and subsidies in Japan's EPA.

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<sup>1</sup> See, 2016 Report on Compliance "RULES FOR THE REALIZATION OF FAIR COMPETITION CONCERNING STATE-OWNED ENTERPRISES", 2017 Report on Compliance "ATTEMPTS TO REINFORCE REGULATIONS FOR STATE-OWNED ENTERPRISES".

## **2. SUMMARY OF LEGAL DISCIPLINES**

### **(1) CPTPP State-owned enterprises is signed (In March 2018 and entered into force in December of the same year)**

#### **(a) Definitions related part (Article 17. 1)**

The “State-Owned Enterprise” refers to (1) an enterprise that is mainly engaged in commercial activities (2) that the party owns or controls through ownership interests, etc., in a company. The activities that an enterprise engage in are based on the “not-for-profit basis” if whose purpose is not profit-making, or when it makes sure that the income does not exceed the amount to cover the appropriate cost for the activity (“cost-recovery basis”). If an enterprise operates based on the “cost-recovery basis”, its activity does not fall under “commercial activities” in above because it is not oriented toward profit-making.

As a requirement (2) for “state-owned enterprises”, a party (a) directly owns more than 50% of the share capital, (b) controls more than 50% 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.

As to “designated monopoly”, it means a privately owned monopoly that is designated after the date of entry into force of this Agreement and any government monopoly that a party designates or has designated.

#### **(b) Scope related part (Article 17. 2)**

This chapter shall apply with respect to the activities of state-owned enterprises and designated monopolies of a party that affect trade or investment between the parties within the free trade area.

Activities take by a central bank, financial regulatory body, or clearing agency etc., are excluded from the scope. Furthermore, Sovereign wealth funds and independent pension funds and enterprises owned or controlled by them are also excluded from the application of the chapter, except for some provisions for non-commercial assistance. Moreover, government procurement, services supplied in the exercise of government authority, providing goods or services exclusively to one's own party in order to carry out governmental functions is also outside the scope of this chapter. In addition, certain provisions such as non-discriminatory treatment and commercial consideration obligations, non-commercial assistance, and transparency are not applied to state-owned enterprises or designated monopolies, if the annual revenue from the commercial activity falls below the threshold in any of the past three fiscal years. The threshold as of the date of entry into force of this Agreement is 200 million Special Drawing Rights (SDR), which shall be adjusted at three-year intervals (Annex 17-A).

#### **(c) Parts related to substantive provisions**

##### **(i) Commercial considerations and non-discriminatory treatment (Article 17.4)**

Parties are also obliged to ensure non-discriminatory treatment by state-owned enterprises and designated monopolies, with respect to their purchase and sale of goods and services when engaging in commercial activities. It stipulates to ensure that state-owned enterprises accords to a good or service supplied by an enterprise of another Party treatment no less favourable than it accords to a like good or a like service supplied by enterprises of the Party, of any other Party or of any non-Party.

##### **(ii) Non-commercial assistance (Article 17.6)**

It provides for, due to the non-commercial assistance to state-owned enterprises with respect to its

production and sale of a good or supply of a service, adverse effects to the interest of other parties such as significant market price suppression must not occur.

The chapter defines non-commercial assistance as ‘assistance to a state-owned enterprise by virtue of that state-owned enterprise’s government ownership or control.’ Here, ‘assistance’ means (i) Direct transfer of funds or potential direct transfer of funds or liabilities ((A) grants or debt forgiveness, (B) loan on terms more favourable than commercially available terms, loan guarantee, etc., (C) equity capital investments inconsistent with normal investment practices of private investors) Or (ii) provision of goods or services (excluding social infrastructure) under conditions that are more favourable than those that are commercially available.

Moreover, (i) if the access to these assistance is explicitly limited to state-owned enterprises, (ii) if assistance is used predominantly by the party’s state-owned enterprises, (iii) when disproportionately large amounts of assistance are provided to the party’s state-owned enterprises, or (iv) if state-owned enterprises are preferentially treated at the discretion of the party, that assistance shall be considered “based on being owned or controlled by the government”.

### **(iii) Transparency (Article 17.10)**

It provides for transparency for state-owned enterprises and designated monopolies, such as the obligation to provide a list of state-owned enterprises, obligation to notify the designate monopolies or expansion of the scope of monopoly, obligation to provide information of state-owned enterprises or government monopolies at the request of other party, obligation to provide information of policies and systems regarding non-commercial assistance .

## **(2) Japan-EUEPA**

### **<State-owned enterprise, chapter>**

#### **(a) Definitions related part (Article 13. 1)**

In Japan-EUEPA, definition is stipulated in Article 13.1. “State-Owned Enterprises” refer to (1) an enterprise that is engaged in commercial activities (2) it is required that a party owns or controls based on capital relations, etc. Activities performed by enterprises operating under the “non-profit-basis” or “cost-recovery-basis” do not fall under the category of profit-making oriented activities (Article 13.1 (b), (See (2) (1) (a) above for the principle of non-profit and cost-recovery.))

The requirements (2) for “state-owned enterprises” are as follows, in which a party (a) directly owns more than 50% of the share capital; (b) controls, directly or indirectly 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; or (d) has the power to legally direct the actions of the enterprise or otherwise exercises an equivalent degree of control in accordance with its laws and regulations.

A “designated monopoly” has been stipulated as an entity as the sole provider or purchaser of goods or service in party’s relevant market.

#### **(b) Scope related part (Article 13. 2)**

The provisions of this chapter apply only to commercial activities conducted by state-owned enterprises, enterprises with special rights or privileges, or designated monopoly.

This Chapter does not apply to a state-owned enterprise, an enterprise granted special rights or privileges or a designated monopoly, if in any one of the three previous consecutive fiscal years the annual revenue derived from the commercial activities of the enterprise or monopoly concerned was

less than 200 million SDR. Non-discriminatory treatment and commercial consideration obligations shall not apply to certain financial services provided by state-owned enterprises in accordance with government mandates, cabotage in maritime transport, certain air services or support for air services, and audio-visual services.

**(c) Parts related to substantive provisions**

**(i) Commercial considerations and non-discriminatory treatment (Article 13.5)**

As with the CPTPP, a party shall in the event that its state-owned enterprise, an enterprises granted special rights or privileged enterprise, or a designated monopoly enterprise (hereinafter “entity”.) engage in commercial activities, ensure that the entity acts in accordance with commercial considerations in the purchase or sale of goods or services, and that the entity accords to a good or service supplied by an enterprise of another Party treatment no less favourable than it accords to a like good or a like service supplied by enterprises of the Party, of any other Party or of any non-Party.

**(ii) Transparency (Article 13.7)**

It provides for information exchange for the purpose of ensuring transparency. Specifically, if a party has reason to believe that its interests under this Chapter have been adversely affected by the commercial activities of the other party's entity, the party may request to provide the following information about the commercial activity of the entity in writing. The target information includes the organizational structure and management structure of the entity, the shareholder composition and voting rights of the entity, the outline of the government department or public body that regulates the entity, the business information such as annual revenue and total assets for the most recent three year period for which information is available, any exemptions, immunities applicable to the entity based on the laws and regulations of the requested party, and measures related to such exemption.

**Subsidies Chapter**

**(a) Definitions related part**

In Japan-EUEPA, the principle for subsidies is stipulated in Article 12.1. While recognizing that subsidies “may be granted when they are necessary to achieve public policy objectives”, it states that “[i]n principle, subsidies should not be granted by a party when it finds that they have or could have a significant negative effect on trade or investment between” Japan and the EU. The definitions are stated in Article 12.2, where “subsidy” and “specific subsidy” are defined by referring to the provisions of Article 1.1 and Article 2 of the ASCM(See Article 12.2 (b) and (c).) respectively. Furthermore the chapter applies to subsidies irrespective of whether the recipients of the subsidy deal in goods or services.

**(b) Scope related part.**

Article 12.3 stipulates the scope of this chapter. Firstly, this chapter applies to subsidies as long as the subsidies with specificity are related to economic activities. On the other hand this chapter does not apply to (1) subsidies granted to enterprises entrusted by the government with the provision of services to the general public for public policy objectives, (2) subsidies granted to compensate the damage caused by natural disasters or other exceptional occurrences, and (3) subsidies to audio-visual services. Articles 12.5 (notification obligation) and 12.6 (consultation obligation) do not apply if the cumulative amounts or budgets of subsidy which are less than 450,000 special drawing rights per beneficiary for a period of three consecutive years. Article 12.6 (consultation obligations) and Article 12.7 (prohibited

subsidies) do not apply to agricultural and fishery subsidies, and Article 12.7 does not apply to subsidies granted temporarily to respond to national or global economic emergency, and subsidies granted by sub-central levels of government of each Party.

### **(c) Substantive provisions**

Article 12.5 stipulates the notification obligation. Each Party is obliged to notify in English the legal basis, form, amount or budget of any specific subsidies that it grants or maintains, and where possible, the name of recipient every two years (the first notification shall be made within three years after the effective date of the agreement). If this information is made publicly available on the official website, or notification is made pursuant to Article 25.2 of the ASCM, the notification obligation is deemed to have been fulfilled. Furthermore, it is stipulated that there is a notification obligation for subsidies related to services in 10 sectors that are listed in Article 12.5 (3).

Article 12.6 stipulates for consultation. If a subsidy has or could have a “significant negative effect on its trade or investment interests under this Chapter”, a party may request for a consultation to the other party in writing. If a request for consultation is made, the requesting party can seek for information on the legal basis and policy objective of the subsidy, the form, the dates and duration of the subsidy, the eligibility requirements, the total amount of the subsidy and the possibility of limiting the subsidy, , the recipient of the subsidy where possible, and other information that allows the impact of the subsidy on trade or investment to be assessed. The requested party shall provide relevant information related to the subsidy in writing no later than 90 days after the date of receipt of the request.

Article 12.7 stipulates two types of prohibited subsidies. The subsidies that have or could have a significant negative effect on trade or investment between the parties, shall be prohibited if it falls under (1) legal or other arrangements whereby a government or a public body is responsible for guaranteeing debts or liabilities of an enterprise, without any limitation as to the amount and duration of such guarantee; or (2) subsidies for restructuring an ailing or insolvent enterprise without the enterprise having prepared a credible restructuring plan.

### **(3) Japan-Australia EPA**

In the Japan-Australia EPA, with regard to Article 15.4, bearing in mind the relationship between the promotion of competition and other policy objectives, the parties recognize that seeking to ensure that governments do not provide competitive advantages to state-owned enterprises simply because they are state owned can contribute to the promotion of competition.

## **3. CONCLUSION**

So far, the overview of background on state-owned enterprise and subsidy and the outline of legal disciplines for those have been outlined.

The main discipline of the state-owned enterprise chapter is non-discriminatory treatment, commercial considerations and transparency/information exchange as defined by CPTPP and Japan-EUEPA. Furthermore, CPTPP and Japan-EUEPA more specifically define the state-owned enterprises. But the scope of the state-owned enterprise in Japan-EUEPA is wider than that of CPTPP. In CPTPP, the provision defines the state-owned enterprise as that “principally” engages in commercial activities and meets certain requirements, on the contrary, Japan-EUEPA uses no such a word, “principally” in the definition. It further stipulates that when a party has authority to legally direct activities of the enterprise or otherwise exercise equivalent degree of control in accordance with its laws and

regulations, it falls under the state-owned enterprise. Also, the scope of CPTPP is different from that of Japan-EUEPA.

In the CPTPP, there is only a provision for “non-commercial assistance” in the chapter on state-owned enterprises, and there is no separate chapter on subsidies, while in Japan-EUEPA there is an independent chapter on subsidies. The main rules of the subsidy chapter are the notification and consultation obligations for specific subsidies, and the prohibition of subsidies that fall under certain types defined under the Japan-EUEPA.