

Position Paper on EU preference schemes in public funding measures

General comment: This position paper is without prejudice to the German position on European preference in the MFF negotiations, the European Competitiveness Fund and public procurement.

The overarching goal for the EU must be to secure its interest at the global stage and to advocate for a regulatory framework that strengthens companies in Europe and their competitiveness. Part of this agenda is a discussion of EU preference rules. Germany emphasizes the need for the EU to improve its overall competitiveness in an open manner and in close cooperation with partners and like-minded countries. This paper only contributes to the discussion of EU preference rules with respect to public funding programmes related to the IAA, and does not preempt the discussion on the EU public procurement reform

For critical and core strategic sectors and product groups, EU preference schemes for public funding measures can be examined, if other alternative measures such as diversification through free trade agreements, raw material partnerships, public support programs, resilience or other qualitative criteria (e.g. NZIA, CO2 emission reduction in order to avoid CO2 emissions associated with long-distance shipment of goods) are failing to reach the desired objectives. While setting up such preference schemes for public funding measures, the EU should aim for a “made *with* Europe”-approach, including FTA partners, economic partnership countries and like-minded partners.

For the discussion on the design of a possible EU preference scheme in public support and the selection of technologies or product groups, the objectives of such rules must be clearly formulated, as different design features may result depending on the objectives.

Accordingly, the following must be defined: 1. the possible strategic areas (technologies, product groups and components) and 2. the criteria for the necessity of European preference, including conditions such as a strict proportionality test and ensuring trade policy interests, 3. EU preference must be defined, designed and it must be clarified how it is measured and implemented as unbureaucratically as possible.

As regards possible proposals to accelerate industry we remind that the IAA should not propose new legislation in trade policy instruments, including conditionalities on FDI.

II.1 Identification of targeted technologies

In general preference rules should apply to selected / core and strategic technologies and product groups. The Identification of these technologies / product groups should follow transparent criteria.

We see three possible justifications that could determine the scope of preference schemes:

1. Defence, national security

National security reasons offer a genuine rationale for preference schemes. However, national security exemptions are well established, which is why there are already separate processes that deal with defence and national security. Hence, this position paper excludes the security and defence industry.

2. Economic security argument

From an economic security point of view some technologies might qualify for EU preference rules. Strengthening economic security is here differentiated into two areas: critical supply and technological sovereignty. Both are imperative as we see a worrying trend of increased willingness to exploit and weaponize critical dependencies. This threatens to impede sovereign decision-making in a global environment increasingly dominated by geopolitics.

a) Critical supply

In some strategic sectors, it is important to secure the supply of certain goods and services in order to mitigate risks to public safety and continued prosperity. Economic security is strengthened in particular when critical dependencies are reduced through diversification and EU production.

Examples could include; chemical base inputs; general semiconductors; and important medical devices and medicines.

b) Technological sovereignty

Some sectors are facing particular geopolitical pressure with **implications on EU sovereignty**. Overall, the aim of the objective to strengthen the EU's technological sovereignty is understood as the ability to independently develop, use, and further develop strategic technologies at a globally competitive level, in the interests of security.

Examples could include batteries, advanced semiconductors, quantum technologies, cloud services, AI models and compute capacity, drones, robots, vehicle automation systems and energy technology.

3. Support for implementing lead markets for key products and technologies

According to the argument for supporting key transition in technologies or with regard to products, the objective is to provide targeted support (through funding) for individual technologies or products for a specific period of time in order to enable an internationally competitive industry to newly establish itself for the long term. This includes technologies and products which are under existential pressure by unfair means from international competitors and that are substantial for the domestic economy. Examples include the implementation of lead markets for climate-friendly raw materials and, where applicable, products from innovative production processes (e.g., "green" steel). This frame also fits AI or purchase grant for domestically produced EVs. This should be considered for technologies and products where European suppliers would be faced with strongly inhibited chances to compete without EU preference rules due to e.g. unfair competition in third countries, like state subsidies or discriminatory regulations. However, in order to provide sufficient incentives for innovation, preference schemes should from the beginning be defined as broadly as possible (i.e., "Made with Europe" - as underlined in the lead paragraph) and be limited in time.

II.2 Criteria for the necessity of EU preference rules and proportionality assessment

If a technology falls under one of the above-mentioned areas, this should not automatically result in the application of EU preference rules. These will be reviewed on the basis of four fundamental criteria:

1. **Subsidiarity through alternative measures:** It must be examined whether targeted measures such as diversification through free trade agreements, raw material partnerships, resilience or other qualitative criteria (e.g. NZIA, CO2 emission reduction in order to avoid CO2 emissions associated with long-distance shipment of goods), or other measures such as warehousing, recycling, and the development of alternative technologies are already being effectively used or will be taken to reduce critical dependencies, and whether substitution (switching to other products for which there are no critical dependencies) is possible.
2. **Vulnerabilities:** Taking potential for diversification with other countries into account, this criterion examines whether there are high import or technological dependencies on individual countries, which could result in vulnerabilities.
3. **Cost Analysis:** This criterion requires an assessment of the expected cost increases for products and the effects on downstream supply chains and end consumers upon the introduction of EU preference rules— any increases in production costs from preference schemes should be carefully assessed and kept

at bay. It also examines the associated bureaucratic burden (documentation requirements) and should follow the goal to minimize bureaucratic burden. It also takes into account, whether EU preference rules will impair the competitiveness of European companies per se and their products in third-country markets, and whether there are any negative impacts on the EU as an investment location. Furthermore, it needs to be considered that EU preference rules can impact innovation activities both positively and negatively, which could result from a lack of technology transfer/knowledge spillover and lower innovation incentives due to a more limited competitive environment.

4. **Impact on Trade Relations with Third Countries:** This criterion assesses to what extent EU Preference are suitable as a tool as well as whether there are risks to ongoing negotiations on free trade agreements or the risk of breaches of obligations under existing free trade agreements and WTO obligations, and whether countermeasures by third countries are to be expected. This should also take into account the extent to which a third country strategically establishes and expands critical dependencies or exercises them in its trade relations, as well as past usage of economic dependencies for strategic or geopolitical purposes.

If, after reviewing the categories, it is decided that a product group is eligible for EU preference rules, the specific design must be defined.

II.3 Definition of EU preference

In general, EU preference should be defined as “Made with Europe” or EU Plus (including FTA partner countries and comparable comprehensive economic partnership agreements with the EU and like-minded partners), ensuring trade policy interest. Regarding the objectives of economic security and technological sovereignty, it may be necessary – in narrow instances – to focus solely on European content (EU content). “Made with Europe”/EU Plus should be the preferred approach wherever possible to ensure maximum competition. However, a strong European position in the emerging technologies, including sovereign access to them, should still be assured regardless of EU preference rules. With regard to funding measures where European budgetary resources are used to build research and production capacities, an approach can be chosen that includes local content requirements. This must be examined on a case-by-case basis, provided that this concerns a targeted technology and the criteria 1 to 4 are met.

II.4 Design principles for EU preference rules

For effective implementation of a preference scheme, at least the following principles should apply:

- **Clear definition of the product groups addressed by EU preference rules:** It will be crucial that any rules are applied to the same product groups in all EU Member States. This will ensure that the single market is not fragmented and that competition within the EU is upheld.
- **Technology selection by the EU:** The Council should be responsible for reviewing the individual product groups. The list of technologies/product groups (Annex 1) should provide a guideline for the identification of core and strategic technologies. It is proposed that the Commission draw up a list of proposed technologies that could fall under the EU preference rules based on a thorough cost-benefit analysis. The final selection will be agreed upon with the Member States. In addition, the CRMA could be considered.
- **Continuous review of the technology list:** It must be ensured that the classification of technologies as strategic and critical is dynamic: technological progress and/or the expansion of domestic capacities or changes in geopolitical circumstances generally lead to a change in the critical/strategic classification (no permanent isolation from international competition). It will be necessary to review the technology list at predetermined intervals as well as on an ad-hoc basis to take geopolitical and economic policy changes into account. The Council should be involved in this review (no delegated power).
- **Restricting duration of EU preference rules:** Particularly for the goals of technological sovereignty and emerging technologies, it is crucial that EU preference rules have time limits to incentivize companies to develop internationally competitive products and drive innovation. At the same time, the time limit must be chosen so as to provide sufficient investment incentives for companies. Extensions should be possible for cases where unfair practices by third countries persist and continue to artificially inflate their competitiveness in order to avoid undesirable effects.
- **Capture EU Contents plus FTA as unbureaucratically as possible:** One approach would be to capture the share of European value added via the rules of origin in customs data as well as prevent potential circumvention. Bureaucracy must be kept to a minimum.