

Rules and enforcement: resisting anticompetitive temptations in the recent EU experience

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1. Introduction

In the last two years the global financial and economic crisis raised in all countries the issue of how to respond to the resulting economic and social challenges. In many respects, the search for the appropriate institutional framework to avoid the worst scenarios and lead economies back to recovery is still ongoing. The course of events led to a widespread rethinking of several assumptions which formed the conventional wisdom before the crisis. One of the issues is whether an open market economy, in which the allocation of resources is governed by the competitive process, is still the model to be followed or whether a much larger role of governments in the operation of markets should be looked for.¹ A different, although related question, is whether at least temporary protection from competition, including the suspension of the enforcement of local competition policies, can be a useful emergency solution to mitigate the economic and social impact of the crisis.

Recently, in Europe the difficulties in the sovereign bond markets of some Member States shifted the focus of public policy debate on further dramatic issues: will the Economic and Monetary Union survive the different public budget situations of its Member States in the absence of a unified political governance? In this paper, however, we will focus our analysis on the first group of issues, which concern not only the EU, but all economies worldwide.

By now, several contributions have demonstrated that the origin of the recent global crisis cannot be attributed to competitive markets as such, but to the framework within which competitive market forces operated.² With particular reference to the banking sector, the argument was raised that in hard times a competitive environment may be conducive to excessive risk-taking. The theoretical argument is that competition reduces the present value of the expected profits from banking activities and, due to imperfect monitoring by regulators and markets, this can lead banks to prefer further

¹ See, for instance, Barry Hawk and James Keyte (2010), *Change You Might Believe In: Antitrust Enforcement and the Obama Administration*, paper presented at the 9th Conference on Antitrust between EU law and national law, Treviso, 20 May 2010, p. 2; see also "Global Competition Policy", December 2008 issue.

² See, for instance, Carmine Di Noia and Stefano Micossi, with J. Carmassi and F. Peirce (2009), *Keep It Simple – Policy Responses to the Financial Crisis*, Brussels and Rome, CEPS and Assonime; John Taylor (2009), *Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*, Stanford, CA: Hoover Institution Press.

enhancing risk taking, in the hope that the positive outcomes will materialize, with respect to the alternative of strengthening their capital base.³ This argument has soon been dismissed as lacking policy relevance. As two members of the Chief Economist's Team of the Commission DG Comp put it, "to the best of our knowledge, neither banks nor regulators have suggested that rents in banking were insufficient in the context of the public policy debate surrounding the financial crisis. In any event, allowing for the accumulation of rents in banking for the sake of financial stability is a distant second best relative to direct ex ante prudential regulation".⁴

However, from an empirical perspective, in times of economic downturn anticompetitive temptations grow stronger, quite independently of the origin of the crisis. Policy makers face mounting demands for subsidies and, more generally, for protection from competitive pressures by a highly heterogeneous plethora of incumbents from very different sectors such as banking, automobiles and professional services. Is it always correct to accommodate such demands for protection or, instead, the policy response should be guided by clear principles which allow to discriminate between useful measures and potentially harmful responses?

The economic relevance of the issue should not be underestimated. Extensive public action has been undertaken by all governments to respond to the crisis, both at the macro and at the micro level. State aid involved huge amounts of money: in the US, for instance, the Bush administration (Paulson plan) committed 700 billion dollars to clear banks budgets of toxic assets, while the Obama administration committed 787 billion dollars to address the challenges of the crisis mostly in the banking, insurance, and car manufacturing sectors. According to the latest EU State aid Scoreboard, only in the financial sector altogether the Commission has approved crisis measures put forward by Member States for an overall maximum volume of 4131,1 billion euros. The effective use of the possibilities for State guaranteed funding and of recapitalization measures taken together amounted to 1235,2 billion euros.

Since the available resources are limited, a first obvious challenge for policy makers is to make an efficient use of public money. A distinct, although related requirement, is to minimize the distortions of competition which may result from a misguided accommodation of demands for protection. Protective barriers and subsidies can

³ OECD (2009), *Competition and the Financial Crisis*, Paris.

⁴ Andrea Amelio and Georges Siotis (2009), *Applying EC Competition Rules during Testing Times: some Issues*, in "Concurrences – Revue des droits de la concurrence", no. 2/2009, 3-8, esp. 8.

negatively affect the incentive to compete efficiently in the longer term and give rise to moral hazard. The resulting distortions may last well beyond the crisis.⁵ Indeed, the shift to an economic system less based on competition does not represent an insurance against future economic downturns. Moreover, an open market economy based on private initiative and competition is still the best instrument we know to ensure the efficient allocation of resources which may lead the economy back to recovery. Therefore, public action in response to the crisis should carefully try to minimize distortions of competition, within a strategy aimed at fully exploiting the potential of an open and competitive market economy for future economic growth.

The EU Treaties provide a peculiar institutional framework which can facilitate resistance to anticompetitive temptations. In particular, the EU rules on competition and the internal market provide specific mechanisms for the control of state aid and limit the possibility for Member States to adopt measures which may adversely affect trade, including the freedom of establishment and the freedom to provide services.

In autumn 2008, at the outburst of the crisis, fears were expressed that these constraints, with particular reference to the rules on state aid, would have unduly limited the flexibility of Member States in responding to the crisis. A temporary suspension of the application of EU state aid policy and more generally a weakening in the enforcement of EU competition rules were invoked and national emergency responses to the crisis, often with a protectionist flavor, appeared as an attractive alternative to an allegedly rigid and myopic protection of the basic principles of a market economy at the EU level.

The experience of these two years has shown that, in the main, as far as state aid policy is concerned the European Council and the Commission managed to resist. Member States gave the needed political support to a coordinated strategy of response to the crisis based on the maintenance of the fundamental principles of the internal market and the European Commission succeeded, so far, in combining an enhanced flexibility with the safeguard of the system.

As for the rigorous enforcement of the internal market rules, there are still several open issues. Notable tensions have emerged in the last few years, not only in connection with the recent crisis, and the demand for protectionism mounted in several Member

⁵ In Argentina, for instance, the weakening of competition policy following the 2000 financial crisis resulted in a lasting decline in the relevance of competition principles. See Carlos Winograd (2009), *Argentina in the Eye of a Practitioner*, in "Concurrences – Revue des droits de la concurrence", no. 2/2009, 18-34.

States.⁶ Indeed, it has long been recognized that removing barriers to open markets must confront a fundamental difficulty: the costs of greater market freedom inevitably fall on incumbents, who will therefore resist liberalizations, whereas those likely to benefit from them are usually less aware of the attendant advantages and therefore will not make their voice heard. Over time, there have been several waves of low popularity of economic integration in the EU internal market, owing either to legitimate concerns regarding the protection of social values and cohesion, or to the lack of visible benefits or, naturally, to the impact of market opening on vested interests. When the economy is down, the problem worsens. The pro-competitive institutional framework, which in 2006 has been strengthened by the horizontal directive on services in the internal market, has been confronted with strong temptations to seek refuge in forms of economic nationalism.

Notably, the President of the European Commission Barroso felt the need of an initiative to “relaunch the Single Market” which “has been, and remains, the cornerstone of Europe’s integration and sustainable growth”. To this aim, Barroso entrusted the former Internal Market and Competition Commissioner Mario Monti to prepare a report aimed at re-vitalising support for the single market, through a new and more comprehensive strategy at the service of Europe’s economy and society.⁷

In this paper we consider the main features of the EU system for the control of state aid and for avoiding unjustified restrictions of competition in the services sector in the light of the stress test represented by the recent crisis. We argue that they represent a virtuous model, which can provide useful suggestions for the economic governance of other countries.

2. Control of state aid

The system for the control of state aid based on articles 107-109 of the Treaty on the functioning of the EU is a peculiar feature of the European legal order. The goal of the discipline is twofold: tearing down barriers to the creation of the Single Market (which make state aid policy similar to international trade rules) and eliminating distortions to

⁶ Carlo Bastasin (2009), *Partisan Protectionism: Political Consensus, the Euro and Europe’s Response to the Global Crisis*, in S. Micossi, G. Tosato (2009), *The EU in the 21st century. Perspectives from the Lisbon Treaty*, Centre for European Policy Studies, Brussels.

⁷ See the Mission letter from the President of the European Commission to Professor Mario Monti, 20 October 2009, Pres (2009)D/2250, available on the Commission’s website.

competition within the Single Market (which qualifies state aid control as a part of competition policy).

Paragraph 1 of article 107 prohibits any aid granted through State resources which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods and may affect trade between Member States. Paragraph 2 contains some exceptions to the prohibition rules (notably for aid having a social character granted to individual consumers without discrimination related to the origin of the products, or in case of natural disasters). Importantly, paragraph 3 establishes that state aid which contributes to pursuing a set of objectives of common European interest without unduly distorting competition between undertakings and trade between Member States may be considered compatible with the Common market. State aid is subject to prior notification to the European Commission and cannot be implemented before approval (so called standstill obligation). The European Commission is in charge of assessing whether state aid is compatible with the Treaty. Member States can be requested to recover aid which has illegally been granted, in order to restore the market situation as it would have been in the absence of the aid. Private actions against aid which has illegally been granted and for the recovery of damages can be brought before the civil courts of Member States by competitors adversely affected. Although private enforcement of the rules on state aid is still underdeveloped, recently the Commission has begun to promote a more widespread knowledge of the discipline by national courts.⁸

It must be recalled that rules aimed at impeding selective subsidies which provide an advantage to recipients and may therefore adversely affect trade are provided also by WTO law.⁹ Some clearly distortive subsidies (e.g. subsidies conditional on the use of national products) are prohibited as such (*per se*), while others can be prohibited if a WTO Member State proves that they have damaged its economy. In some cases the complainant is allowed to adopt countervailing measures.

Differently from article 107 of the Treaty, the WTO rules do not contemplate the possibility to authorize an otherwise prohibited aid measure taking its positive effects into account. This is an important difference between the two systems. While the WTO system is fundamentally a mechanism for international dispute resolution, the EU has a

⁸ European Commission, Notice on the enforcement of State Aid law by national courts, 2009/C 85/01.

⁹ See in particular the Agreement on Subsidies and Countervailing Measures (WTO-GATT 1994), in Annex A of the Agreement which established the WTO, OJ 1994 L336/156.

more ambitious system of governance of state aid policy which aims at allowing only aid measures either innocuous or whose net effect is beneficial to the European economy.¹⁰ These differences are reflected in procedural rules. In the WTO system, an investigation starts only upon initiative of a Member State, whereas the EU law requires prior notification and therefore provides systematic assessment by the Commission of any state aid measure, in the EU public interest.¹¹

Given the more systematic and ambitious scope of the control of state aid in the EU, a myopic attitude by the Commission in front of the crisis might have caused the breaking down of the system. However, the possibility, under article 107, paragraph 3, to declare aid compatible with the Treaty when it is justifiable in the public interest, gave the Commission sufficient flexibility to govern the aid process during challenging times.

Interestingly, the crisis hit the EU after a huge modernization of the system of state aid control, started by the Council at the end of the Nineties. For long, state aid has been the Cinderella of European competition policy. The modernization process entailed more transparent procedures and the elimination of some notification requirements. The Commission started to explain its strategy concerning state aid in plain language, unprecedented in this area. Notably, it has tried to convey the message that EU member States should tend towards a system with “less and better targeted state aid” and that state aid measures can be justified only when they aim to remove clear market failures. The 2005 state aid action plan encouraged Member States to reduce the total amount of state aid and at the same time to reorient the rest towards horizontal objectives.¹² The Commission argued that, if a Member State does not take into account the consequences of its aid policy on other States, the result can be the granting of an excessive amount of aid, through a wasteful subsidy race which has, as a further consequence, the distortion of market mechanisms. The goal of reorienting aid measures towards horizontal targets is closely related to the need to ensure that the negative impact on competition of the remaining aid measures (in many circumstances, in fact, government support is an appropriate or even necessary tool) will be minimized.

¹⁰ For a more comprehensive comparison, see Fabrizio di Gianni (forthcoming), *Competition and Trade Defence Instruments: searching for a point of equilibrium for an organic policy of the European Commission*.

¹¹ Only *de minimis* measures and some block exempted aid measures are not subject to the prior notification requirement.

¹² State Aid Action Plan, *Less and Better Targeted State Aid: a Roadmap for State Reform 2005-2009*, SEC(2005) 795.

Before the outburst of the crisis, the new approach of EU state aid policy was working satisfactorily. Following the adoption of the Action Plan, the total amount of aid declined and a reorientation towards horizontal objectives has been implemented. Overall government subsidies decreased from 1 per cent of European GDP in the 1990s to 0.5 per cent in the period 2004-2008. While in the mid-1990s only 50 per cent of government subsidies were targeted towards horizontal objectives as opposed to individual bailouts, by 2008 horizontal aid measures had risen to nearly 90 per cent.¹³

As for substantive enforcement criteria, the modernization of state aid policy entailed the adoption of a “more economic approach” in order to help reaching the above mentioned goals. Under this approach, the assessment of a market failure is the necessary starting point of the evaluation of any aid measure since “only if there is a market failure can a measure have the potential to increase economic efficiency”.¹⁴ Not only the evaluation of single measures or aid schemes, but also soft law is now based on the concept of market failure. Also special rules for subsidies to small and medium size firms or to innovation are now being justified within this context.

The financial and economic crisis stopped abruptly the trend towards a reduction of state aid. From a substantive viewpoint, however, the conceptual framework of state aid policy did not turn out to be inadequate: as already seen, it does not prohibit aid measures as such; on the contrary, it allows aid measures conditional on their being necessary and proportionate to address market failures. Indeed, there were a number of market failures specific to the crisis which the Commission had to take into account, in the new context, adapting when needed its usual rules of evaluation. Under this perspective, special public measures may be seen as a mere adaptation of the system to hard times, not as its relinquishment. In the same perspective, however, special measures must proportionate and strictly necessary to overcome the crisis.

Importantly, from the very start the Commission received political support from the European Council. The Ecofin Council of 7 October 2008 invited Member States to coordinate national intervention in a European setting and to respond to common

¹³ Joaquin Almunia (2010), *Competition, State Aid and Subsidies in the EU*, OECD, 9th Global Forum on Competition.

¹⁴ Hans W. Friederszick, Lars-Hendrick Röller, Vincent Verhouden, (2008), *European State Aid Control: an Economic Framework*, in Paolo Buccirossi ed., “Handbook of Antitrust Economics”, Cambridge Mass. The MIT Press, p. 650. See also European Commission (2009), *Common Principles for an Economic Assessment of the Compatibility of State Aid under Article 87.3*, available on the European Commission website.

values. Somehow the Commission proceeded by trial and error, due to the novelty and complexity of the economic environment, and at times met harsh criticism, but in the main it succeeded in avoiding wrecking the system.

As a first step the Commission indicated that its objective was maintaining and respecting the fundamental principles of competition policy, while taking into due account the imperatives raised by the crisis. Some general principles were established: the Commission recognized the need for more aid, but stressed the importance of maintaining a strict control at the European level on the new flow of subsidies and of ensuring the return of the system to its normal operation as soon as possible. An appropriate legal basis for the temporary adoption of exceptional measures was found in article 107, paragraph 3, letter b of the Treaty, which allows the Commission to consider compatible with the Common market state aid measures needed to “remedy a serious disturbance in the economy of a Member State”. Normal criteria will continue to be applied to state aid when the system will return to normality. The extremist proposal of suspending state aid rules was rejected; the milder alternative of applying article 103, paragraph 3, letter b with a very loose interpretation has been rejected as well.

The Commission invited Member States, before considering the adoption of exceptional measures, to use the opportunities already existing in the system: for instance, it suggested them to take advantage of the 26 categories of aid covered by the General Block Exemption Regulation.¹⁵ Only when usual channels proved to be insufficient, Member States should consider the adoption of exceptional measures that, in any case, had to be in line with the specific indications of the Commission.

The Commission itself followed a similar pattern, trying first to take a “business as usual” approach and shifting to new rules only when this approach turned out to be not viable.¹⁶ The first cases that the Commission dealt with at the very beginning of the crisis (German Landesbanken Sachsen LB,¹⁷ IKB,¹⁸ and UK Northern Rock¹⁹) were assessed under the usual rules, i. e. article 107, paragraph 3, letter c and the 2004

¹⁵ Neelie Kroes, (2010), *Competition policy and the crisis - the Commission's approach to banking and beyond*, Competition Policy Newsletter , 1.

¹⁶ For an in-depth analysis of State aid policy during the crisis, see Nicola Pesaresi (2010), *Solving the financial crisis: the contribution of the European competition policy on government subsidies*, paper presented at the 9th Conference on Antitrust between EU law and national law, Treviso, 20 May 2010.

¹⁷ Restructuring aid to Sachsen LB, case C9/2008.

¹⁸ Restructuring aid to IKB, case C10/2008.

¹⁹ Northern Rock, case NN70/2007, Restructuring aid to Northern Rock, case C14/2008.

Guidelines on rescue and restructuring aid.²⁰ As the crisis began to show its systemic nature, the Commission shifted to a new set of measures. Although the new discipline is exceptional, being based on article 107, paragraph 3, letter b, in order to avoid loss of control of the system the Commission established some strict procedural rules. For example, “each application of article 87 (3) (b) must be examined on an individual basis, taking into account objective criteria, in particular, the evaluation of national authorities responsible for ensuring financial stability”.²¹

The new regime pursued two different aims: addressing the problems in the financial sector and amending the effects of the crisis on the real economy.

For the financial sector, the Commission adopted a package of four Communications. The “Banking Communication” of October 2008 indicates how Member States can best support financial institutions in compliance with EU state aid rules.²² The approach of the previous guidelines on rescue and restructuring aid was adjusted in order to meet the new challenges. The main principles resulting from the Communication, aimed at minimizing interference with market mechanisms, are: the temporal nature of the intervention, its neutrality (non discrimination in the access to aid measures) and the need for a contribution by the beneficiaries of the aid. Initially the Commission imposed behavioral constraints on aid recipients, requiring them not to compete too vigorously in order to minimize the distortions of competition. This approach, traditionally followed for rescuing individual companies under the 2004 Guidelines, has been harshly criticized in general, since freezing existing positions is an additional distortion which may be detrimental to competition.²³ In the crisis environment, where one of the problems was the credit squeeze, these behavioural remedies soon turned out to be not only potentially distortive, but also a little bizarre. By the end of 2008, the use of credit ceilings had been abandoned. The “Recapitalization Communication” of December

²⁰ European Commission, Community guidelines on State Aid for rescuing and restructuring firms in difficulty, 2004/C 244/02.

²¹ Antoine Winckler and François-Charles Lapr v te (2009), *When the watchman must take the wheel - state aid control of financial institutions and other political imperatives during the economic crisis*, *Concurrences*, no. 2, 2009, 9-17.

²² Communication from the Commission, *The application of state aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*, 2008/C 270/02.

²³ Alberto Heimler (2009), *European State Aid policy in search of a standard. What is the role of economic analysis?*, paper presented at the Fordham 36th Annual Conference on International Antitrust Law and Policy.

2008²⁴ complements and clarifies the guiding principles set out in the Banking Communication, especially as far as the recapitalization of banks is concerned. It is based on the distinction between fundamentally sound, well-performing banks and distressed, less performing ones. This distinction is aimed at treating in a different way banks which are in difficulty only because of the general crisis and those with company-specific problems, depending on managerial strategies and choices. Absent differential treatment of the two kind of banks, aid granted in order to face the crisis would *de facto* finance the inefficiency of the latter type of banks, therefore directly distorting market mechanisms. A link between the price of capital injection and the risk profile of the beneficiary was established, in order to preserve market incentives.

The “Impaired Assets Communication”²⁵ of February 2009 aims at clearing the way to measures helping to clean up financial institution balance sheets by removing toxic assets and underperforming loans. Member States must guarantee full transparency and should coordinate between themselves in order to select the kind of assets eligible for relief measures.

The fourth step taken by the Commission in the banking and financial sector followed the belief that the strategy of halting the landslide was succeeding and that Member States started to restore confidence in the market. In July 2009 the Commission published the “Restructuring Communication”.²⁶ Under the previous three communications the Commission requires Member States to submit a viability plan for fundamentally sound banks or a restructuring plan for banks in difficulty, whenever state aid is granted to an individual financial institution. The Restructuring Communication sets out the conditions under which restructuring aid will be assessed by the Commission, providing for additional flexibility if compared with the 2004 Guidelines. The three basic principles are that banks receiving state aid must be viable in the long term without further State support, the banks and their owners must carry a fair share of the restructuring burden and distortions of competition in the Single Market must be limited.

²⁴ Communication from the Commission, *The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition*, 2009/C 10/03.

²⁵ Communication from the Commission on *the Treatment of impaired assets in the Community Banking Sector*, 2009/C 72/01.

²⁶ Communication from the Commission on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the state aid rules, 2009/ C 195/04.

The strategy of the Commission with respect to aid to the real economy is mainly contained in the “Temporary framework” issued by the Commission in December 2008.²⁷ The framework applies to all economic sectors. Basically, it is an adaptation of the existing rules which had been revised shortly before the outburst of the crisis, namely the *de minimis* regulation of 2006²⁸ and the General block exemption of 2008.²⁹ The aim is to facilitate the financing of firms in a situation of credit squeeze and therefore safeguard their ability to invest. The Framework applies only to companies whose problems do not pre-date the crisis.³⁰

While the increase of the minimum aid threshold gives general financial relief to firms hit by the crisis, the other measures are allowed to correct more specific situations of credit squeeze emerging from the crisis. Differently from the usual *de minimis* aid, the measures covered by the Temporary framework must be notified to the Commission.³¹ This allows the Commission, which ensures a swift assessment, an effective monitoring of the process.

The temporary nature of the Framework is intended to foster the credibility of the exceptional nature of the discipline. Member States and companies should not expect a general softening of the control on state aid. Indeed, time limit is set strictly: temporary measures are applicable only until the end of 2010.

The next challenge for the Commission is steering the overall exit strategy. This final test will reveal whether the EU has succeeded in adapting its system to the needs of

²⁷ Communication from the Commission, *Temporary framework for state aid measures to support access to finance in the current financial and economic crisis*, 2009/C 83/01 amended 2009/C 303/04.

²⁸ Commission Regulation (EC) no. 1998/2006 of 15 December 2006 on the application of articles 87 and 88 of the Treaty to *de minimis* aid.

²⁹ Commission Regulation (EC) no. 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of articles 87 and 88 of the Treaty (General Block Exemption Regulation).

³⁰ Namely, companies which were not in difficulty on 1 July 2008. In particular, the Temporary Framework provides: an extension of the *de minimis* threshold; State guarantees for loans at a reduced premium; subsidized interest rates; temporary derogation from the risk capital guidelines in order to increase the tranche of finance per target SME (from € 1.5 million to € 2.5 million) and a reduction of the minimum level of private participation (from 50% to 30%); extended facilities for aid in the export credit insurance market; subsidized loans for the production of green products involving the early adaptation to or going beyond future Community product standards.

³¹ However, once a scheme of aid has been approved by the Commission, aid given to individual companies under the scheme must not be notified.

exceptional circumstances without permanently changing the basic approach to state aid.

The EU institutions have already attempted a few steps in this direction. The Ecofin Council of 2 December 2009 recommended the adoption of a strategy for the phasing out of support measures in the financial sector which is transparent and duly coordinated among Member States. The process should start with government guarantee schemes, incentivizing the exit of sound banks and inducing other banks to address their weaknesses. In April 2010 the DG Comp published a working paper indicating the criteria to be followed. It reports that the use of guarantees has considerably declined since the peak in 2009 and that an exit process has already begun at the level of individual banks and of Member States.³² The DG Comp argues that as a consequence of the improvement in market conditions, the risks for financial stability at large have subsided and the distortions of competition between those banks which have received an aid and those that issue strictly under market conditions has increased. Therefore, it envisages increasing guarantee fees in order to bring the funding costs of beneficiary banks closer to market conditions. Moreover, it suggests to require banks that continue to rely on government guarantees but are not under restructuring obligations to demonstrate their long-term viability. The aim is to provide a signal that banks have to prepare for a return to normal market mechanisms without state support. On the other hand, the DG Comp recognizes that the amendment of the conditions for government guarantee schemes should keep a sufficient degree of flexibility in view of “the remaining fragility of the recovery process as illustrated by the current turbulences in relation to sovereign bond markets”. New challenges may lead to postpone, but should not lead to abandon the exit strategy.

The European Council has played a fundamental political role in steering a coordinated response to the economic downturn, both when the crisis began and when improvements in market conditions suggested that the exit strategy could be gradually undertaken. Member States have always notified aid measures, the Commission has swiftly examined and generally approved them, although in some cases requiring some changes and the removal or clearly protectionist measures. Not only the system of

³² DG Competition Staff Working Document, *The Application of State Aid Rules to Government Guarantee Schemes Covering Bank Debt to be Issued After 30 June 2010*, 30 April 2010, available on the Commission’s website. More generally, the latest State Aid Scoreboard shows a decline in the amount of aid.

state aid control held out, it also helped governments to discriminate on the merits between requests of aid during the economic turmoil. Unexpectedly, although several problems remain unresolved, the European regime has come to be viewed as a best practice internationally.

One of the problems which remain unresolved is which measures (if any) should be imposed on the beneficiaries of aid to minimise the distortions of competition which may result from selective aid. It has to be recognized that the EU system contains some mechanisms which indirectly limit the distortions of competition: state aid is prohibited unless aimed at correcting a specific market failure and should not go beyond what is strictly necessary, both in its amount and in its temporal scope. However, these mechanisms are not sufficient to fully get rid of the problem. During the crisis, for instance, some Spanish banks strongly complained about the aggressive competition by banks which had received support in other Member States. As already argued, limiting the competitive conduct of the beneficiary of the aid is not an ideal solution, since it has its own anticompetitive consequences. In this respect, when corrective measures are needed, structural remedies such as divestiture obligations seem a preferable alternative.

3. Strengthening the Internal Market: from the services directive to the Monti Report

The institutional framework for the accomplishment and maintenance of the Single Market provides several instruments and arrangements which can be useful to resist anticompetitive temptations. As widely known, the Single Market requires both negative and positive integration, i.e. the elimination of obstacles to the free movement of goods, services and factors of production and the adoption of common policies to ensure the proper operation of markets forces. The objective has not been fully attained yet: indeed it can be argued that the accomplishment of the Single Market is a moving target, which will never be reached definitively. It is necessary to remove the remaining barriers to the exercise of fundamental freedoms, but also to ensure that new barriers are not created, for instance by national interventions to cushion the impact of the economic slump.

The recent EU experience aimed at removing the remaining obstacles to a Single Market for services provides a number of interesting insights.

Since the 1980s the Court of Justice acknowledged that the principle of mutual recognition of national legislations can also be applied to services. Moreover, also for services the introduction of restrictions was subjected by the case law to tests of imperative need, adequacy and proportionality of the restrictive measures.³³ However, it soon became clear that the barriers to the establishment of the Single Market for services could not be removed solely on a case-by-case basis, by relying on the direct application of the rules of the Treaty on the freedom of establishment and the freedom to provide services. The removal of barriers required coordination of national regulatory models, i.e. common rules such as directives.

Most directives concerning services follow a sectoral approach. They cover, for instance, the regulated professions, insurance, banking and financial services, services relating to travel and tourism, television broadcasting, air and rail transport, electronic communications, electricity, gas and postal services.

The sectoral approach, however, was not able to tackle the barriers to the freedom of establishment and the freedom to provide services existing in a myriad of ever evolving services that would never be covered by ad hoc directives. The 2006 Directive on services in the internal market was adopted with the aim of removing all remaining barriers to the internal market for services through horizontal rules. The scope of the directive covers all services with the exclusion of some activities already covered by specific EU regulation and some services such as, for instance, gambling activities or services provided by notaries. Importantly, the directive applies to restrictions at all levels of government, including local restrictions. This is particularly important since often insidious regulatory or administrative obstacles to competition are established by regional or local governments. The directive requires Member states to adopt measures of administrative simplification and to remove unjustified regulatory restrictions. For restrictions included on a black list, there is a irrefutable presumption that they are incompatible with the Treaty. For restrictions included on a grey list, the presumption is rebuttable. As for the provision of services, the directive introduces the statutory requirement for Member states to apply the mutual recognition principle and allows them to impose additional requirements only for a narrow set of overriding policy reasons related to public policy, public security, public health and the protection of the environment (an “enhanced” mutual recognition principle). Moreover, it strengthens administrative cooperation systems.

³³ For a more detailed analysis of the case-law, see Fabrizia Peirce, *The Directive on Services in the Internal Market: an Update*, Assonime, Note e studi n. 13/2009, available at www.assonime.it.

Special institutional arrangements have been deemed necessary to ensure an effective and coordinated implementation of the services directive. In particular, each Member State has been required to present a report to the Commission on the authorization regimes and the potentially restrictive regulatory provisions that it intends to maintain, demonstrating their compatibility with Community rules. Each report is forwarded to all Member States and is subject to mutual evaluation. Moreover, the introduction of new restrictions has to be notified to the Commission and reviewed under a Community procedure. The notification and mutual evaluation procedure aims at bringing out in the open and subject to review all measures potentially violating EU law.

Notably, the provisions of the directive do not entail any new legal principle since they basically incorporate general principles already established by the case law of the Court of Justice. However, by imposing transparent procedures and a systematic review of restrictions, which have to be notified to the Commission and Member States and justified one by one, they strengthen the presumption in favour of free movement and open access.

The implementation of the services directive will eliminate a multitude of small obstacles to the freedom of enterprise in Europe and will therefore provide a larger set of opportunities which may be profitably used by citizens and undertakings and contribute to economic recovery.

The implementation process, however, calls for an unprecedented effort: it involves a huge variety of activities representing about 40 % of the EU GDP and requires Member States an extensive review of existing rules at all levels of government, important legislative changes and the setting up of projects such as administrative Points of Single Contact for service providers. A very interesting feature is how the mutual evaluation process is developing. In January 2010 Member States presented the main results of their screening efforts. Subsequently, Member States met in small groups of five countries for an in-depth discussion of their experiences in specific areas. Then, the Commission started organizing plenary meetings with all Member States to discuss the different issues. On 25 May 2010, the Competitiveness Council highlighted the need to raise the political profile of the mutual evaluation process, which should be closely linked to the broader development of horizontal policies for the Internal Market. The Council considers it a key project that should help identifying additional initiatives to further improve the functioning of the Internal Market for services, be them of a legislative or non-legislative nature. Therefore, the Council stresses the need for a

close involvement of Member States in the process which, according to article 39, paragraph 4, of the directive will lead the Commission to submit a mutual evaluation report together with the appropriate proposals for additional initiatives to the Parliament and the Council.

Another interesting feature of the services directive is that the initial proposal met strong opposition by trade unions in several Member states, since it was perceived as threatening social dumping within Europe. Prolonged negotiations led by the European Parliament eventually succeeded in reaching an acceptable compromise.³⁴ The story however clearly indicates that the issue of political support for market integration policies cannot be neglected.

The pro-competitive Single Market agenda requires an active marketing effort vis-à-vis citizens and stakeholders so as to make the resulting benefits visible and understood by the public. There is also the need for effective measures supporting those who find it more difficult to cope with the consequences of integration. These measures will have to give particular attention to creating the conditions for enhanced flexibility of economic structures and factor markets, including appropriate support for human capital investment and employability.³⁵

Mario Monti carefully addressed the issue of how to build consensus on a stronger Single Market in his report to the President of the European Commission on “A new strategy for the Single Market at the service of Europe’s Economy and Society”.³⁶ Based on an extensive consultation process, the report draws “a map of the expectations and concerns surrounding the Single Market” and argues that reconciling the different positions around a new carefully defined agenda for the relaunch of the Single Market is possible. This effort is also necessary, due to the economic, fiscal and social legacy of the crisis: “given the very limited margins available for budgetary stimuli, making the Single Market more efficient is Europe’s best endogenous source of growth and job creation”. The report advocates a comprehensive strategy, which

³⁴ Stefano Micossi (2006), *Fixing the Services Directive*, CEPS Policy Brief no. 100, Centre for European Policy Studies, Brussels, 26 April. See also Fabrizia Peirce (2009).

³⁵ Ginevra Bruzzone and Luigi Prosperetti (2009), *Market Integration and Competition Policy: the Challenges Ahead*, in S. Micossi and G. Tosato eds. (2009), *The European Union in the 21st Century: Perspectives from the Lisbon Treaty*, Centre for European Policy Studies, Brussels.

³⁶ Mario Monti (2010), *A New Strategy for the Single Market at the Service of Europe’s Economy and Society*, report to the President of the European Commission José Manuel Barroso, 9 May 2010, available on the Commission’s website.

includes not only initiatives aimed at strengthening the Single Market (removing the remaining bottlenecks and plugging the gaps) and at making enforcement more effective, but also a number of measures aimed at creating the political climate for sustainable action. To this aim, Monti elaborates on to the notion of a “highly competitive social market economy” contained in article 3, paragraph 3, of the Lisbon Treaty. In particular, the report envisages initiatives dealing with the conciliation between economic freedoms in the Single Market and workers’ rights, the integration of EU’s policy goals in public procurement policy, the balancing of competitiveness and cohesion through regional development policies, an active industrial policy based on “sound competition and state aid policies”.

As for this last point, there can be the risk that under an approach based on the integration of policies, industrial policy objectives will systematically prevail over the objective of maintaining an open market economy based on undistorted competition. But it is not necessarily so: a more integrated approach to structural policies can also be undertaken without weakening the fundamental principles of each policy area. For instance, the need to reconcile competition policy with the promotion of efficiency and competitiveness does not necessarily require external constraints, but only the application of proper competition principles. In modern competition policy, it is clear that the goal is not the maintenance of a fragmented market structure, but the protection of the competitive pressures that are essential to the operation of the market process. Efficiency is seen as a value, not a risk for competition. Competition rules are not, in themselves, an impediment to the growth of European companies, even through mergers and acquisitions. Acknowledgement that cooperation among competitors may, under certain conditions, produce positive results, for instance in standard-setting, is also fully compatible with the modern approach to the application of antitrust rules.

A further area in which the Monti report envisages a number of initiatives is the external dimension of the Single Market. The idea is that the Single Market should remain open, but not disarmed, vis-à-vis competitors at the global level. A strictly related issue is whether the EU model for the control of state aid and for the protection of the fundamental freedoms in the Internal Market is “exportable” at the international level.

4. An exportable model?

Interestingly, the Monti report mentions “a widespread perception that European businesses are subject to a strict state aid regime, whereas competitors in the rest of the world may benefit from various forms of government’s support with less control ... Unfair competition adds to a perceived discrimination suffered by business when operating in foreign markets. Grants of subsidies are less transparent and public procurement more geared to keeping public purchases within the home market than in Europe”.³⁷

Indeed, the EU system for the control of state aid is peculiar on the global scene. It can be argued that the current EU system is the institutional response to a number of issues which emerged from a story of massive presence of the State and widespread interventionist approach in European economies. In other more market-oriented economies the control on the effective use of public resources and the fact that presence of the State in the capital of companies is usually temporary may be deemed sufficient. However, it can also be argued that a system for the control of state aid based on clear principles may help governments to make effective choices on the most effective and less distortive subsidies. Moreover, as stressed by the Monti report, a stricter state aid regime in one country may raise the issue of the absence of a global regulatory playing field. In this respect, the Monti report recommends that the EU promotes a pro-active market access agenda in multilateral *fora* with a specific focus on subsidies and presses for the introduction in bilateral free trade agreements of provisions on subsidies going beyond the WTO rules.

A first important experiment in this direction is the recent Free trade agreement between Korea and the EU, initialled on 15 October 2009. The Agreement contains a section on subsidies which adds to the WTO basic rules further enhanced provisions (WTO plus rules), including for instance the prohibition of unlimited guarantees and subsidies for ailing companies without a credible restructuring plan. The regulatory gap with the EU system is therefore narrowed. A specific enforceable dispute settlement system is also provided. With reference to this agreement, it has been observed that “time and time again, most recently during the financial crisis, EU state aid control has proven to be an essential coordination tool for Member States, preventing harmful subsidy races and preserving the free flow of goods and services across borders. A similar logic applies on an international level and provides the justification and rationale

³⁷ Monti Report (2010), p. 89.

for including provisions on subsidies in free trade agreements”; “in the midst of a worldwide economic crisis, the EU and Korea are sending a stronger anti-protectionist signal to the rest of the world”; “it goes without saying that multilateral or even global subsidy control would be preferable to bilateral control”.³⁸

Exporting at the global level the overall EU institutional framework for the accomplishment of the Internal Market, including arrangements such as those provided by the services directive, does not seem an easy task. However, the main principles, including the requirement that any restriction of competition should be strictly justified on the basis on a well-defined set of objectives of public interest, should be considered best practices in international initiatives aimed at promoting better regulation worldwide.

Rome, 23 June 2010

³⁸ For a more detailed analysis, see Anna Jarosz-Friis, Nicola Pesaresi and Clemens Kerle (2010), *EU-Korea FTA: a stepping stone towards better subsidies' control at the international level*, Competition Policy Newsletter, no. 1/2010.