

September 6, 2020

Response to the European Commission's Consultation on Its White Paper on Foreign Subsidies

On behalf of the Information Technology and Innovation Foundation (ITIF), I am pleased to submit comments on the European Commission's public consultation on its "white paper on levelling the playing field as regards foreign subsidies."¹

I am Dr. Robert D. Atkinson, president of ITIF, an innovation policy think tank based in Washington DC. ITIF has long been interested in the issue of innovation policy and in particular the role of government support, including unfair subsidies, in affecting innovation and overall economic outcomes. We have written extensively on "innovation mercantilism," the use of unfair policies and programs to distort trade and innovation, of which subsidies are a key component.

Answers to questions the Commission has raise in its public consultation follow:

GENERAL QUESTIONS RELATING TO THE THREE MODULES

Do you think there is a need for new legal instruments to address distortions of the internal market arising from subsidies granted by non-EU authorities ('foreign subsidies')?

Yes. The Chinese government provides more distorting subsidies to its industries than any country in history. For example, without government subsidies Huawei's EU market share would be significantly less. China paid for the development of their first switch. State-owned Chinese banks have made a \$100 billion line of credit available to Huawei customers, including free financing, loan periods up to 30 years, and payment holidays. *The Wall Street Journal* reported that "Huawei had access to as much as US\$75 billion in state support over the past 25 years, including grants (\$1.6 billion), credit facilities (\$46.3 billion), tax breaks (\$25 billion), and subsidized land purchases (\$2 billion)." As Usha and George Haley's detail in "Subsidies to Chinese Industry: State Capitalism, Business Strategy, and Trade Policy," subsidies are a core part of Chinese

¹ European Commission, white paper on levelling the playing field as regards foreign subsidies (Brussels, June 17, 2020, COM(2020) 253 final), https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.

policy. For example the central government has allocated 50 billion Euros for subsidies to Chinese semiconductor firms.

Do you think the framework presented in the White Paper adequately addresses the distortions caused by foreign subsidies in the internal market?

No.

MODULE 1

Do you consider that Module 1 appropriately addresses distortions of the internal market through foreign subsidies when granted to undertakings in the EU?

There is much that is positive in Module 1. However, without changes the problem of Chinese industrial subsidies—the major violator in the world—will not be able to be adequately addressed. As such, rather than be reactive and starting investigations around individual cases, the Commission should institute a process of ongoing and in-depth investigations into Chinese industrial subsidies of all kinds at all levels of government in China. Doing reactive one-off investigations will mean limited ability to gain needed and complete information in a timely way. This is because the web of Chinese subsidies is vast and opaque.

Moreover, the Commission should define subsidies somewhat broadly, including not having to make a profit, free land, low-interest loans, and generous equity investments, as these and other means are part of the Chinese subsidy playbook.

Do you agree with the procedural set-up presented in the White Paper, i.e., 2-step investigation procedure, the fact-finding tools of the competent authority, etc.? (See section 4.1.5. of the White Paper)

China is not and will not be transparent about its subsidies. So in cases where the foreign company and country are not forthcoming and transparent, or delays and obfuscates, EU authorities should be allowed to assume the presence of problematic subsidies and be authorized to take relevant action. Otherwise, the Chinese government will likely string out investigations over time, limiting the information that is available.

In addition, the scope should be broadened to companies without a presence in the EU who export to the EU. Subsidized exports are a distortion if they unfairly take away market share from EU companies.

Do you agree with the substantive assessment criteria (section 4.1.3) and the list of redressive measures (section 4.1.6) presented in the White Paper?

Countervailing tariffs or import bans should be included as part of redressive measures. This is particularly important in the case of China, where it may be difficult to assess the full subsidy and obtain a payment. This is even more true in innovation industries where the subsidies can include theft of foreign IP and massive cash grants to support R&D done in China that indirectly benefits the EU subsidiary. For example, China is massively subsidizing its state-owned airplane maker COMAC and this will likely lead to reduced global market share of Airbus (and Boeing). If COMAC attempts to eventually sell to EU airlines, a countervailing duty (or ban) would help address this distortion.

Moreover, I would encourage the Commission to not just take into account current distortions, but include the effects subsidies could have on future distortions.

Do you consider it useful to include an EU interest test for public policy objectives (section 4.1.4) and what should, in your view, be included as criteria in this test?

Yes. The EU interest test should be broadened to include whether the subsidy harmed EU innovators and global innovation overall? One of the most underappreciated aspects of Chinese subsidies is the harm done to global innovation by taking market share away from more innovative non-Chinese companies. We see this in 5G where, as ITIF has shown, Chinese subsidies and other unfair practices have meant that Huawei and ZTE have taken market share away from EU companies Nokia and Ericsson, even though the latter are more innovative per dollar of sales. The same dynamic has occurred in solar panels and high speed rail, and is likely to occur in industries like biopharmaceuticals, aviation equipment, and semiconductors.

Do you think that Module 1 should also cover subsidised acquisitions (e.g. the ones below the threshold set under Module 2)? (section 4.1.2)

Yes. It will be important to be proactive and instigate a subsidy review for all acquisitions from China before the acquisition is made. A number of Chinese company acquisitions of US companies (such as the purchase of printer maker Lexmark) were subsidized by the Chinese government; although the subsidies were opaque and hard to track. In some cases, as in semiconductors, these subsidies are presented as private venture capital investments, when in fact they are government funneled money through an intermediary to hide the fact that it is a government subsidy. Purportedly Chinese government funded venture capital is greater than the GDP of the Netherlands. And they use that money in part to finance EU acquisitions in order to obtain the technology for use in China.

Do you think there should be a minimum (de minimis) threshold for the investigation of foreign subsidies under Module 1 and if so, do you agree with the way it is presented in the White Paper (section 4.1.3)?

Yes. However, we don't agree that "the larger the beneficiary the more likely the subsidy causes distortion". China provides significant subsidies to small, technology startups, including subsidized venture investments in them, as a way to gain in emerging technologies. These can be very distortive and harmful.

Do you agree that the enforcement responsibility under Module 1 should be shared between the Commission and Member States (section 4.1.7)?

While shared enforcement may be needed it raises the risk of protectionism and overzealous application by national authorities. For example, there is a risk that some nations could instigate actions against allied partner countries that might provide modest and beneficial subsidies, such as R&D grants. The focus should be on egregious and highly distortive subsidies. Otherwise the entire enterprise could devolve into "fortress Europe." Because of this the Commission should be able to review and override national investigations, and it should make it clear that it is focused on egregious subsidies, particularly from countries with a longstanding practice of economic distortion, such as China.

MODULE 2

Do you consider that Module 2 appropriately addresses distortions of the internal market through foreign subsidies that facilitate the acquisition of undertakings established in the EU (EU targets)?

While we agree with the the process of review for the typical non-EU acquisition, we would recommend that for attempted acquisitions of EU companies by Chinese companies (or any other nation that is identified by the Commission as systemically mercantilist) that before the acquisition is approved that their needs to be a review for subsidies (defined broadly to include, among other factors, supported by intellectual property theft or forced technology transfer, financial advantages as a state-owned enterprise, and others). Only if the review proves the absence of more than de-minimis subsidies would the merger be allowed to proceed (provided it does not affect EU national security). If subsidies are present the acquisition would be prohibited, even if the acquirer makes a commitment to give up the subsidies. This is because Chinese subsidies are not clear and opaque and are very difficult to identify fully.

Do you agree with the procedural set-up for Module 2, i.e. ex ante obligatory notification system, 2-step investigation procedure, the fact-finding tools of the competent authority, etc.? (See section 4.2.5 of the White Paper)

No. As noted, we would argue that acquisitions by firms headquartered in systemically mercantilist nations like China must first prove that they are not subsidized before an acquisition can proceed.

Do you agree with the scope of Module 2 (section 4.2.2) in terms of:

| | Yes | No | Other |
|--|-----|----|-------|
| definition of acquisition | | | |
| definition and thresholds of the EU target (4.2.2.3) | | X | |
| definition of potentially subsidised acquisition | | | |

Even acquisitions of very small companies (startups with no profits) can be problematic if acquired by subsidized companies, particularly from China. This is why we would recommend that all acquisitions and equity investments by Chinese firms be subject to screening and review before allowing them.

Do you consider that Module 2 should include a notification obligation for all acquisitions of EU targets or only for potentially subsidised acquisitions (section 4.2.2.2)?

No. There are two factors to review in any foreign investment review screening: national security and subsidies. The former would include reviews whether they are subsidized or not. But they would only focus on acquisitions with potential national security implications for the EU. The latter would include targets in sectors.

Do you agree with the substantive assessment criteria under Module 2 (section 4.2.3) and the list of redressive measures (section 4.2.6) presented in the White Paper?

We don't agree that the size of the target is necessarily related to the level of distortion. As noted already, subsidized acquisitions of technology startups by Chinese firms is highly distortive.

Do you consider it useful to include an EU interest test for public policy objectives (section 4.2.4) and what should, in your view, be included as criteria in this test?

Yes. See comments in Section 1 above re: public interest test.

Do you agree that the enforcement responsibility under Module 2 should be for the Commission (section 4.2.7)?

Yes, but when it comes to tracking acquisitions of technology startups Member states may be better positioned to identify these proposed deals. Perhaps a formal agreement can be made between the Commission and Member states to inform the Commission of potential technology startup acquisitions, again, particularly by China.

INTERPLAY BETWEEN MODULES 1, 2 AND 3

Do you consider that:

| | Yes | No | Other |
|--|-----|----|-------|
| a. Module 1 should operate as stand-alone module | | | |
| b. Module 2 should operate as stand-alone module | | | |
| c. Module 3 should operate as stand-alone module | | | |
| d. Modules 1, 2 and 3 should be combined and operate together? | X | | |

QUESTIONS RELATING TO FOREIGN SUBSIDIES IN THE CONTEXT OF EU FUNDING

Do you think the framework for EU funding presented in the White Paper appropriately addresses the potential distortions caused by foreign subsidies in this context?

As noted, it is much easier to track subsidies in rule-of-law, democratic nations where transparency is the norm. This is far from the case in China. As such, it will be difficult for the Commission to effectively assess the full extent of Chinese subsidies, because they are in such a diverse number of forms and exist at all levels of government in China. And related to this many “subsidies” that give Chinese firms unfair advantages are not in the form of easily trackable government loans or grants. Moreover, China itself refuses to abide by its WTO commitments about subsidy disclosure. In contrast, “subsidies” from Commonwealth nations and the United States are much more easily tracked and identified. As such, having a two-tier system—one for nations that comply with the WTO subsidies regime and one for nations that do not—would be advisable.

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