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Modernisation of EU State aid control: An Economic Perspective

Vincent Verouden, Ph.D.
Adviser to the Chief Economist
European Commission (DG COMP/CET)

Competition

Overview

- Introduction
- A framework for economic assessment
- Outlook: State Aid Modernisation

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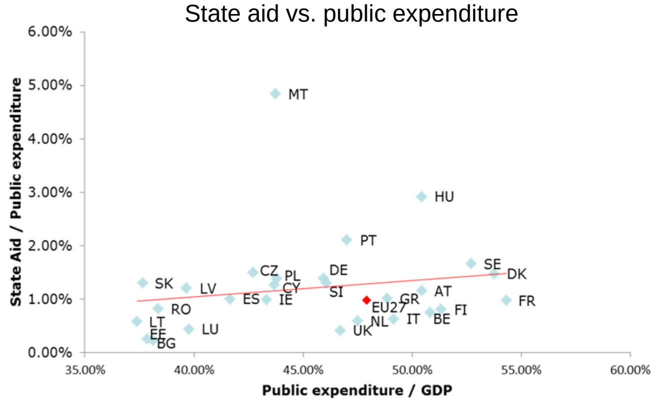
I. State aid in the EU

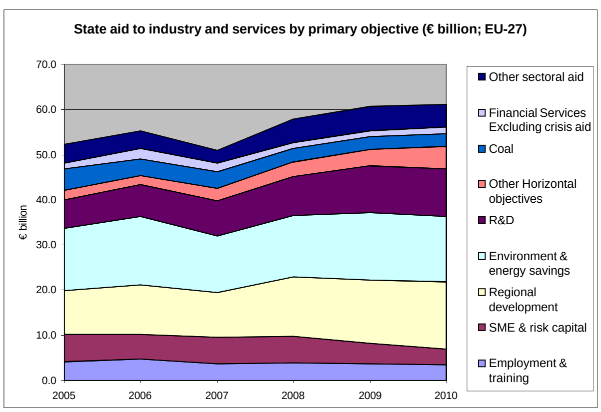
Approx. EUR 60 billion p.a.

- For Industry & Services
- Non-crisis related



Source: Eurostat data (average over 2005-2010)

Main objectives of State aid



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Source: EC State aid Scoreboard (2011)

The "two faces" of State aid

- State aid may pursue sound public policy objectives of the Member States
- State aid may distort competition and trade
  - negative spill-overs on other MS
  - undermine functioning of internal market

Art. 107 TFEU: a two-step approach

- Article 107(1) TFEU: notion of state aid and general prohibition

  "Any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market".

- Articles 107(2) and 107(3), 106(2) TFEU: derogations (aid compatible with Treaty)

Compatible aid under Art. 107(3) TFEU

- Art. 107(3) EC: the following types of aid "may be considered" compatible
  - a) economic development of most disadvantaged regions of Community
  - b) important common European project or serious disturbance in the economy of a Member State
  - c) development of certain economic activities or certain economic areas
  - d) culture and heritage conservation
  - e) other categories as may be specified by a decision of the Council
- Margin of discretion à frameworks and guidelines, block exemption regulations

II. A framework for economic assessment

- Compatibility assessment essentially about striking a (good) balance between
  - Benefits of state aid (objective/effectiveness)
  - Costs of state aid (distortions)
- Necessary to bear in mind: enforcement and compliance costs
  - Architecture of state aid rules: block exemptions vs. more substantive analysis of individual cases (rules based)

Benefits of state aid (objectives)

- Efficiency rationales: correcting market failures, e.g.
  - Externalities
    - positive: e.g. R&D spill-overs, training
    - negative: e.g. environmental pollution, bank failure
  - Asymmetric/imperfect information
    - e.g. imperfect information in financial markets
  - Coordination failure
- Equity rationales: redistribution/cohesion (strong political dimension)

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Effectiveness of state aid

- Key questions:
  - o Does state aid make a difference?
  - o If so, to what extent?
- Requires assessment of the counterfactual
- Concern: aid may not be necessary
  - Recent empirical literature points to potentially important differences in effectiveness of aid between large firms and SMEs
    - *E.g. Criscuolo, Martin, Overman & Van Reenen (NBER, 2012) on regional aid in UK; Wallsten (RAND, 2000) on R&D aid in the US; González, Jaumandreu & Pazó (RAND, 2005) on R&D aid in Spain; Bronzini & Iachini (Bank of Italy, 2010) on R&D aid in Italy; ...*

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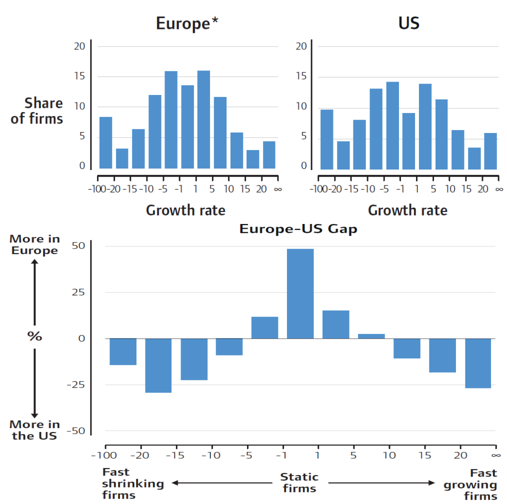
Negative effects of state aid

A. Allocative inefficiencies

» Product market distortions

1. Prevention of exit
   - Economic literature identifies the "churn process" (entry/exit process) within industries as a major driver of productivity growth
     - *E.g. Foster, Haltiwanger & Krizan (2000, NBER; 2006 REStat) for the USA; Disney, Haskel & Heden (2003, Econ J) for the UK; Bartelsman, Haltiwanger & Scarpetta (2004); Bravo-Biosca (2011); …*
   - State aid may interfere with this process
2. Distorting dynamic incentives/moral hazard
   - Important concern in the context of aid to banks (TBTF)
3. Creation or maintenance of market power

Churn process (EU vs. US)



Europe has a larger share of 'static' firms, the US has more fast growing and shrinking firms

Source: Bravo-Biosca (2011)

Negative effects of state aid (2)

Other allocative inefficiencies:

» Input market distortions / locational inefficiencies

» Distortive impact on other sectors

» Shadow cost of taxation
- Particularly relevant where state aid driven by subsidy races

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Negative effects of state aid (3)

B. Distributional concerns (shifts in welfare)

» Across EU Member States
- Example: regional investment aid

» Within Member States
- E.g. from tax payer to owner or beneficiary (particularly when driven by subsidy races)

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III. Outlook: State aid modernisation

- Reform programme 2012-2013
- Builds on State Aid Action Plan (2005)
- Main aims:
  - o Support growth-enhancing objectives
    - - Identification and definition of key assessment criteria ("Common Principles") for market failure, incentive effect, aid to the minimum, appropriateness, distortions, …
  - o Better prioritisation of cases
  - o More streamlined procedures
- Important aspect: market information tools

A preview (some first orientations)

Objective of aid (market failure/equity)	Risk capital: Better targeting of measures aimed at promoting access to risk capital; design 'safe harbours' R&D&I/Broadband: Presumption of no market failure in cases where an aided project replicates what the market already offers
Incentive effect	Generally: More emphasis on incentive effect/counterfactual
Aid to the minimum	R&R: "burden sharing" requirements Generally: leveraging private investment
Appropriateness	Environmental: design aid such that it does not undermine regulation or market mechanisms (e.g. in the context of CO2 emissions: preserve price signals of ETS) R&D&I: (conditional) loans in case of liquidity issues; grants where risk/return profile not sufficient
Distortions	R&R: "burden sharing" requirements Regional: aid for large projects only in 'a' regions; more attention to sectorial overcapacity Generally: More emphasis on efficient selection of projects (to preserve entry/exit process)

Conclusion

- Rationale of EU state aid control: limiting (cross border) distortions within the EU, while promoting objectives of common interest
- Economic analysis helps in making the trade-offs more explicit, identifying less distortive alternatives à essential for reform

Thank you for your attention