

# Agenda

## Advancing economics in business

### A brave new world? Implications of state aid modernisation

Current reforms to state aid rules could lead to a number of far-reaching changes, with the European Commission focusing on those cases that represent the most pressing threats to the internal market. For cases that pose fewer concerns, Member States would have an increased role in ensuring that aid is in line with the Commission's regulations. How this will play out in practice depends on whether there are sufficient incentives for compliance

The European Commission has set out an ambitious programme of reforms to the rules that are used to assess state aid.<sup>1</sup> These reforms aim to streamline the current, highly complex nature of state aid rules, increase dialogue with Member States, and focus on those cases that are likely to have the most significant impact on economic growth. This article explores the potential reforms to state aid rules in more detail, and, given the backdrop to these reforms, considers what the 'brave new world' of state aid procedures might look like.

The financial crisis of 2007/08, which has since evolved into a eurozone debt crisis, has fundamentally changed the state aid landscape. Since its onset, state aid within the EU-27 has risen sharply, from less than 1% of EU GDP in 2007 to around 13% in the period between 2007 and 2011.<sup>2</sup> Around 900 to 1,000 new state aid cases currently appear each year.<sup>3</sup> The onset of the crisis led to a need to co-ordinate crisis interventions across Member States, intervene quickly, and provide consistent policy responses across the EU.

The financial crisis has also led to changes in the objectives of state aid, with state aid now having a critical role not only in promoting economic growth, but also in ensuring that public budgets are set on a sustainable path.

However, there is currently limited prioritisation of cases, and state aid rules are also highly complex, comprising around 39 separate guidelines and communications. There are also few, if any, legally binding timescales, and the flow of information is typically between the Commission and the relevant Member State, rather than directly with the main parties concerned.

Through its modernisation reforms, the Commission aims to improve the systematic screening of cases, in order to streamline state aid rules and provide for faster Decisions (see the box below).

#### The objectives of the modernisation reforms

The main objectives of the reforms are to ensure the most effective use of public money and to speed up Decisions, with greater emphasis on ensuring the incentive effects of aid.

- **Support for growth-enhancing objectives.** A key objective of the reforms is to ensure that only 'good aid' is granted—ie, aid that aims to rectify actual market failures and is directly linked to the EU's 2020 objectives in terms of stimulating innovation, growth and employment at times of significant budget constraints for Member States.

- **Better-prioritised enforcement.** The reforms target a reduction in red tape for administration and aim to increase efficiency by focusing on the most important and potentially distortive cases.

- **Streamlined rules and faster Decisions.** The reforms also aim to clarify and simplify the rules for state aid, enhance consistency, and streamline the assessment process, while making well-informed Decisions within 'business-relevant' timescales.

Source: European Commission (2012), 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, EU State Aid Modernisation (SAM)', May.

## What might the future state aid landscape look like?

The Commission’s plans to simplify and improve the transparency of state aid rules could lead to a number of wide-ranging changes in the next year or so, as shown in Figure 1 below.

If the reforms go ahead as envisaged, in the ‘new world’ of state aid assessments, the cases that have the greatest potential to distort competition within the internal market will undergo closer scrutiny, and enforcement may become more effective and efficient thanks to Member States taking on increased responsibility. The improved case prioritisation would be accompanied by new information-gathering powers for the Commission, with ‘legally binding’ timescales, as in the current merger procedures.<sup>4</sup> The existing 39 sets of guidelines will be replaced by a smaller number reflecting the overarching common principles.

As discussions during state aid investigations currently take place between the Commission and the Member State concerned, state aid proceedings, perhaps surprisingly, do not always involve the party with the greatest interest in the outcome—ie, the aid beneficiaries themselves. This significantly hampers the Commission’s ability to obtain the necessary information to assess the aid measure. However, under the package of reforms, the parties concerned would be required to provide more substantive and better-quality evidence. This would allow the Commission to obtain faster, more reliable information from market participants, to enable more robust assessments.

## Identifying cases that could pose the most significant threats to the internal market

Identifying the most significant cases is central to enabling the reforms to work as intended. Indeed, the European Parliament has recently called on the Commission to publish detailed identification criteria.<sup>5</sup>

To date, economics has had a limited role in considering possible distortions to competition. Although the legal threshold for the presence of a distortion to competition is low compared, for example, with the standard applied in a merger case, assessments of the potential of a particular measure to distort competition are likely to achieve far greater importance. For example, distortions to competition may be significantly greater if the aid beneficiary has market power, and faces closer non-differentiated competitors, as aid may reinforce this position by further weakening any competitive constraint that other operators can exert.

To identify cases of ‘good aid’, it would be important to accompany this assessment with a more in-depth evaluation of alternatives to aid, as well as the likely impact of aid, than at present.

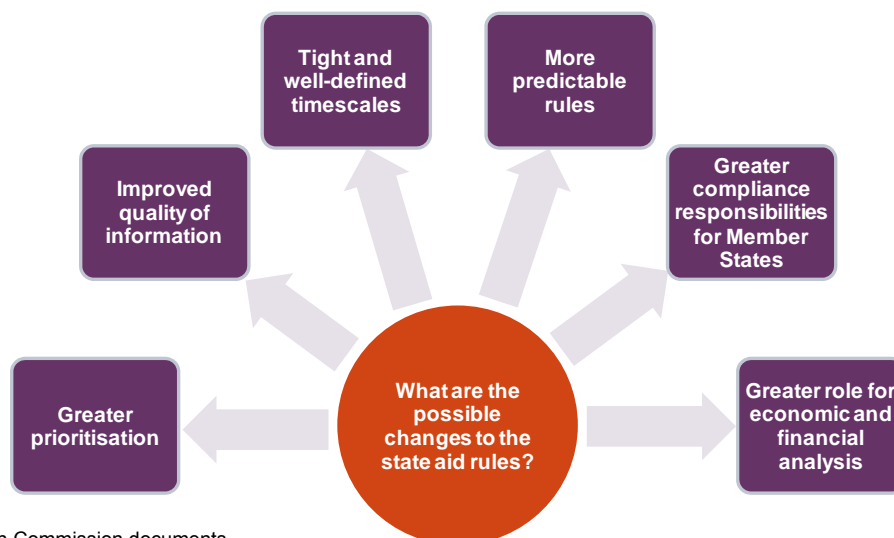
### Are there potential alternatives to aid?

Currently, there is limited scope for detailed analysis to assess the potential for using market alternatives as substitutes for aid. To be able to identify ‘good’ types of aid more easily, economic and financial analysis could play a far greater role in evaluating and weighing up the pros and cons of possible market alternatives.<sup>6</sup>

### Does aid always lead to improved outcomes?

The analysis of the likely benefits of the aid is typically limited, and it is sometimes presumed, without detailed

Figure 1 What might the ‘brave new world’ look like?



Source: Oxera, based on Commission documents.

analysis, that aid will have a positive impact. Under the current structure, such considerations come into play at various stages (eg, in the balancing test), but not always in a coherent way.

Indeed, the Commission has recognised that it has often been presumed that restructuring aid ‘saves a considerable amount of jobs and activities which would otherwise disappear’, without concrete evidence or quantification of these effects.<sup>7</sup> However, a significant proportion of companies that receive aid are likely to fail regardless of the aid. In particular, studies have shown that almost 50% of companies that received rescue aid, and one-third of companies that received rescue and restructuring aid, between 1995 and 2003 did not survive until the end of 2004 (when economic conditions were relatively prosperous).<sup>8</sup> This suggests that there is a wide scope for EU state aid law to make better use of economic and financial tools in defining what aid should or should not be prohibited.<sup>9</sup>

### Assessments of cases that pose the greatest threat to the internal market

The Commission’s reforms are likely to lead to additional ex ante scrutiny, with far greater emphasis on more detailed and comprehensive analysis for the larger, more complex and ‘most dangerous’ cases.<sup>10</sup>

If detailed and better-quality information is available from market participants, there could be a far greater role for sophisticated tools of economic and financial analysis. Combined with an increased role for sectoral guidelines, this is likely to lead to more transparent and predictable rules. As an example of what state aid assessments might look like in the ‘new world’, see the box below.

### How to enforce ‘lighter-touch’ regimes for the smaller cases?

Currently, Member States cannot grant state aid unless it has been notified and authorised by the Commission, except if it is covered by a block exemption. However, in order to allow for greater concentration on those

cases that have the greatest potential to distort competition, the proposals aim to extend the block exemption rules. This would mean that a Commission Decision with a full appraisal would not be required in all cases.

This would give the party with the most interest in ensuring that the aid is granted—ie, the Member State itself—increased responsibility for ensuring that the aid is in line with the Commission’s regulations for block exemptions. The Commission would therefore have to rely more heavily on the Member States for the ex ante assessment, which would require far greater co-operation than at present between the two in terms of enforcement.

As the European Parliament recently highlighted, there is an important question about how, and whether, this can work in practice.<sup>11</sup> For the reforms to work effectively, changes may need to be introduced such that responsibilities for ensuring compliance are taken more seriously. Currently, the Commission’s main remedy against unlawful state aid that has already been paid is that it has to be refunded to the Member State concerned. However, not only is the Commission’s track record of enforcing refunds imperfect, but the current design of remedies also does not have strong incentive or deterrence properties.

This contrasts with other areas of competition policy, where parties have powerful incentives to comply as a result of the combination of a degree of leniency shown to the company that reports the infringement (if sufficient evidence is provided to the authorities), fines, and the potential for substantial damages to be awarded.<sup>12</sup>

In these cases, parties harmed by anti-competitive conduct also have appropriate incentives to sue in order to obtain redress. In state aid, competitors of aid beneficiaries are less likely to engage in an original private action, since the outcome may be merely that the aid is refunded to the subsidising Member State. In theory, courts can order the award of damages to

#### How might state aid modernisation work in practice?

The Commission’s Decision in relation to state funding received by the Belgian postal operator, bpost, for fulfilling its public service obligations provides a useful example of what might be involved in future state aid assessments in the ‘new world’.<sup>1</sup>

Underpinning the Commission’s Decision was a detailed assessment of bpost’s public service contracts, as well as a thorough consideration of the relevant economic and financial issues. For example, in order to assess

what constitutes a ‘reasonable’ level of profit, the Commission took into account an array of factors, from the appropriate framework for assessing profitability in the postal sector, to detailed analysis of the appropriate comparator companies for bpost for the purposes of estimating profitability. The analysis also considered the impact of the mechanism to provide compensation on risks faced by bpost, as well as the extent to which bpost was incentivised to improve productivity.

Source: <sup>1</sup> European Commission (2012), ‘Commission Decision of January 25th 2012 on the Measure SA.14588 (C 20/2009) implemented by Belgium in Favour of De Post-La Poste (now bpost)’, January 25th.

claimants that are disadvantaged through a competitor receiving illegal state aid. However, in practice, this is rare, as it is often the claimant that must prove that a measure qualifies as state aid, which is typically difficult due to challenges in obtaining the necessary information. If, in state aid cases, the incentives to bring private actions, including awarding damages for state aid prohibitions, are aligned more effectively, this is likely to improve compliance.

## How might the reforms play out in practice?

The 'brave new world' of state aid rules is expected to be in place by the beginning of 2014. The package of reforms could bring important benefits, including tighter timescales, greater information-gathering powers, and

the possibility of more sophisticated and in-depth analysis. This should lead to more robust Decisions on the cases that are likely to have the greatest impact on the internal market. However, this is likely to come at the cost of removing scrutiny from smaller cases, with the Commission needing to rely to a far greater extent on ex ante monitoring by the Member States themselves.

To ensure that this state aid modernisation leads to significant benefits, it will be important that these reforms are accompanied by improved deterrence tools. A lighter-touch regime for smaller cases in the absence of good deterrence depends on compliance from Member States in terms of only granting aid where it complies with the Commission's regulations.

<sup>1</sup> European Commission (2012), 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, EU State Aid Modernisation (SAM)', May 8th.

<sup>2</sup> European Commission (2012), 'Facts and Figures on State Aid in EU Member States, 2012 Update', December 21st.

<sup>3</sup> Koopman, G.J. (2012), 'State Aid Modernisation', European Commission, slide 8.

<sup>4</sup> For further details, see Slaughter and May (2012), 'The EU Merger Regulation, An Overview of European Merger Control Rules', March.

<sup>5</sup> European Parliament (2013), '2012/2920 (RSP)—17/01/2013, Text Adopted by Parliament Single Reading', available at: <http://www.europarl.europa.eu/oeil/popups/summary.do?id=1244089&t=d&l=en>.

<sup>6</sup> The Commission's new broadband guidelines provide further guidance about the criteria to assess whether the positive effects of aid outweigh their potential negative effects. For further details, see European Commission (2013), 'Communication from the Commission, EU Guidelines for the Application of State Aid Rules in relation to the Rapid Deployment of Broadband Networks', *Official Journal of the European Union*.

<sup>7</sup> See European Commission (2008), 'Invitation to tender, COMP/2008/A3/015'.

<sup>8</sup> London Economics (2004), 'Ex-post Evaluation of the Impact of Rescue and Restructuring Aid on the International Competitiveness of the Sector(s) Affected by such Aid, Final Report to the European Commission—Enterprise Directorate-General', June, p. viii and p. 28.

<sup>9</sup> Oxera (2009), 'Should Aid be Granted to Firms in Difficulty? A Study on Counterfactual Scenarios to Restructuring State Aid', prepared for the European Commission, December.

<sup>10</sup> Koopman, G.J. (2012), 'Modernising EU State Aid Policy', European Commission, 'Autumn Conference on European State Aid Law', November 30th, slide 11.

<sup>11</sup> European Parliament (2013), op. cit.

<sup>12</sup> For example, in the majority of European Commission cartel Decisions in recent years there has been some form of leniency for the cartelist that was the first to report the cartel and to provide sufficient evidence of its existence to the authorities. Subsequent whistleblowers may obtain some reduction in the fine if they co-operate with the investigation.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Leonardo Mautino: tel +44 (0) 1865 253 000 or email [l\\_mautino@oxera.com](mailto:l_mautino@oxera.com)

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