

## **The Confederation of Swedish Enterprise's position on the proposal for a European Chips Act**

On 8 February 2022, the European Commission presented a series of measures to reinforce the semiconductor ecosystem in the EU. The European Parliament and the EU member states will subsequently negotiate the proposals in accordance with ordinary legislative procedure. Here is Confederation of Swedish Enterprise's view and analysis of the European Chips Act.

### **Our main points:**

- The Confederation of Swedish Enterprise rejects the proposal for a Regulation establishing a framework of measures for strengthening Europe's semiconductor ecosystem (Chips Act)
- The proposal has not been subject to any impact assessment by the European Commission. The Council and the European Parliament should work to ensure that the need for new EU legislation in this area is first reviewed in more depth, before moving on with negotiations
- Semiconductors are an important input for many businesses. New investment in research and development in the field of semiconductors is welcome. However, in many respects, the Commission's proposals result in such negative effects that the implementation of the proposal is not justified; substantial state aid that risks distorting competition; regulations that restrict the business freedoms; and the risk of an increased administrative burden
- There is also a key issue of principle: if public intervention and control to the extent that is now being proposed is accepted, there is a risk that additional inputs/production types are considered so important that the same approach can also be justified for them. Free, well-functioning, and dynamic markets risk becoming more limited and rigid. Increased support for and restrictions on production could also contribute to a "state aid race" and to increased barriers to trade.

### **The Chips Act proposal**

The Regulation forms a central part of the Commission's proposed European Chips Act. It also includes a communication from the Commission outlining the initiative, a proposal for a Council Regulation amending Regulation (EU) 2021/2085 establishing the Joint Undertakings under Horizon Europe, as regards the Chips Joint Undertaking, and a recommendation on a common Union toolbox to address semiconductor shortages and an EU mechanism for monitoring the semiconductor ecosystem.

The Regulation includes:

- Proposals for the reallocation of existing EU funding for research and development. Allocated funds within the Horizon Europe and Digital Europe programmes will be reallocated, corresponding to EUR 1.65 billion from each programme. Funding would go to R&D&I, pilot facilities, the creation of competence centres, and a new "Chips fund" that will make it easier for SMEs to access financing.

- A new process for classifying semiconductor production facilities within the EU as either an *Integrated Production Facility* or an *Open EU Foundry*. These classifications are to be made by the Commission and entails restrictions on businesses' freedom. The classification also allows for extensive state aid from member states, up to 100% of financing costs, with direct reference to the Treaty on the Functioning of the EU. Member states shall undertake to prioritise the establishment/expeditious processing of authorisation processes and similar, and to appoint a responsible authority which shall have the primary responsibility for processing and co-ordinating applications related to planning, construction and operation.
- Requirements for member states to regularly monitor the semiconductor value chains. This includes gathering information from market participants and communicating with the Commission and a proposed new institution called the European Semiconductor Board. In the event of a crisis, (a severe shortage of semiconductors), the Commission would be able to force specific facilities mentioned in paragraph 2 above to give priority to certain orders, even if this is contrary to national law or existing contracts. The Commission would also be able, at the request of the member states, to act as a joint purchasing organ and procure crisis-related products.

## The proposal does not address the current shortage of semiconductors

The proposal has not been subject to any prior impact assessment that describes the current situation and that provides realistic forecasts of how the value chain of semiconductors is expected to develop in the coming years in terms of supply and demand globally, as well as global investment. There is widespread agreement that the severe shortage of semiconductors, that has existed for some time and that has had major impacts on large parts of European industry, and the political pressure that has followed have led to the proposal being rushed without the standard procedures that should precede this type of far-reaching proposal. This is despite the fact that the proposal itself will not adequately improve the current situation. Any new facilities for the production of semiconductors in Europe, insofar as they affect the supply of semiconductors of the relevant type for companies in Europe, are many years in the future. Other measures prescribed in the initiative are unlikely to significantly affect the supply of and access to semiconductors. There are therefore no convincing reasons why the proposal must necessarily be drafted and negotiated at such a high speed.

## The lack of thorough review and impact assessment

Furthermore, there is a lack of a thorough review of current initiatives in the segment, such as ongoing IPCEI projects and work by the Industrial Alliance for Processors and Semiconductor Technologies, and what role these can play. Neither has there been a corresponding review in the field of research on how funding for research in semiconductors from the EU and member states is currently structured and its extent, and whether increased ambitions can be managed within the framework of existing research programmes. There has also been no impact assessment into the negative effects on other research funding caused by the reallocation of funds from Horizon Europe and Digital Europe. There is also a lack of insight into major investments announced globally by private and public actors. In this context, it can be stated, for example, that:

- The US Senate has approved a new bill that includes investments of USD 52 billion for new semiconductor manufacturing.
- South Korea has announced subsidies and tax incentives for semiconductor manufacturing equivalent to USD 450 billion over the next ten years.
- The company TSMC has announced investment of USD 100 billion over the next three years.

- Samsung has announced investment of USD 151 billion by 2030.
- The company Hynix has announced investment of USD 97 billion in existing facilities in addition to investment in four new factories for a total of USD 106 billion.
- Intel has announced investment in a new factory in the US of USD 20 billion and has announced investment in Europe corresponding to approximately USD 30 billion, of which SEK 17 billion relates to a new factory in Magdeburg, Germany.

Source: Financial Times, Bloomberg, Fortune.

There is also a lack of an impact assessment that explores alternative ways of promoting the increased supply of semiconductors in the future, for example through increased trade and the extensive investments being made globally.

It is also necessary to analyse aspects that concern monitoring of the value chain via the so-called European Semiconductor Board, including administrative costs that this proposal entails for businesses and its administration at EU and member state level.

## Controlled production

To be classified as one of the two eligible factory categories – *Integrated Production Facility* or *Open EU Foundry* – the Commission is to introduce an additional administrative process that must take place in parallel to the Commission's examination of a state aid notification. A factory is only eligible if it meets the set requirements. The Commission then continuously monitors compliance. If conditions are deemed not to have been met at a later date, a factory may lose its status as an eligible factory. What then happens with state aid already granted is not clear, but the logical and problematic consequence must be that such state aid must be recovered from the beneficiary, which may jeopardize the entire project.

Special conditions are also attached to the status of eligible factories, which mean that production in a situation of scarcity or crisis may be controlled by the Commission. How the Commission will carry out that role is not specified, nor is what type of production and which customers should be prioritised and how prioritisations are made. This appears highly legally uncertain. It cannot be clearly predicted what may be described as a crisis that activates this function, nor *how* the control of production will be conducted. It can be reasonable to ask whether the Commission has the necessary resources, knowledge and ability required to understand, assess and weigh different needs against each other and make decisions that are operationally significant to production. There is also the risk of politicisation and that the needs of different member states and sectors are set against each other in such situations. This can lead to negative incentives and a risk of corruption. It can also be stated that control over production is shifted from businesses and owners to politicians and administrators in such a scenario. Hence, the Confederation of Swedish Enterprise strongly opposes such a development.

In addition, it is not clear whether such a controlled facility within the EU will be relevant to the needs that are most prevalent in a crisis situation. To be relevant, production needs to be centred around products that are primarily in demand by businesses in the EU Single Market. As the Confederation of Swedish Enterprise understands it, the European auto industry and other large consumers of semiconductors mainly do not use the most advanced semiconductors. Nevertheless, it is in particular support for the manufacture of such advanced semiconductors that the Chips Act describes as appropriate. There is no sufficient description and analysis of different types of production and what the need is for different types of semiconductor products.

Furthermore, the value chain is extremely complex and dependent on different types of raw materials and components. A specific production plant in the EU is in turn dependent on raw materials and inputs, and the product that the plant produces may need to be further refined or combined with other inputs before it is resold, for example for installation in a vehicle or white goods. If other such parts of the value chain are not available, a production facility within the EU will nevertheless play no role in a crisis.

## European competitiveness

A plant established in the EU, even if it receives large amounts of state aid for the investment, must nevertheless operate as a competitive business. As the semiconductor market is global, production needs to be as competitive as similar production in Asia and the United States. It cannot be assumed that this can be achieved, even by an existing company that opens a facility and brings with it its business model and know-how. European companies will also continue to value price and quality highly. It is also not necessarily the case that a factory in southern Europe has greater security of supply than a factory in Texas or Taiwan. Value chains are global and complex, and in general not even companies know in detail where all the components in all their inputs ultimately come from. Companies strive for secure, efficient and diversified value chains, and geographical distances are only one factor in assessing which suppliers they wish to work with.

In the event of a crisis – when the Commission takes control of production of an EU-based facility – an operator that has existing orders from an EU-located facility may see their orders cancelled in favour of other orders that the Commission deems more important. This means that in a crisis, it will be more uncertain to have orders at an EU facility than a counterpart in a third country. This in itself can be a competitive disadvantage for new, EU-based facilities, as customers may at any time risk losing their orders with no right to compensation (as proposed in Article 21.6). This can represent a competitive disadvantage for such facilities.

There is furthermore a risk that facilities will not be competitive, and that there will be surpluses due to the extensive investment currently being made globally. In that case, further operational support risks being necessary to prevent production disappearing altogether – an extension of the argument that it is necessary to secure the supply of semiconductors in the event of a fresh crisis. Already very costly support may therefore need to be followed by additional costly operating support that displaces other important investment and cost reductions for business and loosens the important resistance to distorting competition in the single market with public operating support. The question is also whether such operating support could be made WTO-compatible.

## Regarding funding from the EU budget

Increased research and development funding in the EU budget is welcomed. Research in semiconductors is vital, and research in the field in Sweden is of a very high international standard. It is therefore positive that more funding for semiconductor research is being announced. Other aims of such funding, such as promoting the creation of pilot facilities, the creation of competence centres, and a new “Chips fund” that will facilitate for smaller companies to gain access to financing, are also welcome. However, what is not welcome is that under the proposals, resources are taken from other research funding. This risks displacing other research and innovation that is important to business. More research funding is thus shifted from open calls for competition into politically defined projects. It would have been preferable if funding had been taken from other parts of the budget that do not

negatively affect business, so that less productive expenditure could have been converted into more productive and future-oriented expenditure.

## Recommendation to member states: a co-ordination mechanism

The Commission has made a Recommendation to member states to set up an immediate co-ordination mechanism to deal with the current shortage of semiconductors together with the Commission. The Recommendation, which was adopted on the basis of Article 292, applies from 8 February 2022 and is therefore not something that the member states or the European Parliament have the opportunity to influence per se. Within the framework of the Recommendation, member states are to collect information from businesses and business associations linked to the semiconductor value chain. This may refer to production opportunities, production capacity and current disruptions and bottlenecks. Information must be shared, inter alia, with a new expert group to be put together by the Commission. One of the measures that the European Semiconductor Board can recommend is the introduction of an export control regime, i.e., trade restrictions. The Recommendation applies until a permanent system can be adopted as proposed in the Regulation.

There are obvious objections and concerns to raise in connection to this. Not least the administrative burden that follows from extensive and recurring demands for information gathering from companies that are already working hard to deal with the lack of semiconductors. Furthermore, there is a risk of leakage of trade secrets if information that could be business- and technology-critical is to be submitted.

The Confederation of Swedish Enterprise is generally sceptical of the possibility of mapping the global market and value chains in a relevant way in line with the high ambitions expressed in the Regulation. Value chains are extremely complex and dynamic. Not even businesses themselves can describe how all aspects of different value chains are interconnected. In addition, they are in constant transformation due to changes in business models, prices and technology. Furthermore, such information gathering can, for natural reasons, only reflect what is happening in the EU's single market, as there is no opportunity to obtain information from all actors in third countries, where the majority of production is also located. There is an imminent risk that this measure will only lead to increased administrative costs for businesses and an administrative structure that in itself increases costs. It can also be questioned what standard it sets for other industries and value chains, if it begins to be perceived as appropriate and legitimate that other industries and value chains also need to be monitored and thus operate under an administrative structure that consumes resources and does not necessarily contribute to competition and resilience.

## The state aid rules

A central part of the Regulation relates to qualifying certain production facilities to give them preferable treatment in inquiries to grant state aid to such facilities. State aid for investments is not in itself a new phenomenon – it is a prominent aspect of the state aid rules, which enables state aid to be granted in the event of market failures to ensure that societal gains can be incorporated in certain investments that cannot be implemented on market terms. The Regulation is based on the provisions of the Treaty of the Functioning of the EU, which contain a general ban on state aid, but which also allow for state aid for certain specified purposes. Based on this, the Commission, under the Council's mandate, has developed legal acts that describe the conditions and purposes for which state aid can be granted in more detail, such as environmental improvement, energy efficiency, education, regional development, etc.

Concerning state aid, there are a number of factors that are problematic with the Commission's proposals:

- **Legal basis.** The Regulation does not present a new legal basis for considering state aid for such investments that are compatible with the EU single market. There was also no such legal basis prior to this, which describes why it would be compatible. The Regulation itself only states that member states may grant state aid and provide administrative assistance in national authorisation procedures, but that this does not affect the Commission's competence in state aid under Articles 107 and 108 of the Treaty, where applicable. Instead, the Commission provides more clarity in its accompanying communication, which describes the issue of state aid in detail. It states that state aid will be assessed directly under Article 107 (3) (c) of the Treaty, which reads as follows:

*"...aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest."*

To directly invoke the provisions of the Treaty is not unique. It occurs, but then usually in exceptional and isolated cases where aid can be justified on the basis of the provisions of the Treaty and the circumstances of the case, but where it does not fall within the scope of any existing legal act. In this case, however, it does not apply a specific situation; rather, it involves a completely new type of activity that must be systematically given special treatment and examination. The communication describes, inter alia, which circumstances the Commission must take into account, e.g., that the facility shall be the first of its kind in the EU and shall apply such a technological level that goes beyond that currently used within the EU (beyond state-of-the-art). This type of treatment could open the door for more new types of state aid to be approved by the Commission, it could lead to more state aid and less legal certainty and predictability of the granting of state aid in general.

- **Amount of state aid.** State aid may be granted for up to 100% of the funding gap, i.e., the difference between costs and revenues during the lifetime of the investment based on credible calculations. It is exceptional that this high level of state aid is allowed. Compared to the framework for state aid for research and development, the same amount of state aid can be given to basic research, while state aid for industrial research is limited to the equivalent of 50%, and experimental development even lower. It is equivalent to the state aid available under the IPCEI rules. These rules have been criticised by the Confederation of Swedish Enterprise for being used too extensively, and there are still requirements to reduce distortions of competition, e.g., that several member states should be included, that it should relate to research and development and not mass production, and that the results should be widely disseminated to the benefit of many.
- A basic principle and economic rationality for the use of state aid is that there must be some form of **market failure**. For example, it may be that a market does not sufficiently prioritise green investment, or investment in basic research and development that cannot be turned into profitable products but that bring great societal benefits. In the case of semiconductors, one can ask whether there is a market failure, especially in the long term. The market for semiconductors is highly globalised. At present, there is an imbalance in supply and demand, but all indications are that the market will adapt and even out imbalances, just as market tend to do does when it is not disturbed by barriers and regulations. Nor is it in itself a market failure that a certain type of production does not exist within the EU. If such a fact is to be considered from now on as a legitimate basis for state aid to be granted, it opens up the

possibility that far more production could be given state aid, which would be extremely detrimental to the internal market, our trade relations, and EU competitiveness.

- State aid shall **only be granted for the first facility of its kind**. In other state aid rules, there are no rules that exclude state aid being given to several actors. In this case, support will only be given to the first plant of its kind, based on the logic that one plant should be sufficient to secure the supply of semiconductors in Europe. This leads to both a problematic competitive situation, where the member state that first attracts an actor and through promises of large amounts of state aid is able to apply for and obtain approval for a project from the Commission excludes all other member states. This will turn the process into a competition between applicants to get their project ready as quickly as possible, which can increase the amount of support to attract existing players in the market, and impact the quality of the project.

## Distortion of competition

Whenever the state aid regulations are opened up, it leads to an increased amount of state aid and distortions of competition between businesses from different member states that have different resources and willingness to use the regulations. Based on the state aid that has been granted to date within the framework of the IPCEI in semiconductors, as well as statements in the media, it is especially Germany and France that show the greatest willingness and capacity to use state aid in this area. The Netherlands may also have special interests, as it has a significant cluster of semiconductor operations, especially with ASML Holding, (31,000 employees globally), which is the only company in the world that produces machines that can make the smallest semiconductors.

Distortions of competition do not arise primarily through the state aid to the plant itself, as according to the proposed Regulation it must be first of its kind in Europe and thus unable to compete with another factory in the EU. Rather, it occurs if the owner(s) of the factory also have other financial activities and can utilise the financial benefits of the state aid and a new factory in adjacent markets. This can also be done by other parts of the value chain or R&D&I in the member state where a new plant is established being able to take advantage of the proximity to a production plant. It can also happen through the crowding-out effects of other investments and/or support for research and development, and that new establishments are outcompeted or completely absent.

## Concluding remarks: the development of EU industrial policy

The proposal to open up more state aid in this way, along with new bureaucratic processes and political control of day-to-day market production, is being launched just when the EU is already moving towards more intervention in the functioning of markets. The IPCEI regulations, which allow large amounts of state aid for projects in various deemed strategically important technologies, are used to a large extent and the amount of state support within the EU increases.

Large sections of the new policy proposals entail reduced confidence in markets' ability to stimulate innovation, efficiency and optimal solutions for society on their own, and that it is instead necessary for politicians and administrators to implement targeted measures of various kinds with taxpayers' money. Given current trends, the European Chips Act is particularly problematic, as it involves another significant step towards more regulation, administration and intervention, when what is needed is more free trade, open markets, regulatory simplification and wide-ranging investment in research and development based on open calls and competition based on excellence. There is a risk that the European Chips Act will become a model for how other important input goods will also be handled, namely that there is a need for regulated and subsidized production within the EU.

Current trends are increasingly being strongly influenced by geopolitics and security policy. It is not primarily the role of business to take geo- and power-political considerations into account in the way that nation states or associations can take. The focus for business is to create favourable conditions for the companies of today and tomorrow to operate and how increased competitiveness can best be stimulated. Increased geopolitical tensions should also be managed mainly through increased openness and more intensive trade based on the comparative advantages of different countries to achieve mutual dependence rather than protectionism and strategies for increased autonomy.

Lastly, macroeconomic trends point to further increase in public spending and an expansive EU expenditure policy, for example in the form of selective state aid. According to figures from Eurostat, average inflation in the euro area increased from 5.9% in February to 7.5% in March. Inflation is driven by increased energy costs, which then feed into the rest of the economy. At the same time, many countries are choosing to rapidly increase defence spending, and that the EU will in future need to pursue a restrictive expenditure policy to finance the repayment of joint borrowing under the auspices of Next Generation EU. All this suggests that measures need to be taken to combat inflation and avoid further increases in public spending, which is also a reason not to loosen legal restrictions on member states to increase such spending.

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*The Confederation of Swedish Enterprise is the voice of businesses in Sweden. We are Sweden's largest and most influential business federation, representing 60 000 member companies in all sectors with almost 2 million employees.*