

EU Foreign Subsidies Regulation: Analysis and Responses from a Public Affairs Perspective

Competition Law / International Trade Newsletter

November 17, 2023

Author:

[Kazumochi Kometani](#)

k.kometani@nishimura.com

[Kojiro Fujii](#)

k.fujii@nishimura.com

1. Background and Summary

The twelfth of October 2023 marked commencement of the EU Foreign Subsidies Regulation (FSR) notification requirements.¹ As explained in our previous Newsletters, the FSR introduced regulations on concentrations and government procurement that seek to ensure subsidies granted by foreign countries (hereinafter referred to as "non-EU countries") do not distort competition when recipient companies conduct business in the EU.² If a company that intends to engage in a covered transaction of a certain size or larger has received a "financial contribution" of a certain amount or more from a non-EU country, the company is required to notify the European Commission, who then must approve the transaction before it can be implemented. The European Commission investigates whether foreign subsidies distort competition, upon receipt of notification or *ex officio* (with respect to concentrations that are not subject to the notification requirements). Approval will be granted if it is determined that the subsidy will not distort the EU internal market; "[a] *distortion in the internal market shall be deemed to exist where a foreign subsidy is liable to improve the competitive position of an undertaking in the internal market and where, in doing so, that foreign subsidy actually or potentially negatively affects competition in the internal market.*" The FSR enumerates certain categories of subsidies that are most likely to cause distortions.

While the FSR has penalty clauses for non-compliance with the notification requirements, it provides no limit on the scope of foreign subsidies that require notification. Consequently, to determine whether notification is necessary, a company may be forced to keep track of all subsidies received by all related companies around the world. This definitional failure has been criticized as imposing an excessive burden on companies operating within the EU.³ The problematic nature of the FSR lies not only in the overbroad scope of the notification requirements, but also in the lack of clarity in applying the criteria for determining whether and how competition in the EU internal market will be distorted. Although in practice, for the time being, companies have no choice but to determine how to respond with a priority on compliance, this article considers possible further actions, from the perspective of public affairs, based on analysis of the nature and normal practice of subsidies and subsidy policies, summarized in the following four points:

- (1) Regarding subsidies received in Japan and any other non-EU country, companies may consider making a case to EU authorities that when a subsidy's stated specific purpose and conditions clearly indicate the

¹ Article 54.4 of the FSR.

² See N&A Newsletters, dated [15 May 2023](#) and [14 August 2023](#) for detailed explanation of the FSR.

³ See "Joint statement on the draft Implementing Regulation for the EU's Foreign Subsidies Regulation" issued by 13 business organizations on 4 April 2023, available at (https://www.jbce.org/images/News_IMG/Trade/FSR_IR_Joint_Industry_Statement_4th_April_2023_FINAL.pdf) [accessed on 12 November 2023].

benefit will be consumed by domestic investment, the subsidy will not cause EU internal market distortions.

- (2) Regarding subsidies and any other governmental support whose purposes and conditions are not transparent, it is difficult to produce objective evidence that subsidies or such other government support will not cause distortion, and thus, companies may cautiously determine whether they, including their group companies, should accept them.
- (3) On the premise of response (1) above by individual companies, companies should urge the EU authorities to limit the scope of FSR notification obligations to subsidies (and other government support measures) received from countries with low transparency.
- (4) On the premise of response (2) above by individual companies, to avoid being at a competitive disadvantage in relation to competitors that actively receive subsidies (from transparent sources or otherwise), companies may urge the EU, Japan, and other countries to promote the formation of international rules at the WTO and elsewhere that prohibit subsidies to the extent possible, except where it can be demonstrated that subsidies specify certain legitimate policy objectives, and their amount and other conditions are designed as necessary to achieve them.


While responses (1) and (2) above are actions that can be primarily taken by individual companies, (3) and (4) involve approaching governments, thus requiring collective actions by an industry or industries.

2. Analysis of Subsidy Objectives and Subsidy Policy Practice

Government subsidies are not limited to gifts, but broadly include provisions of low-interest loans and other economic benefits, and are used to achieve various policy objectives. Most subsidies to business enterprises are intended to promote some type of investment, and are granted with the aim of encouraging the maintenance and expansion of the supported activities by improving their economic feasibility. In a market economy, business investments that could be made feasibly without subsidies are normally not subsidized. This practice is because such subsidization would distort the market, thereby generating inefficiency, and *visé-versa*.

Subsidies are used normally to correct what contemporary economic theory calls a “market failure.” For example, some subsidies aim to internalize the “positive externalities” of research and development (“R&D”) activities. R&D activities are likely to have knowledge production “spillover,” meaning that they are likely to have positive effects on other entities beyond the conducting company. However, the scope of such positive effects and beneficiaries is so unclear that it is difficult for companies that conduct R&D activities to receive appropriate compensation for this spillover. This lack of appropriate compensation serves as a dis-incentive to R&D engagement. As such, if the implementation of R&D activities is left to the market (i.e., the sole discretion of individual companies), there will be a “market failure” in which the implementation of R&D activities will be at a suboptimal level, stymying innovation. Subsidies can be an effective means to solve this problem by reducing some of the associated R&D risks for individual companies, thus encouraging them to invest in R&D.

Accordingly, governments suppose that subsidy recipients make investments that would not be made unless the subsidies are granted. On this basis, we believe that the FSR, which requires companies to notify the EU Commission of all subsidies received “abroad” (i.e., outside the EU) as potentially distorting competition in the




EU internal market, is likely to impose excessive obligations from a policy perspective. As such, the EU authorities should be persuaded to treat ordinary subsidies that correct “market failures” as not distorting competition in the EU internal market, regardless of their amount. Rather, it should be emphasized that such subsidies only have the effect of improving the functioning of market economies, and consequently, benefit the EU as well by increasing international trade and investment. To be clear, a recipient company may profit by implementing a project that has attained economic feasibility through subsidies correcting for positive externalities, but this profit gain is a return on its investment and, thus, is not equivalent to an increase in funds resultant of direct subsidy. The targeting of this return is tantamount to the denial of legitimacy for any and all subsidies.

However, some governments may provide subsidies in the absence of “market failure” (i.e., lacking purpose) without aiming to correct a particular “market failure” (i.e., lacking legitimacy), or beyond what is necessary to correct a “market failure” (i.e., lacking rationality). If such a subsidy is granted, while the level of corporate activity will not change for the recipient company, compared to the counterfactual situation where it had not received the subsidy, the subsidy only will result in increasing the amount of cash on hand. Such subsidization would enable the recipient company to use its increased surplus funds to offer prices that competitors cannot offer in the EU internal market.

Therefore, the EU’s foreign subsidy information request requirement only is fair to the extent that it is applied to those in receipt of subsidies likely to have such market-distorting potential. In this regard, if a government is found to be granting subsidies that only increase the amount of cash on hand at a recipient company, it is likely to be criticized domestically (by taxpayers and by such a company’s competitors). Thus, it is reasonable to assume that it would be politically difficult for a government that ensures transparency in its subsidy policy to grant such a problematic subsidy. Consequently, it is plausible to argue, for example, that the FSR notification requirements scope should be limited to only subsidies received from countries with low transparency subsidy policies where little or no information on the purpose, scale, conditions, etc., of individual subsidies is publicly disclosed or available. The same treatment should be applied to subsidies received from countries that fail to ensure sufficient transparency in the management of government-related institutions, such as state-owned enterprises and state-operated enterprises.

By limiting the scope of information collection on a country-by-country basis, the EU, which imposes regulations on subsidies as part of its competition policy, would effectively display trust and respect for countries with transparent subsidy policies on par with their own. The EU still might have doubts about such foreign governments' finding of “market failures” and their policy decisions as to the optimality of the amount and conditions for correcting them. However, it would be hypocritical for the EU to argue that it is unable to trust countries with enhanced subsidy transparency that allow for critical assessment of subsidy policies and practices domestically and abroad, while the EU maintains stable international economic relations with any country within the trade liberalization framework under the WTO Agreement (or any other framework).

Under the GATT/WTO Agreement, if exporters have received subsidies and the domestic industry of an importing country suffers material injury from their exports, in order to prevent and remedy that injury, countervailing duties may be imposed (i.e., to offset any price reduction effects) without regard to their aim or design. Relying on this justification of countervailing duty measures, the EU may try to justify the FSR regulations based on their being designed only to the extent necessary to prevent foreign subsidies from having negative effects. However, this argument appears as if it may be based on an incorrect understanding of the



countervailing duty provisions. As mentioned earlier, if the subsidies received by exporters are the optimal measure aimed at correcting a “market failure,” application of import prevention measures would be questionable from an efficiency standpoint. Countervailing duties are imposed on the premise that foreign subsidies are usually consumed for domestic production of products that may be sold domestically and exported abroad, and are permissible only if subsidized exports are causing or threatening to cause material injury to the domestic industry of the importing country. Accordingly, the countervailing duty provisions provide no basis for justification of the FSR, which tries to capture all foreign subsidies even where there is no basis to suspect that they have such injurious effect.

3. Suggestions

The foregoing analysis of subsidy policy and practice from a public-affairs perspective suggests the following responses:

- (1) Make a case that the EU should treat subsidies received in Japan and elsewhere as consumed by investment in the granting country, and consequently, as not distorting competition in the EU internal market.**

There are a few provisions in the FSR that may suggest a targeting of subsidies aimed at correcting any “market failure.” For example, the FSR specifies “*a foreign subsidy in the form of an unlimited guarantee for the debts or liabilities of the undertaking*” as one category of subsidy likely to distort EU internal market competition. However, the FSR does not limit its scope to such subsidies.

As mentioned above, ordinary subsidies are intended to increase investment in the granting country, and should have the effect of decreasing rather than increasing the amount of funds available to recipient companies, especially for international expenditure. More generally, the normal purpose of government subsidies is to correct a “market failure,” and the normal amount and conditions are determined to ensure that they are not excessive for that purpose. Therefore, foreign companies operating within the EU should consider requesting that subsidies they receive from their home countries or any other non-EU country be treated as not distorting competition in the EU internal market, unless they fall into any of the categories specified as those that clearly indicate otherwise. Further, in support of these claims, they should consider asking their home-country governments to explain their subsidy policies to the EU.

- (2) Since it is difficult to produce objective evidence that subsidies and other government support that do not specify the purpose, conditions, etc., will not cause distortion, companies, including group companies, should cautiously determine whether or not to receive such subsidies and other governmental support.**

The FSR has provided an opportunity for companies operating internationally to reconsider how to deal with subsidies. Subsidies, especially gifts, appear beneficial to recipients in and of themselves, and to put it in simple terms, to some it may appear obvious that it is better to “take what you can get.” If you only are doing business domestically, there may be little inconvenience to this way of thinking. However, this may not be the case for companies doing business overseas. The FSR has demonstrated that receipt of domestic subsidies may be viewed negatively in foreign markets, not only subjecting companies to countervailing duty

investigations but also other more extensive risks.

However, the authors want to emphasize that there is no need for companies to be reluctant about receiving subsidies. There is theoretical basis to argue that it is in the public interest to receive subsidies which are designed and implemented as the optimal means of correcting "market failures," and other than administrative burden there should be no problem with them, when they are challenged under the FSR, etc.

In contrast, problems may be found in subsidies that cannot warrant such explanation. Companies should consider carefully whether or not it is better to receive a subsidy granted based on a vague policy objective, unclear calculation method, or ill-defined use condition, even if it appears obvious that it is financially advantageous to receive it. Companies now must be fully aware of, in addition to well-known domestic subsidy acceptance risks, such as conditions attached to subsidies that may restrict business activities unreasonably or make it difficult for recipients to withdraw from the supported business, etc., international risks, such as that posed by the FSR when receiving subsidies without any quantitative limit or condition. Further, the unlimited scope of the FSR regulations signals that companies need to establish internal policies regarding the receipt of subsidies for the entire corporate group, rather than at a single corporate level.

This need for heightened awareness reconfirms for corporate subsidies that "there is no such thing as a free lunch."


(3) Request that EU authorities limit the scope of FSR notification requirements to subsidies received from countries with low transparency regarding subsidies and other government support measures

Section (1) suggests that companies consider arguing that no distortionary effect should be found for notified ordinary subsidies. Taking this concept one step further, this section suggests that companies consider requesting that the EU categorically exclude from the scope of the notification requirements those subsidies received from countries whose subsidy policy is so transparent that the EU can easily determine the purpose, legitimacy, and rationality of subsidies. They further may consider requesting that the EU focus on subsidies received from countries with many state-owned and state-operated enterprises and with low transparency in their management and accounting. Low-priced supply of raw materials and other goods by state-owned enterprises and state-operated enterprises in-and-of itself may constitute subsidy, and thus, the preferential treatment of state-owned enterprises and state-operated enterprises may effectively be considered equivalent to the granting of subsidies to their customers without clear indication of grounds.

This approach will not be effective unless the governments of companies' home countries, which plan and implement their own subsidy policies, take the lead. In order to request their governments to negotiate with the EU, it is more effective to lobby with broad support from industry associations, economic organizations, etc., than for companies to do so individually.

(4) Request that the governments of Japan, the EU, and other countries promote the formation of international rules for proper and effective regulation of subsidies at the WTO and other fora, so that companies will not be at a disadvantage in competitive relationships with competitors.

Section (2) suggests that companies carefully examine the legitimacy and rationality of available subsidies, and



then, cautiously consider whether they should receive subsidies that are unclear in these respects. Nevertheless, this suggestion will generate concern that companies will be placed at a competitive disadvantage if, while following such suggested approach, competitors adopt a different approach, specifically, have no hesitation in receiving subsidies that are not transparently implemented.


Therefore, in the least, simultaneous with having adopted such an approach, companies should require that the EU consider adopting international rules that prohibit subsidies facially unrecognizable as aimed at correcting “market failures” and designed as rational tools to achieve such purpose. It must be reiterated that the problematic nature of the FSR lies not only in the overbroad scope of the notification requirements, but also in the lack of clarity in applying the criteria for determining whether and how competition in the EU internal market will be distorted. As long as these regulations are introduced, companies doing business within the EU will have no choice but to be more cautious about receiving subsidies in foreign countries, as mentioned earlier. Thus, as long as the EU maintains the FSR, it should be held responsible for clarifying what kind of subsidies are problematic. In addition, in order to enable companies to make such decisions easier, international rules should be formed to ensure and enhance transparency regarding the purpose and amount of subsidies, and enforcement should be strengthened. If possible, companies may consider requesting the introduction of international rules requiring that domestic administrative relief procedures or other means be maintained to eliminate subsidies that do not meet with the aforesaid substantive requirements.

If the FSR is maintained in the absence of such international rules, the EU internal market might be occupied by companies lacking a law-abiding spirit. Even if they are actually receiving subsidies in their home countries, etc., they would intentionally fail to specify them in their notifications, if any, considering that the low transparency in the countries’ subsidy policies would make it impracticable for the EU authorities to assess properly the accuracy of such notification. Unless and until such companies are properly found and penalized, they will gain unfair competitive advantage in the EU's internal market.

Of course, the governments of other countries, including Japan, also should be interested in establishing such subsidy regulations. These international rules must be intergovernmental, and thus, the EU, Japan, and other governments are needed to take the initiative in negotiations. Here too, requests from individual companies have meaning, but it would be more effective to gain widespread support from industrial associations, economic organizations, etc.

4. Closing Remarks

The aim of the FSR would be to prevent foreign subsidies from providing recipient companies with unfair competitive advantages in the EU internal market. Like the CBAM and the introduction and tightening of human rights and environmental due diligence, this should be viewed as part of the EU attempt to address the insufficiency of regulations or excessiveness of support in foreign countries, with aim at improving them through changes that may bring in line the corporate behavior of companies doing business in the EU internal market. These measures are obviously unreasonable in failing to pay proper deference to the sovereignty of other countries, insofar as they are founded on the assumption that such other countries should adopt the same policy catalog as the EU. However, other countries and their business enterprises may be able to co-exist with these measures, if the EU is prepared to accept a solution to the effect that the equivalency rather than the sameness of relevant policies and implementations is sufficient, and thus will be sought through improving their



transparency. As noted earlier, for the EU, there is a risk that uncompromising implementation of the FSR will give rise to a significantly negative outcome by driving more law-abiding companies out of the EU internal market, or causing them to downsize their operations. In order to enhance the EU's awareness of such risks and to seek constructive solutions, coordinated efforts are needed to go beyond individual companies, to industry, and even to the national level.

(End)

In order to respond to the business needs of our clients, we publish newsletters on a variety of timely topics. Back numbers can be found [here](#). If you would like to subscribe to the N&A Newsletter, please fill out [the N&A Newsletter subscription form](#).

This newsletter is the product of its authors and does not reflect the views or opinion of Nishimura & Asahi. In addition, this newsletter is not intended to create an attorney-client relationship or to be legal advice and should not be considered to be a substitute for legal advice. Individual legal and factual circumstances should be taken into consideration in consultation with professional counsel prior to taking any action related to the subject matter of this newsletter.

Public Relations Section, Nishimura & Asahi (Gaikokuho Kyodo Jigyo) newsletter@nishimura.com