

## EDITORIAL COMMENTS

### *Protecting the EU's internal market in times of pandemic and growing trade disputes: Some reflections about the challenges posed by foreign subsidies*

*“NOW, what I want is, Facts. Teach these boys and girls nothing but Facts. Facts alone are wanted in life. Plant nothing else, and root out everything else. You can only form the minds of reasoning animals upon Facts: nothing else will ever be of any service to them. This is the principle on which I bring up my own children, and this is the principle on which I bring up these children. Stick to Facts, sir!”*

Charles Dickens, *Hard Times*, 1854

In these opening lines of *Hard Times*, the main character, a headmaster called Mr Gradgrind, reveals his belief that facts are important because they enable individuals to further their own interests. However, the unemotional and mechanical way he calls for facts deprives his pupils of feeling and imagination; this passage also opens a work of fiction in which Dickens suggests that facts alone cannot bring intellectual pleasure. Noting the repeated and ambitious announcements made over the last couple of months by the European Commission, unanimously backed by the Heads of State and Government of the Member States,<sup>1</sup> about the need for State aid control on a worldwide scale in order to ensure a genuine level playing field throughout the EU's internal market, this great novel comes to mind, especially when assessing the challenge in terms of fact finding and evidence gathering which the pursuit of such an initiative will imply.

### *The Commission White Paper on levelling the playing field as regards foreign subsidies*

The EU's competition and internal market rules, as well as its existing trade defence instruments, play an important role in ensuring a level playing field. The White Paper on foreign subsidies screening, adopted by the European

1. See European Council Conclusions of 21–22 March 2019, para I.3.

Commission in June 2017, points at a regulatory gap, however.<sup>2</sup> Subsidies by EU Member States' public authorities have always been subject to EU State Aid rules in order to avoid distortions of competition in the internal market. Subsidies granted by third countries' public authorities to companies active in the EU (so-called "foreign subsidies"<sup>3</sup>) are, however, not caught by these rules, even though they appear to have an increasingly negative impact on competition in the internal market. The White Paper reports that there is a growing number of instances in which foreign subsidies seem to have facilitated the acquisition of EU companies or distorted investment decisions, market operations or pricing policies of their beneficiaries, or have distorted bidding in public procurement, to the detriment of non-subsidized companies. What is more, according to the White paper, in some cases, the grant of foreign subsidies is driven by a third country's strategic objective to establish a strong presence in the EU, or to promote an acquisition and later to transfer technologies to other production sites possibly outside the EU. Such cases do not fall within the scope of the EU's merger control and antitrust rules, as these rules do not specifically take into account whether an economic operator may have benefited from a foreign subsidy, nor do they allow the European Commission or Member States to intervene solely on the basis of those rules. The same is true as regards the existing EU trade defence rules, insofar as they only relate to exports of goods from third countries.

Consequently, the Commission's White Paper proposes a number of approaches in order to address this regulatory gap.<sup>4</sup> The first three options (so-called "Modules") aim at addressing the distortive effects caused by foreign subsidies in the internal market generally (Module 1), in acquisitions of EU companies (Module 2) and during EU public procurement procedures (Module 3). These Modules might be complementary to one another, rather

2. See European Commission White Paper on levelling the playing field as regards foreign subsidies, COM(2020)253 final of 17 June 2020.

3. See Annex I to the White Paper, in which a broad definition of "foreign subsidies" is given: a financial contribution by a government or any public body of a non-EU State (including a private body entrusted with functions normally vested in the government, or directed by the non-EU government) which confers a benefit on a recipient, established in or outside the EU, and which is limited, in law or in fact, to an individual company or industry or to group of companies or industries. Thus the definition covers (i) foreign subsidies granted directly to companies established in the EU; (ii) foreign subsidies granted to a company established in a third country, where such a subsidy is used by a related party established in the EU; and (iii) foreign subsidies granted to a company established in a third country where such a subsidy is used to facilitate an acquisition of an EU company or participate in public procurement procedures in the EU.

4. Following the outcome of a public consultation on the White Paper ending 21 Sept. 2020, the European Commission will present legislative proposals in order to tackle the distortive effects of foreign subsidies on the Internal Market, see European Commission press release IP/20/1070 of 17 June 2020.

than alternatives. The White Paper also sets out a general approach to foreign subsidies in the context of EU funding.

More specifically, under Module 1, the supervisory authority, which would be a national authority or the European Commission, could act upon any indication or information that a company in the EU benefits from a foreign subsidy. If the existence of a foreign subsidy can be proved, the authority would then impose measures to remedy the likely distortive impact, such as redressive payments and structural or behavioural remedies. However, it might also consider that the subsidized activity or investment has a positive impact within the EU or on a public interest recognized by the EU which outweighs the distortion, and therefore decide not to pursue the investigation further (the “EU Interest Test”).

The first module could be complemented by Module 2, which is intended to address specifically distortions caused by foreign subsidies facilitating the acquisition of EU companies. This module aims at ensuring that foreign subsidies do not confer an unfair benefit on their recipients when acquiring (stakes in) EU companies, either directly, by linking a subsidy to a given acquisition, or indirectly by *de facto* increasing the financial strength of the acquirer.

Under Module 2, companies benefitting from financial support from a non-EU government need to notify their acquisitions of EU companies, above a given threshold, to the competent supervisory authority. The White Paper proposes that the Commission is the competent supervisory authority. Transactions may not be concluded while the Commission’s review is pending. Should the supervisory authority find that the acquisition is facilitated by the foreign subsidy and distorts the internal market, it could either accept commitments by the notifying party that effectively remedy the distortion or, as a last resort, it could prohibit the acquisition. Under this Module, the Commission could also apply the EU Interest Test.

Foreign subsidies might also have a harmful effect on the conduct of EU public procurement procedures. This issue is addressed under Module 3. Foreign subsidies may enable bidders to gain an unfair advantage, for example by submitting bids below market price or even below cost, allowing them to obtain public procurement contracts that they would otherwise not have obtained. Under this module, the White Paper proposes a mechanism where bidders would have to notify the contracting authority of financial contributions received from third countries. The competent contracting and supervisory authorities would then assess whether there is a foreign subsidy and whether it made the procurement procedure unfair, in which case the bidder would be excluded from the procurement procedure.

Finally, the White Paper sets out ways to address the issue of foreign subsidies in the case of applications for EU financial support. All economic operators should compete for EU funding on an equal footing. Foreign subsidies may however distort this process by putting the beneficiaries of such subsidies in a better position to apply. The White Paper proposes options to prevent such unfair advantage. Among others, in case of funding distributed through public tenders or grants, a similar procedure would apply to the one foreseen for EU public procurement procedures. Moreover, the White Paper emphasizes the importance of ensuring that international financial institutions that implement projects supported by the EU budget, such as the European Investment Bank or the European Bank for Reconstruction and Development, mirror the approach to foreign subsidies.

### *Fighting foreign subsidies in times of pandemic*

The decision to launch this fight against foreign subsidies comes at a delicate moment in that it coincides with a considerable relaxation of the EU's internal subsidies discipline, both qualitatively (i.e. in terms of conditions) and quantitatively (in terms of amounts). How realistic is it to strive for an increase in discipline over foreign subsidies when the world economy including the EU's is hit by a shock that is both novel and large?

Most recessions are caused by stresses that come from within the economic and financial system. This new threat originated from outside, and global trade, for instance, registered a historic fall, touching the levels of the 2008 financial crisis according to the WTO.<sup>5</sup> In the second quarter of 2020, GDP went down by 12.1 per cent in the euro area, by 11.9 per cent in the EU, and by more than 20 per cent in the UK.<sup>6</sup> Private consumption, the largest component of GDP, contributed most to the overall fall in demand, as it generally does. But there were also big declines elsewhere, particularly in gross capital formation. On the output side, all major sectors – services, production, and (particularly) construction – contracted strongly. Economies are being affected in large part by a virus that is not yet well understood. Nor is it clear when, or even if, there will be an effective vaccine. The spending component that is hit hardest in recessions is investment. Not only is investment forgone but also – and particularly in this recession – changing patterns of demand render parts of the existing capital stock prematurely obsolete, even though they remain physically sound. In addition to COVID-19, the Union must deal with the consequences of switching from fossil fuels to renewable forms of energy; adjustment requires investment on a huge scale.

5. See WTO Goods Trade Barometer Index value, June 2020.

6. See Eurostat – News release euro indicators No. 121/2020 of 31 July 2020.

With the private sector having temporarily lost its magic charm for investment, there is a clear case for public investment to fill the gap, not least in infrastructure. Arguably, investment is not a direct substitute for private sector capital formation but a most useful complement that does much to enhance an economy's productivity in the long term. After the 2008 financial crisis, governments, alarmed by ballooning public debt, tightened fiscal policy too soon, increasing taxes and cutting government expenditure before their economies were back on a self-sustaining, investment-driven growth path.<sup>7</sup>

For all these reasons, public authorities at various levels of governance in virtually all countries in the world have dramatically increased expenditure, in particular through grants, soft loans and other forms of subsidies. For its part, the European Council agreed in July 2020, after more than 90 hours of negotiations, on the so-called *Next Generation EU* package, amounting to €750 billion (consisting of €390 billion in grants and €360 billion in loans), with emphasis on economic resilience, hefty transfers to poorer regions, and using the economic crisis caused by the pandemic as an opportunity to boost public financing under the EU's green and digital agenda.<sup>8</sup> In parallel, in March 2020 the European Commission adopted a Temporary Framework to enable Member States to use the full flexibility foreseen under State aid rules to support their economy and help overcome the extremely difficult situation triggered by the COVID-19 outbreak.<sup>9</sup> The Temporary Framework provides for a range of types of aid, which may be granted by Member States, from direct grants to subsidized public loans to State guarantees for loans. The original Temporary Framework was adopted in April 2020 and amended three times, extending the types of aid originally covered by the Temporary Framework to include, *inter alia*, the facilitation of research and development and expanded production for COVID-19 related products, and to facilitate the protection of employment in the Member States. This Temporary Framework is based on Article 107(3)(b) TFEU and complements other possibilities available to Member States to mitigate the socio-economic impact of the COVID-19 outbreak in line with EU State aid rules, notably the possibility

7. See, for this analysis of the economic impact of the pandemic, Llewellyn, "Why the UK economy stands out", *Financial Times*, 14 Aug. 2020.

8. See European Council Conclusions of 17–21 July 2020, Section I, "Next Generation EU".

9. See European Commission Temporary framework for State aid measures to support the economy in the current COVID-19 Outbreak, adopted on 19 March 2020, amended on 3 April 2020 and further amended on 8 May 2020 and 29 June 2020 (Communication C(2020)1863 final, O.J. 2020, C 911/1, last amended by C(2020) 4509 final). In addition, the European Commission made a series of targeted amendments to State aid rules, relaxing discipline further in order to mitigate the economic impact of the pandemic.

under Article 107(2)b TFEU to compensate specific companies or specific sectors for the damages directly caused by exceptional occurrences, such as the COVID-19 outbreak. While at the beginning most State aid was granted to meet companies' problems of liquidity, they gradually aimed more at ensuring their solvability.

It turns out that, compared with the 2008 financial crisis, much more State aid has been approved under relatively soft conditions set by the Commission.<sup>10</sup> The total amount approved so far in these exceptional circumstances is well beyond two trillion euros – Germany accounting for the biggest part – and triggering a debate over whether deeper-pocketed Member States are undermining the internal market's level playing field. This argument was used by some in order to convince the richer Member States to be more forthcoming in accepting the EU aid package in July 2020, even though one may doubt whether such Union aid, given its lower total size and different purpose, its conditionality and beneficiaries, lends itself to levelling out the distortions of competition triggered by State aid granted by the Member States individually to their national industries.<sup>11</sup> Moreover, one may wonder whether the combination of this massive EU and Member State aid, considering its inevitably distortive effect on competition within the internal market, does not make it more difficult to call simultaneously for subjecting foreign subsidies to a strict discipline.

*Fighting subsidies in the form of Member States' tax rulings favouring inter alia foreign multinationals*

The initiative to fight foreign subsidies also comes at a moment when the Commission faces increasing difficulties in effectively combatting tax subsidies under the EU State aid rules, as a result of a series of recent General Court judgments, especially where such subsidies take the form of rulings whereby a national administration confirms the future application of its tax

10. Figures comparing State aid approved by the Commission so far during the current crisis and State aid for the real economy it approved during the banking crisis in the period 2008–2010, are available at <[ec.europa.eu/competition/state\\_aid/what\\_is\\_new/State\\_aid\\_decisions\\_TF\\_and\\_107\\_2b\\_107\\_3b\\_107\\_3c.pdf](http://ec.europa.eu/competition/state_aid/what_is_new/State_aid_decisions_TF_and_107_2b_107_3b_107_3c.pdf)>; <[ec.europa.eu/competition/recovery/financial\\_sector.html](http://ec.europa.eu/competition/recovery/financial_sector.html)>; and <[ec.europa.eu/competition/publications/reports/working\\_paper\\_en.pdf](http://ec.europa.eu/competition/publications/reports/working_paper_en.pdf)>. See for an analysis of State aid control during the 2008–2010 crisis from a substantive and procedural perspective, the individual chapters and sections by Derenne, Gerard, Gilliams, von Bonin, Soltész, Laprèvote, Kavanagh, Coppi, Navarro Varona and Moscoso in Merola, Derenne and Rivas (Eds.), *Competition Law in Times of Economic Crisis – In need of Adjustment* (Bruylant, 2013), pp. 229–380.

11. “EU State aid – EU members clash over State aid as richer countries inject more cash”, *Financial Times*, 1 May 2020.

rules in favour of a specific tax payer. Many of the Commission's investigations into these tax rulings, some of which go back to the previous century and are often addressed to US-based multinationals, successfully operating on the EU's internal market and paying little if any tax on their profits generated in that market, have led to negative decisions with recovery orders under Article 108(2) TFEU that are now *sub judice* in Luxembourg.

The key issue in all these cases is whether the Commission has provided the necessary evidence that the rulings give rise to a discriminatory application of the national tax rules by reference to their objective, thus favouring a specific company as opposed to others in the same legal and factual situation, and therefore meeting the so-called "selective advantage" criterion enshrined in the definition of State aid in the sense of Article 107(1) TFEU ("... aid which distorts competition ... by favouring certain undertakings or the production of certain goods"). Despite an impressive body of case law, starting in 1974,<sup>12</sup> there is still discussion on how this criterion should be applied and how the burden of proof in that respect is distributed between the Commission and the Member State issuing the tax measure.<sup>13</sup> Arguably, but not undisputed,<sup>14</sup> under Articles 107–108 TFEU, the Commission has the daunting task of eliminating the economic externalities of a tax subsidy, implying that it has a duty to first identify the tax that *would* have been due by a given company in the absence of the tax measure it considers incompatible with the internal market in the sense of Article 107(3) TFEU. This in turn means identifying the relevant reference system applicable to other companies in the same situation, and on that basis defining the "normal tax" or the "normal tax rate".<sup>15</sup> Then the Commission must prove that the tax measure under investigation

12. See Case 173/73, *Italy v. Commission*, EU:C:1974:71, para 15.

13. Compare e.g. the judgment in Case C-143/99, *Adrian-Wien Pipeline GmbH*, paras. 41 et seq. EU:C:2001:5598 with more recent case law of the General Court on selectivity and fiscal State aid, e.g. in Joined Cases T-760/15 & T-636/16, *Netherlands and others v. Commission (Starbucks)*, EU:T:2019:669 and in Joined Cases T-755 & T-759/15, *Luxembourg and Others v. Commission (Fiat-Chrysler)*, EU:T:2019:670 (under appeal: Case C-885/19 P).

14. See among the many commentaries Hancher, "Oysters and Pearls – or Coffee and Cars?", (2019) *ESTAL*, 223–225; Fausta Todhe, "Fiscal State aid: How far can it stretch?", paper presented at the FIDE XXVIII Congress in Estoril on 23 May 2018; Bacon, *European Union Law of State aid* (OUP, 2017); Werner and Verouden, *EU State Aid Law and Economics* (Wolters Kluwer, 2016). As for WTO law, there is an extensive and interesting discussion of this issue in the WTO Appellate Body report of 12 March 2012 in DS353 (*Boeing case*) – the Washington State B&O tax rate for Larger Commercial Aircrafts ("LCA") and the concept of revenue foregone compared to the normal tax rate, available at <[wto.org/dispu\\_e](http://wto.org/dispu_e)>. See for an alternative approach, based on the U.S. Supreme Court case law, in order to assess the existence of State aid in *Apple* and other taxation cases: Mason, "Identifying illegal subsidies", (2019) *American University Law Review*, 479–564.

15. See also Commission Notice of 19 July 2016 on the Notion of State Aid as referred to in Article 107(1), O.J. 2016, C 262/1–50.



constitutes a derogation from that system. Finally, it has to check whether that derogation is justified by the “nature or logic” of the reference system. An important issue raised in that context is whether the Commission is right to include an arm’s length principle (i.e. that transactions between affiliated parties should be compared with transactions that would have been made between independent parties) in the definition of “selective advantage” as a tool to ensure the protection of the principle of non-discrimination.<sup>16</sup>

Many of the problems the Commission faces when pursuing these investigations are illustrated by the recent General Court judgment in the *Apple* case.<sup>17</sup> The Commission decision targeted tax rulings issued in 1991 and 2007 (!), whereby Ireland endorsed a tax construction that, arguably, enabled the Apple Group to avoid paying tax on 99 percent of the profit it generated outside the Americas from 1991 to 2014. Under that construction, the Apple Group set up two subsidiaries – ASI and AOE – which, although incorporated in Ireland, were considered not to be tax resident in Ireland. Both subsidiaries obtained an exclusive IP licence under an intra-group sharing agreement they concluded with Apple Inc., the parent company of the Apple Group. In return for these licences, ASI and AOE made substantial annual payments to Apple Inc. The purpose of the rulings was to determine ASI’s and AOE’s taxable profit as non-resident companies in Ireland. Under Irish tax law, that determination required attributing to their Irish branches the part of the companies’ profit generated by those branches’ trading activities. In order to do so, the branches were treated for tax purposes as if they were separate entities operating independently from and at arm’s length with the rest of the company to which they belonged. Arguably, in the case of ASI and AOE, the “rest of the company” consisted of nothing more than the occasional meeting of the companies’ board of directors, mostly by telephone (“the head offices”). Since a branch does not enjoy separate legal personality from the company to which it belongs, every profit attribution exercise requires, as a first step, an allocation of the assets owned and the risks assumed by the

16. And whether the Commission is right in claiming that this arm’s length principle is independent from the one originating in the U.S. a century ago or the more recent OECD framework. See the Commission Notice, previous footnote. Cf. also Todhe, “The rise of an (autonomous) arm’s length principle in EU State aid rules?”, (2019) EStAL, 249–263. Thus, for the Commission, the purpose of the arm’s length principle is to ensure that transactions between integrated companies are treated for tax purposes by reference to the amount of profit that would have arisen if the same transactions had been carried out by non-integrated companies. Otherwise, the Commission claims, group companies would benefit from a favourable treatment, leading to unequal treatment between companies that are factually and legally in the same situation. See, generally, Buriak and Lazarov, “Between State aid and the fundamental freedoms: The arm’s length principle and EU law”, 56 CML Rev., 905-948.

17. See Joined Cases T-778 & 892/16, *Ireland and Others v. Commission (Apple)*, EU:T:2020:338.



company between that branch and the “rest of the company”. In the case of Apple, that required a determination of whether the Apple IP licences owned by ASI and AOE should be allocated to their Irish branches for tax purposes. That depended on an assessment of the functions performed by those branches relative to the functions performed by the companies’ head offices. Ireland did not perform that assessment when granting the rulings; it simply accepted Apple’s assertion that those branches were low-risk “routine” entities and that the Apple IP licences were held outside Ireland and, therefore, should not be attributed to the Irish branches. Consequently, all profit generated from the use of the licences was allocated to the (*de facto* non-existent and non-taxable) head offices of ASI and AOE.

In the decision under review, the Commission had based the existence of a selective advantage on two findings. Under the primary line of reasoning, it concluded that Ireland should have allocated the Apple IPP licences held by ASI and AOE to its Irish branches, since only the branches had the capacity to generate any income from these licences. In its subsidiary line of reasoning, based on the assumption that the Apple IP licences should be attributed to an entity outside Ireland, the Commission claimed to have identified three errors in the method which the Irish authorities had endorsed in the tax ruling in order to attribute profits to the Irish branches, leading to a lowering of the Irish branches’ taxable profits and thus giving rise to a selective advantage.

The General Court dismissed both the primary and subsidiary line of reasoning regarding the existence of a selective advantage. In dismissing the primary finding, the General Court considered that the Commission had not sufficiently demonstrated that the income attributed to the Irish branches represented the value of the activities actually carried out by the Irish branches, thereby relying on Irish tax law and case law. It further held that attributing essential functions to the Irish branches solely based on the fact that the companies had no staff outside the branches (the so-called “exclusion approach”) was inconsistent with Irish law and OECD guidance.<sup>18</sup> In fact, the General Court found that the Commission had not succeeded in demonstrating that the rulings conferred a selective advantage on ASI and AOE. In particular, the General Court rejected the Commission’s finding that the Apple IP licences held by ASI and AOE should have been allocated to their Irish branches. It relied in that respect, first, on the limited activities performed by those branches as identified in the Decision and, second, on the strategic decisions taken and implemented outside those branches, in particular by employees of Apple Inc. On the subsidiary finding of advantage, the General Court, while noting the defective and inconsistent nature of the tax

18. *Ibid.*, paras. 267, 269, 273, 274, 275, 277, 281, 283, 298 to 302.

rulings,<sup>19</sup> considered that the methodological errors identified by the Commission were not sufficient to demonstrate the existence of an advantage. It held that the Commission had not demonstrated that the companies' operating expenses was an inappropriate profitability indicator for determining their annual taxable profit.<sup>20</sup>

At the time of writing, the European Commission still has the possibility to lodge an appeal against this judgment of the General Court. Leaving aside the question to what extent, in doing so in a case of this factually complex nature, grievances can be defined on points of law only that stand up to judicial scrutiny, there is little doubt that the decision whether or not to appeal (or alternatively to re-adopt a new decision, possibly after extending the procedure foreseen in Art. 108 (2) TFEU; or to simply drop the case) will be based on an assessment of the extent to which it constitutes a precedent, limiting unduly the Commission's power to fight tax measures it considers harmful for the internal market and from which also globally operating multinationals with headquarters outside the EU are able to benefit.

Of course, these cases are highly complex, and require an in-depth knowledge of both EU State aid law and the applicable national tax and company law legislation and case law, as well as the delimitation between the scope of Articles 107–108, 113, 114 and 116 TFEU in order to determine the legal basis for acting against the distortion of competition resulting from the rulings in question, and also a full understanding of the facts, including the sophisticated corporate structures, internal transfer pricing systems and profit allocations of the multinationals concerned, covering sometimes decades and therefore raising issues of legal certainty if recovery of alleged State aid is ordered. From a public interest point of view, one should not underestimate the need to counter the distortive effects on the functioning of the internal market which result from measures that allow multinationals to create value in one or more Member States whilst allocating the ensuing profits to entities they control elsewhere, in or outside the EU, that are merely empty shells and effectively exempt from tax. However, just as the Commission struggles to identify State aid in Member States' tax measures, so it will most probably struggle when engaging in screening third country tax measures in search of foreign subsidies – perhaps even more so, because it may face difficulties in compelling those countries or the companies established outside the EU and benefiting from these measures to produce the necessary evidence.

19. *Ibid.*, paras. 347 and 500.

20. *Ibid.*, paras. 355 to 417.

*Fighting foreign subsidies under existing trade law*

As pointed out above, there are a range of trade law instruments that can be used by the EU to fight foreign subsidies: its own Regulation 2016/1037 on protection against subsidized imports from third countries,<sup>21</sup> a series of bilateral agreements with third countries (either dedicated entirely to competition or with provisions on competition as part of wider free trade and other international agreements),<sup>22</sup> and the Agreement on Subsidies and Countervailing Measures (the so-called ASCM), annexed to the WTO Agreement, are among the most important ones, but have shortcomings in terms of effectiveness. A detailed analysis would go beyond the scope of these editorial comments but it suffices here, for instance, to point to the fact that under the first instrument, countervailing duties can only apply where a subsidy is conferred by the third country on goods that are exported to the EU. In fact, what is supposed to happen is that the subsidy is stopped, and the price of the goods raised again, so that the countervailing duty can be discontinued and a refund eventually granted. It is not a punishment, but an incentive to stop subsidizing. As for bilateral agreements, the emphasis is much more on cooperation and coordination with foreign competition authorities than on effective and enforceable subsidies control. The current negotiations with Switzerland and the UK, two of the EU's most important trading partners, clearly show, despite a political commitment of the parties to that effect, how difficult it actually is to agree on any meaningful mechanism in that respect.<sup>23</sup> The free trade agreement between the EU and South Korea of 2010 includes just a few rules on subsidies, which do not go much further than the WTO rules. In essence, these rules, which only apply to goods, consist of the prohibition of two well-defined types of subsidies: (i) legal arrangements

21. See Regulation (EU) 2016/1037 of the European Parliament and of the Council on protection against subsidised imports from countries not members of the European Union, O.J. 2016, L 176/55 et seq. (codification).

22. An overview of all the bilateral agreements is available at <[ec.europa.eu/competition/international/bilateral](http://ec.europa.eu/competition/international/bilateral)>.

23. As regards Switzerland, the most important agreement with State aid provisions is the free trade agreement of 1972 and the more sector specific transport agreement of 1999 which, considering the lack of enforceability, should be overhauled by an institutional framework agreement (available at <[dfa.admin.ch](http://dfa.admin.ch)>), negotiated in 2018 with the aim of consolidating mutual market access, but which is still awaiting signature and ratification by both parties. In the latter draft a solution was found for a dispute settlement mechanism in a way that should not affect the autonomy of the EU legal order, as clarified by the ECJ particularly in its Opinion 1/91, *EEA Agreement*, EU:C:1991:490, Opinion 2/13, *ECHR Accession*, EU:C:2014:2454, and Opinion 1/17, *CETA*, EU:C:2019:541 – an issue which remains one of the stumbling blocks in the current negotiations with the UK on an agreement on State aid control, to which the two parties committed in accordance with the Political Declaration of 12 Nov. 2019, setting out the framework of their future relationship, available at <[ec.europa.eu/brexit](http://ec.europa.eu/brexit)>.

whereby a public body assumes responsibility for all contingent liabilities of a company; (i) rescue aid without an appropriate re-structuring plan, these two norms being combined with a reporting obligation.<sup>24</sup>

With respect to the ASCM, the Joint Declaration of the US, the EU and Japan of January 2020,<sup>25</sup> inspired by certain experiences with Chinese subsidies, reminds us of some of its concrete weaknesses. According to the Declaration, the current list of prohibited subsidies provided for in Article 3.1 of the ASCM is considered insufficient and new types of unconditionally prohibited subsidies need to be added: unlimited guarantees; subsidies to an insolvent or ailing enterprise in the absence of a credible restructuring plan; subsidies to enterprises unable to obtain long-term financing or investment from independent commercial sources operating in sectors or industries in overcapacity; “certain direct forgiveness of debt”.<sup>26</sup> According to the Declaration, other types of subsidies have such a harmful effect that a reversal of the burden of proof would be justified, so that the subsidizing Member must demonstrate that there are no serious negative trade or capacity effects and that there is effective transparency about the subsidy in question (e.g. excessively large subsidies; subsidies that prop up uncompetitive firms and prevent their exit from the market; subsidies creating massive manufacturing capacity, without private commercial participation; and subsidies that lower input prices domestically in comparison to prices of the same goods when destined for export). No doubt, reaching a consensus among all WTO Members on these proposals will take years.

When comparing EU law and WTO law on subsidies at a more conceptual level, one notes that, whilst there are important similarities and overlaps, the basic legal rules are different. As regards the definition, Article 107(1) TFEU states:

“... any aid granted by a Member 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, ... [which] affects trade between Member States ...”

24. EU-South Korea Free Trade Agreement, available at <eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2011:127:FULL&from=EN>.

25. See Joint Statement of the Trade Ministers of Japan, the United States and the European Union of 14 Jan. 2020, available at <trade.ec.europa.eu>.

26. Subsidies law is closely related to discrimination law; export and import substitution subsidies are prohibited because they are legal mechanisms to partition markets and discriminate. However, some of the issues identified in the Statement cited in the previous note seem to be different and may give rise to difficulties in terms of evidence.

In WTO law, the definition is in Article 1 ASCM and is determined by the following three constitutive elements: (i) a financial contribution, that (ii) can be attributed to a government or another public body and (iii) whereby a benefit is conferred specific to an enterprise or industry or group of enterprises or industries. In addition, only subsidies which are specific within the meaning of Article 2 ASCM are actionable. Consequently, whilst most cases should produce the same result under both regimes, it cannot be excluded that under one regime something is found to be a subsidy or aid whilst under the other it is not.<sup>27</sup>

More generally, there are several important differences, notably:

- The EU default rule is that State aid is prohibited; the WTO default rule is that subsidies are allowed;
- EU rules require *ex ante* notification; WTO rules involve *ex post* control;
- WTO relates to State-to-State disputes; EU State aid law provides for a role for companies;
- WTO rules prohibit certain subsidies, but otherwise require that they have adverse price and volume effects on trading partners; EU State aid (such as environmental State aid) can be declared compatible with the internal market, whereas no such possibility exists in WTO law: if e.g. a green subsidy is to escape WTO law, it will have to be shown that it does not cause adverse price or volume effects for trading partners;
- WTO remedies allow for countervailing duties and are prospective only; EU State aid, if incompatible with the internal market, requires recovery by the State of the benefits received, with compound interest or the company put into liquidation.

In terms of rationale, EU State aid law flanks the internal market and should be considered a *lex specialis* of the general infringement procedure set out in Articles 258–260 TFEU. It recognizes that Member States may want to counterbalance the consequences of the creation of the internal market, but will be permitted to do so only within the confines of a policy defined at EU level on the basis of Article 107(3) TFEU. By contrast, the rationale of WTO subsidies law is that Members should be able to countervail in order to offset the subsidy and incentivize its removal; that certain subsidies that are market partitioning by definition (export and import substitution subsidies) are

27. See for a deeper analysis of the differences between EU law and WTO law in relation to subsidies control, and questioning whether EU law is stricter in all respects: Slotboom, *A Comparison of WTO and EC Law: Do Different Objects and Purposes Matter For Treaty Interpretation?* (Cameron May, 2006).

prohibited; and that other subsidies should not cause adverse price and volume effects for trading partners – otherwise they should be brought to an end. There is no doubt that these different rationales reflect and are closely tied to the different levels of integration in the EU and the WTO. The same is true, *mutatis mutandis*, as regards the special subsidy control regimes established by the EU's bilateral agreements, each with their own definition of subsidies, and their own procedural and substantive norms.

Moreover, in relation to enforcement and judicial protection, the WTO has been facing a serious problem since 2017, as of when its Dispute Settlement Body (DSB) has been unable to fill the outstanding vacancies on the WTO Appellate Body (AB), due to obstruction by the United States. Consequently, since 11 December 2019, the AB has been unable to hear appeals, due to an insufficient number of members. As a result, it has become possible for a losing defendant to appeal against a panel report “into the void”, thereby preventing its adoption by the DSB. In the light of this situation, 23 WTO Members<sup>28</sup> have recently decided to participate in a multi-party interim arbitration arrangement (MPIA). Pursuant to the MPIA, the participants agree that any panel reports issued in disputes between them may be appealed before an arbitration tribunal established pursuant to Article 25 of the DSU. It is expected that the MPIA will be fully operational within the next few months.<sup>29</sup> However, the MPIA has been designed only as a temporary solution.<sup>30</sup>

The EU has made proposals to reform certain aspects of the DSU in order to address some of the concerns cited by the United States as a justification for obstructing the appointments to the AB. Those concerns relate, in particular, to alleged “overreaching” by the AB, the issuance of rulings beyond the 90-day deadline prescribed by the DSU, the value of the AB reports in subsequent disputes, and the extent to which the AB may review issues of fact, including the interpretation of municipal law, but there is no expectation that a consensus on reform can be found any time soon. In parallel, also within the EU, judicial protection and enforcement of international trade rules may develop further. For instance, the ECJ has been called to rule in the (pending)

28. The participants are the EU (committing 27 EU Member States as well as the UK until the end of the transition period) + 22 third countries.

29. For more extensive analysis of the WTO crisis e.g. Bronckers, “Trade conflicts: Whither the WTO?”, (2020) LIEI, 221–244; Howe, “Making the WTO (not so) Great Again: The case against responding to the Trump trade agenda through reform of WTO rules on subsidies and State enterprises”, (2020) *Journal of International Economics Law*, 1–19.

30. In addition, the European Commission has proposed an amendment to the existing Enforcement Regulation for trade disputes which would enable *inter alia* the EU to impose counter-measures in situations where EU trade partners violate international trade rules and block the dispute settlement procedures included in multilateral, regional and bilateral trade agreements, COM(2019)623 final of 12 Dec. 2019.

appeal in Case C-872/19 P, *Bolivarian Republic of Venezuela v. Council*, as to whether third countries are admissible when lodging an action for annulment of an EU act of secondary law.<sup>31</sup> The case in question concerns a restrictive measure against a third country in the context of CFSP but the ruling may well have implications for other areas and, if this action is declared admissible, would give third countries a legal remedy which the EU would not, or not under the same conditions, have in their jurisdiction or under WTO law or under a bilateral agreement concluded with a given third country.

The limits of existing trade law described above confirm what is stated in the Commission's recent White Paper about existing "regulatory gaps" which do not allow optimal consideration of foreign subsidies.<sup>32</sup> This is indeed the case with respect to subsidies to acquire companies in the EU or subsidies to participate in procurement bids or merely subsidies to support the operation of a company in the EU. However, one cannot claim, either, that the existing instruments are toothless, nor that the Commission is not trying to make full use thereof.<sup>33</sup> Only very recently, for instance, the EU used its implementing powers under Regulation 2016/1037 to countervail subsidies granted by Chinese banks to Egyptian companies for the production of goods exported from Egypt to the EU, rebutting arguments according to which its action was contrary to the ASCM, the principle of sovereignty under public international law, and customary international law on State responsibility, which have been codified by the International Law Commission (ILC Articles on the Responsibility of States for Internationally Wrongful Acts) in accordance with its mandate under Article 13(1) (a) of the UN Charter.<sup>34</sup> Another *cause célèbre* is the ongoing *Airbus/Boeing* litigation, based *inter alia* on violations

31. In the course of the proceedings, the ECJ has asked the Council and Commission as well as all 27 Member States to express their opinion in writing on this question of principle, thus suggesting that it has not been decided exhaustively yet in e.g. its judgment in Case C-547/10 P, *Switzerland v. Commission*, EU:C:2013:139.

32. See also Section 3, "Gap analysis", of the White Paper cited *supra* note 2.

33. See the European Council Conclusions of March 2019, cited *supra* note 1, calling for an increased use of the existing EU's trade defence instruments and, in the same sense, the so-called mission letter of the then European Commission President-elect Ursula von der Leyen to the then EU Trade Commissioner-elect Phil Hogan of 10 Sept. 2019.

34. See European Commission Implementing Regulation (EU) 2020/776 of 12 June 2020 imposing definitive countervailing duties on imports of certain woven and/or stitched glass fibre fabrics originating in the People's Republic of China and Egypt and amending Commission Implementing Regulation (EU) 2020/492 imposing definitive anti-dumping duties on imports of certain woven and/or stitched glass fibre fabrics originating in the People's Republic of China and Egypt, O.J. 2020, L 189/1-170 (appealed by Egyptian companies before the General Court, Case T-480/20, *Hengshi Egypt Fiberglass Fabrics et al. v. Commission*, pending). See in particular Implementing Regulation (EU) 2020/776 paras. 670 et seq. on the issue of attributing to China subsidies in favour of the Egyptian companies granted in the context of a cooperation agreement between China and Egypt.



of the ASCM before the WTO. In 2004, the US started WTO proceedings against the EU for subsidies to Airbus, and, on the same day, the EU started WTO proceedings against the US for subsidies to Boeing. The Airbus subsidies, granted by France, Germany, the UK and Spain, mostly took the form of royalty-based financing. Both sides have been found to grant subsidies injurious to the other (in original panel and appeal proceedings before the WTO); and both sides have been found to have failed to comply with the original findings (in compliance panel and appeal proceedings). We are now in the third round of litigation (to quantify loss on both sides), where no appeal is possible, at least at present. In December 2019, the US was authorized to retaliate against the EU for an amount of USD 7.5 billion annually, until the EU complies. The EU award is still pending.

### *Final considerations*

The fundamental long-term interests of the EU lie in the prosperity associated with the security and predictability of rules-based international trade. International trade law is often about balancing trade and (other) public interests<sup>35</sup> and needs to be interpreted and applied in a balanced manner. This tension is particularly noticeable in cases of subsidies, which are granted by public authorities around the world for many legitimate and less legitimate reasons, with multiple intended and non-intended effects, and in increasing amounts. The EU should be mindful of this now that the Commission has announced in its White Paper to make the proper assessment of foreign subsidies one of its top priorities as far as they affect the internal market's level playing field, laudable as that objective may be considering the seriousness of the problem it seeks to address.<sup>36</sup> Moreover, experience in vetting State

35. See e.g. Van den Bosche and Zdouc, *The Law and Policy of the World Trade Organization – Text, Cases and Materials* (Cambridge University Press, 2018), pp. 19–28, on balancing trade against trade restrictive measures in order to protect national security, to protect and/or promote non-economic societal values and other interests, such as public health and sustainable environment, human rights, minimum labour standards, consumer safety, and cultural identity and diversity.

36. See section 1 (“Introduction”) and section 2 (“Problem definition”) of the White Paper cited *supra* note 2, from which one can infer that this initiative is part of a wider and multi-faceted EU agenda to strive for strategic autonomy. This strategy also encompasses the recently adopted Regulation (EU) 2019/452 of the European Parliament and the Council establishing a framework for screening of foreign direct investments that target the EU's or the Member States' critical assets, O.J. 2019, L 791/1. The Regulation complements the White Paper initiative in that it is limited to controlling the impact of investments on security and public order, see generally Hindelang and Moberg, “The art of casting political dissent in law: The EU'S framework for the screening of foreign direct investment” in this *Review*. See also the

subsidies in different jurisdictions teaches us that, very often, when pursuing this objective the main challenge is that international litigation tends to be extremely fact-intensive and the arguments exhaustive. The law often requires extensive clarification, based on detailed interpretative rules, whilst the facts and evidence to build a case are vital and often voluminous. Indeed, also in this context, Headmaster Gradgrind would have been right in insisting that facts matter; and without adequate powers and sufficient resources to collect them, the EU's efforts to increase discipline over foreign subsidies may well run into difficulties, even leaving aside other legal, economic and political or geopolitical challenges it has to face in these turbulent times.<sup>37</sup>

European Commission guidance to the Member States concerning the implementation of that regulation (COM(2020)1981 final of 25 March 2020).

37. See for an extensive and rather gloomy analysis of the current state of affairs e.g. Montanaro and Violi, "The Remains of the Day: The international economic order in the era of disintegration", (2020) *Journal of International Economic Law*, 299–322.

