The EU Foreign Subsidies Regulation: New Economic Statecraft of the EU or Business as Usual?

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Graphics Credit: REUTERS/Yves Herman

The war in Ukraine, the war in Israel, Covid, tense trade relations with China, disrupted supply chains, and also the changes in relations with the United States, to name just a few prominent examples, are forcing the European Union ("EU") to rethink its own position in the world economy.

The reaction of many countries to these events is protectionist measures. Subsidies are one of the simplest protectionist measures. Subsidies have more than tripled worldwide in the last decade.[116] To name just one prominent example: In August 2022, U.S. President Joe Biden announced the Inflation Reduction Act ("IRA") – $1 trillion in subsidies including tax incentives. [117] French President Emmanuel Macron responded to the IRA by saying that it would be a "killer for our industry."[118q] Another example is the global race to boost the green industry through subsidies.[119]

Subsidies are often highly debated in the world trading system.[120] The EU is therefore also quickly tempted to react with subsidies in order to protect its own

[q] See also Nelson (2023), who also quotes the British and South Korean position on the IRA: "dangerous" because it "could slip into protectionism."

See Nelson, Eshe. 2023, January 21. "At Davos, European Distress Over a 'Made in America' Law." *The New York Times*. https://www.nytimes.com/2023/01/21/business/davos-europe-inflation-reduction-act.html?searchResultPosition=11.

market.[121r] The opposite of protectionist measures is the market-based approach including free trade and free investment. The fundamental conditions for this are political will and ensuring that the market functions properly.

The aim of the EU is to "ensure a level playing field in the EU's Single Market."[122s] A competitive, strong, and open single market enables EU companies to compete and operate globally. [123] The European Commission ("Commission") describes in its white paper on leveling the playing field as regards foreign subsidies that economy's resilience can only be achieved through openness to trade and investment.[124] However, the basic prerequisite is that trade and investment are accompanied by "fairness and predictable rules."[125] The Commission gives a few examples of unfair practices such as "shielding industries from competition through selective market opening, licensing and other investment restrictions, as well as providing subsidies which undermine the level playing field to both state-owned and private sector companies."[126]

So how to react to such unfair practices? The EU decided to regulate third-country subsidies through the Foreign Subsidies Regulation ("FSR"). My work analyzes how the FSR closes a gap in the EU economic statecraft and preserves the competitiveness of the EU internal market.

Gap in EU Economic Statecraft

The main objective of the EU is to establish an internal market.[t] The internal market is a system designed to protect competition from distortions.[127] Distortions of competition in the EU internal market have so far been prevented by the following economic statecraft: EU State Aid Law, Foreign Direct Investment Screening ("FDI Screening"), and Merger Control.

EU State Aid Law

In the EU, state aid granted by Member States to companies is subject to strict control. The aim is to ensure fair conditions for all companies to carry out their activities in the European internal market.[128] Art 107 (1) TFEU establishes a general prohibition of aid.[u] Paragraphs 2[v] and 3[w] set out exceptions to this rule. Member States have transferred extensive competition competences to the EU.[x] Consequently, there is no further regulation by the member states in this regard. Furthermore, EU state aid law only affects the EU internal market, and in fact only "domestic" EU companies are affected. Thus, EU state aid law is a behind-the-border EU intervention.

FDI Screening

Foreign direct investment can be a great opportunity for countries, but at the same time the country must ensure that its national security interests are not affected.[129]

The EU has no competence to regulate FDI screening uniformly at-the-borders of the EU. Consequently, twenty-seven member states regulate more or less restrictive FDI. In fact, the EU Commission only has the right to issue an opinion.[130] However, the opinion is not binding for the respective member state. It could be argued that FDI screening did not play a major role in the past because it was usually not a major issue or no notification requirement was necessary. But with

[r] The Economist (2023, February 9) calls it "the copycat trap."
[s] Fixed term *see i.e.* European Commission (2020, February 28) is the enforcement body pursuant to the EU Treaty.
[t] Art. 3 (2) subsection 3 TEU; Art. 3 (1) b) TFEU (exclusive competence of the EU).
[u] Article 107(1) of the TFEU defines both aid and implements a fundamental prohibition on aid: "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."
[v] Article 107(2) TFEU lists exceptions to aid considered compatible with the internal market, i.e. repair of damage caused by natural disasters.
[w] Article 107(3) TFEU in turn lists further exceptions that may be considered compatible with the internal market, i.e. to remedy a serious disturbance in the economy of a Member State.
[x] Art. 3 (2) subsection 3 TEU; Art. 3 (1) b) TFEU.

the Ukraine war and the tightening position towards China, some member states have also tightened the FDI screening or make / want to make more use of their screening competence.[131] In 2022, for example, Slovakia introduced a new FDI screening process, and eight other member states tightened their FDI screening process.[132]

Thus, the FDI screening takes place at the border of each individual Member State and the EU has no competence in this regard; the FDI Screening is an at-the-border of each Member State intervention.

Merger Control

The EU's legal instruments with regard to corporate competition rules include a ban on cartels (Art. 101 TFEU), the ban on the abuse of a dominant market position (Art. 102 TFEU), and EU merger control.

Merger control is a split competence: if certain criteria are fulfilled, an exclusive competence of the EU Commission is established. If these criteria are not fulfilled, responsibility remains with the individual member states. The establishment of exclusive EU jurisdiction is based on turnover thresholds of the merging companies and on the notification requirement[y]. Furthermore, there is the ability for a referral to be made by the EU Commission to national antitrust authorities and vice versa. Consequently, merger control is carried out either by the EU Commission or by the respective member state.

The merger control is carried out for domestic companies as well as for companies from third countries when entering the EU single market or the domestic market of the respective member state. Consequently, it is an intervention behind-the-border with regard to the EU internal market or the individual market of the member state.

Description of the Gap in Legislation

The EU's goal is to ensure a "strong, open and competitive internal market."[133] The internal market is threatened by third-country subsidies. Whenever companies receive financial support from governments, this financial support allows them to gain a competitive advantage over their competitors. For example, financial support may allow a company to offer low prices and unfairly disadvantage competitors, or they may facilitate the financing of acquisitions of EU companies. Companies can also undermine the level playing field in public tenders by helping subsidized companies undercut their competitors.

The EU State Aid law prohibits, with very few exceptions, subsidies from EU member states within the EU. Until now, however, companies from third countries have been allowed to invest in the EU, even though they have received substantial subsidies from third countries. This can and has led in the past to considerable market distortions in the EU internal market. FSR as an instrument "at the border" of the EU should prevent such distortions in the future.

That is why FSR was created. FSR is a separate pillar in addition to merger control, FDI screening, and state aid law. It should be emphasized, however, that FSR affects the regulatory content of all the three aforementioned interventions.

On 12 January 2023, the FSR regulation became effective, but was not applicable until 12 July 2023.

Working Mechanism of FSR

FSR creates 3 new tools for the Commission to audit financial contributions received by companies operating in the EU from third countries:

(1) "A notification-based tool to investigate concentrations involving financial contributions

[y] Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation).

granted by non-EU governments, where the acquired company, one of the merging parties or the joint venture generates an EU turnover of at least €500 million and the transaction involves foreign financial contributions of more than €50 million;

(2) A notification-based tool to investigate bids in public procurement procedures involving financial contributions by non-EU governments, where the estimated contract value is at least €250 million and the bid involves a foreign financial contribution of at least €4 million per third country; and

(3) A general tool to investigate all other market situations, where the Commission can start a review on its own initiative (ex-officio)."[134]

From this previous description it is clear that FSR is an intervention of the EU at the border. Compared to the previous interventions, this is a measure that always takes place at the EU external border – at-the-border EU intervention. Consequently, a screening for distortions of competition is carried out at the external border.

Will FSR be a Success?

Initially, EU companies welcomed the FSR project because it should lead to equality of arms:[135] third countries were previously allowed to provide unlimited support to their players. EU member states, on the other hand, are heavily regulated by EU state aid law as to what support they can allow domestic European companies to receive.

In the case of FSR, the Commission chose the consultation procedure for the draft implementing regulation, including the forms. But after the first draft became known, there was a wave of criticism from the corporate world; in some cases, there was talk of horror.[136]

One of the main points of criticism from companies was the enormous administrative burden. The Commission has tried to address this criticism in its implementing regulation.[137] In addition, many terms of the FSR are blurry, i.e. the FSR is not directly based on subsidies for the audit, but on foreign financial contributions.[z]

You cannot call it equality of arms because EU companies can also face major bureaucratic hurdles. In addition, the above-mentioned limits are too high to prevent distortions of competition; for example, the start-up sector is not included. Even an economic market such as Germany, which is based on large SMEs, is only partially covered by the "protection of the FSR." There is also a huge risk that the European single market will become unattractive for foreign direct investment. This applies all the more if other factors are added, such as a high level of interest rates.

Conclusion

In summary, it can be said that FSR serves to protect the European internal market. In this respect, FSR could be classified as a protectionist measure and the EU could be accused of behaving like other countries.

At a second glance, it can be seen that the EU aims to uphold free trade and free investment in the EU internal market and to maintain these objectives for the future. The EU is thus trying to find a third way against protectionism and purely liberal trade and investment. Only time will tell whether a new economic statecraft of the EU will develop from this. In any case, it would be desirable for the EU to continue to push in this direction. In the handling of FSR, care will nevertheless be taken to ensure that bureaucracy does not outweigh the benefits.

[z] The term "foreign financial contributions" encompasses more than the concept of subsidies.

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