

Essays on law and economics of state aid

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Summary

The competition policy of the European Community has undergone extensive reform during the past decade. Competition rules have been modernised and simplified and enforcement has been decentralised.

The most significant aspect of modernisation has been the introduction of more rigorous economic analysis, both in the areas of anti-trust and state aid. Indeed, it has been described as the “cornerstone of the modernisation process”.

The Courts of the European Community have also shown an increasing tendency to annul Commission decisions on the grounds that they are based on unsound economic analysis.

The papers collected in this dissertation seek to gain a deeper understanding of the Community’s state aid rules and system of state aid control by using economic reasoning. They examine whether the state aid rules and procedures promote efficient allocation of resources and whether national administrations are given strong enough incentives to comply with the requirements of the Community’s state aid regime.

Economics is the study of how people and organisations respond to incentives. It has a methodological foundation that shapes its analysis. Economics, therefore, offers a useful tool to examine what effects the law may have on the behaviour of both market operators and public authorities that enforce it.

There are, however, significant differences between law and economics. The most important difference is the fact that economics places at the centre of its analysis the pursuit of efficiency – the maximisation of personal and collective welfare. This criterion may diverge from the

objectives of the law. For example, price discrimination, as other forms of discrimination, may be abominable in the eyes of the law but to economics it is a legitimate practice as long as it improves efficiency. The emphasis on efficiency also implies that rules and procedures are judged by economics according to their effects rather than form or intention.

Despite the fact that it is now widely acknowledged that proper application of competition rules requires a good understanding of the underlying economic principles, very little has been done by economists in the field of state aid. Some of the papers in this dissertation, as for example, those on services of general economic interest, are virtually a first attempt to assess the economic rationality of related state aid rules.

The most frequent conclusion of the papers is that state aid rules could be further improved by making them stricter. The Community system of state aid control still allows amounts and types of aid that may be excessive and too generous, respectively. However, the reform of state aid policy initiated by the State Aid Action Plan may succeed to reduce state aid amounts in line with the overall Lisbon objectives.

The application of the “refined economic approach” of the Action Plan has not generated policy uncertainty, as many commentators had feared. Admittedly it is still too early to reach a definitive conclusion on its effects and application. But the handful of negative decisions by the Commission suggest that it will largely use it to prohibit poorly designed aid measures that grant public money to large companies without any apparent need for public support.

Part I reviews the concept of state aid and its interpretation in the case law. It also explains the system for notification, authorisation, prohibition or recovery of aid.

Part II considers why the EC needs state aid rules and what such rules should aim to do. It evaluates the new “refined economic approach” and the related “balancing test”. It argues that in principle the test should use more explicit market and trade share thresholds to identify cases capable of appreciably affecting cross-border competition. It also examines the record of the Commission and concludes that on the basis of the few negative decisions that have been taken so far the test does not appear to seek to quantify the positive and negative effects of aid. Rather it develops a screening process for identifying cases of aid with objectionable features. In this sense it is not a fully-fledged economic cost-benefit analysis. Indeed, from an economic perspective one of the most serious weaknesses of the system of state aid control is that member states are not required to carry out an ex post assessment of the effects of their state aid measures.

Part III addresses a number of distinct issues concerning the interpretation of the various aspects of state aid such as the concept of undertaking and the meaning of economic activity, the concepts of cumulation and de minimis aid, public funding of infrastructure and broadband networks, and the market economy investor principle.

Part IV focuses on the evolution of the case law with regard to state aid hidden in tax exemptions and special tax treatment. On the whole the five chapters in that section are in favour of the efforts of the Commission and the Courts to apply vigorously Article 87 to tax measures.

Part V considers the problem of how public authorities may support providers of services of general economic interest. Under certain conditions, regulation and obligations imposed by law can be more efficient policy instruments than public subsidies. The four chapters in that section express three criticisms of current practice. First, at present there is no requirement for public authorities to demonstrate that the

market cannot provide the service in question without the imposition of a public service obligation. Second, aid granted as a means of compensation for public service obligations may allow recipients to gain a competitive advantage over their rivals in related markets. This can be avoided through auctioning of service contracts. Third, the exemption in Article 86(2) is too lax because it allows the granting of aid to inefficient providers.

Part VI turns its attention to sectoral issues and the rules contained in three guidelines: those on aid for rescue and restructuring of companies in difficulty, those on aid for regional development and those that apply to maritime transport. The chapters on rescue and restructuring criticise past and current rules for being too accommodating. Although more recent rules on rescue and restructuring aid are definitely stricter, the current regime does not ask important questions such as what is the benefit to society from preventing the collapse of a company. Regional aid rules also omit to ask vital questions such as what is the magnitude of the regional “handicap” that has to be offset by public incentives to induce investment in backward regions. It does not follow automatically that the regional handicap is the same for every sector or industry and that it is equivalent to the ceiling of aid allowed by the Commission.

Part VII assesses the overall system of state aid control in the Community. It examines an “unthinkable” proposition: the decentralisation of state aid control and the delegation of certain tasks to national authorities. It also argues that the integrity of the system is weakened by member states that grant illegal aid with apparent impunity. They suffer no other penalty apart from having to recover the aid after it is discovered and found to be incompatible with the common market – a process that may take several years.

The last chapter provides an overall assessment of the on-going reform of the state aid rules and procedures. The rules are now wider, affording national authorities more possibilities for granting state aid, but at the same time the refined economic approach and the balancing test impose stricter criteria, especially, concerning the necessity of aid to large companies.

On the whole, the Community system has been effective in restraining the propensity of member states to subsidise their firms for strategic or political reasons. It has prevented significant distortions to cross-border competition. But it is not a perfect system. Too much aid has been allowed and the granting of illegal aid is not penalised vigorously enough.