

Dutch government assessment of White Paper on foreign subsidies

Introduction

On 17 June 2020 the European Commission presented a White Paper on levelling the playing field as regards government subsidies from third countries. It describes possible instruments designed to counteract the distortive effects of subsidies and other forms of third-country government support. This assessment sets out the Netherlands' views on these instruments. It starts with a summary of the White Paper, before moving on to a more detailed analysis and assessment of the various elements. The Netherlands welcomes the White Paper and looks forward to legislative proposals on this matter.

Summary of the White Paper

The Commission has analysed the extent to which existing international and EU instruments can counteract the distortive effects of subsidies and other forms of government support from third countries in the internal market.

- EU competition regulation, specifically merger control and the prohibition on the abuse of a dominant position, does not take account of the effect of state support for an undertaking by the government of a third country. EU state aid control is only concerned with government support by EU Member States.
- Moreover, the Commission recognises that bilateral trade agreements, and trade policy and trade defence instruments, including World Trade Organization (WTO) rules such as the SCM Agreement,¹ cannot address all forms of (financial) support from third country governments.²
- The Commission also points out that the EU Foreign Direct Investment (FDI) Screening Regulation focuses on the impact of FDI on the protection of public safety and public order. Combating the distortion of competition in the internal market caused by third-country government support falls outside the scope of the FDI screening mechanism.
- European public procurement rules do not address market distortion caused by third-country government support either. Contracting authorities are not under any obligation to investigate state aid of this kind and often lack the necessary information and expertise to do so. Existing instruments offer insufficient basis to exclude bidders on this ground. Nor does the International Procurement Instrument (IPI)³ provide a solution according to the Commission, since its purpose is to improve access for European companies to public procurement markets outside the EU (reciprocity) rather than rectify distortions of the level playing field in the internal market.⁴

The Commission concludes that the existing instruments do not always provide sufficient basis to combat the distorting effects of third-country government support in the internal market. It outlines three instruments which could be introduced to address this regulatory gap:

1. Module 1 addresses distortions caused by *subsidies from third countries in all market situations*. If the Commission or a designated national authority suspects that an undertaking which operates in the internal market enjoys an advantage in the form of state aid from a third country that is prohibited in the internal market, an investigation may be started which may lead to corrective measures being taken.
2. Module 2 is intended to specifically address distortions caused by *subsidies facilitating acquisitions*. Undertakings receiving government support that wish to acquire an undertaking in the internal market, must provide notification of this so that an investigation can be conducted into whether this government support is improper and any appropriate measures can be taken.
3. Module 3 is a public procurement instrument which would impose an obligation on undertakings that may be receiving third-country government support to *notify the contracting authority hereof when bidding for the contract*.

¹ Agreement on Subsidies and Countervailing Measures.

² Trade defence instruments focus on the import of goods and not on services, investment or the operations of EU-based subsidiaries of parent companies from third countries.

³ See Parliamentary Paper 35207, no. 33 for the government's position.

⁴ If the IPI is applied against a certain third country, the instrument's impact is also felt in the European public procurement market, so indirectly it does contribute to a more level playing field in the internal market.

The Commission also raises the question as to whether additional rules are needed on access to EU funds for undertakings receiving third-country government support. The Netherlands supports further investigation of this question. One issue that would need to be addressed is whether restricting access to these funds would be feasible in practice and whether it would impose an excessive administrative burden. The Netherlands believes a careful assessment of the various interests would have to be conducted if the Commission were to favour further steps in this context.

The Commission's analysis of the problem corresponds closely with the Dutch government's position on achieving a level playing field in the internal market.⁵ The Netherlands had already proposed a level playing field instrument and presented it as the preferred path of solution. The White Paper builds on and explicitly mentions the Dutch proposal. The Commission, like the Netherlands, proposes a stricter and more extensive supervisory regime for the internal market, as unfair competition by undertakings receiving government support and operating in the internal market poses an increasing problem.

1. Proposals to address third-country government support in general, and specifically in the case of acquisitions (modules 1 and 2)

1.1. Module 1

This module could be used to address all forms of distortion of competition by third-country government support where the beneficiary is established in or operates in the internal market. The Commission presents two options for determining the scope of module 1. The module would in any case apply to third country undertakings that have set up a subsidiary in the EU. Its scope could be extended to third-country undertakings operating in the internal market when they export goods or services to the EU or invest in the EU.

The current proposal envisages the Commission and designated national supervisory authorities exercising their respective powers in a complementary manner. The existing cooperation mechanism as set out in Regulation (EC) No. 1/2003 on the implementation of the rules on competition is mentioned as an example of how the Commission and national supervisory authorities could work together in this context. The process in module 1 would have two steps. In the first step the Commission or a national supervisory authority would initiate a preliminary review in response to information that becomes available, for example from market operators. The competent supervisory authority would assess whether government support was being provided from a third country and whether this government support could distort competition in the internal market. If this is not the case, the preliminary review is ended.

If the supervisory authority concludes that the government support may distort the functioning of the internal market, an in-depth investigation would follow. This is the second step. If the supervisory authority concludes that the government support has indeed distorted the functioning of the internal market, it may impose measures on the undertaking concerned to remedy those distortions. Any distortion must be weighed against the potential positive impact the government support might have on public interests such as climate policy, public safety, job creation and the digital transformation (Union interest test). This module does not feature a notification mechanism which could trigger a review. In addition, the same 'de minimis' amounts apply to foreign subsidies as apply to state aid within the EU.

The first possible measure mentioned by the Commission to remedy distortions to the internal market is a requirement to reimburse the government support to the third country. The Commission rightly points out, however, that such a measure would be unlikely to be effective, since in practice it would be difficult to establish that the foreign subsidy has actually been paid back in full. The Commission mentions a number of alternative measures which might be more feasible. These include structural remedies, behavioural measures and redressive payments. The type of measure ultimately imposed would depend on the type of government support and its

⁵ Parliamentary Papers, House of Representatives, 2019/2020, 21501-30, no. 470.

impact on the internal market. Possibilities include the compulsory divestment of certain assets, compensatory payments to EU Member States, and the prohibition of certain investments or specific market conduct. This is in line with the enforcement options proposed by the Netherlands as part of the *level playing field instrument*.

1.2. Module 2

The second module is intended to address government support that facilitates acquisitions of (or acquisitions of significant stakes in) undertakings established in the EU. This could take the form of either third-country government support that is directly linked to a proposed acquisition or support that increases the financial strength of the beneficiary undertaking to the point that it can make an acquisition. The White Paper currently suggests that the Commission be made exclusively competent for enforcing module 2. The Commission presents a number of options for limiting the scope of this module. Examples include a threshold based on the turnover of the undertaking to be acquired (comparable to that applied in the case of merger control) or a threshold linked to the size of the subsidy facilitating the acquisition.

FDI Screening Regulation

The FDI Screening Regulation facilitates the cooperation and information sharing in assessing foreign direct investments for possible threats to security and public order. The instruments proposed in the White Paper are intended to serve a different purpose, namely addressing distortions to competition caused by third-country government support. As the Commission notes in the White Paper, the procedures of the two instruments may overlap if a foreign direct investment constitutes an acquisition that is facilitated by a foreign subsidy and also raises concerns with regard to security and public order. This may lead to parallel yet independent procedures which pursue different ends.

The Netherlands would like to see greater clarification of the relationship between the FDI screening mechanism and the instruments envisaged in the White Paper. The Netherlands believes it is important to emphasise that the EU respects the essential functions of the state such as maintaining public order and protecting national security. National security in particular remains the exclusive responsibility of each member state.

In contrast to module 1, module 2 proposes an *ex ante* notification obligation. This means that the supervisory authority would have to be given advance notice by the undertaking concerned of investments and acquisitions in the internal market, so that the supervisory authority can examine whether these transactions would involve government support constituting a distortion of competition on the internal market. The Commission suggests that the notification obligation could be limited to acquisitions and investments by companies receiving third-country government support.

The supervisory authority would then have to demonstrate that the acquisition or investment was indeed made possible by government financing, and that this financing has distorted the internal market. Subsidies that directly and demonstrably facilitate an acquisition or investment are assumed to be distortive. These are subsidies which are directly linked to acquisition transaction. With regard to subsidies that facilitate an acquisition *de facto* rather than directly, it will have to be assessed in each case whether they distort the internal market.

The Commission sets out a number of indicators that could be relevant to this assessment. They include the size of the subsidy, the situation of the beneficiary undertaking, the situation in the relevant market or markets, and the size of the beneficiary undertakings' presence in the internal market. The Commission mentions the openness of the market in the country of origin of the beneficiary undertaking as a potential factor.

As in module 1, module 2 features a two-stage investigation. The Commission carries out a preliminary assessment to decide whether there is sufficient evidence that the acquirer has benefited from government finance which would facilitate the acquisition. If there is, an in-depth investigation can be conducted. If that investigation shows that the acquisition or investment would indeed be facilitated by government finance and that this would distort the internal market, two measures could be imposed. The acquirer could be obliged to make commitments sufficient to mitigate the distortion or, ultimately, the acquisition or investment could be blocked. As in the case

of module 1, it may be decided to impose no measures if the negative impact of the distortion is outweighed by the positive impact in terms of EU policy objectives.

1.3. Combination of modules 1 and 2

In the White Paper, the Commission expresses a preference for a combination of modules 1 and 2 instead of two separate modules, through which measures could be imposed if third-country government support distorts competition in the internal market. A combined instrument of this kind would focus on detecting acquisitions that distort the internal market. Acquisitions exceeding the thresholds set in module 2 would be subject to an ex-ante notification obligation and would be investigated by the Commission, while acquisitions with a low transaction value and other forms of market distortion caused by third-country subsidies could be examined after the event by Commission and Member States' designated supervisory authorities.

1.4. Assessment of modules 1 and 2

The Netherlands warmly welcomes the Commission's initiative in developing an instrument which could better tackle distortion caused by foreign subsidies and looks forward to a concrete legislative proposal. The Netherlands has a number of suggestions and questions which should be addressed as the proposal is elaborated.

The proposed module 1 exhibits many parallels with the Dutch government's proposal for a level playing field instrument. The Dutch government has invited the Commission to incorporate the Dutch approach in future proposals in this area. The Netherlands is therefore very positive about the proposed module 1, and also has a number of questions and points of attention about its design and scope.

The Netherlands would for example like to see a definitive legislative proposal that addresses the fact that government support need not always take the form of subsidies or that it can also be received by undertakings via indirect channels. The level playing field can also be distorted by, for instance, cheaper or exclusive access to certain raw materials or data. Competition in the internal market can also be distorted by companies from third countries that enjoy an unregulated position of dominance in their domestic market, enabling them to generate excessive profits. The Netherlands advocates making instruments broadly applicable, i.e. also covering undertakings from third countries that do not have a subsidiary in the EU but are active in the EU internal market, for example because they export goods or services to the EU.

Financial support given outside the internal market is difficult to detect. It can be very difficult in practice for a supervisory authority to show that government funding has distorted the internal market in a specific case. In this context, the Dutch government refers to its proposal for a level playing field instrument, which suggests a different indicator to establish that a company is distorting competition in the internal market with the aid of government funding or excessive profits from an unregulated position of dominance in its domestic market. This indicator is market behaviour that does not, or only slightly, correspond with the behaviour of comparable undertakings that operate in the EU internal market, so that the point of reference is not directly a policy decision of the third country in its own jurisdiction. It would therefore be logical in the Netherlands' view for the future instrument to have an internal market legal basis, for example article 114 TFEU, while the Commission proposes a legal basis in common trade policy.

The Netherlands also has questions about the role national authorities might play in investigating third-country government support. In general, national supervisory authorities have limited expertise in this area. Moreover, a decentralised approach brings with it the risk of national governments or third countries exerting political pressure and thereby distorting the level playing field within the internal market. At this stage the Netherlands favours an exclusive role for the Commission as supervisory authority, as in the case of state aid. The system must incorporate sufficient checks and balances and minimise the administrative burden.

In addition, in modules 1 and 2 it is unclear to what extent the supervisory authority must show that a foreign subsidy would distort the functioning of the internal market. A legislative proposal

must also address the timeframe within which investigations carried out under the modules are to be completed, as this will go a long way in determining the instrument's effectiveness.

If an investigation finds that an undertaking from outside the internal market enjoys a form of government support that is prohibited within the internal market, measures may be imposed. The Netherlands takes the view that such measures must not only be effective in remedying the distortion that has been identified, but must also have a certain deterrent effect, as is the case with the supervisory regime for competition. In this context the Netherlands would like to point out that the White Paper does not discuss possible measures to deal with repeated non-compliance with previously imposed measures or commitments made. The Netherlands would like to see greater clarity as to the scope of the measures. The Netherlands supports the application of an EU interest test in modules 1 and 2, and giving the Commission exclusive competence to carry out this test which should also take account of the importance of a level playing field in the internal market for innovation and sustainable technologies, for example. With this in mind, it would make sense when drafting a legislative proposal to examine whether sector-specific additions or exceptions are required.

Finally, the Netherlands has a number of specific questions and observations concerning module 2. In the proposal as it currently stands, this module has relatively high turnover thresholds. While this limits the administrative burden on the Commission, it means that very few investments in, and acquisitions of, for example, innovative startups and scale-ups would fall within the scope of this module. It could also be argued that the notification obligation places too high an administrative burden on both market operators and supervisory authorities. The Netherlands therefore questions whether the turnover thresholds and notification obligation contribute to the effectiveness and proportionality of an instrument of this kind. The Commission could launch investigations into specific investments and acquisitions on its own initiative.

In addition, the proposal to include the openness of the market in the beneficiary undertaking's country of origin in the assessment means that this instrument could be seen as defensive from a trade policy standpoint. It would be more logical, the Netherlands believes, for an assessment to take account of artificial advantages enjoyed in the domestic market which result in excessive profits, as proposed in the Dutch government's proposal for a level playing field instrument.

In its White Paper, the Commission expresses a preference for a decentralised model combining modules 1 and 2 in which the designated national authorities may start an investigation. The Netherlands sees module 2 primarily as an elaboration of module 1. Module 1 could after all also be formulated in such a way that it provides for the investigation of market distortions arising from government financing in takeovers of or acquisitions of a significant interest in EU-based companies.

2. Proposal for a public procurement instrument

Based on its analysis, described above, the Commission finds that an additional public procurement instrument is necessary. It puts forward a proposal to this end under which economic operators (irrespective of their country of origin) that submit their bid for a contract are required in certain cases to notify the contracting authority if they have received government support from a third country. This obligation would apply not only to them, but also to any members of a consortium to which they belong, as well as subcontractors and suppliers. The notification would have to contain the information needed to assess whether the economic operator in question has received foreign subsidies that distort the procurement procedure. Other stakeholders would be entitled to inform the contracting authority that a notification should have been made in the procedure. These submissions would have to be substantiated.

The contracting authority would forward the notifications and submissions to the competent authority and publish them. The Commission proposes that the competent authority for this instrument be the same as under module 1, i.e. a national competent authority or the Commission. If the competent authority decides to start an investigation, it would consist of two stages:

1. A preliminary review in which the competent authority would examine whether a more detailed investigation is justified, thereby minimising as far as possible the risk of delays to the procurement procedure.
2. An in-depth investigation. During the in-depth investigation of the bidder in question, the contracting authority may continue assessing bids as it normally would. If the winning candidate in the procurement procedure is a bidder other than the subject of investigation, the contract may be awarded. If, however, it seems likely that the bidder being investigated will be the winning candidate, the procurement procedure must be suspended until the investigation is complete.

If the supervisory authority finds on the basis of the investigation that the bidder has received third-country government support that distorts the market, the contracting authority decides whether the government support distorts the procurement procedure. If so, the bidder is excluded from the procedure. In addition, the contracting authority may decide to exclude the bidder from future public procurement procedures for up to three years.

2.1. Assessment of the proposed public procurement instrument

The Netherlands concurs with the Commission's analysis of market distortion due to third-country government support in public procurement procedures. This support enables the bidders concerned to compete unfairly with other parties in terms of the tenders they are able to submit. This unfairness may be reflected not only in the price the recipient of the foreign government support is able to offer, but also in the position it has been able to attain in the market. If it acquired its knowledge, experience or size with government support that would be prohibited in the EU, this amounts to unfair competition even if the company concerned submits a bid at market prices.

The Netherlands also concurs with the Commission's analysis that EU public procurement rules inadequately address market distortion caused by government support from third countries. More specifically, the possibility to reject tenders considered to be abnormally low is inadequate in this regard, in part because market distortion need not consist of an abnormally low bid, but can also exist where a company would not have been able to participate in a procurement procedure had it not received state aid. Nor does the International Procurement Instrument (IPI) address this kind of market distortion, since it is focused on achieving reciprocity rather than a level playing field.

Instruments that tackle market distortions in general do of course have an impact on subsequent public procurement procedures, but they usually work too slowly to remedy market distortions *during* a procurement procedure. The proposed module 1 and this public procurement instrument can therefore both contribute to tackling market distortion in procurement procedures.⁶ However, the application of module 1 against companies suspected of receiving market-distorting third-country government support would potentially affect several procurement procedures (if the economic operator takes part in several procedures) whereas the procurement instrument would only affect a specific bid by the economic operator in a given procedure. Coordinating the use of module 1 and the procurement instrument would be desirable here in order to avoid several individual contracting authorities having to simultaneously apply the public procurement instrument when module 1 could also be applied to the company in question.

The Netherlands warmly welcomes the Commission's initiative in developing an instrument that can be used during a public procurement procedure and looks forward to a concrete legislative proposal. The Netherlands would however like to raise a number of issues concerning the proposed procedure and criteria, its relationship with other instruments, and legal aspects that should be addressed in the further elaboration of the proposal. With regard to the proposed procedure and criteria, it is important for the Netherlands that the criteria on the basis of which the competent authority decides to carry out a review or an in-depth investigation be worked out in detail. The Netherlands would like more attention to be paid to the risk of delay to the procurement procedure in cases where the competent authority decides not to initiate an in-depth investigation. The Commission could examine whether it would be better to combine the two stages (i.e. the preliminary review and the in-depth investigation) and permit the contracting authority to continue assessing the bids from the outset, provided it does not proceed to award the contract to the

⁶ Module 2 does not particularly affect procurement procedures since it specifically concerns acquisitions and investment.

undertaking that is the subject of investigation. The proposal assumes that the bidder itself will provide information about any subsidies received. While it is true that public procurement procedures involve submitting self-declarations, the Netherlands points out that the information to be provided in the proposed notification would be difficult for stakeholders and contracting authorities alike to verify. It is doubtful whether the competent authorities have sufficient knowledge on this point. It is also unclear to the Netherlands what criteria the contracting authority – armed with the results of the supervisory authority's investigation – would apply to determine whether the market had been distorted in the public procurement procedure, or whether the contracting authority can reasonably determine this.

The Commission should also clarify how the proposed instrument would relate to other instruments, such as the assessment of abnormally low tenders (article 69 of Directive 2014/24/EU) or a measure under the IPI. The Netherlands would ask the Commission whether it sees scope to integrate the proposed public procurement instrument and the instrument to assess abnormally low tenders. The Netherlands would also like clarity as to the possible concurrence of this public procurement instrument and the IPI in an ongoing procedure. Introducing another public procurement instrument that can be used during the procurement procedure in addition to the IPI will further increase the administrative burden on contracting authorities and business.

Finally, the Netherlands notes that it is not clear whether the proposed instrument introduces a new ground for exclusion and, if so, whether it is optional. If the Commission intends to introduce a new ground for exclusion, the public procurement directive will have to be amended accordingly.