SPEECH

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State aid reform – Modernising the current framework

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Ladies and Gentlemen,

In the legal world, until a few years ago, it seems that state aid policy was seen as the poor cousin of antitrust and mergers within the competition policy family. In this respect, the lawyers were nevertheless some distance ahead of competition economists who had mostly not noticed its existence at all. Politicians of course have always given state aid law the respect it so richly deserves. The Judges in the Courts also!

Today's conference on state aid law and the discussions that we have had show that state aid policy is now more than ever an area that is central to competition policy, an area rich for debate and an area where great progress is being made. I would like to thank the Centre of European Law and the European State Aid Law Institute
for organising such a distinguished line up of speakers and thinkers. It's a good time to be articulating ideas, since this is a moment of change. Under Commissioner Kroes, this pillar of competition policy is undergoing radical modernisation.

State aid reform: modernising the current framework

Let me briefly outline the changing framework for state aid control before picking up some of the issues that came up during the day. As you will have realised by now, State aid reform is one of the top priorities for Commissioner Kroes during her mandate. Her starting point is that competition drives competitiveness, and that first and foremost we need to trust the market. She sees the main job of governments as creating the right structural conditions for markets to work. The role of state aid is to help address market failure.

This is, as such, not new. This is the rationale of the Treaty: state aid should target common objectives in areas where markets alone would fail to deliver. If State aid is not properly targeted it should be, and is, prohibited.

In June 2005, the Commission launched its State Aid Action Plan, a comprehensive reform programme that aims to transform State aid into an effective EU policy tool for growth and jobs. Our aim is to create mutual understanding with the Member States as to the foundations of the policy that should be applied for the future. There are four guiding principles underpinning the reform programme:

- less and better targeted state aid: this is the overall objective set by the Member States in the European Council;

- a refined economic approach: a greater emphasis on economic analysis is an instrument to better focus and target state aid;

- more effective procedures, including better enforcement, higher predictability and enhanced transparency; and

- a shared responsibility between the Commission and the Member States.

This reform programme is a response in the context of the Commission's strategy to boost growth and jobs. It is also a response to the need to develop clear and understandable guiding principles in order to increase both transparency and proper enforcement in the field of state aid.

- *The refined economic approach*

The refined economic approach is a central pillar of the reform, and I will expand a little on this. The message to this eminently legal audience is that it's not too scary, because the approach embodies some very well-known concepts.

Let's start by admitting that the economic analysis of the impact of state aid on markets is considerably more complex than in antitrust and mergers. First, State aid control is not only about competition between companies and concerns of market power, but – in its essence – is about the proper functioning of the internal market and 'competition between Member States'. It is damaging for the internal market, and bad for competition in general, if Member States embark in harmful subsidy races.

Second, State aid control is not only about the economic efficiency test of consumer welfare; it also takes into account wider public objectives such as cohesion, environmental protection and social objectives. There is thus necessarily a more political dimension to state aid control.

In this context, the so-called 'balancing test' is not a revolution. It simply provides a general framework for assessing the compatibility of state aid under Article 87(3) of the Treaty. It is not a revolution as State aid policy, like other areas of economic law, has always been intrinsically linked with economic reasoning.

The balancing test aims at applying economics in the Commission's decision making practice more systematically and in a way that is better geared to economic realities.

So what does the balancing test consist of? It's more common sense than rocket science.

1. a well-defined objective of common interest has to be identified (such as cohesion, growth, employment, environment)

2. the aid instrument has to well target the identified objective of common interest :
    - State aid is the appropriate policy instrument
    - the aid measure has an incentive effect
    - the aid measure is proportional to the problem tackled

3. the distortions of competition and effect on trade should be limited so that the aid measure is not on balance contrary to the common interest.

This approach is now becoming a reality and is being introduced step by step in our new rules. It has already been enshrined in the Risk Capital Guidelines which were adopted in May 2006. The next step will be the new framework on Research, Development and Innovation which has been extensively discussed today. This framework will form the second cornerstone towards implementation of the refined economic approach.

- *Regional aid*

Another major step is the successful start of the implementation of regional aid reform. As discussed earlier today, the new regional aid maps for more than half of the Member States have already been approved by the Commission on the basis of the new Regional Aid Guidelines adopted in December 2005. They will apply, like the guidelines, for the period 2007 – 2013, which coincides with the next programming period for the EU structural funds. The Member States and the Commission have made a considerable effort to redesign the rules so as to address the new diversity among regions in the enlarged EU, so that aid is better targeted towards the regions most in need.

- *Simplification*

What else have we achieved so far? Another general principle of this reform process is better regulation. This Commission in general, and Commissioner Kroes in particular, are determined to keep the costs of regulation down to the minimum. We are therefore pursuing an agenda of simplification and cutting red tape. We see block exemptions as very useful tools for reducing the administrative burden on Member States, since they avoid the need to notify measures that are not problematic for competition and trade. The Block Exemption Regulation for Regional Aid has been adopted in October 2006 and will enter into force in January 2007. Later this year, the Commission intends to adopt the new *de minimis* proposal, doubling the threshold to 200,000 Euro over a three year period. This should simplify the action of Member States towards supporting SMEs.

Further progress will be made with the General Block Exemption, that will consolidate and simplify the current regulations. We also intend to widen its scope and include certain aid to innovation, environment and risk capital.

Notion of aid

The balancing test provides the future general framework for assessing the compatibility of state aid under Article 87(3) of the Treaty. A good part of today's discussion however focussed on the preceding step: the existence of aid within the meaning of Article 87(1).

Here, the Commission's flexibility is more limited. While the Treaty entrusts the Commission with a wide discretion as regards the compatibility assessment, it has – like the national courts – no discretion under Article 87(1): there is no scope for balancing negative with positive effects. We are required to establish whether a measure transfers state resources, is imputable to the State, confers an economic advantage, favours certain undertakings or sectors of the industry by its selective nature and, finally, whether it affects competition and trade between Member States.

Like any other provision of economic law, Article 87(1) must however be applied with economic reasoning. In some cases the Commission adopts a "no aid" decision based on such economic reasoning. There have been some 20 cases in 2006 so far, one of which, a Dutch case about loans to the company *VAOP*, after a formal investigation procedure. Such cases are brought to the Commission either through notifications or through complaints, and the Commission is normally required to take a decision. The dividing line between an aid and a general measures is indeed sometimes difficult to draw. However, the Commission in its "no aid" decisions, and the Court in cases like *British Aggregates*, help to clarify the dividing line. This will contribute in the long run to reducing the number of complaints and notifications of such cases.

We have also seen in today's discussions that fair competition between Member States may be impaired by things other than potentially harmful subsidy races. Here, the Council's Code of conduct for business taxation is one tool to identify potentially harmful tax measures. The scope of state aid control is limited by the Treaty, wisely so, to selective advantages conferred by a Member State to undertakings or sectors of the industry. The recent *Azores* judgement, also discussed today, has brought important clarifications for regionally differentiated tax systems within a Member State. As your discussion today shows, we will have to continue to reflect about these issues.

There remain grey and overlapping zones between Community legislation and the application of state aid rules, in particular in areas where Council legislation provides possibilities for Member States to deviate from commonly set taxation rates. The energy tax Directive and the Directives on excise duties on mineral oils are examples discussed today. Here, the upcoming review of the Environmental Aid Guidelines may be a good opportunity to clarify open questions.

Procedural aspects

A good part of today's talks focussed on procedures – before the Commission, before the European Courts, before national courts. Here as well, the State Aid Action Plan prepares the ground to work towards more effective procedures, better enforcement, higher predictability and enhanced transparency.

Where do we stand on this? There is still much work to do in this area, but progress is being made. Let me pick up three issues: First, regarding enforcement, the Commission is now consistently pursuing Member States who fail to comply with State aid law and we have brought a number of Member States to Court. We are also actively pursuing the so-called *Deggendorf* jurisprudence, whereby a Member State cannot pay out new aid to a company, unless it has recovered from this company all remaining unlawful and incompatible aid. As a result, more aid is being recovered by Member States.

Second, the Commission is concerned about the long delays observed for recovery of aid. Here, the ECJ's *Scott* judgement of the 5th of October is a real breakthrough. The Court states that a national law providing for an automatic suspensory effect of actions brought before national Courts is inconsistent with the objectives of immediate and effective execution of Commission decisions required by Article 14 of the Procedural Regulation. The national law should therefore simply not have been applied. It is now up to the national courts to follow this clear line for speedy recovery of unlawful aid. To further improve the situation, the Commission will adopt a notice providing "best practice" guidance for the execution of recovery decisions at national level. We will also explore how we can enhance cooperation between the Commission and national courts in the fight against illegal aid. This will result in a revision of the 1995 cooperation notice.

But we want to go further: we want to tackle illegal aid at the roots. Member States should have clear incentives to notify aid which they intend to grant to the Commission. This is not about confrontation, but about partnership with Member States. The Commission must ensure that state aid decisions are taken within a timescale that is relevant to business. Decisions taken several years after aid has been granted, followed by lengthy proceedings before national and European Courts may be of academic interest, but are of little relevance for the competitiveness of European industry.

To speed up proceedings, we need Member States to cooperate by providing complete notifications and timely and accurate replies to our questions. We have also reviewed our own internal procedures and discussed proposals on best practices guidelines within the present rules with the Member States. If guidelines are considered useful, these could be finalised and published around summer 2007. We have received a series of suggestions on how to reform our procedures further – similar to the ideas put forward earlier this afternoon. The State Aid Action Plan foresees that the Commission considers proposals to reform the Procedural Regulation. It is however too early to speculate further on this today.

Conclusion

Ladies and Gentlemen,

The State aid reform project is well under way. Important parts have been adopted or will be adopted still this year. Next year, the Commission will tackle further challenges and move further towards effective procedures and a revised substantive rulebook with sound economic foundation.

State aid policy is on its way to being a better performing tool for Member States to deliver more jobs and growth in Europe.

Thank you very much for your attention.