

Paper to EuroMemo Group Conference in Helsinki,

28th of September Workshop 4 - Social policies in the EU and the Nordic Welfare model: assessment and future prospects

A Nordic perspective: State Aid Rules

- Restricting room for Social Policy and Public Service?

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Abstract

EU and the "following" EEA regulation on state aid is little noticed as an economic policy issue in the Nordics in relation to its potential importance. Even less are the attention on its possible impact on welfare state and the distribution of income and balance of power in labour markets.

There seem to have been dynamics since 1990-ies under these rules through case law going further than an reasonable economic understanding of the articles founding the internal market. The communication from EC and ESA and national authorities have been drivers in the same direction. They have given confusing information mixing up what is lawful and not. This combined with neglecting the basic criteria for supranational regulation: it should be limited to cases that do have an significant impact on cross border trade. This has established the impression that state aid including even money for public services as a main rule is bad for the economy. Through the growth of services in the economy, the state aid rules, well justified for trade in goods, has "invaded" the complex borderline between public service and markets.

The Commission is now through their guidelines reversing this trend emphasizing more the original text that unlawful state aid is limited to cases with more than marginal impact on cross border trade. Economists should care more about EU regulations on the economy. If not, they are leaving it all to courts and lawyers to control what in reality are economic policy issues; without sound economic analysis.

1. Introduction

Supranational regulations are needed for the internal market, but economists should see an important task to improve process and decision making. The EU regulations are a complex mix of law, economics and political mechanisms. I have now for some time studied the state aid rules and found that economists could do a lot more to prevent unjustified marketisation of welfare and public service, at least in my country. Doing so in this case would have support both in the grounding legislation and economic rationality. Giving more priority to economic analysis and efficiency could at the same time assist the Brussels institutions focusing on the big issues and reducing unwise use of resources on small things undermining their legitimacy.

More interest among economists on institutional economy could even on a broader basis prevent harmful impact from globalization. Law dynamics are risking to exclude research and analysis of costs and benefits.

Norway is part of the internal market except for agriculture and fisheries and the customs union. An important element in the agreement is to follow the EU regulation of State Aid. The EFTA Surveillance Authority (ESA) deals with the Agreement on the European Economic Area (EEA Agreement) in Iceland, Liechtenstein and Norway. This area includes a population of 5 ½ million compared to 500 millions on the EU side. The EEA Agreement aims at uniform implementation and application of the common rules in each of the 31 EEA States. EU Member States are supervised by the European Commission. EU has its ECJ; the EFTA side its EFTA court.

The basic objective for Norway joining the EEA was to achieve full internal market access for consumers and producers without becoming a full member of EU. In this respect the EEA is broadly regarded as a success to the Norwegian

economy. What has been challenging compared to the political preconditions for joining has been two main perspectives:

- More impact on labour market standards and power balance between employers and labour
- More influence on industrial policy and now public sector policy through EU State Aid rules¹

These elements are coming as a surprise and in conflict even with important preconditions for the internal market, stating national autonomy on both designing the tax system, the way public service and welfare system works.

2.State Aid as obstacle to trade

In a national context state aid represents a normal and well established part of economic policy in most countries. The concept State Aid is including direct transfers and subsidies but even exemptions and "discount" on other economic obligations on production of goods and services. EU law and EEA basically recognize state aid as an important part of economic policy measures and as a responsibility of national regulations when not interfering with other parts of EU law².

It is, however, easy to see that unrestricted use of state aid in individual countries can counteract the intended stimulus to trade through reducing barriers between participating countries. State subsidies may have a similar effect on protecting companies and domestic jobs as tariffs and non- tariff barriers.

Therefore within a free trade area there is a case for common rules for state aid influencing cross country trade. Unregulated state aid affecting trade may have

¹ NOU 2012: 2, *Outside and Inside* (expert evaluation on EEA membership 1994-2011).

Only summary in English

² Complicated by the fact that state aid is defined in two different ways; see chapter 4.

negative impact on efficiency and, above all, disturb planning and investment decisions in the economy.

From the basic objective of taking care of cross country activity, the impact on trade is the crucial criteria for what is regarded as unlawful state aid. In article 61 in EEA Agreement³ we have underlined this point:

*"Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA 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 Contracting Parties**, be incompatible with the functioning of this Agreement"*

At least in Norway before joining the EEA, the issue state aid, was given much attention. For the export perspective the restrictions on protectionism in other participating states were emphasized. But at the same time room for manouvre were emphasized aiming at safeguarding natural resources and balancing employment in areas of the country exposed to economic impact from abroad. In the decision in 1992 there were mostly focus on tradeable goods in industry, no reflection on possible impact on public service from state aid regulation. Tax policy and public ownership⁴ was considered at of national autonomy.

3.Change over time

In the beginning State Aid rules probably contributed to stop a race for subsidies for instance in manufacturing as protectionist measures. There has of course

³ Same as Article 107

⁴ Article 125 in EEA Agreement:

This Agreement shall in no way prejudice the rules of the Contracting Parties governing the system of property ownership

been disagreements in many single cases, but cross border regulation has been justified, as mentioned above.

Over time it is to be expected that regulatory systems may change their role. Structural change in the economy through both technological and institutional mechanisms will always matter. The big changes in national markets for energy, telecom and ICT also meant changes in how to organize and manage the production and increase of trade in new areas.

Having restrictions on state aid, there are arguments for autonomy of ownership in the economic entities should not be used as a loophole for subsidies through "soft capital costs, where cross border trade has an important role to play. Once having the principle of free movement even for services, the strong growth of for this part of the economy would have an impact on rules and regulating institutions. But in some ways this understanding in my country – and probably others- has been taken much further than expected both from a democratic and economic rationality point of view. In particular this is the case where markets and public services are alternatives and/or competitors.

The route for this derailment seems to have been:

- An expansion of the definition of state aid
- Very unclear definitions on what public services that should be exempted; reference is made to a vast literature on "SGEI"⁵
- An expansion to split the understanding of a given service production, according to the above criteria, and control even small shares of what basically are the services. One example is public sport arenas having capacity for renting and ticketing local population and even events attracting outside visitors. Or state hospitals having parking, catering and pharmacy with some sales to patients as consumers and even to

⁵ See 9 below

neighboring people to the hospital. Or schools renting rooms or giving courses to other than their primary targeted students. The potential number of cases is unlimited and growing as part of more pluralism both in private and public services and how they are organized.

- The right even to locals disliking local government activities; may mobilize a lot of cases
- Different from cases under Competition Law, for cases under State Aid Law it ... " *is not necessary to establish that the aid has a real effect on trade between Member States and that competition is actually being distorted, but only to examine whether that aid is liable to affect such trade and distort competition*"⁶. It has been established as something like a principle both in regulation and in the courts that there is no need for documentation of the effects on trade. The courts take their decisions without any analysis. Trade effects are mentioned, men that seems very randomly. And perhaps more as a way of escaping obvious "unsensible" solutions. However by this tradition, in reality there seem to have been established a kind of opposite principle of proof.

But as we explain more in the following chapter, this trend is now contradicted by several occasions by the EC in reality increasing the importance of the trade effect criteria.

4. Effect on trade criteria on revival?

The EEA restriction on state aid has been overstated in the communication from both ESA and national authorities. This seem to have reinforced the case law from courts and practice by many parties involved. Such presentations of the rule are frequently telling⁷ : *"The general prohibition on state aid....."* ,

⁶ Sak C- 518/13 Eventech, ECLI:EU:C:2015:9

⁷ The www.ESA site under the headline The Role of ESA

when the text of the law, as cited on page 3, tells the main criteria as "is affecting trade". In addition there are great number of exemptions.

Adding to the confusion is also that ESA is using the concept "State Aid" in two different understandings; inconsistently including both lawful and unlawful. In their statistics are both accounted together as State Aid in itself.

The above mentioned process has led to several cases concerning public entities having only national and even local economic activity. Involved in such cases have been local commercial producers and cases beyond a reasonable economic understanding of what is "affecting trade within the EEA".

Of course there are different views on pros and cons on the role of competition among economists and where to draw borderlines between markets and the state. But we should have a common interest in two aspects:

- A qualified analysis of costs and benefits as a base for rules and decisions
- A reasonable balance between national autonomy and what to be handled at the EU/EEA level; the latter should go after the more important cases, "disturbing" cross border trade

There seem, as indicated above, to be some reorientation in this direction in EU. The Commission in 2017 decided to simplify and "clarify" the State Aid rules for

- port and airport infrastructure
- culture and heritage conservation
- for sport and recreational infrastructures⁸

This was following as a part of the discussions on regulating services called

⁸ COMMISSION REGULATION (EU) 2017/1084

SGEI⁹. They are services of particular importance to citizens and therefore require public intervention. One important package came in 2005, followed by another in 2011 for services that are small and of a local nature and therefore "do not have a significant effect on trade". Such a narrowing should also make it more easy focusing on larger cases to have more impact on a cross border market.¹⁰

5. More attention from economists are needed

Services are the biggest and the fastest growing part of the economy in most developed countries. Trade in services across countries did expand later than for goods. The internal market reflected ambitions to make a change.

A particular challenge is to deal with public services. Health, caring and education are among the biggest employers in the economy. And in many countries Government or- at least other non profit entities- are dominating both production and demand. In Norway, with similarity to the other Nordics, almost all education and health services are in the Government sector. And across Europe there is a vast variety of different forms and ways to protect these services from the market forces.

This gives a double argument for limiting the globalization in those areas:

i) The services in question are in particular exposed to market failures well known for economists:

- externalities
- asymmetric information in favour of producer compared to often vulnerable users
- dividing people socially and by income

⁹ Services of General Economic Interest, see Sauters (2014)

¹⁰ Commission Decision of 20.12.2011

- high transaction costs and complicated governance control

- ii) Harmonized "market" rules to promote trade are highly misplaced. Supranational rules are difficult to design and tend to favour markets over more solidaristic solutions

It is time for economists to be more "on deck". The issues, at least from a Nordic perspective are dominated by lawyers and bureaucrats. Politicians, economists and media seem to be far from the playing field. This seems strange; all the time the internal market is basically an economic idea, and through that is an important organizer of society.

The supranational decision making and control regime limits transparency and democratic control. Jura is taking over for research and analysis normally carried out on national level. This can be costly and weakening important mechanisms aiming at both quality and equity.

A relevant understanding of economics can also challenge important goals. Many business lawyers understand economics as to achieve most possible market competition . They do not understand the justification of public sector and they misunderstand the purpose of trade. They seem to see competition as a goal for itself, and do not see trade basically as a means to explore comparative advantages.

The most urgent form of "unjustice" in this understanding of economics is the absence of "competition neutrality" for private entrepreneurs compared to public entities. That might be a relevant thing to discuss if wage and working condition where in their mind. That even has a basis in international law (ILO), and partly sheltering workers from the competition logics.

No, what they worry about is taxes and soft capital costs. In Norway we have the special problem that ESA is going in the opposite direction of EC. They have claimed that as a general rule all activity in public sector which even touch any market should be separate companies being taxed for their income and lose their state guarantee. This demand is based not on economic analysis, even failing to mention what services are relevant. State owned Market oriented activity in Norway are already moved to the business sector through separate companies.

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