

# **Fifty Years of Molding Article 87: The European Commission and the Development of EU State Aid Policy (1958-2008)**

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## **Abstract:**

This study explores the development of state aid law and policy in the European Union. It focuses on how the European Commission utilized the authority delegated to it under the Rome treaty to shape the meaning of Article 87 (ex Article 92) and how, in doing so, was able to shape the legal contours of the state aid regime. The chief means by which the Commission molded policy was to use its administrative discretion to manipulate the pliant language of the provisions contained in Article 87. The study also emphasizes the constraints on the exercise of Commission autonomy. The Commission had to cope with a “dilemma of discretion” at the heart of its state aid mandate. Even as the Commission had considerable autonomy to exercise its delegated autonomy, it was also subject to embedded institutional control mechanisms and political pressures that served to condition that autonomy. We argue that the history of EU state aid policy is written in the efforts of the Commission to navigate that dilemma.

## I. INTRODUCTION

On 25 March 2007, citizens of the twenty-seven member states of the European Union commemorated the fiftieth anniversary of the Treaty Establishing the European Economic Community – known colloquially as the Rome Treaty. On that date in 1957, the governments of France, (West) Germany, Italy and the Benelux initiated an ambitious experiment in economic and political cooperation, the overarching objective of which was the creation of “an ever closer union among the peoples of Europe.” The lodestar of this effort was the agreement to establish a common market. Governments believed that the dismantling of barriers to cross-border economic activity would lead to a higher standard of living for all and, ultimately, a more peaceful continent.

Though the market-creating program embodied in the treaty was principally about the elimination of “barriers,” it also addressed other measures germane to the establishment of a common economic space. One of these was the provision of government assistance – what is referred to generically as “state aid”. All Community governments utilized the public purse, to one degree or another, to address national economic and social challenges. But Treaty negotiators recognized that the full potential of a continental market would remain under-realized to the extent that governments remained free to provide public assistance without constraint. One concern was that state aid was *economically inefficient*. The provision of subsidies and other forms of public assistance would provide firms unearned competitive advantages – advantages that would have the effect of dampening the very competitive pressures market integration was designed to release. Another concern was that the unconstrained provision of public assistance was *politically risky*. Subsidizing or otherwise supporting domestic actors might be viewed by other member states as “beggaring” thy Community neighbor – a way to shift adjustment costs. Subsidy risked counter-subsidy, leading to costly and politically damaging subsidy races. To address these risks government negotiators incorporated into the treaty a body of rules designed to limit aid provision whilst simultaneously preserving it as a tool of national policy. These are found in Articles 87-89 [ex. Articles 90-92].

Article 87 constitutes the substantive heart of the Community’s state aid rule framework. Article 87(1) stipulates what measures constitute state aid within the meaning of the treaty. It also stipulates that such measures are subject to a general prohibition. The prohibition is, however, neither absolute nor unqualified. Article 87(2) and Article 87(3) list policy objectives for which otherwise prohibitable aids might benefit from exemption. They include a range of economic and social objectives.<sup>1</sup> Articles 88 and

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<sup>1</sup> Article 87(2) reads: “The following shall be compatible with the common market:

- a. aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerns;
- b. aid to make good the damage caused by natural disasters or exceptional occurrences;

89 outline procedures governing administration of Article 87. At the heart of this administrative framework sits the European Commission. Under the treaty, the Commission determines whether an aid measure falls within the meaning of Article 87(1) and, if so, whether it fulfills the criteria for an exemption Article 87(2) or Article 87(3).

### *50 Years of State Aid Control*

What began as a set of untested treaty provisions has, viewed fifty-years on, evolved into an effective, if still unfinished, policy regime. One can point to many achievements. For instance, the *volume* of state aid has declined significantly. As recently as 1986, aid distributions across the Community amounted to 1% of GDP.<sup>2</sup> By 2006, the volume of aid had dropped by almost half to 0.58%.<sup>3</sup> Governments have also altered the *type* of aids they distribute. Highly distorting aids, such as operating and export aids, once the stock and trade of national industrial policies, have virtually disappeared. Finally, the *purposes* for which governments grant assistance have changed. Rescue aids and other forms of industry- and sector-focused aid have given way increasingly to aid intended to serve “horizontal” objectives (e.g., aid for training, employment, and research and development). In 2006, over 85% of total aid was so oriented.<sup>4</sup>

Reductions and reorientation notwithstanding, state aid remains a “prevalent and persistent phenomenon” across the EU.<sup>5</sup> The volume of aid, though on the decline, nonetheless remains substantial.

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- c. aid granted to the economy of certain areas of the Federal republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.”

Article 87(3) reads: “The following may be considered to be compatible with the common market:

- a. aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious unemployment;
- b. aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member States;
- c. aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest. However, the aids granted to shipbuilding as of 1 January 1957 shall, in so far as they serve only to compensate for the absence of customs protection, be progressively reduced under the same conditions as apply to the elimination of customs duties, subject to the provisions of this treaty concerning common commercial policy towards third countries;
- d. aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest\*\*;
- e. such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.”

Subparagraph d was inserted by the Maastricht Treaty. Prior to then, paragraph e was paragraph d.

<sup>2</sup> See S. Bilal and R. Polmans, *Is State Aid in Decline? Trends of State Aid to Industry in the Member States of the European Union*, in UNDERSTANDING STATE AID POLICY IN THE EUROPEAN COMMUNITY (S. Bilal and P. Nicolaidis, eds. 1999), Table 3, p.53.

<sup>3</sup> State Aid Scoreboard, Autumn 2007 Update, COM(2007)791 final, Table 2.

<sup>4</sup> *Id.* at. 22.

<sup>5</sup> Bilal & Polmans, *supra* note 2 at 47.

In 2006, member states collectively distributed around €66.7 billion.<sup>6</sup> Particularly troubling for state aid authorities is the volume of illegal and unlawful aid.<sup>7</sup> Since 2000, governments have distributed almost €10 billion in aid that can be so categorized. And, despite Commission efforts to pressure offending governments to recover this aid, almost €2 billion remains outstanding.<sup>8</sup>

### *Administering State Aid Rules: Navigating the Dilemma of Discretion*

The purpose of this study is to examine the Commission's role in shaping the development of EU state aid policy. We explore the degree to which the European Commission was able to shape the evolution of state aid policy. As the body vested with the near exclusive authority to apply treaty state aid rules, the Commission was uniquely well-positioned to influence the pace and direction of developments. The Rome Treaty not only endowed the Commission with the authority to interpret treaty state aid provisions, but it also had the operational autonomy to apply them. Given this potent mix of authority and autonomy one might have expected the Commission to have acted forcefully and decisively to clamp down on state aid. But it did not. In the early years of the Community, Commission competition officials in DG IV (now DG COMP) acted with caution. It would be decades before Commission officials sought to broadly assert its authority – and, even then, they would do so with a caution that seemed to belie the institution's formal mandate. Slow though the Commission may have been in developing its competence, develop it did. Central to this process was the Commission's effort to “shape” the meaning of state aid through the policy guidelines, notices and other “soft law” instruments. It is only in the last ten years that the Commission has begun to consolidate its gains by “hardening” state aid law through formal legal instruments. How are we to explain the Commission's slow, incremental, but progressive development of Community state aid policy? What factors counseled caution, when the Commission's formal mandate seemed to endow it with such a formal policy arsenal?

We argue that an important part of the explanation can be found in the “dilemma of discretion” that lay at the heart of the Commission's mandate.<sup>9</sup> Throughout its history, the Commission has had to reconcile the responsibility use its authority with the negative consequences that could arise from the effort to do so. The source of the dilemma is found at the nexus of the Commission's delegated authority and the language of the rules it was mandated to administer. We will show that while Treaty state aid rules (esp. Article 88) endowed Commission competition officials with a substantial grant of authority,

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<sup>6</sup> State Aid Scoreboard, *supra* note 3, Table 1.

<sup>7</sup> Aid is “illegal” if it is distributed even though it was found not to be compatible with the common market. “Unlawful” aid, by contrast, is government assistance that may be “legal” in the sense just mentioned, but is distributed in violation of the procedural requirements set forth in Article 88.

<sup>8</sup> 2007 State Aid Scorecard, *supra* note 3, Table 18.

<sup>9</sup> M. Smith, *Autonomy by the Rules: The European Commission and the Development of State Aid Policy*, 54 J. COMM. MKT. STUD. 36 at 59 (1998).

the Commission's autonomy to exercise that authority was not unconstrained. In particular, member governments had available a variety of means to challenge Commission decisions or otherwise limit the Commission's behavior. As a result, the Commission had to remain sensitive to how its actions were perceived by the very actors whose behavior the Commission was charged with controlling. The Commission's task was made more all the more difficult due to the imprecise language in which state aid rules were crafted. Core economic and legal concepts lacked definitional precision. It was unclear, for instance, what precisely constituted "a state aid" within the meaning of the treaty. This meant, among other things, that though the Commission had the authority to interpret these provisions, those interpretations might well be challenged by states reluctant to cede control over this important policy instrument.

We argue that the existence of this dilemma had a profound impact on how the Commission approached its state aid authority. On the one hand, the coupling of a strong administrative mandate with a vaguely worded substantive rule framework provided Commission competition authorities with an opportunity. It provided authorities with the resources to "mould" the meaning of state aid and, in so doing, shape the very development of Community policy. At the same time, the absence of precision in the rules meant that its interpretations might be challenged. For, even as the treaty makes clear that the Commission possesses the authority to prohibit state aid, governments (and other actors) had the means to challenge, overturn or otherwise undermine those decisions. It is the presence of these "control mechanism" that encouraged Commission officials to approach their delegated authority with caution.

The balance of the article is structured as follows. The first section examines more closely the root cause of the Commission's dilemma. The second section examines how the Commission coped with the administrative challenge posed by the dilemma. We chronicle the incremental, but progressive, approach to the development of policy. We conclude with some brief observations about the contribution and limitations of the "dilemma of discretion" as a construct to understand Commission-member state dynamics.

## **II. TREATY STATE AID RULES & THE DILEMMA OF DISCRETION**

### **A. Interpretive Ambiguity and the Meaning of State Aid**

Viewed as a general rule framework to guide policy, the intent of treaty state aid rules is straightforward enough – all government assistance that distorts cross-border economic activity is prohibited, save those aid measures that meet stipulated exemptions. Policy intent in one thing, applying the rules themselves in particular situations is quite another. This is because neither the economic nor

legal concepts anchoring the prohibition in Article 87(1) or the exemptions in Article 87(2) and Article 87(3) are articulated with any degree of precision. Consider the language of Article 87(1). It holds: “[s]ave as otherwise provided in this Treaty, any aid granted by a Member States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.” Though the language clearly indicates that the objective is to prohibit those aids deemed incompatible with the common market, the article provides no set of necessary and sufficient conditions to determine what it means “to favor certain undertakings” or “the production certain goods.” Nor does it specify what criteria and/or measures should be used to determine whether an aid measure “affect(s) trade” between Member States. Indeed, the provision gives no specific indication what sorts of government measures would even be considered aid and thus subject to assessment.

The exemptions contained in Article 87(2) and Article 87(3) are crafted in similarly ambiguous language. Take Article 87(3)(a). It holds that otherwise incompatible aid may nonetheless be acceptable if that aid is used “to promote the economic development of areas where the standard of living is abnormally low or where there is serious unemployment.” The provision, however, provides no specific guidance for determining what sorts of aid measures “promote” development. It is also silent on what it means for the standard of living in an area to be “abnormally” low, for unemployment to be “serious,” and, for that matter, what is meant by an “area”. Or take Article 87(3)(c). The provision provides a derogation for aid “to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest.” The provision, however, gives no indication what is meant either by “certain economic activities” or “certain economic areas”. Is “certain” defined by meeting the condition that the aid does not “adversely affect trading conditions”? Or, does the provision provide more interpretive flexibility?

The presence of such interpretive ambiguity in Article 87 has implications for how the provisions are administered. Most significantly, the imprecision of the language renders the rules non-self-executing. A self-executing provision is one whose meaning is sufficiently precise that those subject to the provisions know precisely how it is to be applied under all relevant circumstances. Article 87 lacks that level of precision. Rather, the *application* of Article 87 is predicated on first *interpreting* it. In state aid, the authority to interpret cum apply Article 87 is delegated by member states to the European Commission.

## **B. Delegation, Control and the Dilemma of Discretion**

A central tenet of this study is that the relationship between member states and the Commission is fruitfully represented as one of principal and agent.<sup>10</sup> Member states are conceptualized as principals. They are so by virtue of holding sovereign property rights. The European Commission, on the other hand, is their agent. It has no pre-existing sovereign rights. Prior to the Rome Treaty, the intergovernmental contract that brought the EEC into being, the European Commission did not exist. Member governments brought the Commission into being, assigned it the roles it would perform and delegated to the body the authority to perform the roles assigned to it.

The reasons states delegate sovereign rights to third party agents such as the Commission are many. Chief among them is the desire to enhance the credibility of intergovernmental commitments.<sup>11</sup> Principals, either because there are unwilling or unable to perform some task, delegate the performance of that task to another. In this case, member governments recognized that the inconsistent application of state aid provisions had the potential to undermine the efficacy of the rule framework. It was possible, even likely, that states, left to their own devices, would find it politically expedient to interpret treaty provisions in a manner that privileged domestic political, economic and/or social priorities over international obligations. Instead of risk the defection attendant to the decentralized administration of the state aid provisions, negotiating governments choose instead to delegate that authority to the European Commission.

The substantive contours of the Commission's state aid authority are stipulated in its delegation contract. A delegation contract defines the constitutive relationship between principals and agents. It includes the agent's substantive mandate assigned to the agent and the authority delegated to it to exercise those tasks. It also includes embedded those monitoring and control mechanisms intended to ensure the agent operates within its mandate. Such mechanisms are included to minimize the threat both of agent shirking (that the agent will not perform the function it was assigned to perform) and agent slippage (that the agent will act beyond its mandate to pursue goals other than those it was assigned to perform).

Article 88 constitutes the substantive core of the delegation contract between member state principals and the Commission in the area of state aid policy. Article 88 stipulates that the Commission is to perform two related functions. The first is to evaluate the compatibility of all *proposed* government aid measures. The second is to monitor all existing aid programs to ensure that all programs are executed in a

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<sup>10</sup> See, for instance, M. Pollack, *Delegation, Agency, and Agenda Setting in the European Community* IN. ORG. 51 (1997), THE ENGINES OF EUROPEAN INTEGRATION (2003). T. Doleys, *Member States and the European Commission: Theoretical Insights from the New Economics of Organization*, J. EUR. PUB. POL. 7 (2000). J. Tallberg, *Delegation to Supranational Institutions: Why, How and With What Consequences?* W. EUR. POL. 25 (2002). For a dissenting view, see H. Kassim and A. Menon, *The Principal-Agent Approach to the Study of the European Union: Promise Unfulfilled?* J. EUR. PUB. POL. 10 (2003). For a more general discussion of the utility of agency theory in the study of international organization, see, D. Hawkins, et al. DELEGATION AND AGENCY IN INTERNATIONAL ORGANIZATIONS (2006).

<sup>11</sup> *Id.*, Hawkins, et al.

manner that conforms to the provisions in Article 87. To enable the Commission to perform this role, Article 88(3) empowers the Commission to evaluate all government plans to “grant or alter” aid. If, upon completing the examination, Commission competition officials conclude that the aid raises no concerns – i.e., falls outside the scope of Article 87(1) – governments are cleared to implement it. If, on the other hand, the Commission determines that a proposed aid falls within the meaning of Article 87(1), *and* it concludes that the aid does not warrant exemption under either Article 87(2) or Article 87(3), the Commission can issue a “negative decision” – a legally-binding act that enjoins the government from implementing the proposed aid.

Pursuant to its mandate to monitor all *existing* aid programs, Article 88(1) tasks the Commission to “keep under constant review” all ongoing member state aid-granting activities. Where it identifies an aid that raises concerns, the Commission has the authority to conduct a formal investigation. If, after completing its examination, the Commission concludes that the aid poses no difficulties, then it closes the investigation and no further action is taken. If, however, the Commission concludes that the existing aid no longer compatible with the common market and that it does not qualify for exemption under either Article 87(2) or Article 87(3), then Article 88(2) empowers the Commission to demand the responsible government “alter or abolish” that aid.

Extensive though it was, the Commission’s state aid authority was not unconstrained. Member governments incorporated into the Commission’s delegation contract an array of legal and administrative controls designed to limit, bypass or otherwise condition Commission behavior.<sup>12</sup> Some were specific to the exercise of the Commission’s state aid authority. For instance, Article 88(2) subparagraph 3 provides a procedure whereby member states can circumvent the Commission’s authority to apply Article 87. Under the procedure, a member state can directly petition other member governments in the Council of Ministers to declare an aid program compatible with the common market. The procedure outlined in Article 89 can also serve as a means to control Commission autonomy. Article 89 stipulates that the Council may pass regulation governing how the Commission applies Articles 87 and 88.<sup>13</sup>

In addition to those mechanisms focused on the Commission’s exercise of its state aid authority, member government principals included in the treaty other, more general, control mechanisms. The most important among these involve Community courts. Under Article 230 (ex. Article 173), member

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<sup>12</sup> For a discussion of Commission autonomy and how control structures “condition” that autonomy, see T. Doleys, *Member States and the European Commission: Theoretical Insights from the New Economics of Organization*, J. EUR. PUB. POL. 7 (2000).

<sup>13</sup> It should be noted that neither the mechanism in Article 88(2) nor the procedure outlined in Article 89 is easily used. The utility of Article 88(2) is blunted somewhat by the need by member states to act unanimously. Article 89, for its part, holds that Council can act only on the basis of a proposal made by the Commission. Thus, utilization of this mechanism is effectively predicated on the willingness of the Commission to limit its own authority. If the Commission expects the article to be used in this manner, it might be unwilling to make the required proposal.



governments provided a legal mechanism that can be used to bring action against the Commission on the grounds of “incompetence, errors of substantial form, of infringement of this Treaty or any legal provision relating to its application, or to the abuse of power.” If the Court agrees with the petitioning government, it can strike down the offending action. In a complementary provision, Article 232 (ex. Article 175) provides a means to bring action against the Commission for the “failure to act”. If the Court determines that the Commission has failed to act when required to by the treaty, it can render a binding judgment requiring it to do so.<sup>14</sup>

In addition to embedded legal channels, member governments have other means to exercise influence over the exercise of Commission authority. One is the threat of re-contracting. Member governments can modify or rescind the Commission’s authority by altering through treaty amendment the “constitutional” foundations of that authority. Another is noncompliance. Noncompliance is an extra-legal measure whereby a government fails to execute an authoritative decision delivered by the Commission. Noncompliance can manifest itself in many ways. It might find expression as an extended delay in the execution of a Commission decision – in which case the member state acknowledges the binding character of the decision, but claims that it is unable to meet its obligation for some reason or another. A government might claim, for instance, that administrative or procedural difficulties prevent it from executing the decision in a timely fashion. Noncompliance might also be expressed as an explicit declaration not to comply. Here the government makes no pretence that it is bound by the decision. It simply does not act pursuant to its obligation.

Whatever mechanism a government/governments seeks to utilize, it/they do so with the objective of realizing some benefit. However, governments also understand that each of these mechanisms has an associated cost. The costs may be transactional or reputational. Due to the existence of these costs, governments must weigh the anticipated benefits of control against the costs associated with the use of any given incident. The result is that some mechanisms are more likely to be used than others.

It warrants note that the “dilemma of discretion” with which the Commission must deal in the execution of its delegated state aid authority is not unique to this policy domain. The dilemma exists, to a greater or lesser degree, in all policy areas in which the Commission possesses delegated authority. However, the dilemma is perhaps nowhere more acute than in state aid policy. This is due to three factors. The first is the exceptionally wide scope of the Commission’s authority in competition policy. In no other issue domain is the Commission’s substantive authority and operational autonomy as great. Second, state aid engages acute political sensitivities. Member governments had long held public

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<sup>14</sup> For a more comprehensive examination of the control mechanisms governing member state-Commission relations, see M. Pollack, *supra* note 10; J. Tallberg, *Delegation to Supranational Institutions: Why? How? and with What Consequences?* W. EUR. POL. 25 (2002).

assistance to be an important industrial and social policy tool. Government could be expected to accept limits on its use only grudgingly. The third factor is the opacity of the state aid rule framework itself. The need for legal certainty placed a substantial burden on the Commission to clarify the meaning of state aid and the associated exemptions. It also demanded that the Commission do so in a way that was transparent, consistent, functional *and* politically acceptable. It is thus not difficult to understand why former Competition Director General Claus-Dieter Ehlermann described state aid control as “one of the most difficult and delicate tasks” undertaken by the Commission.<sup>15</sup>

### **III. THE DEVELOPMENT OF STATE AID POLICY**

#### **A. 1958 to the early-1970s: Eschewing Conflict**

During the first decade of the Community, the Commission approached its state aid authority tentatively. The first task authorities undertook was to bring clarity to the concept of “state aid”. The text of Article 87(1) offered only limited guidance in this regard. It stipulates that government assistance “in any form whatsoever” could be considered state aid. While such a broadly cast provision had the benefit of preventing governments from crafting schemes specifically to circumvent the language of the article, the drawback was that governments and firms lacked legal certainty about what specific types of measures might fall within the ambit of the prohibition.<sup>16</sup>

One way the Commission sought to bring interpretive clarity to the concept was by initiating an inventory of existing government aid programs.<sup>17</sup> The Commission asked member states to provide information on the nature and purpose of all schemes.<sup>18</sup> It would be some years, however, before the Commission made its first statement on the matter. The statement came in 1963 in response to a parliamentary inquiry on the matter. Included among the modalities that the Commission understood to fall within the meaning of Article 87(1) were: “tax exemptions, preferential interest rates, guarantees of loans on especially favorable terms, acquisition of land or buildings either gratuitously or on favorable terms, provisions of goods and services on preferential terms, indemnities against losses and other measures having equivalent effect.”<sup>19</sup>

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<sup>15</sup> Ehlermann 1995:1213.

<sup>16</sup> D. Schina, *STATE AIDS UNDER THE EEC TREATY, ARTICLES 92 TO 94* (1987) at 15.

<sup>17</sup> 2<sup>ND</sup> EEC GENERAL REPORT, pts. 131-133 (1959); 4<sup>TH</sup> EEC GENERAL REPORT, pt. 57 (1961); 6<sup>TH</sup> EEC GENERAL REPORT, pt. 47 (1962).

<sup>18</sup> 3<sup>TH</sup> EEC GENERAL REPORT, pt. 151; 6<sup>TH</sup> EEC GENERAL REPORT, pt. 47.

<sup>19</sup> OJ(Special Ed) 1963 at 235. The last phrase is particularly significant, as it signaled the Commission’s intention to apply an “effects based” test to aid measures. Over the years the Commission would identify many more “forms” of aid. They included *inter alia* state exchange rate guarantees, interest free loans, accelerated depreciation

At the same time that Commission authorities were grappling with the language of Article 87(1), they were also beginning to consider the meaning (and thus practical application of) the provisions in Article 87(2) and Article 87(3). Both addressed circumstances under which otherwise incompatible aid might still be authorized. However, the interpretive *cum* administrative challenge posed by Article 87(3) was more acute than that of Article 87(2). Under Article 87(2), the Commission had no scope for administrative discretion. Its role was limited to confirming whether an aid measure met one of stipulated policy objectives. That was decidedly not the case for aids seeking exemption under Article 87(3). For such aids, the Commission enjoyed considerable administrative discretion. After determining whether an aid met one of the stipulated policy objectives, the Commission had the discretion to decide whether to ultimately approve the aid – the language of the article being that such aids “*may* be considered compatible with the common market” (emphasis added).

Apparently cognizant that the exercise of discretion – particularly if it resulted in the prohibition of an aid – would open itself to criticism or challenge by member states, the Commission acted to clarify what it regarded as the meaning of these provisions and thereby define the conditions under which it would act. The first effort in this regard involved national programs of regional aid. Specifically, it involved how the Commission viewed the application of subparagraphs (a) and (c) of Article 87(3).<sup>20</sup> The Commission chose to focus on regional aid for several reasons. First, regional aid was among the most widely employed forms of aid during this era. Second, and more importantly given the intent of treaty rules, though such aids were designed to affect the internal redistribution of national resources to economically disadvantaged areas, regional aid programs had, by the late 1960s, begun to evince negative external effects. Cross-border competition for investment was on this increase. This was giving rise to beggar-thy-neighbor aid races, which, in turn, was leading precisely to the type of market distortions that state aid rules were intended to prevent.<sup>21</sup>

The Commission’s actions reflect the dilemma with which it was faced. The Commission could have mobilized its statutory authority to prohibit those aids that it determined were distorting community markets. But it did not. Rather, the Commission instead sought to encourage governments to bring regional aid programs into line with Community rules *as it understood them*. The main vehicle for doing

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allowances, preferential access to public contracts and employment premiums. For a more complete accounting of measures identified by the Commission during the early years of the Community, see, for instance, Schina *supra* note 16 at 16-17. For a contemporary account of the forms state aid take, see, BELLAMY AND CHILD: EUROPEAN COMMUNITY LAW OF COMPETITION (P. Roth, ed. 2001); and A. Knaul and F. Perez Flores, *State Aid*, in FAULL AND NICKPAY: THE EC LAW OF COMPETITION (J. Faull and A. Nickpay, eds. 2007).

<sup>20</sup> See, for instance, 8<sup>th</sup> EEC GENERAL REPORT, pt. 74.

<sup>21</sup> Noted the Commission: “The Commission is anxious to achieve some measure of harmony among the Member States with regard to regional aid, both because of the need for balanced growth in the various regions of the Community and in an endeavour to put an end to the efforts of member countries to outbid each other and to the distortions due to excessive competition at the Community level.” 2<sup>ND</sup> EC GENERAL REPORT, pt. 47 (1969).

this was a 1971 Commission Communication to the Council in which it articulated the “principles of coordination” that would guide how it intended to apply Article 87(3)(a) and (3)(c) to national regional aid.<sup>22</sup> By indicating the parameters to which such aid programs were to meet – they must conform to a common aid ceiling; they must be transparent; they must be regionally specific; and the sectoral incidence of aid must be measurable – the Commission stipulated the conditions under which governments could *lawfully* distribute otherwise incompatible aid.<sup>23</sup> Publication of the principles in no way insured that governments would respect them. Nevertheless, by publishing them, the Commission was shaping how regional aids would be understood under state aid law.

Although Commission efforts during the era focused primarily on developing and clarifying the meaning of Article 87, attention to enforcement was not altogether absent. The Commission took particular interest in sectoral aids, particularly those to shipbuilding, textiles, synthetic rubber, cinema, and aircraft production.<sup>24</sup> But its efforts were muted. The Commission occasionally raised objection to elements of an aid program. While the Commission monitored many programs closely<sup>25</sup>, it rarely asserted its Article 88(2) authority to formally scrutinize the content of an aid scheme. Even rarer still was the effort to declare an aid measure incompatible.<sup>26</sup> The Commission was either unwilling, or it felt it was unable, to forcefully assert its authority.

While it is hazardous to read a unifying logic into Commission actions, the evidence supports the contention that consideration of the dilemma attendant to the exercise of its state aid authority shaped Commission behavior during this era. Article 88 may have endowed the Commission with the statutory authority to act, but the Commission demonstrated little eagerness to do so. Rather, it sought instead to focus on clarifying the meaning of Article 87 and to encourage member states to adapt their behavior accordingly.

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<sup>22</sup> OJ C 111/7 (1971). For an overview of “the principles” see 1<sup>ST</sup> REPORT ON COMPETITION POLICY, pts. 140-153 (1972). For a general analysis of the Commission’s approach to regional policy during this era, see G. Schrans, *National and Regional Aid to Industry under the EEC Treaty*, C. M. L. REV. 10 (1973) and Schina, *supra* note 16 at 67-79.

<sup>23</sup> The chief means for doing this was to define the acceptable scope and limits of such aid. For instance, the Commission placed a hard limit of 20 percent net grant equivalent; aid intensities above that ceiling could expect not to be granted a waiver. The principles also emphasized the need for aid to be transparent and proportionate to the problem being addressed.

<sup>24</sup> See 3<sup>rd</sup> EEC GENERAL REPORT, pt. 152; 4<sup>th</sup> EEC GENERAL REPORT, pts. 53-55; 5<sup>th</sup> EEC GENERAL REPORT, pt. 52; 6<sup>th</sup> EEC GENERAL REPORT, pt. 48; 7<sup>th</sup> EEC GENERAL REPORT, pts. 72-74; 8<sup>th</sup> EEC GENERAL REPORT, pts. 77-81; 9<sup>th</sup> EEC GENERAL REPORT, pts. 81-86.

<sup>25</sup> The Commission reports examining 60 aid cases in 1964 [7<sup>TH</sup> EEC GENERAL REPORT, pt. 69 (1964)]; 43 cases in 1965 [8<sup>TH</sup> EEC GENERAL REPORT, pt. 73 (1965)]; 45 cases in 1966 [9<sup>TH</sup> EEC GENERAL REPORT, pt. 78 (1966)]; 35 cases in 1967 [10<sup>TH</sup> EEC GENERAL REPORT, pt. 64 (1967)]; and 34 cases in 1968 [1<sup>ST</sup> EC GENERAL REPORT, pt. 62 (1969)].

<sup>26</sup> See 9<sup>th</sup> EEC GENERAL REPORT, pt. 80.

## **B. Early-1970s to Mid-1980s: The Dilemma Magnified**

The Commission's dilemma was perhaps never more acute than in the period between the mid-1970s and early-1980s. Recurrent economic crises made Commission action on state aid, in the estimation of Cini and McGowan (1998: XX), both "imperative and impossible." It was imperative due to the rising level of aid activity. Recession and rising unemployment led governments to rely on the public purse with increased frequency and intensity.<sup>27</sup> There was an increased sense that this was undermining the still-nascent foundation of the common market. However, the very conditions that made Commission action necessary also made taking action politically risky. In this environment, there was a risk that governments and their publics would not tolerate interference with national industrial and employment policies. Nor were they likely to be swayed by appeals to Community solidarity. The threat of pushback was high.

Given the prevailing environment, the Commission acted in a predictably measured manner. Early on, it eschewed enforcement actions in favor of the policy development-through-clarification approach it had pursued throughout the 1960s. Governments were encouraged to abide by Community discipline. But the Commission was in no position to be overly aggressive. But, as the economic malaise wore on and the volume (and impact) of aid continued to increase, pressure on the Commission mounted. The tipping point came in the early 1980s with the surge of aid activity attendant to the global recession.<sup>28</sup> It was only then that the Commission began to speak openly about the need for greater enforcement.<sup>29</sup>

A review of Commission activities during this era reveals three areas of action. They arise sequentially and each builds on the one previous to it. The first is the development and use of *policy frameworks*. The second is the articulation of what is known as the *compensatory justification doctrine* as a general principle guiding the application of Article 87(3). The third was the effort by the Commission to extend the scope of state aid to the relationship between member governments and *public undertakings*.

### **1. The Role of Policy Frameworks**

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<sup>27</sup> 5<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 130-134 (1976), 10<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 158 (1980).

<sup>28</sup> For a view from the Commission on both the perils of the era and the need for action, see F. Adriessen, *The Role of Anti-Trust in the Face of Economic Recession: State Aids in the EEC*, E.C.L.R. 2 (1983).

<sup>29</sup> The statistics are instructive. Between 1957 and 1972, the Commission issued only three negative decisions under Article 88(2). The Commission would issue four negative decisions in 1974 alone. And, between 1981 and 1984, the number of negative decisions averaged over thirteen a year. For data on negative decisions issued by the Commission for the years 1958-1994, see, [http://ec.europa.eu/comm/competition/state\\_aid/decisions/negative/ineg\\_1990.html](http://ec.europa.eu/comm/competition/state_aid/decisions/negative/ineg_1990.html).

Over the course of the 1970s, the Commission continued the process, begun in 1971 with the “principles of coordination” for regional aid, of clarifying how it intended to apply its discretionary authority – particularly as it applied to the approval of derogations under Article 87(3). Taking different forms – guidelines, frameworks, codes, and notices – these policy statements detailed restrictions on aid modalities, the types of costs eligible for compensation, and applicable aid ceilings. In addition to updating its regional aid framework,<sup>30</sup> the Commission elaborated a framework to guide sector-specific rescue and restructuring aid.<sup>31</sup> In it, the Commission codified the criteria it would apply to industry-specific aid seeking exemption under Article 87(3)(b). Among the criteria were that aids: must be justified by the prevailing circumstances in the industry; must lead to the restoration of long-term viability; should be progressively reduced; should be proportionate to the problem being addressed; and must avoid transferring adjustment costs on to other states.<sup>32</sup> In addition to guidelines for sectoral aids, the Commission also established frameworks addressing certain categories of “horizontal” aids. These included aids to support environmental protection<sup>33</sup> as well as assistance to facilitate the emergence and development of small and medium sized enterprises (SMEs).<sup>34</sup>

The Commission’s utilization of policy frameworks represented a pragmatic response to the dilemma of discretion. They were not formal regulatory instruments. They had no basis in Community law and were not legally-binding on member states. They were instead “soft law” instruments.<sup>35</sup> Non-binding though they were, the Commission intended them to be, and governments increasingly came to see them as, authoritative statements of Commission policy toward the aids they addressed.<sup>36</sup> As such, they provided Commission authorities a non-interventionist means to *steer* government behavior.<sup>37</sup> And because the frameworks were developed in consultation with member governments, the risk that member

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<sup>30</sup> The Commission revised, elaborated and extended the principles in 1975 and again in 1978. See, 1<sup>ST</sup> REPORT ON COMPETITION POLICY, pts. 143-153 (1972); 3<sup>RD</sup> REPORT ON COMPETITION POLICY, pts. 80-83 (1974); 5<sup>TH</sup> REPORT ON COMPETITION POLICY, pts. 85-87 (1976); and 8<sup>TH</sup> REPORT ON COMPETITION POLICY, pts. 151-156 (1979).

<sup>31</sup> 8<sup>TH</sup> REPORT ON COMPETITION POLICY, pts. 172-179 (1979). For a more detailed explication of the Commission’s approach to “operating” and “restructuring” aid during the 1970s and 1980s, see F. Cownie, *State Aids in the Eighties*, EUR. L. REV. 11 (1986); A. Evans and S. Martin, *Socially Acceptable Distortion of Competition: Community Policy on State Aid*, EUR. L. REV. 16 (1991).

<sup>32</sup> General Principles on Sectoral Aids. COM(78)221 Final. For a discussion, see 8<sup>TH</sup> REPORT ON COMPETITION POLICY, pts. 172-177.

<sup>33</sup> 4<sup>TH</sup> REPORT ON COMPETITION POLICY, pts. 176-182 (1975).

<sup>34</sup> 6<sup>TH</sup> REPORT ON COMPETITION POLICY, pts. 253-256 (1977). More generally, see Evans and Martin, *id.*

<sup>35</sup> See M. Cini, *The Soft Law Approach: Commission Rule-Making in the EU’s State Aid Regime*, J. EUR. PUB. POL. 8 (2001).

<sup>36</sup> F. Rawlinson, *The Role of Policy Frameworks, Codes and Guidelines in the Control of State Aid*, at 57 in STATE AID: LAW AND POLICY (I. Harding, ed. 1993).

<sup>37</sup> *Id.*, and G. della Cananea, *Administration by Guidelines: The Policy Guidelines of the Commission in the Field of State Aids*, in STATE AID: LAW AND POLICY (I. Hardin, ed. 1993).

states would later accuse the Commission of acting arbitrarily or of overstepping its authority was minimal.

## 2. The Compensatory Justification Principle

The compensatory justification principle (CJP) represented an attempt by the Commission to clarify – and, in so doing, “tighten” – the conditions under which it would approve aid.<sup>38</sup> The doctrine holds that for an aid measure to enjoy benefit of exemption under Article 87(3) it must “contain a compensatory justification which takes the form of a contribution by the beneficiary or aid over and above the effects of normal play of market forces to the achievement of Community objectives as contained in the derogations of Article 87(3) EEC.”<sup>39</sup> There is no compensatory justification if market conditions would have led the aid recipients themselves to make investments represented by the aid.

The Commission developed the CJP, in part, as a response to claims – made by some governments – that the Commission should be obliged to approve aid so long as the aid serves one of the objectives outlined in Article 87(3). In effect, governments claimed that the Commission’s discretionary latitude under Article 87(3) was not as great as the phrase “*may be considered compatible with the common market*” suggested. The Commission, however, understood its discretion in broader terms. With the principle, the Commission argued that it was necessary for an aid to be *consistent with* one of the objectives, consistency was not sufficient to warrant exemption. Rather, governments have the additional burden to demonstrate that the aid is *indispensable* to the achievement of that objective (i.e., that the objective would not otherwise be achievable but for the provision of aid).

The Commission first applied this innovative doctrine in 1979 in a case involving an aid proposed by the Dutch government.<sup>40</sup> The aid was intended to enable cigarette manufacturer Philip Morris to increase productive capacity at a facility located in Bergen-op-Zoom, an economically depressed region of the Netherlands. After examining the proposal, the Commission issued a “negative decision,” debarring the government from disbursing of the aid.<sup>41</sup> Among the reasons it gave for doing so was that the aid lacked a compensatory justification. In that decision – described by Ehlermann as a “watershed” in the history of Commission competition policy – the Commission reasoned that since Philip Morris was

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<sup>38</sup> Whereas policy frameworks represented a Commission effort to mould state aid policy as it applied to specific classes of aid behavior, the compensatory justification principle (CJP) represented an effort to provide a general principle that applied to individual aids not granted under a sectoral, regional or horizontal framework.

<sup>39</sup> 10<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 213 (1981). For a general discussion, see K. Mortelmans, *The Compensatory Justification Criterion in the Practice of the Commission in Decisions on State Aids*, C. M. L. REV. 21 (1984).

<sup>40</sup> The case is discussed in detail in 10<sup>th</sup> REPORT ON COMPETITION POLICY, pts. 214-217 (1981).

<sup>41</sup> Decision 79/743/EEC, OJ C 217 (1979)

a highly profitable company it did not require state assistance to induce it to undertake the proposed investment.<sup>42</sup>

Philip Morris challenged the Commission's decision. Utilizing the judicial procedure outlined in Article 173, the company petitioned the court to have the decision annulled on the grounds that the Commission had erred in its application of Community law. It argued *inter alia* that the concept of compensatory justification had no basis in Community law, that the Commission had misinterpreted and misapplied Article 87(3), and that since the aid met an objective in Article 87(3) it should have been approved. The Court rejected the argument. Rather, the Court, in what is widely seen as a landmark ruling on Commission state aid authority, confirmed the institution's exclusive authority to interpret and apply Article 87(3).<sup>43</sup> In so doing, the Court effectively endorsed the Commission's use of its discretionary authority to develop and apply the compensatory justification doctrine and an interpretive principle.

### 3. State Aid and Public Undertakings

But of all the Commission's activities during those troubled economic times, perhaps the boldest involved its attempt to more closely scrutinize the relationship between public enterprises and governments. Public enterprises occupy a unique place in Community law. They are both to be treated the same as private enterprises, but also recognized as different. For instance, Article 295 [ex. Article 222] ("the neutrality clause") states that Community law can in no way prejudice public ownership. But, so long as that principle is not violated, public enterprises are to be treated the same as private firms. This extends to the rules of competition. An expression of this can be found in Article 86 [ex Article 90].<sup>44</sup>

From the earliest years of the Community, the Commission recognized the potential for abuse inherent in the special relationship between governments and public undertakings. The concern lay in the threat that governments might exploit the often complex financial structure of public enterprises as a cloak behind which to funnel illicit aids. Although the Commission had long recognized the challenge posed by this relationship, it took no positive steps to address the matter until the mid-1970s.

The Commission's first effort in this regard was an attempt to identify and measure what it termed "commercially unjustified costs." Commercially unjustified costs are the costs enterprises incur pursuant to the public service functions they perform. Such costs, the Commission had consistently held,

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<sup>42</sup> C.-D. Ehlermann, *State Aids Under European Competition Law*, FORD. INT. L. J. 18 at 417 (1994).

<sup>43</sup> Philip Morris v. Commission (C-730/79) [1980] ECR 2671.

<sup>44</sup> Article 86(1) reads: "In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89."



warrant compensation.<sup>45</sup> However, the Commission was insistent that the level of that compensation should not exceed the actual costs incurred. But, due to the opacity of financial relations between public firms and governments, the Commission found it almost impossible to distinguish legitimate compensatory payments from illicit government aids.<sup>46</sup> The underlying problem was, as the Commission explained in the 1976 edition of its *Report on Competition Policy*, one of financial transparency.<sup>47</sup>

### *The Transparency Directive*

By the late 1970s, the Commission had adopted the position that if it were to effectively apply state aid to public enterprises it would have to pull back the veil on financial relations. To do this, the Commission adopted a directive under the authority delegated to it by Article 86(3) [old Article 90(3)].<sup>48</sup> Known colloquially as the Transparency Directive, the Commission sought to require governments to make available, upon request, information on financial transactions concerning the nature and effect of their links with public undertakings. This included information regarding the compensation for operating losses, the provision of investment capital, and the provision of non-refundable grants or of loans on preferential terms. The information was to be used, in the language of the Directive, to ensure “a fair and effective application” of Treaty state aid rules to public enterprises.

The directive was deeply controversial. This was apparent even at the drafting stage. The Commission took care not to overreach, cognizant of the political sensitivities involved. During consultations with member governments, the Commission acceded to demands that it pare back or drop several provisions. For instance, it was “convinced” to exclude from the scope of the directive public undertakings in certain politically sensitive sectors (e.g., water, energy, transport, public credit institutions, post and telecommunications).<sup>49</sup>

Commission effort to tone-down the directive did little to placate its most steadfast opponents. Several governments regarded the directive as an unlawful assertion of Commission authority – “slippage” in the terminology of principal-agency analytics. The governments of France, Italy and the United Kingdom led the charge, challenging the legality of the directive before the Court. They argued that the Commission lacked the competence to issue the directive under Article 86. Rather, directives addressing “the concept of aid” should have been offered under Article 89 (i.e., a procedure that, not

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<sup>45</sup> See Schina *supra* note 16 at 134-135.

<sup>46</sup> 6<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 275 (1977).

<sup>47</sup> *Id.* at pts. 272-276. See also, R. D'SA, EUROPEAN COMMUNITY LAW ON STATE AID 310 (1998).

<sup>48</sup> Commission Directive 80/723 on the Transparency of Financial Relations between Member States and Public Undertakings, OJ L 195 (1980).

<sup>49</sup> Insert reference

coincidentally, requires member government assent). The Court rejected the states' petition.<sup>50</sup> In another of what had become a string of supportive rulings on state aid cases, the Court held that the Commission was acting within its statutory authority.<sup>51</sup>

The Transparency Directive was the first move in what would be an administrative two-step on the part of the Commission to assert greater control over the provision of government aid in the public sector. The directive demonstrated the Commission's growing concern with illicit aid and its desire to prairie open government accounts. But the Transparency Directive did nothing *per se* to address the provision of public aid. Importantly, the Commission had yet to clarify how it intended to apply Article 87 in light of the financial intricacies between public enterprises and public authorities. This would be the subject of the second move in the Commission state aid two-step – the development and application of the “market economy investor principle.”

#### *The Market Economy Investor Principle (MEIP)*

The Commission state purpose in articulating the *market economy investor principle* (MEIP) was to clarify the concept of aid as it applied to government investment in undertakings.<sup>52</sup> Formally articulated in its 1984 *Communication on the Application of Article 92/93 to public authorities' holdings*, the MEIP test sought specifically to elaborate what it meant for an aid to “advantage” an undertaking within the meaning of Article 87(1).<sup>53</sup> The MEIP holds that when a government invests in an undertaking on terms and in conditions which would be acceptable to a private investor operating under normal market considerations of risk and profit, the investment should be not considered a state aid. However, if it can be determined that a private investor operating under such considerations would not make the investment, then there is a presumption that aid is being granted.

The MEIP proved highly controversial. Like its cousin, the compensatory justification principle, the MEIP had no legal basis in the Rome Treaty. Rather it was a construct developed by the Commission using the discretion it enjoyed under Article 88. It was perhaps inevitable, therefore, that it would be challenged. And challenged it was. The landmark case in this matter is *Belgium v. Commission*.<sup>54</sup> The

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<sup>50</sup> France, Italy and the United Kingdom v. Commission (Joined Cases C-188-190/80) [1982] ECR 2545. For a discussion see 12<sup>th</sup> REPORT ON COMPETITION POLICY, pts. 222-224 (1983), and Schina, *supra* note 12 at 136.

<sup>51</sup> Included amongst early Commission “victories” were decisions in *Italy v. Commission (Italian Textiles)* (C-173/73), *Produits Bertrand v. Commission* (C-40/75), *Commission v. UK and UK v. Commission* (Joined cases C-31 & 53/77), and the aforementioned *Philip Morris v. Commission* (C-730/79).

<sup>52</sup> It was developed, at least in part, as a reaction to an earlier effort to apply Article 87 to state acquisition of capital holdings in which it claimed that such interventions were automatically contrary to state aid provisions. The Court, however, ruled otherwise, holding that the Commission had to provide clear justification for the decision that such an acquisition was not compatible with the common market. See Courts ruling in *Inter Mills v. Commission* (C-323/82) [1984] ECR 3809.

<sup>53</sup> EC BULLETIN 9-1984, pt. 2.1.30. See also 14<sup>th</sup> REPORT ON COMPETITION POLICY, pt. 198 (1985).

<sup>54</sup> *Belgium v. Commission (Meura)*, Case C-234/84, [1986] ECR 2263.

case concerned a capital subscription granted by a Belgian regional investment authority to a financially threatened firm. The Commission, employing the MEIP, declared the assistance to be aid within the meaning of Article 87(1) and, after determining that the firm did not warrant exemption under Article 87(3), declared the assistance to be incompatible with the common market and ordered the aid abolished.<sup>55</sup> The Belgian government responded by petitioning the ECJ under Article 232 for an annulment of the decision. The government argued that the Commission had misapplied Article 87(1) by interpreting it in light of the MEIP (just as Philip Morris had argued in its petition with regard to the compensatory justification principle). The Court rejected the Belgian government's argument. In its decision, it instead endorsed the exercise of Commission discretion, describing the MEIP as "an appropriate way" to determine the existence of aid.<sup>56</sup>

Though it would be impossible within the confines of a conference paper to provide a comprehensive account of how the Commission coped with the "dilemma of discretion" during the era, the above account offers a window into this most challenging period. As the economic malaise dragged on and governments relied to an ever greater extent on the state purse to buttress flagging domestic industries, the logic of the Community project compelled the Commission to act. Moving tentatively at first, relying on efforts to gently steer governments through the use of policy frameworks, the Commission became increasingly assertive in the latter half of the 1970s and into the early 1980s. But, in all its actions, it recognized the still tenuous position it occupied vis-à-vis member states. While it scored considerable successes in developing state aid policy through the articulation of the compensatory justification principle and the market economy investor principle, the reality was that governments continued to grant unlawful aids. And, at least to this point, the Commission demonstrated little will to confront that challenge directly.

### **C. Mid-1980s to Late-1990s: New Possibilities**

If the 1970s and early-1980s marked a era when Commission action on state aid was both "imperative and impossible," the period beginning in the mid-1980s represented the opening of a time of "new possibilities." More market-friendly governments were in the ascendance across major EU states. And their effort to re-launch Europe through the drive to complete the single market marked a watershed. Member governments and the Commission alike understood that as remaining non-tariff barriers came down, subsidies and other forms of state assistance would be one of the few remaining tools available for governments to shield politically-sensitive and/or economically-threatened undertakings. Greater control

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<sup>55</sup> Commission Decision 84/496/EEC of 17 April 1984, OJ L 276 (1984).

<sup>56</sup> *Belgium v. Commission (Meura)* (C-234/84), [1986] ECR at 2263.

of state aids was thus a necessary concomitant of further liberalization.<sup>57</sup> Overall, the political environment was more sympathetic to state aid control than at any time in the Community's history.

## 1. State Aid Surveys

Understanding the need to act, and sensing the favorable change in the public mood, the Commission stepped-up its monitoring efforts in the 1980s. One of the early manifestations of this intensified approach was publication of the Commission's *Surveys on State Aid*.<sup>58</sup> The culmination of the work of a State Aid Task Force established by Competition Commissioner Sutherland in 1985, the *First Survey on State Aid* was published in 1989. It would be followed by eight more surveys published at semi-regular intervals over the next thirteen years.<sup>59</sup> The surveys are significant because they shone, for the first time, a bright light on the scale and scope of aid activity across the Community. They included data on budgetary expenditure as well as the priorities and instruments of aid. The Commission used the surveys to help identify those aids (and aid-givers) which posed the greatest risk to the achievements of the single market.<sup>60</sup> And, because the data was collected annually, the surveys provided benchmarking instrument by which to track the progress (or lack thereof) in controlling aids. It also provided a tool to identify, name and shame profligate member states.

## 2. The Continuing Importance of Policy Frameworks

Although the State Aid Surveys served to draw greater attention to *existing* aid giving activities, the bulk of Commission resources remained focused on controlling the provision *new* aids. In this regard, policy frameworks continued to figure prominently. Many of the frameworks originating in the previous era were renewed, updated and/or replaced with new policy guidelines. For instance, the framework for synthetic fibers, originally implemented in 1977, and renewed on multiple occasions, was revised in 1993, and ultimately replaced in 1996 with a new set of guidelines.<sup>61</sup> Where guidelines were revised or replaced, the trend invariably was toward tightening the conditions under which aid was granted.

The Commission also introduced an array of new policy frameworks. Among these, perhaps the most noteworthy (and controversial) was the introduction in 1989 of an aid framework for the motor

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<sup>57</sup> See, for instance, 16<sup>TH</sup> REPORT ON COMPETITION POLICY (1986); C.-D. Ehlermann, *The Contribution of EC Competition Policy to the Single Market*, C. M. L. REV. 29 (1992); L. Brittan, EUROPEAN COMPETITION POLICY: KEEPING THE PLAYING FIELD LEVEL (1992).

<sup>58</sup> 17<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 171 (1988).

<sup>59</sup> SURVEYS ON STATE AID were published in 1989, 1991, 1992, 1995, 1997, 1998, 1999, 2000, and 2001. Following the publication of the 9<sup>TH</sup> SURVEY ON STATE AID in 2001, the Commission moved to a new reporting modality, the STATE AID SCOREBOARD.

<sup>60</sup> For a brief background on the motivation behind the State Aid Surveys, see 17<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 172 (1988).

<sup>61</sup> See, OJ C 346/3 (1992); Code on aid to the synthetic fibres industry, OJ C 94/11 (1996).

vehicle industry.<sup>62</sup> When it was announced, two member states – Spain and Germany – announced that they did not intend to abide by the framework. After a series of unsuccessful negotiations failed to resolve the dispute, the Commission decided to exercise a little leverage over the states by announcing that it was opening formal investigatory proceedings under Article 88(2) for all aids granted by these two states in the motor vehicle sector.<sup>63</sup> Faced with the threat that the Commission would scrutinize every aid provided in the sector, the Spanish government quickly capitulated and agreed to abide by the guidelines. The Commission responded by promptly ending Article 88(2) proceedings. The German government, however, refused to relent. The government argued that the framework advanced what it regarded as undesirable industrial policy objectives. In view of the German government’s continued resistance, the Commission proceeded with its investigation. At the conclusion of proceedings, the Commission adopted a negative decision.<sup>64</sup> The decision required the German government to notify the Commission of all significant aids distributed henceforth, and that if it did not, those aids would be considered illegal and subject to recovery.

The Commission’s actions were unprecedented and, in the opinion of one analyst, marked the beginning of a “new era” for policy frameworks.<sup>65</sup> The Commission, through its actions, had effectively transformed hitherto “soft law” requirements of policy frameworks into a “hard law” obligation. The situation evinced an increasingly confident Commission – one that was willing to stand firm in the face of government opposition and was prepared, if necessary, to draw on the full measure of its statutory authority to secure government compliance.

In addition to the motor vehicle framework, the Commission expanded considerably the use of “horizontal” frameworks. In 1986, the Commission introduced a framework addressing aid for research and development (R&D).<sup>66</sup> This was followed in 1992 with a framework oriented to facilitate the development of small and medium-sized enterprises (SMEs).<sup>67</sup> Emphasis on the role of horizontal was given additional fillip with in 1993 with the publication of the Commission’s White Paper *Growth, Competitiveness and Employment*.<sup>68</sup> Set against a background of economic slowdown and rising unemployment, the White Paper mapped out a strategy to stimulate Community competitiveness. It argued, in effect, that Article 88(3) left ample interpretive space for the Commission to approve aids designed to do more than just help poor regions and failing industries. It could facilitate new technologies and enhance Community’s external competitiveness. The Commission singled-out aid to SMEs, aid to

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<sup>62</sup> Community framework on State aid to the motor vehicle industry, OJ C 123/3 (1989).

<sup>63</sup> 19<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 127 (1990).

<sup>64</sup> OJ C 188 (1990).

<sup>65</sup> Cini, *supra* note 35.

<sup>66</sup> Community framework for State aid for research and development, OJ C 83/2 (1986).

<sup>67</sup> Community guidelines on State aid for small and medium-sized enterprises (SMEs), OJ C 213/2 (1992).

<sup>68</sup> COM (93) 700 final. For a discussion, see 23<sup>rd</sup> REPORT ON COMPETITION POLICY, pts. 27-35 (1994).

promote employment, and aid to facilitate R&D as having a particularly positive role to play in economic restructuring. In each case, the Commission took action, introducing new policy frameworks or revising existing ones so as to reflect this enhanced emphasis.<sup>69</sup>

But even as the White Paper saw a constructive role for horizontal aid measures, it took dim view of aids to firms in difficulty. The Commission had long been concerned that such aids rarely addressed underlying structural problems. Notwithstanding efforts to encourage governments to use aids to rationalize production, they more often than not functioned as operating aids. In view of this, the Commission decided to adopt an overarching policy framework designed to address the provision of so-called “rescue and restructuring” aid. Adopted in 1994, the framework adapted and extended principles already found in the other sector-focused frameworks, including the original sectoral guidelines published in 1978.<sup>70</sup> For instance, in order to qualify for exemption under Article 87(3) proposed aids would have to be “necessary” and “proportional” to the problems they sought to resolve and must demonstrate a “compensatory justification.”

Finally, in addition to adaptations to the manner in which it handled horizontal and sectoral aids, the Commission continued to refine its approach to regional aid. The Iberian enlargement and reunification of Germany, with its calls for greater “economic and social cohesion,” provided the Commission impetus to assert more control over the aid granting of governments – particularly within the wealthier member states.<sup>71</sup> Active policy measures had to be taken to reverse the centripetal attraction exerted by the more prosperous regions.<sup>72</sup> In 1988, the Commission acted on this principle by adopting the latest in the line of regional aid frameworks.<sup>73</sup> In it the Commission sought to enhance the “pro-cohesion” effect of regional aid. Among other things the Commission articulated criteria to determine what specific regions fell within the meaning of “under-developed” under Article 87(3)(a) and thus were deserving of the greatest assistance. In 1998, responding to the pending accession of a substantial number of new states whose level of economic development were well-below the Community average, the Commission replaced the 1988 Communication with a set of more formally articulated Guidelines.<sup>74</sup> The new Guidelines consolidated all Commission Communications into a single instrument and, in so doing,

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<sup>69</sup> Community framework for State aid for research and development, OJ C 45/5 (1996); Community guidelines on State aid for small and medium-sized enterprises (SMEs), OJ C 213/4 (1996); Community guidelines on aid to employment, OJ C 334/4 (1995) and OJ C 218/4 (1996).

<sup>70</sup> Community guidelines on state aid for rescuing and restructuring firms in difficulty, OJ C 368/12 (1994). See 24<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 357 (1995).

<sup>71</sup> 20<sup>th</sup> REPORT ON COMPETITION POLICY, pts. 173-179 (1991).

<sup>72</sup> Brittan, *supra* note 57 at 87.

<sup>73</sup> Commission communication on the methods for the application of the EEC Treaty Article 92(3)(a) and (c) [now Article 87] to regional aid (OJ C 212/2 (1988).

<sup>74</sup> Guidelines on national regional aid, OJ C 74/6 (1998). See, 27<sup>TH</sup> REPORT ON COMPETITION POLICY, pts. 206-208 (1998).

unified the criteria used to assess regional aid. Chief among these criteria was the introduction of lower aid ceilings.

#### **D. From the Late-1990s to the Present: Commission Policy Coming of Age**

Three events would shape the context within which the Commission would execute its state aid authority during this era. The first was completion of economic monetary union. Loosed of monetary policy, states lost yet another tool on which to draw to achieve domestic economic, social or political objectives. State aids would, as a result, take on even greater significance. Second was articulation and implementation of the so-called Lisbon Strategy. Launched in 2000, the Lisbon Strategy was intended to elevate Europe to the world's most competitive knowledge based economy by 2010. To achieve this, it was widely recognized – by member states and the Commission alike – that substantial public investments would be required to upgrade the Community's knowledge infrastructure. The challenge, from the Commission's perspective, was to insure that public funds were used in the manner intended.<sup>75</sup> The third event shaping state aid policy during this era was enlargement. The planned accession of twelve Central and Eastern European states, many of whom were previously centrally planned economies, and all of whom were relatively poor by Community standards, would lead to a substantial increase in demands placed by an already resource-stretched Commission. Competition Commissioner Monti estimated in 2003 that state aid workload could rise by as much as 40%.<sup>76</sup>

Fortunately for the Commission, it would address these challenges within what was an increasingly permissive political environment. At the dawn of the 21<sup>st</sup> Century, member states appeared more forthcoming than ever in acknowledging the need to control state aids. At the March 2001 Stockholm European Council they publically committed to bringing down the volume of aid and to redirect what aid that remained toward less-distorting horizontal objectives. Although the Commission welcomed the sense of urgency expressed by governments, getting states to lend rhetorical support for vigilance on state aid had never been a particular problem. The problem had always been one of follow-through. Governments, if generally suspicious of the motives of others, rarely questioned the necessity or propriety of their own aid programs. The question was whether member states were genuinely committed to change.

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<sup>75</sup> For a discussion of how Commission authorities see the role of state aid policy in meeting Lisbon goals, see T. Kleiner, *Reforming State Aid Policy to Best Contribute to the Lisbon Strategy for Growth and Jobs*, COMPETITION POLICY NEWSLETTER 2 (2005).

<sup>76</sup> M. Monti, *New Challenges for State Aid Policy*, NEW DEVELOPMENTS IN EUROPEAN STATE AID LAW 8 (Proceedings of the Experts' forum held in Brussels on June 19, 2003).

## 1. The “Enabling” Regulation (Regulation 998/98)

This latest era in the development of Community state aid policy finds its beginning in a 1998 regulation passed by the Council. Regulation 994/98, more commonly known as the “enabling” regulations represented a significant development in the evolution of the Commission procedural authority.<sup>77</sup> The regulation, the first to be adopted under Article 89, was intended to provide a measure of relief to an overtaxed Commission competition bureaucracy. The Commission had, in some sense, become a victim of its own success. The extensive array of policy frameworks articulated by the Commission that served as the core of Community state aid policy relied for their effectiveness on state observance of the Article 88(3) notification requirement. Notification afforded Commission authorities the opportunity to confirm that states had indeed conformed proposed aid programs to the guidelines set forth in these framework. It also created a substantial procedural burden. The vast majority of notified aids raised no concerns. The Commission was obliged, nevertheless, to process all notifications. By the mid-1990s, the Commission was receiving 400-500 new aid notifications annually. The sheer volume of notification was beginning to overtax an already resource-strained body. As a consequence, the Commission was finding it increasingly difficult to direct adequate resources to searching-out non-notified aid and to conducting thorough investigations for the relatively small number of notified aids that raised concerns.

To bring a measure of relief to this notification-overload, the Commission submitted a proposal to the Council on the basis of Article 89 for a regulation that would give it the authority to issue what “block exemptions” for certain categories of aid. If granted, this would allow Commission authorities to declare those aids *ex lege* compatible with the common market, and thereby exempt from prior notification.<sup>78</sup> Viewed through the lens of the analytical framework advanced in this paper, the proposal was effectively a request by the Commission to member governments that they amend the delegation contract. Specifically, the Commission was requesting the formal delegated authority to “harden” many of the soft law frameworks that it had developed over the preceding thirty years.

In May 1998, the Council approved the regulation. The Commission responded quickly, issuing regulations for aid to SMEs,<sup>79</sup> employment aid,<sup>80</sup> and training aid.<sup>81</sup> The Commission also issued a

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<sup>77</sup> Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 92 and 93 (now 87 and 88 respectively) of the Treaty establishing the European Community to certain categories of horizontal State aid, OJ L 142/1 (1998).

<sup>78</sup> 27<sup>TH</sup> REPORT ON COMPETITION POLICY, pt. 203 (1998).

<sup>79</sup> Commission Regulation 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises, OJ L 10/3 (2001); later amended by Regulation 364/2004 of 25 February 2004 amending Regulation (EC) No 70/2001 as regards the extension of its scope to include aid for research and development, OJ L 63/22 (2004).

<sup>80</sup> Commission Regulation 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment, OJ L 337/3 (2002).



regulation covering *de minimis* aid.<sup>82</sup> Codification held many benefits for the Commission. It enhanced the clarity, stability and, ultimately, the legitimacy of what had hitherto been a hodge-podge of Commission practice and case law. Formalizing the guidelines also insulated its policy preferences from state pressures. But formalization had its costs. Codification reduced the Commission's flexibility in interpreting and applying its guidelines. So, even as the Commission enjoyed enhanced statutory authority, the exercise of that authority came at the cost of narrowing the scope of its discretion.

It is important to note that not all policy frameworks were replaced with block exemptions. The scope of the Enabling Regulation was narrow. Article 1 explicitly confines Commission authority to granting block exemption to certain categories of *horizontal* aid. Noteworthy by their exclusion were aids addressing regional aid and aid programs addressing politically-sensitive industries (e.g., motor vehicles, textiles). While governments sought to limit the scope of the Commission's new authority, the Commission itself decided it would not seek to codify guidelines for certain categories of aids. For instance, the Commission eschewed formal regulation in environmental aid, rescue and restructuring aid, and aid for research and development, deeming it "inappropriate" to do so due to the complexity of the aid schemes.<sup>83</sup>

## 2. The Public Sector Revisited: Services of General Economic Interest (SGEI)

One of the most high-profile and politically divisive area of Commission activity during this era was its effort to apply treaty state aid rules to "services of general economic interest" (SGEI). SGEI are general interest services subject to specific public service obligations imposed by member states. Examples of SGEI include public utility networks (energy, transport, telecommunications), social services (hospitals, social housing), radio and television broadcasting, water and sewage. Like public enterprises (discussed in the previous section), SGEI enjoy special legal status under Community law. Article 86(2) provides that undertakings entrusted with public service obligations are to be treated like any other enterprise under Community law, BUT only "insofar as the application of such rules does not obstruct the performance...of the particular tasks assigned to them." The Treaty of Amsterdam enhanced the status of

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<sup>81</sup> Commission Regulation 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid, OJ L 10/20 (2001); later amended by Commission Regulation No 363/2004 of 25 February 2004 amending Regulation (EC) No 68/2001 on the application of Articles 87 and 88 of the EC Treaty to training aid, OJ L 63/20 (2004).

<sup>82</sup> Commission Regulation 69/2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid, OJ L 10/30 (2002); later replaced by Commission Regulation 1998/2006 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid, OJ L 379 (2006). The De Minimis Regulation differed from the other block exemptions in that it applied to all forms of aid, regardless of sector or purpose (except agriculture, aquaculture and fisheries) so long as the cumulative total of that aid remained below the threshold stipulated by the Commission (less than €100,000 per undertaking over a three year period).

<sup>83</sup> See, R. Hankin, *Final Conclusions from the Commission's Perspective*, NEW DEVELOPMENTS IN EUROPEAN STATE AID LAW (Proceedings of the Experts' forum held in Brussels on June 19, 2003).

SGEI, incorporating a new Treaty principle emphasizing that “the Community and Member States...shall take care that such services operate on the basis of principles and conditions *which enable them to fulfill their missions* (emphasis added)” (Article 16).

The challenge facing Commission officials was how to reconcile Treaty protection of the legitimate functioning of SGEI with Treaty provisions on state aid. On this question, there had long been two schools of thought.<sup>84</sup> The first held that public funding *is not* considered state aid *unless* the conferred advantage is greater than the level of remuneration appropriate to compensate for the costs of providing the services. This view was known as the “net compensation approach.” The second view, known as the “state aid approach,” held that the mere fact that an aid is intended to offset the additional costs of providing a public service cannot prevent it from being considered an aid within the meaning of Article 87. Therefore, all such aid should be subject to notification and evaluation.

The issue was more than just legal semantics. Whether one view or the other prevailed was of practical significance to the Commission. Under the compensation approach, states would have no obligation to notify and the Commission, by extension, would have no need to evaluate each measure. Such aid would, in effect, enjoy a general exemption from state aid procedural requirements. The state aid approach, by contrast, held that government support to SGEI should be regarded as “new” aid under Article 88(3). Interpreted thusly, states would have to notify the Commission of all new aids and the Commission would have to evaluate each. The Commission would be in the position of having to decide whether public assistance amounted to aid and, if so, whether that aid qualified for exemption under Article 86(2) or one of the derogations in Article 87. If the conditions did not warrant exemption, the Commission would then find itself in the politically uncomfortable position of having to prohibit the aid. In view of the political sensitivities such aid touched, the Commission’s had long dealt with the dilemma of discretion by opting to subscribe to the “net compensation” school of thought. But its decision to do so was challenged.

The controversy played itself out over a series of aid cases that ultimately resulted in the intervention of the courts. The doctrinal war heated up with a challenge to a Commission decision not to consider public assistance to France’s *La Poste* aid within the meaning of Article 87(1). The Court (CFI) disagreed. In its decision, known as *FFSA*, the Court held that even though government assistance may not have fully compensated the undertaking for the additional costs of fulfilling its public service obligations, the measure nevertheless put the recipient in a more favorable position vis-à-vis competitors and thus should have considered it aid.<sup>85</sup> Curiously, the Court seemed to reverse itself in a subsequent

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<sup>84</sup> See, for instance, C. Rizza, *The Financial Assistance Granted by Member States to Undertakings Entrusted with the Operation of a Service of General Economic Interest*, in *THE LAW OF STATE AIDS IN THE EUROPEAN UNION* 67-69 (A. Biondi, et al., eds. 2003).

<sup>85</sup> *FFSA and others v. Commission*, T-106/95, [1997] ECR II-229

case. In *Ferring*, the Court reasoned that since the aid did not exceed the extra costs incurred by the undertaking pursuant to its public service obligation, it did not confer an “advantage” with the meaning of Article 87(1) and, as a consequence, should *not* be classified as aid.<sup>86</sup>

The landmark decision on this matter, however, is to be found in the Court’s ruling in *Altmark*.<sup>87</sup> Described by Knaul and Flores as the “compensation plus” approach, the Court seemed to return to a position endorsing what had been the Commission’s preferred approach, albeit with one clarifying proviso.<sup>88</sup> The Court put forward a four-part test to determine whether public assistance constituted aid. Compensation would not be considered aid, and thus not subject to Commission scrutiny, provided each of the stipulated conditions were met. If, however, any of the conditions was not met, the measure would be considered aid and thus subject to notification and evaluation.

The full implications of *Altmark* for Commission practice are still not clear. What is clear post-*Altmark* is that SGEI remains a contentious and highly unsettled area of Community law. In view of this, the Commission has taken measures to indicate its interpretation of the decision and how it intended to apply the court’s criteria. These were presented as a package of three instruments. The first was a decision<sup>89</sup>, based on Article 86(2) in which the Commission specifies conditions under which public compensation measures are considered compatible with the common market and thus do not need to be notified. This was followed by a policy framework<sup>90</sup> specifying the conditions under which compensation not covered by the decision is compatible with state aid rules. Finally, the Commission amended the Transparency Directive<sup>91</sup> to make clear that companies benefiting from public compensation must keep separate accounts so that aid measures can be evaluated and cross-subsidization avoided.<sup>92</sup>

### 3. State Aid Action Plan (SAAP)

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<sup>86</sup> *Ferring SA v Agence centrale des organismes de surety sociale (ACOSS)*, C-53/00 [2001] ECR I-9067.

<sup>87</sup> *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, and *Oberbundesanwalt beim Bundesverwaltungsgericht*, C-280/00, [2003] ECR I-7747.

<sup>88</sup> A. Knaul and F. Perez Flores, *State Aid*, in *THE EC LAW OF COMPETITION 1751* (J. Faull and A. Nikpay, eds., 2d. ed., 2007).

<sup>89</sup> Commission decision of 28.11.2005 on the application of Art. 86 (2) of EC Treaty to State Aid in form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest.

OJ L 312/67 (2005).

<sup>90</sup> Community framework for State aid in the form of public service compensation, OJ C 297/4 (2005).

<sup>91</sup> Commission Directive 2005/81/EC of 28 November 2005 amending Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, OJ L 312/47 (2005).

<sup>92</sup> 2005 REPORT ON COMPETITION POLICY, Box 4. See also L. Svane, *Public Service Compensation in Practice: Commission Package on State Aid for SGEI*, COMPETITION POLICY NEWSLETTER 3 (2005); Hancher et. al. *supra* note 4 at 209-211.

Beginning in the late 1990s, a recurrent theme in Commission communications on state aid policy was the need to “rationalize and modernize” state aid control. The overarching aims in doing so were to improve transparency and legal certainty, to reinforce vetting of large aid programs and the simplification of monitoring for aids of minor importance. The afore-mentioned Enabling Regulation was meant to contribute to these goals. Another major contribution to this effort was the so-called Procedural Regulation.<sup>93</sup> Passed in 1999, the regulation codified what had been a mixture of case law and soft law that had long governed the procedural requirements of state aid control. In so doing, it enhanced legal certainty for the Commission and member states alike. Importantly, from the perspective of the Commission, it codified the scope of its authority to demand *inter alia* that states provide information to evaluate aid programs (information injunction), that states suspend granting aid unlawfully until the Commission taken a decision on the compatibility of aid (suspensive injunction), and that states recover those aids distributed in contravention of these procedural requirements (recovery injunction).<sup>94</sup> These procedural aspects and others were clarified and extended by the Commission itself five years later when it authored the aptly-labeled Implementing Regulation.<sup>95</sup>

But it would not be until 2005 that the Commission would put forth a comprehensive plan for how to reform state aid rules. Labeled the “State Aid Action Plan” (SAAP), the Commission touted the program as a root-and-branch reexamination of how it approaches state aid. Set to unfold over a five year period (2005-2009), the reform program was meant, in the words of Competition Commissioner Neelie Kroes, to give state aid policy “clearer meaning and a clearer direction.”<sup>96</sup> Among the focal points of reform was re-orienting aid to better meet the objectives of the Lisbon Strategy.

The Commission identified four goals that would guide the modernization program. The first was “less and better targeted aid.” A mantra from the Commission (and the Council) since the late 1990s, it expressed its intention to redouble its efforts to insure that aids are necessary, proportionate and have a compensatory justification warranting departure from market competition. The second area identified by the Commission was in improving the quality of its own analysis. Specifically, the aim is to continue its move from a legalist approach to a more rigorous, economics-based approach. The third focuses on procedural aspects of state aid control. Although the Procedural and Implementing Regulations

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<sup>93</sup> Council regulation 659/1999 laying down rules for the application of Article 93 of the EC Treaty (now Article 88), OJ L 83/1 (1999).

<sup>94</sup> For a discussion of the Procedural Regulation and its impact, see A. Sinnaeve & P.J. Slot, *The New Regulation on State Aid Procedures* C. M. L. REV. 36 (1999).

<sup>95</sup> Commission Regulation 794/2004 of 21 April 2004 implementing Council regulation 659/1999 laying down rules for the application of Article 93 of the EC Treaty (now Article 88), OJ L 140/1 (2004). For a discussion, see A. Matthias-Werner, *Reform of procedural rules for state aid cases*, COMPETITION POLICY NEWSLETTER 2 (2004)

<sup>96</sup> N. Kroes, *Reforming Europe’s State Aid Regime: An Action Plan for Change* (Speech given at University of Leiden Joint conference on European State Aid Reform, 14 June 2005) (SPEECH/05/347).

represented a marked improvement over the *status quo ante*, the Commission sees this modernization effort as a opportunity to further clarify government obligations and, in so doing, encourage greater compliance. The fourth goal is to encourage “shared responsibility” between Commission and member states. The goal is a not-so-veiled reference to persistent member state non-cooperation and non-compliance. Despite long-standing efforts by the Commission to both encourage (through policy frameworks and block exemptions) and coerce (through enforcement) member state to meet with their state aid obligations, the provision of unlawful and illegal aid remains a persistent problem.

It remains to be seen whether the Commission’s action plan will achieve all of these stated goals. There are, however, signs of progress. In 2006, the Commission adopted revised guidelines for risk capital<sup>97</sup>, guidelines for aid to research and development and innovation<sup>98</sup>, and a new *De Minimis* rule.<sup>99</sup> The Commission followed this more recently with new guidelines for environment aid<sup>100</sup>, a new communications on state guarantees<sup>101</sup>, and in what is undoubtedly the most significant achievement, the Commission introduced the General Block Exemption (GBE).<sup>102</sup> The GBE incorporated and harmonized the provisions previously existing in five separate regulations. In doing so it replaced existing block exemptions for aid to SMEs, R&D aid, employment aid, training aid and regional aid.

#### IV. CONCLUSION

I have sought to demonstrate the utility of using the dilemma of discretion as an analytical lens through which to understand Commission behavior and, in particular, the Commission’s role in shaping the meaning of state aid under Article 87. Over the course of the last 50 years, the Commission has found itself forced to weigh the benefits of exercising its delegated authority against the perception that it is overreaching its mandate. Cognizant of the “dilemma” underlying the exercise of its discretion, the Commission approached the exercise of its authority tentatively in the early years of the Community. However, as the Commission grew in both confidence and stature, it began to push to bounds of its

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<sup>97</sup> Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises, OJ C 194/2 (2006).

<sup>98</sup> Community framework for State aid for research and development and innovation, OJ C 323/1 (2006).

<sup>99</sup> Commission Regulation No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid, OJ L 379 (2006). For a discussion of how the Commission sees the connection between the SAAP and the revised policy guidelines for risk capital and aid to R&D&I, see B. Tranholm Schwarz , *New Guidelines of State Aid Promoting Risk Capital Investments*, COMPETITION POLICY NEWSLETTER 3 (2006) and T. Kleiner and R. Repplinger-Hach, *The New Community Framework for State Aid for Research and Development and Innovation*, COMPETITION POLICY NEWSLETTER 1 (2007).

<sup>100</sup> Community guidelines on State aid for environmental protection, OJ C 82/1 (2008)

<sup>101</sup> Commission Notice on the application of articles 87 and 88 to State aid in the form of guarantees, OJ C 155/10 (2008).

<sup>102</sup> Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Article 87 and 88 of the Treaty, OJ L 214/3 (2008)

authority. It did so by acting similar to a policy entrepreneur exploiting windows of opportunity created by the confluence of uncertainty and change born of the broader process of integration.<sup>103</sup> But, in all its actions, the Commission seldom courted open political confrontation with member states. Rather, it used its discretionary authority to steer state behavior in desired directions.

The study, through its focus on the dilemma of discretion, extends the application of the principal-agent frameworks as analytical tool for understanding the complex relationship existing between the Commission and member governments. Although it has become fashionable to examine the European Union using the concepts and tools of domestic/comparative politics, the Community has its origins as a construct of international politics. As such, it is important to remember that the Commission owes its existence to the willingness of contracting governments to compromise their sovereign rights. While, on the one hand, governments may have viewed vesting a “third party” actor with the responsibility (and authority) for advancing and defending the “community interest” as a means to give credibility to their agreement, they continued to remain jealous of defending national prerogatives. This tension informed every aspect of the organizational design of the European Union – including the mandate and authority delegated to the Commission. The Commission, particularly in the early years of the Community, acted in a manner that reflected the political vulnerability of its position. But the authority member states delegated to the Commission was real. And, over time, as evidenced above, the Commission asserted that authority with greater confidence – and to greater effect.

Lest one be accused of explanatory overreach, it is important to acknowledge the limits of the framework explored in this study. The only strong claim made here is that the dilemma of discretion, and the principal-agent approach on which it is based, provides a degree of analytical leverage over the development on state aid policy and, in particular, the Commission’s role in those developments. No claim is made that it sufficient to account for all developments. It is an approach whose value is in highlighting opportunities and constraints. It is unable to explain why various actors behave as they do.

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<sup>103</sup> For the standard statement on the role of policy entrepreneurs, see J. Kingdon, *AGENDAS, ALTERNATIVES AND PUBLIC POLICIES* (1984). On the application of the concept to the role of the Commission, see, M. Smyrl, *When (and How) Do the Commission’s Preferences Matter?* 79 *J. COMM. MKT. STUD.* 36 (1998); and B. G. Peters, *Agenda-Setting in the European Community*, 9 *J. EUR. PUB. POL.* 1 (1994).