EU experience with State aid control as a mechanism to regulate government intervention in markets and assessing its impact

EU-China Competition Week
22 March 2017, Beijing

Disclaimer: the views expressed are those of the speaker only and cannot be regarded as stating an official position of the European Commission

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Competition

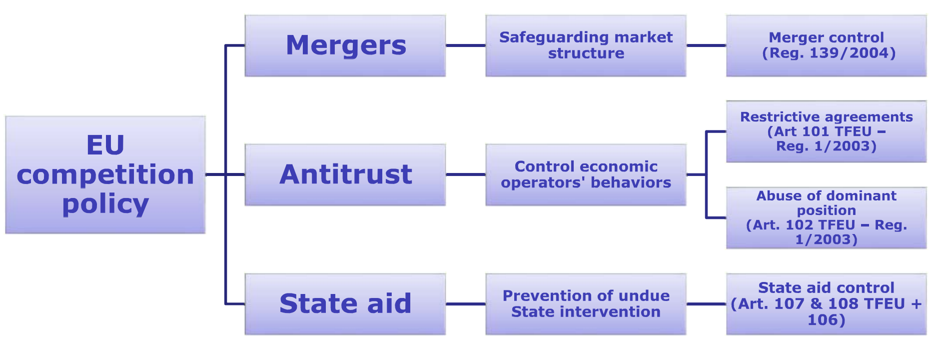
Summary

State aid control in a nutshell
Basic economics of subsidies
How State aid control is implemented

Competition

1. State aid control in a nutshell

State aid control as one instrument of EU competition policy



Why do we control State aid in the EU?

- EU internal market, level playing field between undertakings
- Role in liberalisation
- Competitive EU industry
- Avoid subsidy races between EU Member States
- Element of cohesion within the EU

What is State aid?

(1) State resources

(2) Confers an advantage to an undertaking

(3) Selectivity

(4) Potential to distort competition

(5) Effects on trade between Member States

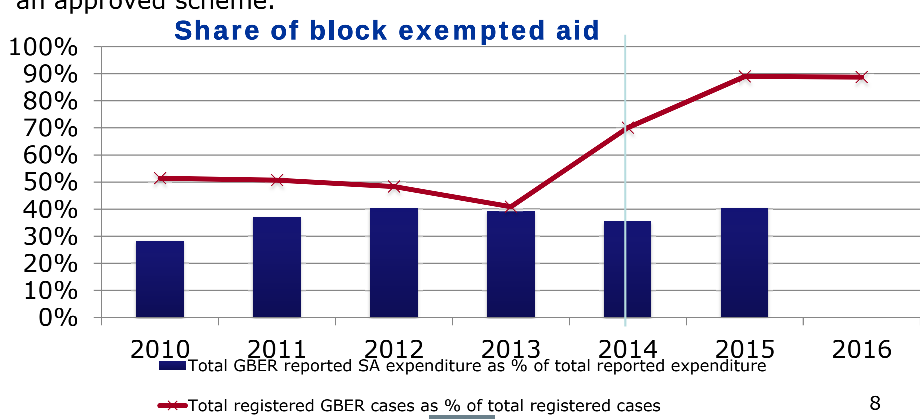
Article 107(1) TFEU – all criteria must be met

Limits to the Notion of Aid

- **Notice on Notion of aid (2016) gives clear guidance when public investments fall outside the scope of State aid, such as:**
  - Activities exercising public power (e.g. army or police)
  - Solidarity-based social security schemes
  - Health care services based on the principle of solidarity
  - Education and non-commercial research activities
  - Most activities related to culture, heritage and nature conservation
  - General measures (i.e. non selective ones)
  - Market-conform investments
  - Measures with no impact on trade

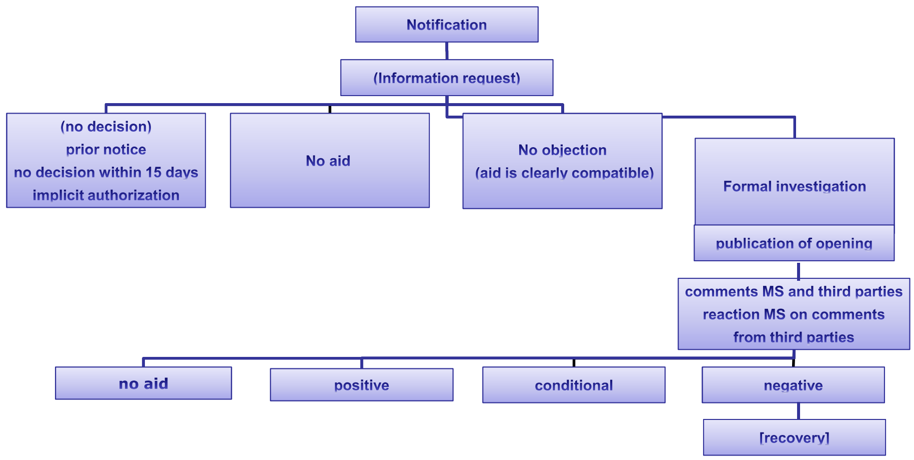
Notification requirement, and exceptions

All new aid needs to be notified to the Commission before being granted by the Member States. **Unless** it is covered by a block exemption regulation (**General Block Exemption Regulation**) or by an approved scheme.



Procedure

Simplified version of the procedure

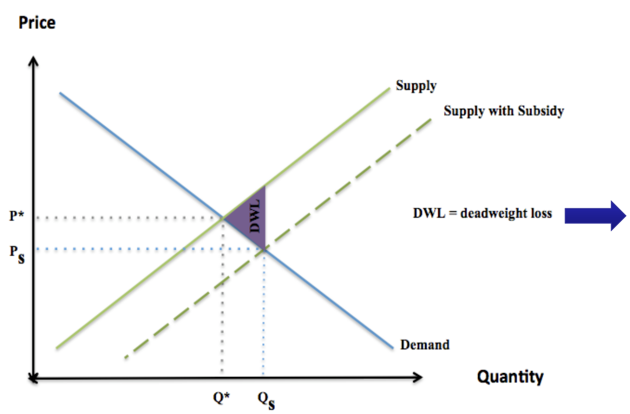


How the Commission assesses aid measures: the Common Compatibility Principles

1. contribution to well-defined objective of common interest
2. need for state intervention
3. appropriateness of state aid as policy instrument
4. existence of incentive effect
5. proportionality of the aid amount (aid limited to minimum necessary)
6. avoidance of undue negative effects on competition and trade
7. transparency

2. Basic economics of subsidies

Static economic effects of a subsidy



DEADWEIGHT LOSS:
Loss of economic efficiency that occurs when equilibrium for a good or service is not achieved or is not achievable

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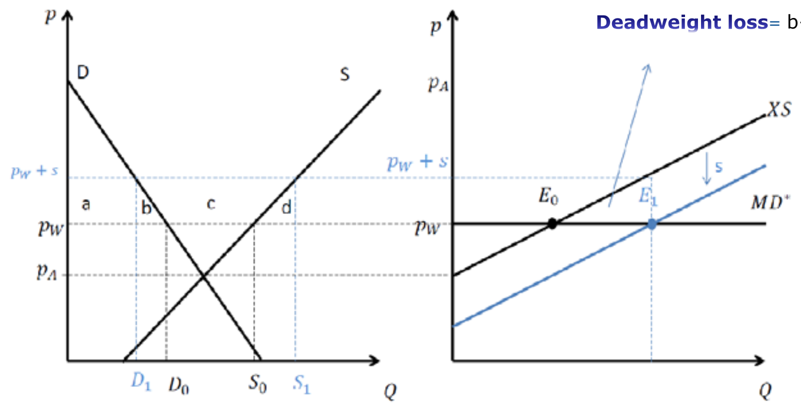
Export subsidies: simple welfare effects

Deadweight loss= b+d



HOME (SUBSIDIES) **EXPORT MARKET**

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Welfare effects of export subsidies: Home country

$$\Delta SC = -a - b$$

$$\Delta SP = a + b + c$$

$$\Delta GOV(\text{subsidy}) = -b - c - d$$

$$\Delta \text{Welfare} = -(b+d)$$

- Producers' surplus (a+b+c) implies a loss of welfare for consumers in the subsidising country (-a-b)
- Moreover, the government has to pay for the subsidy −b-c-d
- **NET NEGATIVE WELFARE EFFECTS**

Medium-term potential effects of subsidies

- Especially in low-skills sectors, subsidies (to maintain employment, for instance) may lead to low mobility of the labour force and traumatic responses to structural adjustments

→ **RISK OF SUBSIDY DEPENDENCE**

- The more prescriptive subsidies are, the higher the probability of distortive consequences and difficult-to-reverse path dependence

→ **RISK OF RESISTANCE TO INNOVATION**

- Massive subsidies may lead to production overcapacity, affecting worldwide prices (if the subsidising country is large enough)

→ **RISK OF UNSUSTAINABLE SECTORIAL GROWTH**

Rationale for international discipline / control of subsidies

- The theory of international trade provides an economic rationale for multilateral trade agreements
- When a country adopts a **mercantilist commercial policy**, other countries may reproduce this approach, with possible "race to the bottom"
- **Externalities** may arise, forcing countries to consider disciplines
- This **need for fairness** requires the existence of an independent body, which guarantees **stability and predictability** for investors and governments: e.g. agreements cannot be modified arbitrarily
- As showed by academic literature (Collie, 2000), this rationale applies also to **export subsidies**: when there are many countries, "*the range of values for opportunity cost where the Nash equilibrium export subsidy is positive and the prohibition of export subsidies is beneficial is quite large*"

3. How State aid control is implemented

The Commission's commitment to better regulation in State aid

- Commission's efforts to improve the quality of EU policies and law-making
- State aid rules:
  - Preceded by **impact assessments**
  - Followed by **evaluations**
  - Open **public consultations** of all stakeholders
- **Bilateral discussions with Member States** are a crucial component of the assessment of State aid measures, guaranteeing a cooperative approach
- Also, State aid rules and decisions are **adopted by the whole Commission** (college of Commissioners from all EU Member States) **after inter-service consultation** (different policy perspectives, not only DG Competition's, are taken into account)

State aid to banks in the EU: responding to the financial crisis

- 2007-2008 Global Financial Crisis: an exceptional, once-in-a-lifetime situation
- Specific State aid rules adopted to effectively respond to the financial crisis
- From 2007 until 2015, 112 banks in the EU, representing around **30% of the EU banking system in assets, received State aid**
- Commission approved restructuring plans for 56 of these banks
- Commission's State aid policy response to the crisis was key for the **survival of the EU internal market**

Rescue and restructuring aid: the most distortive form of aid

- Empirical studies show the importance of market entry/exit as **drivers of growth**
- State support for troubled firms can impose a number of costs:
- By preventing the exit of the recipient firm, or by freeing it from the need to restructure as a response to financial distress, Rescue & Restructuring aid maintains an **inefficient allocation of resources and keeps productivity and output below optimum levels**
- Indirect negative effect through its consequences on the incentives of firms: excessive level of risk taken by potentially aided firms, lack of investments from rival firms

INNOVATION IS NOT REWARDED, MORAL HAZARD IS ENCOURAGED

- **Harm to the level playing field between Member States**: Member States may use aid to ensure the continuation of domestic production, shifting the burden of adjustment to production facilities in other Member States
- As a consequence, **rules in this area are particularly restrictive**, but have been instrumental in **fostering the modernisation of industrial sectors**, especially in some EU economies

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