



VOLUME 2 | NUMBER 2 | AUTUMN 2006

Competition Policy International

Some Reflections on the European Commission's State Aid Policy

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This article first sets out the main economic and legal requirements for a competition enforcement system to be effective, as well as the main building blocks upon which the effectiveness of any such system depends. It then explains how the Commission is currently implementing these requirements in its reform of the State aid control system. It describes how Commissioner Kroes launched for that purpose the State Aid Action Plan and sets out how, in the context of this plan, the political and economic objective of promoting “less and better targeted aid” must be complemented by improvements as regards both procedure and the economic assessment of aid. It goes on to discuss the economic foundations of the new approach and in particular the so-called balancing test which will underlie both the analysis in individual cases and new legislation. It then explains how the reform objectives have already been implemented in a number of recent legislative or quasi-legislative texts. The article concludes by describing the remaining challenges, on both substance and procedure, in order for the State aid reform to constitute one of the cornerstones of the Commission's strategy for growth and jobs.

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I. Why We Launched a State Aid Reform

A. BASELINE REQUIREMENTS FOR AN EFFECTIVE COMPETITION LAW ENFORCEMENT SYSTEM

When designing an effective competition law enforcement system—whether for State aid control, merger control, or antitrust—there are a number of baseline requirements.

First and most importantly, rules and individual enforcement actions must be based on sound law and economics. On the legal side, enforcement must be—and widely seen to be—subject to the rule of law, due process requirements, and effective judicial control. On the economic side, the long-term legitimacy of any competition enforcement system rests on the economic story which it tells. Any competition enforcer should be able to explain why and how its enforcement actions contribute to the wider public interest.

Second, the enforcement system must be designed in a way that guarantees coherence and predictability. Coherence of enforcement ensures equal treatment of businesses. Predictability in the enforcement allows businesses to plan for the long term. There may sometimes be a trade-off between predictability of enforcement and the need to deal with each case on its merits. The objective must nonetheless be to guarantee as much predictability as possible.

A third baseline requirement is that the system should allow the enforcement agency to concentrate its limited resources on specific priorities. The enforcer should be able to determine those priorities on the basis of the expected direct and demonstrative effects of decisions. The system should make it possible to concentrate resources on the potentially most harmful conduct and on precedent-setting cases.

Fourth, as to the length of investigation procedures, any effective enforcement system must enable a public agency to take decisions in a timeframe relevant either to the business transaction or public policy initiative concerned. Decisions must therefore be taken when they still have an impact on the economic effects which they aim to address. Precedents must also be set at a moment when they still have the intended wider policy impact.

Last but not least, enforcement must always go hand-in-hand with an effective competition advocacy policy. The ultimate goal of competition policy is to make markets work better in the interest of consumers and of businesses. Only where enforcement and advocacy are both used in parallel in a mutually reinforcing way can this objective be achieved.

B. BUILDING BLOCKS THAT ALLOW A COMPETITION ENFORCEMENT SYSTEM TO FULFILL THOSE BASELINE REQUIREMENTS

To fulfill the requirements set out above, a competition system should contain a number of building blocks.

First, enforcement actions must be based on clear and agreed enforcement objectives. Otherwise we cannot guarantee any coherent and predictable policy. In the field of antitrust and mergers, for example, we explicitly pursue a consumer welfare objective.

Second, rules and individual enforcement actions must be based on a clear and economically sound agreed assessment methodology. Similar cases must be assessed according to the same tests. The assessment methodology should be used not only for the assessment of individual cases but also for the design of general assessment rules. Without a clear assessment methodology, it is difficult to ensure coherence and predictability.

Third, the enforcement architecture (i.e., all substantive, procedural, and internal rules taken together), must allow the agency to set the correct priorities. Block exemptions, *de minimis* rules, notification thresholds, as well as filters in substantive rules or procedural rules, should allow us to deal quickly, and with limited resources, with unimportant or easy cases. For the remaining cases, there should be the right mix between rules ensuring predictability of outcome (*per se* rules)¹ and rules ensuring predictability of assessment methods (effects-based analysis).

Fourth, as regards the timing of procedures, it is necessary to have procedural rules and internal best practices which ensure a rapid investigation and rapid internal decision making.

Fifth, the system must provide for tools such as explanatory guidelines which ensure the transparency of the applicable rules and the enforcement policy.

C. IS THERE ROOM FOR IMPROVEMENT IN THE AREA OF STATE AID CONTROL?

The quality of the EC State aid control system has been substantially improved over the last decade. Just to name the most significant achievements, in 1999, the Council adopted the first procedural regulation² in the field of State aid. This breakthrough on the procedural front was soon followed by the first *de minimis*

1 See *infra*, Section III.B.

2 Council Regulation 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 (now Art. 88) of the EC Treaty, 1999 O.J. (L 83) 1.

Regulation,³ and by a number of block exemption Regulations⁴ that have significantly reduced the number of notifications of unproblematic cases and thereby reduced red tape. Texts like the *R&D Guidelines* or the *Regional Aid Guidelines* have been constantly adapted to economic and technical progress, enlargement and ever-deeper economic integration within the internal market.⁵ Those texts have been designed on the basis of extensive consultations of stakeholders and are accepted to be based on sound policy and economic principles. Nonetheless, there is still room for further improvements.

One key area is the setting of enforcement priorities. Existing jurisprudence on the application of the concepts of distortion of competition and effect on trade in Article 87(1) of the EC Treaty⁶ does not allow these concepts to act as a filter for prioritizing workload. Measures with little or no real economic impact on cross-border trade or competition remain within the scope of the notification obligation.

One consequence of this is that unimportant complaints add substantially to the background tasks of the European Commission (the Commission). From the perspective of the individual complainant, every complaint is of course important. As a public enforcement authority we are however responsible for safeguarding the interests of *all* European citizens and are given only limited resources to do so. Ideally an authority should thus be able to choose the complaints that it wishes to pursue on the basis of the interest that they present for the European Community as a whole.

As regards the notification obligation, the block exemption regulations have significantly reduced the number of notifications. However, the Directorate-General for Competition (DG COMP) still receives on average 322 notifications per year.⁷ Similar to what happened in the antitrust field before modernization,

3 Commission Regulation 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to De minimis aid, 2001 O.J. (L 10) 30.

4 Commission Regulation 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid, 2001 O.J. (L 10) 20; Commission Regulation 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises, 2001 O.J. (L 10) 33; Commission Regulation 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment, 2002 O.J. (L 337) 3.

5 Community guidelines on State aid for rescuing and restructuring firms in difficulty, 2004, O.J. (C 244) 2 and Guidelines on national regional aid for 2007-2013, 2006, O.J. (C 54) 13.

6 Article 87(1) of the EC Treaty states:

Save as otherwise provided in this Treaty, 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 common market.

7 Calculation reflects the average number of notifications from 2001 to 2005.

resources have to be used as a matter of priority for notified cases, which are often not the most distortive ones. As a consequence, non-notified new aid or distortive existing aid measures are often only discovered and investigated if there is a complainant and if there are residual resources available.

Another area for possible improvement is the average length of our procedures. The approval of the large number of straightforward notified aid cases takes on average about five to six months. In cases involving the opening of a formal investigation, the time taken to reach a final decision in notified aid cases is on average twenty months and in non-notified aid cases on average thirty months. The main reason for such long delays is the time it takes for Member States to respond to requests for information. The provisions of the current procedural regulation⁸ limit the Commission's possibilities for speeding up procedures. In such a context, some Member States—in particular those with complex internal decision-making processes—regularly exceed the indicated time limits, which we set. In addition, under the current procedural regime, the Commission only has the power to formally request information from the Member States even if the information ultimately needs to come from the companies concerned. If the Member State concerned is slow in providing the information requested, the Commission investigation can be delayed substantially.

A third area for possible improvement relates to the type of information that we gather to make our decisions. As already indicated, under the current rules, the aid-granting Member State is the main—and sometimes the only—source of information at the basis of a Commission investigation. This may lead to a lack of information regarding the impact of the aid on competition and trade, mainly because the national authority concerned does not normally have that sort of information available itself. This is also the reason why the notification forms currently used request either little or no information on the affected markets and competitors.

A fourth and final area for possible improvement is the notification obligation. It is clear that the fundamental obligation, provided by the treaty, for Member States to notify new aid before its implementation, is still not respected in a large number of cases. Between 2001 and 2005, DG COMP has had to open procedures in 259 cases that had not been notified. The current procedural framework, or at least the way in which it is interpreted and applied, does not appear always to ensure equal treatment of Member States. Thus, illegal State aid continues to disrupt market incentives and flows of trade within the European Community.

8 See, in particular, Council Regulation 659/1999, art. 5 & 10.

To sum up, the long-term credibility of State aid control in a globalizing world requires decisions to be taken more rapidly and to better reflect economic reality in a systematic manner. The legitimacy of State aid control rests on the presumption that we will effectively address those forms of aid which have predominantly negative effects on competition and on the functioning of the internal market. These concerns led Commissioner Kroes to decide on a wide-ranging reform of State aid policy, dubbed the “State Aid Action Plan.”

II. The State Aid Action Plan

A. A GLOBAL RESPONSE TO THE CHALLENGES OF STATE AID POLICY

On the initiative of Commissioner Kroes, the Commission launched the State Aid Action Plan (SAAP)⁹ on June 7, 2005.¹⁰ The SAAP presents an indicative roadmap for State aid reform for the period 2005 to 2009. It is being implemented in close cooperation with Member States and other stakeholders, as is shown by the numerous consultations organized in the context of this project.¹¹

The Commission was already committed to reviewing a number of legal instruments such as guidelines which were due to lapse during 2005 and 2006. Instead of proposing piecemeal improvements which would increase the risk of inconsistency between the various instruments, Commissioner Kroes decided to address all aspects of the reform in a comprehensive and consistent manner. This opportunity was seized on to clarify the objectives of State aid policy, and to call for a new partnership with Member States to make it a success.

THE LONG-TERM CREDIBILITY OF STATE AID CONTROL IN A GLOBALIZING WORLD REQUIRES DECISIONS TO BE TAKEN MORE RAPIDLY AND TO BETTER REFLECT ECONOMIC REALITY IN A SYSTEMATIC MANNER.

The SAAP was adopted in June 2005 as a consultation document intended to launch a political debate about the future of State aid control. We are trying to involve stakeholders at every stage of our reform project, just as we did with the modernization of antitrust and the reforms to merger control.¹²

9 EUROPEAN COMMISSION, STATE AID ACTION PLAN: LESS AND BETTER TARGETED STATE AID: A ROADMAP FOR STATE AID REFORM 2005–2009, COM(05)107 final, available at http://ec.europa.eu/comm/competition/state_aid/others/action_plan/saap_en.pdf.

10 See EUROPEAN COMMISSION, PRESS RELEASE No. 680, STATE AID: COMMISSION OUTLINES COMPREHENSIVE FIVE YEAR REFORM OF STATE AID POLICY TO PROMOTE GROWTH, JOBS AND COHESION (2005).

11 See EUROPEAN COMMISSION, STATE AID REFORM, at http://ec.europa.eu/comm/competition/state_aid/overview/sar.html (visited Aug. 21, 2006).

12 Green Paper on the Review of Council Regulation (EEC) 4064/89 COM(01)745 final at 6; Council Regulation 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty, 2003 O.J. (C 243) 3.

The SAAP looks at the underlying philosophy of State aid control, and presents the challenges ahead and the guiding principles that we intend to implement to address these challenges. It outlines four guiding principles for the reform of State aid policy:

- 1 less and better targeted State aid;
- 2 better procedures and administration;
- 3 a shared responsibility between the Commission and Member States; and,
- 4 a refined economic approach.

These principles will establish a consistent policy that will be simpler in its overall architecture and easier to grasp for stakeholders. The second section of the SAAP reviews the individual areas that will be affected by the reform and sets out proposed changes based on these four principles.

B. THE FOUR PILLARS OF THE STATE AID REFORM

1. Less and Better Targeted State Aid

The European Council of March 2005 restated the aim of “less and better targeted State aid.”¹³ When governments decide to intervene in the market they should not use taxpayers’ money for piecemeal support of undertakings in difficulty or branches of industry in steady decline. The governments that met in the European Council agreed instead to redirect their aid towards horizontal objectives of common interest.

Some forms of State aid clearly distort competition and prevent the market from providing the right incentives for business to become more efficient and to innovate to the final benefit of customers. This should not, however, be misunderstood as a drive against state intervention in whatever form. Many areas of government activity, for instance, fall outside the sphere of State aid control. State intervention in sectors such as education, security, or social security, for example, often does not constitute State aid as the activities at stake are may not be economic in nature. Aid can, of course, also be granted to individuals, for instance, for social reasons, without their being considered as undertakings falling under the scope of State aid rules.

In areas where the State aid rules are relevant, the idea of less State aid means that governments have agreed to reduce to a minimum those support measures not targeted at commonly agreed Lisbon objectives. That it is the governments of the Member States themselves that have set and agreed this objective is

¹³ See Presidency conclusions of the European Council Brussels, 22 and 23 March 2005, available at http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ec/84335.pdf.

important: reducing and better targeting State aid is not something that can be achieved by Commission intervention alone. Unfortunately, the day-to-day actions of Member States are all too often at variance with their stated policies in the European Council. Member States regularly disregard notification obligations and provide illegal and incompatible aid, as already indicated above.

Whether less aid will indeed be provided in the next years will, therefore, largely depend on the Member States' commitment and discipline. The Commission intends to do whatever it can to help, particularly by facilitating the possibilities of granting aid that works in favor of the Lisbon objectives. We are starting to make progress: the "State Aid Scoreboard" shows that increasing amounts of aid are being redirected towards horizontal objectives.¹⁴

2. More Effective Procedures, Better Enforcement, Higher Predictability, and Enhanced Transparency

The SAAP also includes proposals to improve the efficiency of State aid procedures and to speed up decision making. Better procedures and administration means focusing on the crucial cases, and acting swiftly in those cases in a transparent manner. We need to make State aid rules simpler, clearer, and more user-friendly. A first strand of action in this respect is to provide for larger State aid areas to be covered by so-called block exemption regulations, which authorize the granting of aid without the need for notification to the Commission. With more Lisbon-targeted State aid covered by such regulations, the Commission intends to both reduce the administrative burden on Member States while at the same time freeing up its own resources to focus on the cases that are most distortive of competition. Our intention is to consolidate the many existing regulations into one overarching regulation, so that coherence is increased and the architecture of State aid policy is easier to grasp for all involved.

In addition, the Commission intends, as a first stage, to issue best practices guidelines to streamline individual treatment of the cases under the current legal regime. At a later stage, it may issue proposals to the Member States in order to revise the procedural regulation¹⁵ with a view to improving the speed of decision making and to increase deterrence mechanisms in order to tackle State aid granted illegally.

Finally, to increase transparency, we intend to engage in more advocacy to enhance the overall public awareness of State aid policy. A specific network is being set up with Member States in order to enhance the policy dialogue. Moreover, we will try to intensify the involvement of national courts, especially regarding the treatment of illegal aid granted in violation of the notification

14 See EUROPEAN COMMISSION, STUDIES AND REPORTS, at http://ec.europa.eu/comm/competition/state_aid/overview/studies.html (visited Aug. 21, 2006).

15 See *infra*, Section V. Conclusions and Next Steps.

obligation. After a recent study realized by scholars and practitioners about the way in which State aid rules are applied in national jurisdictions,¹⁶ we intend to issue a revised notice on cooperation between national courts and the Commission.¹⁷

3. A Shared Responsibility Between the Commission and Member States

The Commission cannot improve State aid practice without the effective support of Member States: their commitment to comply with their obligations to notify State aid and to provide the market information required for the Commission to realize its assessment is crucial if we are to achieve “less and better targeted aid” as requested by the European Council. On the other hand, the Commission’s responsibility lies in designing new instruments to support Member States in granting clearly compatible aid with the minimum of red tape. The *de minimis* rule and the expanded general block exemption, as well as more pragmatic guidelines, which stick more closely than before to business reality—such as the recently adopted guidelines on risk capital¹⁸—will play a central role in this respect. In such a revised environment, Member States can then more easily design aid measures fulfilling the Lisbon agenda.

4. Refined Economic Approach

Proper economic analysis is at the heart of all competition policy. By refining the economic approach underlying State aid policy, the Commission can better balance the economic effects of aid with the common interest objectives such as regional cohesion or environmental protection. Whereas an assessment of the negative effects of aid has much in common with the analysis in antitrust and mergers, the assessment of the positive effects raises questions as to the equity and efficiency benefits of the aid. The latter aspect is most clearly spelled out when an aid measure addresses a market failure, which hampers the market to deliver a Pareto-optimal output. The following section discusses the refined economic approach in more detail.

16 JONES DAY, LOVELLS, ALLEN & OVERY, *STUDY ON THE ENFORCEMENT OF STATE AID LAW AT NATIONAL LEVEL (2006)*, available at http://ec.europa.eu/comm/competition/state_aid/overview/studies.html.

17 Notice on cooperation between national courts and the Commission in the State Aid field, 1995 O.J. (C 312) 8.

18 See EUROPEAN COMMISSION, PRESS RELEASE NO. 1015, STATE AID: COMMISSION ADOPTS GUIDELINES ON STATE AID TO SUPPORT RISK CAPITAL INVESTMENTS IN SMEs (2006).

III. Sound Economic Foundations: The Refined Economic Approach

A. THE CONTRIBUTION OF ECONOMICS TO STATE AID

Economic analysis is not new in the field of State aid. State aid rules are already based on economics, and economic concepts—like market failures or incentive effect¹⁹—are mentioned in our guidelines. The Commission has already applied a robust economic analysis not only in the important areas of rescue and restructuring, the multi-sectoral framework and research and development (R&D) but also in other individual cases.²⁰ However, the common economic concepts and methodologies underlying the largely form-based State aid rules have, in the past, not always been adequately spelled out, which in turn may limit the clarity and predictability of State aid policy.

The traditional per se or form-based approach to rule-making typically relies on quantitative thresholds and limitative lists of cumulative conditions which attach automatic legal consequences to the fulfilment of these conditions. Under such an approach, legal consequences are thus triggered independently of the economic effects of a conduct or measure. A more effects-based approach to rule-making seeks to provide a methodology on how to establish, in an individual case, the actual or likely economic effects of a measure or conduct on the markets in order to trigger the legal consequences foreseen by the rule. The latter approach typically relies on explanations of the objectives of the rules and their underlying economic concerns, the different steps and elements of the tests to be applied and the positive and negative assessment criteria or presumptions which need to be taken into account. Under such an approach, the rules also set out how to balance these different criteria in order to reach a final assessment and decision.

In analyzing the compatibility of State aid under Article 87 (3) EC, the actual or potential economic effects of State aid should be assessed. A more refined economic assessment of State aid is intended to improve the analysis of both the negative and positive economic impact of State aid and will formalize the balancing exercise of those different effects. Analyzing the effects of State aid requires an understanding of how economic behavior, and consequently the market equilibrium, may be affected—positively and negatively—by a given aid measure.

19 See, especially, State Aid and Risk Capital, 2001 O.J. (C 235) 3; EUROPEAN COMMISSION, DRAFT COMMUNITY FRAMEWORK FOR STATE AID FOR RESEARCH AND DEVELOPMENT AND INNOVATION, available at http://ec.europa.eu/comm/competition/state_aid/others/action_plan/rdi_frame_en.pdf; and Community Guidelines for State Aid in Environmental Protection, 2001 O.J. (C 37) 3.

20 See, e.g., Commission decision of 9 November 2005 on the State aid which the Federal Republic of Germany has implemented for the introduction of digital terrestrial television (DVB-T) in Berlin Brandenburg, 2006 O.J. (L 200) 14.

There are many situations where the key assumptions of the basic model of competitive markets are not met. Imperfect competition, coordination problems, incomplete information, externalities, and public goods, all present hypotheses where the market fails in its role of producing economic efficiency. Economists refer to these problems as “market failures,” situations where a market fails to produce efficient outcomes. Looking at such market failures provides guidance as to the potential for government intervention. In particular, State aid may be an appropriate response to a market failure, provided its benefits outweigh its negative impact on competition and trade.

To do this balancing—traditionally dubbed the “balancing test”—it is necessary to identify—and as far as possible to measure—the positive and negative aspects of the aid. In the fields of mergers and antitrust, the negative and positive effects are assessed essentially on the basis of the benchmark of the consumer welfare standard.²¹ It is, however, not possible to transpose this consumer welfare standard directly to the world of State aid, not least because State aid can be justified on the basis of non-economic grounds such as social or regional cohesion which consumer welfare does not measure. To that extent, the correct welfare standard for State aid policy—expressed in economic terms—appears to be the social welfare of the European Union, which is equivalent to the notion of common interest found in Article 87(3) of the Treaty.

Social welfare takes into account the wellbeing of all citizens and includes their appreciation of how welfare is divided among them. Therefore, as a standard, social welfare of the European Union also requires a degree of political understanding, as citizens' preferences may evolve over time. Indeed, State aid can affect both the way in which the economic pie is made larger by a given policy (efficiency) and how the pie is then divided between citizens (equity).

In order to assess the economic impact of the aid, the basic methodology is one of *ex ante* counterfactual—comparing what would happen to the market with State aid with what would be likely to happen without it.

B. THE BALANCING TEST: THE CORNERSTONE OF COMPATIBILITY ASSESSMENT

In the perspective of this welfare standard, the SAAP proposes to formalize the balancing test in three steps. The first two steps address the positive effects of State aid, and the third the negative effects and resulting balancing of the positive and negative:

21 See, e.g., Guidelines on the assessment of horizontal mergers under the Council Regulation on the control of concentrations between undertakings, 2004 O.J. (C 31) 5 and DG COMPETITION, DISCUSSION PAPER ON THE APPLICATION OF ARTICLE 82 OF THE TREATY TO EXCLUSIONARY ABUSES (19 December 2005), available at <http://ec.europa.eu/comm/competition/antitrust/others/discpaper2005.pdf>.

- 1 Is the aid measure aimed at a well-defined objective of common interest? (e.g., growth, employment, cohesion, environment)
- 2 Is the aid well-designed to deliver on this objective? (i.e., does the proposed aid address the market failure or other objective?)
 - a Is State aid an appropriate policy instrument?
 - b Is there an incentive effect? (i.e., does the aid change the behavior of firms?)
 - c Is the aid measure proportional? (i.e., could the same change in behavior be obtained with less aid)
- 3 Are the distortions of competition and effect on trade limited so that the overall balance is positive?

Clarifying the methodology for assessing an aid in this formalized manner will bring a number of benefits.

First, it should lead to more effective enforcement, through a more rigorous assessment of aid in individual cases. In economic jargon, a refined economic approach will reduce the likelihood of type I or type II errors—often referred to more colloquially as false positives and false negatives. In an exclusively form-based system, such errors are, by the very nature of the system, more frequent. Coming more often to the right result should strengthen the acceptance by stakeholders of decisions adopted by the Commission.

Second, this approach should lead to better State aid legislation. Indeed, an economically sound, coherent, clear and transparent legal framework can only be drawn up, presented to stakeholders, and enforced on the basis of a better understanding, by the Commission, of the economic effects which different types of aid have in different factual settings.

Third, the approach should yield better targeted aid. Under a more refined economic approach, the effectiveness of aid to achieve objectives of common interest will be subject to closer analysis, especially in large cases. A better understanding of the mechanisms underlying the effectiveness of aid will in turn help Member States to devise more effective and better targeted aid. A more effects-based economic approach is thus also essential to achieve the Lisbon objectives.

Fourth, we should be put in a position to realize a better prioritization of enforcement action. The new methodology should allow us to focus our resources on the potentially most distortive aid measures.

A greater focus on the economic approach to assessing State aid cases does not mean that State aid control will become more uncertain. The opposite is more likely to be the case. From the perspective of someone trying to address a genuine problem in an effective and efficient way, pure per se rules, may occasional-

ly look capricious and arbitrary, and dealing with such rules can be frustrating and create disillusion with the system as a whole. At the same time, refining the economics underlying State aid policy does not mean that per se rules disappear entirely to be replaced by pure case-by-case analysis and never-ending economic assessment. As we have found in antitrust and mergers, and as we are already demonstrating in the implementation measures discussed in more detail below, it is perfectly possible to combine clear rules with economic analysis—the safe harbor of the risk capital guidelines, for instance, are ample proof of that.

The challenge is to find the right balance between per se rules based on established and tested economic criteria, and a full effects-based assessment appropriate for selected individual cases. Thus, the more refined economic approach must include the continued use of per se rules where clear and simple rules are required, provided only that they are based on past empirical evidence and tested periodically against economic realities. Future soft law State aid rules, like guidelines and frameworks, should however also leave ample room for individual assessment of aid measures on the basis of their effects.

IV. Implementation

A. ENDORSEMENT BY STAKEHOLDERS

The public consultation showed a broad degree of support for the reform: more than 130 submissions were received, and the European Parliament and the European Economic and Social Committee both issued reports.²² The Commission has already taken a number of proposals contained in these submissions into account in its ongoing implementation, and will continue to consult both Member States and other stakeholders widely on the different subprojects which constitute the SAAP.

B. IMPLEMENTATION OF THE STATE AID ACTION PLAN

The year 2005 saw the adoption of a new package of rules relating to services of general economic interest, of guidelines on regional aid, and the first proposals for aid to innovation. By the end of 2006, the Commission intends to deliver two essential Lisbon related instruments: the new framework on R&D and innovation (R&D&I) and the new risk capital guidelines. A revised version of the de minimis Regulation will also be adopted, which is essential to reduce the regulatory burden on Member States. It will incidentally also allow the Commission to focus its attention on those aid measures which have the greatest potential to damage competition. All of these measures should support the action of Member States towards making Europe a more attractive place to invest and to do business.

22 See EUROPEAN COMMISSION, RESULTS OF THE CONSULTATION ON THE STATE AID ACTION PLAN (9 February 2006), available at http://ec.europa.eu/comm/competition/state_aid/others/action_plan/consult.html.

C. SERVICES OF GENERAL ECONOMIC INTEREST

Services of General Economic Interest (SGEI) are of particular importance for citizens and usually need to be financed through state intervention. Whether such financing constitutes State aid is a very fact specific question. The Commission's objective in this area is, therefore, to set up a clear procedural framework which will ensure that companies can receive public support to cover all costs incurred when providing an SGEI entrusted to them. In particular, the package adopted in July 2005 should provide legal certainty with regard to compensatory measures, while ensuring transparency in order to avoid both over-compensation and cross-subsidization from SGEI earmarked funds into non-public service activities. The latter constitutes a particular concern in liberalizing markets such as telecoms, post, or energy markets.

The cornerstone of the package is a Commission Decision, adopted on the basis of Article 86(3) of the EC Treaty,²³ which specifies the conditions under which compensation to companies for the provision of public services is compatible with State aid rules and does not have to be notified to the Commission in advance. The decision plays a role similar to the block exemptions adopted in other State aid areas, and exempts from the notification obligation any compensation of less than EUR 30 million per year, provided its beneficiaries have an annual turnover of less than EUR 100 million. This decision should seriously reduce red tape with regard to the financing of SGEI by local and regional authorities.

For all forms of compensation not covered by the decision—for instance those whose amount exceeds the ceiling—the SGEI framework²⁴ specifies the conditions under which compensation is compatible with State aid rules. Such compensation will have to be notified to the Commission due to the higher risk of distortion of competition. Compensation that exceeds the costs of the public service, or is used by companies on other markets open to competition, is not justified, and is therefore incompatible with the State aid rules concerning the SGEI.

Finally, an amendment to the Commission's Transparency Directive²⁵ clarifies that companies receiving compensation and operating on both public service and other markets must have separate accounts for their different activities, so

23 Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, 2005 O.J. (L 312) 67.

24 Community framework for State aid in the form of public service compensation, 2005 O.J. (C 297) 4.

25 Commission Directive 80/723/EEC of 25 June 1980 on the transparency of financial relations between Member States and public undertakings, 1980 O.J. (L 195) 35, as amended lastly by Commission Directive 2005/81/EC of 28 November 2005 amending Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, 2005 O.J. (L 312) 47.

that the absence of over-compensation can be documented by the company concerned and checked by the Commission.

These texts have been well received by Member States and by the academic world.²⁶ They should create the legal certainty required in the area of financing of SGEI, by providing for clear exemptions for smaller SGEI and offer, for the rest, a clear framework allowing a refined economic analysis of their positive and negative effects.

D. COMMISSION COMMUNICATION ON INNOVATION

Two months after the adoption of the SGEI package, the Commission adopted a communication on aid to innovation.²⁷ This addressed a broad range of issues, and was well received.²⁸ Many of the measures have already been adopted in the new draft framework for Research and Development and Innovation (R&D&I) and in the Risk Capital Guidelines. The proposals for innovation aid cover six broad areas: innovative start-ups; risk capital; the integration of innovation into existing rules on State aid for research and development; innovation intermediaries; training and mobility between university research personnel; and, SMEs and poles of excellence for projects of common European interest.

E. COMMISSION GUIDELINES ON REGIONAL AID

In December 2005, the Commission adopted a first set of comprehensive guidelines covering the whole range of regional aid measures.²⁹ Reducing disparities between the regions of Europe is beneficial for all EU citizens as it is both a factor of social stability and provides a tremendous potential for economic growth. It was thus essential to adapt the rules governing regional aid, especially to take into account the recent enlargement of the Community. As a result of enlargement, the gap between richer and poorer regions has increased. Consequently, the new guidelines set out the rules for allowing State aid that promotes the development of poorer regions, covering aid such as direct investment grants and tax reductions for companies. The Guidelines specify rules for the selection of regions that are eligible for regional aid, and define the maximum permitted levels of this aid. In line with EU cohesion policy and European Council requests

26 See, e.g., STATE AID GROUP, ECONOMIC ADVISORY GROUP ON COMPETITION POLICY (EAGCP), OPINION: SERVICES OF GENERAL ECONOMIC INTEREST (2006), available at <http://ec.europa.eu/comm/dgs/competition/sgei.pdf>.

27 Communication of the Commission, Consultation document on State aid for innovation, COM(05)436 final, Sep. 2005, available at http://ec.europa.eu/comm/competition/state_aid/others/action_plan/cdsai_en.pdf.

28 See EUROPEAN COMMISSION, RESULTS OF THE CONSULTATION ON STATE AID FOR INNOVATION (5 May 2006), available at http://ec.europa.eu/comm/competition/state_aid/others/action_plan/rep_inno.html.

29 See EUROPEAN COMMISSION, PRESS RELEASE No. 1653, STATE AID: COMMISSION ADOPTS NEW REGIONAL AID GUIDELINES FOR 2007-2013 (2005) and Guidelines on national regional aid for 2007-2013, 2006 O.J. (C 54) 13.

for less and better targeted State aid, the new guidelines refocus regional aid on the most deprived regions of the enlarged Union. This should help narrow the gap between regions in Europe.

The new guidelines also provide for more flexibility for Member States to decide where and how they want to support regional development. For instance, a new form of aid will be allowed to encourage business start-ups in assisted areas, which will apply to the establishment and expansion phases of small enterprises during the first five years. The new guidelines also contain a number of other changes to clarify and simplify the current rules. In particular, the rules on very large investment projects of over EUR 50 million are included in the regional aid guidelines for the first time, thereby providing for an all-encompassing framework increasing transparency and readability of State aid policy in the area of regional support.

F. SHORT-TERM EXPORT-CREDIT INSURANCE

In December 2005, the Commission also adopted a revised communication on short-term export-credit insurance.³⁰ The purpose of the communication is to remove distortions of competition due to State aid provided in the sector of short-term (less than two years), export-credit insurance, where there is competition between, on the one hand, public or publicly supported export-credit agencies and, on the other hand, private export-credit insurers. Further to an external study³¹ and after consultations with Member States and the private sector, the Commission adopted a revised communication.³² The modifications take into account recent developments on the market of credit insurance, in order to determine precisely in which sub-markets private insurers are indeed providing services throughout the Community. These modifications are in line with the refined economic approach, in that they focus on the question of whether there is a market failure. The existence of such a market failure was indeed acknowledged in this case.

G. RISK CAPITAL

Risk capital and private equity funding are important for the EU's competitiveness. Insufficient availability of such funding in many parts of the Community

30 Communication of the Commission to the Member States pursuant to Article 93 (1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export-credit insurance, 1997 O.J. (C 281) 3.

31 EUROPEAN COMMISSION, THE REPORT ON MARKET TRENDS OF PRIVATE REINSURANCE IN THE FIELD OF EXPORT CREDIT INSURANCE (2006), available at http://ec.europa.eu/comm/competition/state_aid/others/export_credit_insurance_report.pdf.

32 Communication of the Commission to Member States amending the communication pursuant to Article 93(1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export-credit insurance, 2005 O.J. (C 325) 22.

means that public funding may usefully serve as a means to leverage private funds. After a public consultation in 2005 and a study on the size of the equity gap commissioned by the Commission, we adopted new Guidelines in July 2006 that will help stakeholders to determine when State aid in support of risk capital investment in small and medium-sized enterprises (SMEs) is compatible with State aid rules.³³ This will allow Member States to facilitate access to finance for SMEs in their early stages of development, particularly where alternative means of funding from financial markets are lacking. The Guidelines are a prominent example of the Commission's efforts to encourage Member States to focus State aid on improving the competitiveness of EU industry.

An important change in the Guidelines resides in the fact that they include a safe harbor, set at an investment threshold of EUR 1.5 million per SME over a period of 12 months, an increase of 50 percent on the previous threshold. For these cases, the Commission accepts the presence of a market failure, in that alternative means of funding from financial markets are lacking. Above this threshold, because of the greater potential to distort competition, the Commission will make a detailed assessment, and Member States will have to provide evidence of a market failure. Applying different types of assessment on the basis of economic impact is an important change, and implements the SAAP's refined economic approach.

H. DE MINIMIS

The current de minimis rule is contained in Commission Regulation No. 69/2001 of 12 January 2001.³⁴ De minimis aid is considered as falling outside the scope of the State aid rules, because of a presumption that it neither affects trade between Member States nor distorts competition. The instrument should be handled with care because, contrary to the other Commission regulations in the State aid area, it does not detail conditions of compatibility under Article 87(3) EC Treaty, but simply defines what is considered as State aid within the meaning of Article 87 (1). The current threshold is set at EUR 100,000 over a three-year period.

After publication of a draft in March 2006 and a first consultation round with Member States and other stakeholders, the Commission issued a revised draft for consultation in June 2006, proposing to raise the ceiling to EUR 200,000.³⁵ In so doing, it implemented its pledge, announced in the SAAP, to increase the de

33 See *id.*

34 Commission Regulation No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to De minimis aid, 2001 O.J. (L 10) 30.

35 Amended new de minimis block exemption, 2006, O.J. (C 137) 4, available at http://ec.europa.eu/comm/competition/state_aid/overview/sar.html.

minimis threshold to take account of developments in the economy. This should result in a greater number of small subsidies being exempted from the notification obligation under EC State aid rules.

The proposal also contains a number of safeguards to prevent abuse of its provisions, especially with regard to so-called non-transparent forms of aid. Indeed, in line with earlier Commission proposals and, more particularly, the new draft for a block exemption covering certain types of regional aid,³⁶ we proposed limiting the scope of the de minimis regulation to transparent types of aid, defined as being those measures for which it is possible to determine in advance the precise aid amount they include without carrying out a risk assessment.

The final version of this regulation should attempt to cover the largest amount of aid which is unlikely to have any damaging impact on competition—such as, for instance, guarantee schemes in favor of real SMEs—thereby reducing the bureaucratic burden for those support measures, while simultaneously ensuring that the de minimis regulation is not being abused, for instance in favor of large undertakings active on wider geographical markets.

I. RESEARCH AND DEVELOPMENT AND INNOVATION (R&D&I)

Even though effective competition is the best tool to strengthen innovation and competitiveness in the European Community, State aid can occasionally also play a very useful supporting role. State aid can be used to embrace globalization by better targeting public funds, for instance, towards R&D&I, thereby supporting economic reform to deliver long-term competitiveness. With this in mind, the Commission proposed, in April 2005, a draft Community framework for State aid for research and development and innovation.³⁷

Regarding the substance of the rules, we prepared a common text covering not only research and development, but also innovation, given the close links between the two areas. The text generally maintains the existing high aid intensities for fundamental and industrial research, while introducing a new category of experimental development, substantially broadened to include innovation activities. The draft also intends to provide increased legal certainty for R&D projects of universities and for public-private partnerships. Most importantly, there will be ground-breaking new rules on support for innovation.

With regard to the procedural treatment of R&D&I aid measures, notified measures will of course be subject to the refined economic analysis set out in the

³⁶ Draft Commission Regulation on the application of Articles 87 and 88 of the EC Treaty to national regional investment aid, 2006 O.J. (C 120) 2.

³⁷ See EUROPEAN COMMISSION, DRAFT COMMUNITY FRAMEWORK FOR STATE AID FOR RESEARCH AND DEVELOPMENT AND INNOVATION (20 April 2006), available at http://ec.europa.eu/comm/competition/state_aid/others/action_plan/rdi_frame_en.pdf.

SAAP. As we propose to authorize new categories of aid for innovation, and higher aid intensities, we also need, in parallel, to concentrate more of our resources on the most distortive cases. Indeed, State aid may well create the correct incen-

IT IS WORTH STRESSING THAT A DETAILED ANALYSIS DOES NOT MEAN THAT THE COMMISSION WILL NECESSARILY PROHIBIT THE AID. IT MERELY IMPLIES THAT THE POSITIVE AND THE NEGATIVE EFFECTS WILL BE LOOKED AT IN MORE DEPTH.

tives to increase R&D&I in the right circumstances, but it may also imply serious disruptions of dynamic effects for the competitors of aid beneficiaries.

It is worth stressing that a detailed analysis does not mean that the Commission will necessarily prohibit the aid. It merely implies that the positive and the negative effects will be looked at in more depth, using assessment methods

similar to those which the beneficiaries themselves are using before deciding to embark on any large business project.

J. REGIONAL BLOCK EXEMPTION REGULATION

Simultaneously, with the adoption of the new Guidelines on regional aid,³⁸ the Commission also proposed to introduce for the first time a block exemption covering regional investment aid.³⁹ The objective of the draft Regulation is to simplify the administrative handling for Member States, while reinforcing transparency and legal certainty. A first draft of the Regulation was discussed with Member States in April 2006, and a revised version will be discussed again in early autumn. The objective is to adopt the regional Block Exemption Regulation before the end of this year, so that it will enter into force on January 1, 2007, for the new structural funds programming period. That regulation, as a stand-alone instrument, will be of a transitory nature as the areas covered by it are intended to be included in the general, overarching block exemption, to be proposed and discussed in the course of 2007.

K. COUNCIL ENABLING REGULATION

As announced in the SAAP, the European Commission intends to adopt a proposal for a modification of the Council Enabling Regulation by the end of 2006,⁴⁰ in order to enable the Commission to adopt block exemptions in new fields like culture, heritage conservation and natural disasters. Indeed, the Commission could, under the provisions of the existing Enabling regulation, only block

38 See *supra*, Point III 1 C.

39 Draft Commission Regulation on the application of Articles 87 and 88 of the EC Treaty to national regional investment aid, 2006 O.J. (C 120) 2.

40 Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 92 and 93 (now 87 and 88 respectively) of the Treaty establishing the European Community to certain categories of horizontal State aid, 1998 O.J. (L 142) 1.

exempt aid in these areas provided the aid was in favor of SMEs. Excluding large companies from the benefit of such block exemptions is difficult to justify. This situation should therefore be changed. Due to the length of the legislative procedure, however, a new Council Regulation cannot be expected before the beginning of 2008.

V. CONCLUSIONS AND NEXT STEPS

The SAAP will adapt State aid policy to the new challenges facing the European Community. Though the reforms that have been implemented recently in the antitrust and merger area are often cited as a reference, the SAAP has to face a number of supplementary challenges. As explained above the welfare standard on the basis of which we have to conduct our assessment is different from the one in mergers and antitrust and the procedural challenges that we face are also considerable.

As has been set out above, we have already made significant progress in implementing the Action Plan. More work remains to be done.

We need to establish an overarching new general block exemption regulation (GBER), which will integrate all the existing block exemption regulations and also cover the new areas identified in the SAAP. The Commission is currently working on a first draft of the GBER, which will significantly expand the scope for Member States to grant aid without having to notify it to the Commission. The current block exemption already covers aid to SMEs, training aid, and employment aid.⁴¹ In addition to those areas, the GBER should include exemptions in favor of regional aid, R&D&I aid to large companies, and environmental aid. The simpler administrative procedure created by the GBER should mostly benefit SMEs.

The Commission is also considering possible modifications to existing guidelines, such as the environmental guidelines.⁴² These new guidelines should follow the same structure regarding the economic approach as the already-developed draft R&D&I Guidelines and the Risk Capital Guidelines. The final adoption of these guidelines is planned for the third quarter of 2007.

Reflection on more fundamental procedural reforms which would involve changing the rules has also been initiated. It concerns more ambitious reform ideas intended, first, to save time and increase transparency, second, to ensure that State aid is duly notified or recovered if implemented illegally and third, that greater administrative efficiency be achieved, amongst others by allowing for the relevant sectoral information to be gathered more easily. Reform ideas

41 For an overview, see EUROPEAN COMMISSION, BLOCK EXEMPTION REGULATIONS, *available at* http://ec.europa.eu/comm/competition/state_aid/legislation/block.html.

42 Community guidelines on State aid for environmental protection, 2001 O.J. (C 37) 3.

will be subjected, at an early stage, to a risk-benefit analysis in order to assess possible implications, amongst others, for third party rights, the burden of proof of the respective parties in the procedure and the locus standi of parties in court procedures. These reflections should feed into a consultation document to be discussed with Member States in the course of 2007.

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The more refined economic approach and the new procedural framework to be established by the SAAP are not intended to be either more interventionist or more lax. The objective is to provide for a sounder basis for intervention. The project is not limited to the Commission alone. Cooperation from the Member States and participation of all stakeholders is fundamental to the success of the reform. And the success of the reform is in turn fundamental to the success of the Lisbon goals of competitiveness, growth, and jobs. ▼