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STATE-OWNED ENTERPRISES
Rising, falling and returning? A brief overview

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Introduction
Ideas on how best to govern a country, it is almost a cliché to claim, change over time. Whether it be the optimal taxation method(s) and rate(s) or the best means of implementing public policy, determining the ideal role that the state should play in society has shifted over time. In much of the western world, the significance of one public policy tool, the SOE, has oscillated considerably over the last 75 years since the end of the Second World War. These fluctuations are not simply confined to the operations of SOEs themselves but are also reflective of larger philosophical and political questions as to the appropriate role that the state should play – or conversely, should not play – in a modern-day nation. SOEs range in form and function, of course, but they usually are organized in a corporate, hierarchical manner and provide goods and/or services to the citizenry within a market setting and, at the same time, have some sort of public mission/mandate included in their corporate goals. They are owned (or at least partly owned) by a state entity but are not under direct political control as their managers enjoy some decision-making and budgetary discretion and, to a large extent, autonomy from their owners. In theory they could be privatized, but due to political variables and circumstances, are not (Florio, 2014, p. 201). Since they do not simply seek to maximize profits, but rather must meet various objectives set out by their single shareholder, many SOEs are left to find an ideal balance between divergent, and oftentimes, conflicting commercial and policy goals. SOEs worldwide comprise roughly “10% of the global gross domestic product” (Bruton et al., 2015, p. 92) and as such are significant political and economic actors.

The purpose of this chapter is to briefly explore the evolution of thought surrounding SOEs within the international sphere. It argues there are discernible trends regarding views on and use of SOEs as viable public policy instruments, and that these perspectives have oscillated over time during the postwar era. These oscillations, very simply, can be divided into three epochs. The first runs from the end of the war and reaches its zenith in the 1970s and is a time when SOEs were acceptable and lauded public policy instruments which, in many cases, played crucial roles in national economic and industrial development programs. The second era starts during the stagflation crisis in North America during the 1970s and gathers strength throughout the 1980s, 1990s and even into the early 2000s and is...
characterized by staunch criticism of state intervention in general and ardent support for using competitive markets as the ideal means to resolve coordination problems; many SOEs were either eliminated or privatized during this time. Since then, however, the pendulum against SOEs has started to swing the other way and our third epoch starts in the early 2000s and continues to today. This final period is characterized not only by an increasing acceptability of state interventions, but for SOEs as well. The SOEs of today are markedly different in terms of operations, ownership and governance from those of yesteryear, so much so that they resemble more private firms than the lumbering “leviathans” of yesteryear (Musacchio & Lazzarini, 2014). This epoch and much of the contemporary views on SOEs have been shaped by events in, and the growth of, the developing world, particularly in China, where SOEs not only play critical roles in the national development plan, but where state intervention in the marketplace is commonplace. This chapter will outline these epochs, noting some key intellectual, historical and resultant policy outcomes, and then will briefly examine the contemporary post-privatization SOE era by drawing some insights from a timely Canadian case study.

The state is in business: depression, war and SOEs in the postwar period (1945–1975)

The Depression and the Second World War are key events in the development of the west. The Great Depression and the associated economic turmoil of the 1930s vividly illustrated the failure of markets to self-correct, and the seminal importance of state interventions to mitigate the markets’ failures which brought it about. In a similar manner, the war effort showed vividly the capacity of the modern state to coordinate collective behavior towards a common purpose to defeat the Axis powers. Such coordination was responsible for both winning the war and ending the Depression as well as ushering in the unprecedented period of economic growth, technical advancements and the creation of the modern-day Keynesian welfare state that characterized many postwar western nations. SOEs were key policy tools during this era and while they were significant in the prewar time period as well, particularly in public services such as sewage, water and mail, their use was often the result of efforts to counter privately held monopolies and/or to counteract market failures in these critical segments of the economy (Musacchio & Lazzarini, 2014, pp. 23–24). Similarly, nationalizations of key industrial segments of the market, particularly in Europe, were also common in the prewar period. More generally, the postwar economic boom was a result of the massive growth of the state since corporate productivity was enhanced by the dramatic increase of many public goods such as roads, healthcare and public education. These investments, in turn, were only possible due to the massive productivity improvements made within the private sphere and the resultant expansion and growth of the tax base. The circular, mutually interdependent relationship between economic growth and state expansion was exemplified throughout this period. Further, widespread support for the state and its interventionist policies in the United States continued throughout the early Cold War since as H. W. Brands (2001) points out, national governments were charged with protecting the population from nuclear annihilation, so providing basic public and social goods was not such a significant intellectual stretch – even in the United States, a nation so keen on individual rights and freedoms.

The postwar period was “the great age of public enterprise” (Toninelli, 2000, p. 18). By 1980, SOEs accounted for 7% of GDP in developed nations and 11% in mid-income countries (Musacchio & Lazzarini, 2014, p. 33). Their value according to Musacchio and
Lazzarini (2014) can be explained by four perspectives: The “industrial perspective,” which holds that states use SOEs to correct for market failures, particularly underinvestment, and that SOEs fill gaps left by market actors that are unable or unwilling to make such outlays. This void is often due to multiple factors including a lack of capital, short-term payback horizon expectations of investors or outright risk aversion on behalf of private actors, among other shortfalls, and that state-led remedies are necessary to boost industrial activity and/or promote entrepreneurial endeavors. Encouraging coordination and/or vertical integration among actors in an industry and overcoming large risks and long-term time horizons of new discoveries and technologies, likewise, is an additional market failure that SOEs resolve. In a similar vein, Mazzucato argues forcefully that the technological developments of the internet revolution were less the results of private sector efforts than a direct result of state-led (basic) research and high-risk investments made by “The Entrepreneurial State” (Mazzucato, 2013).

The “social perspective” argues that SOEs meet policy (and political) needs of governments. The so-called “double bottom line” over and above strictly commercial imperatives could include providing employment, supporting regional/geographic specific roles (such as maintaining services, selling goods or operating particular plants) and often includes providing goods/services at below market costs (frequently these goods/services are paid for by internalized transfers of revenues or “cross-subsidization” within an SOE; Baldwin, 1975). This view includes sectors where profit maximization, in and of itself, is a problematic organizational goal and provision by SOEs helps to attenuate this drive – gambling and alcohol distribution are two such examples. Public ownership is also a means to both mitigate (if the alternative is a privately owned monopoly) and capture the value derived from markets where monopoly provision offers significant advantages, so-called natural monopolies. SOEs according to this perspective are vital policy tools that aid governments in resolving politically significant problems they must manage.

The third perspective is the “political” view of SOEs. Somewhat cynical in nature, the political perspective opines that SOEs illustrate the inherent inefficiencies associated with the public provision of goods and services (government failure), and that they are used by the political sphere for either personal or partisan gain(s). Politically motivated patronage or maintaining unnecessarily large workforces are the best example of such behavior, but other areas where problematic political interference arises include procurement, product offerings, pricing or asset location, to name just a few. SOEs in this light are entities where decisions are guided not by a business case nor a clear public benefit, but rather are steered by (P) political or partisan motivations. Cronyism and outright “rent seeking” by well-connected individuals and firms are the resultant effect of using SOEs, since these firms make – or are made to make – decisions based on electoral interests or donation trends within the political sphere. Such a perspective reminds observers that when firms are owned by the state political concerns of the government oftentimes will trump economic and financial considerations meaning that resources will be sub-optimally allocated. Not surprisingly, such an outlook means that outright privatization is regarded as the only way out of this dilemma and the incapacity of SOEs to adequately distance themselves and their operations from the realm of politics.

Fourth and finally, SOEs exist due to path-dependent, place-specific variables and histories. These are critical for recognizing why SOEs were the initial policy choice, the nature of their evolutions as well as how (and why) governments have opted (or not) to reform or privatize these firms. It is within this framework that ideological variables, political culture and public opinions on ownership are key factors which shape the decisions regarding
SOEs. This perspective, for instance, recognizes the importance which factors such as promoting social and political national cohesion, supporting national defense and other strategic initiatives, along with using SOEs to stimulate and sustain economic growth were core objectives of SOEs in the western world. While regulatory failure (usually in the case of monopolies) and socialist-inspired employment goals were oftentimes tertiary functions of these firms (Millward, 2011). It reminds us that SOEs and the political milieu in which they reside are products of their geographic and temporal contexts, and that all trends and generalizations must be nuanced with pertinent parochial variables. All four rationales, to varying degrees, help to explain why governments relied on SOEs as policy tools throughout the postwar period, an era that for much of the western world saw incredible economic growth and unprecedented improvements in the material well-being of the citizenry.

The markets strike back: rethinking intervention and SOEs (1975–2001)

The view that SOEs were valuable policy tools did not last. The reasons for this demise were numerous. Strong criticism of state intervention in general and SOEs specifically started in the 1970s as the postwar boom came to an end. The oil shocks and stagflation (rising inflation and unemployment) of the early 1970s illustrated the shortcomings of the Keynesian-inspired economic model that, up until this time, had brought about unparalleled economic growth, particularly in North America. Large public debts, increasing annual deficits, rising inflation and slower economic growth caused leaders and policy makers to rethink their commitments to the efficacy of state interventions in the market; a neo-liberal perspective was replacing the postwar neo-corporatist paradigm regarding the ideal role of the state in modern capitalist economies (Vickers & Wright, 1988). In the political realm, the election of Ronald Reagan in 1980 and Margaret Thatcher the year before, both staunch advocates of free markets and privatizing SOEs, signaled to the world that the misgivings of state interventions had shifted from rhetorical observations to political reality.

These new ideas in the political sphere reflected shifts within the realm of economics. Arguments purporting the inherent superiority of allocating resources via private markets over that of state bureaus were on the rise at this time and were famously articulated by Milton Friedman whose pivotal book, *Capitalism and Freedom*, was published in 1962. (He was awarded the Nobel Prize in Economics in 1976.) Keynesian-inspired policy makers and economists were largely displaced by pro-market monetarist professionals as a new policy paradigm emerged throughout much of the western world’s public bureaus, particularly in finance and treasury departments (Hall, 1993). Adding to this zeal, of course, was the fall of the Iron Curtain and the Berlin Wall in the late 1980s and early 1990s, and the subsequent rapid (and, in many cases, deeply problematic) privatization of many eastern European and (former) Soviet Union SOEs. These events and the resultant enthusiasm attached to both victory in the Cold War and triumph of markets (and democracy) over other means of governance led one notable academic, Francis Fukuyama, in 1992 to announce the “End of History” and the ascension of liberal economic and political ideals over that of all other forms of collective organization (Fukuyama, 1992). Many academics and policy makers, particularly economists, reveled in this sea change. Some declared (almost with a tinge of glee) that not only had capitalism won out against socialism, but they went further to declare that these macro geopolitical shifts illustrated that private firms in competitive markets were always superior to SOEs since:
[t]he pursuit by government officials of political goals and personal income, as opposed to social welfare, further strengthens the case for private ownership, as the dismal record of state enterprise around the world and the tragedy of communism illustrate all too well.

(Shleifer, 1998, p. 148)

There were other reasons why reforms were needed to the SOE sector. Technological improvements, in many cases, eliminated the value of publicly owned natural monopolies, particularly in sectors such as telecommunications. Increased globalization and interdependence within industries and sectors, and a desire to reduce the number of workers, their wages and union power were additional key factors (Vickers & Wright, 1988). Shortcomings in efficiency and effectiveness plagued SOEs. For instance, there are ample studies that show how private firms, and post-privatized firms, were more efficient than their SOE counterparts (Boardman & Vining, 1989; Megginson & Netter, 2001). This is not surprising given that SOEs serve multiple functions often imposed on them by their owners, but such inefficiencies became acute political problems when firms required (growing) ongoing subsidies that, in turn, hindered the capacity of governments to borrow money or to reduce their budgetary deficits, or both. Many countries during the 1990s were opening their economies to international trade which exposed inefficient private and public firms to more competition. Further, privatizations were lauded and actively encouraged by international financial organizations such as the International Monetary Fund (IMF) and the World Bank as conditions for their loans, advice and other assistance. Throughout much of Europe, privatizations were also driven by European Union (EU) economic and political integration criteria, particularly in the telecommunication, utilities and transport sectors (Clifton et al., 2006). Also noteworthy is that while many privatization efforts had an ideological, anti-statist character to them, and some scholars argue that right-leaning governments were more likely to privatize firms (Bortolotti et al., 2003), this was not a steadfast rule since left-leaning governments, Socialist in France and Labour governments in New Zealand (Evakovic & Wilson, 2005), for instance, implemented significant privatization and restructuring programmes during this time period as well.

So, a combination of ideological, economic and, most critically, political variables changed the cost/benefit matrix of decision makers regarding their SOEs and the fiscal burdens they imposed on the state. The financial opportunity costs of operating these inefficient firms, particularly given significant public debts and high interest rates at the time, outweighed the political benefits they conferred to their owners. The result was a relatively simple “no-brainer” financially based decision on behalf of governments to sell them off and to use the proceeds for other purposes (Musacchio & Lazzarini, 2014, pp. 41–43). What had changed during this period was the relative value of the non-commercial functions of SOEs and the tolerance of governments to accept (and pay for) them. So, for instance, the political imperatives to maintain artificially elevated employee levels (or inefficient plants or preferred procurement contracts and the like) at many SOEs imposed considerable burdens on their balance sheets and, in many cases, meant they operated at a loss and required ongoing subsidies from the state. Any real efforts aimed at reducing these burdens were compromised by their public ownership since it was politically impossible to reform them (and eliminate the excess workers, close plants or modernize procurement practices, and the like) while they were under public ownership, since governments would not (or could not) tolerate the blowback such efforts would evoke. Privatization, then, was an easy, politically palatable
“shock” treatment to reform ailing SOEs, and to rectify the financial problems that they were imposing on many state treasuries.

In many countries, governments began selling off their SOEs. Between 1977 and 1999 worldwide just under 2,500 firms were privatized worth an estimated USD1.11 trillion and the value of SOEs as a percentage of world GDP declined from 9% to 6% during this period (World Bank, 1995; Bortolotti et al., 2003). In several countries, the selloff was significant. In Australia, for instance, in 1990 SOEs accounted for 7% of GDP, but by 2011 they made up a mere 1.3% of the economy (Abbott & Cohen, 2014, p. 432). The privatization epoch had two notable waves, the largest one peaking in the mid-1990s with a smaller one cresting around 2006–2008. The first wave captures the effects of privatization efforts within much of the former Eastern bloc countries as there were five times more privatizations between 1988 and 1993 than there were between 1980 and 1987 (World Bank, 1995, p. 25). In more than half of the privatizations in this first wave management of these firms was transferred from the state to the private sector while after 1999 it was more common for the state to retain control while selling off a portion of their equity to private interests (Musacchio & Lazzarini, 2014). So, governments set about casting off their lumbering “leviathans” as the world accepted a new paradigm which centred on the supremacy of markets as the problems endemic to SOEs were widely accepted by both politicians and policy makers.

**Return of the state: reformed SOEs, international development and politics (2001…)**

This condition did not last, and within little time, it was challenged on several fronts. There are a host of factors that helped to reshape commonly held views on SOEs. On the academic front, the increased appreciation for and role of “institutions” in determining how national economies develop and operate (over and above the importance of the marketplace itself), pushed economists to recognize the role that other factors play in aiding economic growth. Douglass North in his seminal 1990 book declared that “institutions matter” in how nations develop, setting forth the widely accepted view that “We are all institutionalists now” (Roland, 2004, p. 110). (He won the Nobel Prize for Economics in 1993.) Policy makers, particularly economists, were willing to recognize the critical importance that factors ranging from contractual rights to culture and historical trajectories, among others, played in shaping a nation’s economic performance. Institutions, it is worth noting, also play a central role at the microeconomic level by reducing transaction costs and improving contracting and regulatory conditions (often when information is less than perfect). Incidentally, these additional rationales support using SOEs as policy tools. The renewed significance of institutions meant that analysis and prescriptions spilled over from economic domain into the policy and political spheres, and thus focused more attention on the role of the state within the economy and society more generally.

Developments in the field of comparative political economy were also crucial. Peter Hall and David Soskice’s 2001 piece on the “varieties of capitalism,” which outlined the divergent degrees of, and associated competitive advantages with, different relations between private firms and various state institutions within modern, developed capitalist nations, was a pivotal development. They divided developed nations into two archetypes, “liberal market economies” and “coordinated market economies,” with the United States and Germany, respectively, as the ideal examples of each. They argued that different models conferred specific competitive advantages to each nation and that these respective regimes necessitated
varying degrees and intensities of state interventions (they focused on vocational training). Hall and Soskice’s arguments raise several key points: That there is great variation between and among developed capitalist economies and that all markets are deeply embedded within the public domain, thus making clear delineations between the public and private spheres more difficult. This means that simplistic claims delineating between “capitalist” and “socialist” or “social democratic” nation states are not as straightforward as previously thought. Additionally, they show that differing institutional configurations within sectors correspond with divergent levels of state intervention, and each type of arrangement will confer unique competitive advantages to private firms operating in a globalized, competitive market place. It is the form and degree of state intervention that matters. In doing so, their arguments nuance claims that shrinking the size and scope of the state, in and of itself, is the key factor determining a country’s international competitiveness (Hall & Soskice, 2001).

Other events were critical to this shift. The terrorist attacks on New York in 2001 illustrated the vulnerability of civilians in North America to politicized violence, and in doing so reinforced in the minds of many the fundamental role of the state to protect the citizenry from harm. On the economic front, the near collapse in 2008 of the North American banking, insurance and automobile manufacturing sectors due largely to weak regulations and poor oversight of the financial system illustrated the precarious nature of many large private firms. Total ruin was avoided thanks to massive interventionist measures by the Canadian and US governments who bailed out automakers, banks and insurance firms preserving jobs and ensuring the viability of numerous markets (Verret, 2010; Ben-Ishai & Lubben, 2011). These events illustrated the supremacy of the political sphere over that of the economic and served to remind everyone that governments must act decisively to maintain order and prevent an economic collapse. It is the state that is ultimately liable for the behavior and operation of firms and the aggregated outcomes from the marketplace, especially when they are sub-optimal. Canadian SOEs in the financial sector, it is worth noting, were essential policy tools which intervened in financial markets relieving liquidity constraints as well as providing real-time analysis and information to the federal government during the crisis (Hodgson, 2010).

Two additional factors are central to the (re)emergence of SOEs on the policy stage. The first is the spectacular rise of China and its use of an alternative model of economic development where the state plays the central role in organizing economic activity. China’s economic growth since Deng Xiaoping implemented structural reforms in 1978 has been nothing short of a human miracle. Over 800 million Chinese people have been lifted out of poverty and now enjoy many of the trappings of a modern lifestyle (World Bank, 2017); never in human history have so many individuals seen such drastic improvements to their material well-being. This success is due largely to its unique development model, often referred to as the “Beijing Consensus,” whereby the state and centralized planning play the dominant role in structuring and managing market forces and the economy, more generally (Ramo, 2004; Naughton, 2010). A highly pragmatic framework shaped by place-specific particularities, it stands in contrast to the universalist “Washington Consensus” first coined by John Williamson. He observed the consensus among many economists who argued that ideally states would provide basic health and education services and critical infrastructure but should leave economic development to the private sector and aid it by implementing tax reforms, trade and labor liberalization, and encouraging foreign investment among other market-oriented reforms (Williamson, 2000). It was a framework endorsed by many (anglo-) western nations and enjoyed support from the World Bank and the IMF, among other international organizations. Many other developing nations, likewise, have embraced the
“Beijing Consensus” development model, particularly the BRICs (Brazil, Russia, India, China), and are currently using public institutions to shape the structure of their economies and are employing SOEs as policy tools (Bremmer, 2009).

Chinese SOEs have played, and continue to play, a fundamental role in its economy. In 1979, for example, just as Deng was introducing economic reforms, SOEs were producing 79% of all industrial output, and these “leviathans” were deeply politicized organizations that in addition to their industrial functions were major employers and provided other social, housing, educational and health services to their employees. Even after thirty years of economic reforms, SOEs continue to be vital entities even though their relative significance has fallen as their production comprises 11.1% of GDP. In absolute terms, however, they continue to be significant as they employ over a third of all Chinese workers, are responsible for almost half of fixed asset investments and are key conduits for foreign investment – over 80% of joint ventures are with state-owned entities (Chiu & Lewis, 2006). The great success that China and other countries have made on the economic front, and their growing significance – in political, economic and military terms – means that they can provide alternative perspectives and arguments on a host of fronts, especially in terms of developing and sustaining national economies. Deng famously articulated his pragmatic economic development model and the ideal roles for the state and the market when he stated: “It doesn’t matter if a cat is black or white, so long as it catches mice.”

Secondly, many SOEs have undergone profound organizational and governance changes. China eschewed the “big bang” policies of the former eastern bloc where SOEs were privatized quickly, and instead has embraced a slow and steady series of organizational and governance reforms. Very generally, Chinese SOEs have moved away from being “economic and social conglomerates” and have set about commercializing their operations. Chinese SOEs are increasingly concerned with the needs of their customers, have set out to find new markets and are offering new products. They are also more attentive to costs, profits and losses, and have shed considerable amounts of debt. Political interference is declining, as is outright patronage, and they are withdrawing from offering social services such as education and healthcare. There is, more generally, a clearer separation between their commercial core operations and their social welfare functions. Perhaps most importantly, and an area which is intensely politically sensitive, they are reducing their employment counts, but are ensuring that redundant employees are employed elsewhere, retrained or otherwise looked after (Hassard et al., 2010).

Outside of China, many SOEs are undergoing similar types of reforms. Often referenced as “corporatization,” “rationalization” or, in the words of the author, “modernization” efforts (Bozec & Breton, 2003; Bird, 2015), these transformations occur in two major areas: operations and governance. On the operational side, SOEs are increasingly focused on financial elements of their operations such as revenues, costs and overall financial viability; they are, for the most part, expected to cover their costs and are not to require on-going subsidies from the state. Many SOEs hire senior executives with private sector experience to lead transformations and/or to run these newly reformed firms. All remaining SOEs continue to perform crucial public policy functions (oftentimes this is one reason why they cannot be fully privatized), but they are to fund these functions through internally generated resources and engage in various forms of “cross-subsidization” taking revenues from one component of their operations to fund policy roles/functions as directed by their single shareholder. While they may provide politically significant public policy functions they do so in a holistic and long-term capacity, and such roles are explicitly stated in formal documents between the government and the firm. They are also focused on providing high-value to
the citizenry, including improved customer service and prices, recognizing that monopoly (or dominant) status in a market does not mean insulation from attending to the needs of customers (Bird, 2010).

On the governance front, SOEs increasingly operate at arm’s-length from their owners. This does not mean they are apolitical and completely insulated from political influence, rather it means that the political demands that are made on them are more formalized and focus on providing specific, politically important policy functions. Governments may (and do) dictate these long-term policy goals to these firms, but they (and do so via prescribed and official channels and they refrain from interference in day-to-day business decisions and their operations, more generally. Outright politicized patronage has come to an end as has other forms of “rent seeking” either for financial and/or for (P)political/partisan gains by members of or individuals affiliated with the ruling government. Operating a modern-day organization and attracting and retaining capable people would simply be impossible if such practices continued. Board appointments, likewise, are often sought for individuals with specific skill assets rather than only for their partisan loyalty. Changes in SOEs governance have received some academic attention, and much of the analysis has focused on quantitative means of evaluation (Musacchio & Lazzarini, 2014; Daiser et al., 2017). But, the critical qualitative “litmus test” of SOE independence is the ability of senior executives to resist attempts to interfere in the firm’s business operations, and to continue their employment despite resisting such efforts.¹

More generally, there are other notable changes within the SOE and state capitalism sector. While governments may have sold off SOEs, this does not always equate to a loss of state control of firms, and after 2006 partial privatizations were more common than complete sales where both control and ownership were placed in the private sphere (Musacchio & Lazzarini, 2014). Two common scenarios are when the state is a majority shareholder and thus controls the firm as any dominant owner might, yet, at the same time, it permits private capital to own a portion of the firm. The second common model is when the state is a minority shareholder and entrusts day-to-day operations to professional managers, yet is still able to ensure that specific public policy goals continue to be met through, for instance, appointing several board positions. Oftentimes these public ownership regimes are exerted via an intermediary such as a holding company (Musacchio & Lazzarini, 2014, pp. 45–52). Other key changes are the vital role that state-owned development banks play in providing capital to domestic firms, often referred to as “national champions,” at subsidized rates (Lazzarini et al., 2015) as well as their role in providing low-cost export-related insurance products and financing throughout the production chain (Bird, 2018).² “Publicizations,” when SOEs purchase private firms or other (former) SOEs, often in foreign markets, is an increasingly common phenomenon (Florio, 2014). The significant expansion of sovereign wealth funds (SWF) over the last ten years is also an additional example of the growth of state capitalism. These state-owned investment funds had, by late 2013, an estimated USD6.1 trillion in assets (Ander & Teply, 2014) and generally make investments that meet both the financial and political objectives of their owners, and often are funded by revenues derived from natural resource extraction. Further, it has been argued that blended governance structures offer unique advantages since public agents enjoy considerable financial advantages – such as low-cost borrowing – while private sector capacities offer significant managerial advantages, particularly life-cycle cost savings (Moszoro, 2014). As a result of all of these changes, particularly the commercialization of traditional SOEs, the old dichotomy between “public” and “private” firms, then, and the accompanying normative arguments as to the superiority of
the former over the latter, is becoming more nuanced, and it is better to see all of these firms, particularly SOEs, as “hybrid” entities (Bruton et al., 2015).

The renewed paradigm: the future of the SOE and the supremacy of the political

In late May of this year, the Federal Government of Canada announced that it was going to purchase Kinder Morgan’s Trans Mountain Pipeline for CAD4.5 billion (Chase et al., 2018). The pipeline runs from the landlocked province of Alberta, home of Canada’s vast bitumen-based oil reserves, through neighboring British Columbia to the Pacific coast where it connects to ocean-bound tankers. Kinder Morgan was trying to treble the pipeline’s daily capacity (to over 800,000 barrels per day) but had recently threatened to abandon the project due to regulatory uncertainty stemming from intense opposition from environmental and indigenous groups as well as hostility from the British Columbia provincial government and many municipalities along the pipeline route. Initial mediocre support from the federal government and an arduous regulatory process added to the uncertainty. With existing pipelines operating at capacity, Alberta’s oil is selling at a substantial discount given the dearth of alternative transport means and customers – 99% of Canada’s oil is exported to its southern neighbor. Getting Alberta’s oil to tidewater via pipelines, by far the most efficient, quickest and safest means of transportation, is of absolute key importance for the federal government, which has Constitutional jurisdiction for large-scale interprovincial infrastructure projects. While many details regarding the structure of this asset and how it is going to be managed are unclear, the government has turned to Export Development Canada (EDC), its export insurance and financing vehicle, to play a major role in this nationalization. Construction through the summer of 2018 was financed through EDC as they provided a CAD1 billion loan guarantee to a consortium of banks. They did so under its “Canada Account,” a separate business line it uses when fulfilling politically significant and commercially risky business activities at the behest of its political master.

The political motivation for this drastic intervention has deep historical roots. Throughout its history, Canadian governments have used SOEs to resolve market failures. From railways to electricity generation to canal construction, among others, they have looked to “Crown” corporations to make up for a dearth of large Canadian firms willing to make significant and risky investments in infrastructure, particularly in the resource extraction sectors. Publicly owned electricity utilities, for instance, were one response to this problem (Nelles, 1974). Canadian SOEs, according to some, even comprise a core component of our unique cultural identity (Hardin, 1974) and evidence for this is found in the fact that all political parties have used SOEs, including (C)conservative ones, that have traditionally held supportive views on state intervention in markets “so long as it was consistent with the fostering of business enterprise and general expansion” (Rea, 1985, p. 18). Despite the sale of numerous SOEs, they still comprise 3.4% of Canada’s economy (Crisan & McKenzie, 2013).

On August 30, 2018 the Federal Court of Appeal ruled against the federal government, bringing Trans Mountain pipeline construction to a halt (Gibson & Rieger, 2018). Citing inadequate consultation with affected indigenous groups, among other reasons, construction cannot continue, the court argued, until the government revisits its consultative process with indigenous groups, and addresses other environmental concerns not adequately dealt with by the regulator, the National Energy Board (NEB). Coincidently on the same day, Kinder Morgan shareholders overwhelmingly approved the pipeline’s sale to federal
government and, no doubt, are breathing a sigh of relief (or perhaps shouts of joy) at their decision. Profit maximizing firms are risk adverse. The importance of building this pipeline cannot be underestimated. Tens of billions of dollars in forgone revenue are at stake (since Alberta oil sells at a significant discount due to limited end customers and pipeline constraints), as is maintaining the confidence of firms to invest in the oil extraction sector and the desperate need to diversify Canada’s exports away from our southern neighbor. Tens of thousands of (well-paying) jobs in construction and in associated resource-extractive industries hang in the balance. Its failure could spark a Constitutional and unity crisis between the provinces of Alberta and British Columbia and would lay bare the impotence of the federal government.

Such a situation illustrates well the importance of SOEs and the enormity and complexity of the challenges they face. It is not clear how the federal government will proceed with Trans Mountain construction, but EDC will surely play a key role in coordinating this project; a completed Trans Mountain pipeline will only be built by some form of state capitalism given the overwhelming political need of the federal government to complete this project, regardless of the costs and obstacles of doing so. SOEs, in these instances, are charged with acting in the long-term and holistic interests of the state and, by extension, their citizen owners. They are powerful tools able to restructure sectors and guide the economic development of nation states. SOEs, including EDC, enjoy significant advantages compared to their private sector counterparts, but at the same time are charged with implementing and financing all sorts of critical public policies. They reallocate resources from one component of their operations to fund others; their shareholders are considerably more patient and understanding than most.

I bet the executives at EDC did not welcome their new marching orders from the federal government to build and manage a pipeline. But implementing the demands of the state has been and will continue to be the raison d’être of all the SOEs. Gone are the days where inefficient and ineffective SOEs were acceptable outcomes to, say, provide citizens with good jobs or locate a factory in a supportive region of the party. SOEs, as the rise of China and the alternative means of economic development of its pioneering model shows, are one of the most vital means states have to shape and grow their economies to bring about long-term benefits to their citizens. As we (in the west, at least) move into the post-privatized era for SOEs, we require a new theoretical paradigm to account for SOEs and their role as viable policy tools – including reconceiving of the State itself as a positive and constructive force. The enormity and complexity of the demands made on SOEs leaves the men and women who run these firms yearning for the clarity that the profit maximization motive provides their private sector counterparts. But, at the same time, such complexity illustrates well how important are the tasks they must resolve and that there are few other alternative policy means that can match the potency of SOEs. It is also what makes studying these firms so incredibly fascinating.

Notes

1 The “political” aspect of SOEs is usually only conceived in a one-way direction from the owning government to the SOE, but incentive to end such interference runs in the opposite direction as well. Patronage appointments and “rent-seeking” behavior, as examples, pose significant risks for governments as well, particularly when such efforts are exposed by opposition parties or other interest groups. Many governments are eager to end these practices since they bring limited political advantages relative to the potential risks involved. Improved governance of SOEs, in other words, is
a two-way street with each group benefiting from a more formalized and transparent set of demands and expectations.

2 Interestingly, Lazzarini et al. (2015) discovered that the Brazil development bank, BNDES, provided loans to relatively healthy companies as shown by their lower level of “high risk” assets. The author’s own work has shown that the Canadian development bank, Export Development Canada (EDC), as well as other Canadian state-owned banks, take on higher risk assets than their private sector counterparts (Bird, 2018).

References

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