ECONOMIC CRISIS AND STATE AID PERSPECTIVES

Application of EU state aid rules in times of financial and economic crisis

Conference of the Romanian Competition Council

Bucharest, 24 February 2009

Dr. Herbert Ungerer, Deputy Director General with special responsibility
for State Aids, European Commission, Directorate General Competition

Ladies and Gentlemen,

I have followed with great pleasure the invitation by the Romanian Competition Council to speak at this major conference held under the auspices of the EU twinning project linking Romania with its partners (the UK and Germany) in this field. This project and the framework it offers stand as an example for the exchange of experience and know-how which are at the heart of the European project – and this exchange of experience is of course of essence in coping with the economic crisis that we are facing across the Union, as a consequence of the well known developments in the global financial and economic markets.

Member States in the European Union have countered the crisis in the banking sector with a series of measures and crisis packages - Romania is one of them, the UK and Germany are others, and I am sure that we will hear more about this during this conference. The European Council has emphasised the urgent need for coordination of those economic and financial packages of an unseen dimension, and it will meet for another extraordinary meeting during next weekend. In response, the European Commission has established a framework for recovery with the European Economic Recovery Plan submitted on 26 November last Autumn and proposing a global effort of 200 bio € of both demand and supply side measures.

It is in this context that the Commission has issued in rapid sequence a series of communications setting out a clear framework for the application of State Aid rules to the measures undertaken to cope with the crisis situation – establishing common principles to be followed but also ensuring necessary discipline in budgetary assistance to companies. Within the time given, let me therefore briefly cover (i) the main reasons for continuous state aid control during the crisis, (ii) an overview of the Commission's approach in the state aid field to the crisis in the banking sector, and (iii) an overview of our current practice in order to tackle the spill-over effects of the financial crisis into the real economy.

[Reasons for state aid control in time of crisis]

The financial crisis has hit all Member States during the last few months, both old and new. It has now spilled over EU wide into a crisis in the real economy, as all recent economic indicators show. And the recent months have also shown once again that State aid rules are indispensable for maintaining the single European market – the ultimate guarantee for economic security and future growth of all of us.

EU State aid rules have helped Member States to find coordinated solutions, have given legal certainty to the measures taken by them in record time and have contributed to maintaining a level playing field.

The latter is particularly important. The basic objective of EU State aid rules is to ensure a level playing field for all European companies and avoid that Member States engage in a wasteful subsidy race which would be non-sustainable for individual Member States and detrimental to the EU as a whole. It might always be tempting for Member States to adopt protectionist measures which might seem suited to safeguard national companies in the short term, and particularly so in high profile sectors such as the car industry. But untamed, such policies would do nothing else but export problems to other Member States, and ultimately lead to deep frictions between deep pocket Member States and those with less deep budgets. And this would be disastrous particularly in a crisis situation of the magnitude which we are currently living. As we have seen in the 1930s' global crisis, protectionism might seem to offer short term pain relief but it does not offer a cure or any guarantee of future economic health. Maintaining State Aid coordination and discipline in such a situation is the only way, to avoid Member States trying to outspend each other, and ultimately outspend the budgetary possibilities of all.

In the financial sector, the application of state aid rules is a vital European contribution to a coordinated reaction to the threats to the stability of the financial system as a whole.

In the real economy, state aid rules act as a *catalyst* for keeping the common goals of European competitiveness in mind even during the crisis. The European Economic Recovery Plan has shown that short term measures to get us through the crisis *should and can* be linked to the Union's long term common goals: promoting recovery, jobs and growth *through* a greener economy, tackling climate change, promoting R&D&I, training of workforce and social and regional development.

Loosening state aid rules at this very moment would risk a disintegration of the European Single Market, a split between Member States into have's and have not's with a strong impact on the macro-economic balances, the rise of protectionism, and the loss of the dynamics for development of equality of opportunity across the Union, as expressed by its cohesion funds and policies.

[Financial Crisis in the banking sector]

From the very beginning of the outbreak of the banking crisis in mid-September 2008, and particularly after the failure of Lehman Brothers, the objective of the European Commission in the field of competition policy in the sector has been to support financial stability. We have acted rapidly to give legal certainty to the measures taken by EU Member States under emergency circumstances, with a view to the systemic importance of the banking sector in all of our Member States economies.

In legal terms, this has meant to activate Article 87.3.b of the EU Treaty, allowing special provisions and state aid measures "to remedy a serious disturbance in the economy of a Member State". In procedural terms, it has meant that we have established fast track procedures which allow assessment and agreement on notified measures within a matter of days where needed. However, as EU Competition Commissioner Kroes has set out in her OECD speech last week, while "individual Member States should retain the choice of which particular scheme best suits their budgetary and banking circumstances, the need for coordination and consistency is non-negotiable". And this means in practice that schemes or individual measures concerning assistance to banks in the current crisis must be notified to the Commission for screening under its State Aid control powers.

Understandably, Member States want to have sometimes a special approach for their own banks. But it is the Commission's task to remain an objective and fair arbiter in order to avoid serious distortions of competition and a disintegration of the internal market. We want to avoid discrimination in favour of national banks and ensure that national measures do not simply export problems to other Member States. And as many here will know, we have acted with determination wherever there were indications that this would happen.

Since the start of the crisis, the Commission has acted rapidly to establish operational guidelines along these principles. It has issued to date communications setting clear frameworks for issuing guarantees to banks and for recapitalisation of banks. The treatment of impaired assets on bank's balance sheets where they exist and where public intervention is needed, will be next.

General and Recap Communications

In its first "Communication on the framework for the application of State Aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis" issued last October[1], the Commission clarified its general approach and provided guidance on a number of types of State intervention in the banking sector, particularly on State guarantees which were the most widespread response to the crisis in a first phase.

When the recapitalizations of banks moved into the focus of attention, the Commission rapidly followed up in December with detailed information on the assessment of such measures under State aid rules with a second "Communication on the recapitalization of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition."[2]

[1] OJC 270/8, 25.10.2008
[2] OJC 10/2, 15.1.2009

These communications have proven to provide crucial guidance on how to take effective measures to stabilize financial markets and ensure sustained lending to the real economy – without creating undue distortions of competition.

The methodology set out in these guidance documents has permitted the swift design and approval of a large number of national schemes and individual measures to tackle the crisis whilst avoiding harmful economic imbalances between banks and between Member States.

In the last 16 weeks, the Commission has adopted more than 40 decisions on schemes or individual measures across the Union, most of them concerning major banks in the Member States and vital to the future working of the system. We have acted quickly to restore confidence in the market. In adopting these decisions we have provided clarity and legal certainty to the Member States, we have maintained the notification discipline and we have demonstrated that EU State aid policy reacts in a pragmatic and responsible way to the evolving market circumstances – firmness on principles, speed and flexibility on procedures.

However, as Commissioner Kroes has set out last week, major tasks are ahead. A European Commission position on principles for cleansing bank's impaired assets, where they exist, is to complement the communications on guarantees and recapitalisation. We are preparing for a *review process* of the approved rescue aids. And we will have to do our job wherever aid has not been notified.

Let me then turn to the real economy.

[Real Economy]

The financial crisis in the banking sector has started to have a hard impact on the *real economy*, as is known to everybody here. Banks are deleveraging and becoming more risk-averse as a consequence of the banking crisis and their resulting situation. Even initially healthy companies have started to experience difficulties in accessing credit. A serious downturn has started to affect the wider economy. Member States have started to react with economic stimulus packages – in line with the Commission's recommendations under the European Recovery Plan.

The challenge for the Commission is to avoid uncoordinated public intervention which would distort competitive conditions and undermine the very objective of the Internal Market. Demand side measures – measures aiming at the injection of purchasing power, insofar as general and in line with internal market rules – will usually not raise State aid concerns. These measures may include for example consumer oriented measures, such as scrapping schemes for old cars, or social measures, such as schemes for unemployed workers. However, we have to follow very closely supply side measures targeted directly at undertakings, particularly in highly sensitive sectors, such as the car industry.

First, let me recall that there are a large number of *existing* "state-of-the-art" State aid instruments which offer a framework for Member States to remedy many crisis-related problems in the real economy. These include state aid measures falling under the EU's Regional Aid Guidelines, the EU's Environmental Aid Guidelines, and the R&D&I Framework which set a clear framework both for national measures and/or combined with the interventions by the EU's structural funds and the EIB. And, as well known in this country, we have substantially facilitated the use of these frameworks and others by issuing the General Block Exemption Regulation last summer which exempts many measures even from the notification requirement to the Commission – as long as these measures are in line with the conditions set in the Regulation. This applies in particular for measures targeting Small and Medium sized Enterprises where the Commission has issued last month a handbook for facilitating compliance with the existing rules even further.[3]

However, in December it became apparent that the magnitude of the economic crisis would require special measures. The Commission adopted the "Temporary Community Framework for State aid measures to support access to finance in the current financial and economic crisis".[4]

This Temporary Framework gives Member States special possibilities to tackle directly the effects of the credit squeeze on the real economy. The Temporary Framework is limited *in time* (valid only for measures adopted up to end 2010), and maintains the requirement of *notification* for all schemes or measures falling within its provisions. In line with the approach in the banking sector, it is based on the exceptional provisions of Article 87.3.b of the EU Treaty.

Under the framework, Member States may grant the following measures which will be considered as a compatible under EU state aid rules:

[3] Handbook for Community State Aid rules for SMEs, DGCOMP website, http://ec.europa.eu/competition/index_en.html
[4] OJC 16/1, 22.1.2009

- Schemes providing for lump sums of aid up to €500,000 per company for the two year period, to relieve them from current financial difficulties;
- state guarantees for loans at a reduced premium for all enterprises, both working capital and investment;
- subsidized loans for all enterprises, both working capital and investment,
- increased interest subsidies on loans for the production of green products;
- risk capital aid up to € 2.5 million per SME per year in cases where at least 30% of the investment cost comes from private investors;
- relaxations concerning existing conditions for public support for export credit insurance.

Granting of aid under these provisions is subject to certain conditions set out in the Communication. Le me also be clear: State aid should not be used to postpone or avoid necessary restructuring of companies facing structural difficulties, even under conditions of crisis. The Temporary Framework does not apply to companies whose problems date from before the crisis – a date set at 1 July 2008 in the Framework. For those companies, the EU's Rescue and Restructuring Guidelines continue to constitute the most adequate tool to restore long-term viability. In such cases, a restructuring operation which ensures long-term viability remains the adequate response.

In the meantime, most of the major stimulus packages – as far as they fall under aid to companies – have been filed with the Commission under the Temporary Framework, with many more cases in the pipeline. We have adopted schemes and measures filed in compliance with the Framework in record time.

In order to provide guidance on the application of the Temporary Framework in practice, the Commission has set up an Economic Crisis Team to serve as a first point of reference for all stakeholders. Contact points have been published on our website. Our teams are standing by to help.

At this point in time, we have still not received notifications from Romania concerning the crisis measures planned or taken in this country. We have however established a good record of cooperation with the Romanian authorities in other fields of State Aids, such as on ongoing privatizations. Based on the experience in the Craiova automobile case and the decisions on state aid measures taken in that context, we have established jointly with the Romanian authorities a pre-consultation mechanism on privatization cases, and we have screened in the context of this close and very fruitful cooperation more than 30 cases, now cleared in their vast majority – in a number of cases with a number of modifications. We have also noted that the Romanian authorities have very actively taken up the new possibilities provided under the General Block Exemption and that extensive programmes in the fields of R&D and regional development have been set up under these provisions. We are confident that this experience of close cooperation will very soon extend to the measures taken in Romania both as regards the financial sector and the real economy.

[Conclusion]

Ladies and gentlemen, Commissioner Kroes said in her speech of last week at the OECD that "Brussels can set the tone of response to the crisis and we can coordinate and enforce fairness, but we need all hands on deck". She added "The hands are many – Member States, the Council, ECB, EIB, the Commission and our international partners. The answer must come from all of these partners".

This sets the framework for the application of State Aid rules in the current crisis. Let me end on this note.