

Position on fitness check of 2012 State aid modernisation package, railways guidelines and short-term export credit insurance

The European Commission (EC) has launched a fitness check of the 2012 State aid modernisation package, the railways guidelines and the short-term export credit insurance communication to evaluate whether the rules have actually worked in the way intended and are still fit for purposes.

State aid rules play an important role in safeguarding fair competition as they ensure a level playing field for all enterprises in the internal market, regardless of their origin or place of establishment. State aid must therefore be transparent and justified. State aid rules provide a necessary framework to ensure an efficient functioning of the internal market and efficient use of public resource as well as to prevent unjustified market intervention by public authorities.

The European Commission should ensure that an efficient functioning of the EU internal market and fair competition remain core goals of State aid rules. A general approach should hold that State aid should be an exception rather than a common practice. Modernisation of State aid rules should not compromise between the general prohibition of State aid and eagerness to prioritize the control of state aid that exerts a more significant impact on the internal market. The pursuit of EU policy objectives per se should not be used as a sufficient justification by Member States to provide State aid.

General principles

In order to ensure that State aid rules support an efficient functioning of the internal market and fair competition, State aid rules should comply with the following general principles:

- 1) the promotion of a market-based economy and private enterprise;
- 2) prohibiting public institutions from establishing and pursuing commercial activities;
- 3) efficient public spending;
- 4) prohibiting in-house transactions between state-owned and state-controlled undertakings;
- 5) transparent ex-ante and ex-post assessment of the compatibility of State aid;
- 6) transparency of State aid provided to any undertaking;
- 7) a strict enforcement of State aid rules.

On horizontal and vertical measures

Private undertakings may be supported through horizontal or vertical measures. Horizontal measures refer to the reduction of the regulatory and tax burden or administrative supervision mechanisms which result in lowering the costs of business activity, barriers to market entry or legal uncertainty. Such measures are applicable to all market participants and the whole economy and are in line with the goal of achieving a better functioning of the internal market and promoting competition.

Vertical measures refer to various forms of support that is granted to market entities on a discretionary basis by public institutions through the use of state finances. State aid falls under this category of measures. Support extended to market entities through vertical measures is generally provided based on political rather than market priorities. It is important to note that political priorities and market-based needs are difficult or even impossible to reconcile. In general, special financing schemes for undertakings mean that they can avoid or alleviate market risks which are instead taken on by public finances. Such measures distort competition and the functioning of the market as their beneficiaries obtain an unjustified competitive advantage. If state support is extended to one particular undertaking, this inevitably implies limitations for other market players, plus requires additional expenses from the national budget and taxpayers. The application of vertical measures and related financial considerations may also affect incentives to engage in or sustain from conducting economic activity, pushing aside market signals that should otherwise guide business decisions.

It should be noted that in many cases EU funds, including structural funds, create distortions of competition, especially in sectors like agriculture. The development of infrastructure projects too may be conditional on the rules of financial support rather than the actual market or societal needs. Such distortions undermine the efficiency of the internal market, harm consumers and impose onerous costs on public finances and taxpayers.

EU institutions, including the European Commission, should therefore encourage Member States to use horizontal measures rather than vertical measures to support market participants.

Main issues with the State aid regime

The EU State aid regime and its application are associated with the following general concerns:

- 1) **Late or no notification about State aid.** Member States are found to be reluctant to notify the European Commission about the provision of State aid and to undergo an assessment to determine whether the provision of State aid is legitimate and compatible with the EU's internal market and competition rules. For example, most of the State aid cases in Lithuania have been of late notification and/ or market participants have had to act as a watchdog to pressure public institutions to issue notification of provided or planned state aid.¹
- 2) **Lack of transparency.** The EU institutions have improved considerably access to information on provided state aid. The register of State aid has contributed significantly to the monitoring of state aid. However, measures should be taken to allow market participants to familiarise themselves with planned cases of state aid prior to the adoption of a decision to grant state aid. Given that State aid gives a competitive advantage to state aid recipients over their competitors, other market participants should be able to easily access such information in a timely manner in order to at least be able to adjust their business decisions accordingly.
- 3) **State aid in liberalised (network) industries or in understories under liberalization.** In such sectors as railways, energy and airways, where state monopolies dominated for a long time, the majority of undertakings are still owned and/or controlled by the state. Allowing state aid in these sectors generally means that the state continues to support its owned/controlled undertakings. This creates barriers to market entry by other companies and is contrary to the goal of full liberalization.
- 4) **State aid to the agricultural sector.** State aid modernization should not overlook measures applied in the agriculture sector. Agriculture is known to be most severely affected by anticompetitive support measures and behaviour. The European Commission should initiate a comprehensive State aid fitness check in this sector to

¹ In three out of four cases Lithuania notified the Commission about infringements on the stand still obligation and only in response to the pressure from market participants, as exemplified by the last four decisions on State aid in the energy sector. See, Griguolaite, R. (2019) Recent State Aid Decisions in the Energy Sector: Lithuania, *European State Aid Quarterly*, 18(3), pp. 208-2011.

ensure that it opens up to innovation, improves productivity and boosts competitiveness in line with market principles.

- 5) **State aid thresholds.** While it is understandable that the European Commission is eager to focus its scrutiny on cases that represent a significant impact on the internal market, state aid notification thresholds are of varying importance across Member States. The same state aid threshold may have a lower impact on market participants in Germany while bringing a much more significant effect in the markets of much smaller Member States. State aid that is lower than a prescribed threshold, even if exerting a sizable effect in a particular market, would thus remain unassessed. That means “legalising” all aid below the threshold by default. Such an approach runs counter to the general prohibition of State aid under EU law.

Some specific concerns regarding State aid

In-house transactions

In-house transactions are transactions which contracting organizations pursue with the legal persons controlled by them without applying public procurement rules. The Commission should pay special attention to such transactions as they potentially undermine market competition and allow avoiding assessment under the State aid rules.²

In-house transactions intersect between the internal market, competition and public procurement rules. The EU public procurement regime establishes minimum requirements and criteria that such transactions are supposed to meet in order to be legitimate. However, this list is not exhaustive, and Member States have a right to prescribe additional requirements regarding in-house transactions.

In 2017 Lithuania introduced a ban on in-house transactions by state enterprises (notably, in-house transactions remained in place for municipally-owned companies). Despite that, the Lithuanian Public Procurement Office reports that the value of in-house transactions in 2018 more than doubled, showing an increase of 113 percent. In 2018, Lithuanian municipalities concluded 32 in-house transactions for a total value of 327 mln euros, while the total number of in-house transactions that were valid in that same year was 125, amounting for a total value of 780 mln euros.³ Recent research from the Lithuanian Free Market Institute shows that in 2018 most in-house transactions were concluded with municipally-owned companies in larger cities and their neighbouring municipalities. These municipalities account for more than 70 percent of the country’s registered enterprises, so it is quite unlikely that there were no other market providers of relevant services or goods. The analysis of in-house transactions suggests that municipalities often do not disclose the value of such transactions; buy a range of services without specifying them or defining their exact scope; and in-house transactions are long term contracts (some for 15-20 years).

In-house transactions grant an advantage to state-controlled entities over competitors by ensuring them a continuous flow of revenues. A lack of transparency may likely disguise such distortions of competition and abuse of market power.

The situation is even more disturbing with state-owned companies where transactions are now made between daughter-daughter companies, given that vertical transactions between mother companies from daughter companies are now prohibited. Two state-owned monopolies Lithuanian Energy (Lietuvos Energija) and the Lithuanian Railway (Lietuvos Geležinkeliai) use horizontal in-house transactions in order to overcome vertical in-house transactions. These companies also make procurements under the category of unpublished negotiations or buy services/goods vertically whereby a daughter entity buys from the mother company. For example, the Lithuanian Railway’s value of transactions

² Currently a relevant case pending at the CJEU C-285/18 *Irgita*.

³ Research report on in-house transactions in Lithuania is available at: https://www.llri.lt/wp-content/uploads/2019/03/PB_Vidaus-sandoriai-savivaldyb--se_20190327.pdf (in Lithuanian language).

concluded with controlled entities amounted to 102 mln euros in 2018. In this way, antitrust, procurement and State aid rules are circumvented.

The use of State aid in state-run business ownership

State aid rules shall apply to government initiatives to establish and pursue economic activity. In sectors with competitive markets the state itself should not engage in commercial activities. The state shall mandate only the provision of services that serve the general public when absolutely necessary, conditioned upon the requirements under SGEL.

The European Commission shall scrutinize plans of Member States' governments to provide particular goods and/ or services on the market via state undertakings/ public institutions instead of using better and cheaper products and services that are available on the market. Notably, the Lithuanian Government and Parliament have debated proposals to allow state-run hospitals to establish state-owned pharmacies.⁴ This would constitute an obvious example of State aid, but no actions have been taken yet to consult or notify the European Commission.

On unnotified aid

Member States are reluctant to issue notifications on state aid and there is no culture of discipline to respect a 'stand-still' obligation. The European Commission should not only declare cases when notifications are late or state aid is not notified, but should propose measures for better monitoring and sanction Member States for non-compliance with the prior notification rule.

In this context, it is important to note that governments of Member States are ambitious in pursuing their political agenda and late notification or failure of notification are often times a consequence of ignorance of State aid rules, i.e. the inability to contextualise proposed national aid measures within the general prohibition of State aid. Therefore, more cooperation between national competition authorities and the European Commission would be welcome in ensuring better monitoring of national aid measures and political initiatives to provide state resources to market participants.

As an example, the Lithuanian governmental has proposed "e-coupons" which are aimed to support families with children under six years of age. Electronic coupons would grant monthly discounts for food and other agriculture products. Such coupons could be used only in small retail food and agriculture product stores. Such retailers would receive a state subsidy if they offered an additional 10 percent discount to the clients using e-coupons. This would grant a competitive advantage to one segment of retailers who would become indirect recipients of state aid. The Ministry of Agriculture is already running a pilot project. The Lithuanian Government is reluctant to take into consideration the opinions of the national competition authority and other stakeholders regarding the necessity to assess this policy initiative in light of State aid rules.

This case illustrates the importance of promoting the culture of compliance with State aid rules by national government. It is important that state aid modernization and state aid enforcement efforts should address such issues as a matter of priority.

The assessment of State aid and its enforcement

The European Commission should create better conditions for market participants to voice their positions on proposed State aid and its measures. The practice of solving most issues with Member States through notifications of state aid

⁴ Draft amendments to the Law on Pharmacy No XIII-1939 are currently under the legislative procedure.

and by giving preference to preliminary investigations is contrary to transparency goals and undermines the depth of assessment regarding likely distortions of competition and the principle of proportionality of aid.

In addition, Member States pursue their public policy aims by means of state aid and justify its necessity by simply referring to their intentions of achieving specific EU policy objectives. Even if that were the actual case, such state aid should be subject to proper assessment.

Many EU public policies (e.g. energy and climate change) impose an obligation on Member States to act. Paradoxically, Member States are tempted to act themselves rather than creating market conditions and removing barriers for private actors to contribute to the accomplishment of these public policy objectives through market mechanisms. Thus, the European Commission should encourage Member States to propose more market-based solutions to pursue EU or national public policy objectives when assessing the necessity and proportionality of support.

Furthermore, the initiative to focus the enforcement of State aid rules on the most problematic cases would imply broadening the range of state aid measures which are exempt from the notification obligation. Thus, if the Commission is to prioritise state aid control, that will be linked to greater responsibility for the Member States. The state and, more broadly, all state and public entities that may grant/receive aid would, in a sense, become a judge in their own cause. In such a way, economic nationalism will be programmes and will open ways to support state owned and/or controlled entities, which will likely increase legal and market uncertainty for other market participants. Steps should be taken to avoid that.

Conclusion

State aid grants to selected undertakings advantages that distort market competition. It is important to ensure that an efficient functioning of the EU internal market and fair competition remain core goals of State aid rules. The general approach should hold that State aid should be an exception rather than a common practice. Modernisation of State aid rules should not compromise between the general prohibition of State aid and eagerness to prioritize the control of state aid with a more significant impact on the internal market. The pursuit of EU policy objectives per se should not be a sufficient justification by Member States to provide State aid.