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**SUBSIDIES, COMPETITION AND TRADE – Contribution from UNCTAD**

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This contribution is submitted by UNCTAD 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](http://oe.cd/sctr).

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## *Subsidies, Competition and Trade*

### - Contribution from UNCTAD -

1. Through this paper UNCTAD presents its contribution to the issue of subsidies, competition and trade, which will be the subject of debate and discussion at the forthcoming Global Forum on Competition.
2. UNCTAD's contribution herewith takes into account the United Nations Set of principles and rules on competition ("Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices<sup>1</sup>, **the UN Set**), which is the only internationally agreed instrument in this field, and which has influenced the adoption of competition law and policy across the world. Section C (iii) on Preferential or differential treatment for developing countries is highlighted.
3. UNCTAD shares its views on the need for competition authorities to consider the intervention of member States in their economies through public measures usually associated with the granting of public funds, while recognizing that in several developing countries the constraints to the effective independence of competition authorities does not allow them to develop monitoring or controlling powers in this regard. However, all competition authorities should use their advocacy role to influence governments in the design and implementation of these public measures. Regional economic organizations may provide the appropriate structure for the analysis of subsidies' effects in the regional market at stake, to prevent competition restrictions. UNCTAD also suggests that international review mechanisms are needed within the World Trade Organization framework to ensure that these public measures and actions do not hinder competitive markets, negatively impacting developing countries, which are not well equipped and may lack experience to face this challenge.

### **1. To what extent are subsidies currently incorporated by competition authorities in competition analysis?**

4. The economics of subsidies and other forms of State aid control are related to several areas of economics<sup>2</sup>: first, to public economics, since it amounts to a form of public intervention in the economy associated with the use of public funds with budgetary implications; second, to the economics of competition, as State aid confers an advantage to some enterprises, having hence the potential to interfere with the competitive process; and third, to international trade theory, as State aid can affect trading conditions. This allows for member States' Governments to pursue national economic and/or political goals, which in turn provides a rationale for supranational (European) state aid control.
5. Most of the State aid control analysis is not firmly rooted in economic principles. Indeed, State aid measures may be justified to achieve non-economic objectives related to social-economic and equity goals. For example, European state aid encompasses economic

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<sup>1</sup> <https://unctad.org/system/files/official-document/tdrbpconf10r2.en.pdf>.

<sup>2</sup> HW Friederiszick, LH Röller, and V Verouden, "European State Aid Control: An Economic Framework", in Bucirossi (ed) "Handbook of Antitrust Economics+ (Cambridge MA: MIT Press, 2008) 625, 652–654.

efficiency as well as equity objectives. There may also be relevant theories of competitive harm at stake, such as keeping inefficient rivals in the market.

6. The allocation of public funds to support economic activities has consequences for taxpayers, being especially important in developing countries as there will be several other competing public goals to pursue.

7. Therefore, although subsidies and other related public measures could be considered by competition authorities, which may provide governments with a unique perspective regarding its drafting and implementation, seeking to protect and promote competition in the markets, that is not necessarily the case in several developing countries, especially those whose competition authorities are young and somewhat inexperienced.

8. Indeed, for some developing countries' competition authorities' effective independence vis-à-vis governments remains a challenge, preventing competition authorities to receive the responsibility of monitoring and controlling public funded measures' effects in the markets.

9. When competition authorities are entrusted with State aid control, the focus should be about ensuring if the measure at stake meets the necessary conditions so that any negative effects on competition are offset by the positive effects on the general interest goals selected. In this sense, it is important that these public measures are granted based on objective conditions, have an incentivizing effect (that is, for a company to carry out an investment, for example), be proportional to the amount of investment made and have a positive impact in the form of increased innovation and improved products overall.

10. At national and regional levels, given that Governments can alter the conditions of competition in the markets with this type of measures, competition authorities should do advocacy, as they know the structure of markets and are well placed to assess the effects of public aid on competition. In the current context, such intervention is even more necessary, given that the public financing needs are great and the means available are limited. Therefore, especially towards economic recovery after the COVID-19 pandemic and to face the impact of the geopolitical crisis on the food and energy sectors, it is crucial to carefully select economic sectors, type and size of companies (notably for microenterprises and small and medium-sized enterprises), as well as investments which may be supported with public funds in order to ensure that the recovery is sustainable and inclusive, and that markets will remain open and competitive eventually.

11. At regional level, some regional economic organizations have the competence to analyze the impact of public aid and to rule on its compatibility with the rules of the Treaties governing it.

12. This is also the case of the West African Economic and Monetary Union-WAEMU, whose founding Treaty<sup>3</sup> (Article 88c) prohibits the granting of State aid that could distort competition. The WAEMU Commission has adopted several decisions on aid granted by Member States which were found incompatible with the Treaty in at least two cases.<sup>4</sup>

13. In the same perspective, Part VII of the East African Commission (EAC) Competition Act, 2006 (the Act), provides that a Partner State may grant a subsidy if it is

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<sup>3</sup> <http://www.uemoa.int/en/amended-treaty>.

<sup>4</sup> Décision n° 008/2010/COM/ UEMOA du 04 juin 2010 invitant l'Etat du Sénégal à mettre fin aux exonérations accordées sur les importations d'emballages en papier kraft. Décision n° 002/2011/COM/UEMOA du 29/08/2011.

in the public interest to do so.<sup>5</sup> However, before granting any subsidy, a Partner State shall notify the Authority. Further, the Act establishes that a Partner State shall not grant any subsidy for the promotion of exports or imports between the Partner States, nor any subsidy granted on the basis of the nationality or residence of persons or country of origin of goods or service.<sup>6</sup>

14. At national level, in the Dominican Republic, the competition authority (Procompetencia) can analyze “the effects on the conditions of competition of subsidies, State aid or incentives granted to public or private undertakings, charged to public resources, and shall proceed, where appropriate, to request the public authorities, by means of a reasoned recommendation report, to abolish or modify such subsidies, as well as to adopt any other measures conducive to the restoration of competition”.<sup>7</sup> In this sense, Procompetencia presented on Friday, November 4, 2022 at the Central American Forum on Competition, held in El Salvador, a new publication on the results on “The impact of state aid from the perspective of the competition”.<sup>8</sup>

15. Finally, it is important to point out the importance of establishing a dynamic control of public aid measures in supranational regional organizations, given that its effect on trade between Member States can be very pernicious and, consequently, likely to distort competition in the geographical market concerned. In this regard, UNCTAD has recently recommended that the Central American countries establish a coordination mechanism between the competition authorities to advise the member states of Secretariat for Central American Economic Integration-SIECA on this issue using the new Central American Competition Regulation.<sup>9</sup>

## 2. Should subsidies be incorporated (more or differently) into the competition analysis, and if so, why and how?

16. The growing use of subsidies alters trade and investment flows, detracts from the value of tariff bindings within the framework of the multilateral trading system and other market access commitments and undercuts public support for open trade and free competition.

17. Competition authorities should request information from public aid granting bodies when analyzing cases of alleged restrictive practices by certain companies to have a more comprehensive picture of the markets at stake. They should also rule on the need to eliminate or suspend the granting of State aid to the companies infringing competition rules.

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<sup>5</sup> <https://www.eacompetition.org/laws/category/competition-act>.

<sup>6</sup> The EAC comprises 7 Partner States: Democratic Republic of the Congo, Republic of Burundi, Republic of Kenya Republic of Rwanda, Republic of South Sudan, Republic of Uganda, and United Republic of Tanzania.

<sup>7</sup> Article 15 of the Ley No. 42-08 sobre la Defensa de la Competencia, G. O. No. 10458, del 25 de enero de 2008.

<sup>8</sup> On the occasion, the president of the board of directors of Procompetencia, María Elena Vásquez, highlighted that the report constitutes a valuable work tool because it proposes a conceptual framework and analytical tools that will allow the institution to have a reference framework to carry out other incentives as well. important for the economic and social development of the country. See <https://procompetencia.gob.do/en-foro-de-recac-procompetencia-presenta-resultados-estudio-sobre-ayudas-estatales>.

<sup>9</sup> [https://www.sc.gob.sv/index.php/sala\\_multimedia/reglamento-centroamericano-de-competencia](https://www.sc.gob.sv/index.php/sala_multimedia/reglamento-centroamericano-de-competencia).

18. Consequently, competition authorities should not only be consulted advise at the stage of designing and implementing these public measures, in their role as advocates, but may also consider in their analysis the effects of such measures in anticompetitive practices and in horizontal and vertical mergers (in their role as enforcers).

19. Regarding developing countries, the following policy recommendations should guide subsidies analysis in connection to the promotion of a sound competition policy<sup>10</sup>:

- Subsidies or other forms of governmental support are necessary only if the private sector would otherwise not engage in business activities.
- Where no performance standards have been imposed upon the recipients of subsidies—i.e., waivers—they were wasted;
- Subsidies have to be granted only for a limited period of time and in a degressive mode so that firms have an incentive to “grow up”;
- If the Government's threats to remove subsidies in time or to remove them for firms not meeting performance standards are not credible, subsidies tend to be ineffective.
- To avoid discriminatory distribution of subsidies maximum transparency is necessary. For example, if the Government is forced to publicize its subsidies it would be under permanent pressure of justification and public control;
- Potential infant industries vary in their need for selective protection, or in other words, promotion;
- Selected firms, industries or branches have to be reviewed constantly. Should additional information surface, or if it can be safely predicted that those industries will not achieve international competitiveness within a reasonable length of time, the initial promotion strategy has to be revised. A control or feedback mechanism has thus to be institutionalized. If mistakes are recognized remedial action has to be taken quickly and future choices have to be considered in the light of past experiences.

### 3. What theories of harm may apply to subsidies, and what is the economic basis for these theories?

20. The assessment of the impact of subsidies may be particularly complex<sup>11</sup>. Two main dimensions need to be considered: the characteristics of the subsidy itself and of the affected markets.

21. The subsidy characteristics refer to the type and amount of the measure of financial support and in particular to its impact on the cost/revenue structure of the recipient. In this regard, reference is generally made to *marginal costs* but ‘measuring marginal costs is a notoriously difficult exercise, exacting in its data demands and inherently error-prone’. Consequently, the proxy of variable costs is often used, but in many cases, this does not yield accurate results either. However, it is not only variable costs that should be taken into account. Although to a lesser degree, a reduction in fixed costs, which do not depend on

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<sup>10</sup> Prof. W. Lachman (1999) “The development dimension of competition law and policy” UNCTAD Series on Issues in competition Law and Policy, New York and Geneva.

<sup>11</sup> Luca Rubini (2009) “The distortion of competition” in “The definition of Subsidies and State Aid: WTO and EC Law in Comparative Perspective”. See <https://academic.oup.com/book/36369>.

output, may also distort competition because it may enable the firm to continue in the market.

22. The assessment of market characteristics is not easy either. First, a crucial prerequisite of the market analysis is the *definition* of the *relevant* product and geographical *market*. Although inspiration can be drawn from other areas of the law, such as competition law, the economic scenario is different in the case of subsidies and adjustments should be made. Once the market has been defined, a necessary, but not sufficient, prerequisite for the subsidy to be liable to produce a distortion to competition is that the market is neither monopolistic nor perfectly competitive, which is often the case since most of the markets tend to show oligopolistic tendencies.

23. Various factors may then determine the impact of the subsidy on competition, including the size of the beneficiary, market shares and concentration ratios, barriers to entry, the degree of product differentiation, how far it complements neighboring markets, the segmentation of national markets, the tradability of the goods or services and impact on location choices, the process leading to the grant.

24. Two important economic circumstances stand out. First, a significant factor to consider is whether the beneficiary enjoys *market power* or may obtain it as a consequence of the subsidy. Secondly, a correct approach to the idea of distortion of competition, and its underlying concept of causality requires that subsidies may be determined to have caused the said harm only if that production decision would not have occurred *but* for the subsidy. This requires a *counterfactual* analysis which may be particularly exacting but is in principle necessary if one wants to avoid attributing to the measure at stake an event which would have taken place anyway and is in fact attributable to another factor.

#### 4. What analytical techniques can be used to assess these theories, and what types of evidence are needed to use them?

25. Given the complexity of the assessment of the impact of subsidies, a more effects-based approach is recommended as a means of achieving a greater effectiveness of state aid control, i.e., a means to better distinguish “good public measures” from “bad public measures”. In this context, it is appropriate to use a general balancing test as a conceptual framework for analyzing public aid cases. In essence, this test asks whether (i) the measure addresses a market failure or other objective of public interest; (ii) the measure is well targeted and whether (iii) the distortions of competition are sufficiently limited so that the overall balance is positive. This approach is appropriate both in the design of the State aid rules and in the analysis of individual State aid cases, in particular, in those cases involving large amounts of aid<sup>12</sup>.

#### 5. Is there (or should there be) a difference in how domestic subsidies and foreign subsidies should be assessed when dealing with a competition enforcement case?

26. Subsidies may be given in many forms, making accurate measurement a challenging proposition. Although subsidies data is generally scarce, it is especially more difficult for indirect and implicit subsidies, which makes it challenging to compare

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<sup>12</sup> HW Friederiszick, LH Röller, and V Verouden, “European State Aid Control: An Economic Framework, in Bucirossi (ed) Handbook of Antitrust Economics” (Cambridge MA: MIT Press, 2008) 625, 652–654.

subsidies across countries, sectors and types.<sup>13</sup> Such data is required across different countries, sectors and types; to estimate the potential effects of subsidies on domestic and foreign economies, such as competitiveness, trade, innovation, and investment. For instance, it is difficult to estimate the effects of subsidies on trade as subsidies may be levied for various objectives and in various forms, which may affect production, consumption, competition, and welfare. The link between trade, competition and subsidies is difficult and controversial. There is neither a generally accepted definition of subsidies nor a set of generally accepted policy objectives.

27. The assessment of the domestic and foreign subsidies should be similar. Focusing on the existing multilateral trade system, the rules for subsidies and trade in goods are set out mainly in the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures (SCM Agreement) and the WTO Agreement on Agriculture (AoA).<sup>14</sup> Subsidies affecting trade in services are subject to the WTO Agreement on Trade in Services (GATS), where disciplines are less well developed. There are also disciplines on the provision of export credits under the OECD Export Credit Arrangement and several free trade agreements (FTAs) and bilateral investment treaties (BITs) that go beyond WTO rules and contain provisions disciplining the behavior of SOEs and subsidies.<sup>15</sup>

28. The application of these rules is not effective and that is why there is currently an international debate to modify and improve them, with varying membership and differences in ambition and urgency.

29. These include subsidies to fisheries, agriculture, and industry, with a specific focus on certain areas such as subsidy notification requirements at the WTO, State Owned Enterprises (SOEs), or export credit practices and competition policy instruments developed by the OECD.

30. It must be said that the WTO Agreement on Fisheries Subsidies was adopted at the 12th Ministerial Conference (MC12) on 17 June 2022 marks a significant advancement for ocean sustainability by prohibiting harmful fisheries subsidies, which are a key factor in the widespread depletion of the world's fish stocks. The Agreement is limited to disciplines on the prohibition of subsidies for IUU fishing and left out those on subsidies contributing to overfishing and overcapacity. This part of negotiations, including adequately defined special and differential treatment for developing countries, is deferred to continued negotiations.<sup>16</sup>

31. In the context of WTO reform discussions, where much of the current policy debate on industrial subsidies occurs, some advanced economies consider that the ASCM inadequately captures certain subsidy practices and should be updated. The EU-Japan-U.S. "Trilateral" has called for new disciplines on subsidies they consider contributing to "overcapacity," on implicit government guarantees, and on lending on non-commercial

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<sup>13</sup> The availability of data is only better in agriculture, with disciplines and notification requirements at the WTO as well as the OECD Producer Support Estimate.

<sup>14</sup> Efforts to amend the SCM Agreement and the AoA (under the WTO Doha Development Round) led to the 2015 Nairobi Ministerial Decision on Export Competition but no other changes. Negotiations related to the AoA are ongoing.

<sup>15</sup> Subsidies, Trade, and International Cooperation. Prepared by staff of IMF, OECD, World Bank, and WTO, 2022.

[https://www.wto.org/english/res\\_e/booksp\\_e/repintcoosub22\\_e.pdf](https://www.wto.org/english/res_e/booksp_e/repintcoosub22_e.pdf).

<sup>16</sup> [https://www.wto.org/english/tratop\\_e/rulesneg\\_e/fish\\_e/fish\\_e.htm](https://www.wto.org/english/tratop_e/rulesneg_e/fish_e/fish_e.htm).

terms.<sup>17</sup> Canada has called for addressing what it sees as a “distortion of competitive conditions” resulting from certain industrial subsidies and the “market-distorting effects of SOEs.” Several of these WTO members have proposed strengthening the relevant rules by, among other things, reviving disciplines (allowed to lapse at the end of 1999) that would establish a presumption of harm from certain types of subsidies as well as expanding the list of prohibited subsidies.

32. The need to act urgently in this area has led the EU to adopt a new instrument to control aid granted to foreign companies operating in the European internal market. Indeed, the Commission welcomed the political agreement reached on July 2022 between the European Parliament and EU Member States on the Foreign Subsidies Regulation (‘FSR’). The FSR is an important addition to the EU toolbox to address distortions caused by foreign subsidies and ensure a level playing field for all companies operating in the EU Single Market.<sup>18</sup>

33. The Foreign Subsidies Regulation, covering concentration, public procurement procedures and all other market situations, will close a regulatory gap in the Single Market. So far, the lack of rules allowed subsidies granted by non-EU governments to go largely unchecked, while subsidies granted by Member States are subject to close scrutiny. The FSR complements the EU’s international efforts to modernize subsidy rules in the World Trade Organization.

34. Many developing countries are generally concerned that developed countries support certain economic activities whereas many of them do not have the means to do so.

35. The issue of cotton subsidies during the Doha Round negotiations at the WTO and, more recently, emergency support provided during the COVID pandemic are examples.<sup>19</sup> Many developing countries are concerned about competitive disadvantages and trade distortions.

36. In addition to the need to modernize the WTO subsidies rules, there are other key aspects of the debate at the WTO such as the case of the transparency and notifications requirements, fossil-fuel subsidies, export credits and the overcapacity in certain industrial sectors (steel and semiconductors).<sup>20</sup>

37. International cooperation becomes essential to deal with this enormous problem caused by subsidies granted without reasonable criteria in terms of efficiency and sustainability. Due to its broad mandate on all areas related to trade and development and its work supporting developing countries in identifying their interests in the discussions and negotiations within the WTO, UNCTAD is the ideal forum to make progress in this important area and bring together the opinions and criteria of developing countries, whose interest must be taken into account in these negotiations.

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<sup>17</sup> [https://cadmus.eui.eu/bitstream/handle/1814/72218/RSC-PP-2021\\_08.pdf?sequence=1](https://cadmus.eui.eu/bitstream/handle/1814/72218/RSC-PP-2021_08.pdf?sequence=1).

<sup>18</sup> [https://competition-policy.ec.europa.eu/international/foreign-subsidies\\_en](https://competition-policy.ec.europa.eu/international/foreign-subsidies_en).

<sup>19</sup> See, for example, UNCTAD (2022) “Impact of the COVID-19 Pandemic on Trade and Development: Lessons Learned” - <https://unctad.org/webflyer/impact-covid-19-pandemic-trade-and-development-lessons-learned>.

<sup>20</sup> See footnote 15.