Developments in EU State aid control

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Outline

1. State aid control – why, what and how?
2. 3 scenarios:
   - ✓ Location – shopping for subsidies
   - ✓ Bailing out ailing firms
   - ✓ Financing of undertakings
3. Conclusion

I. State aid control

Why State aid control?

- "level playing field" – fair competition
- Internal market – fair competition accross borders
- avoid subsidy races to the benefit of consumers (better goods/services at low prices) and citizens (less taxpayers' money spent)

State aid (SA) control is about interventions by Member States (as opposed to Antitrust & Merger Control)

State aid represents about 1% of GDP

Architecture of State aid control

- Set out in the Treaty (binding on Member States)
- Exclusive EU competence
- State aid control by the European Commission
- Very limited role of Council / no role of European Parliament

- Wording in the TFEU on what is State aid has not changed since 1957
- But: scope of SA control has increased over time + importance and awareness of SA control has increased significantly

Example: Airports (Leipzig/Halle)

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The two steps of State aid control

1. Is there State aid?

Notion of State aid

- Defined by TFEU (Article 107(1))
- No discretion for the Commission or Member States (objective notion)
- Interpreted by the European Court of Justice
- Commission summarizes and provides additional guidance (Notice on the Notion of Aid)

2. Is the State aid allowed?

Compatibility

- In most cases discretion for the Commission to decide on compatibility
- Commission adopts abstract rules (Guidelines/Frameworks/etc.)

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What is State aid?

The 6 elements of the definition:

- Transfer of state resources
- Advantage
- Undertaking
- Selectivity
- Distortion of competition
- Effect on trade between Member States

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What is State aid?

Transfer of state resources

- Positive transfers or foregone revenues; examples:
  - ✓ Tax waivers
  - ✓ Free use of land/free electricity/…
  - ✓ Non-payment of obligatory social charges
  - ✓ Guarantees, unless if market remuneration is paid
  - ✓ Direct grants
  - ✓ Capital injection, unless if market conform
- What if EU funds are involved?

  Example of structural funds – European Commission supports economic development across all EU countries, in line with the objectives of the Europe 2020 strategy. Subject to State aid control

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What is State aid?

Advantage

- Measure improves financial situation of company
- No State aid if MS acts like normal buyer / seller / investor ("Market economy operator test", MEOP)

  E.g. capital injection

  ✓ what is return on investment and is this in line with what a private investor would expect?

  ✓ Only remuneration as shareholder can be taken into account, not "public considerations" (e.g. creating employment) → such considerations might be relevant in deciding whether the aid is compatible

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What is State aid?

Undertaking

- Any entity that is offering goods and services on a market
- Activity counts, not form/set-up
  - ✓ Also departments of public administration, or non-profit organisations can be undertakings!
  - ✓ State owned enterprises (SOEs) can be both recipient and grantor of aid
- Borderline areas: education, health care, culture, …

Selectivity

- Includes measures for one company, but MUCH wider
- Distinction by sector, size of companies, location, public ownership, …
- "De iure" or "de facto" (laid down in law or factual selectivity)

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What is State aid?

Distortion of competition &

Effect on trade between Member States

- Both are closely linked
- Broad interpretation

Important exceptions:

- small amounts (de minimis Regulation)
  (200,000€ over a 3 year period)
- purely local services ("big on big, small on small")

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Compatibility

Underlying idea: State aid is compatible/allowed when positive effects outweigh the negative effects

- General Block Exemption Regulation (GBER) and other exemption provisions
  The GBER is a set of simplified rules, which are easier to apply
  → Self-review by Member States
  → Safeguards: transparency, monitoring
- Guidelines, Frameworks, etc…
  → Review by European Commission
- "Directly under the Treaty" (Articles 107(2)+(3))
  → Review by European Commission

http://ec.europa.eu/competition/state_aid/legislation/legislation.html

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Compatibility – common principles

Compatibility depends on sector/area, but there are common underlying principles

1. Objective of common interest
2. Need for state intervention
3. Is State aid the right tool?
4. Incentive effect
5. Proportionality (is the aid limited to minimum necessary?)
6. Avoidance of undue negative effects on competition and trade
7. Transparency

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Procedural set-up

Typical cases without real competition concerns (~90%):

- Commission develops abstract rules (most important: GBER)
- Member State checks itself (self-review)

Potentially more distortive cases/atypical cases:

- Member State has to notify the measure
- Commission checks before implementation ("standstill obligation")

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Procedure

Types of cases

- Notifications
- Complaints → important source of information; also provides extra-check in GBER context (self-review by Member States)
- Ex officio investigations
- Monitoring

Steps in a case

- Prenotification
- Notification
- Commission investigation in 2 phases
- Final negative decision typically includes **recovery**: Member State has to claw back the money from the company

Commission powers

- Broad investigative powers to collect information (including from third parties, sanctioned with fines)

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II. Scenarios

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Location: shopping for subsidies

Article in the New York Times (25 September 2017) – Nothing Is Too Strange for Cities Wooing Amazon to Build There

- Amazon, on the hunt for a place to build a second headquarters, where it plans to invest $5 billion and create 50,000 jobs has begun an enormous competition among cities across North America
- Tax policy experts are more skeptical of Amazon's bidding process and how much cities stand to benefit
- "They would like a package of tax incentives for something they were going to do anyway."

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Location: shopping for subsidies

- Art Rolnick, an economist at the University of Minnesota, called Amazon's bidding process – and the broader practice of cities competing for stadiums and factories – "blackmail"
- "If you look at it from a national perspective, it's zero returns. Minnesota might win one, Wisconsin wins the next one. The company wins each time. It's corporate welfare."

US has no State aid control rules, although some attempts have been made to rein in this kind of subsidies races

(cf. Dormant commerce clause; Cuno v. DaimlerChrysler, Inc.) See also https://www.ftc.gov/sites/default/files/attachments/us-submissions-oecd-and-other-international-competition-fora/stateaidftc.pdf

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Location: shopping for subsidies

- State aid control rules offer a framework for such process
- Subsidies are normally not allowed (no incentive effect)
- However, subsidies can exceptionally be allowed for regional development where

"the aid gives and incentive to opt to locate a planned investment in the relevant area rather than elsewhere because it compensates for the net disadvantages and costs linked to a location in the area concerned", but "if the aid does not change the behaviour of the beneficiary by stimulating (additional) investment in the area concerned, it can be considered that the same investment would take place in the region even without the aid. Such aid lacks incentive effect to achieve the regional objective and cannot be approved as compatible with the internal market."

Guidelines on regional State aid for 2014-2020, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2013:209:0001:0045:EN:PDF

Bailing out ailing firms

Issue: companies kept alive on the back of subsidies, without addressing structural problems, leading to problems for undertakings in other Member States

- Risk of interventions by Member States designed to protect their industries. Competition on the back of aid would transfer difficulties from one Member State to another at substantial cost to the Community as a whole.
- 1970's: first guidelines have been developed in particular for industries in crisis (Shipbuilding, Textiles, Manmade fibres, Steel)
- Purpose of the Commission's initiatives in defining guidelines has been to avoid the risk of competition on subsidies and at the same time to encourage the restoration of the industries' competitiveness.

Bailing out ailing firms

Principles:

1. aid should not be given where their sole effect would be to maintain the status quo (i.e. operating aid to cover loss making activities)
2. while rescue aid may be needed in order to provide a breathing space during which longer-term solutions to a company's difficulties can be worked out, they should not frustrate any necessary reductions in capacity and should therefore be limited to cases where they are required to cope with acute social problems; and
3. aid should not be given to investment projects which would result in capacity being increased.

See VIIIth Report on competition policy (1978)
https://publications.europa.eu/en/publication-detail/-/publication/5d69f730-2f0e-4d65-8ede-1193554df9fd/language-en

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Bailing out ailing firms

1994: first guidelines (GL) on aid for rescuing and restructuring

1999: revised guidelines

2004: revised guidelines

2014: revised guidelines

✓ Building on experience gathered through cases

E.g. introduction "one time, last time principle" (1999 GL) – later extended to cover rescue aid based on the Bull-case (2004 GL)

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Bailing out ailing firms

Key principles

- Contribution to a common objective: preventing market exit is not sufficient!
  - → Demonstration of social hardship or market failure
- Rescue aid: temporary liquidity support; max. 6 months
- Temporary liquidity support: new in 2014 GL
  - ✓ up to 18 months
  - ✓ simplified restructuring plan
  - ✓ One time, last time

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Bailing out ailing firms

- Restructuring aid:
  - ✓ Restructuring plan
  - ✓ Restoration of long-term viability
  - ✓ Need for State intervention and incentive effect (counterfactual analysis compared to scenario without aid)
  - ✓ Appropriateness
  - ✓ Proportionality (aid limited to minimum)
    - ✓ Substantial contribution beneficiary
    - ✓ Burden-sharing
  - ✓ Measures to minimise distortion of competition

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Bailing out ailing firms

- State aid rules on rescue and restructuring must be seen as complementary to the broader policy with measures aimed at economic development (e.g. structural funds)
- Focus of the EU Commission on "jobs and growth"
  - ✓ Generous view on social aid/training to employees
  - ✓ Example after closure of Caterpillar plant – setting up of Task Force assisting the Belgian authorities, including through (compatible) State aid measures.

Financing of undertakings

Providing of financing to undertakings can be State aid, unless if done at market terms

- Loans: use of reference rate as proxy for a market rate, if no direct benchmark available
- Guarantees:
  - ✓ no unlimited guarantees permitted; the guarantee must be linked to a specific transaction
  - ✓ Borrower is not in financial difficulties
  - ✓ no coverage of more than 80% → own risk constitutes an incentive to do a proper risk assessment
  - ✓ Market price paid for the guarantee
- Equity: MEOP-test

III. Conclusion

State aid control

- State aid = in principle prohibited
- BUT state aid control is not aimed at eliminating all or any state aid, but is rather intended to ensure that aid is allowed only in warranted instances and implemented in the least anticompetitive way

State aid control

- Framework to allow subsidies to be used in an acceptable manner
- Has been refined over time based on case experience
- SAM 2014 – further refinements:
  - ✓ Transparency
  - ✓ Evaluation
  - ✓ Common assessment principles
- Flexible, e.g. response to financial crisis, while safeguarding internal market
- Has proven extremely effective

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Thank you!

Questions?

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