

Understanding the Foreign Subsidies Regulation

INTRODUCTION

The Foreign Subsidies Regulation (FSR) is a new instrument through which the European Union seeks to ensure the level playing field in the internal market.¹ The FSR came about as a result of concerns about the effects of, especially, Chinese subsidies on the internal market of the European Union that could not be remedied using existing remedies. In particular, the FSR seeks to prevent distortions caused by foreign subsidies received by operators engaged in economic activity within the internal market.

In its design, the FSR is a hybrid instrument drawing on concepts under EU competition law (merger control and State aid law), the EU Basic Anti-Subsidy Regulation,² EU public procurement law and the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement). Reflecting that hybrid character, the legal bases of the FSR are Article 114 of the Treaty on the Functioning of the European Union (TFEU) (internal market harmonisation) and Article 207 TFEU (common commercial policy). Nevertheless, in practice and in the academic commentary on the FSR, competition and public procurement lawyers are primarily active in the public discourse on this new autonomous instrument of the European Union. Trade lawyers appear to focus less on this new instrument. In part, this is understandable because mergers and participation in public tenders in the European Union are likely to be, in the short term, the main areas of economic activity affected by the new powers of the Commission and, where necessary, the remedies which the Commission may impose. This is especially confirmed by the fact that, at present, the notification-based tools are already being used. At the same time, the definition of a foreign subsidy in the FSR, the balancing test and the manner in which investigations (including in third countries) might be conducted are just a few examples of how the practice of trade remedy investigations might inform the application of the FSR.

¹ Regulation (EU) 2022/2560 of the European Parliament and of the Council of 14 December 2022 on foreign subsidies distorting the internal market OJ 2022 L 330, p. 1, recital 6.

² Regulation (EU) 2016/1037 of the European Parliament and of the Council of 8 June 2016 on protection against subsidised imports from countries not members of the European Union (Basic Anti-Subsidy Regulation) OJ 2016 L 176, p. 55.



FILLING A GAP IN THE AVAILABLE REMEDIES

Existing EU trade and competition policy instruments were not designed to address the distortive effects of foreign subsidies.

The European Union – unlike other major trading partners granting subsidies – operates an elaborate State aid control mechanism, which prohibits the granting of aid by its Member States unless authorised by the Commission under (now) Article 107 TFEU. That model of controlling the granting of subsidies (that is, State aid) was developed because of the recognition of the importance of protecting undistorted competition for the functioning of the internal market. Moreover, there was an additional concern that certain Member States might trigger a “race to the bottom” by excessively subsidising domestic businesses with lasting effects on competition in the internal market. The same concerns persist today, especially as a result of various types of flexibility envisaged under EU State aid control and the incentives created for the Member States to contribute to, for example, the Green Deal Industrial Plan.

However, EU State aid control targets aid granted by the Member States, but not subsidies of third countries and their effects on competition in the internal market. Likewise, EU trade remedies legislation does not empower the European Union to take action against the effects of foreign subsidies (including on investment and trade in services) other than against imports of goods benefitting from those subsidies. The Basic Anti-Subsidy Regulation and Part V of the SCM Agreement only allow the European Union to impose countervailing duties on imports of subsidised goods into the European Union that cause or threaten to cause material injury to the EU industry. They do not address potentially distortive effects of subsidies granted by third countries on, notably, services, investments, or other financial flows within the internal market. This is also recognised by the FSR, which states that “[t]rade defence instruments enable the Commission to act when subsidised goods are imported into the Union, but not when foreign subsidies take the form of subsidised investments, or when services and financial flows are concerned.”³

To fill this perceived gap, the FSR underlines that its objective is that of “establishing a harmonised framework to address distortions caused, directly or indirectly, by foreign subsidies, with a view to ensuring a level playing field, contributing to the resilience of the internal market and thereby EU’s open strategic autonomy.”⁴ Moreover, the FSR is without prejudice to the application of EU competition law, the

³ Regulation (EU) 2022/2560, *supra* note 2, Preamble, Recital 5.

⁴ *Id.* Recital 7 and art. 1.

Basic Anti-Subsidy Regulation, the Foreign Direct Investment (FDI) Screening Regulation, the International Procurement Instrument (IPI), and Regulation 2019/712 (the Regulation on subsidies in air transport). In addition, recital 9 in the preamble to the FSR explicitly confirms that “[t]his Regulation should be applied and interpreted in light of the relevant Union legislation, including that relating to State aid, mergers and public procurement.”

Those features explain why there is considerable uncertainty about how the FSR will be applied. In turn, those features affect the due diligence and other compliance obligations of companies and the preparatory steps that they must undertake for notifying transactions or otherwise anticipating the initiation of a Commission investigation into the distortive effects of foreign subsidies on competition in the internal market.

Against that background, the FSR offers means to redress (foreign) subsidies which are not already captured by existing EU and WTO subsidies regimes. Recital 69 FSR explicitly states that “[t]he implementation of this Regulation by the Union should comply with [. . .] the WTO Agreement” and that it “should complement the Union[‘s] effort to improve multilateral rules on addressing distortive subsidies.” In the absence of progress in reforming multilateral disciplines on subsidies, the FSR already provides the European Union with an opportunity to collect information about the incidence and magnitude of subsidies worldwide. The FSR further allows the European Union to experiment with what might (or might not) become clear, justifiable, and practical rules on these subsidies. In fact, the European Union might intend to start building a critical mass within the WTO Membership for the approach reflected in the FSR and ultimately gain leverage in negotiations on multilateral reform. In effect, the FSR might prompt other WTO Members to re-evaluate the adequacy of the current SCM Agreement.

THREE ENFORCEMENT TOOLS

The FSR enforcement regime is organised around three “tools” for the European Commission (“Commission”) to investigate the distortive effects of foreign subsidies. Under the *ex officio* tool, the Commission may investigate the distortive effects of foreign subsidies on the internal market of its own initiative, regardless of the level of the subsidy or the economic activity in the European Union possibly affected by the subsidies. In essence, the *ex officio* tool must be understood as operating as a type of

catch-call control. So far, no ex officio investigation has been initiated. In addition, the FSR provides for two notification-based tools: the M&A tool and the public procurement tool. Within the scope of these two tools, concentrations and participation in a public procurement tender must be notified to the Commission under certain conditions, and the Commission may also request notification when notifications are not mandatory. Compliance with these novel notification requirements requires significant preparation and investment in due diligence from companies investing and operating in the European Union. Moreover, nothing in the FSR precludes the Commission from, in essence, using the powers under the new instrument to pursue the European Union's industrial policy goals. As things stand, notifications are being filed and pre-notification discussions are being organised. On 16 February 2024, the Commission announced that it had started its first in-depth investigation, under the public procurement tool, into subsidies received by a Chinese State-owned rolling stock manufacturer active in the rail transport sector.

USING THE FSR EX OFFICIO TOOL

Whilst the notification-based tools are already being actively used, we await the first use of the ex officio tool. Although the FSR does not provide for a complaints mechanism, the Commission is nevertheless, on a gradual basis, starting to offer some insights on the sectors and contexts in which it might resort to that tool.

The European Union explicitly situates foreign subsidies within its Economic Security Strategy.⁵ The European Union considers that its economic dependency on trading partners might pose risks to its economic security and thus its autonomy. The priorities of the EU Economic Security Strategy centre around: (i) promoting the European Union's competitiveness; (ii) protecting the European Union from commonly identified economic security risks; and (iii) partnering with like-minded countries.⁶ The EU Economic Security Strategy identifies foreign subsidies as threats to the EU internal market and stresses that the Commission "is ready to deploy" the FSR to address the "weaponization of economic dependencies."⁷

⁵ European Economic Security Strategy JOIN (2023) 20 final, at <<https://data.consilium.europa.eu/doc/document/ST-10919-2023-INIT/en/pdf>> (accessed 2 January 2024).

⁶ *Id.* at 2–3.

⁷ *Id.* at 7–8.

Moreover, various reports signal that the Commission might also use the *ex officio* tool to focus on sectors of economic activity that are central to the European Union's sustainability efforts. The 2023 Strategic Foresight Report states that "to achieve open strategic autonomy, including economic security", the European Union should make "better and more strategic use of [. . .] the regulation on foreign subsidies" whereby the European Union ensures "strong linkages between market access and high sustainability standards."⁸ Similar to its climate-recalibrated enforcement of EU State aid rules, the Commission might focus on foreign subsidies that distort the EU internal market in view of the European Union's ambitions related to climate, environmental protection, and energy. Likewise, in the European Wind Power Action Plan,⁹ the Commission announced that it would use the FSR tools to counter any foreign subsidisation of wind-related products on the EU market.¹⁰ To that end, the Commission has explicitly encouraged the European wind industry to submit further evidence on foreign subsidies granted to their competitors.

Moreover, apart from China, the Commission has closely monitored other major subsidisers, including the United States. On 18 July 2023, Executive Vice-President Dombrovskis signalled that the European Union might adopt trade defence measures in respect of imports of US-originating goods subsidised under the Inflation Reduction Act (IRA).¹¹ The statement of Commissioner Dombrovskis indicates that the European Union is ready to recalibrate its common commercial policy instruments to protect its interests against any effect on trade and, ultimately, distortion in the internal market, including effects resulting from the commercial policies of its trade partners, such as the United States.

However, in recent years the European Union and its Member States have also decided to make significant amounts of State aid available in order to pursue industrial policy goals. More broadly, the global subsidies race has gained momentum in recent years. The participation of the Member States in this race limits the remedial scope of the FSR and undermines the general and undifferentiated narrative underlying the FSR that strict EU State aid control puts at a disadvantage European companies. In fact, if the

⁸ Commission Communication to the European Parliament and the Council, "2023 Strategic Foresight Report: Sustainability and people's wellbeing at the heart of Europe's Open Strategic Autonomy" COM (2023) 376 final.

⁹ Commission Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, "European Wind Power Action Plan" COM (2023) 669 final.

¹⁰ *Id.* Action 12.

¹¹ European Commission, "Statement by Executive Vice-President Dombrovskis at the ECON Committee of the European Parliament on the EU's reaction to the US Inflation Reduction Act (IRA)" (18 July 2023), at <https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_23_3926> (accessed 2 January 2024).

European Union seeks to treat domestic and foreign subsidies on equal footing, this means that as the level of State aid control is loosened, the scrutiny of foreign subsidies is to be correspondingly weakened. Thus, if the European Union wants to facilitate the granting of State aid for various green (tech) projects and investments, the scrutiny of the subsidies given to its trade partners for those very purposes must likewise be weakened under the FSR. This should, especially, be the case since such aid benefits economic activity in the European Union. Moreover, if the European Union's trading partners increasingly make their (green) subsidies dependent on using local content, those subsidies promote investments at home – and not abroad. Against that type of subsidy – a main concern of the European Union – the FSR is not necessarily a strong response.

*Isabelle Van Damme**

Partner at Van Bael & Bellis

Visiting Professor

College of Europe, Belgium

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