

The Draft Foreign Subsidies Regulation – Relationship with other Union Instruments – Some Thoughts on Multilevel Enforcement and Duplication of Efforts

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Abstract

The article analyses the interaction of the proposed new Foreign Subsidies Regulation with other existing instruments under EU law and international agreements that deal with or regulate subsidies from non-EU sources and their effects in the EU. The analysis looks at the relationship with, in particular, EU competition, State aid, public procurement and countervailing duty rules, as well as with a number of international agreements. The conclusion is that a concurrent application of the new rules with the existing rules is intended (except for subsidies covered by the countervailing duty regime). A considerable additional administrative burden, for economic operators (not only in countries targeted by the measures such as China) and the public administration will result from the new rules.

Keywords: Subsidies, State Aid, Foreign Subsidies, Foreign Subsidies Regulation, Countervailing Duty Rules, WTO Subsidy Rules, Mergers and Foreign Subsidies, Public Procurement and Foreign Subsidies, Hierarchy of Norms (Applicable to Foreign Subsidies), Concurrent Application of Rules (to Foreign Subsidies)

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A. Background

The Draft Foreign Subsidies Regulation¹ (the “Draft Regulation”) reflects the fact that foreign subsidies distort competition in the internal market. It is based on a perceived mismatch between the control the Union can exercise over State aid granted by Member States and that over third country subsidies. The mismatch follows from the Commission’s gap analysis:²

- The Commission found that the Union’s competition law instruments, trade and FDI policy, as well as public procurement rules do not *adequately* address distortions that foreign subsidies cause, because, while addressing some of their effects in some cases, they do not address their effects on the internal market comprehensively. Merger Control deals with competitive effects of concentrations (and not subsidies), FDI screening focuses on security concerns (not subsidies) and public procurement rules do not specifically address subsidization either.
- The Commission reaches a similar conclusion as regards international agreements: the scope of application of the WTO/countervailing duty rules (including the Agreement on Subsidies and Countervailing Measures (“ASCM”))³ is too narrow and not working properly (measures can be taken *vis-à-vis* imported goods only; it’s not relevant for services and capital flows (foreign direct investment), and the dispute settlement process is broken as a result of the U.S. blockage). The official texts are relatively silent with respect to Free Trade Agreements (“FTAs”);⁴ the concern is that the FTAs do not lead to sufficiently effective scrutiny of foreign subsidies.

However, while the existing rules may not cover all cases and may not always address them from the perspective of preventing distortions of the internal market, such rules do apply and regulate foreign subsidies and their treatment in certain cases. The proposed new rules will therefore take center stage in an already complex “web” of rules applicable to foreign subsidies. And, unsurprisingly, if a multitude of rules apply to a single situation, such a multitude leads to uncertainty and a need for rules defining which rules should actually apply and in what order.

1 *European Commission*, Proposal for a Regulation of the European Parliament and of the Council on foreign subsidies distorting the internal market, 5/5/2021, COM (2021) 223 final; EP, Legislative Observatory (OEL), file 2021/0114 (COD).

2 See, *European Commission*, White paper on levelling the playing field as regards foreign subsidies, COM(2020) 253 final, as well as Chapter 2 of the impact assessment report accompanying the proposal for the Draft Regulation.

3 Agreement on Subsidies and Countervailing Measures (“ASCM”), an agreement that is part of Annex 1A (Multilateral Agreements on Trade in Goods) of the Marrakesh Agreement Establishing the World Trade Organization, OJ 1994 L 336/3.

4 See, however, the impact assessment attached to the Commission Proposal, point 1.5.4, p. 53.

B. Relationship of the Draft Regulation to other legal rules

I. Overview

The relationship of the Draft Regulation with other legal instruments applicable within the Union's legal order is addressed in some detail in Art. 40, which must, moreover, be placed in the context of the rules on the hierarchy of norms that generally apply within the Union.

The basic principles, based on primary law, are well established:⁵

- Primary law (i.e., the rules of the treaties themselves (incl. protocols etc.)) ranks above secondary law, while various rules of secondary law generally have the same rank. Secondary law can further specify the hierarchical relationship between various rules of secondary law.
- It follows from Article 218(11) TFEU that international agreements rank below EU primary law and it follows from Article 216(2) TFEU that international agreements rank above EU secondary law; and
- The provisions of an international agreement, from its coming into force, form an “integral part” of Union law.⁶

Against this background it is not surprising that Art. 40 of the Draft Regulation is aimed at regulating the relationship of the Draft Regulation to other instruments consistent with such general rules.

As regards the relationship of the Draft Regulation with international agreements, Art. 40(7) provides – in line with the hierarchical rank of international agreements – that no investigations and no measures under the Draft Regulation shall be taken, if that “would be contrary to the Union's obligations” under its international agreements. Art. 40(7)(2) requires, even more specifically, that no “specific action against a subsidy within the meaning of Art. 32.1 of the Agreement on Subsidies and Countervailing Measures” shall be taken under the Draft Regulation.

As regards its relationship with autonomous secondary EU law, Art. 40 Draft Regulation provides for more detailed rules. Most of the specified instruments shall apply “without prejudice” to (i.e., concurrently with) the Draft Regulation, and only in a limited number of cases shall the Draft Regulation take precedence over other EU secondary legislation, as outlined in the table below:

⁵ See e.g., *Lachmeyer/von Förster*, in: von der Groeben/Schwarze/Hatje (eds.), Art. 216 AEUV, Rn. 16, 24; *Terbechte*, in: Schwarze (ed.), Art. 216 AEUV, para. 20; ECJ, Case C-308/06, *Intertanko*, [2008] ECR 4057, paras. 42 et seq.

⁶ ECJ ever since Case 181/73, *Haegemann*, [1974] ECR 49, para. 5; *Lachmeyer/von Förster*, in: von der Groeben/Schwarze/Hatje (eds.), Art. 216 AEUV, para. 16.

Concurrent Application (“without prejudice”)		Draft Regulation Takes Precedence
The competition rules: Art. 101, 102, 106, 107, 108 TFEU	Countervailing Duty Regulation (2016/1037) ⁷	Regulation on protection against injurious pricing of vessels (2016/1035) (until fully entry into force) ⁸
Regulation 1/2003 ⁹ and the Merger Regulation (139/2004) ¹⁰	FDI Screening Regulation (2019/452) ¹¹	Regulation on unfair pricing practices in maritime transport (4057/86) ¹²
	Regulation on safeguarding competition in air transport (2019/712) ¹³	

These rules are analyzed in more detail below.

II. Relationship of the Draft Regulation to other Union internal, autonomous rules

The Draft Regulation provides in Art. 40 that it will apply concurrently with several other internal rules (“this Regulation is without prejudice to ...”). The underlying rationale is generally that those other internal rules, even where applicable to foreign subsidies, do not specifically address third country subsidization and its effect on the internal market.

1. Concurrent application with other internal rules is the rule

Pursuant to Art. 40(1), the Draft Regulation will apply concurrently with the competition rules applicable to undertakings, i.e., Art. 101, 102, 106 TFEU and sec-

7 Regulation (EU) 2016/1037 of 8 June 2016 on protection against subsidised imports from countries not members of the European Union (“Countervailing Duty Regulation”), OJ 2016 L 176/55, as amended.

8 Regulation (EU) 2016/1035 of 8 June 2016 on protection against injurious pricing of vessels, OJ 2016 L 176/1.

9 Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition; OJ 2003 L 1/1, as amended.

10 Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation), OJ 2004 L 24/1, as amended.

11 Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union, OJ 2019 L 79I/1.

12 Council Regulation (EEC) No 4057/86 of 22 December 1986 on unfair pricing practices in maritime transport, OJ 1986 L 378/14.

13 Regulation (EU) 2019/712 of 17 April 2019 on safeguarding competition in air transport, OJ 2019 L 123/4.

ondary legislation, such as Regulation 1/2003¹⁴ and the Merger Regulation (Reg. 139/2004).¹⁵ As regards the rules of primary law, this may involve a slight overstatement, because secondary legislation (as the Draft Regulation, once enacted) cannot modify the scope of application of primary law. So, in the (unlikely) event of any inconsistency, the Treaty rules would always take precedence.

Pursuant to Art. 40(6), the Draft Regulation will also apply concurrently with certain “specialized” competition rules, such as the Regulation on safeguarding competition in air transport (Reg. 2019/712).¹⁶ The Draft Regulation would require “concentrations” and procurement proceedings involving air carriers to be analyzed under the Draft Regulation.

In addition, under Art. 40(1), the Draft Regulation will apply concurrently with the State aid rules (Art. 107, 108 TFEU) and, although secondary implementing legislation in the field of State aid is not specifically mentioned in Art. 40(1), it must be inferred that such implementing legislation (including the Procedural Regulation 2015/1589¹⁷ and the General Block Exemption Regulation)¹⁸ also applies concurrently (as the State aid rules in the Treaty do not properly work without such implementing rules). The reason for the concurrent application is that the subject matter of both sets of rules is different: the State aid rules deal with State aid granted by Member States; the third country subsidy rules deal with subsidies granted by third countries. These sets of rules should, therefore, in practice, be mutually exclusive. The theoretical possibility that a subsidy is granted jointly by a Member State and a third country is not dealt with in the Draft Regulation, but concurrent application is possible in such cases, and one would expect that the substantive outcome would then be aligned. Moreover, as indicated above, the Draft Regulation cannot modify the scope of application of primary law, so in the (unlikely) event of any inconsistency, the Treaty State aid rules would take precedence over the Draft Regulation.

The Draft Regulation will also apply concurrently with the framework for the screening of foreign direct investment, i.e., Regulation 2019/452,¹⁹ in light of the different legislative objectives: Foreign Direct Investment rules address public security concerns, while the Draft Regulation addresses distortive effects of third country subsidies on the internal market.

It may appear more surprising that, pursuant to Art. 40(2), the Draft Regulation applies concurrently with the Countervailing Duty Regulation (Reg. 2016/1037).²⁰ Both sets of rules specifically deal with third country subsidies, so that the “stan-

14 See above, footnote 9.

15 See above, footnote 10.

16 See above, footnote 13.

17 Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, OJ 2015 L 248/9.

18 Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, OJ 2014 L 187/1.

19 See above, footnote 11.

20 See above, footnote 7.

standard” reason for concurrent application does not apply. But in practice, the Draft Regulation is not aimed at concurrent application, as is apparent from its Art. 40(7) and Art. 32.2 of the WTO Agreement on Subsidies and Countervailing Measures (the “ASCM”).²¹ The latter requires that “[n]o specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994”, and Art. 40(7) mandates that the Draft Regulation must not be applied where Art. 32.2 ASCM is applicable. Hence:

- Third country subsidies covered by the GATT rules and, more specifically, the ASCM (which are subsidies affecting trade in goods) fall within the scope of the Countervailing Duty Regulation only, which implements the specific requirements of the WTO and the ASCM into an autonomous EU internal trade defense instrument; they do not fall within the scope of the Draft Regulation. That would include cases in which the ASCM considers that certain subsidies are “OK” or are “not actionable”. For example, a goods-related financial benefit offered by a third country indiscriminately to all small and medium-sized enterprises is considered, pursuant to Art. 2.1 (b) and footnote 2 ASCM, to be non-specific and hence not an actionable subsidy. Even though such a financial benefit may be considered a subsidy for purposes of the Draft Regulation (following the approach in EU State aid law, which considers subsidies limited to SME’s to be specific), the Draft Regulation could not be used to act against or investigate such a subsidy.
- All third country subsidies not covered by the GATT/ASCM rules fall within the scope of the Draft Regulation. These are, in particular, subsidies linked to the provision of services, subsidies for the creation of intellectual property not incorporated into goods, subsidies supporting foreign direct investment (in particular supporting the acquisition of undertakings) and subsidies in support of procurement bids (where unrelated to the supply of goods).

The approach of Art. 40(2) thus rests on the assumption that the application of the Draft Regulation and the Countervailing Duty Regulation should, in fact, be mutually exclusive. It is, however, likely that there will be more complex cases in which one foreign subsidy supports both goods and services (and/or the underlying IP). An example could be a single subsidy for the creation (through research and development) of production know-how that is used (i) to build a production facility for goods, which are later sold domestically and for export to the EU, and (ii) licensed to interested parties within and outside the EU. The ASCM would likely cover the subsidies reflected in the goods exported to the EU. As a result, it is likely that the entire (single) subsidy is covered by the ASCM, so that “no specific action” against the subsidy should be taken on the basis of the Draft Regulation (even as regards the resulting IP being licensed to the EU). But the Draft Regulation does not specifically address these more complex cases.

21 See above, footnote 3.

2. Precedence of one rule over the other is the exception

As outlined in the overview, primary law and international agreements are, in principle, higher ranking rules that can take precedence over the Draft Regulation. However, this is not addressed in Art. 40, perhaps because there is little scope for conflict with primary law. And the relationship with international agreements is analyzed in section III. below.

Art. 40 of the Draft Regulation provides only for two specific cases where the Draft Regulation will take precedence over other EU secondary legislation:

- Regulation 2016/1035 on protection against injurious pricing of vessels.²² The reason for the precedence granted to the Draft Regulation is that Regulation 2016/1035 is not yet effectively applicable,²³ because the underlying OECD 1994 Shipbuilding Agreement²⁴ is not yet applicable (see Art. 18(2) of Reg. 2016/1035) and no longer expected to become applicable. If (and once) Reg. 2016/1035 becomes fully applicable, the order of precedence will be reversed.
- Regulation 4057/86 on unfair pricing practices in maritime transport.²⁵ The reason for the precedence granted to the Draft Regulation is that Regulation 4057/86 is essentially dead-letter-law, because it has been applied only once, early in the 35 years of its existence.²⁶

III. Relationship of the Draft Regulation to international agreements

Article 40(7) of the Draft Regulation addresses the relationship between the Draft Regulation and international agreements:

(7) An investigation pursuant to this Regulation shall not be carried out and measures shall not be imposed or maintained where such investigation or measures would be contrary to the Union's obligations emanating from any relevant international agreement it has entered into.

Article 40(7) then distinguishes between the ASCM²⁷ (which is one of the WTO Agreements implementing the GATT 1994) and other agreements under (public) international law. For subsidies covered by the ASCM, Art. 40(7) Draft Regulation

22 See above, footnote 8.

23 See Commission Proposal for the Draft Regulation, Legislative Financial Statement, COM(2021) 223 final, p. 35, point 1.5.4.

24 OECD Agreement – Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry, 21 December 1994. The European Communities ratified the Agreement (see Press Release IP/95/1377), the United States did not, and hence the Agreement has not yet entered into force, see <https://www.oecd.org/sti/ind/shipbuildingagreement-overview.htm> (16/9/2022).

25 See above, footnote 12.

26 See Council Regulation (EEC) No 15/89 of 4 January 1989 introducing a redressive duty on containerized cargo (...), OJ 1989 L 4/1.

27 See footnote 3.

provides (as discussed above, in II.B.2, *supra*) that the Draft Regulation shall not apply, being therefore limited to subsidies not regulated under GATT/ASCM rules.

There is no similarly precise rule as regards other international agreements. Hence, the Draft Regulation should not be applied if the three conditions of Art. 40(7), first sentence, are cumulatively met, i.e., where investigations or measures under the Draft Regulation would (i) be *contrary* to the *Union's obligations* emanating from (ii) *any relevant international agreement* (iii) *it has entered into*.

Hence, there must be, *first*, an international agreement that deals with the issue of third country subsidization. A number of international agreements do so, with varying degrees of detail and precision. For example, the Agreement establishing a European Economic Area (“EEA-Agreement”)²⁸ mirrors the EU State aid rules. Detailed substantive State aid rules are also contained in the Stabilization and Association Agreements (“SAA”) that link the Union with the six Western Balkan countries that aspire to join the Union.²⁹ Other Free Trade agreements broach the subject but provide much less substantive and procedural detail as regards what constitutes a permissible subsidy and how and by whom that is to be determined.³⁰

Such an agreement must, *second*, provide for an obligation for the Union not to unilaterally regulate covered subsidies. Such an obligation can be inferred, where the agreement provides that a particular institution or a particular party to an agreement shall have primary responsibility to determine whether a subsidy is permissible and consistent with the obligations under such agreement.

Some agreements prohibit subsidies in principle and provide for precise substantive criteria for their possible approval, cross-referencing EU State aid rules. They identify who is responsible for granting approvals and provide the procedure for such approval. The EEA Agreement probably provides the best example for such a comprehensive agreement. In that case, (only) the EFTA Surveillance Authority is responsible for approving State aid (subsidies) granted by the EFTA States.³¹ By pretending to have enforcement powers over the same subsidies, the Union would breach its commitments under public international law.

Other Agreements regulate the substantive requirements for subsidy approval (sometimes cross-referencing EU State aid rules) and provide for a rule that an independent authority in the contracting party granting the subsidy should review the

28 Agreement on the European Economic Area, OJ 1994 L 1/3, Art. 61 et seq.

29 The six SAA with six Western Balkan countries (WB6: North-Macedonia, Albania, Montenegro, Serbia, Bosnia-Herzegovina and Kosovo*) are similar in substance. An example is the Stabilisation and Association Agreement between the European Communities and their Member States of the one part, and the Republic of Serbia, of the other part, OJ 2013 L 278/16, in particular Art. 73.

30 E.g., Free Trade Agreement between the European Union and the Socialist Republic of Viet Nam, OJ 2020 L 186/3, in particular Art. 2.12, Art. 10 Section B; Free Trade Agreement between the European Union and the Republic of Singapore, OJ 2019 L 294/3, in particular Art. 11, Section C; Comprehensive Economic and Trade Agreement (CETA) between the European Union and Canada, OJ 2017 L 11/23, (provisional application), Chapter 7, Art. 7.1. et seq.; the aforementioned agreement excludes, for example, subsidies from the scope of their dispute settlement regimes.

31 EEA Agreement (see footnote 28), Art. 62 (1) (b).

subsidy but without regulating the procedure in detail or by reference to EU law. The SAA with the EU Membership candidates fall within that category. Given that the Agreements provide for enforcement through an independent authority in the accession candidate country,³² the Union would likely breach its commitments under public international law if it assumed broad conflicting unilateral enforcement powers.

However, the SAAs do permit the Union to take unilateral action in individual State aid cases, after referring the case to the Stabilisation and Association Council established under the SAA, provided that such Council does not resolve the matter satisfactorily.³³ The Union cannot comply with the requirement of prior referral to the Association Council in cases where the Union requires notification to the Commission by companies benefitting from foreign subsidies prior to concentrations and public procurement processes, because the Commission is only made aware of the cases as a result of the notification. By accepting notifications and processing such cases the Commission would assume broad enforcement powers, in spite of the primary enforcement responsibility having been attributed to the independent authority in the partner country.

Nevertheless, as regards *ex officio* investigations under Article 7 et seq. of the Draft Regulation, the Commission may investigate individual cases after an unsuccessful referral to the Stabilisation and Association Council. The SAAs provide for the application of WTO rules as between the SAA parties (even where one SAA party is not a WTO member). Therefore, if the subsidy falls within the scope of the ASCM, the individual case would have to be dealt with pursuant to the Countervailing Duty Regulation, while other individual subsidy cases could be dealt with pursuant to Art. 7 Draft Regulation.

Other examples of agreements allocating primary enforcement powers to independent authorities can be found in some sectoral agreements between the Union and certain third countries, which provide for State aid rules and some degree of independent enforcement, such as the Energy Community Treaty,³⁴ the Transport Community Treaty,³⁵ and the Agreement on a European Common Aviation Area.³⁶ This comes on top of special internal rules in these sectors.³⁷

Yet other Agreements, like the general free trade agreements with, for example, Vietnam, Singapore or Canada (CETA), only contain far less-detailed general commitments to avoid distortive subsidies, which lack precision and enforcement mechanisms. In the absence of a particular attribution of competences for the implemen-

32 E.g. the SAA with Serbia (see footnote 29), Art. 73(4).

33 E.g. the SAA with Serbia (see footnote 29), Art. 73(10).

34 The Energy Community Treaty, OJ 2006 L 198/18, Art. 18(1)(c).

35 Treaty establishing the Transport Community, OJ 2017 L 278/3, Art. 17 et seq.

36 Multilateral Agreement between the European Community and (...) on the establishment of a European Common Aviation Area, OJ 2006 L 285/3 (adoption (ratification) by the Union only in 2017 (OJ 2018 L 26/1 and OJ 2019 L 10/1 (entry into force)).

37 See above, part B.II, and footnotes 11, 12, and 13.

tation and enforcement of these rules, it is unlikely that the exercise of unilateral enforcement mechanisms by the Union would breach those agreements.

The Agreement must, *third*, have been entered into by the Union. This requirement will only exceptionally raise issues. There are some instances where the Union requires (e.g., candidate) countries to enter into, or join, international agreements, which provide for detailed substantive and procedural State aid rules (e.g., CEF-TA).³⁸ The Union may be estopped from applying the Draft Regulation, if that would interfere with the process under such agreements.

C. Conclusion

The Draft Regulation provides for a new instrument, which has broad repercussions for the role of the Commission as a preeminent enforcement agency, the administrative burden for undertakings and the balance of power, and including within the Commission itself.

First, the new instrument will place a significant administrative burden on economic operators. It will not just be Chinese or third country undertakings that will be subject to proceedings, but EU and U.S. entities benefitting from third country subsidies are also covered, and given the level of transparency, it is likely that the latter will be the more obvious targets for Commission investigations and competitor complaints.

The rules on the relationship with other policy instruments show that such additional administrative burden and a significant level of overlap and duplication is deliberate, as it is the necessary consequence of concurrent application with other, existing rules. The Commission's justification for this approach is consistent with its gap analysis and the differing policy objectives pursued by the Draft Regulation and the existing rules.

That approach is nevertheless very burdensome. A prime example are mergers, where the same concentration (exceeding relevant thresholds) will have to be notified two times, based on two different forms, to the same European Commission, DG COMP, that will have to take two separate decisions. Additional burden for the Commission, national administrations and bidders will also result in procurement cases.

The additional burden is, second, compounded by legal uncertainties and complexities. The question of when the use of the Draft Regulation infringes an "obligation" under an international agreement will be hotly debated. In some sectors (e.g., transport and energy), the overlap between the Draft Regulation and various internal rules and specific international agreements covering foreign subsidies will increase the level of complexity even further. And finally, the significant substantive and procedural differences between foreign subsidies falling within the scope of the countervailing duty / ASCM rules, and those falling within the scope of the Draft

38 Central European Free Trade Agreement, the text of the agreement and implementing rules are available at: <https://cefta.int/legal-documents/> (16/9/2022).

Regulation (much increased enforcement powers of the Commission) are likely to lead to significant tensions.

Third, the administrative burden for the Commission will significantly increase. The Commission estimates that a massive 145 full-time officials will be needed to deal with the additional case load once the Draft Regulation is fully applicable.³⁹ Foreign subsidies were thus far dealt with by the Directorate General for Trade, based on “traditional” countervailing duty (and ASCM) enforcement powers. The implementation of the Draft Regulation (although largely based on Art. 207 TFEU) will be attributed, however, to DG COMP. That is likely to affect the internal balance of power within the Commission.

In sum, the Draft Regulation will have significant repercussions, not only because it significantly increases the administrative burden for undertakings and the administrative powers of the Commission, but also because of the concurrent application of new and old rules, leading to overlap and duplication.

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39 See Proposal (footnote 1), p. 12 (under 4. Budget).

