

Chapter 4. Trust and the level playing field - The evolving state ownership

Chapter 4 applies a broad definition of “level playing field”, which is taken to indicate different treatment of state-owned enterprises (SOEs) in the competitive landscape, with respect to corruption and other irregular practices, as well as the conduct of SOEs active in foreign jurisdictions. It demonstrates that SOEs active in certain sectors – notably steel production – tend to be less profitable than private peers, yet less likely to go out of business. Similarly, SOEs appear to have a heightened risk of getting involved in some forms of corruption, but they are less likely than private companies to divest from certain projects or disengage from business partners due to integrity concerns. The chapter finally takes stock of ongoing OECD initiatives that either aim directly at, or could have as an outcome, raising trust in state-owned enterprises and their commercial operations.

The increasing presence of state-owned enterprises (SOEs) in the global economy has given rise to concerns about preserving a level playing field between companies owned by sovereign states and the rest of the business sector. One rationale for state ownership of enterprises is that market failures lead the state to create SOEs and obliges them to help meet public policy objectives. While in some cases the state accurately calculates the cost of meeting those objectives, and provides appropriate reimbursement, in others the SOE is over-compensated, for instance through preferential treatment. Support might be justified as long as these benefits accurately match the costs incurred by the companies in carrying out their public policy obligation – but in practice this can become highly complex when the SOEs pursue a variety of objectives that might lead to internal conflicts or trade-offs. The challenge for both regulators and the state acting as an enterprise owner is to build trust that SOEs will operate according to generally accepted corporate practices when active in competitive markets. Among the areas of current concern to OECD governments are:

- *Competitive neutrality.* One of the most pertinent sources of unease about SOEs is the fear among their competitors that they enjoy undue state support that may take a number of forms including direct market-distorting subsidies, preferential market access, regulatory forbearance and unreasonably low rates of return on the capital invested. This, in turn, could either allow artificially profitable SOEs to crowd out more productive competitors, or allow financially weaker SOEs to stay in markets where a comparable private operator would have ceased operations.
- *SOE integrity.* Another trust issue arises from a widely held perception that SOEs are prone to get involved in corruption scandals and other irregular practices. State ownership matters in this context because, first, enterprises operating closely to the public authorities might perceive a degree of impunity. Secondly, if SOEs are insufficiently separated from the functions of the state they can become embroiled in more widespread irregularities within national political systems. Where this is the case the playing field is uneven since SOEs then effectively operate subject to different rules.
- *Cross-border operations.* When state-owned enterprises operate abroad, they are sometimes viewed with scepticism in their host country. In some cases they may be mistrusted because certain of the objectives of state ownership are either ill understood or perceived as illegitimate. In other cases there may be a perception that they benefit from a privileged position in their home jurisdictions which can confer competitive advantages abroad. In addition to such competitive-neutrality related issues, some SOE objectives may be perceived as posing threats to host countries' essential security interests. This brings at risk both the national competitive landscape and the level playing field among nations.

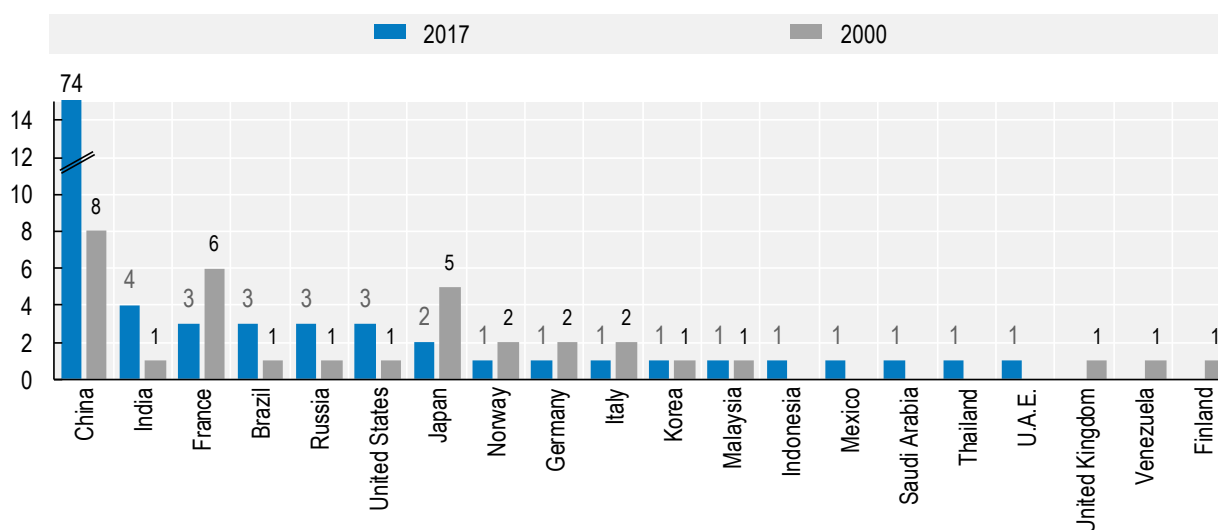
4.1. The global SOE landscape

Evidence of the growing importance of SOEs in the global economy is most visible at the top of the “corporate league table” since in almost all economies SOEs are on average larger than private firms. Currently, 102 of the world’s largest 500 enterprises (measured by annual revenues) are wholly or majority owned by sovereign governments. The trend is upward. Less than two decades ago 34 of the largest enterprises were state-owned – in other words, the state’s share has trebled (Figure 4.1).

The significant shift is mostly because of the growing prominence of China’s SOEs. In 2000, there were eight Chinese firms among the top-500, whereas today’s number stands

at 74.¹ The importance of SOEs in other emerging markets has also grown, with the number of large SOEs in India, Brazil and Russia growing and a number of new countries seeing their national SOEs appear on the list (e.g. Mexico, Indonesia, Saudi Arabia and Thailand). Conversely, the prevalence and size of SOEs in European countries as well as Japan have waned during the period under review. The geographic shift from OECD countries toward emerging economies has been accompanied by sectoral change, since SOEs in advanced economies are mostly found in the network industries and hydrocarbons sectors (plus in some cases finance), while in emerging countries they can be found among a much broader range of economic activities.

Figure 4.1. SOEs among the world's largest 500 enterprises

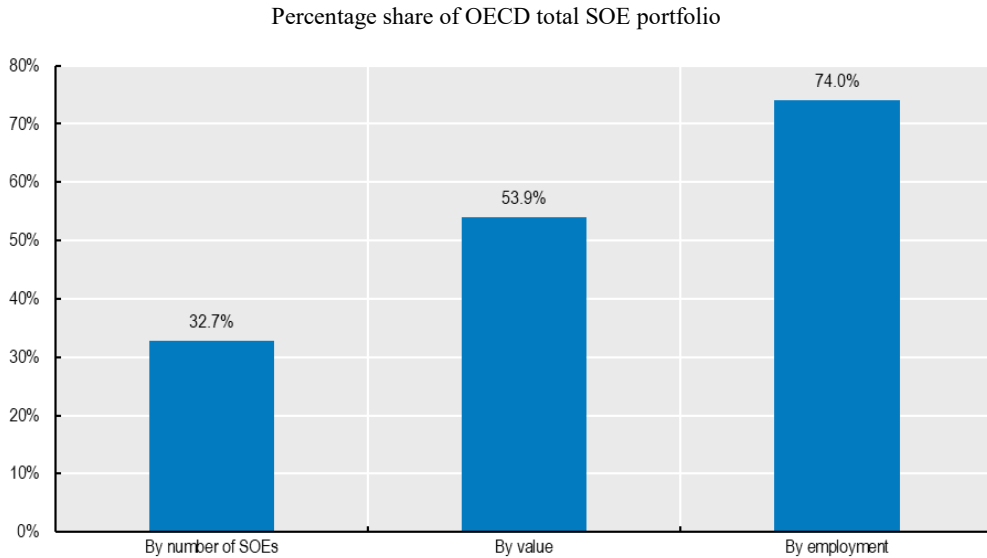


Source: OECD calculations based on Fortune Global 500.

4.1.1. A granular look: SOEs in the infrastructure sector

In countries that have had active privatisation programmes in the past, many or most of the remaining SOEs tend to be found in the infrastructure sectors. Mostly this reflects the fact that they have either monopoly positions in certain market segments or are subject to an array of public policy objectives that would make them hard to privatise. Figure 4.2 illustrates the relative importance of this sector in the SOE portfolios of OECD member governments. This in turn implies that a successful implementation of the policies seen in some countries of supporting national recovery via infrastructure spending, as well as a pent-up need for investment in some others, will depend strongly on well-functioning SOEs.

New approaches to infrastructure investment are also being developed, including through public-private partnerships (PPPs). Recent data shows that more than USD 93 billion worth of PPPs in the infrastructure sector were contracted in 2018.² Through PPPs important economic gains can be made, if for example the state's access to low-interest financing is combined with the higher operational efficiency of private sector operators. Conversely, relying solely on private sector finance is often not an optimal solution and can in some cases be little more than an attempt to shift debt off the public sector balance sheet.

Figure 4.2. State-owned enterprises in the infrastructure sector

Note: The figure is based on a definition which includes in the infrastructure sector “transportation”, “energy” and “other utilities”. Notably, this excludes telecommunication.

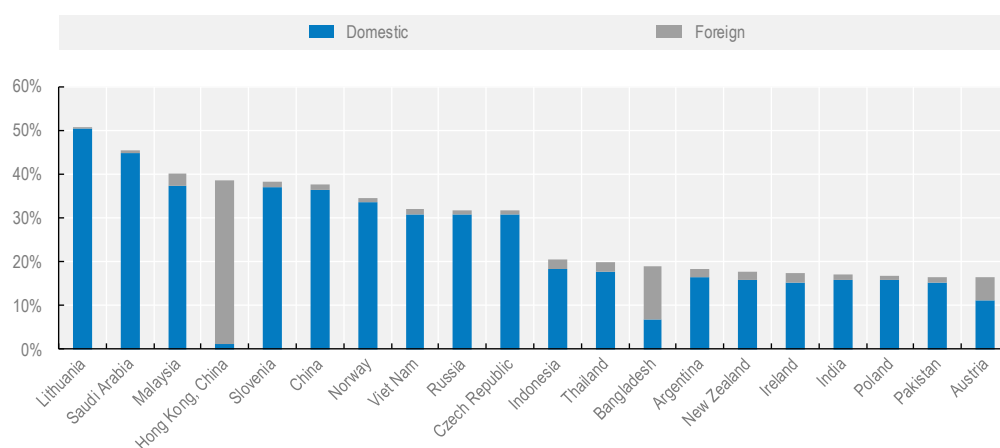
Source: OECD (2017).

PPPs may involve SOEs in several ways. First, the state often participates in the partnership via an existent state-owned enterprise, or establishes a new operation company to oversee the PPP. Secondly, a surprisingly high proportion of the “private” participants tend to be state controlled – and typically operating outside their domestic jurisdictions. More than 19% of the infrastructure PPPs launched in 2018 involved public institutions, roughly half of which SOEs and the other half state-controlled institutional investors.

4.1.2. State ownership of stock-market listed companies

Governments have also become important shareholder owners in many stock markets, mainly as a result of partial privatisations through stock market listings. In many cases, divestment through the stock market has not led to any change in control, as governments remained as largest shareholder in the newly listed companies. Figure 4.3 illustrates the level of government ownership of stock market listed companies. In Lithuania, Saudi Arabia; Hong Kong, China and Malaysia, for example, governments hold on average over 40% of the capital. In the case of Hong Kong, China, the large non-domestic government ownership represents the Chinese government ownership. In 15 out of the 53 markets shown in the figure, governments hold more than 20% of the capital of listed corporations.

In the context of trust in a level playing field, key questions relate to SOE performance and financial structures relative to private competitors. Table 4.1 summarises performance and leverage indicators for SOEs and non-SOEs in each market. SOEs are defined broadly to include those where government are the ultimate beneficiary owners of at least 20% of the capital. In most of the economies under review SOEs display significantly poorer rates of return than private firms. At the same time SOEs exhibit higher leverage in most markets compared to non-SOEs companies.³ This could indicate a higher degree of risk willingness on the part of these companies as well as their creditors, which in this case may well be linked to their proximity to the state.

Figure 4.3. Government ownership of listed companies, end 2017

Note: The table shows market capitalisation weighted average ownership for governments. Calculations are based on ownership data for at least 80% of market capitalisation in each jurisdiction. The countries included in the table are the ones in the sample where the SOE segment of the stock market is at least one fifth of the total number of listed companies.

Source: OECD Capital Market Series dataset, FactSet.

Table 4.1. Performance and leverage for SOEs and non-SOEs, end 2017

| | Number of companies | | Average leverage | | | Average performance | | |
|------------------|---------------------|----------|------------------|----------|------------|---------------------|----------|------------|
| | SOEs | Non-SOEs | SOEs | Non-SOEs | Difference | SOEs | Non-SOEs | Difference |
| China | 470 | 823 | 41.5% | 15.5% | 26% | 6.7% | 10.8% | -4% |
| Hong Kong, China | 98 | 132 | 69.7% | 45.9% | 24% | 8.8% | 14.8% | -6% |
| Hungary | 3 | 7 | 21.3% | 33.4% | -12% | 7.4% | 9.2% | -2% |
| Indonesia | 15 | 47 | 58.3% | 54.6% | 4% | 10.3% | 21.3% | -11% |
| Lithuania | 3 | 11 | 29.2% | 22.1% | 7% | 3.7% | 12.0% | -8% |
| Malaysia | 44 | 61 | 63.7% | 30.8% | 33% | 20.4% | 19.0% | 1% |
| Russia | 31 | 45 | 50.6% | 88.7% | -38% | 5.0% | 55.0% | -50% |
| Saudi Arabia | 21 | 45 | 67.8% | 36.4% | 31% | 14.7% | 15.8% | -1% |
| Slovenia | 6 | 3 | 49.3% | 62.7% | -13% | 6.9% | -1.5% | 8% |
| Viet Nam | 19 | 37 | 33.4% | 39.3% | -6% | 22.9% | 18.0% | 5% |

Note: The table excludes financial companies. State owned enterprises (SOEs) are identified as companies where governments own at least 20% of the capital. Non-SOEs are identified as companies with less than 20% government ownership. Leverage is computed as the 5-year average of $\frac{\text{long-term debt}_t}{\text{total capital}_t}$ and performance as the 5-year average of $\frac{\text{net income}_t}{\text{total capital}_{t-1}}$. The columns "difference" report the average leverage (performance) in SOEs minus average leverage (performance) in non-SOEs. The markets in the in the figure have at least 20% of its companies defined as an SOE.

Source: OECD Capital Market Series dataset, FactSet.

These findings lend themselves to the interpretation that there may be little evidence that SOEs in general, insofar as they enjoy benefits from their ownership, translate this into either high performance or a cushioned balance sheet. Rather, they could be underperforming in both respects and avoid having to take corrective action or exit the market due to a continued support from the state. An alternative interpretation might be that SOEs tend to be concentrated in areas and sectors that are often avoided by private investors on account of low profitability.

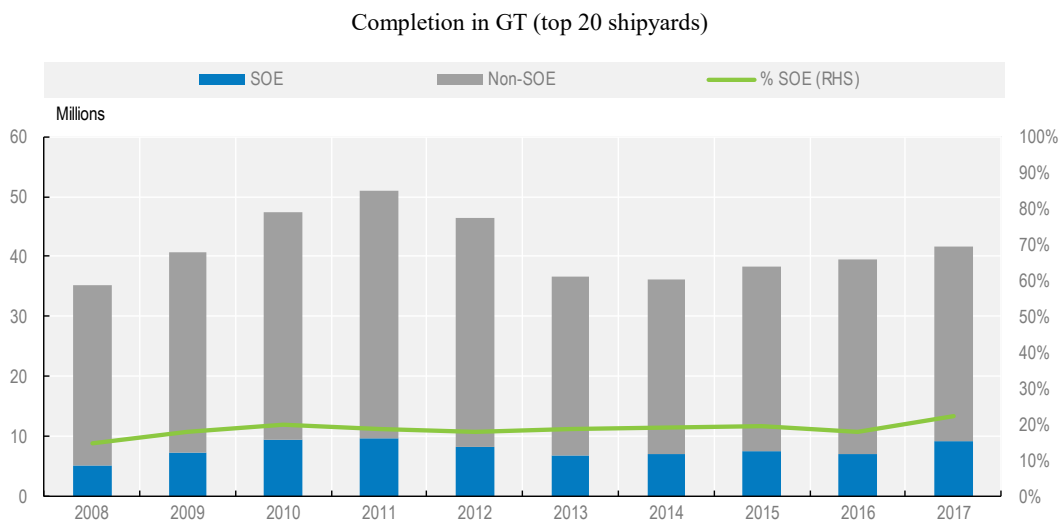
4.2. State-owned enterprises and the maintenance of a vibrant competition landscape

This section sheds light on two important trust-related aspects of SOEs' conduct in competitive markets. First, is there a risk that they could benefit from their ownership to crowd out more efficient competitors? If this is the case it can take a multitude of forms, including outright market-distorting subsidies, artificially low rates of return or a privileged position in their domestic markets. An illustrative case arises from the steel and shipbuilding sectors where it is frequently alleged that SOEs contribute to a persistent overcapacity in international markets. Secondly, SOEs actions in competitive markets, including their commitment to a level playing field and compliance with competition law more generally, is an area of interest. State-owned enterprises are overseen by politicians and/or high-level government officials and are widely perceived as setting the “tone at the top” in national corporate landscapes. Examples of unhealthy competitive practices by SOEs are liable to lead to a loss of public trust in the state as well as in the business sector.

4.2.1. The presence and financial performance of SOEs in the shipbuilding and steel industries

The widespread presence of the state in the shipbuilding and steel markets has raised concerns related to the beneficial treatment that state-owned enterprises possibly receive from their governments, the market-distortions that such treatment can generate, and the implications for excess capacity in these sectors. While definitions of SOEs vary and might not cover the full extent of state control, available indicators for shipbuilding and steel suggest a significant presence of the state in these two sectors.

Figure 4.4. Ship completions by state-owned and other firms, 2008-2017



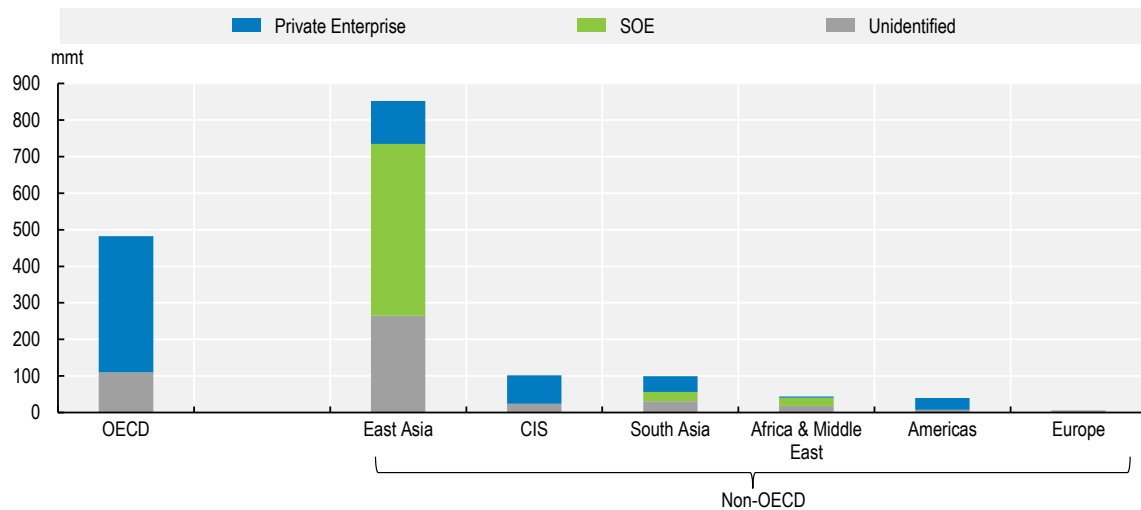
Source: OECD calculations based on Clarkson World Fleet Register database.

The studied sample comprises the world's 20 largest yards, and it follows the definitions of the Clarkson World Fleet Register database concerning whether a given company is considered as an SOE. The data show that SOEs play a large role in the global shipbuilding industry, with seven SOEs among the top 20 companies by completion in gross tonnage (GT) terms. These seven SOEs, all of which are located in China, represent 22% of total

ship completions of the top 20 companies. The share of SOEs in ship completions has fluctuated slightly, from 15% to 22% over the last decade (Figure 4.4).

The steel industry is more geographically diverse than shipbuilding, with hundreds of companies in around 100 economies involved in crude steel production. Similar to shipbuilding, the state accounts for a large share of the sector's output. In 2016, state enterprises produced at least 522 mmt of crude steel in 2016, accounting for at least 32% of global crude steel production that year.⁴ In addition, 22 of the world's largest 100 crude steel-producing companies were either directly or indirectly linked to some degree of state ownership. Steel production by state enterprises takes place entirely in non-OECD economies, particularly in East and South Asia as well as in the Middle East.

Figure 4.5. Steel production by state-owned enterprises and other firms, 2016



Note: The chart represents 2016 steel production figures (mmt) at regional level by ownership type. The column on the left group together the total crude steel production for all OECD/EU economies. Columns on the right side include production data for all non-OECD/EU economies by region. Figures for SOEs and Private Enterprises refer to crude steelmaking production for the top 100 steelmaking companies. "Unidentified" stands for all the remaining crude steel produced by companies that are not in the list of the 100 largest steelmakers. *Source:* OECD calculations based on data from the World Steel Association and ORBIS (OECD (2018c)).

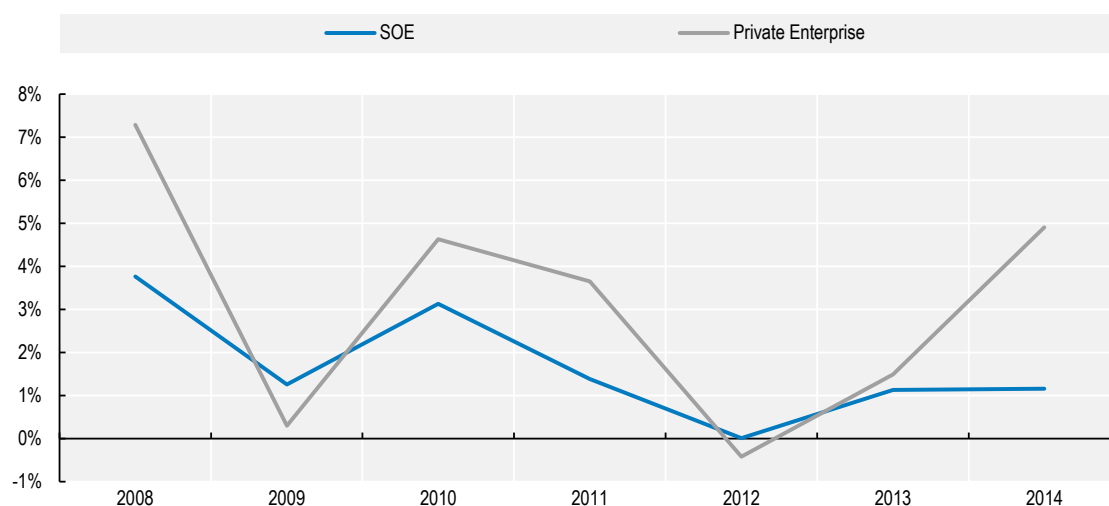
Are state owned steel firms less profitable than their private counterparts?

Firm-level data containing information on ownership and financial indicators shows that state enterprises in the steel sector are characterised by a lower level of profitability (Figure 4.6). This is backed-up by recent work within the OECD Steel Committee which shows that, after controlling for a number of aspects that can influence firms' financial performance, there is a negative and statistically significant relationship between state ownership status and profit margins, suggesting that state enterprises are less efficient than private entities at least when it comes to steel (OECD, 2018c). Such inefficiencies in steel state enterprises may arise from governance, suboptimal incentives to public management and/or relaxed budget constraints associated with public support or lax regulation.

While there may be rationales for state ownership, concerns have been raised regarding the potential lack of transparency and preferential treatment granted to SOEs. This may result in distortions and contribute to excess capacity in some sectors. In the steel sector, recent research shows that most of the plant closures in recent years have affected private

companies, despite their higher average profitability (see Table 4.2). Data on recent investments in steelmaking capacity around the globe also suggest that a considerable share of planned and on-going capacity investments are being implemented (Table 4.3). Here the picture is more mixed: both SOEs and private enterprises plan or are currently implementing, such investments. The data do, however, suggest that going forward the balance between capacity in OECD and non-OECD countries is likely to tip further toward the latter.

Figure 4.6. Profit margins by ownership type



Note: The chart compares the average net profits of all SOEs companies, with the average net profits of an equivalent number of private enterprises with the same characteristics.

Source: OECD calculations based on data from ORBIS.

Table 4.2. Capacity closures by ownership type

Data covers 2016 and 2017

| | Number of closures | | Capacity closed (mmt) | |
|----------|--------------------|---------------------|-----------------------|---------------------|
| | SOEs | Private Enterprises | SOEs | Private Enterprises |
| OECD | 0 | 11 | 0 | 13.4 |
| non-OECD | 14 | 16 | 7.6 | 8.7 |

Source: OECD (2018c).

Table 4.3. Investments in new steel capacity by ownership type

Crude steelmaking capacity investment projects (expected to be) deployed between 2012 and 2025

| Capacity (mmt) | Operating/Underway | | | Planned | | |
|-----------------|--------------------|---------------------|--------------|---------|---------------------|--------------|
| | SOEs | Private Enterprises | Unidentified | SOEs | Private Enterprises | Unidentified |
| OECD | 0 | 25.8 | 1.9 | 0 | 24.9 | 11.1 |
| non-OECD | 152.7 | 120.3 | 46.2 | 97.4 | 133.2 | 22.1 |
| No. investments | SOEs | Private Enterprises | Unidentified | SOEs | Private Enterprises | Unidentified |
| OECD | 0 | 15 | 4 | 0 | 9 | 9 |
| non-OECD | 70 | 89 | 52 | 41 | 50 | 34 |

Source: OECD (2018c).

4.3. State ownership and competition regulation

4.3.1. *Competitive neutrality*

The issues that have arisen in steel markets are just one example of the types of competitive distortion that can result from misguided intervention by governments. To guard against these risks, governments can establish rules for competitive neutrality in order to help build trust in a level playing field – i.e. ensuring that no enterprises are advantaged, or disadvantaged in a way that prevents, restricts or distorts competition within a market. Such rules consider the competitive effect of actions by government that create an advantage or disadvantage based on an enterprises' ownership and legal status, as well as the location of their activities or head office, their public service obligations, their importance as a major employer, their proximity to the state power, their systemic importance, their market dominance, or their charitable status. A related distortion of the competition landscape may occur where SOEs – typically within the financial sector – are used by their government owners to grant subsidies and other concessionary treatment to private companies (or other SOEs) active in competitive markets.

Where markets are distorted by such factors, consumers may find it worthwhile to purchase from less efficient firms, and even where efficient firms did manage to survive and thrive, they might face less competitive pressure and thus set higher prices or innovate less. Furthermore competitors in the market might not be able to trust that their comparative advantage will not be artificially diminished, thereby reducing their incentive to invest.

Prominent examples of countries with rules on these matters include a comprehensive competitive neutrality framework in Australia, the implementation of which is overseen by an autonomous body, the Productivity Commission. Specific rules on anticompetitive conduct by SOEs are moreover in place in Sweden and other Nordic countries. In some countries, competitive neutrality principles are enshrined in the constitution (e.g. Brazil, Chile, Mexico and the Russian Federation). In most jurisdictions, competition authorities have “soft” powers allowing them to recommend changes in regulatory framework or in legal provisions, which may lead to a distortion of competitive neutrality. China recently saw an introduction of such rules in its Fair Competition Review System.

Concerns have however been voiced as to whether purely domestic rules are sufficient and adequate. This question has come up for instance when companies domiciled in strictly rules-based domestic environments face international competition from firms that are not subject to similar constraints. This might justify an international approach to rule making. Indeed, rules on competitive neutrality do already exist at an international level, for example the European Union has wide-ranging state aid rules as well as public procurement directives.

The WTO also has rules on subsidies and a general procurement agreement. Though complaints and enforcement under WTO rules operate at a governmental level and are not open to enterprises themselves. Enforcement and complaints under EU State aid rules are not limited to the governmental level. Given the possible impact of state aid on competition, enterprises play an important role. They can lodge complaints with the European Commission against state aids granted by an EU Member State, and can also intervene during formal investigation procedures on state aid cases. If a State is found to have granted unlawful state aid, the benefitting enterprise has to pay it back, which resolves the distortion by removing the aid, rather than allowing other States to match it, and thereby prevents expensive subsidy battles. An overview of tools and mechanisms for maintaining a level playing field in some economies is provided in Table 4.4.

Table 4.4. Examples of measures to ensure a level playing field amid state ownership and controls

| Distortion | Tools | Jurisdiction | Relevant Authority |
|---------------------------------|---|-----------------|---|
| State- controlled market player | Corporate governance | Italy | Competition Authority |
| | Transparency rules (legislation & guidelines) | European Union | n.a |
| | Rationalise the number of SOEs | Chinese Taipei | Task Force for Facilitating Privatization of Public Enterprises |
| | Tax neutrality, Rate of return policy for public undertakings | Spain | Ministry of Economic and Finance |
| | Debt neutrality | Australia | Australian Government |
| Public service obligations | Open, fair and transparent bidding process | Australia | Australian Government |
| | Accounting separation rules | European Union | European Commission |
| | Reimbursement for public service obligation rules | European Union | European Commission |
| | Structural separation | Sweden | Competition Authority |
| | Access equality | The Netherlands | Competition Authority |
| | Benchmark for compensation, accounting for public service obligation | Hungary | State Aid Monitoring Office |
| Subsidies | Ex ante and ex-post state aid control (including the possibility to order the benefitting enterprise to reimburse unlawful state aid) | European Union | European Commission |
| | Mechanism to supervise the use of public funds | Spain | General State Controller, Regional Controllers |
| Sectoral regulation | Regulatory impact assessment | Finland | Competition Authority |
| | Market studies and advocacy | United Kingdom | Competition Authority |
| | Ex ante policy co-ordination | Japan | Competition Authority |
| | Disapply or denouncing the regulation | Peru | Competition Authority |
| | Judicial review | Italy | Competition Authority |

Source: Authors' compilation, based on OECD (2015b).

The perhaps most frequently aired complaint about an uneven playing field relates to SOEs' supposedly easier access to finance. At issue is SOEs access to credits from state-controlled financial institution, as well as more broadly the fact that private banks are often willing to make funds available at preferential rates due to actual or perceived state guarantees for SOE debt. This could be linked to a broader corporate issue, as SOEs tend to be significantly larger than private firms. Small and medium-sized enterprises (SMEs) are often thought to be at a competitive disadvantage in their access to bank credits which, insofar as this reflects discrimination rather than a higher default risk among the SMEs, adds an important additional dimension to concerns about a level playing field.

4.3.2. Anti-trust enforcement in the presence of SOEs

Rigorous antitrust enforcement, applied regardless of ownership, nationality, legal or financing status, plays a key role in levelling the playing field. For instance it directly addresses those cases where a dominant firm, whether it be a privately owned enterprise, or a domestic or foreign state owned enterprise is able to distort competition to exclude rivals. However, investigations against SOEs can pose a variety of challenges due to the distinctive nature of SOEs, and additional difficulties can emerge when foreign SOEs are involved.

An initial challenge is that, as most competition standards are based on enterprises having profit maximising objectives and facing a level playing field, neutral enforcement might require adapting the analytical tools typically applied in competition proceedings to reflect the advantages that SOEs may benefit from. For example, in the case of predatory pricing

strategies, SOEs' characteristics and privileged position can affect their costs, and thus the use of recoupment tests and cost-benchmarks for enforcers.

In the assessment of specific anti-competitive behaviours, another challenge can arise when defining the SOE's economic entity in mergers and antitrust cases, as the extent of the State's involvement in the SOE's decision-making process is not always clear-cut. This aspect will also influence the calculation of turnover, central to establish the need for notification of a merger or the appropriate fine in a cartel case. These considerations are particularly relevant when SOEs are involved in cross-border cases, as governance systems might vary and their functioning may be difficult to grasp correctly.

Different accounting standards for SOEs and lack of transparency regarding costs can also make it burdensome for agencies to obtain relevant information from SOEs, on which to base their assessment. Moreover, effective enforcement against anticompetitive conduct by SOEs also requires effective sanctions for such entities. However, fines may be less effective deterrents to anticompetitive conduct by SOEs that can pass them onto taxpayers. Finally, SOEs might also have means to obstruct proceedings if their government ties play a role, e.g. in the form of possible explicit or implicit government pressure during an investigation against an SOE. It is therefore important to maintain the independence of competition authorities.⁵ Table 4.5 provides examples of a number of cases where the relevant competition authority had to address issues linked to the involvement of one or more SOEs, domestic or foreign, in the investigation.

Table 4.5. Recent competition enforcement involving SOEs

| Issue | Case | Type | Conduct | Jurisdiction |
|--|--|----------|---|----------------------------|
| Definition of the economic entity | China Ocean Shipping Tally Shenzhen/China United Tally (Shenzhen) ¹ | Domestic | Cartel | People's Republic of China |
| | EDF/CGN/NNB Group of Companies ² | Foreign | Merger | European Union |
| Involvement of foreign SOEs: definition of the economic entity and weight of a foreign state's interpretation of its own legislation | Vitamin C: Animal Science Products, Inc. v. Hebei Welcome Pharmaceutical Co., 585 U.S. | Foreign | Cartel | United States |
| Involvement of foreign SOEs: access to information | Gazprom ³ | Foreign | Abuse of dominance | European Union |
| Involvement of foreign SOEs: application of the act of state doctrine | ESSA/Mitsubishi ⁴ | Foreign | Exclusive distribution agreements | United States |
| Cost-benchmarks used in predatory pricing | Deutsche Post AG ⁵ | Domestic | Predatory pricing | European Union |
| Effectiveness of sanctions | South African Airlines (multiple cases) ⁶ | Domestic | Abuse of dominance and cartel behaviour | South Africa |

1. Decision at http://samr.saic.gov.cn/gg/201807/t20180720_275163.html (Chinese only).

2. Case No. COMP/M.7850.

3. Commission decision of 24.05.2018, Case AT.39816 – Upstream gas supplies in Central and Eastern Europe.

4. Sea Breeze Salt, Inc. et al. v. Mitsubishi Corp. et al., CV 16-2345-DMG, ECF No. 45 (Aug. 18, 2016) and Sea Breeze Salt, Inc. v. Mitsubishi Corp., No. 16-56350 (9th Cir. 2018).

5. Case COMP/35.141.

6. See South Africa contribution paper to OECD 2018 Roundtable on Competition Law And State-Owned Enterprises.

Source: Authors' compilation.

As neutral enforcement of merger control and antitrust rules has an important role in helping achieve competitive neutrality, factors that can create challenges for competition authorities and potentially lead to under or over-enforcement need to be constantly taken into account and assessed on a case-by-case basis. This will help to send a signal to all enterprises that anti-competitive conduct will be prosecuted, thus building trust in the existence of a level playing field.

4.4. The risk of corruption and irregular practices in the state-owned sector

State-owned enterprises have figured prominently in corruption-related prosecutions in recent years. The majority of bribe payments aimed at foreign public officials that were detected between 1999 and 2014 were destined for SOE employees and managers (OECD, 2014).⁶ A recent OECD survey of board members and senior management in hundreds of large, economically significant SOEs showed that almost half of the companies (and 42% of the individuals) had witnessed corrupt acts or related irregular practices within their organisations in recent years (OECD, 2018a).

Citizens, as the ultimate shareholder, should be able to trust that SOEs and the state owner limit the potential for the abuse of SOEs or by SOEs for private gain. In turn, an active and professional state owner should expect that SOEs are behaving in line with state requirements and laws, including those relating to integrity and anti-corruption. SOEs should expect that state representatives will not seek to unduly influence the company's operations. Failing at any one of these outcomes can mean a simultaneous loss of the public's trust in SOEs and the state. The achievement of such outcomes – mitigating the omnipresent risk of corruption and embedding integrity in the SOE sector – is ultimately a job for both SOEs and their state owners.

4.4.1. *What are the reputational and economic fallouts of SOE corruption?*

The benefits of SOE ownership are economic, political and social – and so too are the costs of SOE corruption and irregular practices. The costs borne by SOEs or the state (and even society) can come in the form of sanctions, diversion of funds to illicit purposes or in foregone productivity gains of unfair market competition among others. Corruption or exploitation of SOEs can impact the delivery of critical public services. It can be damaging for political officials or entities responsible for SOE oversight and detrimental to the public's faith in democratic processes and institutions. Recent corruption-related scandals have shown how quickly trust in SOEs and the state as owner can be damaged.

Recent examples include two SOEs that were the targets of two of the largest FCPA enforcement actions of all time. The “Operação Lava Jato” (“Operation Car Wash”), putting Brazil's state-owned oil company, Petrobras, at the centre of an extensive transnational bribery scheme involving multiple Brazilian construction conglomerates. Operation Car Wash had a chilling effect on the perceptions of society regarding politicians and political processes. With convictions of political figures, the scandal has reinforced the perception among many that the government is not acting in the public interest but for private interests (OECD, 2018b).

In another highly publicised case the SOE, somewhat more unusually, appeared as the bribe payer. In 2017, Swedish state-owned telecommunications company Telia was handed the largest global settlement of the time, amounting to USD 965 million, for violating the FCPA and making corrupt payments related to its market entry into Uzbekistan in 2007. Telia suffered not only financial losses. After receipt of the 2017 settlement, Telia's

President and Chief Executive referred to the company’s efforts, following management and leadership changes in 2013, to “regain trust from all [our] stakeholders”, citing it as “a never-ending journey as we aspire to embed this into our culture making sure that all employees understand the importance of doing the right thing all the time” (Telia, 2017).

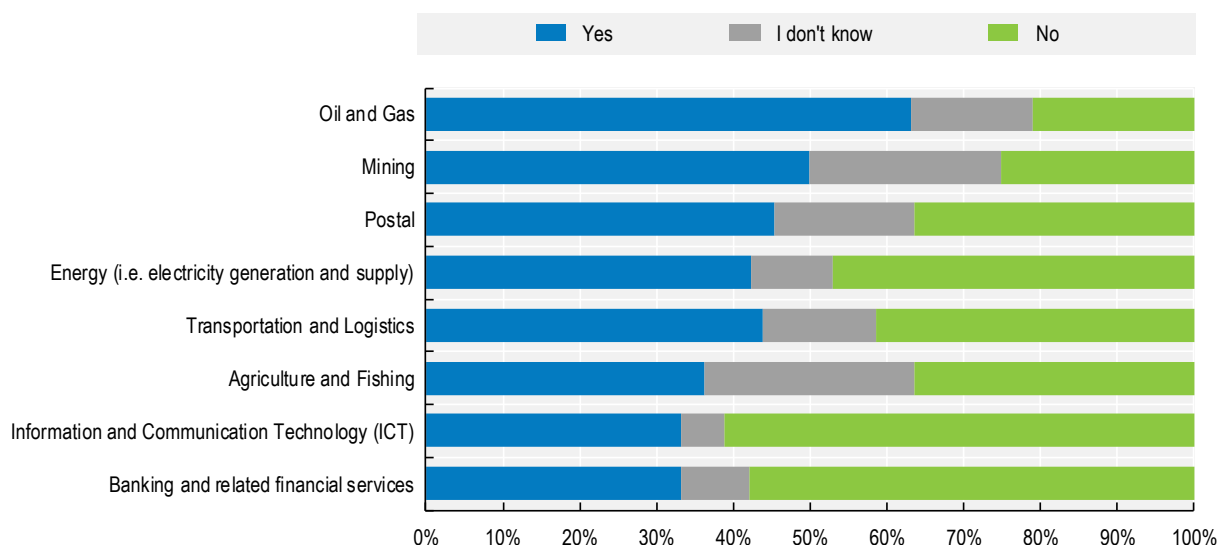
4.4.2. What are the main risks of corruption and other rule-breaking in SOEs?

SOEs face corruption-related risks that are both external and internal to the company. As mentioned, almost half of the surveyed SOEs reported that such risks materialised in their company in the last three years. Such occurrences resulted more likely from the override of or ignorance to controls, rather than their absence. Indeed, SOEs reported that their main obstacles to improving integrity in their company as (i) a lack of a culture of integrity in the political and public sector; (ii) a lack of awareness among employees of the need for, or priority placed on, integrity, and (iii) opportunistic behaviour of individuals.

When it comes to the likelihood of rule-breaking there are important sectoral differences between SOEs. The 2018 report showed that SOEs in the oil and gas sector are particularly likely to have experienced corruption and other irregularities, followed by mining and the utilities sectors (Figure 4.7). A straightforward interpretation is that the incentives and opportunity for corruption are greater in SOEs that handle large financial flows, whether in the form of concessions or large-scale public procurement projects.

Figure 4.7. Those who reported witnessing corruption and other irregular practices, by sector of respondent

Sectors of respondents that said “yes” to “in your assessment, did any of the [listed] risks materialise into activities/actions in the last three years in (or involving) your company?”



Note: Based on 289 responses falling into the retained 8 categories with more than 10 respondents.

Source: OECD (2018b).

Not all types of rule-breaking are equally likely to materialise, or equally damaging if they do materialise, and may depend on sector and country of operation. OECD (2018b) provides a heat-risk mapping of corruption-related risks of the surveyed SOEs for their likelihood of occurrence and theoretical impact. The aggregated survey data showed that receiving bribes is considered more likely than offering bribes. This is consistent with the

aforementioned Foreign Bribery Report findings. SOEs are also concerned about risks that, while not explicitly corruption, may be representative of control weaknesses or vulnerabilities of the company.

SOEs' exposure to corruption may be influenced by SOEs ownership or market position, often in high-value sectors with frequent transactions. Opportunistic actors may feel protected by a perception that SOEs may be insulated by state ownership, or seek to exploit an SOEs' market-dominant position or involvement in the delivery of public services. Moreover, SOEs are protected from a threat of bankruptcy or hostile take-over that private companies face. Risks of corruption in SOEs may or may not be qualitatively different from private firms, but the OECD survey found that SOEs in some cases appear less able or less willing than private firms to avoid known high-risk activities.⁷ Table 4.6 shows that private firms were approximately twice as likely as SOEs to take decisions that mitigate known risks of corruption.

Table 4.6. Actions taken by SOEs in the face of corruption risks

| Action | SOEs | Non SOEs |
|---|------|----------|
| Respondents said their companies have ceased business operations in a particular jurisdiction because of the integrity or corruption risks involved | 12% | 39% |
| Respondents that said their companies have taken internal remedial/disciplinary action following violation of your organisation's integrity or anti-corruption policies. | 46% | 70% |
| Respondents said their companies have substantially revised at least one business project because of the corruption and integrity risk(s) involved. | 30% | 66% |
| Respondents that said their companies severed a relationship with at least one business partner (e.g. supplier, service provider) because of the risk of exposure to or engaging in corruption. | 32% | 66% |

Note: This analysis is done on 261 individual responses – not by company. Broad comparisons made with a survey of non-SOEs where the number of respondents was 57.

Source: OECD (2018b).

4.5. Concerns about threats to essential security interests resulting from SOEs' operations abroad

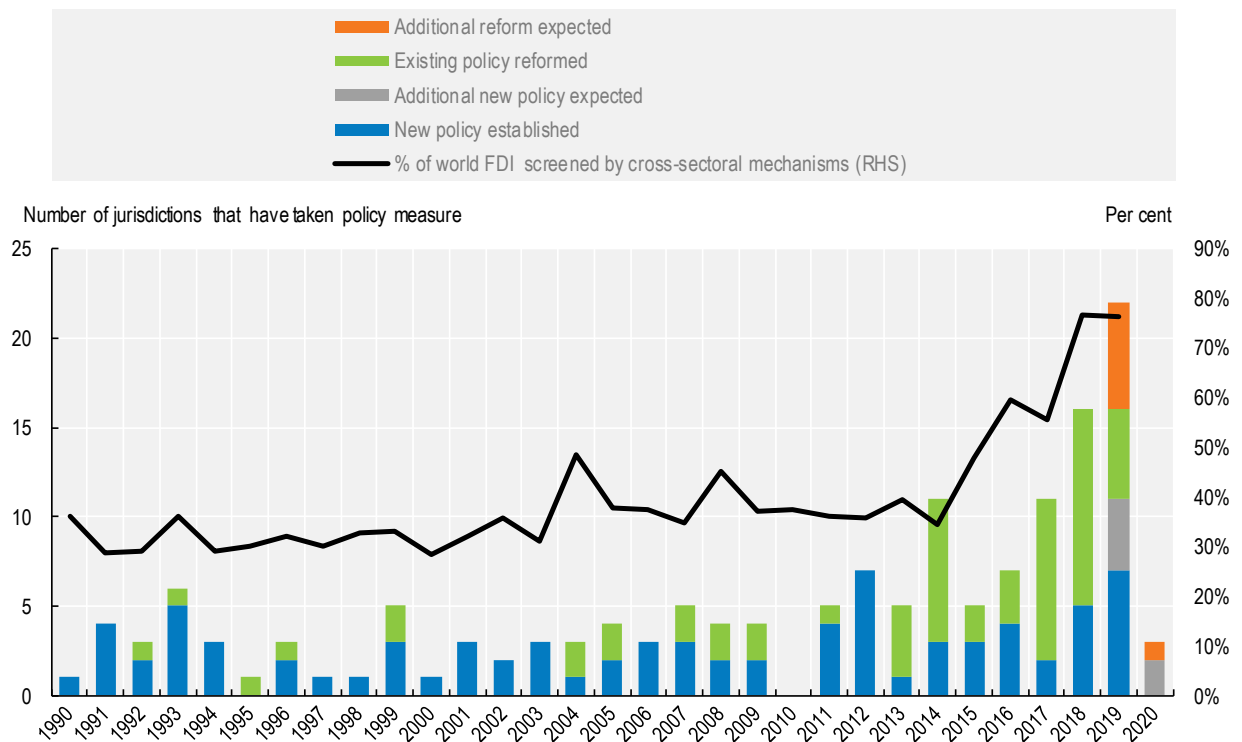
Governments that own enterprises most often pursue specific policy objectives with these enterprises. These may include non-commercial objectives such as safeguarding their essential security interests, for instance by keeping closer control over critical infrastructure operated by these enterprises; or ensuring availability and supply under volatile or adverse market conditions that private owned companies may not be able to withstand for longer periods. Many of these objectives are legitimate when and where they are associated with the home country of a given SOE.

When SOEs are allowed or encouraged to operate abroad, host countries of their investments may perceive some of these non-commercial objectives in a different light: the intentions and objectives of the home country may conflict with the essential security interests of the host country of SOEs' investments. Also, the host country may suspect that the foreign SOE may threaten its essential security interest directly. It could perceive the SOE as a front used by the home government for espionage or sabotage; could fear that a strong position of the foreign company in certain sectors may be used to exert pressure on the host government; or limit sources of supply of critical infrastructure, products or services.

The awareness of threats to essential security interests stemming from economic integration and in particular foreign ownership of certain assets has increased globally. The origin of investments from less than transparent economies or investments made by State-controlled entities play an important role in the risk assessment of open economies in which such investment may take place. Technological change, the vulnerabilities created, transmitted or aggravated by advanced technology, and the importance and use of data for various, including nefarious purposes, have recently attracted particular attention and heightened attention on the security implications of certain investments. A more assertive stance of some countries in global economic and strategic competition has likely also contributed to greater awareness and concerns about countries' interests, modes of operation, and resulting threats to essential security interests that may be associated with international investment.

This awareness is documented by a steep increase in the number of countries that have established or strengthened policies to manage acquisition- or ownership-related risk to their essential security interests. In the past two years, nine out of the world's ten largest economies have taken such policy measures, and many smaller economies have likewise introduced such policies since 2017, many for the first time. As a consequence, since around 2009, the share in global FDI inflows subject to cross-sectoral investment screening to safeguard essential security interests has doubled from around 40% to 80% of total global FDI inflows now (Figure 4.8).

Figure 4.8. Investment policy measures to safeguard essential security interests



Note: Data for 2018 and 2019 are based on OECD projections.

Source: OECD; FDI data based on IMF and OECD Foreign Direct Investment Statistics database; data for 2018 and 2019 OECD projections.

Countries' policies reveal the perception of threats as they set out the characteristics of transactions that they subject to review. Collectively, policies contain almost as many

different acquirer-related aspects as they mention asset-related features, showing that for their perception of risk, the identity and features of the acquirer matters quite a bit. Foreign state ownership of the acquirer specifically is explicitly identified by a number of countries, suggesting a latent distrust about the intentions that foreign governments and their SOEs have when investing abroad. The number of jurisdictions singling out state-ownership explicitly on the face of their policies has grown steadily.

Numerous countries have become increasingly concerned about SOEs motivation for foreign investment. Accordingly, several jurisdictions have revised their respective foreign investment policies by distinguishing between state-owned and private entities. The European Union has also included government control, including through significant government funding, as a factor that EU Member governments may consider in their assessment.⁸

Policies that seek to safeguard countries' essential security interests from threats associated with inward investment are expected to evolve quickly in the next years. A number of jurisdictions – including five of the G7 Members – have signalled their intentions to introduce new policies or are working on reforms to strengthen their mechanisms. Some of these changes are transformational and include controls over outward flows of sensitive technology and permanent surveillance of certain assets to address latent risks of critical infrastructure. There are also plans in some jurisdictions to take critical assets into state-ownership or control them through “golden share” arrangements – an approach reminiscent of a situation that prevailed before large-scale privatisation of such assets in the 1980s that created the exposure in the first place.⁹

4.6. OECD initiatives to ensure a level playing field

The OECD is engaged in numerous activities aimed at improving the governance of SOEs and enhancing the levels of trust in SOEs among competitors and the public. This work centres on encouraging the implementation of the OECD Guidelines on Corporate Governance of State-Owned Enterprises, the world's only internationally endorsed recommendation on good ownership practices by the state. The Guidelines have been publicly endorsed by all OECD member countries as well as Argentina (for an overview, see Box 4.1).

4.6.1. Ensuring competitive neutrality

As previously noted, the state may not only distort the level playing field by favouring entities that it controls, or by allowing those entities to abuse their market power, it may also take actions as a buyer, regulator or supporter that can distort competition in markets in which it does not compete. Where the distortion is caused by governments' actions as a buyer of services these can be addressed by following the OECD recommendation on public procurement. Meanwhile those caused by the state's actions as a regulator can be addressed using the existent OECD Competition Assessment Toolkit.

Further work is therefore currently underway in the OECD, where the Competition Committee is in the process of looking at developing possible principles of competitive neutrality that countries should seek to apply.

4.6.2. Transparency and disclosure

A key aspect of maintaining trust in the level playing field is for economic actors to be subject to high standards of transparency and disclosure as it ensures that owners/shareholders can hold the boards and management accountable; it fosters investor confidence and lowers risk; and ensures a level playing field between market participants.

Box 4.1. OECD Guidelines on Corporate Governance of State-Owned Enterprises

The *OECD Guidelines on Corporate Governance of State-Owned Enterprises* are recommendations to governments on how to ensure that SOEs operate efficiently, transparently and in an accountable manner. These are their main tenets:

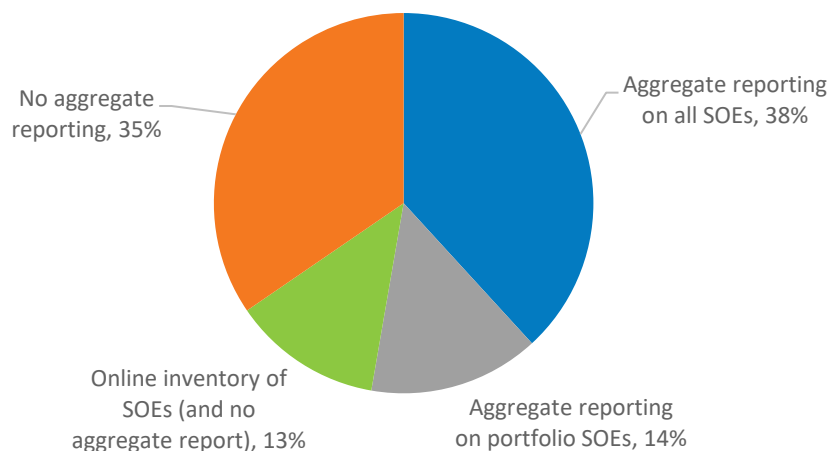
- The state should disclose the **rationales for state ownership** to the general public, who are the ultimate owners of SOEs. The purpose of state ownership should be to maximise value for society.
- The **state as an owner** should be professional, transparent and accountable.
- SOEs should compete on a **level playing field** with private companies. State ownership and regulatory functions should be separate to avoid conflicting objectives.
- Non-state **shareholders should have equitable treatment** and equal access to corporate information.
- SOEs should respect stakeholders' rights and implement high standards of **responsible business conduct**.
- SOEs should be subject to the same high standards of **accounting, auditing and disclosure** as listed companies.
- SOE **boards of directors** should have the mandate, autonomy and independence to set enterprise strategy and oversee management, absent of political interference.

Source: Adapted from OECD (2015).

Transparency of course involves corporate financial and non-financial disclosure, but equally important is the quality of auditing which is instrumental in building trust in the disclosed information. The OECD consensus implies that SOEs may be audited by state auditors, but should also be subject to independent external audits. Recently, however, the risk of a weakened competition in an audit sector comprising a shrinking number of global firms, as well as apparent conflicts of interest of auditors who sell a wide array of non-audit services to the corporate sector, have given rise to some concerns in this respect.

Since the adoption of the Guidelines on Corporate Governance of State-Owned Enterprises over a decade ago, many countries around the world have instituted reforms leading to increased transparency in the state-owned enterprise sector, both at the level of individual SOEs and at the level of the state. Heightened disclosure practices have often occurred in tandem with other trends, including the professionalization of the state-ownership function, SOEs' corporatisation and the listing of some SOEs on stock exchanges. In a majority of OECD's member and partner countries annual reporting on SOE portfolios (or at least some aspects of SOE portfolios) are now an enshrined practice (Figure 4.9).

Ensuring adequate transparency and disclosure of the state-owned enterprise sector has gained importance beyond the domestic reform agenda. This is because over the past decade the global economy has witnessed an increase in SOEs' international trade and investment activity, and an increasingly number of SOEs are essentially operating as multinationals. At the international level, recent firm-level analysis confirms that there is still a general lack of information or disclosure by SOEs (OECD, 2019b; Transparency International, 2016), which in turn has contributed to concerns about SOEs perhaps operating abroad according to non-commercial considerations.

Figure 4.9. Regular reporting on SOE portfolios by the state (55 contributing countries)

Source: OECD (2018d).

Further OECD initiatives are underway to address these issues. The Working Party on State Ownership and Privatisation Practices will be developing best practices for disclosure by individual SOEs and by their government ownership. In a world where SOEs figure increasingly prominently in debates about international trade and investment, the implementation of such guidance will be an important step toward building trust, at home and abroad.

4.6.3. Fighting corruption

Avoiding corruption in SOEs is primarily the responsibility of the State as an enterprise owner, but at the same time the state cannot be overly intrusive or intervene on an ad-hoc basis without jeopardising the rules of good corporate governance. An active and informed ownership, exercised on a whole-of-government basis in accordance with the OECD Guidelines on Corporate Governance of State-Owned Enterprises, remains essential. Many state owners have clear rules and expectations in place to promote integrity and prevent corruption in their companies.

But more can and should be done. Some of the most problematic cases of SOE corruption have been attributed to a more widespread lack of integrity in the public sector, including among those charged with exercising ownership over the SOEs. It is vitally important for policy makers and high-level public officials to implement high standards of integrity throughout the public sector.

The OECD has adopted a new recommendation, titled “The Anti-Corruption and Integrity Guidelines for State-Owned Enterprises” (OECD, 2019a).¹⁰ These Guidelines are the first international instrument to offer states, in their role as enterprise owners, support in fighting corruption and promoting integrity the enterprises they own (see Box 4.2). They supplement and complement existing global standards providing good practices for fighting corruption and ensuring integrity. Their implementation will be a vital step toward building public trust in SOEs and public officials involved in their operations.

Box 4.2. Main building blocks of the Anti-Corruption and Integrity Guidelines for SOEs**Integrity of the state**

- Apply high standards of conduct to those exercising ownership of SOEs on behalf of the general public.
- Establish ownership arrangements that are conducive to integrity.

Ownership and governance

- Ensure clarity in the legal and regulatory framework and in the State's expectations.
- Act as an informed and active owner with regards to integrity in SOEs.

Corruption prevention

- Require adequate mechanisms for addressing risks of corruption.
- Require adoption of high quality integrity mechanisms within SOEs.
- Safeguard the autonomy of SOEs and their decision-making bodies.

Corruption detection and response

- Establish appropriate accountability and review mechanisms for SOEs.
- Taking action and respecting due process for investigations and prosecutions.
- Invite the inputs of civil society, the public, media and the business community.

Source: Adapted from OECD (2019a).

Ensuring national security

The OECD investment policy community hosts inclusive dialogue on acquisition- and ownership-related policies to safeguard essential security interests and their effect on international investment. This dialogue began in 2006 and is being stepped up now to meet the great demand for policy advice. It sensitises governments for the second-order effect that such policies can have on international investment and endeavours to forge consensus on policy disciplines and good practice to complement the 2009 Guidelines for Recipient Country Investment Policies Relating to National Security were a first milestone on this path. Beyond agreed policy disciplines, international cooperation in implementation will become ever more important now that many countries have introduced review mechanisms to manage potential threats. Such cooperation is likely to include harmonisation of standards across countries to provide a coherent signal to enterprises, how they can diminish their risk profile in relation to acquisition- and ownership-related policies to safeguard essential security interests. State-owned enterprises, which are particularly exposed to such policies in some countries, would then be given a clear signal about host government expectations.

4.7. Challenges and outlook

The outlook is for a continued increase in the importance of SOEs in the international economy. It follows from the structurally high growth rates in economies where state ownership is widespread. Many of these countries have privatisation programmes that are

reducing the number of SOEs, but their effect is generally outpaced by the volume growth of the enterprises that remain state owned.

This need not give rise to concern. The position of the OECD is that state ownership of commercial firms is not a problem insofar as these firms are held to high standards of governance and transparency, as recommended by several OECD instruments. Decisions by respective governments to retain ownership of certain SOEs probably indicates that these enterprises are expected to act differently from private firms in some circumstances. Even this circumstance is not considered problematic if the “public policy objectives” of these enterprises are publicly disclosed and their costs covered in a transparent fashion. Clarity on when such public policy objectives outweigh competition objectives is also considered useful.

The changing geographic balance of the global SOE landscape may, however, pose a challenge as most of the fastest-growing SOEs are located in countries that are not party to the OECD consensus. These enterprises could be subject to a two-sided “trust deficit”, at home when they compete with domestic private firms, and in foreign jurisdictions where these enterprises may be little known or their ownership objectives poorly understood. High standards of governance and transparency should thus apply when SOEs internationalise their activities, thereby deflecting the risk of distorting a different economy where the public policy justifications for the distortions may not exist. The challenge of building trust is increasingly recognised by a growing number of emerging economy governments, some of whom have expressed public commitments to pursuing competitive neutrality and ensuring that SOEs respect the rule of law.

More could be done. The aforementioned OECD initiatives to raise transparency, improve investment regulation related to state ownership and fight corruption in SOEs will all benefit from the active involvement of OECD’s partner countries. Engaging in these undertakings can help countries to build confidence at home as well as among their main commercial partners. A multinational effort to build trust in state ownership will be key to safeguarding an open and competitive environment for trade and investment.

Notes

¹ Part of this growth is due to the fact that one SOE that appeared in the 2000 table was split into six, each of which appear separately in the 2017 table.

² Source: IJ Global. In this context infrastructure is defined to include power generation and transmission, transportation, and water and sanitation.

³ For note, leverage is defined in terms of long-term debt, so companies that have amassed large short-term arrears will not necessarily appear as highly leveraged.

⁴ See OECD (2018c). This paper defines a state enterprise as an entity where the state has significant control of corporate decisions through full or majority ownership, or a significant minority of voting shares

⁵ In this context, the EU has recently adopted a Directive, the objective of which is to ensure that competition agencies across Europe have the guarantees of independence, resources, and enforcement and fining powers necessary to apply competition law effectively, <http://data.europa.eu/eli/dir/2019/1/oj>.

⁶ The OECD Foreign Bribery Report (2014) found that 27% of foreign bribery cases concluded between 1999 and 2014 were destined for officials of SOEs (as compared to other public officials), amounting to 80% of the total value of bribes offered, promised or given.

⁷ An alternative explanation could be that a number of SOEs are legally or politically required to be active in certain economic sectors, which renders them incapable of ceding operations even if they do have concerns about compliance risk.

⁸ Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, <http://data.europa.eu/eli/reg/2019/452/oj>.

⁹ More details on current and emerging trends in acquisition-and ownership-related policies to safeguard essential security interests are set out in a research note by the OECD Secretariat of March 2019, www.oecd.org/investment/Current-and-emerging-trends-2019.pdf.

¹⁰ This work is being led by the Working Party on State Ownership and Privatisation Practices, with the cooperation of the Working Group on Bribery and the Working Party of Senior Public Integrity Officials.

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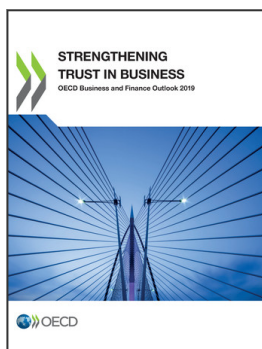
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