



## ECONOMIC POLICY COMMITTEE

THE PRESIDENT

Brussels, 8 September 2005  
ECFIN/EPC(2005)REP/53851

Dear Mr Lowe

***State Aid Action Plan - contribution by the Economic Policy Committee to the consultation on a roadmap for state aid reform 2005-2009***

I am pleased to enclose the contribution of the Economic Policy Committee (EPC) to the Commission's consultation on state aid reform. As a preparatory committee for the Ecofin Council, the EPC works particularly on policy questions linked to economic reform and the Lisbon strategy. The Committee also works closely with the Competitiveness Council and its preparatory bodies. The EPC agreed, at its 1 September meeting, that the reform of the state aid framework was an important part of the economic reform agenda, and necessary to make progress towards the Lisbon goals.

The EPC strongly supports Commission plans to reform the state aid framework. It believes that the objective of such a reform should be an overall reduction of state aids, and better targeting of those that remain, to remove distortionary interventions in markets and to promote sound fiscal policy targets. The EPC strongly welcomes the intention of the Commission to apply a strengthened economic approach to state aid analysis and its effects on competition. It was felt that this approach should be pursued in the context of precise and strict criteria. Overall, the state aid system should be made simpler, more transparent and less burdensome to operate.

I hope the Commission will take these views into account when formulating its concrete proposals for reform.

Yours sincerely,

Joe Grice

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**Contribution by the EPC to the Commission's consultation on State aid reform**  
**(“State Aid Action Plan”)**

2. The European Council in March 2005 called on Member States *“to continue working towards a reduction in the general level of State aid, while making allowance for any market failures. This movement must be accompanied by a redeployment of aid in favour of support for certain horizontal objectives such as research and innovation and the optimisation of human capital. The reform of regional aid should also foster a high level of investment and ensure a reduction in disparities in accordance with the Lisbon objectives.”*

3. State aid rules are an important part of ensuring a level-playing field for competition in the Internal Market and a further opening up of European markets, as part of the renewed Lisbon Strategy to foster growth and employment, by a reduction in the general level of state aid (“less aid”), and a redeployment of state aid in favour of support for certain horizontal objectives as well as social and regional cohesion and improved public services (“better targeted aid”). The Economic Policy Committee (EPC) recalls the 2005-2008 Broad Economic Policy Guidelines (BEPGs) that *“the review of state aid rules should lead to a further push in this direction”*. The latest EU State Aid Scoreboard compiled by the Commission has revealed a certain shift in aid towards horizontal objectives, but no overall decrease in levels.<sup>1</sup>

**Approach of the Action Plan**

4. The EPC welcomes the commitment for a comprehensive reform of state aid rules, set out in the Commission’s consultation on the “State Aid Action Plan”, an indicative road map for state aid reform during the period 2005 to 2009, whereby the same general principles will be applied to all instruments.<sup>2</sup> The Committee also supports the intention of using the state aid rules to encourage Member States to contribute to the Lisbon Strategy by focusing aid on improving the competitiveness of EU industry, creating sustainable jobs, promoting social and regional cohesion and improving public services. This could also help improve the contribution state aid can make in respect of the quality of national public finances (see BEPGs guideline No. 3).

5. The objective of the reform should be an overall reduction of state aids, and better targeting, so as to refrain from distortionary public intervention in the markets and to facilitate the achievement of sound fiscal policy targets. The Committee emphasises the importance of a principled approach to the use of state aids, along the following lines:

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<sup>1</sup> See: [http://europa.eu.int/comm/competition/state\\_aid/scoreboard/](http://europa.eu.int/comm/competition/state_aid/scoreboard/)

<sup>2</sup> [http://europa.eu.int/comm/competition/state\\_aid/others/action\\_plan/](http://europa.eu.int/comm/competition/state_aid/others/action_plan/)

- State aids policy should support the Lisbon strategic objective of making the EU a highly competitive, dynamic, knowledge-based economy, that is able to perform and compete effectively in the global economy;
- State Aids should, in general, only to be used where there is genuine and well-identified market failure (“market failure test”);
- State Aids should only be used where other less distortionary tools are not available to address a problem, e.g. regulatory improvements or the removal of barriers to letting the market provide capital (i.e. avoid “second-best measures”);
- Chosen instruments for support must ensure net benefits for society, not replacing market failure with public failure (e.g. due to information asymmetries);
- Once the desired objective has been achieved, or is no longer justified; if a better instrument becomes available for achieving the objective; or if it cannot be achieved with this type of measure the state aid should be withdrawn (“sunset clause”).

6. The EPC strongly welcomes the intention of the Commission to apply a strengthened economic approach to state aid analysis and its effects on competition. The Committee considers that there are considerable benefits in greater ex-ante clarity on the identification of market failure situations and in the assessment of the aid measures to remedy those failures. This approach should however be pursued in the context of precise and strict criteria, as stable rules and regulations are an overarching goal to provide a business-friendly environment. It should also be emphasised that not all market failures can be corrected by state interventions. The state aid system should be made simpler, more transparent and less burdensome to operate. Effectiveness considerations should have a strong role to play.

7. The economic approach of the Commission for the analysis of state aids should also take into account the impact of direct and indirect public aids offered to enterprises in countries outside the EU.

### ***Distortions to competition***

7. The Committee considers that the Action Plan provides no information on how distortions should be assessed, however, or how distortions to competition should be weighed against the benefits of supporting objectives of common interest. At present the state aid rules do not discriminate effectively between small aids with little risk of distortion (other than aids below the de minimis threshold) and larger aids which have a greater potential to distort competition. This is a major weakness of the current system, which the Commission should address in terms of a strengthened economic approach.

### **Horizontal state aid**

8. The Commission plans to review each of the horizontal state aid guidelines. Irrespective of the Action Plan, the programme for review of the guidelines is largely set by the period of validity of the current guidelines. However, there is little detail on precisely what changes may be made to most of these guidelines.

### ***R&D and innovation***

9. The Action Plan, although giving more detail on state aid for R&D and innovation, does not set out exactly what is meant by innovation or what aids might be allowable under this heading.

10. It defines innovation as follows: *“Innovation is related to a process connecting knowledge and technology with the exploitation of market opportunities for new or improved products, services and business processes compared to those already available on the common market and encompassing a certain degree of risk.”* The Committee suggests that innovation should be understood not only as technological innovation but in a broader sense (see BEPGs guideline No. 8), as the successful exploitation of new ideas and skills, turning knowledge into new and profitable market products, services, models or processes. Often it involves new technologies, but not always.

11. The European Council on several occasions identified the low levels of private R&D investments in the EU as one of the main explanations for the EU-US innovation gap.<sup>3</sup> Strengthened business investment in R&D and innovation is therefore a particular priority. However, also this type of investment should be strictly subject to both the existence of market failures and the prevention of market distortions. The Committee considers that a reasonable basis for a public subsidy to a private firm could be a right for the public to share in the proceeds of the products corresponding to the share of financing.

### ***Small and medium-sized enterprises***

12. To facilitate the start-up of new enterprises, the Commission intends to review the communication on risk capital, in order to consider the need to further increase the flexibility for start-ups and young, innovative SMEs, where this can properly address identified market failures. The Committee considers that such instruments should be horizontal in nature and not targeted to specific sectors. The review should also look into how publicly supported risk capital instruments share upside risks and not just downside. In this context, the Commission could also review the definition of small and medium-sized enterprises (currently less than 250 employees).

### **Regional aid**

13. The section on regional aid sets out its role in supporting convergence, but does not indicate which regions should be eligible for support, and to what level. While the current rules allow less prosperous regions more leeway to use state aid for this purpose, the EU enlargement implies considerable widening of income disparity within the Community.<sup>4</sup> The encouragement of economic convergence between the regions of the Community is largely a process of structural reform as the economic success of a number of Member States in recent years shows. In this context, the Committee on several occasions has noted the need for more data on areas of regional divergence as well as convergence.

14. The Committee therefore considers that the enlarged EU should have a regional policy structure (including ERDF) which, first of all, favours and encourages structural reform. In this respect, further clarification is needed as regards aid to horizontal purposes linked to the Lisbon agenda (point 43 of the Action Plan). There could also be a reference to the reduction of the technological gap between regions. The review should:

- Ensure that Member States' efforts to encourage economic development and cohesion within their own borders distort competition between Member States to the least extent possible;

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<sup>3</sup> See also the latest European Innovation Scoreboard,  
<http://register.consilium.eu.int/pdf/en/04/st15/st15189.en04.pdf>

<sup>4</sup> Third progress report on economic and social cohesion,  
[http://europa.eu.int/comm/regional\\_policy/sources/docoffic/official/reports/interim3\\_en.htm](http://europa.eu.int/comm/regional_policy/sources/docoffic/official/reports/interim3_en.htm)

- Reduce the overall level of intensities for aid allowed for the purpose of regional economic development;
- Take into account the finding of economic research that discretionary aid to individual firms tends to be both distorting for trade between Member States, and ineffective as a national/regional development tool.

15. The Commission notes that state aid control can help prevent a damaging subsidy race between regions, and help create incentives for jobs and growth in the least-developed regions and elsewhere, but does not explain how these different objectives can be achieved. The Action Plan, whilst acknowledging the valuable role played by well targeted regional state aid policy in promoting economic convergence across the EU, should therefore in particular be clearer about the negative impacts of regional aid on competition, and the benefits of replacing it with horizontal aid.

### **Raising the effectiveness of state aid**

16. Each Member State, in line with subsidiarity, bears responsibility for the assessment of the budgetary effects of state aids and their control regarding effectiveness and efficiency. Against this background, the Committee regrets that the Action Plan does not consider the leading role of Member States in assessing the **value for money of state aid** and in evaluating its effectiveness. In a context of increasing pressure on budgets, it becomes more important to use public resources efficiently, i.e. to reach the stated objectives of society at minimum cost. Better understanding of the effectiveness of state aid would also help in determining whether it would offset potential distortions to competition. In this context, impact assessments which take a detailed look at how specific inputs (e.g. expenditure on innovation and R&D) affect outputs (e.g. number of patents per million population), should have a role to play.

### **Streamlining State aid procedures**

17. The increasing complexity and number of various different rules and guidelines progressively adopted by the Commission over time have created the strong need to streamline state aid policy. The Action Plan proposes a range of measures to simplify and speed up the state aid control process. Some of these measures simply involve combining and simplifying the various state aid guidelines and frameworks. This will be a useful step, but on its own it will not make a dramatic difference to the process of determining whether state aids can be approved. The Committee considers that precise time limits for state aid procedures should be fixed in order to avoid prejudicial uncertainties for enterprises. The possibility of a two-phase examination (the second phase being reserved only for the most important cases), which has already been set up for merger control, should be considered for state aids. The Committee therefore considers that there is a strong case for introducing foreseeable and limited deadlines for state aid procedures.

18. The Commission rightly observes the shortcoming of the long time frame for the treatment of state aid cases.

19. The Committee in particular welcomes:

- The intention to issue a general block exemption regulation in a single act to simplify and consolidate the existing block exemptions and integrate a broader range of exemptions. However, the Action Plan does not propose integrating state aid control for agriculture and transport with the controls for other sectors. This potentially represents a missed opportunity for simplification. Moreover, the Action Plan does not indicate how the Commission would propose to allow aid to tackle market failures which are not

covered by the current guidelines, such as market failures in land and property markets.

- The intention to increase the threshold under which Member States may grant de minimis aid without further specific requirements, so as to take account of the evolution of the economy, (currently 100,000 euros). In previous statements, the Commission considered a new amount of 150,000 euros as realistic.
- The intention to clarify the state aid rules for the assessment of public resources involved in Public Private Partnerships, and the intention to integrate the Multisectoral Framework on regional aid for large investment projects into the review of the Community guidelines on regional aid.

20. The Committee reserves its position on the review of the notice on state aid in the form of guarantees, in particular as regards the link with the introduction of the revised international capital framework under Basel II.

21. The Action Plan considers whether there may be a role for **independent authorities in Member States** to assist monitoring and enforcing state aid. The Committee feels that it is not immediately apparent how this would assist in reducing bureaucracy or overall workload.

22. The Action Plan considers the possibility of **enhancing consultation with market participants** ("working with the markets") and other means of gathering relevant sectoral information. This may help in gaining a better understanding of potential impacts, but it would be important to avoid slowing the decision-making process.

23. At the moment control of state aid is an exclusive competence of the Commission. If the **division of labour between the Commission and the Member States** should be changed there would have to be mechanisms to ensure the consistent implementation of the rules and control in the Member States. Intended changes to the procedural regulation 659/1999 need to be carefully considered, also in terms of not increasing the work-load for the Member States.

## **Conclusion**

24. The Action Plan is a useful step forward in setting out how state aid control could be updated and modernised. However, it says little on the crucial question of how distortions to competition should be compared against the potential benefits of state aid. As a result, there is a danger that the state aid system will continue to avoid differentiating effectively between large aids, which have a greater potential to distort competition in the EU; and small aids, which do not cause significant distortions to competition. State aid control must continue to ensure the protection of competition in the Internal Market. The proposals should extend the state aid frameworks where necessary to allow Member States to tackle market failures in areas such as innovation, R&D, SMEs and land and property, while also ensuring they avoid allowing more aid than is necessary to tackle these market failures. And while the proposed simplification of the decision-making process will be welcome, the Commission should be more ambitious than its current proposals, much of which involves tidying up the current arrangements rather than a more fundamental change in approach.

25. These reforms will require significant effort on behalf of the Commission and of Member States in order to ensure a workable system is put in place. Such a joint effort could include the following elements:

- Agreement on a code of conduct for ex-ante assessment of state aid, on how to design aid schemes to ensure value for money, to help Member States focus their state aid in

line with the four principles outlined above, and to reduce distortions to competition. This work, which could be undertaken by the EPC, would also help the Commission in its evaluation of state aid.

- Agreement on precise and strict criteria and stable rules to conduct the process of analysis of state aids in order to provide a business-friendly environment.
- Exchanging good practice on how national aid programmes can be better directed in line with the objectives. This could potentially include: methods of ex-ante and ex-post assessments of aid programmes; increased transparency of state aids within budgets or other overviews of public spending; automatic review processes as the original circumstances used to justify the subsidy will often not remain constant over time.

26. The EPC invites the Commission to take this opinion into account in its consultation process and in drawing up its proposals for next steps. The Competitiveness Council and its High-Level Group may also wish to take these views into account in their discussions of the Action Plan.

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