Kluwer Competition Law Blog

Some Implications of Transatlantic Trade Issues on Competition Law

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Competition law mainly deals with microeconomic issues. Price theory orients its application, with price, supply, demand, and information being important parameters. However, microeconomics does not have a monopoly on influencing competition and competition law. Macroeconomic developments have roles to play as well. These roles may materialize in the form of monetary and budgetary policies. For monetary policy, there seems to be a positive relationship between the federal funds rate and the frequency of M&A activity. But what about budgetary policies?

The purpose of this blog post is to highlight some of the effects recent U.S. budgetary reforms exert on transatlantic competition. I focus on the Inflation Reduction Act ("**IRA**"). The IRA is a recently approved budgetary bill and it is as ambitious as controversial. Some have called it an instrument of a "*climate trade war*", others label it as industrial policy in disguise, whereas proponents cheer for its prioritization of environmentally sustainable economic development as a "seismic shift" in US economic policy. In the following paragraphs, I will highlight some of the provisions of the IRA that relate to competition, briefly examine their stance against international trade rules, summarize Europe's reception of the bill, and conjecture some of its potential impacts on EU competition law.

The IRA: Not New, But Controversial

While the IRA is a lengthy document, two categories of provisions stand out for the purposes of transatlantic competition. These are performance requirements and subsidies. Regarding performance requirements, the IRA promises tax reductions for purchases of electric-powered automobiles of up to USD 7,500 per unit. Initially, this seems like a welcome development since the rapid adoption of electric vehicles may require state support for consumers. However, it is also dangerous since, in doing so, the United States explicitly links environmental protection efforts to performance requirements, including localization of production. Under WTO law, such subsidies may be illegal. For instance, in *Canada/Renewables*, a famous case concerning Canada's renewable energy sector, a WTO Panel and the Appellate Body confirmed that feed-in tariffs (a favourable pricing scheme for purchasing electricity) dependent upon obtaining locally produced components infringed international trade rules.

In terms of subsidies, the IRA appropriates USD 250 billion to help prop up renewable energy production in the US. Investors building new power plants can benefit from a subsidy worth up to 30% of their initial investment. Furthermore, if certain local sourcing requirements are met, such as supplying 40% of materials used in the plant from US manufacturers, the subsidies jump to 40%. These developments have been alarming European officials for the past few weeks. Indeed, French President Emmanuel Macron stated that the IRA is "*super aggressive*", whereas Josep Borrell, the Union's High Representative, expressed doubts as to whether the US is still Europe's economic ally. At the heart of these concerns is the worry that European companies may relocate significant chunks of their businesses to the United States to benefit from these generous subsidies. Coupled with skyrocketing gas prices, some companies such as BASF may already kick off preparations to do just that. Some companies in the US already started receiving large sums – for instance, a joint venture between General Motors and LG acquired USD 2.5 billion for electric battery production.

One can view the IRA saga as a recrudescence of the WTO crisis. As known, the WTO witnessed an "*empty-chair crisis*" in its Appellate Body during the Trump Administration. The IRA, with its potentially illegal subsidies provisions, may represent an extension of that crisis by other means. Many analysts have already demonstrated that the Biden Administration's trade policy is only a "*polite*" version of its predecessor. Coupled with the fact that the EU itself is poised to capitalize on its common commercial policy as a more assertive tool, a subsidy war may occur. Although political compromise seems to be forthcoming, it is also wise to remember that the Canadian renewables dispute was co-initiated by none other than the EU. Indeed, the greatest danger is a full-blown "*subsidies war*" between the two economic powers. On the European side, this can materialize by relaxing state aid rules on environmental grounds or establishing a standalone fund to counteract the IRA. . In fact, the issue has become so important that Margrethe Vestager, the EU's competition chief, has recently made an "urgent" call to update state aid rules to respond to the IRA. The result of such battles would be protectionism disguised as environmentalism, and some commentators already see the EU's proposed Carbon Border Adjustment Mechanism as a harbinger of things to come. Some advocate for an outright abandonment of the EU's market-based carbon markets in favour of a Europeanized IRA. Similar cries of "climate protectionism" emanate from the US as well.

In light of the foregoing, the crux of the IRA's problem lies in its imperative to make buyers choose American goods as often as possible. That is not new. In fact, what is known as the "*Buy American clause*" has been good law in the US for close to a century. It was first enacted in 1933 by President Herbert Hoover, mandating the federal government to purchase American-made products to the extent possible. More recently, Obama's American Recovery and Reinvestment Act contained similar provisions, which tied economic grants to the use of US-manufactured components in an investment project. The IRA thus represents a fresh reaffirmation of an old paradigm in US policy.

The (Anti?)Competitive Impact of the IRA

Aside from trade law, the IRA's performance requirements and subsidies may also distort competition and affect competition law. Loans, grants, and increased demand are all likely to induce a surge in the supply of environmentally sustainable products. This means that the IRA will likely incentivize American producers to develop new, innovative production methods and business models to cater for increased demand. As a result, these firms will unlock new abilities to compete abroad, not only in terms of price but also quality, measured in terms of sustainability.

Furthermore, the scenario is likely to be exacerbated, since it is unclear whether the economic impact exerted by these firms will be caught by the new European Subsidies Regulation. In other words, despite new regulatory tools, the EU may be ill-equipped to deal with market-distorting subsidies of US origin. These developments are in direct tension with the EU's main objective of building a competitive economy based on environmental concerns, as outlined in numerous legislative developments.

The surge in green competition in Europe may also lead to increased supply. Part of the demand that would correspond to that supply will likely come from the EU's relatively well-developed public procurement framework. Indeed, green public procurement has been explored by the European Commission for over a decade, and the regulatory environment is developing. Furthermore, large though the European procurement market may be, business-to-business transactions are also likely to play a role in absorbing supply. Here, competition law may again act as a barrier to a sustainable economy in numerous ways.

For starters, European companies (which are predominantly SMEs) may collaborate to offer sustainable alternatives. These initiatives may also partially offset increasing overseas (including American) competition. However, as the law currently stands, such initiatives risk antitrust condemnation. Even though the new Horizontal Guidelines provide for a carve-out for sustainability agreements, the margin is very narrow and satisfying the burden of proof is tough. Thus, a top-down solution looks elusive for the moment. Rather than a top-down measure, the reform of Regulation 1/2003 may make it possible for a bottom-up approach to emerging, as exemplified by the Dutch, Austrian, Hungarian, and Greek competition authorities.

EU competition law may also affect sustainability initiatives in a more fundamental manner. European competition law is, in principle, not concerned with the disappearance of "*less efficient*" competitors from the market. This tenet orients the EU's state aid policy as well. Essentially, state aid law requires Member States to recover unlawful aid, even if that recovery leads to the disappearance from the market of the recipient. Such disappearance would be appropriate since, in the counterfactual of no aid, economic forces would have naturally excluded that undertaking from the market anyway. [1] At the same time, state aid law recognizes that certain market failures may inhibit the development of desirable products and processes, especially as regards the transition to a sustainable economy.

An equivalent recognition is missing in the realm of antitrust. Indeed, the as-efficient competitor test and principle ("**the AEC concept**"), as currently applied, may inhibit the green transition. This is because the AEC concept understands efficiency in a static manner. As a reminder, the AEC concept requires that, in order for an exclusion to be anticompetitive, the rivals excluded by the dominant undertaking must be at least as efficient as the dominant firm. For the purposes of the concept, that "*efficiency*" is understood as productive efficiency in the form of lower costs. However, we know that novel technologies that promise large gains in sustainability are often lacklustre in terms of cost structure, at least initially. Thus, a static understanding of the AEC concept currently espoused by the case law would not be concerned with the exclusion of such firms as they are not considered "*as efficient*". Furthermore, the law uses the efficiency level of the dominant firm as a benchmark (rivals need to be equally efficient as their dominant counterpart). This understanding acts as a *de facto* blessing for the dominant undertaking's business model.

Conclusion

The relationship between European competition law and sustainability goes way deeper than horizontal agreements. In terms of unilateral conduct, a fundamental premise of EU competition law blesses the exclusion of less efficient competitors from the market as a rule. This is based on a static, rather than a dynamic, understanding of efficiency by the law, expressed in terms of production costs and profit margins. If such an interpretation of the case law prevails without exception, the attainment of the objectives of the European Green Deal will remain in jeopardy. In turn, that would endanger not only a coherent policy and legal framework but also European competitiveness in the face of growing threats, most recently represented by the Inflation Reduction Act promulgated by the Biden Administration.

The debate on the as-efficient competitor principle is still brewing. There is an argument to be made about its permeating nature; that is, the notion that EU competition law is not concerned with the exclusion of less-efficient rivals is a principle set to infiltrate all areas of competition law. While that debate is far from settled, it may already be time to inquire whether the AEC concept is also an epithet in need of limiting principles.

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[1] Some examples include Joined Cases C-164/15 P and C-165/15 P, *Aer Lingus* [2016], Opinion of AG Mengozzi, para 62; Case C-372/97 *Italian Republic v. Commission* [2004] ECR I-03679, para 105; Case C-278/92 *Kingdom of Spain v. Commission* [1994] ECR I-04103, Opinion of AG Jacobs, para 95.

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