

Levelling Foreign Subsidies in the EU: a New Wave of Protectionism?

Great openness to foreign investment has come with opportunities for the EU economy, but also with increased challenges such as perceived level playing field issues due to foreign subsidization. Anti-subsidy legislation helps to preserve the level playing field in the internal market, but subsidies granted by non-EU authorities to undertakings established in the Union which are difficult to tackle under existing laws are a growing concern in the EU political debate. Against this background, the European Commission published a White paper “On levelling the playing field as regards foreign subsidies” (White Paper) in June 2020 in which it considered how the EU can address this challenge [1]. The article analyses the efficiency of mechanisms presented in this White Paper.

Key words: *foreign subsidy, foreign investments, trade regulation, EU.*

JEL: F36, K21, H25

doi:10.17323/2499-9415-2020-4-24-64-70

The article was submitted to the editors in December 2020.

Introduction

The economies of the member states of the European Union (EU) and the EU as a whole demonstrate stable rates of development. However, endless changes in the world economy, e.g. the explosive growth of developing countries and the increase in world trade are forcing countries to modernize their trade policies. According to the UNCTAD statistics, exports of developing countries grew from 1.4 trillion U.S. dollars in 1995 to 9.1 trillion U.S. dollars in 2019; alongside the growth of global exports over the same period from 5.1 trillion U.S. dollars to 18.9 trillion U.S. dollars. Thus, the share of these countries in the world trade turnover increased from 28% to 52% in 24 years [2].

¹ Mikhail V. Glazatov — Deputy Head of Unit, Department for Trade Negotiations, Ministry of Economic Development of the Russian Federation, Moscow, Russian Federation. E-mail: mglazatov@yandex.ru

² Doston B. Karimov — Lead Specialist-Expert, Department for Trade Negotiations, Ministry of Economic Development of the Russian Federation, Moscow, Russian Federation. E-mail: doston001@list.ru

In addition to the rapid development of trade, there is also the increase in foreign direct investment (FDI) from developing countries in favour of developed countries. For instance, the inward FDI flow in the EU has increased in value by almost 1,200 per cent since 2000. In addition, FDI flows into the EU increased by 14%, accounting for 31% of global FDI inflows [3].

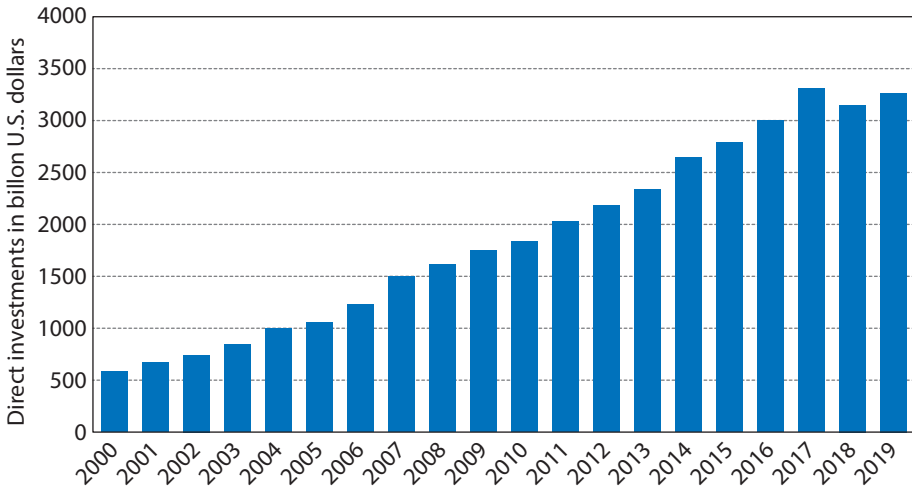


Fig. 1. FDI flow into the EU (2000–2019), bln USD

Source: [4].

As a result, great openness to foreign investment has come with not only opportunities for the EU economy, but also with increased risks such as foreign subsidisation, which needs to be controlled by the authorities to avoid undermining competition within the EU market.

Indeed, the EU in the internal market is faced with the fact that enterprises with foreign capital can be uncontrollably subsidized from abroad, whereby less efficient enterprises grow and increase market share to the detriment of more efficient enterprises [5].

Subsidies as a Market Distortion Factor

According to the EU regulations, subsidies from foreign states in favor of firms with foreign capital in the EU distort the internal market and might be harmful to “local” enterprises (with capital from the EU member states), since the practice of providing domestic subsidies to local enterprises will be regulated by the EU legislation.

Subsidies provided by the Member States are subject to the EU State Aid rules to avoid distortions. According to the general rule established in the Article 107 of the Treaty on the Functioning of the European Union, any aid granted by a Mem-

ber State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States, be incompatible with the internal market. However, several measures shall be compatible with the internal market, namely: aid having a social character, aid to make good the damage caused by natural disasters or exceptional occurrences, aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany.

Other measures may be considered to be compatible with the internal market, namely: aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State, aid to facilitate the development of certain economic activities or certain economic areas, aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union. The Council on a proposal from the Commission may specify other categories of aid that may be considered to be compatible with the internal market.

Article 108 of the Treaty on the Functioning of the European Union established the system of control the compatibility of the aid provided to undertakings by the Member States. Pursuant to this Article, if the Commission finds that aid granted by a Member State or through State resources is not compatible with the internal market or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a time to be determined by the Commission. Thus, the provision of any aid (including subsidies) granting by a Member State is strictly regulated unlike subsidies provided by foreign jurisdictions.

According to the European Trade Commissioner F. Hogan, the trade practices of foreign states including the use of subsidies distort the competitive environment for companies in the EU. In addition to the already available trade policy instruments, e.g. a mechanism for screening foreign investments and trade protection measures, the White paper on levelling the foreign subsidies would be a helpful toolbox for EU market [6].

Commissioner for the Internal Market T. Breton believes that the White Paper delivers a key element for the vision of Europe's New Industrial Strategy based on competition, open markets and a strong Single Market.

Thus, the purposes of the White Paper are broadly to inform and discuss the levelling the foreign subsidies in the EU market. The document proposes three new approaches so-called "Modules" to ensure a level playing field in the market and to address the abovementioned regulatory gap.

Regulatory Modules

Module 1. Instrument to Capture Distortive Effects of Foreign Subsidies. This module assumes a wide coverage of enterprises to assess possible distortions caused by foreign subsidies in the EU. The assessment will not be limited to only EU resident enterprises that benefit from foreign subsidies, but may also cover foreign enterprises active in the EU and receiving foreign subsidies. However, it may be difficult to estimate subsidies; therefore, it suggests using indicators such as the size of the subsidy and the company's share of the EU market. Moreover, the Union proposes to establish a de minimis threshold for foreign subsidies of 200,000 euros for three consecutive years.

Module 2. Instrument to capture distortive effects in the context of acquisitions of EU companies. It aims to identify and eliminate distortions caused by acquisitions of EU enterprises (in whole or part) through foreign subsidies. Thus, the EU intends to eliminate unfair benefits from foreign subsidies in the process of such transactions.

Module 3. Instrument to capture distortive effects by foreign subsidies in the EU public procurement procedures. This module aims to identify and eliminate distortions from foreign subsidies that allow an enterprise to benefit from public procurement. In this case, rules should be developed to tackle foreign subsidies and abnormally low tenders. It is noted that if foreign subsidies allow an enterprise to submit an offer that, in the case of bidding, is below market price/below costs, then a distortion could be assumed.

For an effective mechanism to regulate such cases, enterprises will have to notify the contracting authority at the stage of applying whether they have received relevant foreign subsidies within the last three years and to what extent.

Moreover, in all modules the mechanisms for assessing potential misstatements consist of the same two steps, namely (1) reviewing possible misstatements in the domestic market and, if there is evidence that a particular foreign subsidy is disrupting the proper functioning of the domestic market, (2) will conduct an investigation. At the end of the investigation, if it is confirmed that the functioning of the domestic market may have been or may be distorted because of a foreign subsidy, the competent supervisor has the opportunity to take steps to correct those distortions.

Impact on the European Business

The White Paper was open for public consultation until September 2020. Large EU companies have responded to the European Commission by publishing their reflections on this issue. Thus, the French Association of Large Companies (AFEP) claimed that it would be indeed inappropriate to qualify generic and/or non-com-

pany-specific R&D subsidies granted by third countries as distortive for a company being active on the EU internal market while these types of subsidies granted by the EU Member States are deemed to be compatible with EU treaties [7].

Regarding substantive assessment criteria to be used for module 1 and 2, large French companies insist that standards used for market analysis in the review of EU internal merger and acquisition or state aid could in some instances prove unable to identify certain distortive effects if applied mechanically and cumulatively.

This might be the case for the “level of activity” or the “situation of market” criteria that would leave undetected distortive foreign subsidies used to set a foot on the sectoral market in question and pave the way for a future dominance via a dormant presence. In the same way, privileged access to the domestic market for national operators should be considered as a possible assessment parameter. This is related to a flexible assessment methodology based on a logic of evidence collection and the issuance of implementing guidelines, especially when assessment criteria are to be used by national supervising authorities in the context of module 1.

Also, when it comes to the correlation within the three modules system, it is important that the proposed architecture does not create overlaps or introduce ex-post reviews where ex-ante remedies are preferable for legal certainty, provided that administrative burden and negative impact on economic operations is minimised (for instance for the review of merger and acquisition or in procurement tendering procedures). Therefore, AFEP suggests that module 1 does not cover acquisition operations or public procurement, these operations being then exclusively reviewed under respectively under module 2 and module 3.

In addition, the European Aluminium highlights that the White Paper should be more focused on the accumulated impact of subsidies from the same source distorting the EU market through different economic operators. Redressive measures under each of the Modules must take adequately into account the situation where a single country repeatedly subsidizes different enterprises in different market segments. The European Aluminium supports shared management of responsibilities between the Commission and the Member States, however, the operational aspects and competencies should be clarified and strengthened. The Modules should operate in parallel in a coordinated manner to best address foreign subsidies and address circumvention most effectively [8].

Conclusion

Despite many pros and cons, EU companies welcome the proposal by the European Commission to address the issue of distortive subsidies in the context of the EU funding. The European business supports free and fair trade, which based on a rules-based trade system.

In this way, the White Paper sets out a general approach to foreign subsidies in the context of the EU funding. The White Paper is able present useful concepts for the EU market aimed at capturing the impact of foreign subsidies on enterprises which are based on non-market-oriented mechanisms. It should be noted that this approach, which is relatively new in the history of the EU financial rules would become increasingly widespread among other countries if the EU adopts legislation at an early date.

References

- [1] EU foreign subsidies. URL: https://ec.europa.eu/competition/international/overview/foreign_subsidies.html#:~:text=The%20White%20Paper,companies%20operating%20in%20the%20EU
- [2] UNCTAD Handbook of Statistics 2002. URL: <https://unctad.org/webflyer/unctad-handbook-statistics-2002>
- [3] FDI IN FIGURES. OECD, 2020. URL: <http://www.oecd.org/investment/FDI-in-Figures-April-2020.pdf>
- [4] EU direct investment flows, breakdown by partner country and economic activity (BPM6). URL: <https://appsso.eurostat.ec.europa.eu/nui/submit-ViewTableAction.do> [5] White Paper on Foreign Subsidies. URL: <https://www.dlapiper.com/en/us/insights/publications/2020/12/antitrust-matters--special-edition/white-paper-on-foreign-subsidies/>
- [5] O'Connor B., Toffoletti L., Mazzocchi F. Italy: Nctm Reply to The White Paper on Levelling the Playing Field as regards Foreign Subsidies. 9 November 2020. URL: <https://www.mondaq.com/italy/antitrust-eu-competition-/1002918/nctm-reply-to-the-white-paper-on-levelling-the-playing-field-as-regards-foreign-subsidies>
- [6] Public consultation on the White Paper of the European Commission on foreign subsidies AFEP, 2020. URL: https://afep.com/wpcontent/uploads/2020/10/AFEP_Comments_on_the_White_paper_on_foreign_subsidies.pdf
- [7] White Paper on foreign subsidies — Position paper. European Aluminium, 2020. URL: <https://european-aluminium.eu/media/2994/european-aluminium-position-on-the-white-paper-on-foreign-subsidies.pdf>

М.В. Глазатов³, Д.Б. Каримов⁴

Уравнивание условий применения иностранных субсидий в ЕС: новая форма протекционизма?

Открытость к иностранным инвестициям привела к бурному развитию экономики Европейского союза (ЕС), но в то же время — к возросшим вызовам и угрозам, таким как недостаточное регулирование потоков иностранных субсидий на территорию ЕС. В большинстве своем действующее законодательство обеспечивает равные правила на внутреннем рынке, однако субсидии, предоставляемые иностранными государствами предприятиям, находящимся в ЕС, не контролируются и вызывают обеспокоенность Европейской комиссии. На этом фоне Комиссия опубликовала в июне 2020 г. Белую книгу, в которой рассматривается указанная проблема. В статье анализируется механизм и эффективность данного документа.

Ключевые слова: иностранные субсидии, иностранные инвестиции, регулирование торговли, ЕС.

JEL: F36, K21, H25

doi:10.17323/2499-9415-2020-4-24-64-70

Статья поступила в редакцию в декабре 2020 г.

³ Глазатов Михаил Владимирович — заместитель начальника отдела, Департамент торговых переговоров, Министерство экономического развития Российской Федерации, Москва, Российская Федерация. E-mail: mglazatov@yandex.ru

⁴ Каримов Достон Буриевич — ведущий специалист-эксперт, Департамент торговых переговоров, Министерство экономического развития Российской Федерации, Москва, Российская Федерация. E-mail: doston001@list.ru