

# **Report of the European Commission to the Council of Ministers: Services of general economic interest in the banking sector**

*(adopted by the Commission on 17.6.1998 and presented to the ECOFIN Council on 23.11.1998)*

## **1. Amsterdam Declaration**

At its meeting in Amsterdam on 18 June 1997 the European Council adopted the following Declaration on public credit institutions in Germany:

*"The Conference notes the Commission's opinion to the effect that the Community's existing competition rules allow services of general economic interest provided by public credit institutions existing in Germany and the facilities granted to them to compensate for the costs connected with such services to be taken into account in full. In this context, the way in which Germany enables local authorities to carry out their task of making available in their regions a comprehensive and efficient financial infrastructure is a matter for the organisation of that Member State. Such facilities may not adversely affect the conditions of competition to an extent beyond that required in order to perform these particular tasks and which is contrary to the interests of the Community."*

Austria and Luxembourg subsequently added the following Declaration:

*"Austria and Luxembourg consider that the Declaration on public credit institutions in Germany also applies to credit institutions in Austria and Luxembourg with a comparable organisational structure."*

The Amsterdam Declaration is based on the Commission's confirmation that the existing rules of the Treaty are sufficient to take into account the possible existence within the banking sector of undertakings entrusted with the operation of services of general economic interest. The text refers particularly to public credit institutions in Germany. However, what applies to Germany and German public credit institutions clearly also applies to private credit institutions in Germany and all public and private credit institutions in all of the Member States.

For this reason the European Council requested the Commission to examine whether situations similar to the German system of public banks exist in other Member States:

*"The European Council takes note of the statement on public credit institutions in Germany. It invites the Commission to examine whether similar cases exist in the other Member States, to apply as appropriate the same standards on similar cases and to inform the ECOFIN Council."*

In line with this mandate of the European Council DG IV, the Commission service responsible for competition, sent letters to all Member States requesting appropriate information about their banking sectors. The responses of the Member States to that inquiry are summarised in point 3 of this report.

Credit institutions throughout the Community, whether or not engaged in the provision of a comprehensive and efficient financial infrastructure, perform a variety of operations. Some of

those operations might be services of general economic interest, others might not. The concept of a service of general economic interest may, itself, evolve with time, notably in the light of developments in the internal market. Article 90 (2) of the Treaty applies not in the abstract, but to specific services of general economic interest with the operation of which undertakings are entrusted. Thus, it remains for the Commission to apply Article 90 (2), in the light of the provisions of the Treaty, notably those relating to the free movement of capital and the freedom to provide services, as well as those relating to state aids, to credit institutions entrusted with the provision of specific services of general economic interest.

## 2. Article 90 (2) of the Treaty

Pursuant to Articles 2 and 3 of the Treaty, the Community is to achieve its objective through the establishment of a common market and an economic and monetary union, and by implementing certain common policies and activities. Thus the Treaty is based on the development of the market and of common policies, whilst providing for intervention, where appropriate, at Community level and by the Member States. The possibilities for Member States to intervene include, though are not necessarily limited to, circumstances in which market mechanisms would not lead to an appropriate allocation of resources or the provision of certain services at acceptable prices. Such situations might justify the Member States' intervention in the market in order to achieve certain objectives in the general interest. The Commission considers that services of general interest are of great importance and lie at the heart of the European model of society<sup>(1)</sup>. The new Article 7d of the Treaty provides that:

*"Without prejudice to Articles 77, 90 and 92, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within their respective powers and within the scope of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions."*

Article 90 (2) of the Treaty provides for intervention by the Member States in the case of undertakings entrusted with the operation of services of general economic interest. This is one of the exceptions provided for in the Treaty to the prohibition on State aids contained in Article 92 (1) of the Treaty. It provides as follows:

*"Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community."*

Thus, the following conditions must be satisfied in order for Article 90 (2) to apply:

! The service in question must be a service of general economic interest and must be accurately defined by the Member State.

! The undertaking in question must be entrusted by the Member State with the provision of such a service.

! The application of the competition rules of the Treaty must obstruct the performance, in law or in fact, of the particular tasks assigned to undertakings entrusted with the operation of services of general economic interest. The exemption should be limited to what is necessary.

! The exemption must not affect the development of trade within the Union to an extent that would be contrary to the Community's interest. It is in the Community's interest that the distortion of competition is kept to a minimum.

The Member States are, in principle, free to determine the services of general economic interest. However, according to Article 90 (3) of the Treaty the Commission must ensure the proper application of the exemption contained in Article 90 (2). That means that the Commission must, where necessary, verify whether or not the service in question can be characterised as a service of general economic interest. In conducting such analysis the Commission will have regard to the nature of the service, as well as to the extent to which the same service is provided by the market on the same conditions, and - in the case of a universal service - particularly the Member State's legitimate objective to ensure continuity of service on acceptable conditions throughout its territory.

If the compensation for the obligation to render a service of general economic interest is fixed as a result of the operation of the market, for example where all interested undertakings are given the opportunity to state the amount of compensation they would require to operate the service on behalf of the Member State, and the undertaking to be entrusted with provision of the service is selected by reference to objective and justified criteria, then there is a presumption that the compensation does not constitute state aid for the service provider. In other circumstances, there is a presumption of aid, but such aid may be considered compatible pursuant to Article 90 (2).

In order to benefit from the exemption provided for in Article 90 (2), the principle of proportionality has to be respected. The compensation for the obligation to render a service of general economic interest must be based on the cost of such specific service. As long as these costs are not over-compensated, are limited to what is necessary for the undertaking to perform the specific service in question and the development of trade is not affected to an extent contrary to the Community's interest, the compensation constitutes state aid but may be accepted under Article 90 (2) if the other conditions are met. Compensation in excess of such amounts cannot be deemed compatible under Article 90 (2).

In each case the Commission must strike a balance between the Member State's right to invoke the exemption, and the Community's interest in a minimal distortion of competition. In striking that balance, the Commission will have regard to the extent to which there is competition in the market, that is, to the extent to which the market in question has been liberalised.

With respect to the liberalisation of the market, the financial services sector has been the subject of Community legislation aiming at establishing fair and open competition. Free movement of capital, right of establishment and freedom to provide services have been widely achieved in this field of economic activities. Competition is already strong and will further intensify with the forthcoming European Monetary Union and the introduction of the single currency. With that in mind, it must be noted that each intervention by Member States in this

sector risks causing significant distorting effects, which can only be balanced by a Community interest carrying particular weight.

Finally, it should also be recalled that the state aid rules of the Treaty do not apply to all state aid but only to aid which affects trade between Member States. Therefore, in so far as state aid measures only have local impact, and do not affect trade between Member States, they do not fall within the scope of Article 92 (1) of the Treaty. Thus, in principle, locally operating savings banks or similar credit institutions of purely local impact benefiting from such measures would not be caught at all by Article 92 (1).

### **3. Responses of the Member States to the inquiry**

The responses of the Member States to the inquiry suggest a distinction between three types of activity:

- ! the provision of a basic financial infrastructure, which covers in full a certain territory;

- ! the execution of certain specific tasks by credit institutions on behalf of a Member State; and

- ! the raising of funds exclusively for a Member State.

The first of these activities, the provision of a basic financial infrastructure, which covers in full a certain territory, is analysed in several other sectors, such as electricity supply, transport or postal services by reference to the notion of universal service. The provision of a basic financial infrastructure will be discussed in point 3.1.

As regards the second activity, credit institutions provide services on behalf of Member States. They are used by the Member States to deliver certain services to companies and/or individuals in order to achieve certain public policy objectives. Examples are promotion of SMEs or of export activities. This issue will be addressed in point 3.2.

Point 3.3. deals with the raising of funds exclusively for a Member State.

#### **3.1. Basic financial infrastructure covering a certain territory**

Beside Germany only Austria assign to a certain group of credit institutions, namely the savings banks organisation, the task of providing a comprehensive financial infrastructure. These two countries hold that this constitutes the provision of a universal service. They also state that it is not only this organisation which delivers financial services all over the country. Also credit institutions or groups of credit institutions not having any obligation to cover a particular area provide certainly comparably dense networks of branches or agencies.

A specific case exists in Sweden. While not considering the operation of a comprehensive financial network to be a universal service, the Swedish authorities oblige one credit institution, a subsidiary of the postal service, which offers banking services at the post offices, to provide a nation-wide payment service network. The credit institution receives a compensation for costs incurred in delivering such services to sparsely populated areas where no other credit institution offers such services.

Thus, in this case it is not the provision of banking services throughout the territory of the Member State, but the operation of certain particular branches which is considered by the Member State as a service of general economic interest entrusted to the undertaking in question. The extra cost of these services, which are not ensured by the market, is then reimbursed by the Member State.

The situation in each of the three countries has to be assessed under Article 90 (2) on a case to case basis.

### **3.2. Special services of credit institutions**

A number of Member States consider that certain credit institutions fulfil specific tasks that constitute services of general economic interest. These tasks comprise mainly:

- ! promotion of small and medium sized enterprises ("SMEs");
- ! granting or guaranteeing of export credits;
- ! social housing loans;
- ! municipal financing;
- ! financing of infrastructure projects; and
- ! regional development.

In some cases such particular task is performed by all or a multitude of credit institutions of a Member State. In most of the cases the services are, however, delivered by specialised credit institutions, especially established for that purpose. The vast majority of these special credit institutions are owned by public authorities. Partly they operate in a private law form, partly they have a public law form.

It seems clear that in most of the cases indicated by the Member States the credit institution supports the state in the fulfilment of some specific tasks. A typical example is the granting of loans to SMEs at low rates, subsidised or guaranteed by a Member State. It is true that the banking infrastructure may well be used to distribute such services. However, it can be questioned whether this distribution itself can be regarded as a service of general economic interest. This has to be assessed on a case to case basis. In any case, all conditions mentioned in Art. 90 (2) (see point 2) would have to be fulfilled to allow for an exception from the competition rules for the provision of possible services of general economic interest.

In some Member States such services are not only performed by certain specialised credit institutions but by all institutions interested in offering them. It might be concluded from this that such services can in principle be performed without the need for any specific intervention by the Member State. In the Commission's view, if each credit institution is free to offer the services on behalf of the Member State on the same conditions and with the same compensation this should in principle not cause problems under the competition rules of the Treaty, in so far as the question of aid to the service provider is concerned. On the other hand, if the performance of a task is entrusted to only one or a limited number of credit institutions it has to be ensured that this is done in a way which is compatible with the rules of the Treaty.

However, any state aid nature can per se be eliminated if all institutions have the opportunity to compete on an equal basis for the service to be rendered. By establishing precise specifications a Member State can ensure that the service is rendered at the desired quality and price level. Free competition between interested service providers is thus ensured.

A few Member States also mention the handling of state payments as a service of general economic interest. However, the Commission takes the view that bank transfers are normal banking business and can be carried out by all credit institutions. The Member States are simply using credit institutions to provide them with a normal commercial service. Of course, it is the Member States' competence to decide to use one or more particular credit institutions; such choice does not differ from other procurement decisions and should be made in line with these rules. This view is underlined by the fact that the Community Directive on public procurement of services makes financial services subject to the rules laid down in that Directive<sup>(2)</sup>.

### **3.3. Raising funds for a Member State**

Some specialised institutions have been established with the objective to raise funds for the financing of a Member State. That means that own legal entities have been created in order to hive off the fund raising activities of the Member State. (For example, municipalities might jointly found a credit institution, guarantee its fund raising activities and receive thereby funds for their budgets at lower rates than by raising them on their own.) These institutions raise funds by normal operations on the financial markets. Here, in the Commission's view the crucial element is that the funds raised are actually used for public sovereign purposes, that is the public non-commercial, non-competitive sector. This is ensured if such institutions operate in a way that all advantages remain within the public non-commercial sector.

This approach of the Commission is based on the consideration that any state support, in whatever form (e.g. public guarantee, compensation payments, loss coverage, foregoing of return) received by a credit institution for the specific task of raising funds for the Member State has to be limited in its effects to the performance of that task and may not spill over in any way into competitive activities of the institution.

The most straightforward solution is obviously to actually restrict the credit institution in question to the performance of the particular task and to keep it from any commercial, competitive activities. This would clearly avoid any problems of (cross-) subsidisation of competitive lending business. However, it seems that this strict line is not always followed in practice. Credit institutions specialised in a service for the state often gradually carry out also more and more other, competitive activities. Such development exists, for example, for certain institutions that have started with pure financial service procurement for a Member State but have gradually developed into normal banking operators and cannot anymore be distinguished from normal credit institutions. But even if such competitive lending business is of minor importance, it might well be of relevance under the competition rules of the Treaty. In order to avoid possible problems under the competition rules of the Treaty the simplest solution is to keep the respective credit institutions legally and in practice away from any competitive activities, or at least to operate separate accounting systems.

The funding of a Member State should be limited in its effects to the non-commercial, non-competitive public sector. That means that public undertakings competing with other enterprises in their respective markets may not benefit from such cheaper financing. Also, it

should be emphasised that the term of non-commercial, non-competitive activities is a dynamic one. In line with the development of the internal market and the liberalisation of more and more sectors of the economy that notion requires a different interpretation in the various Member States as well as repeated re-interpretation over time.

### **3.4. Ownership**

The Amsterdam Declaration refers to public credit institutions. However, according to Article 222 of the Treaty the Community is neutral as regards the national systems of property ownership and the competition rules have to be applied in the same way to private as well as to public undertakings. Neither the one nor the other type may be advantaged or disadvantaged by the application of these rules.

According to the answers of the Member States, public credit institutions exist in one form or the other in all of the Member States. Some public credit institutions operate in a private law form, others are based on public law. However, for the application of the competition rules, what is relevant is not the legal ownership or status, but the actual and potential behaviour of these credit institutions on the markets.

Germany expressly states in its response that the state guarantees the public law credit institutions are benefiting from do not constitute a compensation for any service of general economic interest. It is said that services of general economic interest are performed by the credit institutions in question within their competitive activities. However, it is said that the public guarantees are automatically linked to the public law form and thus protected by Article 222 of the Treaty.

It is the Commission's opinion that it is not possible to justify such guarantees by referring to Article 222 of the Treaty. That Article states that the Treaty "*shall in no way prejudice the rules in Member States governing the system of property ownership*". This stipulates the Community's neutrality as regards public and private ownership. With respect to these questions the Commission may not and does not intervene. However, it is the responsibility of the Commission to ensure that such circumstances do not produce a distortion in the market in which these public institutions operate.

In the Commission's view, if the ownership or legal form of a company produces a distortion of competition which is prohibited by the Treaty, especially the state aid rules, then this legal form must be subjected to the discipline of the state aid rules. The Member States are free to choose the legal form for undertakings, but they have, when doing so, to respect the competition rules of the Treaty. This is clearly laid down in Article 90 (1) of the Treaty without prejudice to Article 90 (2).

In particular, that means that if a state guarantee is linked to a certain legal status of a company, such guarantee may constitute state aid under Article 92 (1), and can not be justified under Article 222 of the Treaty.

### **4. Conclusions**

Only two Member States, Germany and Austria, entrust credit institutions with the task to provide a basic financial infrastructure covering a certain territory. Sweden obliges one credit institution to provide a basic service on a national level. Also, the Member States assign

special services or fund raising activities to certain credit institutions. The compatibility of each of these systems with Article 90 (2) of the Treaty has to be examined on a case to case basis.

**footnotes:**

(1) Commission Communication of 11 September 1996: Services of general interest in Europe (OJ 1996 No C 281, p. 3).

(2) Council Directive 92/50/EEC of 18 June 1992 relating to the co-ordination of procedures for the award of public service contracts, OJ 1992 No L 209, p. 1.