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SUBSIDIES, COMPETITION AND TRADE – Contribution from the European Union

- Session II -

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This contribution is submitted by the European Union under Session II of the Global Forum on Competition to be held on 1-2 December 2022.

More documentation related to this discussion can be found at: oe.cd/sctr.

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Subsidies, Competition and Trade

- Contribution from the European Union –

1. Introduction

1. This contribution sets out the European Union's approach to control harmful effects of subsidies on the EU internal market. It describes the existing policy and focuses then on the latest addition to the toolbox, namely the new Foreign Subsidies Regulation.
2. The EU policy in this area is laid down mainly in the **EU State aid rules**. The origin of the EU State aid policy goes back to the founding years of the Union in the 1950s. There was a concern that subsidy races between individual Member States might undermine market integration and put at risk the level playing field in the EU internal market. To ensure an effective control, the implementation of the EU State policy was assigned to the supranational level, namely to the European Commission.
3. 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.
4. The effect of subsidies has also played a role in the **EU Antitrust and merger policy**. Even though the EU State aid policy constitutes a separate legal instrument to address harmful effects of subsidies, there have been instances where subsidies were considered relevant for the specific competition assessment under these instruments.
5. In recent years, there was an increasing perception 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. Increasing trade and investment flows have brought with them an **increased risk of negative spillover effects** through subsidies granted outside the EU. The Commission therefore carried out a legal and economic analysis to identify the possible **regulatory gap** that is captured neither by existing competition, nor by trade instruments. Notably, subsidy control under the WTO rules is essentially limited to trade in goods and does not cover services or investment.
6. After a proposal from the Commission, the EU legislators agreed on a **new Regulation** on foreign subsidies distorting the EU internal market. 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. 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.
7. 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 a multilateral approach to address distortive subsidies globally.¹

¹ See the joint declaration of the European Parliament, the Council and the European Commission, to be issued when the Regulation on foreign subsidies distorting the internal market is adopted.

2. Existing EU subsidy control

8. The Treaty on the Functioning of the European Union (TFEU) 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 favoured 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.

9. The point of departure of EU State aid control is laid down in Article 107(1) TFEU. This article provides that financial support granted by Member States, which favours certain undertakings (or the production of certain goods), distorts the internal market, and negatively affects trade between Member States, and, as such, is therefore, *prima facie*, prohibited. Under Article 108 TFEU, the Commission is given the task to control State aid.

10. However, the principle of incompatibility does not amount to a full-scale prohibition. Articles 107(2) and 107(3) TFEU specify a number of situations in which State aid could be considered compatible. In exercising its powers, the Commission has developed specific approaches depending on the sector or industry concerned, the objective of the aid, etc. In order to ensure transparency, predictability and legal certainty, the Commission has made public the criteria it uses when deciding whether aid measures qualify for exemption in the form of guidelines, communications or block exemption regulations.

11. Article 108 TFEU provides that Member States must notify to the Commission any plan to grant State aid (*ex ante notification*) before putting such plan into effect (*standstill obligation*). Thus, Member States cannot grant any State aid unless it has been notified and authorised by the Commission. In case of non-compliance with the notification and standstill obligation, a negative decision with the obligation to recover the aid can be issued. The Commission has thus been given the exclusive competence to weigh advantages and disadvantages of an envisaged State aid in the context of its compatibility assessment. Due to the economically and politically complex nature of this exercise, the Commission has been endowed with a relatively wide margin of appreciation, within the limits of its own guidelines and subject to judicial review by the European courts.

12. In addition to EU State aid rules, the Commission's toolbox to control subsidies in the larger sense also includes the Trade Defence Instruments (TDIs) that allow the EU to react to unfair competition in terms of injurious imports of goods which are unfairly priced below their normal value (anti-dumping instrument) or subsidised (anti-subsidy instrument). These instruments, however, have their limitations. The EU anti-dumping and anti-subsidy rules apply to the import of goods and do not cover services, investment or other financial flows in relation to undertakings operating in the EU. In addition to the limitation on goods, the EU's anti-subsidy rules in principle only apply to subsidies to companies in the granting (third country) jurisdiction. As regards the EU's anti-dumping rules, unfair price practices of a third country exporter (dumping) need to cause material injury to the EU industry.

13. Finally, there are a number of sectoral rules, which allow the EU to ensure a level playing field in the internal market in those specific sectors. Regulation (EU) 2019/712 on safeguarding competition in air transport outlines the investigative powers of the

Commission and the redressive measures it may impose relating to various practices, such as discrimination and subsidies, which distort competition between EU and non-EU air carriers, and which cause, or threaten to cause, injury to EU air carriers. Regulation (EU) 2019/712 covers discriminatory treatment adopted by a third country or subsidies granted by a third country government to the detriment of EU air carriers.

14. Regulation (EU) 2016/1035 on protection against injurious pricing of vessels allows the EU to act against the sale of vessels that are sold at less than normal value due to, e.g. subsidisation, and therefore cause injury to the Union industry. While this Regulation has formally entered into force, it has never been applied as its application is conditional on the still outstanding ratification of the OECD Shipbuilding Agreement by South Korea and the US. Regulation (EEC) 4057/86 concerns unfair pricing practices in maritime transport made possible by the fact that the shipowner concerned enjoys non-commercial advantages but since its 35 years of existence, it has been used only once. This is because it has proven difficult to show that the conditions (e.g. the existence of dumping prices) under the Regulation are fulfilled.

3. Foreign subsidies in traditional competition law instruments

15. Under current EU competition law, foreign subsidies can 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 (3.1.). It can also be relevant if such foreign subsidies are used by a dominant undertaking to foreclose competitors, which may be abusive under Article 102 TFEU (3.2.).

3.1. Foreign subsidies and dominance

16. Economic and financial power has been considered relevant in several cases to assess the existence of dominance.² Given that foreign subsidies may strengthen the economic and financial power of undertakings, it follows that foreign subsidies must 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).

17. This was expressly confirmed in the *RJB Mining* ruling with respect to concentrations and State aid. In this ruling, the General Court held that when assessing a concentration “*the Commission cannot ignore the consequences which the grant of State*

² In *Continental Can* for instance, the Commission concluded that Continental had a dominant position in light of a combination of factors, including the fact that Continental was the world’s largest producer of metal cans, and enjoyed large turnover and profits. Finally, Continental’s economic and financial strength facilitated easier access to finance than its competitors could expect (*Continental Can Company*, OJ 1972 L 7/25). In *BPB Industries*, the Commission stated that it was necessary to consider “*not only the position of BPB in the market but also its technological and financial resources*” when deciding whether or not the undertaking dominated the market (*BPB Industries*, OJ 1989 L 10/50, para. 115). In *AstraZeneca*, the Commission compared AstraZeneca’s financial strength, resources and specialisation in the pharmaceutical sector with those of the two main competitors in the relevant market in considering dominance (*AstraZeneca*, OJ 2006 L 332/24, paras. 565-566, upheld on appeal in Case T-321/05, *AstraZeneca v Commission* [2010] ECR II-2805, paras. 286 where the Court held that AstraZeneca’s superior financial resources to those of its competitors was such as to reinforce its market position in relation to them).

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*”.

aid to those undertakings [i.e. the parties to the concentration] has on the maintenance of effective competition on the market”.³

18. Following this ruling, the Commission took into consideration State aid and foreign subsidies in several merger cases.⁴ However, according to the Commission “*in the absence of other indicators, financial strength as such will not be sufficient to lead to the creation or strengthening of a dominant position*”.⁵ In particular, “*the mere fact that a merging company may have access to financial means that it is not lawfully entitled to, and that it may use such means to finance the acquisition of control in another company, does not as such lead to the conclusion that the resulting acquisition of control is incompatible with the common market under Regulation (EC) 139/2004*”.⁶

19. In view of this decision-making practice, it appears that the Commission only takes 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 merged entity will have the ability and incentive to successfully foreclose rivals to a sufficient extent so as to significantly impede effective competition.

20. These strict conditions explain why foreign subsidies have not played a decisive role for the assessment of concentrations to date.⁷

3.2. Foreign subsidies and unilateral conduct in dominance cases

21. Despite fewer precedents for unilateral conduct involving foreign subsidies or State aid, dominant undertakings may be considered to abuse their position, for instance if they use State support to engage in predatory cross-subsidization.⁸

22. In *UPS Europe SA v. Commission*, 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.⁹

³ *RJB Mining PLC v. European Commission*, T-156/98, ECR II-337, para. 114.

⁴ 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. In *STX/Aker Yards* in particular, the Commission made clear that: “*In principle, the Commission is obliged to take into account in its merger analysis any subsidies as factors potentially increasing a merged entity’s financial strength, in so far as evidence supports the existence or the likelihood of such subsidies*” (para. 85). See also J. M. Carpi, EU Merger Control in a globalised economy, available at SSRN: <https://ssrn.com/abstract=3797497> (“*Subsidies granted by a foreign government may also form part of the overall assessment of a firm’s financial strength and market position*”). 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).

⁵ *Deutsche Post/DHL (II)*, COMP/M.2908 para. 32.

⁶ *Deutsche Post/DHL (II)*, COMP/M.2908 para. 38.

⁷ See in particular: *STX/Aker Yards*, case COMP/M.4956; *Abu Dhabi Mar/ThyssenKrupp Marine Systems*, COMP/M.5943 and *Alitalia/Etihad*, case COMP/M.7333.

⁸ See e.g. *Deutsche Post AG*, COMP/35.141.

⁹ *UPS Europe SA v Commission*, T-175/99, para. 55: “*In the absence of any evidence to show that the funds used by the undertaking holding a monopoly for the acquisition in question derived from abusive practices on its part in the reserved letter market, the mere fact that it used those funds to acquire joint control of an undertaking active in a neighbouring market open to competition does not in itself, even if the source of those*

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 engage in an abusive conduct (e.g. predatory pricing).

4. Economic context of distortive foreign subsidies

23. 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% of global trade, or alternatively – around 43% of EU's GDP¹⁰. Around 38 million jobs in the EU are dependent on exports, a figure which has been steadily growing in the past decades¹¹.

24. The EU is also among the top providers and destinations for foreign direct investment, accounting for 32% of the global outward FDI stock and 25% of global inward FDI stock in 2021¹². As an open economy, the EU benefits from trade and investment, making its economy closely interlinked with the rest of the world.

25. In recent years, there has been a growing concern that the openness of the EU and the increasing trade and investment flows coming into the EU might be coupled with largely uncontrolled foreign subsidies. Despite a certain lack of transparency¹³, research shows 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 growing over the past decade¹⁴. 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 sought as a means to support decarbonisation 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.

funds was the reserved market, raise any problem from the standpoint of the competition rules and cannot therefore constitute an infringement of Article 82 EC or give rise to an obligation on the Commission to examine the source of those funds in the light of that article'.

¹⁰ DG Trade Statistical Guide, August 2022, excluding intra-EU trade.

https://trade.ec.europa.eu/doclib/docs/2013/may/tradoc_151348.pdf

¹¹ DG Trade, EU exports to the world: effects on employment, 2021. https://trade.ec.europa.eu/doclib/docs/2018/november/tradoc_157516.pdf

¹² UNCTAD, World Investment Report 2022, Statistical Annex. <https://unctad.org/topic/investment/world-investment-report>

¹³ While the WTO Agreement on Subsidies and Countervailing Measures imposes certain reporting obligations on WTO members, the WTO found in October 2020 that 83 out of 164 WTO members were yet to submit their full subsidy notification for 2019, while 68 were yet to submit their notifications for 2017 and 58 have not made their notification for 2015, more than five years after due date. Source: WTO, Chair cites “chronic” low compliance with subsidy notification requirements, 27 October 2020, https://www.wto.org/english/news_e/news20_e/scm_27oct20_e.htm

¹⁴ Evenett, S.J. and 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>

26. 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 if granted by an EU Member State and assessed under State aid rules.¹⁵ Such foreign subsidies have a negative effect on non-subsidised 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.

27. Foreign subsidies may be distortive in relation to many economic activities and across various sectors. Generally, a subsidy may distort the market when providing an unfair advantage to its beneficiary and thus resulting in strengthening its competitive position.

28. This may be the case, for instance, when a subsidy is used to foreclose a market or a part of a market to a competitor, serving as a high barrier to entry or preventing the competitor from increasing its market share. In this situation, a subsidised company may use predatory pricing or price dumping, sustaining losses over a certain period of time to deter competition.

29. 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 preventing competitors from increasing their market share.

30. A subsidy may be used to enter new markets or increase a market share 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 on price).¹⁶

5. Regulation on foreign subsidies distorting the internal market in a nutshell

31. On 10 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. This Regulation closes the regulatory gap within the internal market described above under Section 4 by setting out three different procedures that allow the Commission to investigate foreign subsidies that distort the internal market, and to redress such distortions: a notification procedure for large concentrations;¹⁷ a notification

¹⁵ European Court of Auditors. The EU's response to China's state-driven investment strategy, 03/2020. https://www.eca.europa.eu/Lists/ECADocuments/RW20_03/RW_EU_response_to_China_EN.pdf

¹⁶ 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. 5 May 2021.

https://ec.europa.eu/competition/international/overview/impact_assessment_report.pdf

¹⁷ 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.

procedure for tenders in large public procurement procedures;¹⁸ and more generally an ex officio procedure, which can be used in all market situations.

32. 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 outweighed by positive effects, the Commission may impose redressive measures on the undertaking or accept its commitments to redress the distortion. In the following, those key concepts of the Regulation are further explained:

33. 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. The term ‘third country’ covers 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’. This is the case if it is limited, in law or in fact, to one or more undertakings or industries.

34. If there is a foreign subsidy, the Commission needs to assess whether that subsidy causes a distortion on the EU internal market, i.e. whether it has negative effects. This is the case where a foreign subsidy is likely to improve the competitive position of the undertaking in the EU internal market and thereby negatively affects competition in the internal market. The 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.

35. According to the Regulation, 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.

36. The Regulation also sets out a balancing test. The Commission may, on the basis of information received, balance the said negative effects of a foreign subsidy on the EU internal market against its positive effects on the development of the relevant subsidised economic activity on the EU internal market. Other positive effects can also be taken into account in the assessment, including those related to the relevant policy objectives. 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

¹⁸ 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.

into account when determining the nature and level of redressive measures or commitments.

37.

38. 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 behavioural measures, such as the provision of access to infrastructure, or the repayment of the foreign subsidy. What matters, is that the redressive measures or commitments 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.

6. Outlook

39. Following the European Parliament's approval of the political agreement on 10 November 2022, the Council of the European Union will also endorse it before the end of 2022. The Regulation will enter into force 20 days after its publication in the Official Journal of the European Union, and will start to apply 6 months after the entry into force, i.e. most likely as of mid-2023. 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.

40. By the time that the Regulation becomes applicable, the Commission will complement the Regulation with implementing acts on procedural aspects.