SEPTEMBER 2016

COMMENTARY

WTO Law Insufficient to Ensure Competitive Neutrality under EU Standards

The principle of "competitive neutrality" is generally considered to mean that privately owned and state-owned enterprises should compete on a level playing field. The idea is that no actor operating on the market should be subjected to unwarranted competitive advantages or disadvantages. According to a definition proposed by the Organisation for Economic Cooperation and Development, "competitive neutrality" is a:

> "regulatory framework
>
> (i) within which public and private enterprises face the same set of rules and
> (ii) where no contact with the state brings competitive advantage to any market participant."

This means that competitive neutrality does not necessarily concern the interplay between privately owned and state-owned enterprises but can also cover advantages given by the state to a particular privately owned enterprise, such as a national champion.

In any event, the concept of competitive neutrality is wide, and its achievement requires several elements. This *Commentary* focuses on subsidization, one of the most important elements underpinning the principle of competitive neutrality. The World Trade Organisation ("WTO") Agreement on Subsidies and Countervailing Measures governs the use of subsidies. The agreement applies to the 164 WTO members, which includes the European Union. The European Union has also created a state aid regime, which results in the imposition of constraints on its members states.

WTO Subsidies Regime

The WTO Agreement on Subsidies and Countervailing Measures defines "subsidy" as a financial contribution, income, or price support by a government or public body that confers a benefit. Not all government measures that confer benefits constitute a subsidy under the WTO regime—there must be a financial contribution, income, or price support. The granting of such subsidies by a WTO member can be addressed by another WTO member if the subsidy in question is specific. Subsidies are considered to be specific if they are provided to an enterprise or industry, or group of enterprises or industries, or to export goods or goods using domestic inputs. By contrast, a subsidy that is generally available within an economy is not considered to distort the allocation of resources and is therefore not subject to the agreement.

The agreement has two main mechanisms through which specific subsidization by a WTO member can be addressed by another WTO member. The first mechanism laid down in the agreement is the imposition of countervailing measures, which are unilateral trade defense measures imposed by an importing country against the goods of another exporting country. These measures typically consist of the imposition of additional import duties (countervailing duties). Countervailing measures can be imposed when the import of the goods (that benefit from specific subsidization) cause injury to the domestic industry of the importing country producing the same goods.

The second mechanism of the agreement concerns enforcement through recourse to WTO dispute settlement. There is only *ex post* control of subsidization under the WTO regime, meaning that any action taken to counter or assess the WTO compatibility of subsidization can be taken only after the subsidization has occurred. Depending on the nature of the specific subsidy, the review by the WTO dispute settlement body will differ. Export subsidies and import-substitution subsidies are prohibited under WTO law per se. Other specific subsidies can be challenged only if they cause adverse effects to the interests of another WTO member.

EU State Aid Regime

The state aid regime that the European Union has imposed on itself is unique. It places significant limits on its member states' ability to subsidize companies—rules that generally go well beyond the WTO subsidies regime. Under EU law, for state aid to exist there must be an advantage, in any form whatsoever, that is conferred on a selective basis to enterprises by national public authorities. Intervention must be by the state or through state resources and give the recipient an advantage on a selective basis, which distorts or may distort competition and is likely to affect trade between EU member states.

There are only certain situations in which EU member states can grant subsidies under EU law, in particular if the aid contributes to well-defined policy objectives of common EU interest without unduly distorting competition between enterprises and trade between member states. This can include:

- subsidies with a social character;
- aid granted to offset damage caused by natural disasters;
- certain cultural subsidies; and
- aid granted for the economic development of certain areas where the standard of living is abnormally low.

The assessment typically involves, on the one hand, a balance between the expected positive impact of the aid on the policy objective concerned and, on the other hand, the expected distortions.

New state aid measures (which are not *de minimis* or covered by a block exemption) must be notified to the European Commission for prior approval. Such prior approval is required before state aid may be granted. In addition, the Commission has significant powers that allow it to order the repayment of incompatible state aid. Finally, complaints can be lodged by enterprises as well as private individuals.

Regime Differences

The relevant concepts are defined differently under EU state aid law and WTO law. This results in a number of substantive differences between what can and cannot be addressed under both sets of rules. For instance, while in principle EU law prohibits all measures that qualify as state aid subject to a set of exceptions (related to specific policy objectives), WTO rules prohibit only export subsidies and import substitution subsidies. Under WTO law, other subsidies are not prohibited as such but can be addressed only if they are specific and cause adverse effects or injury to another WTO member.

Additionally, while the WTO rules are limited to trade in goods, EU state aid also governs subsidies that distort trade in services. In this respect, the scope of the aid that comes within the ambit of EU state aid legislation is thus significantly wider than the measures that are subject to the WTO rules on subsidies.

WTO rules also apply to measures taken by the European Union itself, which are not granted through resources of any of the member states. EU state aid legislation by contrast puts no constraints on aid granted directly from the Union budget.

Other key differences between the two regimes relate to more procedural aspects, which generally make the EU regime more stringent than the WTO regime. One of these differences is that, in principle, state aid requires prior approval of the Commission in the European Union, while under the WTO regime, no such prior approval procedure exists (only a notification requirement). Further, the Commission has significant investigative powers that allow it to tackle illegal state aid. Conversely, under the WTO regime, another WTO member can take action only after the subsidy has been granted, either by initiating an anti-subsidy investigation with the aim of imposing countervailing measures or by lodging a WTO dispute. The EU regime thus allows for both *ex ante* and *ex post* control, while the WTO regime allows for *ex post* control only.

Under the EU regime, incompatible state aid that has been granted to an enterprise must be recovered by the member state that granted it. This is in addition to the withdrawal of the subsidy. Conversely, under the WTO regime, only prospective remedies are available. Either countervailing measures are imposed, which limit or prevent further subsidized imports from entering the relevant market, or a successful WTO dispute results in the subsidy being withdrawn. There is no system whereby subsidies that are inconsistent with WTO law must be repaid. The EU regime allows for *ex tunc* remedies, while the WTO regime allows only for *ex nunc* remedies.

Comment

The European Union is unique in imposing a strict internal regime of subsidy control. The purpose of such a strict state aid regime is to limit distortions in the common market as much as possible (i.e., to ensure competitive neutrality). This has been a key requirement for the proper functioning of the internal market. However, the same level of competitive neutrality is lacking in the rest of the world, and this may place EU enterprises at a disadvantage when compared with competitors in other WTO member states.

A version of this Commentary *was first published in the International Law Office International Trade Newsletter.*

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