EU Communication

STATE AID REFORM

cep **Policy Brief** No. 2012-50 of 3 December 2012

Centrum für Europäische Politik

KEY ISSUES

Objective of the Communication: State aid law is to be reformed and specifically targeted at the "Europe 2020" strategy and at budget consolidation.

Parties affected: Companies and public authorities.

Pros: (1) Clearer State aid rules and definitions reduce legal uncertainty and reduce the administrative burden.

(2) More frequent *ex post* controls initiated by the Commission increase the likelihood of unlawfully granted State aid being detected.

Cons: (1) State aid control is to be exploited to promote the Europe 2020 targets.

(2) The Commission wishes to promote budget consolidation through growth-inducing State aid. However, State aid control can best contribute to budget consolidation by granting less State aid and thereby avoiding additional State expenditure.

CONTENT

Title

Communication COM(2012) 209 of 08 May 2012: **EU State Aid Modernisation**

Brief Summary

► **Background and aims**

- State aid is inconsistent with the internal market as a matter of principle and therefore prohibited (Art. 107 (1) TFEU). By State aid is meant:
  - companies receive State transfers such as subsidies, tax privileges or guarantees;
  - companies thereby gain an economic benefit;
  - transfers are only provided to selected companies so that distortion of competition might be created as a result and
  - internal EU trade might be impeded.
- As a general rule, any State aid that Member States wish to grant must be submitted to the Commission for prior approval ("*ex ante* examination", Art. 108 (3) TFEU).
  - Member States must communicate all information necessary for approval to the Commission. The Commission approves State aid if it is consistent with the internal market (Art. 2 and 4 et sqq. "Procedural Regulation" REG (EC) No. 659/1999).
  - If a Member State grants State aid that is subject to prior approval but in fact has not been approved by the Commission beforehand (Art. 10 and Art. 20 Procedural Regulation):
    - the Commission must initiate a control if a complaint in this regard is lodged; or
    - it may initiate a control upon its own initiative ("*ex-post* control").
- The Council may stipulate the "categories of aid" which are exempted from the approval obligation and enable the Commission to substantiate them through Regulations (Art. 109 TFEU). Such substantiation was accomplished by the Council's "Enabling Regulation" [REG (EC) No. 994/98]. On this basis, the Commission has exempted the following State aid from the prior approval requirement:
  - State aid of up to 200,000 Euros flowing to a company within a period of three years [*de-minimis* aid Regulation (REG (EC) No. 1998/2006)]; and
  - aid granted to small and medium-sized enterprises (SME), research, development and innovation (R&D&I), environmental protection measures, employment and training as well as regional targets [General Block Exemption Regulation (REG (EC) No. 800/2008)].].
- Whether or not State aid is exempted from the approval requirements in the individual case must be examined by Member States.
- The Commission has adopted numerous State aid guidelines containing framework requirements which Member States must consider when shaping their policies.
- The Commission wishes to "modernise" the State aid laws. The present Communication contains the reform measures aimed at by the Commission. The objective of the reform is:
  - to focus the Commission's approval on State aid that has a substantial impact on the internal market and, at the same time, to strengthen the cooperation with Member States;
  - to streamline the State aid procedure so as to enable the Commission to adopt its decisions faster; and

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- to tailor the requirements for State aid in such a way that they better promote economic growth in Member States; this should
  - serve to implement the growth strategy "Europe 2020" (s. CEP Policy Brief) and
  - support Member States in a "smart" budget consolidation.

  The last two of these targets are to be achieved by restructuring State aid.

► **Promoting the growth strategy "Europe 2020" by means of "good aid"**

– In order to promote the growth strategy "Europe 2020", the Commission wishes to facilitate the granting of "good aid" (No. 12). Good aid:
  - is targeted at pursuing "common interests" – meaning efficiency gains and the promotion of equal living conditions;
  - distorts competition as little as possible; and
  - addresses a "market failure" – which is when the market does not itself ensure an efficient use of resources.

– In order to ensure that "good aid" generates the maximum possible growth impact, it should
  - supplement and not replace private spending, and
  - induce aid beneficiaries to undertake activities they would not have done without the aid ("incentive effects").

► **Promoting "smart" budget consolidation in Member States**

In order to support Member States in budget consolidation, the Commission wishes (No. 14)

– to improve the quality and efficiency of aid, and
– to have the findings gained from aid control integrated into the country-specific recommendations for structural reforms which the Commission, as part of the Stability and Growth Pact [Art. 121 (2) TFEU in conjunction with Art. 5 (2) REG (EC) No. 1466/97] and within the framework of the "European Semester" (see CEP Policy Brief), addresses to Member States.

► **Re-targeting State aid**

– In order to re-target State aid at the two objectives – supporting the growth strategy "Europe 2020" and promoting the "smart" budget consolidation – the Commission wishes to harmonise the basic criteria for aid control: market failure, incentive effects and negative impacts of aid.
– To this end, it wishes to define "common principles" which outline how it assesses the different criteria when controlling aid (No. 18a).
– Thereupon it wishes to revise the State aid guidelines and make them consistent with the "common principles" (No. 18b), in particular the State aid guidelines for broadband rollout, infrastructure, research, development and innovation, environment, education, rescue and restructuring aid, regional development and risk capital.

► **Extension of approval-exempt aid – increased control of State aid with a significant impact on the internal market**

– The Commission wishes to increase the number of approval-exempt State aid measures in order to focus their *ex ante* examination on State aid that has a significant impact on the internal market (No. 19 et sqq.).
– To this end, by amending the Enabling Regulation, the *de-minimis* Regulation and the General Block exemption (No. 20), it wishes to:
  - increase the threshold of 200,000 Euros where it does not "correspond to market conditions"; and
  - enlarge the groups of approval-exempt State aid, in particular to include aid granted to culture, to make good the damage caused by natural disasters and to (partly) EU-funded projects.
– If the number of approval-exempt aid measures is increased, the Member States' responsibility to examine whether or not the individual aid instrument is actually approval-exempt grows. Therefore the Commission would like to see (Nos. 19 and 21):
  - a clearer definition of aid rules and
  - enhanced *ex post* control.

  Moreover, Member States shall establish "effective national systems" to ensure that State aid measures exempt from the *ex ante* notification obligation comply with Union law.

► **Streamlining the procedure**

– In order to streamline the State aid procedure, the Commission wishes to provide further clarification of the "key concepts" relating to aid law in view of the interpretation by the European Court of Justice (ECJ, No. 23a).
– In order to streamline *ex post* control and to allow for more *ex officio* investigations, the Commission wishes to change the Procedural Regulation so that (No. 23b):
  - complaints regarding aid that is potentially subject to approval and has a significant impact on the internal market must be handled with "priority"; and
  - it is endowed with more "efficient tools" to obtain all the necessary information from market participants in good time.

Statement on Subsidiarity by the Commission

The Commission does not address the issue of subsidiarity.

Policy Context

The Commission has carried out a number of consultations on the planned changes in order to gather public opinion of the reform. The most important parts of the reform package shall be adopted by the end of 2013. A priority complaint-handling on State aid with significant impact on the internal market was approved by the ECJ ("Ufex" Case C-119/97) and thereupon included by the Commission in the Code of Best Practice for the conduct of State aid control procedures (2009/C 136/04).

Options for Influencing the Political Process

Leading Directorate General:	DG Competition
Committees of the European Parliament:	Economic and Monetary Affairs (leading); rapporteur N.N.
Committees of the German Bundestag:	Economics and Technology (leading); Affairs of the EU

ASSESSMENT

Economic Impact Assessment

With its scheme to facilitate the granting of "good aid" and thus promote the growth strategy "Europe 2020", **the Commission is exploiting State aid control to steer the economic policies of Member States according to its own ideas**.

"Good aid" should only be permitted if it rectifies market failure and thus enhances efficiency. However, since the concept of market failure is based on a theoretical ideal that in reality only very rarely takes place, almost every market is affected by market failure to a certain extent (see CEP-Study p. 11–14). This gives the Commission considerable scope of discretion when it comes to approving State aid. **It is therefore to be expected that the Commission will mitigate the efficiency requirements regarding State aid so as to in turn improve the chances of achieving the "Europe 2020" targets.**

The fact that "good aid" is supposed to supplement private means and induce aid beneficiaries to undertake additional activities reduces windfall profits.

The budget consolidation propagated by the Commission is undoubtedly necessary. **The Commission's Proposal to improve the quality and efficiency of aid**, however, **gives rise to the concern that budget consolidation is to be achieved through an increase in growth inducing State aid**. Such a practice has regularly failed in the past; states pursuing such consolidation strategies normally had after several years higher deficits and debt levels than before. It is therefore not without good reason that the Commission refers in other Communications to the fact that budget consolidation should be achieved primarily by cuts in expenditure or by increased taxes [cp. Principle 5, Communication COM(2012) 342; s. CEP Policy Brief]. For even with extensive *ex ante* examination it cannot be predicted with sufficient certainty which growth effects aid will generate indirectly. Therefore, **State aid control can best contribute to budget consolidation by granting State aid as sparsely as possible and thus avoid additional state expenditure**.

It remains unclear why the Commission wishes to include the findings of State aid control into country-specific recommendations that it regularly makes to the Member States within the framework of the Stability and Growth Pact. Having State aid target the strategy "Europe 2020" suggests that the aim of the Commission is to oblige Member States to implement the "Europe 2020" targets.

The Commission's intention to intensify controls of State aid with significant impacts on the internal market suggests that such aid has until now not been examined according to its significance. However, the suggestion made with the aim of relieving the Commission to increase the ceiling for approval-exempt aid amounts (*de-minimis* aid regulation) and to extend approval-exempt aid types (General Block Exemption Regulation) should be rejected. Both measures increase the danger of granting State aid whose competition distorting impact exceeds the efficiency enhancing effects by far. Whether or not and to what extent State aid impedes the internal EU market does not necessarily depend on the amount of State aid.

In particular smaller amounts can also have a significant negative impact on the internal EU market in sectors in which predominantly SME operate. Moreover, there are several Member States which, due to their tight budget situation, are struggling to grant State aid even below the *de-minimis* threshold; consequently, increasing the threshold can lead to competitive disadvantages for companies in such countries. The proposed increase of the *de-minimis* threshold can therefore aggravate the economic recovery of such countries. Moreover, the European Court of Auditors refers to the fact that when *de-minimis* aid is granted, it is often not checked how often such aid has been granted to a company in the preceding three years (Special Report No. 15/2011, p. 17). Against this background, an increase in the threshold is wrong.

By **extending approval-exempt State aid** – as the Commission itself states – **Member State responsibility grows,** as they then have to assess themselves more often whether the requirements for an approval-exempt State aid are consistent with Union law. In light of this, **a clearer formulation of State aid rules would be appropriate**.

The Commission and Member States often pursue different interests in granting State aid. While the Commission wishes to prevent State aid that noticeably distorts competition, the Member States wish to grant exactly such types of aid in order to support domestic enterprises in competition or to motivate foreign enterprises to invest in the Member State concerned. **Therefore, it is questionable whether "national systems" can ensure compliance with EU legal requirements concerning approval exemption**. Intensifying *ex post* control can only contribute to compliance with EU law to a limited extent. On the one hand it is questionable whether *ex post* control takes place to such an extent that most of the incorrectly granted aid is identified. On the other hand, the discouraging effect of *ex post* control is low, as there are no real consequences for Member States for unjustifiably granted State aid. Only enterprises are affected by this, as they must repay State aid with interest. Also in view of the differing interests of the Commission and Member States, an extension of approval-exempt State aid is not recommendable.

The Commission's **objective to streamline control procedures by further clarifying key concepts reduces legal uncertainty for all participants, relieves the Commission and Member States of administrative burdens and improves planning safety** for companies. Currently, an *ex ante* examination often takes more than two years (Special Report, No. 15/2011,p. 27), otherwise 5% of the State aid registered with the Commission would not have to be registered. Hence, the precise definition of key concepts releases control capacities which can make the duration of control procedures much shorter.

More frequent *ex post* controls increase the likelihood that State aid granted unlawfully will be detected. To date, the Commission still depends on the Member States' cooperation with regard to *ex post* control. However, their interest in supporting the Commission in assessing a complaint is normally relatively low. Therefore, the Commission should be enabled to collect the necessary information directly from market participants. The accompanying administrative burdening of companies should be kept as low as possible however.

Legal Assessment

Competency

Unproblematic. The Council may adopt implementing regulations relating to State aid procedures and enable the Commission to define exemptions from the approval requirements (Art. 109, Art. 108 (4) TFEU).

Subsidiarity

The principle of subsidiarity is not applicable as the measures are all within the scope of the exclusive competence of the EU (Art. 3 (1) lit. b TFEU).

Proportionality

Depending on the design of the reform measures.

Compatibility with EU Law

Currently not assessable.

Compatibility with German Law

Currently not assessable.

Conclusion

With its intention to facilitate the granting of "good aid", the Commission is exploiting State aid control in order to steer the economic policies of Member States according to its own ideas. It is to be expected that the Commission will mitigate the efficiency requirements regarding State aid in order to in turn improve the chances of achieving the "Europe 2020" targets. The Commission's Proposal to improve the quality and efficiency of aid, however, gives rise to the concern that budget consolidation is to be achieved by increasing growth-inducing State aid. State aid control can best contribute to budget consolidation by granting State aid as sparsely as possible and thus avoid additional state expenditure. By extending approval-exempt State aid, Member State responsibility grows. Against this background a clearer formulation of State aid rules is appropriate. The Commission and Member States often pursue different interests in granting State aid. Therefore, it is questionable whether "national systems" can ensure compliance with EU legal requirements concerning approval exemption. The Commission's objective to streamline control procedures by further clarifying key concepts reduces legal uncertainty for all participants, relieves the Commission and Member States of administrative burdens and improves planning safety. More frequent *ex post* controls increase the likelihood that unlawfully granted State aid will be detected.