MANAGING FOREIGN SUBSIDIES IN THE EU

BY JOÃO AZEVEDO[1]

1 DG COMP, EU Commission. The information and views set out in this text are those of the author and do not necessarily reflect the official opinion of the European Commission. This paper updates and follows a previous contribution from DG COMP to the OECD on December 1, 2022: https://one.oecd.org/document/DAF/COMP/GF/WD(2022)40/en/pdf.

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In this paper, we describe the European Union's approach to control harmful effects of foreign subsidies on the EU internal market. The EU policy in this area is set out mainly in the EU State aid rules. The purpose has been to identify and avoid harmful support measures while allowing governments to continue to use State aid to facilitate the development of certain economic activities. The effect of subsidies has – to a limited extent - also played a role in the EU antitrust and merger policy. In recent years, the need for the control of EU State aid to be complemented by a control of subsidies granted by non-EU government has been increasingly recognised. The Commission identified a regulatory gap that is captured neither by existing competition, nor by trade instruments. The EU legislators agreed on a new Regulation on foreign subsidies distorting the EU internal market in 2022. This Regulation entered into force in January 2023. The Regulation lays down rules and procedures for investigating foreign subsidies that favour companies in a way that negatively affects competition in the EU internal market and for addressing such distortions and its main lines will be presented in this paper.

I. INTRODUCTION

In this paper, we describe the European Union's approach to control harmful effects of foreign subsidies on the EU internal market.

A new Regulation on foreign subsidies ("FSR") distorting the EU internal market was agreed on in 2022. This agreement followed the idea that the control of EU State aid needed to be complemented by a control of subsidies granted by non-EU governments that have an impact on the EU internal market, due to a regulatory gap identified by the Commission.

The agreed Regulation lays down rules and procedures for investigating foreign subsidies that favor companies in a way that negatively affects competition in the EU internal market and for addressing such distortions. There is a particular focus on large concentrations and large public procurement procedures for which notifications are required, but the Commission can on its own initiative launch investigations in any other economic activity for which a distortive foreign subsidy was granted.

The new Regulation will start to apply mid-2023. While this Regulation constitutes a unilateral approach to ensure a level playing field in the EU internal market, the EU remains firmly committed to developing the effectiveness of the multilateral framework in addressing distortions caused by subsidies.[2]

II. PAST EU POLICY ON SUBSIDY CONTROL

The EU policy in this area has been set out mainly in the EU State aid rules, that go back to the founding years of the Union in the 1950s. The EU State aid policy is based on the idea of establishing a level playing field between economic operators active on the internal market where goods, services, persons, and capital can circulate freely between Member States and where discrimination between economic operators is prohibited. If certain economic operators are unfairly favored over others by selective State (aid) measures, the playing field becomes uneven. State aid control as provided for in the Treaty of Rome was therefore conceived as a necessary complement to the free movement rules. In addition, State aid, when granted to companies that would not be rewarded by market forces alone, can provoke a misallocation of resources, decreasing the EU's competitiveness in an environment where global markets become more and more integrated and EU industry faces increasingly strong competition from abroad.

Over the decades, the EU has refined its State aid policy for example through a sophisticated set of guidelines and block-exemption rules. The purpose has been to identify and avoid harmful support measures while allowing governments to continue to use State aid to facilitate the development of certain economic activities.

III. FOREIGN SUBSIDIES IN TRADITIONAL COMPETITION LAW INSTRUMENTS

Under current EU competition law, foreign subsidies can – to a limited extent - be taken into consideration when assessing whether the recipient undertaking holds a dominant position under Article 102 TFEU or in the context of a concentration.

Economic and financial power has been considered relevant in several cases to assess the existence of dominance.[3] Given that foreign subsidies may strengthen the economic and financial power of undertakings, it follows that foreign subsidies may be taken into account when assessing whether the recipient undertaking is dominant under Article 102 TFEU or when assessing a concentration (i.e. to determine whether the concentration may create or strengthen a dominant position). This was confirmed in the RJB Mining ruling with respect to concentrations and State aid.[4]

2 See the joint declaration of the European Parliament, the Council and the European Commission in: https://www.europarl.europa.eu/doceo/document/TA-9-2022-0379_EN.pdf.

3 See for instance *Continental Can* and *AstraZeneca.*

4 In this ruling, the General Court held that when assessing a concentration *"the Commission cannot ignore the consequences which the grant of State aid to those undertakings [i.e. the parties to the concentration] has on the maintenance of effective competition on the market,"* T-156/98, ECR II-337, para. 114. With respect to merger investigations, Art. 2(1)(b) expressly states that when assessing a concentration, *"the Commission shall take into account: […] the market position of the undertakings concerned and their economic and financial power."*

Following this ruling, the Commission took into consideration State aid and foreign subsidies in several merger cases.[5.] However, the Commission in its decision-making practice[6], has only taken State aid or foreign subsidies into consideration under strict conditions, requiring in essence:

· *First*, clear evidence proving the existence of such aid or subsidies;

· *Second*, evidence showing that the current market shares of the parties do not already reflect the net advantage associated with such subsidies. To this end, it should be established that the subsidies are liable to improve the merged entity's competitive position and potentially negatively affect competition in the internal market.

These strict conditions explain why foreign subsidies have not played a decisive role for the assessment of concentrations to date.

Foreign subsidies can in principle also be relevant if such foreign subsidies are used **by a dominant undertaking in a way which may be abusive under Article 102 TFEU**. [7]

However, the General Court clarified that the mere use by a dominant undertaking of State funds received through a legal monopoly for the purpose of acquiring control of another company does not amount to an abuse in itself.[8] Accordingly, the use of State funds (i.e. State aid or foreign subsidies) does not amount to a standalone form of abuse, but can nevertheless be abusive if it enables a dominant undertaking to distort competition in the internal market.

IV. FOREIGN SUBSIDIES IN ECONOMIC CONTEXT

The EU is the largest trading block in the world. In 2021, the EU27 trade in goods and services with the rest of the world amounted to EUR 6 275 billion, that is 16.2 percent of global trade, or alternatively – around 43 percent of EU's GDP[9]. Around 38 million jobs in the EU are dependent on exports, a figure which has been steadily growing in the past decades.[10]

The EU is also among the top providers and destinations for foreign direct investment, accounting for 32 percent of the global outward FDI stock and 25 percent of global inward FDI stock in 2021[11]. As an open economy, the EU benefits from trade and investment, making its economy closely interlinked with the rest of the world.

While aid granted by EU Member States is subject to EU State aid control, subsidies granted by non-EU countries to undertakings active on the EU internal market are generally not subject to the same level of scrutiny in the EU. This difference in treatment may result in distortions to the EU internal market, notably where certain foreign subsidies would not have been allowed under State aid rules if granted by an EU Member State.[12]

This situation may be exacerbated by the fact that the use of subsidy measures around the world is widespread and has become much more contentious in recent years. For instance, the number of countervailing duty investigations and WTO disputes over subsidies has been

5 See e.g. *STX/Aker Yards*, case COMP/M.4956; *Abu Dhabi Mar/ThyssenKrupp Marine Systems*, COMP/M.5943 and *Alitalia/Etihad*, case COMP/M.7333. This explains why the Form CO expressly asks for a list and description of "any financial or other support received from public authorities by any of the parties and the nature and amount of this support" (Form CO, Section 3.4).

6 See e.g. *Deutsche Post/DHL (II)*, COMP/M.2908.

7 See e.g. *Deutsche Post AG*, COMP/35.141.

8 *UPS Europe SA v. Commission*, T-175/99, para. 55.

9 DG Trade Statistical Guide, August 2022, excluding intra-EU trade. DG Trade statistical guide - Publications Office of the EU (europa.eu).

10 DG Trade, EU exports to the world: effects on employment, 2021. EU Exports to the World: Effects on Employment (europa.eu).

11 UNCTAD, World Investment Report 2022, Statistical Annex. https://unctad.org/topic/investment/world-investment-report.

12 European Court of Auditors. The EU's response to China's state-driven investment strategy, March 2020. https://www.eca.europa.eu/Lists/ECADocuments/RW20_03/RW_EU_response_to_China_EN.pdf.

growing over the past decade.[13] The increased use of subsidies after the global financial crisis has also shown that subsidy measures are a popular policy tool in response to economic downturns, a trend which has been confirmed in the wake of the COVID-19 crisis. Finally, subsidies might also be considered as a means to support decarbonization efforts or to compensate for increasing energy prices and other inflationary pressures. It is therefore expected that subsidies will gain even more importance in the near future.

Such foreign subsidies can have a negative effect on non-subsidized competitors, which are at risk of being crowded out of the EU, which in turn translates into worse conditions for consumers in terms of price and quality. Foreign subsidies may be distortive across various sector when providing an unfair advantage to its beneficiary and thus resulting in strengthening its competitive position.

This may be the case, for instance, when a subsidy distorts competition between the merged entity and its competitors in the internal market. This may happen if, for instance, the subsidy helps to reduce the company's operating costs (by improving the company's financial power compared to its competitors, perhaps via an unlimited guarantee).

A subsidy may also be used to finance a loss-making enterprise without a restructuring plan that would ensure its long-term viability, keeping it from having to leave the market and allowing it to distort competition.

A subsidy may be used to enter new markets or increase a market presence relatively swiftly (compared with greenfield investment, for instance), namely through mergers and acquisitions of existing companies (e.g. through overbidding in a competitive acquisition process), or through winning public procurement contracts that the company would otherwise not have been able to win (e.g. through undercutting the price).[14]

V. FSR SUMMARY

In November 2022, the European Parliament formally approved the Regulation on foreign subsidies distorting the internal market, which had been politically agreed between the negotiators of the European Parliament and of the Council of the European Union earlier that year. The FSR entered into force on January 10, 2023. This Regulation closes the regulatory gap within the internal market described above by setting out three different procedures that allow the Commission to investigate foreign subsidies that distort the internal market, and to redress such distortions: (i) a notification procedure for large concentrations;[15] (ii) a notification procedure for tenders in large public procurement procedures;[16] and (iii) an *ex officio* procedure, which can be used in all market situations.

If the investigation under one of these three procedures reveals that there is a foreign subsidy that distorts the EU internal market, and if this distortion is not fully outweighed by positive effects, the Commission may impose redressive measures on the undertaking or accept its commitments to redress the distortion.

As regards the definition of a **foreign subsidy**, the Regulation sets out a number of cumulative conditions. There first needs to be a **financial contribution** granted by a **third country**. Such a financial contribution may consist, for example, of a capital injection, a direct grant, or a tax exemption. A "**third country**" may cover not only public authorities at all levels, but also the actions of other entities, in so far as they can be attributed to the third country. The financial contribution needs to confer a **benefit** on an undertaking engaging in an economic activity in the EU internal market. Finally, the financial contribution has to be "**selective**," i.e. if it is limited, in law or in fact, to one or more undertakings or industries.

If there is a foreign subsidy, the Commission needs to assess whether that subsidy causes a **distortion** on the EU internal market: whether it is likely to improve the competitive position of the undertaking and thereby negatively affect competition in the EU internal market. The

13 Evenett, S.J. & Fritz, J. Subsidies and Market Access: Towards an Inventory of Corporate Subsidies by China, the European Union and the United States. The 28th Global Trade Alert Report. CEPR, 2020 https://www.globaltradealert.org/reports/gta-28-report.

14 For further examples, see European Commission. Impact assessment report accompanying the Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market. May 5, 2021. https://ec.europa.eu/competition/international/overview/impact_assessment_report.pdf.

15 Concentrations only need to be notified if the undertakings involved in the concentration received at least EUR 50 million of aggregate financial contributions over the last three years, and one of the merging undertakings or the acquired undertaking or, in the case of acquisition of joint control, the joint venture has an EU turnover of more than EUR 500 million.

16 Tenders only need to be notified if the public procurement has an estimated value of more than EUR 250 million (as well as lots above a threshold of EUR 125 million), and the economic operator participating in the public procurement procedure has received an aggregate amount of EUR 4 million of financial contributions over the last three years.

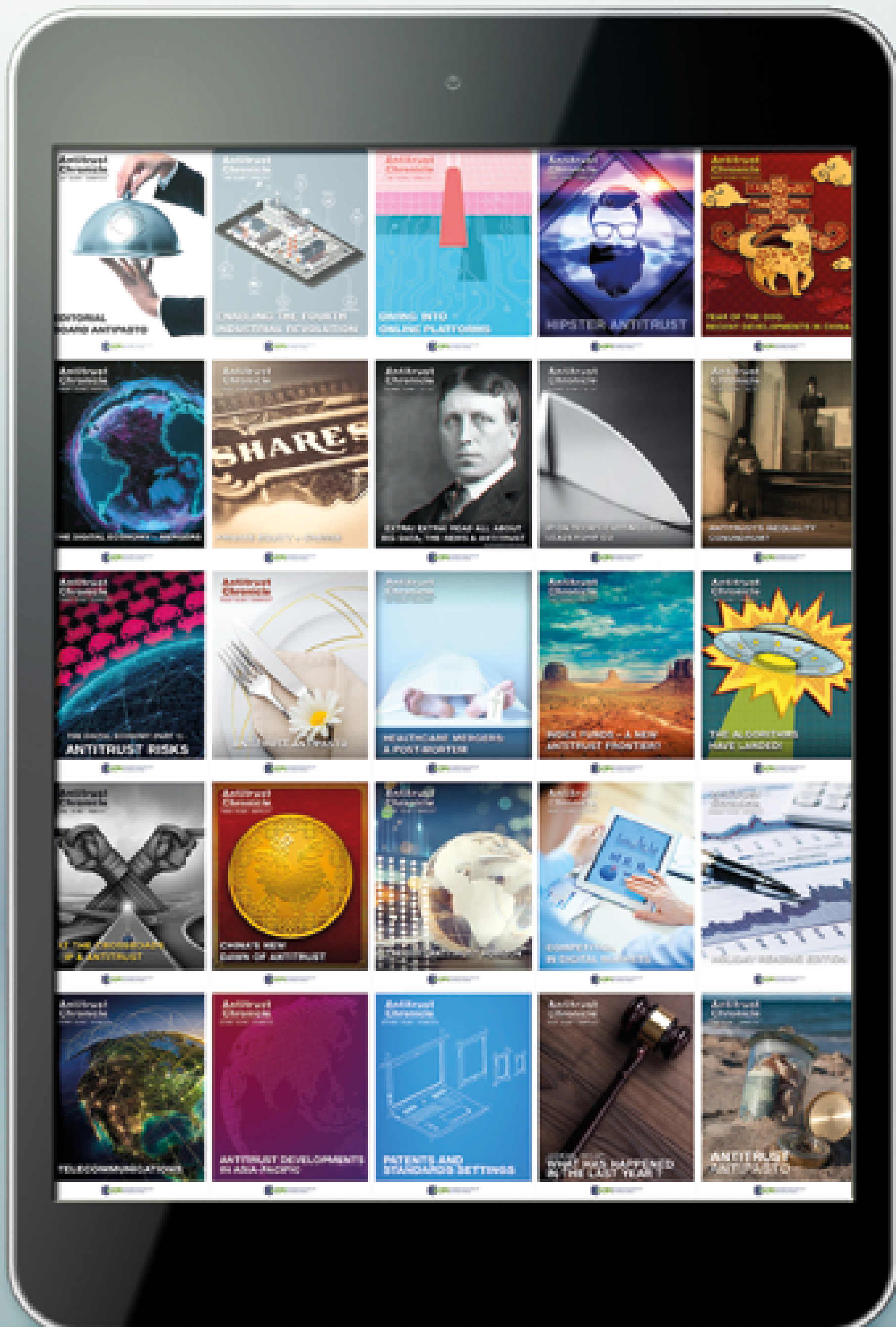
existence of a distortion of the EU internal market is determined on the basis of indicators such as the amount, nature and purpose of the subsidy, or the extent of the undertaking's economic activity on the EU internal market. Certain subsidies, such as unlimited guarantees, are considered particularly likely to distort the internal market, while subsidies below EUR 4 million per undertaking over any period of three years are considered unlikely to do so. Moreover, subsidies below EUR 200.000 per undertaking, per third country and over any period of three years are considered not to distort the internal market.

The Regulation also sets out a **balancing** test. On the basis of information received, the Commission may balance the said negative effects of a foreign subsidy on the EU internal market against its positive effects on the development of the relevant subsidized economic activity, or other relevant policy objectives, in particular on the EU internal market. The Commission will take that balancing into account when deciding on the appropriate remedies or commitments offered by the undertaking under investigation. If the positive effects outweigh the negative ones, there is no need for commitments or redressive measures. Where the positive effects do not outweigh the negative ones, the Commission will take the positive effects into account when determining the nature and level of redressive measures or commitments.

The Regulation provides a non-exhaustive list of possible **redressive** measures or commitments. They can consist of structural measures, such as the sale of an asset; or of behavioral measures, such as the provision of access to infrastructure, or the repayment of the foreign subsidy and have to fully and effectively remedy the distortions in the EU internal market. If need be, the Commission may also prohibit a concentration or the award of the contract. Furthermore, the Commission may impose reporting and transparency obligations, including reporting on future participation in concentrations or public procurement procedures.

VI. WHERE WE STAND NOW

The FSR entered into force on January 12, 2023 and will start to apply 6 months after the entry into force. After the start of application, there will be an additional 3-month period before the notification obligation kicks in. This should provide companies and public authorities with sufficient time to familiarize themselves with the obligations set out in the Regulation.



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