BRIEFING

European Parliament

State aid in the wake of the pandemic, war and foreign subsidies

SUMMARY

Over the last 3 years, the European Union has faced major challenges to its economy and societies, including the coronavirus pandemic, Russia's war on Ukraine and the increasingly urgent need for a green economic transition. The EU's response to these exceptional circumstances have included changes to its fiscal, monetary and investment policies, notably through the adaptation of State aid to allow Member States to support their economies by means of more direct intervention.

Under competition law – the cornerstone of the EU-defining internal market – State aid measures are illegal, unless covered by the exemptions provided by the Treaties. In charge of implementing State aid rules, the European Commission clarifies and regulates the scope of exemptions. State aid rules allow government assistance to compensate for damage caused by natural disasters and exceptional circumstances, such as pandemic or war. State aid projects are subject to notification and Commission approval, unless exempt under the General Block Exemption Regulation.

The Commission adopted a temporary framework in 2020, setting out permissible State aid measures to help Member States support their coronavirus-stricken economies. After Russia's unprovoked, full-scale invasion in Ukraine in 2022, the Commission published a new, wider temporary framework that allowed Member States to use more State aid intervention to ward off an economic slump, notably caused by skyrocketing energy prices. Finally, last year's US bill granting massive state subsidies for the local development of green technology, and China's long-established similar policy, prompted the Commission to propose yet another State aid rulebook in March 2023 – the temporary crisis and transition framework.

Recent State aid rule modifications come against a backdrop of the EU debate on industrial policy. Discussions pit German and French support for more state intervention to create EU industrial champions, against smaller Member States' support for unfettered competition and free trade.

The European Parliament stresses that any new State aid measure must not endanger fair competition in the internal market, which is the foundation of the EU. Parliament has called for aid to be extended through the EU budget, rather than in potentially uncoordinated national state aid provisions.

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Introduction

State aid was formally introduced into the statute of what is now called the European Union by the Treaty of Rome of 1957, which classified it as being any state intervention that distorted competition. The Treaty on the Functioning of the European Union gave a broader and precise definition in 2007. Article 107 provides that any aid granted by a Member State, which distorts or threatens to distort competition, in so far as it affects trade between Member States, is incompatible with the internal market. Exceptions exist (see next chapter). State aid can the form of tax breaks, direct cash injections, equity in a company, preferential loans or loan guarantees.

State aid law has evolved over time, with treaty changes, introduction of subsequent regulations and Court of Justice of the EU (CJEU) rulings. Its main task has always been to underpin the founding principle of the European Economic Community, subsequently the European Union – the internal market, now known as the single market – which ensures the freedom of movement of goods, capital and services (the 'four freedoms').

Competing visions of economic policy among Member States, as well as national interests, have often clashed, resulting in compromises on State aid policies, or in cases examined by the CJEU. Such cases concerned, for example, Member States wishing to keep afloat an almost bankrupt company unlikely to survive in the long term without an investor. The Commission often allowed for such assistance, if, in a particular case, an amount of State aid was deemed similar to that potentially provided by a private investor.

Due to the severity of the 2008-2009 financial crisis and the ensuing recession, Member States were permitted to recapitalise or otherwise assist many banks, to avoid a general collapse of the financial system. In 2012, to strengthen often-volatile economies, the Commission launched a State aid modernisation programme to simplify procedures and focus scrutiny on State aid cases with the biggest impact on the internal market. The 2014 General Block Exemption Regulation (GBER) allowed Member States to grant aid without prior Commission scrutiny in many cases.

The 2020 pandemic, which froze large swathes of the economy and Russia's war on Ukraine in 2022, which deprived the EU of much of its energy supplies and amplified the collapse of many supply chains, were temporary game-changers for State aid. To bolster the economy, the Commission responded: first in 2020, with a communication on the temporary framework for State aid measures to support the economy in the current COVID-19 outbreak, (2020/C 91 I/01) which temporarily allowed for State aid that was bigger in scope, larger in amounts, and faster to implement. After the outbreak of the war, the Commission published the temporary crisis framework for State aid measures to support the economy following the aggression against Ukraine (2022/C 131 I/01), prolonging most measures from the previous framework and extending them to newly affected areas and companies, such as energy producers. As a result, hundreds of billions of euros in State aid have been disbursed to help ailing economies.

Another game-changer for the EU State aid rules came with the 2022 subsidy-loaded US Inflation Reduction Act. This reinvigorated a long-lasting discussion on how to foster fair competition not only inside the bloc, but also on how to make its industries competitive globally through state subsidies. Wide-ranging consultations between the Commission and Member States resulted in a Commission proposal on 17 March 2022 for a temporary crisis and transition framework for State aid measures to support the economy following the aggression against Ukraine by Russia (2023/C 101/03). The Commission communication added to the previous frameworks' formulas for easier State aid provisions for a swifter and greater rollout of green technologies, for example in renewable energy, hydrogen-based energy and batteries.

Law provisions on State aid

Primary law on State aid is provided mainly in Articles 107-108 of the Treaty on the Functioning of the European Union. Article 107.1 states that: 'Save as otherwise provided in the Treaties, 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 shall, in so far as it affects trade between Member States, be incompatible with the internal market'.

The Treaty states that a State-aid intervention is compatible with the internal market, if it:

- 'has social character and is granted to individual consumers without discrimination related to the origin of the products concerned;
- is to make good the damage caused by natural disasters or exceptional circumstances.'

The Commission may consider whether a case is compatible with the internal market; if it:

- 'promotes development of areas where standards of living are low or unemployment is exceptionally high;
- promotes the execution of important projects of common EU interest;
- remedies serious damage in a Member State's economy;
- promotes economic activities in certain areas that do not adversely affect trading conditions to an extent contrary to the common interest;
- promotes culture heritage, unless the projects are contrary to common interest.'

Under Article 108 TFEU, EU Member States must notify the Commission about individual State aid measures and gain approval before the aid is implemented. The Treaty gives the Commission the power to prohibit a State aid project, take it to the CJEU, and to cancel State aid already extended. The Council may, by unanimity, decide that aid a State is granting or intends to grant is considered compatible with the internal market.

There are 12 regulations that put into practice the application of the Treaty parts that give the Commission oversight of State aid rules. Another regulation enables the Commission to adopt the Block Exemption Regulations for State aid. In 2020, over 90 % of EU State aid was already exempted, 2 years after the Commission scrapped the notification obligation for regional aid and aid for research and development.

The Commission publishes an annual State aid scoreboard, which details State aid expenditure in the previous year. The latest edition covers 2021.

The role of the European Parliament

As decisions regarding State aid are the European Commission's remit, Parliament's principal role is scrutiny of the executive. The Commissioner for Competition appears before Parliament's Committee on Economic and Monetary Affairs several times a year to explain the approach taken and discuss individual decisions. Parliament is involved in State aid decisions through the consultation procedure.

Parliament also monitors developments in competition policy and the Commission's work in this field. Parliament's dedicated Economic & Monetary Affairs Committee (ECON) Working Group on Competition Policy and Parliament's yearly resolutions on the Commission's annual report on competition policy, provide policy input and guidance for Parliament's view on addressing EU competition policy challenges. These resolutions have called for the ordinary legislative procedure to be extended to cover competition law.

Parliament's February 2023 resolution called for an EU strategy to boost industrial competitiveness, trade and quality jobs. Parliament welcomed the simplification of State aid due to be proposed in the new temporary crisis and transition framework. Such procedures should notably apply to companies producing strategic items, such as items for clean innovative technologies and for energy purposes. Parliament stressed that any uncoordinated State aid across Europe would hamper economic recovery. It called for more EU-level aid through the EU budget, rather than uncoordinated national State aid provisions. Parliament 'stands firmly against any attempt to make State aid rules flexible while not providing a European solution to all Member States that do not have large fiscal capacities to rely on massive state aid'. Parliament also supported the creation of a European sovereignty fund.

State aid measures following the outbreak of the pandemic

Just after COVID-19 struck EU economies in 2020, the Commission adopted guidelines for it to assess State aid, in the form of the communication on a temporary framework for State aid measures.

This temporary framework was established:

- for a limited period, until the end of 2020;
- to remedy difficulties faced by companies and other economic entities;
- to ensure that the disruption caused by the COVID-19 pandemic does not undermine companies' viability, especially that of small and medium-sized enterprises (SMEs).

The framework focused on ensuring that sufficient liquidity remains available to businesses, and the continuity of economic activity during and after the coronavirus crisis. It defined a first series of measures that the Commission considered compatible with the internal market, based on Article 107 and subject to certain conditions. The initial temporary framework allowed five types of temporary measure:

- aid in the form of direct grants, repayable advances or tax benefits (with specific conditions for agricultural, fisheries and aquaculture sectors);
- aid in the form of guarantees on loans;
- aid in the form of subsidised interest rates for loans;
- aid in the form of guarantees and loans channelled through credit institutions or other financial institutions;
- short-term export credit insurance.

The framework allowed for direct grants, selective tax advantages and advance payments. Member States were able to set up schemes to grant a company up to €800 000 to address urgent liquidity needs. It permitted state guarantees for loans taken by companies from banks, subsidised public loans for firms, and safeguards for banks that channel State aid to the real economy, as well as short-term export credit insurance.

The Commission also widened the scope of the GBER in 2021, to allow Member States to grant even more aid without prior Commission scrutiny. The GBER covers mostly the following areas of aid:

- regional aid,
- for small and medium-sized enterprises (SMEs),
- aid for research, development, and innovation,
- training aid, aid for disadvantaged workers and for workers with disabilities,
- for environmental protection,
- to make good the damage caused by certain natural disasters,
- social aid for transport of residents of remote regions,
- broadband infrastructures,
- culture and heritage conservation,
- sport, as well as multifunctional recreational and local infrastructures,
- regional airports and ports.

State aid following Russia's war on Ukraine

Russia's full-scale invasion of Ukraine in February 2022 has serious effects on EU economies, sending energy prices to historically high levels, exacerbating the post-pandemic disruption of supply chains and subjecting businesses to strict sanctions against Russia. The Commission tabled an EU response in March 2020. The communication extended the flexibility envisaged under State aid rules, applied until then to pandemic-hit enterprises, to entities impacted negatively by the war.

The new rules focused on compensating for high energy prices. Member States were allowed to partially compensate companies, in particular intensive energy users, for additional costs due to exceptional gas and electricity price increases. This support could be granted in any form, including direct grants. The overall aid per beneficiary could not exceed 30 % of the eligible costs, up to a maximum of €2 million at any given point in time. When a company incurred operating losses, further aid may have been deemed necessary to ensure the continuation of an economic activity. To that end, Member States could grant aid exceeding these ceilings: up to €25 million for energy-intensive users and up to €50 million for companies active in specific sectors, such as production of aluminium and other metals.

For energy producers and distributors, much higher aid was envisaged in the form of recapitalisation, temporary liquidity support and subsidised loans. Member States spent billions of euros in State aid to save energy production and distribution firms from bankruptcy.

For other companies, the overall aid could not exceed €400 000 per undertaking at any given point in time and could be granted in the form of direct grants, tax and payment advantages or other forms such as repayable advances, guarantees, loans and equity. In fisheries and agriculture, aid was capped at €35 000 per entity.

Liquidity support in the form of guarantees was restricted. The overall amount of loans per beneficiary could not exceed:

- 15 % of the beneficiary's average total annual turnover over the last three closed accounting periods;
- 50 % of energy costs over the 12 months preceding the month when the application for aid was submitted;
- upon appropriate justification, to be provided by the Member State, the amount of the loan may be increased to cover liquidity needs, from the moment of granting, for the coming 12 months for SMEs and for the coming 6 months for large enterprises

In October 2022, the Commission prolonged the temporary crisis framework, in view of Russia's continued aggression against Ukraine and the feedback received from Member States.

Debate on a new State aid framework

From October 2022 to March 2023, Member States and the Commission debated a new temporary framework to grant a special State aid status for companies rolling out clean technology. This was to be partly a response to the United States' Inflation Reduction Act (IRA), which, it was feared, could divert green investment from Europe to the US. The new framework would also aim at accelerating implementation of the EU's Green Deal to fight climate change. Statements by EU leaders and high-ranking officials revealed that France favoured a long-term industrial policy that could use State aid to build strong EU companies capable of withstanding competition from the US and China. Germany also urged further loosening of State aid rules, but only temporarily. A group of smaller Member States, with fewer financial resources than the EU's two biggest economies, were wary about an excessive relaxation of State aid rules, however, as it could undermine competition in the internal market. This group includes Belgium, Czechia, Denmark, Finland, Hungary, Ireland, Latvia, the Netherlands, Poland, Slovakia and Sweden. Their case was strengthened by a letter sent to Member States by Competition Commissioner Margrethe Vestager. This letter showed that France and Germany, the richest EU Member States, together accounted for 77 % of State aid notified under the temporary crisis framework up to that date. Many other Member States have generally backed an anti-protectionist, pro-free trade approach.

In their Council conclusions of 9 February 2023, Member States 'took a note' of the Commission's plan to propose an EU sovereignty fund in the medium-term. Commission President

Ursula von der Leyen wants to propose to set up this fund by mid-2023, to boost research, innovation and strategic industrial projects. It is as yet unclear how the fund would be financed.

The February 2023 meeting of Heads of State and Government concluded that the Commission needed to further develop its State aid plans. 'Procedures need to be made simpler, faster and more predictable, and allow for targeted, temporary and proportionate support to be deployed speedily, including via tax credits, in those sectors that are strategic for the green transition and are adversely impacted by foreign subsidies or high energy prices'. The Council conclusions also noted on EU-level funding, that 'at the same time, to facilitate the green transition across the Union and to avoid fragmenting the Single Market, a fully effective EU policy response requires fair access to financial means'.

Inflation Reduction Act (IRA)

The US adoption of its IRA in August 2022, fed into a long-standing debate on how to strengthen EU industry, especially in green technology and digitalisation, to ensure investment takes place in Europe rather than in the US or China. The US$739 billion spending bill provides for US$369 billion investment in energy security and combatting climate change. Examples of the Act's provisions relevant to State aid include:

- Tax credits for investments into advanced energy projects, including those expanding or establishing manufacturing facilities for the production of clean energy equipment and vehicles;
- A production tax credit for domestic manufacturing of components for solar and wind energy, inverters, battery components, and critical minerals;
- A tax credit of up to US$7 750 for clean vehicle purchases, for which a minimum percentage of critical minerals has been extracted or processed in the US or a country with which the US has a free trade agreement. The EU is negotiating to be included in this group.

In Washington, US President Joe Biden and Commission President Ursula von der Leyen agreed 'to take steps to avoid any disruptions in transatlantic trade and investment flows that could arise from their respective incentives'. They also announced that 'we are working against zero-sum competition so that our incentives maximise clean energy deployment and jobs – and do not lead to windfalls for private interests'.

Green Deal industrial plan

European Commission President Ursula von der Leyen presented further ideas on another temporary overhaul of State aid rules on 1 February 2023, outlining a Green Deal industrial plan, (GDIP) a crosscutting programme to strengthen the competitiveness of EU industries at a time of green transition. It covers four components: the regulatory environment, financing, skills and trade. The plan builds on previous initiatives, complementing efforts under the European Green Deal, and REPowerEU.

The Green Deal envisages zero net emissions of greenhouse gases by 2050, and net emissions reduced by at least 55 % by 2030, compared to 1990 levels. The RePowerEU initiative provides for energy saving, by boosting the production of clean energy and diversifying energy supplies. President Von der Leyen announced consultations with Member States on transforming the current State aid temporary crisis framework into a new temporary crisis and transition framework and on a further revision of the GBER.

According to the Commission, public spending could now co-finance private investment, thereby significantly increasing the total amount available to foster the green transition and create quality jobs. The Commission would also permit the swifter use of State aid for important projects of common European interest (IPCEI), and large cross-border projects, particularly those launched in the area of hydrogen-based energy.

As promised in the GDIP, on 16 March 2023, the Commission proposed a draft net-zero industry act; a regulation that would set the target of 40 % of the EU's overall strategic net-zero technologies manufacturing capacity to be reached by 2030. These technologies include:

- solar photovoltaic and solar thermal, onshore wind and offshore renewable energy,
- batteries and storage,
- electrolysers and fuel cells,
- biogas/biomethane,
- carbon capture, utilisation and storage,
- grid technologies,
- sustainable alternative fuels technologies, advanced technologies to produce energy from nuclear processes with minimal waste from the fuel cycle, small modular reactors.

The Commission also complemented its GDIP with a proposed critical raw materials act, to facilitate sufficient access to materials, such as rare earths, that are vital to manufacturing technologies, including batteries and wind turbines. The plan envisages reducing EU dependence on China and others in obtaining these materials.

The GDIP promises that the Commission will propose a European sovereignty fund in the medium-term, to further help finance clean technology, as part of the mid-term review of the EU's long-term budget later this year. However, it remains unclear how this fund would be financed. Many Member States want to use already-pledged EU funds that have remained unused to date.

Temporary crisis and transition framework

The Commission's new, keenly awaited temporary crisis and transition framework for State aid measures to support the economy following the aggression against Ukraine by Russia, which came into force on 17 March 2023, prolongs and modifies State aid rules established in the previous temporary crisis framework for entities still suffering the adverse effect of Russia's war on Ukraine. The scope and amount of State aid allowed to assist companies up to the end of 2023 are similar to those offered under the previous framework.

However, a key new element of the communication is fostering support for sectors that are key to the transition to a net-zero economy, in line with the GDIP. New State aid provisions should make it easier and faster to develop new capacities in batteries, solar panels, wind turbines, heat-pumps, electrolysers and carbon capture usage and storage, as well as for production of key components and for production and recycling of related critical raw materials. The aid permitted is temporary, until the end of 2025, and limited in scope, to avoid distorting competition on the internal market. However, the aid limits can be lifted on a case-by-case basis if the beneficiary could demonstrably receive an equivalent investment in a third country jurisdiction outside the European Economic Area. According to the communication, this 'aid may not exceed the minimum amount needed to incentivise the aid beneficiary to locate the investment in the area concerned in the EEA'. The clause is meant to prevent companies from moving investment to the US, thanks to IRA subsidies, or to China.

In other cases, the aid intensity may not exceed 15 % of the eligible costs and the overall aid amount may not exceed €150 million per undertaking, per Member State. In certain poorer areas of the EU, the aid intensity may be increased to 20 % of the eligible costs and the overall aid amount may not exceed €200 million per undertaking, per Member State. This aid must not incentivise a company to move production between EU Member States. The Commission also made a distinction between aid awarded in a bidding process and without one. In the former case, the amount of aid may be higher. The process of obtaining a permit to set up a new clean tech entity is to be accelerated.

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