

The Confederation of Swedish Enterprise's position on the 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 member states will subsequently discuss the Commission's proposals in accordance with ordinary legislative procedure. Here is Swedish Enterprise's initial view of the Act.

Our overall view

Regarding the European Chips Act, Swedish Enterprise would like to make the following general points:

- Reforms to promote business and trade in semiconductors are fundamentally positive. Semiconductors are a key input for many Swedish companies, and many Swedish companies and universities are at the forefront of this area. Increased R&D&I in the value chain in the EU is to be welcomed, assuming it does not take place at the expense of other important R&D&I activity.
- However, the European Chips Act is generally more problematic. It contains proposals that are in themselves negative: 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.
- We do not share the view that increased production within the EU is of such considerable value that it justifies the proposed interventions. The planned measures will not address the supply constraints experienced since the outbreak of the pandemic. In the long run, considerable investment will be made globally, using private and public funds, which makes it likely that the degree of diversification could be increased, thereby building resilience to future crises.

Chips Act: contents

The Commission's package of measures includes four documents/legislative proposals:

- A communication from the Commission that describes the initiative in full.

- A proposal for a new regulation that establishes a framework of measures for strengthening Europe's semiconductor ecosystem (including attachments) (herein "the Regulation").
- A proposal for a new regulation that amends Regulation (EU) 2021/2085 establishing the Joint Undertakings under Horizon Europe, as regards the Chips Joint Undertaking.
- The Commission's recommendation on a common Union toolbox to address the shortage of semiconductors and an EU mechanism to monitor the semiconductor ecosystem.

The documents mainly contain three types of reforms/measures:

1. **The Chips for Europe initiative**, articles 3 to 9 in the Regulation. Sets out how EU funding from existing programmes will be reserved. This applies to the current Multiannual Financial Framework (MFF) 2021–2027 and amounts to EUR 1.65 billion from the Horizon Europe and Digital Europe programmes, respectively. Funding goes to R&D&I, pilot facilities, the creation of competence centres, and a new 'Chips Fund' that will make it easier for smaller companies to access financing.
2. **Security of supply**, articles 10 to 14 of the Regulation. Describes the possibility of classifying a new production facility as either an Integrated Production Facility or an Open EU Foundry. The classification must be made by the Commission and entails restrictions on companies' freedoms. The classification allows for extensive state aid from member states, up to 100% of a funding gap, with direct reference to the Treaty on the Functioning of the European Union. Member states are obliged to give priority to the establishment/fastest possible processing of authorisation processes and the like, and to appoint a responsible authority that would have the primary responsibility for processing and coordinating the authorisation of applications related to planning, construction and operation of the new plant.
3. **Monitoring and crisis response**, articles 15 to 22 of the Regulation. Member states are required to monitor the semiconductor value chain on an ongoing basis. This includes, inter alia, gathering information from market actors and communicating with the Commission and a new institution called the European Semiconductor Expert Group. In the event of a crisis, (a severe shortage of semiconductors), the Commission would be able to force classified facilities mentioned in paragraph 2 above to give priority to certain orders, even if it is contrary to national law or contracts. The Commission would also be able, at the request of member states, to act as a joint purchasing centre and conduct procurement of crisis-related products.

The Chips Act has not been preceded by an inception impact assessment, an omission that can be criticised. Instead, following the launch of the Chips Act, an open consultation was launched that runs until 20 March. The consultation aims to collect information about, for example, demand for semiconductors and how it is forecast to change, research and development conducted in the sector, and current problems with the availability of semiconductors.

Business models and semiconductor manufacturing production facilities

1. Integrated Device Manufacturers, (IDM) design, manufacture, and sell semiconductors. For example: Intel, Samsung and Texas Instruments.
2. Fabless semiconductor companies, design and sell but do not produce semiconductors. For example: AMD, Nvidia and Qualcomm.
3. “Merchant” or “pure-play foundries” only manufactures on behalf of other actors (fabless) and does not engage in any design or sales activities. For example: GlobalFoundries, TSMC and UMC.

Under the Commission’s proposals, support can be granted for two types of factories:

1. Integrated Production Facilities: for the manufacture of an IDM actor.
2. Open EU Foundries: for “pure-play” actors that manufacture on behalf of other fabless semiconductor companies.

Controlled production

To be classified as one of two different types of eligible production facility (see above), the Commission would introduce a review procedure, i.e., an additional administrative process that would take place alongside the Commission’s examination of state aid notification. A facility can only become eligible if it meets these requirements. The Commission would regularly monitor compliance with the conditions. If the conditions are not deemed to have been met at a later date, a production facility may have its eligibility withdrawn. What happens to financial support that has already been granted in such circumstances is not clear, but the logical and problematic consequence must be that aid must be recovered from the beneficiary, something that could jeopardize the entire project.

Special conditions are also attached to the status of eligible production facilities, which means that production at a time of scarcity or crisis can be controlled by the Commission. How the Commission will handle that role is not specified in detail, nor is how it would decide what type of production and how and which customers would be prioritised. Clearly, such a scenario would result in the control of production being transferred from companies and business owners to politicians and administrators – something that Swedish Enterprise rejects.

Competitiveness

A plant established in the EU, even if it receives large amounts of investment support, must nevertheless conduct operations that are competitive. As the semiconductor market is global, production needs to be as competitive as similar production in Asia or the US. It cannot be assumed that this can be achieved, even if it is one of the existing companies that establishes operations and brings with it its business model and know-how. European companies will also continue to value price and quality highly, nor is it a given that a factory in southern Europe enjoys any greater security of supply than a factory in Texas or Taiwan.

In the event of a crisis, in which the Commission intervenes and controls production from an EU-based facility, an operator that has existing orders from a facility located in the EU may see their orders cancelled in favour of other orders or needs that the Commission deems more important. This means that in a crisis, orders placed at an EU facility may be less certain than having orders with an equivalent producer 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 without the right to compensation, (as proposed in Article 21.6).

There is a risk that production facilities will not be competitive, and that there will also be a surplus due to the extensive investment now being made globally. There is therefore a risk that operating aid will be necessary to ensure that production does not disappear, still based on the argument that it is necessary to secure the supply of semiconductors in the event of a new crisis. The question is whether such operating aid is WTO-compatible.

Funding from the EU budget

Increased EU funding for a sector with a strong R&D&I focus is reasonable in essence. Unfortunately, under the proposals, funding is taken from other research funding and thus risks displacing other research and innovation that is important for business. More research funding is thus syphoned away from open, competitive calls for proposals to politically defined projects. It would have been better if funding could have been taken from other parts of the EU budget that do not negatively impact the business community.

Recommendation to member states: a coordination mechanism

The Commission has recommended that member states, together with the Commission, set up an immediate coordination mechanism to deal with the current shortage of semiconductors. The recommendation, which was adopted on the basis of Article 292, applies from 8 February 2022 and therefore, neither member states nor the EU Parliament have had the chance to influence the decision. Under the stipulations of the recommendation, member states are to collect information from companies and business associations linked to the value chain for semiconductors. This may refer to production opportunities, production capacity and current primary disruptions and bottlenecks. Information must be shared, inter alia, with a new expert group to be selected by the Commission. One of the measures that the expert group will be able to recommend is the introduction of protective measures on exports, i.e., trade restrictions. The recommendation applies until a permanent system can be adopted as proposed in the Regulation.

There are obvious objections and fears to raise in connection with this. Not least the administrative burden resulting from the extensive and recurring collection of information that must take place from companies that are already working hard to address the shortage of semiconductors. Furthermore, the risk of business secrets being leaked when information that may be business- and technology-critical must be submitted.

State aid regulations

The proposals are based on unpicking state aid regulations for investment support for certain types of production facilities. State aid for investments is by no means new or controversial, it is a fundamental part of the state aid regulations and can be granted with reference to various sources of law. The general block exemption is mainly used, which offers opportunities to provide support for several different purposes, such as environmental improvement, energy efficiency, training, regional development etc.

What is new in this case?

- **Amount of aid.** Aid can be given up to 100 per cent of the funding gap, i.e., the difference between costs and revenues a project is expected to generate throughout its lifecycle based on reliable calculations. It is unusual that so much aid can be given. Compared to the framework for R&D support, this amount of aid can be given to basic research, while aid for industrial research amounts to 50 per cent of that level and aid available for experimental development research is even less. This the equivalent amount available according to the IPCEI regulations. Swedish Enterprise has criticised these regulations for being used too extensively. In the IPCEI regulation, there are moreover a number of requirements to reduce distortions of

competition, for example that several member states should be included, that it should be about R&D&I and not mass production, and that the results should be widely disseminated for the benefit of many.

- **Legal basis.** The Chips Act does not present a new legal basis for considering investment aid for such investments as compatible with the internal market. Neither is there any existing legal basis that sets out why the Act would be compatible. Rather, the Commission states that it will assess this directly against Article 107(3)(c) of the Treaty, which states:

“Aid to facilitate the development of certain economic activities or of certain regions, where such aid does not adversely affect trade to an extent contrary to the common interest.”

Relying directly on the provisions of the Treaty is not unique, but it is new for this type of aid not to relate to established acts but to refer directly to the Treaty. This could open the door for the Commission to approve more and new types of aid, and thereby lead to a greater amount of aid and less legal certainty and predictability regarding the provision of state aid in general.

- 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 the market does not prioritize green investments sufficiently, or investments in basic research and development that cannot be turned into profitable products but that bring great societal benefits. In this case, one can question whether there is a market failure, especially if one looks at the long term. The market for semiconductors is highly global in nature. At present, there is an imbalance in supply and demand, but all indications are that the market will adapt and even out the imbalance, just as the market typically does when it is not disturbed by obstacles and regulations.
- Aid shall **only be granted for the first installation of its kind**. Within other state aid rules, there are no rules that exclude that support can be 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 a problematic competitive dynamic, where the member state that first attracts an actor, and with promises of large amounts of aid can notify and obtain approval for a project with the Commission, excludes all other member states. This will turn it into a competition of getting projects ready as quickly as possible, which can increase the amount of aid to attract existing players in the market and be negative for the quality of the project.

Competition distortion

As is always the case, when the state aid regulations are loosened, it results in an increase in the amount of aid and distortions of competition between companies from different member states that have different resources and willingness to use the regulations. Germany and France currently show the greatest willingness and opportunity to use state aid, and it is likely that this will probably also be the case when it comes to providing support to a semiconductor plant. The Netherlands may also have special interests, as it has a significant cluster of semiconductor operations, especially 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 due to aid to the production facility because, under the proposed regulations, it must be the first of its kind in Europe and thus unable to compete with another plant in the EU. Rather, the distortion happens if the owner or owners of a plant have other financial activities and can use the financial benefits of the support and a new factory also in adjacent markets. It can also be due to 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.

Long-term: the direction of travel of EU industrial policy

The proposals to make more support available in this way, as well as the new bureaucratic processes and political control of normal market production, is to be launched at a time when the political climate in the EU is already moving towards more intervention in the functioning of the markets. The IPCEI regulation, which allow large amounts of state aid for projects in various technologies deemed strategically important, are used to a large extent and the amount of state aid in the EU is increasing.

A large part of the new policy proposals indicate reduced confidence in the market's ability to independently stimulate innovation, efficiency and optimal solutions for society, and that it is instead necessary for politicians and administrators with taxpayers' money to implement targeted measures of various kinds. Given current circumstances, the Chips Act is particularly problematic, as it involves another step towards more regulation, administration and intervention, when we instead need more free trade, markets to open up, regulatory simplification and broad-based investment in research and development.

There is a risk that the Chips Act will become a model for how other important input goods are handled, i.e., acceptance that there needs to be regulated and subsidised production in the EU.

Finally, current developments are strongly driven by increased geopolitical issues and security policy. It is not primarily the role of business to take geopolitical issues into account. Rather, focus should be on creating favourable conditions in which today's and tomorrow's companies can operate. In addition, increased geopolitical tensions should be addressed mainly through greater 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.

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