State Aid Enforcement in Context:
Competitiveness, economic reforms and enlargement

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A. Introduction

Ladies and Gentlemen,

I would like to begin by thanking you for the invitation. I am very pleased to be given the opportunity to express to this forum my views on state aid enforcement in the current political and economic context. A challenging context indeed. Today, we are only a few days away from taking the great step of enlarging the European Union - going from 15 to 25 Member States. In addition, we face a challenge, reiterated by the European Council in March, in meeting the urgent need for enhancement of the competitiveness of the European economy.

Keeping this context in mind, I will start by giving my views on the direction in which state aid policy should go in the current context. Then, I will describe recent trends in the state aid granted by Member States, to illustrate if we are heading in the right direction or not. And, finally, I will outline in more concrete terms the state aid policy developments that are under way.

B. A strict and proactive economics-based approach to state aid

In recent years, we have pursued the goal of stringent state aid control, based on sound economic analysis. Such a state aid policy has to be seen as part of a proactive competition policy, as is also explained in a Communication which the Commission adopted a few weeks ago.

This "Communication on Proactive Competition Policy" explains how competition contributes to the competitiveness of Europe's enterprises. Now, how can state aid policy contribute to increased productivity and employment?

- First, by ensuring fair and strong competition, and
- Second, by allowing corrections of market failures.

B.1. Fair and strong competition

Strong competition is a **driver of innovation, efficiency improvements and necessary restructuring** in a global market. Competition thereby creates benefits for consumers and society as a whole in the form of lower prices, better quality and greater choice. If, on the contrary, competition is distorted by state aid, this partly destroys the incentive for firms to pursue technological innovations and cost-efficient solutions and, as a result, crucial driving forces behind growth and employment will be lost.

Our state aid rules are also **essential to economic reforms** in Member States. The proven beneficial effects for consumers and companies of the opening of markets such as telecommunications and postal services should not be undermined by state aid measures.

I know it is tempting for governments during recessions to bail out ailing firms through state aid – especially if elections are coming up - but I want to stress that this <u>cannot</u> be a responsible and sustainable choice. It merely shifts the burden of restructuring on to more efficient firms and it reduces the incentive to innovate and to be efficient while delaying necessary restructuring in the Member State in question. The result will be lower potential future growth.

The need for strict control of state aid throughout the Union has been recognised by successive European Councils. At the Stockholm European Council in 2001, Member States committed themselves to continuing their efforts **to reduce** the general level of state aid expressed as a percentage of GDP by 2003 **and to redirect aid** towards horizontal objectives of common interest, including cohesion objectives. Since Stockholm, the Council has adopted further sets of conclusions on state aid, all built around the principle of “less and better state aid”, which, Heads of Government recognised, is “a key part of effective competition.”

B.2. Correction of market failures

It is important to note here that not all state aid is bad. **Better state aid,** such as horizontal aid to increase the level of risk capital and research and development, is **correcting market failures** with a view to improving **productivity and achieving a more efficient allocation of resources**. Furthermore, allowing incentives to enterprises to increase their levels of employment, in particular of workers who suffer from a disadvantage, increases **participation in the labour market.**

These types of aid are justified, but it is essential that the state aid rules be carefully designed so as to target the market failure precisely and keep the distortion to a minimum. Allowing the aid poses a risk of distortion of competition, which will harm competitiveness. On the other hand, forbidding the aid poses the risk of missing an opportunity to correct a market failure, which could foster competitiveness. In practice, it is a difficult task to achieve the right balance and get the economic incentives exactly right. This is why I have stressed that economic underpinning of state aid policy is crucial to an integrated approach to competitiveness.

To sum up at this stage, in my view state aid policy plays a crucial role in the integrated approach to achieving competitiveness and the direction in which we have to go in the current context is obvious: we must **apply a strict and proactive economics-based approach** to state aid policy.

C. State aid granting by Member States is on the right track

Let us now turn to the performance of Member States. The Commission's state aid Scoreboard indicates that the majority of **Member States appear to be responding positively** to the call for "less and better targeted state aid".

From the relatively high levels of state aid in the early and mid-nineties, the overall volume of aid fell dramatically from €67 billion in 1997 to €52 billion in 1999. Between 1999 and 2002, total aid continued to decline, though less sharply than in previous years, falling by just over €1 billion a year on average. The overall level of state aid granted by the fifteen

Member States was estimated at €49 billion in 2002. **Virtually all Member States have reduced aid levels as a percentage of GDP**: total aid fell from 0.64% of GDP in 1999 to 0.56% in 2002. Let me remark that all these figures exclude state aid granted in the fields of agriculture, fisheries and transport.

The other commitment given by Member States concerns the **redirection** of aid away from the potentially more distortive sectoral and ad-hoc aid towards aid for horizontal objectives. Here again the results are encouraging. The share of aid granted for horizontal objectives increased by seven percentage points over the period 1998/2000 to 2000/2002. In fact, around 73% of total aid in 2002 was granted for horizontal objectives including R&D, SMEs, the environment and regional economic development. The remaining 27% was aid directed at specific sectors such as manufacturing, coal and financial services.

However, the degree to which this positive trend could be observed varied between Member States. In several Member States - Belgium, Denmark, Greece, Italy, the Netherlands, Austria and Finland – virtually all the aid granted in 2002 was earmarked for horizontal objectives, including cohesion. On the other hand, some Member States have regularly awarded aid to rescue and restructure ailing firms.

The handing out of state aid also faces **constraints from national public finances**. Less and more efficient aid obviously reduces the strain on the budget and wastes less taxpayers' money. It is therefore worth mentioning that Member States have begun to exchange information on ongoing efforts to reduce and redirect aid and to evaluate the effectiveness of state aid measures.

D. State aid policy in the pipeline

Let me now turn to the state aid policy developments in the pipeline. Of course, I cannot address this subject without an immediate reference to **enlargement**.

The Commission has been actively preparing for enlargement for some time. Following the completion of the negotiations, the work has been focused on implementation of the transitional mechanism in the Act of Accession and on the screening of measures which the acceding countries have proposed as existing aid.

This existing aid mechanism has been set up for examining measures which were put into effect in the acceding countries before 1 May 2004 and are still applicable after that date in order to prevent incompatible aid from being "imported" into the EU on the date of accession. The mechanism provides acceding countries and economic operators with legal certainty as regards state aid measures that are applicable after the date of accession. If a measure qualifies as "existing aid", it benefits from special protection against actions by the Commission.

The Commission will have to deal with the additional workload created by examining state aid measures in the ten new Member States, working in new

Community languages, alongside the existing workload.

With 25 Member States, it will become even more crucial that the rules meet their objectives; that they are crystal clear; that procedures are simple; and that cases with a large impact on competition are given the highest priority. In the light of this, I would like to emphasize the following three instruments which are currently under development:

1. The state aid rules and services of general economic interest.
2. Review of the rescue and restructuring guidelines.
3. The "significant impact test"

D.1. Services of general economic interest

The question of the efficient functioning of services of general economic interest is of particular importance to citizens and enterprises and it is essential, therefore, that Member States obtain a clear picture of the interplay between state aid rules and services. The European Court of Justice has given important guidance in its *Altmark* judgment. Under certain conditions, public service compensations do not constitute state aid and, consequently, they are <u>not</u> subject to prior notification to the Commission.

However, to our knowledge, most of the existing systems of public service compensation actually do not meet these conditions. Therefore, with a view to providing legal certainty, the Commission has adopted a draft decision concerning the application of Article 86 of the Treaty to state aid in the form of public service compensation. The objective is to **specify under what conditions compensation which does constitute state aid can nevertheless be declared compatible with the Treaty**. A further aim is to **make clear that compensation schemes which meet the specified conditions are exempted from prior notification**. The decision will be applicable to small services of general economic interest, hospitals and social housing undertakings. For large undertakings, a draft Community framework has also been prepared. This framework will set out when compensation which constitutes state aid can be accepted, and here prior notification to the Commission remains necessary.

I think these draft instruments emphasise that Community law in no way restricts the capacity of Member States to provide high-quality public services for their citizens, but rather serves to prevent harmful abuses, in particular the use of public funds to cross-subsidise activities in sectors open to competition.

D.2. Review of the rescue and restructuring guidelines

We have also put forward a draft proposal to **replace the current rescue and restructuring guidelines**. This has been done for a number of reasons: the current guidelines expire in October 2004, and I have encountered certain shortcomings where the current guidelines do not meet their objectives.

More specifically, I propose to allow certain urgent structural measures during the rescue phase. We also suggest a simplified procedure for emergency aid, if the aid is limited to an amount calculated on the basis of the operating cash flow for the previous year and does not exceed €10 million. As a further simplification, we propose no longer to assess the viability of the restructuring plan for SMEs, thus allowing more of our resources to be focused on bigger cases.

We have also found it **necessary to tighten the rules**. For instance, we propose stricter rules for allowing aid for new companies and more precise rules to avoid repeated rescue operations. Furthermore, minimum percentages of contribution from the beneficiary should be required in order to demonstrate that the markets believe the company will return to viability and to ensure that restructuring aid will be limited to the minimum required to restore viability.

I am not surprised that a few Member States find my proposal too strict, but I can only repeat what I have said already: keeping ailing companies alive with state aid is not a responsible and sustainable reaction to structural problems in the economy.

D.3. "Significant impact test"

The third instrument I would like to mention is the s**ignificant impact test**. Today, the Commission must thoroughly analyse every distortion of competition, no matter how minor and confined to a specific Member State it might be. This is simply not workable in an enlarged Union. Ways must be found to **give the highest priority to cases which pose a significant threat** to competition in Europe.

DG Competition is therefore reflecting on this additional instrument for identifying aid measures which can be dealt with more quickly because the distortion of competition or of trade between Member States is considered to be of less or no concern.

D.4. Comprehensive review in 2005-2006

In 2005-2006, a large number of the Commission's existing regulations, frameworks and guidelines come up for renewal. These changes include state aid exemption regulations, the regional aid guidelines, the framework for research and development aid and the risk capital guidelines.

It is clear that one of the big challenges will be to **redefine regional aid policy** in an enlarged Union, reconciling the overall reduction of state aid volumes with the Community objective of economic and social cohesion within the framework of enlargement.

E. Conclusion

Ladies and Gentlemen, to conclude, the current context underlines the need to ensure a **strict and proactive economics-based approach to state aid**. It is a core part of an integrated approach to competitiveness – not a contradiction. Our scoreboard shows that **Member States are on the right track, granting less and better state aid**, although some States have still some way to go. Also, as regards policy development, we are on track. I believe my review of policy changes in the pipeline shows that **state aid policy is indeed undergoing substantial development** and that the Commission is taking very deliberate steps to ensure that the state aid rules take into account a Union of 25 Member States and that the rules contribute to the objectives of competitiveness and economic reform in the Member States.

Thank you for your attention.