Competing for Capital:
European and North American Responses

By Kenneth P. Thomas

Chapters:

The Development of the State Aid Regime

Chapter 4 of Competing for Capital:

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This book has so far considered the basic rules governing the EU's system of state aid control. In this chapter, I turn to a historical accounting of the development of Commission procedures and powers, and to the changing background conditions in which state aid controls existed. It is not the goal of this chapter to provide the entire history of state aid control, which would require a number of volumes. Instead, I wish to focus on those developments which bear most strongly on the Commission's ability to exercise effective control. The exposition in this chapter will be partly chronological and partly thematic. That is, while it will deal with specific issues in their entirety, they will be treated in the approximate chronological order in which they arose.

This will proceed in eight stages. First, I will examine the first major application of state aid rules, export aid for intra-Community trade. Second, I will turn to early Commission efforts in the area of regional aid, in which the system of differentiated aid maxima for different regions of the Community were created and expanded. Third, I will consider the impact that the addition of new, poorer member states has had on state aid policy. Fourth, I consider Commission efforts in two important sectors, textiles and automobiles. Fifth, I analyze the introduction and development of the most important horizontal frameworks, that for research and development. Sixth, the focus shifts to the question of efforts to evade legal history of state aid rules and their application. In particular, this will focus on Commission initiatives such as the Transparency Directive and the rules on cumulation of aids, and especially on the use of repayment orders beginning in the mid-1980s. Seventh, I consider the crucial cases defining the powers of the Commission (in particular, Philip Morris) and the rights of third parties. Finally, I analyze in detail the political underpinnings of reinforced state aid control beginning in the mid-1980s.

Introduction

When the Treaty of Paris establishing the European Coal and Steel Community was adopted in 1951, the Community took the first step toward state aid control. As Article 4 of the ECSC Treaty states:

> The following are recognized as incompatible with the common market for coal and steel and shall accordingly be abolished and prohibited within the Community, as provided for in this Treaty:
>
> ...
>
> (c) subsidies or aids granted by States, or special charges imposed by States, in any form whatsoever...

Article 54, furthermore, provides that the "High Authority" can impose fines on firms that receive state aid.[1] Similarly, as we have seen in Chapter 3, the Commission was given monitoring and enforcement powers in Article 93 of the European Economic Community Treaty.

Although the Commission had these powers from the dawn of the EEC, state aid control was a low priority until after the completion of the customs union in 1968.[2] Indeed, from 1958 to 1968 the Commission had issued only three final decisions under Article 93(2) proceedings.[3]

Aid for Intra-Community Exports

The first important application of state aid rules came in the area of intra-Community trade; more specifically, the Community sought to ban the use of export subsidies for such commerce. In the joined cases "E.C. Commission vs. France: Re Export Credits (Cases 6/69 and 11/69),"[4] the European Court of Justice ruled definitively that such subsidies on trade between member states were incompatible with the common market. This case involved the use by France of preferential interest rates for steel exporters in intra-European trade. The Commission had first tried to end this program in 1964, which the French finally agreed to in May 1968. That same month, however, the country was hit with a massive political crisis and the government reversed the decision to end the aid. In the Court's decision, the justices accepted the Commission's contention that a preferential lending rate was a specific act, not a general macroeconomic policy, and therefore constituted state aid. It rejected a number of French arguments and concluded that France was in violation of its treaty obligations.[5] As Despina Schina comments, "...the use of export aids in the trade between Member States could threaten the unity and the functioning of the Community itself. It is, therefore, not difficult to understand why such aids were clearly blacklisted."[6] In other words, the fact that the raison d'etre for the EEC treaty was to expand intra-Community trade explains why state aid distorting such trade emerged as an issue early in the life of the Common Market.

A related issue arose in terms of aids for a sector financed through taxes on that sector (so-called "parafiscal" levies). For example, France supported "occupational technical centers" in a number of industries such as clockmaking. These centers provided R&D and technical assistance for French firms, and were financed by taxes on all clocks sold in the country, whether domestic or imported.[7] Similar systems existed in other industries and in a number of other countries. The Commission explained its objections as follows:[8]

> From a purely national point of view, the levying of a tax and the granting of aid represent in fact a redistribution of revenue within one and the same sector. As regards intra-Community trade and competition, such systems raise important problems. Since the tax is also levied on products

imported from other states, the direct competitors of those benefiting from aid contribute to this financing.

The Court upheld the Commission's position in a 1970 decision.[9] In 1971, therefore, the Commission requested the Member States to end all such systems in existence.[10] While this was not accomplished immediately,[11] the general point was won and the Commission was able to challenge similar aid programs that arose later.

Aid for intra-Community exports is a problem that has been largely solved.[12] The horizon by 1995 had become regulation of aid for outward investment (for instance, in Eastern Europe). The Commission argued that such aid could well affect intra-Community trade, with especially negative effects on the poorer Member States. As a result, it opened the Article 93(2) procedure against a number of programs promoting outward investment.[13] In addition, the Commission was seeking agreement among Member States to end aid for export credit insurers,[14] highlighting again its relative success against more serious aids to intra-Community exports.

Systems of Regional Aid

In an important sense, the rules governing regional aid are the centerpiece of EU state aid control. This is because the regional aid system specifies the maximum amount of support that can be given to a company in each and every location within the

EU. This system has been elaborated over the course of more than two decades.

Discussions for a control system for regional aid began with a Commission proposal in 1968 for prior notification of major individual aid awards.[15] One of the major motivations for this policy was precisely the problem of bidding wars for investment occurring:[16]

> The various regions of the Community are therefore increasingly competing with each other to attract investments....Part of the aid granted at present only achieves reciprocal neutralization with unjustified profits for the benefitting enterprises as the only counterpart. In fact, this process of outbidding cannot affect the aggregate flow of investments, which, at Community level, can be mobilized for the purpose of regional development.

Nevertheless, the Commission's proposed solution was unacceptable to Italy and France,[17] which preferred a more comprehensive approach. This was adopted by the Council of Ministers in October 1971 and became effective in 1972. Its main provisions were as follows.[18] First, the entire EC was divided up into "central" and "peripheral" areas, and an aid limit was established for the central areas only, leaving the periphery for later.[19] Second, an aid ceiling of 20% net grant equivalent was established for the central region. Third, aid should be made transparent. Fourth, states were required to designate areas eligible for regional aid according to non-arbitrary criteria and relate aid intensity to the severity of a region's problems, illustrating, as emphasized in Chapter 3, the importance the Commission attaches to the principle of proportionality. Fifth, states were required to track the sectoral distribution of regional aid awarded and provide the data to the Commission. Finally, member states were mandated to provide ex post notification of major individual awards.

The next stage of regional aid control required designation of aid maxima for the entire Community. This turned out to be more difficult politically than expected,[20] and it was not until 1975 that a new system was adopted. From a technical point of view, there was also the problem that many regional aids in the periphery were not transparent, unlike those in the center. Many peripheral programs were based on job creation rather than investment, particularly in Britain and Italy. Those countries requested the creation of alternate maxima expressed in terms of cost per job.[21]

The 1975 coordination principles created four categories of region to replace those of "center" and "periphery." In order of decreasing aid intensity allowed, they were:[22]

1) Ireland, Northern Ireland, West Berlin, Mezzogiorno - maintain existing maximum as of 1 January 1975.[23]

2) French industrial premium areas, British assisted areas, and Italian center-North assisted areas - 30% NGE.

3) German Zonal Border Area, Danish assisted areas - 25% NGE.

4) All other regions - 20% NGE.

The principles of operation of the coordination system (transparency, regional specificity and proportionality, monitoring of sectoral consequences and large individual awards) remained the same.

The third stage of regional aid control came in 1978, when the Commission issued a Communication on the subject establishing cost per job limits in addition to the NGE limits set in 1975, as follows:[24]

1) Worst off areas: 75% NGE or 13,000 European Currency Units (ECU) per job created. For labor-intensive projects, the latter limit would be governing, even if aid exceeded 75% NGE. France's overseas territories (departments) were added to this category.

2) For the French, British and Italian assisted areas mentioned above, the 30% NGE limit was supplemented with a limit of 5,500 ECU per job up to 40% NGE.

3) For the Zonal Border Area and Danish assisted areas, the 25% NGE limit was matched by a 4,500 ECU per job cap, up to 30% NGE.

4) For the rest of the Community, the limits were 20% NGE or up to 3,500 ECU per job, with a maximum of 25% NGE.

As can be seen, in theory the formulations give some bias to labor-intensive projects since higher NGE amounts are permitted if the ECU/job limits carry a project above the standard NGE limit. However, it should be noted that in practice, the Commission never used the ECU/job measure to evaluate regional aid.[25]

In 1988, new changes were made to the regional aid coordination principles.[26] Most importantly, the Commission for the first time issued detailed criteria for how regions should be designated for regional aid eligibility under either Article 92(3)(a) or Article 92(3)(c). The former, the least developed areas of the Community, retain their 75% NGE limit. The Commission also stated that it would under certain circumstances authorize operating aid in such areas.

With this communication the Commission codified to some extent its politically sensitive involvement in the issue of how Member States draw their regional policy aid maps. According to Fiona Wishlade,[27]

> As a result of Commission intervention, almost all of the northern, wealthier Member States of the European Community have seen a reduction in the spatial coverage of their regional aid policies in the last five years. Moreover, some of these countries are engaged in seemingly ongoing, often acrimonious, disputes with DGIV.

While this has primarily involved 92(3)(c) areas, which are not as disadvantaged as 92(3)(a) areas, the Italian region of Abruzzi is a 92(3)(a) region that has been in dispute as its relative economic backwardness has been diminishing. At the same time, it had been eligible for Community Structural Funds as an Objective 1 region (see below), further complicating the picture.[28]

The 1988 Communication also involved a further differentiation among aid maxima, with some regions eligible for as little as 7.5% NGE as their maximum.[29]

Regional aid policy, as we have seen, has been both controversial politically and complicated technically. Beginning with the first regional framework, however, the Commission has steadily extended the coverage of the system and inserted itself directly into national regional development programs through its oversight of area eligibility and the scrutiny of both aid programs and individual awards. This has brought it into conflict with both national governments and, at times, the Regional Policy Directorate-General, DG XVI.[30] Yet DG IV has maintained its ability to initiate policy in this area, most recently with proposals for regional aid to inward FDI that are sure to prove controversial.[31] If successful, this could well mark a direct assault on competition for investment. More recent still, the Commission has proposed to prevent "aid shopping" in the wake of Renault's simultaneous attempts to close plants in France and Belgium while making aid-receiving expansions in Spain.[32]

At the same time, the accession of poorer countries and regions from 1973 to 1990 has increased the importance of regional policy on a Community scale. The vastly increased regional funding since the Single European Act also contributed to challenges for the system of state aid control, as the next section discusses.

Enlargement and Regional Problems

The enlargements of the EC that began with the 1973 accession of Ireland, Denmark, and the United Kingdom vastly widened the economic disparities among Member States. For instance, Irish GNP at accession was 59.2% of the EC average.[33] The addition of the new countries meant that some of the state aid rules that seemed definitively in place, such as the ban on intra-Community exports, had to be relearned. In the Irish case particularly, this norm conflicted with the essential setup of the national industrialization strategy.

Ireland has since the late 1950s pursued an economic development strategy centered on the attraction of foreign multinational corporations (MNCs).[34] A key investment incentive was the Export Profits Tax Relief (EPTR) program (also known as Export Sales Relief), which exempted from corporate income tax 100% of profits on export sales for manufacturing firms. Since this clearly was a violation of the ban on intra-Community export aid, the Commission took the position that this would eventually have to be changed. In the accession negotiations, Ireland pressed for, and obtained, "guarantees that any revised incentive scheme required by EEC codes would be equally effective."[35] In 1978, Ireland announced a system to replace EPTR, which involved a reduction in corporate income tax for manufacturing industry to 10%.[36] Although this did achieve DG IV goals on banning export aids, this was an expensive victory. On the one hand, the Industrial Development Authority has used the tax rate as one of its main selling points.[37] At the same time, the government has contended that it is not state aid at all, but rather a general macroeconomic measure.[38] Thus, the value of this tax expenditure is not included in the estimates of Irish state aid contained in the EU's Surveys of state aid spending. Nevertheless, it is a clear, and unregulated, element in Ireland's competition for investment.[39]

To return to export aid, the issue also came up at various times with regard to other new member states. For instance, in 1988 the Commission made an Article 93(1) proposal[40] to Spain that it change its program for aid to the press because of two elements. First, only Spaniards were eligible. Second, and more important here, was that the aid was based on consumption of Spanish newsprint only, thereby discriminating against foreign newsprint producers. This clear impact on intra-Community trade was disallowed by the Commission.[41]

The reunification of Germany also had a substantial impact on state aid policy. Besides the high level of subsidies provided to promote the transition to a market economy (an average of 13.3 billion ECU per year in 1992-94)[42] and the large increase in DG IV's caseload,[43] there have been major violations of the state aid rules in eastern Germany. In the case of Bremer Vulkan AG, Germany's largest shipbuilder, much of the 850 million DM state aid given to the company to modernize shipyards in eastern Germany was diverted to its West German subsidiaries. When the fraud was uncovered, the company went bankrupt, its former chairman was arrested, and the Commission had to approve more aid for the east German yards.[44] And in the Land of Saxony, the government refused to follow a Commission order not to pay Volkswagen 241 mllion DM in state aid, paying an initial 91 million DM in July 1996.[45] Both of these affairs were deeply embarrassing to the German federal government.

In additon to having to teach new members old rules such as the ban on export aid, enlargement has also affected state aid because, as mentioned above, several of the new members had standards of living that were much below average. Besides Ireland, this was true of Greece (admitted in 1981), Portugal (1986), and much of Spain (1986). After the reunification of Germany in 1990, the EC added a new region, the former East Germany, that was poorer than even those four. Table 4-1 shows the dimensions of the disparity.

Table 4-1: GDP/capita of Cohesion Countries and New Lander 1991, at purchasing power parity

Spain	78%
Ireland	70%
Portugal	59%
Greece	47%
Former East Germany	38% (1991-2)

Source: CEC, Competitiveness and Cohesion, p. 187, Table A.20, and p. 190, Table A.23.

"Cohesion" is the term used to describe the goal of bringing the least economically developed regions of the EU up to the standards of the richer nations. After the accession of Spain and Portugal in 1986, the disparities within the Community were such that it was felt necessary to increase funding for the four poorest countries (often called the "cohesion countries"), Ireland, Greece, Portugal and Spain. It should be recalled that state aid treatment of regional development has always been relatively favorable. In fact, Ireland, Greece, and Portugal are in their entirety classified as 92(3)(a) regions, making them eligible in theory to offer 75% NGE for investment projects. Much of Spain is also classified as 92(3)(a).

After much negotiation, the decision was taken to double the so-called Structural Funds in real terms between 1987 and 1993, with a total of 60 billion ECU (at 1989 prices) being spent in 1989-93. Of this, 80% was earmarked for Objective 1 regions.[46] While the Commission's goal was to concentrate these funds in the four poorest countries, at the same time each Member State wanted to make sure that it received some of the funding.[47] Fiona Wishlade writes, "The highly political nature of these early negotiations is reflected in the criteria for designating eligible areas, especially for Objectives 2 and 5b." This battle coincided with that over aid maps (see above), and yielded rather striking anomalies. The designations for EC Structural Funds did not fully coincide with those for national regional aids. Overall, 46.8% of the EC's population was in non-assisted areas, 40.0% in regions eligible for national and EC regional aid, 7.4% in areas eligible for national aid only, and 5.7% in areas eligible for EC aid only! The Directorate for Regional Policy, DG XVI, and most Member States argued that there should be more coherence between the two sets of aid maps: in particular, that areas designated as Objective 1 should be eligible for Art. 92(3)(a) treatment for state aid, and that Objective 2 and 5b areas should receive 92(3)(c) status. DG IV, however, was not persuaded that the two sets of designations needed to be coordinated in such a fashion, claiming that because regional policy and competition policy had different aims, there was no necessary reason the two should have exactly the same maps.

Besides the intensely political nature of the designation exercise, one other aspect of the expansion of the Structural Funds had important consequences for state control and for competition for investment in general. Historically, much Structural funding had gone to improve infrastructure in the worst-off Member States. However, along with the doubling of the Funds in the 1989-93 round, there was also increased emphasis placed on aiding investment. Hall and van der Wee[48] write:

> Whereas support for investment in transportation, telecommunications, energy and water infrastructure accounted for 80% of total Regional Fund expenditure in the pre-reform years of 1987 and 1988, this figure has been reduced to 55% in Objective 1 regions and to a mere 16% in Objective 2 areas. Meanwhile, a far greater proportion of

resources - 40% in Objective 1 and 80% in Objective 2 - will be used to support investment in industry and services, to improve the business environment and to develop human resources.

This means, of course, as Yuill et al. have pointed out, that the Commission has moved increasingly into the area of itself funding aid granted to firms for investment. They argue[49]

> In absolute terms, Community spending on encouraging productive investment in Objective 2 areas is clearly much smaller than in Objective 1 regions. Nevertheless, it is somewhat perverse that the Commission should contribute to the "bidding-up" process that characterises many international location decisions by supplementing, directly or indirectly, the funds available for encouraging productive investment in the wealthier Member States.

For the 1994-99 round of Structural Funds, there was a further increase in allocations. From spending 21.3 billion ECU (1992 prices throughout this paragraph) in 1993, expenditures on the Structural Funds and the Cohesion Fund were planned to rise to 30 billion ECU in 1999, of which 74% would go to Objective 1 regions. This compares with a budget for the Common Agricultural Policy of 38.4 billion ECU in 1999. Over the 1993-99 period, Structural Action would rise from 30.8% of the EU budget to 35.7%, while the CAP would fall from 50.9% to 45.7%.[50] In addition, due to the accession of Sweden and Finland, a new

Objective 6 was added for regions with extremely low population density, such as Lapland.[51]

Again, the more prosperous states lobbied furiously to receive as much of the Structural Funds as possible. It paid off. Six Member States successfully obtained Objective 1 status for regions which had not been so designated in 1988. In three cases, the primary criterion of GDP per capita below 75% of the EU average was met: eastern Germany, Cantabria (Spain), and Flevoland (the Dutch lands reclaimed from the Ijselmeer). One other case just above the threshold, the Highlands and Islands area of Scotland, was perhaps not surprising since it had already been eligible for 75% NGE aid for very small enterprises despite only being a 92(3)(c) region.[52] However, also receiving Objective 1 designation were part of Hainaut in Belgium (not even 40 km from Brussels, a plant location consultant emphasized in an interview)[53] and part of Nord-Pas de Calais just across the border from Hainaut in France; and the Liverpool area in England. Only one area, Abruzzi in Italy, was to be removed, but only after a three-year transition period.[54]

One other aspect of enlargement and state aid policy has been the European Economic Area (EEA) agreements. While EEA as a whole is outside the subject of this book, in the state aid field the members of the European Free Trade Association agreed to bind themselves by EU rules. With the accession of Austria, Finland and Sweden, this has become largely a footnote, although Norway, Iceland and Liechtenstein still remain bound by the Agreement.[55]

Note, too, that Austria's 1972 free trade agreement with the EC had already bound that country to the subsidy rules, a factor which came into play when Austria provided incentives for Chrysler to locate a minivan plant there.[56]

Similarly, the "Europe Agreements" establishing rules for EU commerce with the Central and East European countries, with a view to eventual accession, also include provisions on state aid. These "boil down to a transposition of Art. 92 and the guidelines, frameworks and decisions that follow from it" into the various agreements.[57] By early 1996, EU experts had held discussions with officials from Hungary, the Czech Republic, Slovak Republic, the Baltic States and Slovenia on state aid rules.[58]

This brief survey shows how the expansion of the European Union has created new challenges for the enforcement of the state aid rules. The Irish case was particularly difficult because an export aid was central to the country's economic development strategy. The solution reached created problems of its own which linger to this day, inasmuch as the new primary investment incentive is uncontrolled by the state aid regulations. This may slowly diminish as Ireland rethinks its economic development strategy in reaction to the Culliton Report, but an end to the 10% corporation tax rate is by no means a sure thing. Beyond Ireland, enlargement has meant new officials to socialize to the state aid rules. But perhaps the greatest difficulty to strict control lays in the continuing political pressures for designating regions in richer countries for Community regional funds, and the expanded use of those funds to fund the competition for investment.

Controls over Sectoral Aid

As Chapter 3 noted, an important difference between U.S. and EU industrial support is the far greater emphasis in the latter on aiding firms and industries in difficulties. While the U.S. witnesses the occasional massive bailout (such as Lockheed or Chrysler), it is at least as common to support entire industries in Europe. At the same time, European officials recognize that subsidy wars for declining industries are just as counterproductive as bidding wars for new investments. As the Commission stated regarding the textile framework in 1977:[59]

> The Commission considers that the present situation requires that certain aspects of the framework be given greater precision with a view to ensuring that the proposed solutions for overcoming the problems regarding structures, surplus capacity and imports from non-member countries <u>are not rendered ineffective by ruinous outbidding</u>.

If one state gives subsidies to an uncompetitive firm, it effectively exports unemployment to other member states. If all subsidize, jobs may be preserved in all the firms, but at the high cost of diverting needed funds from more to less efficient uses. This means that sectoral aid may well be more problematic than supporting new firms, insofar as the latter are likely to be more efficient.

The Commission has tried to balance several competing objectives. When whole industries become uncompetitive on a global scale, it can mean massive layoffs and dislocation for the workers in those sectors. The Commission has looked relatively favorably on aid to firms that will in fact directly benefit their laid-off workers as they move to a smaller but hopefully more competitive size. At the same time, as a fundamentally market-oriented organization, the Commission also stresses the need for efficient production and the minimization of subsidies. Finally, when an industry's problems are thought to be the result of unfair actions by foreign competitors, the Commission also takes trade initiatives to supplement their aid policies.[60] To control the potential for aid wars, the Commission's preferred approach has been the introduction of sectoral frameworks, two of which will be discussed here (textiles and autos). In general, these can be seen as a controlled shrinking of industries in difficulties.[61]

1. Textiles

Like its American counterpart, the European textile industry has been in a long-term decline due to the rise of low-wage manufacturers in less-developed countries (LDCs). With the U.S., the European Commission pushed for trade restrictions to control the market share of LDC producers, known as the Multi Fiber

Agreement.[62] At the national level, governments responded to the problem by subsidizing their domestic industries: "Aids, which up to a few years ago were still limited, have tended to increase," the Commission reported in 1972.[63] The textile framework was introduced in July 1971, and in many ways was the prototype for later sectoral frameworks. In particular, the Commission laid down the principles that aid must not increase capacity in the industry, that it must take into account the Community state of the industry, not just the national situation, and that operating aid was prohibited. Furthermore, it strongly emphasized that the aid most likely to win approval was that designed to bring about genuine restructuring leading to long-term viability.[64] The next year, the Commission followed up by creating an inventory of all aid given to textile firms, no matter under what category the aid was given (i.e., sector-specific, general investment, regional, etc.). It notified the Member States that even aids that were not specific to the textile industry had to be notified in adance for consideration from the point of view of the situation in that sector.[65]

An early example of the framework's application, which illustrates an extremely common pattern in the use of the Commission's state aid regulatory functions, is provided by an aid program for the British clothing industry proposed in 1975. This scheme had three elements: 1) a Productivity Center for the industry; 2) 50% grants for hiring consultants for firm modernizations; 3) 20% grants for plant and equipment. DG IV staff solicited comments from other Member States in the course of its preliminary investigation, which concluded that the first two elements were acceptable, but that the third was not, because of its potential to increase capacity in the industry. Faced with Commission objections on this point, the U.K. government modified its proposal to make clear that investment aid could only be given if there were no capacity increases. In particular, the funds allocated to the program would be used in part to finance the closing of unprofitable operations.[66] Knox points out that the Commission interprets the framework as applying to types of aid that are disproportionately given to the textile industry, citing the example of the U.K.'s Temporary Employment Subsidy, introduced by the Labour government in 1975.[67]

Needless to say, the introduction and elaboration of this framework did not mean the end of the industry's problems. Indeed, difficulties spread to related sectors, such as synthetic fibers, for which the Commission adopted a similar framework in 1977.[68] But the elaboration of frameworks has meant that the Member States have a clear set of criteria around which to design aid programs, and that all parties involved (including recipient firms and their competitors) can expect consistent treatment of aids. Nonetheless, as with other aspects of state aid control, excessive delays and attempts at circumventing the rules sometimes weaken the Commission's position. As Schina concludes:[69]

A close examination of instances where the Commission had to deal with notified aids to the textile industry demonstrates that the Commission has adhered strictly to its principles. Nevertheless, the effectiveness of the Commission's control is weakened by the long delay which often occurs between the notification of a plan of aid and its removal or modification by the notifying Member State, not to mention the occasional failure to obey the Commission's decisions.

2. Automobile industry

Again as in the United States, the European auto industry has suffered from the rise of Japanese exports; more recently, it has been a location for substantial Japanese automotive investment, particularly in the United Kingdom. From 1970 to 1980, Japanese imports went from less than 1% of both the British and West German markets to over 10% of both, while Japanese market share in small European countries such as Belgium, Ireland and Greece ranged from 20% to 40% in 1980.[70] This market penetration represented a substantial problem for European policy, because the auto industry is one of the world's most important in terms of production and employment.[71] Indeed, at the 1989 introduction of the motor vehicle industry framework it was estimated that 10% of all employment in the EU was directly or indirectly related to it.[72]

After the onset of serious problems for the industry in 1980, the Commission signaled its willingness to approve "strictly necessary and temporary aid schemes" to allow European producers to restructure. The following year the Commission announced that it would require annual accounting of all aid given to the industry, whether from sector-specific or other sources.[73] In this relatively permissive environment, subsidies to the automobile industry reached high levels, as the Commission reported in the 18th Report on Competition Policy:[74]

> A compilation of the Commission's experience concerning aids in this sector revealed that most major car producers had benefited from substantial aid flows. Rough estimates based on incomplete information show that this sector has received at least ECU 11 billion in national aid between 1981 and 1986. Over half of this amount was paid to restructure loss-making State-owned companies. Regional aids have also been an important feature in this sector.

Among the more important of these cases were Renault (ECU 2.82 billion approved in 1988, and ECU 35 million ordered repaid; however, a further ECU 846 million was ordered repaid in 1991),[75] Rover (where a L469 million capital injection was allowed; it was later discovered that the U.K. government had given the company's buyer, British Aerospace, an additional L44.4 million in aid that the Commission forced BAe to repay),[76] and 615 billion lire in aid associated with Alfa Romeo's 1987 sale to Fiat.[77]

Based on its experience in these and other cases, the Commission in December 1988 adopted a framework for the automobile industry, which became effective at the beginning of 1989. It provided that all individual automotive projects receiving aid must be notified in advance if the investment totalled over ECU 12 million.[78] In at least one case, the Commission challenged aid that had been chopped up into smaller pieces to evade the ECU 12 million threshhold.[79]

The framework has been politically controversial. At the time of its original adoption, Germany stated that it would not accept it, apparently "concerned that the commission [would] use the new arrangement to ensure that southern European car industries [would be] allowed to receive more state aid than West Germany's larger and more profitable auto manufacturers."[80] Spain, by contrast, opposed the framework because it feared that there would be <u>less</u> opportunity for state intervention. The Commission opened Article 93(2) procedures against both countries in order to force their compliance with the framework.[81] While on subsequent renewals Germany has come around to the Commission's view, Spain remains the only Member State which opposes the framework, challenging it (sometimes successfully) before the Court of Justice at every opportunity.[82]

Overall, the automotive framework appears to have improved the Commission's monitoring capacity in this sector, as well as signalling to Member States and potential aid recipients what is likely to be approved. According to Hancher et al., "The impression one gets from reading the Commission's Decisions and Notices is that the Commission is gradually getting a grip on these extensive aid operations." They go on to note that the Commission's rulings "did achieve extensive restructuring of the industry."[83] This conclusion is supported by the early 1997 battle with Renault, in which the company simultaneously closed plants in Belgium and France while seeking aid to expand in Spain. Negative publicity forced Spain to withdraw its aid offer while the Commission sought to draft rules to prevent cases like this in the future.[84]

3. Conclusions

Sectoral aid frameworks have had some success in controlling aid awarded in crisis sectors, though that does not necessarily mean they would receive a positive evaluation when viewed through a broader lens (for example, that of LDCs vis-a-vis the MFA and the textile aid code). Though not treated here because of space limitations, the steel industry has had two aid frameworks, with substantially different outcomes. The crisis of the 1980s saw steel producing Member States cut capacity and eventually phase out aid entirely (recall that it is specifically prohibited by the ECSC Treaty), while the December 1993 steel agreement collapsed because Member States failed to deliver on their promised capacity cuts. In December 1996, however, the Council unanimously agreed on a new steel aid code, effective until the expiration of the ECSC Treaty in July 2002.[85] The shipbuilding industry has had a framework since 1969 in the form of successive Council Directives with varying levels of maximum aid allowed, yet their longevity, the paucity of negative decisions, and weak compliance mark it as anything but a success.[86]

Nonetheless, we should not conclude on the basis of these cases that frameworks are wholly unsuccessful in controlling aid in sectors where there is strong pressure to subsidize industry. As Hancher et al. suggest (see above), there has been substantial progress in the automobive sector both in reducing planned aids and in forcing restructuring upon the industry. Indeed, some outside observers have seen the EU's use of aid frameworks as one of the stronger points of its control mechanism. Mark Ronayne strongly suggests that Canada can learn directly from the EU in this regard, arguing that the frameworks for specific activities (both sectoral and horizontal) have been helpful in reducing the Commission's enforcement costs.[87] Similarly, Edward M. Graham and Mark A.A. Warner's call for a North American Competition Commission would be based upon "...a set of standards with respect to what are, and what are not, acceptable types and magnitudes of subsidy...,"[88] exactly the sort of thing aid frameworks do. While their suggestion is broader than sectoral policy and indeed envisions a sort of DG IV for NAFTA, there is no reason that some of the standards could not be sectorally based (for example, in the automobile industry).

In terms of overall outcomes, sectoral aid has declined substantially as a percentage of total aid to manufacturing: 33.1% in 1981-86; 26.8% in 1986-88; 21% in 1988-90, 15% in 1990-92, and 17% in 1992-94.[89] Note that these declines come in the context of falling overall aid to manufacturing, as Chapter 6 shows. These figures suggest that the sectoral frameworks have reduced aid, particularly in steel and shipbuilding, which by the late 1980s saw a phase-out and reduced maxima, respectively.

Horizontal Frameworks

Horizontal frameworks are similar to sectoral frameworks in their ability to provide a set of policies around which expectations can converge. They represent announcements by the Commission of the approach it plans to adopt when analyzing similar aids. They differ from sectoral frameworks, however, in their effort to promote broader goals that can apply in a variety of industries. The most important single "horizontal" goal, taking up 10% of all manufacturing aid in 1990-92 and 7% in 1992-94, is support for research and development.[90] (Note that this refers only to aid given by the Member States; the EU itself also provides substantial support for R&D, averaging ECU 1934.6 million for the "research and technological development framework programme" in 1990-94).[91]

Commission guidelines on research and development originally grew out of sectoral concerns, particularly in the aircraft and computer industries. In aircraft, the Commission deplored the widely varying subsidy practices of several Member States and argued that a transnational program was absolutely necessary to meet the dominant position of U.S. producers.[92] It proposed a major program of allowable support, including "advance credits of up to the total amount of R and D costs...reimbursable from the yield on sales when the aircraft are marketed," loan guarantees for production costs, and marketing aid including "long-term credit[,]...insurance against the commercial risk; [and] guarantees against exchange fluctuations or...abnormal and unforeseeable upward cost movements..."[93] This was, of course, the basis of the Airbus program. What is notable for our purposes is the extraordinarily lenient treatment it announced for research and development aid.

Over subsequent years, this lenient treatment was confirmed in decisions: allowing the German government to absorb 75% of the losses of a venture capital firm for R&D by SMEs;[94] grants to cover losses as the French firm Compagnie International pour l'Information (CII) was merged with Honeywell-Bull, and 50% grants for R&D in the Germany data processing industry;[95] 50% grants for research and 25% grants for development (with 50% grants for development when more than one company was involved) in the U.K.;[96] and a German program of 40% grants for R&D staff, available in any industry, without a requirement that firms hire any new R&D staff.[97]

By 1985, however, it had become clear that some Member States were taking advantage of this permissive attitude to skirt the rules, particularly on notification. States were also packaging their aid to appear as if it were R&D oriented, even if that was not the case. As a result, "...state aids for R&D have become one of the largest if not in many Member States the largest form of government intervention in support of industry."[98] For example, in 1981-86 it represented 22% of German aid to manufacturing, 41% of Danish aid, 11% of Dutch aid and 16% of British aid.[99] This set the stage for the December 1985 adoption of the research and development framework. The Commission insisted that prior notification of all programs was an absolute necessity, and further required the notification of individual projects over ECU 20 million in size. It stated that fundamental scientific research was generally not subject to the state aid rules, and that such research carried on in universities or research institutes was definitely not affected unless it was carried out with or for a for-profit enterprise. Finally, it promulgated new aid intensity limits that were lower than many it had approved in the cases listed above: 50% for basic industrial research and lower levels (generally 25%) for development.[100]

As Hancher et al. point out, the introduction of this framework by no means suggested that the Commission had become less favorable toward R&D aid, merely that it wanted to improve transparency in this area. The Commission made 520 decisions on R&D aid between 1986 and 1994, opening the 93(2) procedure only 15 times and issuing no final negative decisions. When the contentious procedure was opened, it led to negotiated changes in the proposed programs, as is commonly the case (see Chapter 3).[101]

On 20 December 1995, the Commission issued a new R&D framework that took into account the higher levels of aid permitted by the GATT Agreement on Subsidies and Countervailing Measures (SCM), as well as incorporating the Commission's standard practices since the adoption of the first framework. As a result of the changed U.S. position on R&D subsidies in the Uruguay Round after the election of President Clinton, the EU's problem in those negotiations went from one of keeping the limits from falling far below those of its 1986 framework to one of reacting to higher limits than it provided.[102] The 1995 R&D framework made it possible to reach the new SCM limits of 75% (basic industrial research) and 50% (pre-competitive development) in those cases where non-EU competitors had received or were about to receive such high levels of aid. In addition, it elaborated its already existing system of bonuses to the 50/25 system for such categories as SMEs, backward regions, and transnational cooperation. Finally, it raised the notification thresholds to ECU 5 million of aid or a project of greater than ECU 25 million.[103]

Like the sectoral frameworks, the horizontal frameworks on research and development have codified an important area of state aid regulation, giving all parties concerned a consistent set of expectations on how proposed aid would be treated. In contrast to the case of sectoral aid, there is no general presumption against R&D aid in DG IV, and this is reflected in the fact that R&D aid has received about the same proportion of manufacturing aid throughout the 1981-92 period: 9% in 1981-86, 11% in 1986-88, 10% in 1988-90, 10% also in 1990-92, and 7% in 1992-94.[104]

It appears that the framework has been useful in reducing non-notification problems in R&D cases. For example, in 1995 only two research aid programs were introduced without notification, one each in Germany and the United Kingdom. In addition, ten French cases of non-notified aid under the EU's Eureka program for R&D from previous years were settled in 1995.[105] These figures suggest that the Commission has made progress in its goal of transparency in R&D aid.

Policing the Rules, Evading the Rules and Expanding the Commission's Powers

This section describes the strengthening of the Commission's powers in the area of state aid. While the discussion so far has suggested a rather gradual development of policy and expertise, the 1980s saw an acceleration in policy initiatives, due largely to the Single European Act's general revitalization of the European idea. Under Commissioners for Competition Policy Peter Sutherland (Ireland, 1985-88) and Sir Leon Brittan (United Kingdom, 1989-92), DGIV's role increased enormously because of the very centrality of its mission to successfully removing the remaining economic barriers between EC Member States. As Sutherland put it in an interview, "Competition policy was brought to the fore by the 1992 initiative. It required an activist policy on antitrust and state aid affairs, and, in both cases, state intervention was the most intractable and, at the same time, the most important issue."[106] In both Sutherland's and Brittan's view, failure to control state aid could lead to new distortions of competition that would undermine the 1992 program's removal of trade barriers.[107]

At the same time, this section contains a heavy dose of legal history. The reason for this is that while Commission initiatives are ultimately political as well as legal actions, they are invariably challenged before the European Court of Justice. The decisions of the ECJ were critical in determining whether the Commission could make a policy initiative stick. I will thus examine several central decisions: Philip Morris (1980), which confirmed the Commission's general powers and many of its preferred modes of analysis; Leeuwarder (1983), where the Court set standards for the economic analysis the Commission was required to perform to justify its decisions; a whole series of cases on aid repayment from the 1970s through the 1990s; and Boussac (1990), concerning procedures to follow for non-notified aids.

After considering Court cases, this section will turn specific Commission initiatives, including the cumulation rules to combat attempts to circumvent aid limits, the inauguration of the Surveys on state aid, the campaign against general aid, and increased use of Article 93(1) procedures against "existing" aid.

1. Introduction

As anyone who has studied regulation is well aware, regulation isn't forever: the regulated will seek ways to evade regulation when it is in their interest to do so. The Member States of the European Union have often sought ways to evade state aid rules without actually violating them. One way is simply in the way particular subsidies are packaged for presentation to the Commission. As Konstantine Gatsios and Paul Seabright note:[108]

> In particular the Commission became more sympathetic in the 1980s towards aids designed to stimulate research and development, not least because of its concern to match the technological advantages of the US and Japan. Not surprisingly, state aid then began increasingly to take the form of R and D assistance, so that the Commission had to intervene in 1985 and set a limit of 50 per cent of a research programme for basic research, with a lower percentage for more applied research.

Similarly, Member States sought to evade the rules by combining different types of aid eligible under different approved aid programs (for example, giving a firm both regional aid and R&D aid for a single investment). This has provoked responses by the Commission to address evasion techniques, notably the rules on cumulation of aids of different types.

One very vulnerable point in the state aid regime is the necessity for states to themselves notify their intent to award aid to firms: non-notification can greatly undermine the effectiveness of the system. Naturally, it is most likely to occur when it is feared that the Commission would not approve the aid in question.[109] Even if eventually discovered, non-notified subsidies can have pernicious effects, if they manage to get a firm through a difficult period when it would have gone bankrupt but for the aid. The problem for the Commission, then, is how to deal with the discovery of non-notified aid in a way that sufficiently penalizes the recipient without violating its rights under EU law. As we will see, its preferred approach would have been to declare all procedurally illegal aid to be automatically incompatible with the common market. However, the ECJ blocked this route in the Boussac case, requiring that the decision on incompatibility be made on substantive rather than procedural grounds.

Instead, the Commission has focused on ex post facto sanctioning of non-notified, incompatible aid. The method chosen has been to order repayment (with interest) of illegal subsidies to the granting state, which at least until the signing of the Maastricht Treaty was the ultima ratio of state aid control.[110] Member States strongly resisted repayment orders at the Court of Justice, advancing a variety of legal theories against this sanction, but the Court swept them all aside, leaving the Commission the clear victor.

In late 1996, however, the Commission moved to augment this sanction, announcing its intention (after having rejected the idea in 1990) of proposing to the Council of Ministers a set of implementing regulations for state aid as provided for under Article 94.

2. Philip Morris

Philip Morris was a landmark case, the first ever to consider the Commission's powers and discretion in state aid cases.[111] At the same time, it was an unexpected case to be the landmark it became. As Cini points out, there was virtually no mention of it in the Reports on Competition Policy until after the Court's decision.[112] What started as a routine denial of investment aid to Philip Morris Holland BV became a cause celebre when the company, unsupported by the Dutch government,[113] challenged virtually the entire legal basis of state aid control. While also noteworthy for the procedural fact that it established the standing of the proposed aid beneficiary to sue the Commission,[114] it was far more important because the company challenged the Commission's discretion in determining exemptions under the statutory derogations of Article 92(3) and because it attacked the entire concept of compensatory justification. In its ruling for the Commission, the ECJ in essence endorsed both these principles: that it was for the Commission to decide whether an aid was justified by one of the conditions set forth in Article 92(3),[115] and that the Commission's requirement for a compensatory justification for awarding an aid was correct. As Evans and Martin conclude, "State aid that distorts competition will be permitted only to accomplish Community goals and only in the presence of market failure. If market forces would accomplish the goal without state aid, and state aid will distort competition, then state aid will not be permitted."[116] Beyond being a legal landmark, however, it was also, as Cini emphasizes, a "political landmark...[that made] a public statement about DG IV's right to restrict the freedom of national and sub-national aid-donors in choosing where and when to grant subsidies."[117]

3. Leeuwarder and requirements for economic analysis

One goal the Commission did not achieve in Philip Morris was that the Court did not say that state aid automatically distorts competition.[118] Had it done so, it would have relieved the Commission of much of its burden of proof. Nevertheless, the Commission's economic analysis in state aid cases continued to remain superficial, in the view of many observers, to say nothing of the Member States. The Court put an end to this trend in Kingdom of the Netherlands and Leeuwarder Papierwarenfabriek BV v. Commission, one of the earliest cases in which the Commission ordered aid repayment. Whereas in Philip Morris, the Commission had specified the company's market share in the Netherlands and established that 80% of the plant's output would be exported within the Community, in Leeuwarder the Commission had not specified either of these central economic datums. Further, it had not raised the important issue of possible overcapacity in the market. Given these shortcomings in the Commission's economic analysis, the Court annulled the decision against the aid and, as

Schina says, "...forced on the Commission a change in attitude."[119] The Court ruled that if the Commission did make a clear statement of its economic analysis, however, that it created a strong (though rebuttable) presumption that the aid threatened to distort competition (or did so, if already introduced).[120] Between Philip Morris, where the Court ruled that there was no need for the extensive economic analysis required in anti-trust cases under Articles 85 and 86, and Leeuwarder, the Court created a standard of analysis that was subsequently followed by the Commission.

Some Member States saw Leeuwarder and similar decisions of the period (such as Intermills) as providing a new way around the state aid rules: prevent the Commission from conducting an adequate economic analysis by not giving it the information to do so.[121] In one example, Case 102/87 France v. Commission (judgment of 13 July 1988), the French government objected to the Commission's estimate of the prevailing interest rate in France,[122] but had offered no information itself. Relying on the requirement of Article 5 EEC that Member States must cooperate in the achievement of Community purposes, the Court ruled against France.

More recently, a 1994 ECJ decision has muddied this somewhat. In Federal Republic of Germany and Pleuger Worthington GmbH v. Commission, Cases C-324/90 and C-342/90, the Court ruled that its Boussac decision (see below) had essentially given the Commission subpoena powers to order Member States to provide necessary information - and that if the Commission did not use these powers, it could not claim that the state in question had failed to provide adequate information for a decisions. It therefore overturned a Commission negative decision and repayment order in the case.[123]

4. Repayment of Illegal Aid

As noted above, aid repayment has been the ultima ratio for controlling non-notified, incompatible aid since the mid-1980s. The Commission's right to do this was established in the ECJ's ruling in Commission v. Germany, Case 70/72 [1973] ECR 813. Although ruling against the Commission on other grounds in this case involving aid to the coal mining industry, it said of the Commission's request for repayment:[124]

> Such a request is admissible since the Commission is competent, when it has found that aid is incompatible with the Common Market, to decide that the State concerned must abolish or alter it. To be of practical effect, this abolition or modification may include an obligation to require repayment of aid granted in breach of the Treaty, so that in the absence of measures for recovery, the Commission may bring the matter before the Court.

Despite this aspect of the ruling, it was not until ten years later that the Commission announced that it would begin using this sanction.[125] On 24 November 1983, the Commission sent a

Communication to Member States notifying them that it would take all possible measures to ensure that notification requirements were adhered to, and informing potential aid recipients that they were potentially subject to having to repay illegally received state aid.[126] In order to have a "gradual implementation of this principle," the Commission decided to focus on cases where the aids were both incompatible with the common market and had been introduced illegally.[127]

Not surprisingly, given the potential power of repayment orders to undo government decisions, these orders were strongly contested by many Member States. In several ECJ cases, the appellant states argued that repaying aid would be in violation of domestic law. For example, Belgium argued in Case 5/86 Commission v. Belgium ([1988] 2 CMLR 258) that undoing an equity participation violated Belgian company laws. The Court rejected these arguments, as it rejected similar ones in Case 142/87 Re Tubenmeuse ([1988] 2 CMLR 601) that undoing that equity participation would conflict with Belgian law on the relative rights of shareholders and creditors.[128]

Another argument raised in some repayment cases was that repaying the aid would force the recipient into bankruptcy. In case 52/84, Belgium v. Commission, the Court ruled that repayment should still be enforced even if bankruptcy were required. This case also established that the only acceptable reason not to obey a repayment order was the factual impossibility of doing so.[129]

A third argument, raised in a number of appeals by different Member States, appealed to the legal principle of legitimate expectations, that is, that the aid recipient should have been able to rely on the national actions to be binding. As Germany argued in Case 310/85 Deufil, the company had a legitimate "expectation that a national decision granting the aid would be definitive."[130] The Court ruled that this was not correct: the notification requirement of Article 93(3) is definitive, all the more so since Community law is binding on all Member States.

Ross suggests that the Court upheld a consistent line that only factual impossibility, not legal impossibility, was a permissible reason to not obey an aid repayment order from the Commission. He concludes, "...the Court seems determined to resist the development of any easily-satisfied escape-route for Member States faced with demands to repay aids."[131]

Table 4-2 shows the increasing use by the Commission of repayment orders through 1993.

TABLE 4-2

COMMISSION USE OF AID RECOVERY ORDERS

YEAR	# OF CASES	COUNTRIES INVOLVED*	AMOUNT (MM ECU)
1982	3	B, NL	67.59
1983	2	B	25.17
1984	6	B, F, NL, UK	177.51
1985	2	D	5.71
1986	3	B, D	6.90
1987	6	B, D, F	829.34

1988	5	F, I	214.18
1989	5	E, F, GR, I	403.90
1990	5	D, F, GR, I	15.399
1991	4	F, I, UK	42.79
1992	5	B, D, E	130.00
1993	3	D, F, UK	125.09

* D=GERMANY, E=SPAIN

Source: Twenty-third Report on Competition Policy, Annex II, pp. 450-52.

The Commission was able to expand this power in the 1990s. First, it began requiring interest to be paid on illegal aid in the case of the Spanish firm Intelhorce SA, which it determined to have received an illegal capital injection.[132] When the German firm Siemens challenged an interest charge before the Court of First Instance (Intelhorce had been appealed on other grounds), the CFI upheld the Commission on 8 July 1995.[133] Second, in the case of the German firm Textilwerke Deggendorf, it established that it could withhold approval of legal aid until illegal aid had been repaid. This was also upheld by the Court of First Instance, on 13 September 1995.[134]

At the same time, Member States have continued to create new ways of circumventing repayment orders. In 1993, Italy adopted a law amending its bankruptcy provisions for large firms that allowed companies made bankrupt by having to repay illegal state aid to be taken over by the state and have its debts guaranteed, in essence being given new aid. The Commission challenged this in December 1994 and ruled against it in March 1996, demanding the repeal of the new law and an aid repayment it was blocking.[135]

The foregoing shows that once the Commission began using repayment orders as a sanction for rules violations, the European Courts backed it up. As Evans and Martin point out, the ECJ has allowed no excuses from Member States seeking to avoid repayment, and more recent history has shown Court support for expanding use of the repayment sanction. In Chapter 6, I will consider the outcome of repayment orders from the substantive, rather than legal angle, and assess their impact on improving rule compliance by Member States.

5. Trying to Sanction Non-Notification: The Legacy of Boussac

In Case C-301/87 France v. Commission [Boussac], 14 February 1990, the French government attempted to overturn a negative decision and a partial repayment order for unnotified aid it gave the textile producer Boussac Saint-Freres in 1983. This case highlights the many problems the Commission has encountered in trying to control non-notified aid. According to Piet Jan Slot's account, the Commission discovered the aid in July 1983, but it was not until May 1987 that France provided all necessary information to the Commission concerning the aid, which was declared incompatible with the Common Market in July 1987.[136] As Slot remarks elsewhere, "Long and tedious negotiations such as took place in the Boussac Case and the Peugeot aid plans weaken the credibility of the Commission and, for that matter, the Community."[137] Needless to say, it is hard to be deterred by a sanction the outcome of which is uncertain (the Commission only required that about 1/3 of the aid be repaid) and the effective date of which may be seven years away (four years to the Commission decision and almost three more to the ECJ ruling in this case) or more. Given this obvious problem, the Commission tried to persuade the Court that non-notified aids are per se illegal, which would greatly strengthen its hand in bargaining with non-notifiers. However, the ECJ did not accept this argument,[138] but did say that the Commission could issue interim orders and demand an immediate suspension of aid payments.[139] On the substantive side of the case, the Court rejected a wide variety of French claims (inadequate reasoning, Commission delays, disproportionate punishment [i.e., repayment], and that the capital injections and soft loans did not constitute an aid because a market investor would have done the same) and upheld the repayment order.[140]

The mixed decision on the procedural side drew varying reactions from observers. Slot saw it as giving no sanction against non-notification, except for using national courts to enforce the directly-effective notification requirement,[141] while K.P.E. Lasok saw it as only delaying the inevitable, at worst.[142] The Commission's view has moved ever-closer to Slot's in recent years. While it initially focussed on making interim orders,[143] by 1995 it decided to recruit national courts more directly into enforcing the notification requirement.[144] However, by late 1996, in a sharp turnabout from its position at the beginning of the decade, the Commission decided to propose implementing regulations under Article 94. These were expected to include procedural rules on notification, time limits, and the rights of defendants and third parties; block exemptions for categories of aid (such as for SMEs) where notification would be replaced by ex post facto reporting; a de minimus rule; and rules exempting certain sectors from state aid rules because they are in their entirety akin to public services (such as public health, education, etc.).[145] Assuming these proposals create real sanctions for non-notification, they should go a long way toward solving the problem. As always, though, the proof will be in the pudding.

6. Evasion techniques: the case of cumulation

Given the incentive states have to avoid the rules when it is in their interest to do so, it is important to consider some of the evasion techniques available. Non-notification and packaging (primarily under the R&D rubric) have been discussed above; there remains one other option that has been used frequently, that of "cumulation" of aids, that is, awarding more than one aid of different types to the same project.

For example, a state with a regional aid maximum of 30% might provide both a 25% NGE regional aid for an investment as well as a 10% NGE R&D grant for the same investment. Both would be within the normally permitted maxima for that type of aid, and likely would not even have to be notified (assuming the programs under which they were given had already been notified and approved), but the total would be in violation of the overall maximum for the region in question. However, because neither aid might not be individually illegal, the Commission would be unlikely to hear about the violation unless there were a complaint from another state or from a competitor of the recipient. It was to prevent situations like this from occurring, particularly in the context of bidding for inward investment,[146] that the Commission introduced, in a 1985 Communication, "Rules applicable to cases of cumulation of aids for different purposes."[147] These rules required the notification of individual cases when two or more types of aid were cumulated and either 1) the aid came to 25% NGE or greater; or 2) the investment was greater than 12 million ECU.

These rules were not immediately accepted by all Member States. France, Germany and Greece all either rejected them or refused to apply them. The Commission instituted infringement proceedings against France before the ECJ for failing to notify aid cumulation procedures; France agreed in 1988. With Germany, the Commission instead opened Article 93(2) proceedings against the 14th and 15th Framework plans for federal/Lander regional aid in order to pressure Bonn on the cumulation question. Germany reached agreement with the Commission in 1987, while Greece did so in 1988, also after a 93(2) procedure.[148]

The evidence is mixed on whether the cumulation rules have fully addressed the problem. Certainly in its first few years, the Commission's calls for transparency in this area suggested that problems remained.[149] Similarly, in 1994, Cini suggested that the problem of cumulation "remains a major problem for the DG IV."[150] Yet neither the 24th nor 25th Reports on Competition Policy mention cumulation as an issue, so perhaps a case can be made that the situation is now better than in the 1980s.

7. Other Commission Initiatives

As Cini has argued, Sutherland's inauguration of the Surveys on state aid was crucial in providing a quantitative snapshot of the entire state aid field, one subsequently used to inform new policy initiatives.[151] She notes how the negative example of Italy as a high aid giver was constantly held up in the first two Surveys, and the apparent treatment of aid as in itself bad. With the information gained from the Surveys, the Commission was for the first time able to say that state aid comprised x% of country Y's GDP, or the government's budget, or its budget deficit. This added to its ability to argue that the total amount of state aid was too high.

In 1989, as part of Commissioner Brittan's policy review, he announced that general investment aid would be an important target and that previously-approved ("existing") general aid programs would come under scrutiny as well.[152] DG IV moved swiftly to challenge a number of these programs, with the Dutch and Belgians agreeing to end general investment programs, and the British undertaking to individually notify every general aid offered under Article 8 of the Industrial Development Act.[153] As a result of this pressure, general aid has fallen as a proportion of total aid to manufacturing from 5% in 1981-86 to just 1.6% in 1992-94 (For more detail see Table 6-16).[154]

Beyond general aid, existing aid programs were a high priority because it was estimated that 80% of all aid was granted under existing schemes, as opposed to new aids. Already under Sutherland, the use of Article 93(1) reviews to examine existing aid was on the upswing.[155] But under Brittan and Van Miert, it became a more regular feature of DG IV practice. For example, the Commission completed reviews of existing aid under Article 93(1) in sixteen cases each in 1994 and 1995, representing about 3% of the cases completed each year.[156]

8. Conclusion

This section has demonstrated the increasingly rapid pace of state aid law and policy since 1980. Beginning with the Philip Morris decision, which created a firm case law base for DG IV's work, the Commission has become more confident in its handling of state aid policy. While this by no means changes the incentives states face to try to evade the rules, the Commission's efforts, upheld by the ECJ, have increased the sanctions for transgressions. This has intensified the ways in which EU powers have clearly reduced the sovereignty of Member States. The following section highlights one of the most sensitive aspects of this, the interaction between state aid law and the use of public ownership of enterprise.

State Aid to State-Owned Firms

State-owned firms and state aid control are mutually problematic. Transactions between the state and state-owned enterprises tend to be less transparent than arms' length transactions. Moreover, as Gatsios and Seabright have argued, it may be inherently less credible for a state to pledge not to reimburse losses of a state-owned firm than it is to make the same commitment vis-a-vis privately owned companies.[157] Both of these factors make regulating aid to public enterprises more difficult than controlling subsidies to private firms.

At the same time, the inherent threat to soveriegnty that state aid control represents is especially sharp in relation to state-owned firms. The legitimacy of state ownership is guaranteed by Article 222 of the Treaty of Rome, and many countries have used public ownership as key ingredients of their industrial strategy. State aid regulation necessarily impinges on decisions of industrial policy, but the special targeting of aid to public enterprises, as occurred particularly under Sir Leon Brittan's tenure as Competition Commissioner, seems to undermine the Treaty's neutrality between public and private ownership. As the Economist has rightly asked, "What is the point of state ownership if the state must run its firms as if they were private ones?"[158]

The Commission's approach to the state-owned sector has changed over the years. This section will focus on its early analysis of state ownership before turning to the first landmark in this area of state aid control, the Transparency Directive of 1980. Next, I will consider the Brittan initiative against aid to the public sector and the conflicts it generated. In this context, we will analyze the Commission's "private investor" principle for assessing the existence of state aid, and the Meura ECJ decision that confirmed it. Finally, I will focus on the current situation, where the most important justification for accepting subsidies has been for the performance of public service requirements (such as providing postal service throughout a country's territory, regardless of the differential cost of serving different locations).

1. Temporary acquisition of shareholdings by the state

In the Second Report on Competition Policy, the Commission addressed the question of state ownership at length.[159] Commenting on several Italian, French and Belgian programs for temporarily acquiring shares of firms in difficulties, it turned Article 222 on its head:

> ...the Commission took the view that the principle of neutrality set out by the EEC Treaty (Article 222) with regard to ownership arrangements in the Member States

> prevents the latter from using their power to intervene in the ownership of production facilities to take measures which, if other intervention techniques were used, would be incompatible with Article 92 et seq., since these distort intra-Community competition and trade. Any other interpretation would entail unacceptable discrimination between Member States or between differing measures adopted by the same Member State, but in fact having the same objectives.[160]

In other words, not only does Article 222 imply that state ownership cannot be burdened by EU decisions, it also cannot be privileged, either.

The Commission acknowledged that it could not be decided in the abstract whether the agencies set up to obtain such temporary shareholdings (such as the Instituto Mobiliare Italiano - IMI) were in fact dispensing state, but only through examination of their actual practices. It decided that the French, Italian and Belgian agencies would have to give reports on each firm assisted under by them, with regional and sectoral data included. In particular, it noted that aid would be considered to be present when it could be shown:

> (a) that the acquisition of holdings are used as an alternative to or a factor strengthening traditional forms [of state aid];

(b) that they are provided for firms in liquidation which would disappear from the market without such assistance;

(c) or, lastly, that the purchases of holdings do not ensure normal renumeration of the capital committed or that they are eventually sold to the partners falling short of the acquisition price.[161]

As will be seen below, this last point strongly foreshadowed the Commission's later "market investor" rule.

2. The Transparency Directive

In June 1980, the Commission adopted Directive 80/723/EEC on "the transparency of financial relations between Member States and public undertakings."[162] This decision requires governments to maintain for five years records covering all financial transactions between governments authorities and state-owned or state-controlled firms, including the specific uses of funds provdided to them, to be provided to the Commission upon request.[163] A pitched legal battle ensued, as two of the most interventionist states, France and Italy, challenged the Directive before the Court of Justice, as did the United Kingdom. Intervening on behalf of the Commission were the Netherlands and Germany, states with far lower levels of state ownership. Britain's position was somewhat anomalous: it did not oppose the goal of the Directive, but joined the appeal on the basis tht the Commission was usurping the Council's legislative powers.[164] In ruling in the Commission's favor, the Court stated that the Directive did not place an unfair burden on public firms, because the financial relations between states and state-owned firms were of a different nature than those involving privately owned firms. However, when, in 1991, the Commission issued a Communication requiring annual reporting of information on state-owned firms, the Court annulled this decision.[165] In response, the Commission issued a new Directive incorporating the annual reporting requirement.[166] Through these Directives, the Commission has increased the quantity and quality of information available to it for controlling aid to the state-owned sector.

3. Brittan's initiative against aid to state-owned firms

In 1989, Sir Leon Brittan took over the Competition portfolio from Peter Sutherland. Following on from Sutherland's activism, Brittan announced his priorities for state aid control in a number of speeches given that March. In particular, he identified a reduction in the overall volume of aid, a review of "existing" (i.e., previously approved) aid, subsidies for exports to non-EC countries, general investment aid, aid for "national champions" and, most important for the present analysis, aid to state-owned firms. As Brittan said in one speech, "The feather-bedding of nationalized industries must be stopped," hardly a surprising statement from a one-time Industry Secretary under Margaret Thatcher.[167] While certainly reflecting his own political views, it remains true that his attack on aid to public firms also underlines the difficulties in regulating such aid. For example, Commission estimates suggest that the ECU value of non-notified aid is ten times greater for state-owned firms than for private companies.[168]

As Cini has pointed out, Brittan's approach to his portfolio was to "concentrat[e] on the most controversial cases."[169] Among the more important cases of aid to state-owned firms he focused on were Groupe Bull (6 billion francs in aid) and Sabena ($1 billion).[170] Yet in these cases, the Commission eventually approved the aid in question. In the case of Bull, the Commission was persuaded to approve the aid (despite the company's long-standing losses) by capacity cuts and by the fact that both IBM and NEC had bought minority stakes in the company.[171] Regarding the Sabena aid, Trevor Soames and Alan Ryan comment that it - along with aid for state-owned Air France and Iberia - was approved "with barely a murmur from the European Commission."[172]

One high-profile case he inherited was that of Renault, in which the French government wrote off 12 billion francs of the company's debt in early 1988.[173] This followed 8 billion francs (ECU 1.13 billion) in capital injections over the previous three years that had been paid without Commission approval.[174] This case was complicated by the fact that the write-off was originally intended by a Conservative French government as a precursor to privatization, but when the Socialists returned to power later that year they balked at privatizing the company. Indeed, the new government refused to take the first step envisioned, that of changing Renault's status from a "Regie" (the equivalent of a government department) to a normal firm (Societe Anonyme). The Commission had originally agreed to the write-off when it was to be followed up by the ending of its Regie status, but with the new government's change of plans, the March 1988 aid approval was voided and it was threatened that Renault would have to repay the 12 billion debt write-off.[175] The Commission split on this issue along a Brittan-Delors axis, but eventually a compromise was reached with the French. In view of a partial change in the company's legal status (remaining a Regie, but subject to normal commercial law) and the completion of about half of the capacity cuts envisioned in the March 1988 decision, the Commission agreed that Renault would only have to repay 6 billion frnacs, with the other 6 billion approved subject to the conditions of the original decision.[176]

4. The current situation

Since Flemish Socialist Karel van Miert replaced Brittan as Competition Commissioner in 1993, when he moved over from the Transport portfolio, the level of rhetoric surrounding aid to state-owned firms seems to have declined somewhat. All the same, important work on public sector aid has continued, and new ground is being broken. The largely state-owned airlines have felt new pressure on the subsidies they once received with little notice in the past, while state-owned firms in a number of sectors have had to justify the subsidies they receive for carrying out "public service" requirements.

After a spate of aid awards to airlines in the early 1990s, the industry's difficulties led to even larger awards, topped by 20 billion francs to Air France in 1994. By this time, according to Soames and Ryan, the Commission began to impose more stringent restructuring requirements on the airlines in return for the aid, largely as a result of stringent lobbying campaigns by privately owned airlines, beginning with aid for Aer Lingus authorized in December 1993.[177] The aid to Air France was also challenged by a number of its competitors in court and has not been decided at the time of this writing. Finally, a capital injection to Iberia was approved in January 1996 with a decision that it did not constitute state aid, yet restructuring requirements were still imposed, including a cut of 3,500 jobs and the sell-off of some of its South American subsidiaries.[178]

Public service requirements have become increasingly prominent in discussions of aid to the public sector. While there are few in the airline industry, Ireland's have been criticized by Aer Lingus' competitors as being set up in a way to be only practically served by Aer Lingus (Community rules require an open bidding process for serving poorly traveled routes a country wants to keep open) and thus a further subsidy.[179] Another important public service case was that of the French Postal Service, regarding which the Commission decided that no aid existed because:

the value of the tax relief is less than the costs of the public service obligations imposed on the post office, namely to provide post offices throughout the country and deliver mail throughout the territory of France irrespective of the fact that the prices for this service may not always correspond to the costs.[180]

Similarly, in November 1996 the Commission decided that payments received by the Portuguese state-owned broadcasting firm RTP did not constitute aid, because it was less than the cost of the channel's public service requirements (covering the entire territory, including the Azores and Madeira, religious broadcasting, etc.), which the commercial complainant did not share.[181]

It seems certain that conflict over aid to state-owned firms will continue for the foreseeable future. Privately owned companies in such industries as steel and airlines have become increasingly vocal about the aid given to state-owned competitors, and such complaints have now begun in areas formerly occupied by government monopolies, such as television broadcasting, postal and telecommunications services. In particular, the issue of whether subsidies to cover public service requirements give government enterprises advantages in competitive markets is bound to stay at or near the top of DG IV's agenda as complaints come in from private competitors.[182] However, as the "no aid present" decisions of cases such as the French Postal Service and RTP broadcasting show, state-owned firms are by no means simply going to be swept from the scene by aggressive use of the state aid rules.

Conclusion

This chapter has shown the gradual expansion of the Commission's powers in the state aid field and how important environmental events such as enlargement have affected state aid policy. Several themes clearly stand out.

First, the legal aspects of state aid policy have proved crucial at a number of junctures. Since the really controversial issues are undoubtedly appealed to the EU courts, the attitude of the courts has played a major role in the development of state aid policy. In particular, the fact that the ECJ (and more recently, the CFI) have generally supported the Commission's actions have lent it a strong hand in prosecuting its policy.[183] This has stood out in the Philip Morris case and in the long series of cases on the Commission's power to order aid repayment which, as detailed above, have both defended it and allowed the Commission to extend it via interest charges and through withholding legal aid until illegal aid is repaid. In terms of constraints on the Commission, Boussac is the most important insofar as it kept from the Commission what would clearly have been a powerful lever against non-notification.

Second, an ever widening area of policy has been codified. Until the mid-1980s, this occurred largely in reaction to crises, both sectoral (shipbuilding, textiles, steel, etc.) and horizontal (i.e., environmental and technological). The Commission's enumeration of these two types of frameworks has made for the speedier handling of aid in the affected areas, as well as guiding Member States toward proposing programs that were likely to be approved.

Third, compliance with the Commission's authority has been uneven among the Member States, but efforts at non-compliance have been met with increased enforcement efforts by the Commission. This has been especially evident in the introduction of the R&D framework and cumulation rules, and most importantly in the use of aid repayment orders.

Fourth, there has been a sharp expansion in the volume of activity by the Commission, as the Table 4-3 shows. (Note that the Commission has from time to time changed its method of aggregating cases, accounting for breaks in the series as noted below.)

TABLE 4-3a

COMMISSION ACTIONS ON STATE AID CASES, 1970-80, EXCLUDING AGRICULTURE AND TRANSPORT

YEAR	# CASES	NO OBJECTION	CONTENTIOUS PROCEDURE	NEGATIVE DECISION
1970	21	15	6	1
1971	18	11	7	3

1972	35	24	11	3
1973	22	15	7	4
1974	35	20	15	-
1975	45	29	16	2
1976	47	33	14	2
1977	112	99	13	1
1978	137	118	19	-
1979	133	79	54	3
1980	105	72	33	2

Source: 13th Report on Competition Policy, point 228.

TABLE 4-3b

COMMISSION ACTIONS ON STATE AID CASES, 1980-86,

EXCLUDING AGRICULTURE, FISHERIES, AND TRANSPORT

YEAR	# CASES	NO OBJECTION	CONTENTIOUS PROCEDURE	TERMINATE PROCEDURE	NEGATIVE DECISION	WITH-DRAW
1981	92	79	30	19	14	--
1982	200	104	86	30	13	--
1983	174	101	55	18	21	9
1984	162	201	58	34	21	6
1985	133	102	38	31	7	11
1986	124	98	47	26	10	5

Source: 20th Report on Competition Policy, point 187.

TABLE 4-3c

COMMISSION ACTIONS ON STATE AID CASES, 1987-95,

EXCLUDING AGRICULTURE, FISHERIES, COAL, AND TRANSPORT

YEAR	# CASES	NO OBJECTION	CONTENTIOUS PROCEDURE	TERMINATE PROCEDURE	NEGATIVE DECISION	CONDITIONAL DECISION	OTHER
1987	294	188	28	30	7	6	35
1988	410	303	36	20	14	9	28
1989	343	259	36	21	16	0	11
1990	492	415	34	20	14	0	9
1991	597	493	54	28	7	2	13
1992	552	473	30	25	8	7	9
1993	467	399	32	19	6	1	10
1994	527	440	40	15	3	2	27
1995	619	504	57	22	9	5	22

Note: "Other" decisions include Commission proposals of "appropriate measures' for modifying or abolishing an existing aid under Art. 93(1) of the EEC Treat; and Council decisions under Article 95 of the ECSC Treaty.

Sources: Twenty-fourth Report on Competition Policy, Annex III, Table 5, p. 63(Twenty-fifth Report on Competition Policy, Part Two, Table 4, p. 316.

Fifth, the Commission moved from a reactive to a proactive approach to state aid under Peter Sutherland and Sir Leon Brittan. The 1980s were a period of policy activism that has left its mark on DG IV.

Sixth, the enlargement of the EU beginning in 1973 has posed challenges to state aid policy. Most obviously, it has meant the socialization of new groups of officials to the rules, such as those banning export aid for intra-Community trade. More fundamentally, the increasing number of members has meant a larger group of actors trying to cooperate on this policy, which cooperation theory warns us is an increasingly difficult task. This has been exacerbated because many of the newer areas are substantially poorer than the original six Member States, creating the dilemma of how to increase growth in the Cohesion states while simultaneously avoiding pressures for races to the bottom in environmental policy, labor and social policy, and increasing levels of investment location subsidies. Some of the choices made along the way (such as allowing Ireland to levy only a 10% corporate income tax on manufacturing and some service sectors, without considering it to be a state aid) have served to intensify rather than ameliorate competition for investment.

Finally, the overall thrust of the Commission's efforts have been to require increasing transparency in state aid policy on a number of dimensions. This includes enforcing the notification requirement more diligently, encouraging Member States to use more transparent forms of aid (discussed further in Chapter 6), publishing more details of its rules and decisions, and compiling and publishing the biennial Surveys on state aid. The amount of information available on state aid in the EU is now quite substantial.

By contrast, as Chapter 5 will show, the same cannot be said for either the United States or Canada. Not only are there few central rules on subsidies and tax expenditures favoring firms, there is no comprehensive data in either country showing the total support given to companies at the federal and sub-national levels. It is to the task of generating ballpark estimates, and analyzing what regulation does exist, that I now turn.

Notes

1.CEC, Competition Law in the European Communities, Volume II: Rules applicable to state aids (situation at 31 December 1989) (Brussels-Luxembourg: CEC 1990), pp. 14-15.

2.Cini, "Policing the Internal Market," p. 151.

3.Sixth Report on Competition Policy, Annex, p. 195. Compare this with the 36 final decisions taken in 1995 under Article 93(2) or the similar steel aid code procedures. See Twenty-fifth Report on Competition Policy, point 219.

4.Common Market Law Reports [1970] Part 41, pp. 43-76.

5.EC Commission vs. France 1970 CMLR 41, pp. 64-69.

6.Schina, State Aids Under the EEC Treaty, p. 46.

7.Second Report on Competition Policy, point 109.

8.First Report on Competition Policy, point 181.

9. Case 47-69 France v. Commission [1970] ECR 487.

10.First Report on Competition Policy, point 183.

11.For some of the cases brought by the Commission to enforce this position, see Second Report on Competition Policy, points 108-11; Third Report on Competition Policy, points 102-4; Fourth Report on Competition Policy, points 159-62; Seventh Report on Competition Policy, points 220-21. Indeed, it came to light in 1980 that France had not complied with the Court decision in Case 47/69, and the Commission instituted infringement proceedings with the ECJ. See 10th Report on Competition Policy, point 211.

12.In 1980,The Ninth Report on Competition Policy, point 139, declared: "The Community discipline eliminating aid in intra-Community trade has become fully effective." Three cases of intra-Community exports over the 1985-89 period (all Italian) are identified by Elaine Ballantyne and John Bachtler, Regional Policy Under Scrutiny: The European Commission and Regional Aid, (Glasgow: European Policies Research Centre, 1990), p. 43. Following Greece's accession to the EC, its export aid program was allowed to continue as a transition measure. However, in 1986 the Commission ordered its phase-out by 1 January 1990. Sixteenth Report on Competition Policy, point 258.

13. Twenty-fifth Report on Competition Policy, point 209.

14. Twenty-fourth Report on Competition Policy, point 390; Twenty-fifth Report on Competition Policy, point 210.

15. First Report on Competition Policy, point 143.

16. First Report on Competition Policy, points 141-42.

17. CEC, Competition Law in the European Communities, Volume II: Rules applicable to state aids (situation at 31 December 1989), p. 97; Cini, Policing the Internal Market, p. 227.

18. First Report on Competition Policy, points 147-53.

19. The "center" at that time consisted of the entire EC except for Berlin, Germany's Zonal Border Area (the area bordering East Germany), the Italian Mezzogiorno, and West and Southwest France.

20. Fourth Report on Competition Policy, point 149.

21. Fifth Report on Competition Policy, point 86.

22. Fifth Report on Competition Policy, point 87.

23.This evolved into a 75% net grant equivalent limit, because that was the existing maximum in the Mezzogiorno at that time. See Douglas Yuill et al., European Regional Incentives 1994/95 (London: Bowker-Saur, 1994), p. 100.

24.Published as the Commission Communication of 3 February 1979, included in Competition Law in the European Communities, Volume II: Rules Applicable to State aids (situation at 31 December 1989) (Brussels-Luxembourg: CEC, 1990), pp. 99-108. In addition to the Communication itself, see the discussion of it in Eight Report on Competition Policy, points 152-53.

25.Personal interview with Reinhard Walther, DG IV, Unit Head for Inventory and Analysis, Brussels, 23 September 1993.

26.Commission communication on the method for the application of Article 92(3)(a) and (c) to regional aid, in Competition Law in the European Communities, Volume II, pp. 109-22.

27."Competition Policy, Cohesion and the Co-ordination of Regional Aids in the European Community," European Competition Law Review, Vol. 14, no. 4, July/August 1993, p. 145.

28.Yuill et al., European Regional Incentives 1994/95, p. 96. Its Objective 1 status was slated to end 31 December 1996.

29.CEC, Competition Law in the European Communities, Volume II, pp. 118-22. In some cases, the limits were specified in terms of gross grant equivalent.

30.Cini, Policing the Internal Market, p. 230, suggests that DG XVI has been relatively weaker than DG IV. Ballantyne and Bachtler, Regional Policy Under Scrutiny, p. 50, note the "protracted, complex and often acrimonious argument between Brussels and national government departments."

31.See 25th Report on Competition Policy, point 151, and Keith Middleman, Orchestrating Europe: The Informal Politics of the European Union (London: Fontina Press, 1995), p. 523.

32.AFX News, "EU's Wolf-Mathies to look at ways of preventing plant transfers for subsidies," 10 March 1997; David Gow, "Euro Eye: First Shots in a Long and Bloody Battle Over Jobs," The Guardian, 15 March 1997, p. 22.

33.John Kurt Jacobsen, Chasing Progress in the Irish Republic: Ideology, Democracy and Dependent Development (Cambridge: Cambridge University Press, 1994), p. 197.

34.Jacobsen, Chasing Progress in the Irish Republic, Chapter 4.

35.Jacobsen, Chasing Progress in the Irish Republic, p. 99.

36.Industrial Development Authority, Annual Report 1979 (Dublin: IDA Ireland, 1980), p. 93. See also 10th Report on Competition Policy, point 173. The Commission also objected to it on the grounds that it was an operating aid.

37.See, for example, the following promotional material: IDA Ireland, Ireland: Put Yourself in Our Hands in the 1990s, p. 1 (Dublin: IDA Ireland, 1991); or IDA Ireland, Guide to Taxes and Tax Reliefs in Ireland (Dublin: IDA Ireland 1991), p. 3, which describes the tax rate as "A Unique Tax Incentive into the 21st Century," and trumpets the tax rate on the cover.

38.Second Survey on State Aid, Annex 1, pp. 1-2. This caused a downward revision of the value of EPTR for the 1981-86 period covered by the First Survey. That the Commission has accepted it as a general measure rather than state aid is even more puzzling in light of its examination of certain extensions of the 10% rate to non-manufacturing operations in terms that treat it as state aid. See 17th Report on Competition Policy, point 249.

39.It should be noted that the Irish are themselves considering ending the 10% tax rate when it expires in 2010. This was the argument of 1992's Culliton Report from the Industrial Policy Review Group. See Doughlas Yuill, Kevin Allen, John Bachtler, Keith Clement and Fiona Wishlade, European Regional Incentives 1993-94, 13th edition (London: Bowker-Saur, 1993), p. 5.

40.Again, this procedure is used with existing aids; see Chapter 3.

41.Eighteenth Report on Competition Policy, point 234.

42.Fifth Survey on State Aid, p. 7, Table 3. The figures are expressed in 1993 prices.

43.Mitchell Smith, "Integration in Small Steps: The European Commission and Member-State Aid to Industry," West European Politics, July 1996, p. 570. He notes that in 1994, 206 of 527 state aid decisions pertained to Germany alone.

44.Imre Karacs, "Bremer head detained in search for missing money," The Independent, 21 June 1996, p. 21; European Report, "State Aid: Commission Extends Bremer Vulkan Investigation," No. 2173, 13 November 1996; European Information Service, "State Aid: Commission to Bail Out East German Shipyards," European Intelligence #113, 7 March 1996.

45."EU Gives Germany Till Aug 10 to Fix VW Subsidies," Reuter European Community Report, 2 August 1996, BC Cycle; European Information Service, "Volkswagen Row Escalates as Bonn Takes Commission to Court," European Report # 2157, 14 September 1996.

46.R. Hall and D. van der Wee, "Community Regional Policies for the 1990s," Regional Studies, Vol. 26, no. 4 (1992), p. 400. For information on the negotiations over the expansion of the Structural Funds (as well as other aspects of the EC budget), see Simon Alterman, "Spanish Drive for Better EC Deal Poses Summit Threat," Reuter Library Report, 9 February 1988; and David Buchan and Tim Dickson, "An End to the Nay-Saying," Financial Times, 15 February 1988, p. 21.

47.Fiona G. Wishlade, "Competition Policy, Cohesion and the Co-ordination of Regional Aids in the European Community," pp. 146-47. The following quote is from p. 146.

48."Community Regional Policies for the 1990s," p. 400.

49.European Regional Incentives 1994-95, pp. 101-102.

50.CEC, Competitiveness and Cohesion, p. 26, Tables 17-18.

51.CEC, Competitiveness and Cohesion, p. 133.

52.CEC, Competition Law in the European Communities, Volume II, p. 120.

53.Telephone interview with a European plant location consultant, 5 November 1993. He said it was suspected that Hainaut had received this designation as a result of Belgian Flemish Karel Van Miert becoming the new Competition Commissioner.

54.CEC, Competitiveness and Cohesion: Trends in the Regions (Brussels-Luxembourg: CEC, 1994), p. 129. For a taste of the intense bargaining over this package, see Chris Porter, "Commission Loses Out in Bruising Regional Aid Battle," Reuter European Community Report, 20 July 1993; and "European Community: Poorer than Thou," Economist, 10 July 1993, p. 41.

55.Twenty-fifth Report on Competition Policy, point 220.

56.Kevin Done, "Chrysler to go to law against EC," Financial Times, 11 November 1992, p. 4; Edward M. Graham, Global Corporations and National Governments (Washington: Institute for International Economics, 1996), p. 82.

57.Claude Rakovsky et al., "Summary of the most important recent developments (International Dimension of Competition Policy)", Competition Policy Newsletter, Autumn/Winter 1995, p. 55.

58.Steffan Depypere et al., "Summary of the Most Important Recent Developments (International Dimensions of Competition Policy)", Competition Policy Newsletter, Spring 1996, pp. 38-40.

59.Commission letter and annex on textile and clothing industries, 4 February 1977, in CEC, Competition Law in the European Communities, Volume II: Rules applicable to state aids (situation at 31 December 1989), p. 50. Emphasis added.

60.Needless to say, EU trading partners may not see these initiatives as benign, but rather as themselves protectionist. These disputes are beyond the scope of this volume.

61.Cini, "Policing the Internal Market," p. 236; Schina, State Aids Under the EEC Treaty, p. 81.

62.Bitterly resented by many LDCs as proof that the industrialized nations only favored free trade when it was beneficial to them, the MFA was only slated for phase-out as a result of the Uruguay Round GATT agreement.

63.First Report on Competition Policy, point 171.

64.First Report on Competition Policy, point 172.

65.Second Report on Competition Policy, point 97.

66.Fifth Report on Competition Policy, points 107-109.

67.F. Knox, Towards 1992: State Aids to Industry (Trade and Tariffs Research, London, November 1989), pp. 17-18. See also Seventh Report on Competition Policy, points 237-241.

68.See Schina, State Aids Under the EEC Treaty, p. 85. Note that the synthetic fibers industry includes products with industrial uses as well as textile/clothing uses.

69.Schina, State Aids Under the EEC Treaty, pp. 84-85.

70.For a good discussion of the early penetration of both U.S. and EU markets by Japanese firms, see Dennis Patrick Quinn, Restructuring the Automobile Industry: A Study of Firms and States in Modern Capitalism (New York: Columbia University Press, 1988), pp. 104-118. For Japanese market share in EU countries over the course of the 1970s, see Figures 4.14 and 4.15, pp. 152-53.

71.See, for example, Kenneth P. Thomas, Capital Beyond Borders: States and Firms in the Auto Industry, 1960-1994 (London: Macmillan, 1997), p. 75.

72.CEC, Competition Law in the European Communities, Volume II, p. 53.

73.The quote is from Tenth Report on Competition Policy, point 206. On the reporting system, see Eleventh Report on Competition Policy, point 215. See also Hancher et al., EC State Aids, pp. 112-113.

74.Point 164.

75.18th Report on Competition Policy, point 227; Hancher et al., EC State Aids, pp. 113-114; Robert McDonald, "State Aids & the Effort to Ensure Fair Competition," EIU European Trends, No. 2, 1992, p. 61; and "The Aid Plague," Economist Survey of Business in Europe, 8 June 1991, p. 17. Useful background on this case can be found in Krish Bhaskar and the Motor Industry Research Unit, The Effect of Different Aid Measures on Intra-Community Competition, Exemplified by the Case of the Automotive Industry, Commission of the European Communities Document, March 1990. pp. 2, 16-18.

76.The most extensive treatment of this case is Cini, "Policing the Internal Market," pp. 347-373. She also notes, p. 356, that L78 million in regional aid was authorized.

77.Hancher et al., EC State Aids, p. 117; McDonald, "State Aids," p. 61; and Krish Bhaskar and the Motor Industry Research Unit, The Effect of Different Aid Measures on Intra-Community Competition, pp. 18-19. Italy was ordered to reclaim the entire amount of this aid.

78. 18th Report on Competition Policy, point 164; Hancher et al., EC State Aids, pp. 119-121.

79. Max Pemberton, Europe's Motor Industry After 1992, EIU Special Report #2090, January 1991, p. 122. This was an investigation of six small Volkswagen investments in Belgium.

80. Reuters, "European Commission and Germany Head for Clash Over Subsidies," 7 April 1989, AM cycle.

81. Krish Bhaskar and the Motor Industry Research Unit, The Effect of Different Aid Measures on Intra-Community Competition, p. 12.

82. On the most recent edition of the Spanish saga, see AFX News, "European Commission reestablishes right to monitor state automobile aid," 5 July 1995; Reuter Textline, "EU: Spain Attacks Commission Decision to Extend State Aid Framework to Car Sector," 21 September 1995; AFX News, "EU probes Spanish state aid for motor industry," 21 September 1995; AFX News, "EU orders Spain to notify car sector state aid projects over 17 mln Ecu," 20 December 1995; and European Information Service, "State Aid: Commission's Extension of Motor Industry Aid Code Not Justified," European Report No. 2216, 16 April 1997. The effect this ECJ decision in favor of Spain will have on 1995 automobile aid decisions is not yet known.

83. Hancher et al., EC State Aids, pp. 121-122.

84. AFX News, "EU's Wolf-Mathies to look at ways of preventing plant transfers for subsidies," 10 March 1997; David Gow, "Euro Eye: First Shots in a Long and Bloody Battle Over Jobs," The Guardian, 15 March 1997, p. 22.

85.On the new steel aid code, See Mederer, "State Aid," p. 46. CITES NEEDED. [I AM AWARE OF FORTHCOMING WORK ON THE STEEL INDUSTRY FROM LUISA PERROTTI.]

86.Hancher et al., EC State Aids, pp. 125-127, 134; Wolfgang Mederer, "State Aid: Summary of the most important recent developments," Competition Policy Newsletter, Autumn/Winter 1996, pp. 46-47. Note that shipbuilding is further complicated by the fact that there is an OECD agreement on aid to the industry. The most recent version of this agreement, designed as a binding treaty to take effect in July 1996, is in limbo at present because the United States has yet to ratify it. See OECD-DSTI-Shipbuilding, "The Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry - Overview," at http://www.oecd.org/dsti/sid/sp7.html, and Mederer, "State Aid," p. 46.

87.Ronayne, Disciplining Industrial Incentives, pp. 86-87, 106.

88.Edward M. Graham and Mark A.A. Warner, "Multinationals and Competition Policy in North America," in Lorraine Eden, editor, Multinationals in North America (Calgary: University of Calgary Press, 1994), p. 479.

89.1981-86 calculated from Second Survey on State Aid, Annex I, Table X B (a revision of data from the First Survey); 1986-88 calculated from Second Survey on State Aid, Annex IV, pp. 2-13; 1988-90 drawn from Fourth Survey on State Aid, Table 7, p. 25; 1990-94 from Fifth Survey on State Aid, Table 7, p. 21. Note that these figures include both steel and shipbuilding, which were both extremely high in the early 1980s and have been the focus of other sectoral frameworks. Without steel and shipbuilding, 1981-86 falls to 16% and 1986-88 to 20% (Second Survey on State Aid, Table IX, p. 30).

90. Fourth Survey on State Aid, Table 6, p. 24; Fifth Survey on State Aid, Table 6, p. 20.

91. Fifth Survey on State Aid, Table A, p. 83.

92. Second Report on Competition Policy, points 100-103.

93. Second Report on Competition Policy, points 102-103.

94. Fourth Report on Competition Policy, points 171-174.

95. Sixth Report on Competition Policy, points 237-238.

96. Eighth Report on Competition Policy, point 210.

97. Ninth Report on Competition Policy, point 195. The Commission did say that it would monitor that the amount of aid going for existing employees was not disproportionate, and that the aid was not being concentrated in particular industries to an extent liable to affect intra-Community trade.

98. Fifteenth Report on Competition Policy, point 218. See also the Gatsios and Seabright quote below.

99. Second Survey on State Aid, Table IX, p. 30. These figures exclude aid to steel and shipbuilding.

100. CEC, Competition Law in the European Communities, Volume II, pp. 134-137; Fifteenth Report on Competition Policy, point 218; Hancher et al., EC State Aids, p. 222.

101. Hancher et al., EC State Aids, p. 219. Data on number of

cases, 93(2) procedures and the lack of negative decisions from 24th Report on Competition Policy, point 383.

102.For more information on these negotiations and the U.S. flip-flop, see Robert O'Brien, Subsidy Regulation and State Transformation (London: Macmillan, 1997), pp. 119-121.

103.Twenty-fifth Report on Competition Policy, point 201.

104.Second Survey on State Aid, Table IX, p. 30; Third Survey on State Aid, Table 6, p. 22; Fourth Survey on State Aid, Table 6, p. 24; Fifth Survey on State Aid, Table 6, p. 20. Note that the 1981-88 data of the Second Survey excludes aid to steel and shipbuilding.

105.Information on total non-notified cases tabulated from Twenty-fifth Report on Competition Policy, "List of state aid cases in sectors other than agriculture, fisheries, transport and the coal industry," pp. 239-275. Discussion of some of these cases comes from case summaries on pp. 235-237. Note that in all of these cases the Commission approved the aids without opening the 93(2) procedure.

106.Bureau of National Affairs, Inc., "Sutherland Reflects on Success and Setbacks in EC Competition Policy, Antitrust and Trade Regulation Report, Vol. 56, no. 1403, p. 253, 16 February 1989.

107.Buraff Publications, "State Aids: Brussels Faces Tough Task in Controlling State Subsidies," 1992 - The External Impact of European Unification, Vol. 1, no. 6, p. 5. On the extent to which subsidies might substitute for the reduction of trade barriers more generally, see Andre Blais, A Political Sociology of Public Aid to Industry (Toronto: University of Toronto Press, 1986).

108.Konstantine Gatsios and Paul Seabright, "Regulation in the European Community," Oxford Review of Economic Policy, Vol. 5, no. 2 (1989), p. 56.

109.James Flynn, "State Aid and Self-Help," European Law Review, Vol. 8 (1983), pp. 307-308.

110.With the Maastricht Treaty, it became possible for the Commission to propose fines to the European Court of Justice for Member States which violated their treaty obligations (which includes following the state aid rules and complying with ECJ decisions upholding Commission decisions).

111.13th Report on Competition Policy, point 226.

112.Cini, "Policing the Internal Market," p. 328, p. 343 n. 50.

113.The law under which the aid was given specifically stated that aids not approved by the Commission would not be granted. See Andrew Evans and Stephen Martin, "Socially Acceptable Distortion of Competition: Community Policy on State Aid," European Law Review 16, no. 2 (1991), pp. 79-111. Except as noted, the following account draws on their treatment of this case on pp. 86-91.

114.Schina, p. 156.

115.Schina, State Aids Under the EEC Treaty, p. 45.

116.Evans and Martin, "Socially Acceptable Distortion of Competition," p. 90.

117.Cini, "Policing the Internal Market," p. 347. Note, however, that she is incorrect to suggest that the case is ironic because the aid to Philip Morris would now be considered exempt under the Commission's de minimus rules. While the aid intensity of under 4% would meet one test of these rules, the several million dollars in absolute level of aid was far above the 100,000 ECU maximum allowed under the rule.

118.Schina, State Aids Under the EEC Treaty, p. 25. Except as otherwise noted, this paragraph relies on her analysis, pp. 25-26.

119.Schina, State Aids Under the EEC Treaty, p. 25.

120.Evans and Martin, "Socially Acceptable Distortion of Competition," p. 86. [CHECK PAGE NUMBER]

121.Malcolm Ross, "A Review of Developments in State Aids 1987-88," Common Market Law Review 26 (1989), pp. 179-80.

122.This case involved a below-market rate loan given to a brewery. Nowadays, the Commission even posts the disputed interest rate, known as the "reference rate," on its Web site.

123.Twenty-fourth Report on Competition Policy, point 491.

124.Quoted in Schina, State Aids Under the EEC Treaty, p. 163.

125.Schina gives some very vague reasons why this was the case: "...either because of practical or social problems or for reasons of public policy..." Strangely, her citations on this point all come from European Parliamentary questions that precede this court decision (Schina, State Aids Under the EEC Treaty, p. 164 including nn. 78-80). More likely, I would suggest, is that the onset of the recession after 1973's oil price hikes led the Commission to be more willing to approve state aid and consequently less concerned with strict enforcement of the rules. Regarding the increases in aid given in the late 1970s - though no good quantification exists - see Cini, "Policing the Internal Market," p. xxx.

126.CEC, Competition Law in the European Communities, Volume II: Rules applicable to state aids (situation at 31 December 1989), p. 36.

127.The quote is from Twelfth Report on Competition Policy, Introduction, p. 11; the discussion of the focus from Fifteenth Report on Competition Policy, point 171.

128.Malcolm Ross, "A Review of Developments in State Aids 1987-88," Common Market Law Review 26 (1989), p. 187?? [CHECK PAGE # and that there's no unintentional quoting].

129.See Schina, State Aids Under the EEC Treaty, p. 166; and Hancher et al., EC State Aids, pp. 511-512.

130.Malcolm Ross, "A Review of Developments in State Aids 1987-88," p. 181.

131.Ross, "A Review of Developments in State Aids 1987-88," p. 188.

132.Hancher et al., EC State Aids, pp. 252, 487-492. This was upheld by the ECJ in September 1994; see Wolfgang Mederer, "Summary of the most important recent developments (state aid)," Competition Policy Newsletter, Autumn/End 1996, p. 50.

133.25th Report on Competition Policy, point 154, fn 87.

134. 25th Report on Competition Policy, point 154.

135. 24th Report on Competition Policy, p. 519; European Information Service, "Commission Outlaws Italian Law on State Aid for Bankrupt Firms," European Report, 16 March 1996. On Italy's bad record of compliance with Commission decisions in general, see Maria Mendrinou, "Non-Compliance and the European Commission's Role in Integration," Journal of European Public Policy, March 1996, Figure 2, p. 5.

136. Piet Jan Slot, "Facts, procedure and comments in Case C-301/87," European Law Review, Vol. 16 (1991), pp. 38-40, 42-43.

137. Piet Jan Slot, "Procedural Aspects of State Aids: The Guardian of Competition Versus the Subsidy Villains?" Common Market Law Review 27: 759-760, 1990.

138. Slot, "Facts, procedure and comments in Case C-301/87," pp. 45-56.

139. Slot, "Facts, procedure and comments in Case C-301/87," pp. 41-42.

140. Slot, "Facts, procedure and comments in Case C-301/87," pp. 42-44.

141. Slot, "Facts, procedure and comments in Case C-301/87," pp. 45-46.

142. K.P.E. Lasok, "The Commission's Powers Over Illegal State Aids," European Competition Law Review 1990, Vol. 11, no. 3, p. 127.

143. See the discussion of Boussac in 20th Report on Competition Policy, point 172, and of the Commission's use of those powers in

the <u>Pari Mutuel Urbain</u> case in <u>21st Report on Competition Policy</u>, point 274.

144. <u>25th Report on Competition Policy</u>, point 155.

145. Wolfgang Mederer, "The Future of State Aid Control," <u>Competition Policy Newsletter</u>, Autumn/End 1996, pp. 12-14.

146. <u>14th Report on Competition Policy</u>, point 199.

147. CEC, <u>Competition Law in the European Communities, Vol. II</u>, pp. 146-148.

148. Ballantyne and Bachtler, <u>Regional Policy Under Scrutiny</u>, p. 40 and Appendix pp. 5-7. On Greece, see <u>18th Report on Competition Policy</u>, point 168.

149. This is emphasized by Ballantyne and Bachtler, <u>Regional Policy Under Scrutiny</u>, p. 40; and Knox, <u>Towards 1992</u>, p. 76.

150. Cini, "Policing the Internal Market," p. 229.

151. Cini, "Policing the Internal Market," pp. 246-254.

152. "New Resolve to Control State Aids," <u>Financial Times Business Law Brief</u>, April 1989; Cini, "Policing the Internal Market," pp. 260-261; and <u>19th Report on Competition Policy</u>, point 121.

153. CEC, "Fair Competition in the internal market: Community State Aid Policy," <u>European Economy</u> no. 48, September 1991, p. 71. See also Cini, "Policing the Internal Market," pp. 260-261.

154. <u>Second Survey on State Aid</u>, p. 30, Table IX; <u>Fifth Survey on State Aid</u>, p. 17.

155. The 80% figure is given in <u>18th Report on Competition Policy</u>, point 169. The same volume makes reference to 93(1) reviews in

1988 for Belgium, the Netherlands, and Portugal at points 175, 182 and 184, respectively.

156. 24th Report on Competition Policy, Annex III, Table 3, p. 637; 25th Report on Competition Policy, Part Two, Table 3, p. 316.

157. Gatsios and Seabright, "Regulation in the European Community," p. 56.

158. "The Aid Plague," Economist Survey of Business in Europe, 8 June 1991, p. 17.

159. This account is drawn from points 122-125.

160. Point 124.

161. Point 124.

162. CEC, Competition Law in the European Communities, Vol. 2, p. 23. This Directive is found on pp. 23-26.

163. Several sectors of the economy were excluded from the original Directive, but were later included in a 1985 amendment. See Hancher et al., EC State Aids, p. 159.

164. A.H. Hermann, "The EEC power struggle," Financial Times, 13 July 1982, p. 2.

165. Hancher et al., EC State Aids, pp. 160-161. Note that a Communication is a weaker legal instrument than a Directive.

166. Twenty-third Report on Competition Policy, point 399.

167. This account comes from David Buchan, "Brussels Threatens to Cut State Subsidies to European Industry," Financial Times, 10 March 1989, p. 18; Reuters, "EC Commissioner Outlines Areas of Aid Review," BC Cycle, 31 March 1989; "New Resolve to Control

State Aids," Business Law Brief, April 1989; and Jonathan Kapstein, "'Subsidy' Becomes a Dirty Word," Business Week, 19 June 1989, p. 48. For more detail on aspects of this policy review beyond its effects on state-owned firms, see Cini, "Policing the Internal Market," pp. 254-262.

168.David Gardner, "EC loses state aid case: Court rules against closer public sector scrutiny," Financial Times, 17 June 1993. Note, however, that this estimate appears to count 1 ECU of capital injection as equal to 1 ECU of grant, when in fact the (net or gross) grant equivalent of capital injections is often far below that of grants. On the other hand, determining just how much below is a tedious process, underscoring the fact that capital injections are a very non-transparent form of aid.

169.Cini, "Policing the Internal Market," p. 218.

170."The Aid Plague," Economist Survey of Business in Europe, 8 June 1991, p. 16.

171.22nd Report on Competition Policy, point 425.

172.Trevor Soames and Alan Ryan, "State Aid and Air Transport," European Competition Law Review 5 (1995), p. 290.

173."The Aid Plague," Economist Survey of Business in Europe, 8 June 1991, p. 16.

174.18th Report on Competition Policy, point 227.

175.Peter Cope, "1992: The Anxieties of the Motor Sector," European Trends, 1988, no. 4, p. 53; 19th Report on Competition Policy, point 187. See also Krish Bhaskar and the Motor Industry Research Unit, The Effect of Different Aid Measures on Intra-

Community Competition, Exemplified by the Case of the Automotive Industry, Commission of the European Communities Document, March 1990, pp. 16-18.

176.On the Brittan-Delors split, see Cini, "Policing the Internal Market, p. 217. For the final decision, see 20th Report on Competition Policy, point 259.

177.Soames and Ryan, "State Aid and Air Transport," p. 290.

178."Spanish subsidies;" "Airlines: The Sky's the Limit For Iberia Following Political Accord," Transport Europe, 19 January 1996; and "Iberia Cash Infusion Shows European State Aid Still Flowing," Airline Financial News, 5 February 1996.

179.Soames and Ryan, "State Aid and Air Transport," p. 308.

180.25th Report on Competition Policy, p. 226.

181."Financing of Public TV in Portugal: No aid involved," Competition Policy Newsletter, Autumn/Winter 1996, p. 48.

182.As Cini ("Policing the Internal Market," p. 283, fn 33) notes, "Complaints are the lifeblood of the directorate." This is equally true whether the aid recipient is public or private.

183.As noted, for example, by James Flynn, "State Aid and Self Help," p. 312.