



**EU Internal Market: Shaping a new  
Commission Agenda 2009-2014.**

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## EXECUTIVE SUMMARY

### 1. Context

- a. *The Single Market is under pressure from:*
  - i. *Disenchantment among citizens about the benefits of both European and global economic integration*
  - ii. *The global financial crisis reinforcing a general disenchantment with more open and less regulated markets, led to a weakening of control over competition policy and state aids in particular*
  - iii. *The complex interactions between climate change policy, energy policy and energy security*

### 2. Proposed Action Agenda

- a. *Defending the status quo:*
  - i. *Strengthen state aids policy by ensuring full access to rights for private actions in the courts against discriminatory state aids at home and in other Member States*
  - ii. *Reinforce the principles of open markets, mutual recognition and the legitimacy of home country oversight of services providers by strengthening ex ante and ex post impact assessments of regulatory change under the oversight of the Commission and committees of national regulators; all designed to improve the legitimacy of the EU level intervention in the regulatory process*
  - iii. *Re-examine the scope for EU level active labour market policies – notably retraining and compensation schemes in exchange for compliance with the principles and practices of the Single Market*
- b. *Creating forward momentum:*
  - i. *Recognise the interaction of climate change and energy policy at an EU level. Burden sharing among Member States in the ETS schemes requires that countries with high carbon/high cost energy sources can access supplies of low carbon/low cost energy. TENS funds may be needed to integrate energy grids so that low carbon electricity and gas can flow across the Union as a whole. Coordination of any national carbon tax schemes may be required to avoid either border adjustments or implicit state aids via exemptions*
  - ii. *Intensified impact assessments utilising the expertise of national regulators should identify where the principle of mutual recognition can be extended case by case*
  - iii. *Commission a new Cecchini Report to justify and garner support for the next stage extension of the Single Market, identifying groups that need to be co-opted. Generate scenarios on necessary productivity growth to sustain European living standards and case studies of the policies needed to generate that productivity growth alongside analyses of who wins and who loses from these policy options and how the losers might be compensated/ helped to adapt to the new circumstances .*

# **EU Internal Market: Shaping a new Commission Agenda 2009-2014**

Dr Peter Holmes and Prof Jim Rollo<sup>1</sup>

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## **MAIN REPORT**

### ***Part 1: The Key Challenges***

#### **Overview:**

Part 1 looks at the general challenges of the prevailing financial and economic context that the incoming EU Commission will confront when formulating economic policy to manage the impact of the crisis on the Single Market. It identifies a significant need to reinforce the case for the Single Market in the context of the crisis when the benefits of liberalisation are questioned. Part 1.3 considers specific issues of importance in crafting internal and external economic policy instruments to meet the agreed targets for global climate change policy post 2012. The section concludes by examining the challenges and opportunities involved in meeting these future targets in a context where global and even EU consensus is lacking.

#### ***1.1 The crisis and its aftermath***

There are two extreme scenarios for the management of the aftermath of the crisis. The first and most desirable, is that consumers and producers return to the market place soon and growth takes off again at above trend levels as the economy heads back towards the long term trend value of GDP. The other extreme is that there is a double dip recession as fiscal and monetary stimulus is reversed in the face of burgeoning public debt and the fear of future inflation. In both scenarios the shift will be from the prevailing policy norm of progressive liberalization/light touch regulation in the context of market led global economic integration, towards one more

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<sup>1</sup> This Working Paper is based on research carried out for the then Office of the Committee for European Integration of the Polish government (UKIE) as part of its preparation for the Polish Presidency of the EU in 2011. The authors are grateful to UKIE and its staff for financial support and helpful comments. All views expressed are those of the authors and do not necessarily represent those of UKIE. Errors are the sole responsibility of the authors. The authors are extremely grateful to Anna Sydorak-Tomczyk and Kamala Dawar for research assistance.

sympathetic to government intervention in markets both by subsidy and more intrusive regulation. This will be notably but not exclusively in financial markets. It may be easier to reverse this trend if growth is buoyant and optimism is returning. However, when unemployment lags the economic cycle and where labour markets are inflexible these lags can be long. Thus, in both scenarios national politicians are likely to be concerned about rising unemployment and likely to look at economic policy choices through the lens of short term impact on output and employment, rather than on long term economic efficiency and the virtues of competition.

Fiscal pressures may exert their own restrictive effects on the propensity to use subsidies and consequently this can make protectionism, among Member States and towards third countries, and regulatory restrictions on competition both seem more attractive. Since 2007 Member States have actively pursued both routes. Governments have offered financial guarantees in the banking sector, for instance The RBS, Lloyds and Fortis, effectively taking private risk on to the public sector balance sheet, undermining the foundations of the Stability and Growth Pact. There have also been disputes in the automobile sector (OPEL, Magna), over whether governments are using financial support to export job losses to plants in other Member States. And there have also been state-sponsored mergers to ensure the *de facto* maintenance of particular firms in the market place via mergers, for example, HBOS/Lloyds, at the expense of increased concentration and reduced competition.

Clearly, the current climate is a difficult one for defending the liberalisation of the service sector because of the perceived failure of liberalization in financial service and the sharp differences in what the appropriate response should be. Free movement of labour to provide services is deeply sensitive in a time of high unemployment. A further challenge comes from the impact of different attitudes to policy on climate change. The EU has been the pioneer of policy in this area but the distributional issues attached to both national and sectoral targets among Member States is a fertile ground for disputes, trade-offs and side payments, within and outside the EU. There are proposals at national levels for carbon taxes in addition to the EU ETS system and the differences of approach risk fragmenting the internal market as well as posing challenges for a common response to external competitiveness threats (Holmes, Reilly and Rollo. 2009). From a direct Single Market perspective there is also the issue of

trade in environmental services and the related issues of subsidisation of innovation in these areas as Member States try to gain ‘first mover’ advantage over each other. Finally there is the issue of EU energy market integration which, while only indirectly related to climate change, offers the possibility of increased efficiency in energy production and use, as well as in the security of supply. This makes meeting the next round of emission reductions potentially easier both economically and politically. However, failure to coordinate these policies on carbon emissions could undermine the internal market, and not only in energy.

### ***1.2 Reinforcing the political and economic case for continuing with the Single Market programme***

The crisis has unequivocally weakened the liberal impetus in the EU with resort to crisis cartels and to state aids as a major line of defence against the instability and economic contraction brought on by the crisis. Monetary policy has been relaxed dramatically and fiscal policy is expansionary well beyond the scope of the automatic stabilisers as governments act to shore up consumption and key sectors. Governments and not markets are seen to be in the ascendant. Trade and the ‘four freedoms’ are perceived by public opinion to have contributed to the crisis notably the free movement of capital and labour, with populist fears being frequently expressed about foreign acquisition of firms, relocation of employment and increased competition from contract labour and self employed workers from abroad. Yet this dichotomy is largely false since the market requires stable institutions and rules to function well and the liberalisation that followed the Single European Act for example was as much an act of policy as any decision to raise barriers to trade at the frontier.

### ***1.3 Future Priorities***

This shift demands a concerted response if the Single Market is to be defended and is to maintain its dynamism. Any response must defend the gains of the Single Market but there also needs to be a forward looking agenda both to help counter the short term effects of the crisis and ensure that the European Union gets back on to a higher and more sustainable growth path to address the long term challenges of demography and globalisation.

Future development to the Internal Market thus needs to focus on the following aspects:

- defending the Internal Market *status quo*: identifying the greatest pressures on the Internal Market which threaten rollback
- prioritising measures that could be the basis for new initiatives where gaps should be filled
- considering the longer term agenda.

## ***Part 2: Defending the Internal Market Status Quo***

### **Overview**

Part 2 identifies the urgent issues threatening the Single Market *acquis* to be competition policy (most particularly state aid) and energy and climate change policy. 2.1 examines the challenges in these policy areas and identifies possible solutions, including strengthening enforcement. Part 2.2 discusses the risk of demands for more harmonisation to “prevent” unfair competition in the areas of financial regulation and labour legislation while part 2.3 focuses on energy and climate change and the risk that without an integrated approach these policies can be used for economically protectionist purposes to either justify excessive subsidies or to justify trade barriers to combat such alleged measures. Part 2 concludes by looking at the need for a pragmatic defence of the *acquis* and the project of the Single Market. We argue that rather than attempting to prevent any erosion of the *acquis*, there should be strict monitoring of *acquis* infringements and elaboration of any legal exceptions to it.

### ***2.1 Competition policy***

The pressing problems:

- the danger of widespread recourse to state aids to defend employment in specific sectors (German government aid of €4.5bn to OPEL, government guarantees of £250bn for UK banks plus £50bn set aside for recapitalization, €3.5bn for Allied Irish Bank, €11bn for Fortis Bank).

- These numbers are so big that they contribute to the impression that the state is now in the ascendant even if the intention is to unwind the guarantees and sell any stakes taken in the nationalised Banks;
- the *de facto* relaxation of the rules on concentration notably in the bank rescues in the UK and elsewhere (Lloyds and HBOS, Fortis and Paribas); attitudes to crisis cartels more generally.

### **Potential solutions:**

#### *For state aids*

- More explicit industrial policy guidelines monitored and managed by the Commission. Securing more precision is very challenging agenda which we cannot solve here. The Commission acknowledges that its guidelines are somewhat subjective.<sup>2</sup> They acknowledge:

“The last and decisive step in the compatibility analysis is to evaluate whether the Member State has demonstrated that the positive effects of the aid, if any, outweigh its negative effects. This exercise can only be done on a case-by-case basis (for individual measures as well as for schemes as a whole) and it is therefore not possible to generally predict how the balancing will turn out in a given case. Nevertheless, a few general principles may be set.”<sup>3</sup>
- Tougher enforcement. This may appear to be an unprofitable approach at present. However the discontent expressed by the British, Spanish and Belgian governments at the idea that the German government might be using its promised aid to Magna to skew job losses towards non German plants suggests that some balance may be returning to the consideration of state aids and the need for effective discipline. The Commission’s success in forcing the German government to acknowledge that the aid it proposed to make available to Magna/Sberbank was also available to other potential bidders, which brought General Motors back into the picture, also points to a re-emergence of Union level disciplines. This could be strengthened if there were clearer

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<sup>2</sup> COMMON PRINCIPLES FOR AN ECONOMIC ASSESSMENT OF THE COMPATIBILITY OF STATE AID UNDER ARTICLE 87.3:

[http://ec.europa.eu/competition/state\\_aid/reform/economic\\_assessment\\_en.pdf](http://ec.europa.eu/competition/state_aid/reform/economic_assessment_en.pdf)

<sup>3</sup> *ibid* para 57



processes for interested or affected private parties to have standing in national courts to challenge illegal state aids that affected them. This implies exploring the scope for:

- strengthening the reporting and monitoring of public procurement in the purchase of goods and services
- time limits or firmer conditionality: mandatory sunset clauses on aid to specific enterprises,
- ensuring more *predictability* by requiring national programmes to have clear criteria for eligibility, duration, total spend per action.

Overall, state aids are where most ground needs to be recovered. Rules have formally been relaxed in the face of the crisis. We go into more detail on this point in the Annex as we feel this area is of great importance. The position on mergers for example reveals some relaxation but also provides evidence that the Commission is already recovering lost ground (such as forcing merged banks to give up branches).

### **Mergers and cartels**

- Ensuring better coherence with social policy. For instance retraining should be the favoured solution to support employment rather than enforced anticompetitive and/or subsidized mergers, if possible. There is a role for the Social Fund and the potential for an extension of the Globalisation Adjustment Fund to take account of post crisis adjustment.
- Setting limits on degrees of market domination both local and at EU level – notably for network industries such as Banking - leading to predictable rules on disposals
- Specific criteria to prevent the creation of enterprises that are “too big to fail” above all in the banking sector

Less strain has been imposed on merger policy than state aid policy at the EU level. Rather than a rush of mergers, M&A activity has been scaled back<sup>4</sup> since a peak in 2007. The Commission has not been forced to accept mergers in the economy at large that would otherwise be unacceptable – except in the banking sector. Here the major

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<sup>4</sup> <http://ec.europa.eu/competition/mergers/statistics.pdf>

concern has perhaps been at the national level and the ability of Member States *in practice* to allow mergers such as HBOS-Lloyds that might have been blocked if they had been scrutinised by the Commission. The Commission has had to nuance its approach very slightly. Commissioner Kroes has acknowledged that they can take account of the “failing firm defence”<sup>5</sup> and the UK’s Office of Fair Trading reminded business what this amounts to in early 2009, even while insisting it would not bend the rules.<sup>6</sup> The Commission does not in fact appear to have invoked this formula in practice.<sup>7</sup>

The main reason of course is that especially in the financial sector, state aid has prevented the threat of failure, although the Commission notes “Nevertheless, it cannot be ruled out at this stage that a failing firm scenario could arise should such measures not be sufficient or not have the intended effects with regard to any particular market or firm.”<sup>8</sup> The Commission has also been able to avoid the need to tolerate crisis cartels. The one area where the Commission has relaxed its rules is that very slightly more firms in 2009 than in previous years were given a derogation from the standstill provisions that require mergers to be frozen until approval.

We can therefore confirm that the biggest issue for competition policy in the crisis has been state aids. However this may not be the case in the future. If state aids are cut back and if financial markets recover, the OECD argues, we may see a revival of merger activity including those involving firms kept open only by state aid. At this point it will be necessary for the Member States to reiterate their support for the Commission’s continuing application of the rules.<sup>9</sup> Where this risks creating social tension, our argument in the rest of the paper suggests that these should be dealt with by social or other adjustment policies.

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<sup>5</sup> Speech by Neelie Kroes to IBA 11 Sept 2009:

<http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/09/385&format=HTML&aged=0&language=EN&guiLanguage=en>

<sup>6</sup> The failing firm defence allows a merger that would increase market share of the acquirer if the acquired firm would otherwise just go out of business:

<http://www.shoosmiths.co.uk/news/1902.asp>; <http://www.oecd.org/dataoecd/9/22/43067294.pdf>

<sup>7</sup> <http://www.globalcompetitionreview.com/reviews/19/sections/67/chapters/734/mergers/> and <http://www.globalcompetitionreview.com/reviews/19/sections/68/chapters/747/private-equity/>

<sup>8</sup> “Competition and the financial markets: The role of competition policy in financial sector rescue and restructuring” Juergen Foecking, Peter Ohrlander and Ernst Ferdinandusse:

[http://ec.europa.eu/competition/publications/cpn/2009\\_1\\_3.pdf](http://ec.europa.eu/competition/publications/cpn/2009_1_3.pdf)

<sup>9</sup> <http://www.oecd.org/dataoecd/9/22/43067294.pdf>

## 2.2 Regulation

The risk of demands for more harmonisation to “prevent” unfair competition

- financial sector: insuring against this may require a degree of central regulation on a minimum range of issues such as capital requirements for banks to ensure that mutual recognition and home country supervision can be maintained to encourage competition across the Single Market
  
- labour legislation: in the present climate the virtues of “flexibility” are likely to be further questioned, especially by “insiders”. Effective functioning of markets requires a careful trade off of the interests involved, including both efficiency and the upholding of socially agreed expectations.

A particularly sensitive area is the posted workers directive and the issues around it. This has led to a number of high profile labour cases, most strikingly the Viking and Laval cases where the ECJ was called upon to pronounce how far it was acceptable for workers in an older Member State to take industrial action to oppose the replacement of a workforce - Finnish by Estonian in Viking and Swedish by Latvian workers in Laval.<sup>10</sup> The ECJ made rulings in these and other cases which restated in principle the right of unions to oppose the decision by employers to act in this way but very severely qualified it in practice. They have been followed by the less well know Luxemburg and Ruffert cases.<sup>11</sup>

In Ruffert, the German *land* of Niedersachsen required contractors to pay the German collective bargain pay rate on public contracts. A Polish based sub-contractor to a compliant German contractor did not do so and the contract was terminated. The ECJ ruled that while there were circumstances in which minimum wage limits could be included in contracts, such as when there was a statutory requirement in existence, this did not apply here. The provisions of the directive were not themselves at issue in this case; the Court ruled that the Polish firm was respecting the German rule but “the

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<sup>10</sup>See R. Zahn, ‘The Viking and Laval Cases in the Context of European Enlargement’, [2008]

<sup>3</sup> Web JCLI: <http://webjcli.ncl.ac.uk/2008/issue3/zahn3.html>

<sup>11</sup> C-319/06 and C-346/06

legislation of the *Land* does not comply with the provisions of the Community directive on the posting of workers.”<sup>12</sup>

These cases have raised a minor political storm. They are widely seen as subordinating the right to strike to market freedoms.<sup>13</sup> It may well be argued that this is a proper principle but in the context of the European political debate should such decisions be taken at the level of the Council (and Parliament) rather than the Court? It follows a long period in which the ECJ gave increasing effect to the Treaty provisions on the right to provide services. This was then followed by a political decision to introduce a directive which whilst consolidating some of the advances made by the court, effectively withdrew others.

The ETUC has argued<sup>14</sup> that this is an area where legislative action is needed to prevent “xenophobia and ill-guided protectionism.” They note the existence of “Monti clauses” (as precedents perhaps for the “Grand bargain”) in the Regulation on the Movement of goods and also in the services directive.

Text in the goods regulation:

“This Directive may not be interpreted as affecting in any way the exercise of fundamental rights as recognised in Member States, including the right or freedom to strike. These rights may also include the right or freedom to take other actions covered by the specific industrial relations systems in Member States.”

Services Directive:

“This Directive does not affect the exercise of fundamental rights as recognised in the Member States and by [...] Community law, including the right to negotiate, conclude and enforce collective agreements and to take industrial action.”

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<sup>12</sup> <http://curia.europa.eu/en/actu/communiqués/cp08/aff/cp080020en.pdf>

<sup>13</sup> Critical perspectives are at:

<http://www.ier.org.uk/system/files/Understanding+the+Viking+and+Laval+cases.pdf>;

<http://www.ier.org.uk/system/files/Fed+News+article+Ruffert+and+Luxembourg.pdf>

<sup>14</sup> [http://www.etuc.org/IMG/pdf\\_ETUC\\_EXEC\\_Viking\\_Laval\\_-\\_expl\\_memorandum\\_7-3-081.pdf](http://www.etuc.org/IMG/pdf_ETUC_EXEC_Viking_Laval_-_expl_memorandum_7-3-081.pdf)

The ETUC argue for a widening of this concept. This may seem very unattractive for those who wish to consolidate the freedom of movement of workers and the right to provide cross border services, but the question arises whether there is a trade off between the extent of the rights and the degree to which they can be enforced, above all how far it is acceptable to leave it to the courts to draw the line between these potentially competing goals.

Should there be political clarification of where the line is drawn between *the freedom of movement of workers* and *the right to provide cross border services*? Tsoukalis, Cramme & Liddle argue that as part of any grand bargain the Posted Workers Directive should be amended and the New Member States offered a deal

“EU budget reform should place particular emphasis on the expansion of common policies where the EU can genuinely make a difference beyond the remit of national policy instruments and what they can realistically achieve at the national level alone – research and innovation; mobility within higher education; cross-border energy infrastructure necessary for energy security and low-carbon transition, alongside flagship social policy initiatives. EU budget funds could be used to realise some form of minimum income or anti-child poverty guarantee across the Union. This could be agreed as a “side payment” to the new Member States for a tightening of the Posted Workers Directive.”<sup>15</sup>

This may seem to go beyond what is politically likely but these observers are EU insiders. Perhaps one could imagine more action within existing parameters. The Globalisation Fund was established in 2006 to provide assistance for all Member States, not merely New Member States (NMS) hit by adjustment problems. This has been strikingly underutilised,

“A total of EUR 49 035 729 (i.e. 9.8 % of the annual amount available to the EGF) was granted in 2008 in eight EGF contributions, five of which were for applications received in 2007 and three for applications received in 2008. These funds were used to co-finance active labour market policy measures

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<sup>15</sup> “An EU fit for purpose in the global age Can we rise to the challenge?” by Loukas Tsoukalis , Olaf Cramme and Roger Liddle Oct 2009: <http://www.policy-network.net/uploadedFiles/Publications/Publications/An%20EU%20fit%20for%20purpose%20in%20the%20global%20age.pdf>

(mostly job-search allowances, training and employment incentives) targeted at 9 941 redundant workers in five Member States.”<sup>16</sup>

### ***2.3 Energy and Climate Change Issues***

Whilst clearly not the only issue for the Single Market, the links between climate change and energy markets are crucial. Key problems lie in the area of ensuring an efficient and equitable allocation of the burden of coping with climate change whilst avoiding the creation of trade barriers in the name of environmental policy

There is some tension between the equity or ‘level playing field’, and the “polluter pays” principle. Free allocation of ETS permits is perceived by some as a subsidy to polluting industries, and selective carbon taxes have been deemed to be distortionary. A relatively early paper on this topic argued

“Do differences in the permit allocation procedures among Member States of the European Union (EU) lead to competitive distortions and state aid in a European carbon trading market? The answer to this question is that it depends on the perspective taken. In principle, the answer is ‘no’ from an efficiency perspective, but the answer is ‘yes’ from an equity perspective.”<sup>17</sup>

In other words free allocations which cannot be sold if they are used create an incentive to curb pollution but are a lump-sum gift to the polluter.

If there is no global or EU consensus some jurisdictions will impose tighter rules than others and will be under pressure to combat “loss of competitiveness.” There is a risk of environmental policy being used as protectionism, whether to justify excessive subsidies or to justify trade barriers to combat such alleged measures. There is a necessity to avoid the manipulation of ETS allocations. The management

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<sup>16</sup> REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL on the activities of the European Globalisation Adjustment Fund in 2008 Brussels, 28.7.2009 COM(2009) 394 final:

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0394:FIN:EN:PDF>

<sup>17</sup> Edwin Woerdman “Developing a European Carbon Trading Market: Will Permit Allocation Distort Competition and Lead to State Aid?”

NOTA DI LAVORO 51.2001 [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=278535](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=278535)

of the removal of free allocation of quotas under the ETS scheme is and will continue to be particularly sensitive. Trade off between the continuation of free allocations versus Border Carbon Adjustments as a means of dealing with the political economy of competitiveness and climate change mitigation

Ensuring equitable sharing of the costs of addressing climate change whilst preserving the right incentives is a primary challenge, as is ensuring the open internal trade in environmental services and those procurement policies, state aid and competition rules do not encourage over-investment in some countries at the expense of others. There are genuine roles for positive EU policies as well as curbs on national fragmentation, including:

- Exploring the scope for EU schemes for financing innovation in environmental goods and services
- Looking for EU funds to complete cross border connectors of EU energy networks to ensure that all EU citizens have the opportunity to take advantage of carbon trading and so minimize energy costs and their carbon footprint

Meanwhile Commission proposals for energy liberalisation are on the table. However they present very significant political problems for a number of Member States who in particular are unwilling to separate distribution and production as a means to increase competition since significant private and public sector energy utilities are integrated across both activities. The presence of long term contracts and pipeline indivisibilities in gas supply also complicates any simple process of liberalisation.

The carbon issue is deeply sensitive in many Member States and more salient in some than others. There is therefore a danger that differences between Member States will not only lead to policy paralysis at EU level but also to Member States going their own way and risking the integrity of the Single Market. There are moreover important external sensitivities. The recent CFI case concerning the Polish and Estonian ETS allocations has illustrated that even within the EU the efficiency equity balance has not been clearly struck.<sup>18</sup> This is even though the particular issue in question will disappear in the next phase of ETS. The dangers of fragmented national approaches

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<sup>18</sup> T-183/07 and T-263/07

do not merely create environmental problems but more mundanely they also create issues for the Single Market. Several Member States have begun to suggest that since the ETS scheme is not enough to achieve the necessary carbon reductions to meet likely internationally agreed targets, other instruments are necessary. France for example is studying a possible national carbon tax and may join Sweden, Finland and Denmark who have had carbon tax schemes for a long time. Purely national responses will potentially create barriers within the Single Market. There is considerable literature in the international trade field about the risks to world trade if countries become concerned about the fact that not all others have the same carbon price. A virtue of the ETS scheme is that it does ensure the same carbon price and does so without the need for border adjustments among countries that are in a joint scheme.

There is a danger that without integrated rules one jurisdiction will seek to impose extra border charges on goods from another. At present the nature of the Scandinavian Carbon taxes is such that this has not arisen. However, if border adjustments against third countries are mentioned<sup>19</sup> this may also become an issue within the EU, particularly if new taxes target non ETS sectors. Legal issues have arisen as noted above in the case of the proposed Danish Carbon tax designed to tax non ETS sectors. The Commission was concerned that the exemptions to avoid double taxation in the original proposal were distortionary.<sup>20</sup> Any carbon tax schemes therefore need to be either common at the EU level or subject to close oversight from Brussels, for example within the context of a framework directive. Disciplines on VAT rates may offer another model of oversight and discipline. A further point that has received little attention but one which is known to be concerning WTO officials is that of the state aids implications of exemptions and there has already been a relevant case involving Denmark.<sup>21</sup> The issue is that both free allocations and tax exemptions are capable of acting as and being treated as state aids. There needs to be clear collective action in this area.

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<sup>19</sup> <http://www.euractiv.com/en/climate-change/france-germany-call-eu-border-tax-co2/article-185580>

<sup>20</sup> <http://www.carbonoffsetsdaily.com/news-channels/europe/ec-authorises-proposed-danish-co2-tax-reductions-under-certain-conditions-2-9181.htm>

<sup>21</sup> <http://www.carbonoffsetsdaily.com/press-release/ec-authorises-proposed-danish-co2-tax-reductions-under-certain-conditions-8979.htm>



The international dimension is also relevant. The scope for Border Carbon Adjustments is already an issue in US legislation as well as the EU Directive. Major Member States are also considering the scope for such measures to punish perceived free riders. While there may be a case for such charges in theory, the room for manoeuvre in calculating justified tax or charge levels leaves space for protectionist impulses which have all the same effects in carbon trade as in other forms of trade with misallocation of resources and efficiency losses as well as dangers to the coherence of the trade system (Holmes, Reilly and Rollo, 2009). From a direct Single Market perspective there is the issue of trade in environmental services and related issues of subsidisation of innovation in these areas as Member States try to gain first mover advantage over each other

Finally, there is the issue of EU energy market integration which, while only indirectly related to GHG issues, offers the possibility of increased efficiency in energy production, use and in security of supply which makes meeting the next round of emission reductions potentially easier both economically and politically. Again, failure to coordinate policies on carbon emissions is likely to undermine intra-EU openness.

The energy and carbon emissions area is one which is fraught with challenges and opportunities for the EU and there are a number of parallel interlinked issues:

- The need to ensure provision of the pan European, indeed global, public good of reduced carbon emissions, which ideally involves the creation of a global carbon market similar to the EU ETS scheme.
- The need to ensure an appropriate allocation of the costs of reducing European Carbon emissions
- The need to ensure energy security across Europe
- The need for an appropriate mix of liberalisation and regulation in the energy sector
- The need to create the necessary network infrastructures
- The need to prevent individual state action from undermining integration and solidarity, including:

- How to develop a future low carbon economy without using it as an excuse to support distortionary state aids etc.
- How to avoid national carbon regimes designed to supplement ETS creating trade frictions as is already threatened on a global scale

The fundamental challenge is to ensure that we get the correct price-related incentives without creating unacceptable distributional issues. The opportunity is precisely that it is far from being a zero sum problem; this is a true European and global public good where common action of some kind can bring general benefits. In principle the ETS scheme can do this provided that the right total number of ETS certificates has been issued and they have been sensibly allocated. From a theoretical perspective the EU should issue a total number of ETS permits corresponding to its international obligations and auction them. But how they are allocated in reality, particularly while there are free allocations is clearly an unresolved issue in the current phase of the ETS. UKIE will be far more aware of the implications of the recent CFI case than the present authors.

This illustrates the fact that whilst it is true that market based allocation systems are capable of creating the same incentives by a variety of means (pollution taxes, saleable quotas, subsidies not to pollute, free versus purchased allocations), the distributional impact must be fully considered. In an ideal arrangement, the total number of allocations would be small enough to secure compliance with emissions reductions targets and would be allocated in such a way as to ensure that those countries who find it hardest to reduce emissions are given the equivalent of a fiscal compensation.

If it is to work well, all stages in the implementation of any ETS schemes requires the possibility to trade permits across as large a domain as possible. Ideally this would be globally, but certainly across the largest economy possible and in the EU case across the Single Market. Thus, high emitters must either buy from low emitters to stay in production, or sell their permits and reduce output so that it comes from the most efficient source. However, this presupposes that reallocation is possible. A lower target assumes that there can be substitution effects. In the case of Poland it appears that there are two basic issues. Poland cannot economically cut its emissions

more than a few per cent by 2020 and it cannot buy in low carbon energy easily due to lack of infrastructure. The problem is made both easier and more difficult by a low ETS price. It is easier if Poland can buy surplus ETS certificates; but harder if the low carbon price fails to create the right incentives. In the ideal scenario Poland would surely be *selling* ETS certificates and buying energy. In reality it finds this difficult. The more open the energy market, the easier it is to address the problem by the cheaper route of buying lower cost energy and selling from a relatively generous allocation.

Clearly areas of Community solidarity that are appropriate in this situation include:

- urgent attention to the consolidation of infrastructure and in particular cross border network connectors for electricity grids and energy pipelines to ensure that energy security can become an EU matter rather than one that Member States address for themselves. Infrastructure is not sufficient for this but it is a necessary precondition
- a sustainable ETS with both a carbon price that generates the necessary investment and a suitable sharing of the adjustment burdens.

The traditional British approach has been to argue that market solutions and liberalisation can solve all the problems in this area, but discussions we have attended in the UK indicate a growing concern that this is only true in the right market conditions. Where energy transmission infrastructure cannot for political reasons be totally unbundled even where it exists we may need to think through the kind of regulation that is needed. If shortages in one market do not in fact lead to arbitraging flows, liberalisation as such may not be the essence of a solution. The energy carbon and green growth issues call for an integrated solution, risks a second best outcome in which efficiency could be reduced rather than increased. Judging any potential liberalisation package therefore requires careful calculation.

This brings us to the final observation. There is room for legitimate fear that just as Green protectionism is a risk to world trade, Green industrial policy threatens to create problems for the Single Market. At the same time we must not forget that in the short term labour market policies with an environmental dimension are clearly better than unemployment. State aids for energy efficiency can both inject money into the

economy in the short term but create almost immediate pay-offs.<sup>22</sup> The EU should encourage this. Targets and rewards of efficiency improvements have perhaps more to offer than renewable targets at the EU level. Countries with the most scope for improvement have the most to gain. Encouraging collective initiatives rather than discouraging national measures might be appropriate here.

The thorny question arises of R&D aid. It is indeed the case that some countries are better placed to support and absorb funds from EU programmes in renewables and in such areas as Carbon Capture and Storage (CCS). State and EU aid rules clearly need to be designed in such a way as to ensure the proper targeting of these measures so that they are not distortionary. (We do need electric cars but this should not be an excuse for supporting ailing factories). And they should also be designed to ensure that the resulting technology is made available on affordable terms to all Member States. There is dispute about how far CCS can be made to work but if it did work, it could provide a breathing space before alternatives such as nuclear power or radical changes in consumption patterns.

## ***2.4 Other Important Areas***

### ***Digital Services and IPR***

Although this report has highlighted two areas, competition policy (most notably state aids) and carbon policy as posing the greatest threats to the SM, this should not suggest that these are the only priorities. More general advances need to be made.

It is widely believed that the digital sector provides good scope for job creation. Recent studies have highlighted the paradox that there the services sector appears to be able to trade more easily externally than within the EU itself. There is not simple explanation or solution but some practical matters have been identified.

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<sup>22</sup> J. Llewellyn (200&), the Business of Climate Change 1 p28  
<http://www.llewellyn.co.nz/climatechange.pdf>.

There are still high costs and practical difficulties for businesses and consumers making cross-border transactions. These include difficulties with cross border movements such including difficulties with cross-border payments or identity verification, as well as differences in rules on consumer protection lessening consumer confidence in buying from websites outside their own country. Fragmented copyright systems also play a part. Complex rights management including trademarks is also capable of creating barriers within the Single Market.

There is a further simple step in intellectual property rules that also needs to be taken. The development of the Community Patent is blocked on matters that are not seen as basic principles. The reduction of transactions costs that the Community Patent would bring about would be particularly valuable for small businesses. This step should be kept separate from tightening or loosening the degree of IP protection.

### ***Public Procurement***

In the previous discussion the issue of public procurement has surfaced a number of times. We have seen how the services directive and the rules on free movement of labour have been invoked in the case of public contracts to challenge infringements. In the past public procurement was one of the slowest areas to show progress. By the time of the Cecchini study in 1988 there was very little progress at all and in 2006 the Commission concluded that:

“Therefore, the enforcement of transparency and competitive tendering rules for the award of public contracts through national review procedures is not guaranteed in equivalent conditions in all Member States (i.e. there is no level playing field at present).”<sup>23</sup>

A review of the effectiveness of the new procurement directives is clearly necessary.

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<sup>23</sup> Impact assessment Report – Remedies in the field of Public Procurement (Commission Staff Working Document) (SEC(2006) 557)

## ***2.5 Pragmatism in defending the *acquis****

The logic of our argument is that a top priority should be the very strict monitoring of *acquis* infringements rather than attempting to prevent any erosion of the *acquis*. Additionally the circumstances where exceptions to the *acquis* may be permitted should be carefully defined, along with the procedural and substantive rules these exceptions are subject to. Exceptions rules must represent a politically sustainable bargain. Formulating precise recommendations is therefore difficult from within this paper. This approach resembles that of the WTO where there is presumption of compliance but a clear definition of the exceptions exists to act as a kind of safety valve, to be judicially interpreted. Admittedly this may fit less well in circumstances where the Single Market is legislated by regulations rather than by framework directives. Nonetheless, if the threat to the *acquis* is as acute as it seems, then it may be better to take this route than the more purist one of no exceptions weakened by arbitrary case by case attrition, although there are clearly risks.<sup>24</sup>

It may also make sense to consider the role that improved process and institutions may play in the context of defending the status quo and in identifying areas where liberalization can be extended step by step<sup>25</sup> with least resistance. Both mutual recognition and home country regulation of services provided overseas are contested by voters, by politicians and by home country regulators and have either been very difficult to implement in goods and non-financial services. Nonetheless they offer the best promise of realising benefits from liberalization. This is partly because they promote the comparative advantage that domestic regulation can help firms to realize. This is not an issue of race to the bottom but rather how different business models emerge under different regulatory regimes, for example, Aldi in Germany versus Carrefour in France.

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<sup>24</sup> It is arguable that the inflexibility, denounced as “stupid” by Romano Prodi was a major flaw in the EMU system.

<sup>25</sup> See Patrick Messerlin 2009 The EC approaches to services: Tensions between domestic and foreign goals (mimeo) and Patrick Messerlin (2009)The EU Single Market in Goods: Between Mutual Recognition and Harmonisation (Mimeo).

One approach to easing these issues would be much more serious impact assessment than is currently undertaken in the context of both EU regulatory proposals, including an element of continuity; not just ex ante assessment but also ex post. Further impact assessment is required of existing national regulation where EU action is proposed. This would identify where it is possible to remove features which generate obstacles to cross border provision or establishment without affecting the public policy objective of the regulation. In a sense this is a proposal to combine the Better Regulation Initiative with an explicit liberalization/pro competition agenda. Not simply a way of removing burdens but also actively reducing prices and increasing productivity, quality and variety of provision.

The difficulty with such a proposal is the question of who carries out and who supervises these impact assessments. One option would be to put this in the hands of a committee of national regulators chaired by the Commission, Perhaps with a subcommittee of member state regulators acting as examiners of each study. The objective would be to extend mutual recognition, rather than search for an idealized and harmonized system. The impact assessments would be designed to be confidence building and analytical rather than harmonizing and definitive. In that way the national regulators would have some confidence in regimes in other countries and would see the opportunity to spread their national norms to other Member States. The studies themselves should be carried out by external consultant selected by open competition.

This proposal would have three advantages: first is simply that it would widen the scope of the evidence base for particular proposals and ex post assessment would ensure that any changes made are subject to review. Second is that in bringing together a group of regulators as the key adjudicators it would build an atmosphere of trust among key officials and practitioners. Third, the combination of better evidence, ex post evaluation and a committee that had some legitimacy in Member States through the involvement of national regulators would increase trust at least at elite level if not perhaps directly at the level of citizens, workers and firms that the process is fair and the proposal is thought through. One very concrete example where progress on this front might be made is that of mutual recognition of qualifications. The situation is at present complex and muddled. A concerted project to ensure mutual

recognition of vocational qualifications could be useful. Again there is a trade-off: guaranteed mutual recognition may call for some minimum harmonisation.<sup>26</sup> There have been concerns in some countries about medical qualifications of third country nationals and free movement within the EU.

Institutions and processes don't make the political sale of a project such as the Single Market by themselves. That requires a major effort by politicians. But evidence produced by a legitimate process is useful in its own right to identify where progress can be made most effectively and can provide a helpful defence against backsliding.

### ***Part 3: Prioritising Next Steps in the Internal Market to Encourage Recovery***

#### **Overview:**

The focus in Part 3 is on identifying tangible and realisable policy measures to encourage economic growth in the Single Market that is 'greying,' 'greening' and facing strong competition from the new and emerging developing countries such as China and India. It begins by highlighting important policy gaps including the energy market and environmental services before proposing the need for a new Cecchini Report to address contemporary challenges to the Single Market. A Cecchini 2 would not only need to address the overall net benefits of policy developments but it would also have to identify gross impacts, recognising losers as well as winners and encompass policies to compensate the losers.

Identifying gaps in the Internal Market worth addressing now:

- **energy market and environmental services**

These are perhaps the most obvious and interlinked areas where new initiatives would contribute to wider objectives. Liberalization in both sectors helps to reduce costs and to encourage greening of European economy. Both have elements of network economies of scale that cross border linkages can help to realize. There is already a Commission proposal for completing the Single Market in energy which provides a

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<sup>26</sup> In one bizarre case a Dutch plumber was refused the right to work in the Netherlands because he had Belgian qualifications. The ECJ rejected this! (Knoors Case 115/78: [http://eur-lex.europa.eu/smartapi/cgi/sga\\_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61978J0115](http://eur-lex.europa.eu/smartapi/cgi/sga_doc?smartapi!celexplus!prod!CELEXnumdoc&lg=en&numdoc=61978J0115))



basis for progress but the political economy based barriers are formidable as incumbents – some still in the public sector

- defend market positions. Given the dependence on external supplies of gas and oil in particular, the security aspects of a Single Market for energy also promise gains from a Single Market for the Union as a whole. Member States however see bilateral arrangements with external suppliers as offering greater certainty at the country level.

- **other services:** identifying important employment considerations for labour mobility providing clear benefits for consumers and the areas where stabilising regulation can be required; considering trade off between mutual recognition and harmonisation

### ***The Longer Term Agenda: Greying, Greening and Keeping up with the BRICS***

The Single Market needs new political impetus. It should also be a key element in the follow up to the Lisbon Agenda and more importantly also in meeting the challenges of continuing globalisation and to the ‘greying’ and ‘greening’ of Europe. Each of these challenges becomes much easier to confront with systematically higher productivity across all of Europe. Strategic industrial policy may have a role to play in this notably in the context of the low carbon economy but mainly it is down to increased competition internally and from abroad as well as investment in human capital and innovation. The strategic approach to these issues needs to be spelled out. The political imperative is clear. The large emerging economic powers – China, India and Brazil in particular are not going away. Indeed their salience in the world economy and in its governance is a given, and the wave of young workers entering the global labour market in the next decade is already born.

Relative economic decline is a given for Europe and as with the rise of the European economies after World War II and subsequently of Japan and other smaller Asian economies, this is in the general good for the global economy. Hiding behind protectionism is only a recipe for accelerated relative economic decline and in the extreme absolute economic decline. To sell this requires a vision of what Europe can be. That vision must link realistic estimates of the degree of improvement in economic performance required to meet the aspirations of European citizens to

concrete policy proposals which are carefully designed to realise the performance required. This requires a step beyond the essentially aspirational nature of the Lisbon Agenda which was seen by many to be unrealistically ambitious from the outset and was without specific context. Any strategy to improve economic performance needs to be spelled out to citizens so that they are clear just what the challenge is in raising the underlying growth rate and identifying policies that can successfully deliver the necessary results.

- The key issue is therefore to relate both the 2020 goals and a concrete Single Market programme to the real palpable policy challenges that Europe faces over the next several decades. There are three obvious challenges that raising productivity would contribute to, which is surely a long term aim of the Single Market? First is managing aging populations. Longer working lives and higher savings would help solve 'greying' but higher productivity would be a better solution (note higher savings implies higher net exports, which would be easier to realise with higher productivity). Similarly on Greening the economy: more open markets in green technology, energy security and better use of resources will contribute to more sustainable growth. And the competitive challenge from the east and the south requires that Europe raises its game to sustain living standards but also defend societal norms and above all welfare states as well as help shape a world economy and society that reflects its values. But that still leaves the challenge of how to decide what should be done to deliver these goals.

It will not be enough to declare some macro goals for 2020 and beyond for review at successive competitiveness councils; and in any case the connection between these macro challenges and the nuts and bolts of economic integration policies that could drive forward the agenda needs to be demonstrated. Above all for the sake of political legitimacy it will not be sufficient to simply state the goals and policies and calculate/assert net economic welfare gains. The relevance of each policy proposal will need to be demonstrated along with costs and benefits and above all an analysis of who gains and who loses and what can be done to compensate the losers. What is needed is another Cecchini Report - but one for our times.

### **A New Cecchini study?**

The Cecchini report was widely seen to be a major and successful tool in garnering support for the original Single Market programme. It was however after the event of the 1985 white paper and indeed the 1986 Single European Act. Its job was to justify a set of political choices: notably a legislative programme already agreed and the economic adjustment to which was already underway as business anticipated the legislative changes and began a wave of cross border investments. Such was the public impact of the Cecchini Report that equivalent exercises have been proposed to justify other strategic policy choices. It must be recognised that subsequent attempts to measure the actual impact of the single Market programme of legislation have come up with much smaller impacts than foreseen in the original report. That has generated a degree of cynicism about proposals for new reports.

Any new study would have to start from different premises. One clear constraint is that unlike the 1980s, the Cecchini study of future impact assessments must not simply address the overall net benefits of policy developments but it must be ready to identify gross impacts, with losers as well as winners being identified. This is necessary for a number of reasons. The Cecchini report was written on the basis of a set of policy proposals that had already been defined, namely the 300 measures in the Cockfield White Paper.<sup>27</sup> Such a precise plan does not exist today and any scenario exercise would in part be designed to identify the nature of necessary policies.

The aim would be to first ask the question of what range of growth rates is required to manage and fund the demographic changes and in particular aging of the European population that is now inevitable against the background of continuing competitive pressure from the emerging economic powers, above all China and India. The second stage would be to assess the necessary impact of this on saving and investment particularly when taken into account with the adjustment for climate change mitigation and adjustment in Europe. These in turn will, against the background of expected growth in the emerging

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<sup>27</sup> "Completing the Internal Market", White Paper from the Commission to the European Council (Milan, 28-29 June 1985) COM (85)310

economic powers, give some sense of the future relative weight of Europe in the world and its ability to influence its own future. With that background then it would be possible to propose and assess the impact of a new Single Market initiative targeted on contributing to raising the growth rate in pursuit of a well specified goal with a strong political pay off.

## **Approaches to Cecchini 2**

- The counterfactual:

The baseline counterfactual is a do nothing option in which the world continues to develop on current trend levels of growth across the globe. Demographics also develop as currently predicted by the demographers. Global warming progresses as under the business as usual assumption.

The key policy variant is a hypothetical full Internal Market since it allows us to understand how far the growth objective can be attained by completing the Single Market?

- A series of analytical issues will need to be dealt with:

Growth must be integrated into the economic analysis of implementing the Single Market. It cannot rely alone on general equilibrium based comparative static approaches. Approaches drawing on Baldwin style linkages between gains from liberalization and investment will be necessary. These approaches would usefully be supplemented by:

- sector based partial equilibrium models. It would it be helpful to include *ex post* evaluation of sector liberalizations to date to calibrate the chosen approach (which would fit with the proposals for intensified *ex post* assessment proposed above).
- As well as general or partial equilibrium approaches there should there be case studies and macro model analyses to help assess employment effects
- drawing on this broad based approach a major element in the outputs of the modelling should be an attempt to map the distributional impact of completing the Single Market on incomes generally, by social groups,

regionally and by age. This would allow an assessment of the flanking policies required to help any losers from completing the Single Market to take advantage of the changed economic climate.

#### ***Part 4: Conclusions and Recommendations***

This paper has outlined the areas and issues that need to be taken forward for further analysis. The social implications of this report are particularly delicate. There is a widespread perception that the Single Market has undermined expectations of job security and that employees and taxpayers are being made to pay for mistakes of others for example in the pension area and in financial sector rescues. There is a need to rethink how far the system must face up to political backlashes against loss of perceived entitlements versus buying out or creating new incentives for people to give up these 'entitlements' voluntarily.

The Monti approach of balancing liberalisation with a social dimension can be traced back to many precedents in the history of the unification process, the ECSC, the philosophy of the Padoa-Schioppa Report<sup>28</sup> and the compensation elements of the structural funds for Mediterranean MS in the run-up to the Single Market. Our discussion however has identified some of the problems with this approach. The trade offs are not just efficiency versus equity but involve multiple "social" claimants. Any harmonisation that reinforces the established rights of labour market incumbents, risks denying them to newcomers both in the old as well as the post-2004 Member States. There is also an 'efficiency' versus a 'legitimacy' element to factor in – voters need reassurance that integration does not come at disproportionate cost. Meanwhile the evidence on the responsiveness of different regulatory regimes to the crisis has led to a questioning of long held beliefs.

One of the successes of the Cecchini Report was in deliberately stressing the overall gains and not highlighting potential losers. In today's world where the gross impacts of economic change are often much bigger than the net effects, that is, with winners

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<sup>28</sup> T.Padoa-Schioppa et al *Efficiency, Stability Equity* OUP 1987.

and losers, it is important to ensure that this is addressed in the Single Market agenda, in terms of

- stressing the overall benefits of market opening in specific cases and not simply treating the benefits of liberalization as self evident
- trying to ensure that the number of losers is kept to a minimum by retraining, for instance
- being aware of the demands that some groups who do lose out feel entitled to make, suggesting direct approaches to EU wide active labour market measures and creating compensation schemes similar to the globalization fund to deal with the losers

### ***Proposed Action Agenda***

#### 1) Defending the status quo:

- i) Strengthen state aids policy by assuring full access to rights for private actions in the courts against discriminatory state aids at home and in other Member States
- ii) Reinforce the principles of open markets, mutual recognition and the legitimacy of home country oversight of services providers by strengthening ex ante and ex post impact assessments of regulatory change under the oversight of the Commission and committees of national regulators; all designed to improve the legitimacy of the EU level intervention in the regulatory process
- iii) Re-examine the scope for EU level active labour market policies – notably retraining and compensation schemes in exchange for compliance with the principles and practices of the Single Market

#### b) Creating forward momentum:

- i) Recognise the interaction of climate change and energy policy at an EU level. Burden sharing among Member States in the ETS schemes requires that countries with high carbon/high cost energy sources can access supplies of low carbon/low cost energy. TENS funds may be needed to

integrate energy grids so that low carbon electricity and gas can flow across the Union as a whole. Coordination of any national carbon tax schemes may be required to avoid either border adjustments or implicit state aids via exemptions

- ii) Intensified impact assessments utilising the expertise of national regulators should identify where the principle of mutual recognition can be extended case by case
- iii) Commission a new Cecchini report to justify and garner support for the next stage extension of the Single Market, identifying groups that need to be co-opted. Generate scenarios on necessary productivity growth to sustain European living standards and case studies of the policies needed to generate that productivity growth alongside analyses of who wins and who loses from these policy options and how the losers might be compensated/ helped to adapt to the new circumstances .

## *Annex: Recent Developments in State Aids Policy and Practice*

There is no doubt that the integrity of the Single Market risks being compromised by the unprecedented growth of state aids allocated to address the crisis. Between 2008 and 2009 the value of state aids grew from 0.54 to 2.2% of GNP, of which 1.7% is identified as “Crisis aid”<sup>29</sup>. The Commission expressed the view that its scrutiny “ensured that the Single Market was not disrupted by disproportionate distortions of competition.”<sup>30</sup> It is arguable that this is a commendable small percentage of GNP. If we consider the scale of the overall deficits that have been incurred it is mildly reassuring that with the exception of Ireland and Hungary no Member State reports “crisis aid” above 6%. The fiscal stimulus has predominantly taken the form of general measures that are not distortionary state aids.

Perhaps as troubling as the scale of the aids is the fact that it exposed a problem in the process of state aid control. The rapid downturn in autumn 2008 gave the Commission very little choice but to greatly extend its “simplification” process whereby an increasing number of aids do not have to be individually scrutinised in advance. The Commission reports that 95% of state aids are either under a general block exemption or are part of a pre-agreed scheme. This has been part of a long evolving policy.<sup>31</sup>

It was inevitable that where the Commission did scrutinise it had to give approval in a very short time. Inspection of the DG Comp website in autumn 2008 revealed a very rapid turnaround of decisions. Being politically realistic we know that in a major crisis Member States will rescue their banks and await approval later.

The current situation nonetheless raises a number of questions for future policy

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<sup>29</sup> COMMISSION PRESS RELEASE IP/09/1884 Brussels, 7 December 2009. “State Aid: Scoreboard Shows Strong Increase Of Aid In Response To The Financial Crisis But Single Market Intact”  
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1884>

<sup>30</sup> *ibid.*

<sup>31</sup> For the back ground see <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2009:016:0001:0009:EN:PDF> also State aid: Commission adopts Regulation automatically approving aid for jobs and growth; July 7 2008. <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1110&format=HTML&aged=0&language=EN&guiLanguage=en>



- Did we go too far in tolerating state aids in the crisis and do we need tighter mechanism if there is another recessionary phase?
- What has it revealed about the weakness of a “rules based” system that is supposed to avoid discretion in a totally unprecedented situation?
- Can we devise better rules for the longer term future post-crisis?

There are a number of reasons why we should worry about state aids:

1. From an overall efficiency point of view there is risk of major cross country distortion threatening the Single Market
2. Uncontrolled state aids have potential macro economic implications both domestically and via cross border externalities to the rest of the EU and Member States need external buttressing to protect themselves from political pressures that may damage budgets
3. The lack of effective rules allows countries with deep fiscal pockets to cause disruption in Member States that have less fewer resources and less flexibility to hand out aids.

New Member States are clearly vulnerable in the latter context.

Between 2003 and 2008 the share in percentage points of state aids in GNP had fallen by 0.02% in the EU but had fallen 0.5% in the new 12 MS (Poland -82%). There is very reason to avoid pressures to reverse this benign trend.

**State aid related to crisis measures (2008; figures in billion €)<sup>32</sup>**

	<b>Total volume approved from 2008 to 11.11.2009</b>	<b>Total reported for 2008</b>	<b>crisis aid</b>	<b>Total crisis aid granted as % of GDP</b>	<b>Share of banking sector as % of total economy</b>
		<i>Total</i>	<i>Aid element</i>	<i>%</i>	<i>%</i>
Belgium	288.31	46.80	17.78	5.17	5.4
Denmark	599.75	2.85	2.85	1.22	5.4
Germany	589.13	180.94	51.14	2.05	3.6
Ireland	388.50	355.76	35.58	19.16	10.9
Greece	28.00				4.0
Spain	250.00	99.13	0.93	0.09	5.1
France	345.95	42.90	16.48	0.85	4.7
Italy	20.00				4.8
Cyprus	3.00				7.8
Latvia	7.44	0.96	0.96	4.17	6.2
Lux	7.26	4.00	2.80	7.64	29.1
Hungary	6.03				4.0
Neth	240.54	17.09	14.08	2.37	5.6
Austria	90.10				5.6
Poland	10.00				5.1
Portugal	24.45	4.30	0.43	0.26	8.2
Slovenia	12.00				4.3
Finland	54.00	0.12	0.00		2.9
Sweden	155.32	1.39	0.36	0.11	3.6
UK	512.17	201.28	68.75	3.79	7.6
<b>EU-27</b>	<b>3631.94</b>	<b>957.52</b>	<b>212.15</b>	<b>1.70</b>	<b>-</b>

<sup>32</sup> Extracted from State aid: Scoreboard shows strong increase of aid in response to the financial crisis but Single Market intact <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1884&f>

Two areas of policy proposal suggest themselves

1. Measures to curb *illegal* aids in the current crisis
2. Measures to credibly restrain the scope of what can be authorised by the Commission as legal aids

Realism suggests that while only 1 is likely to go far at present there is however scope for considering what should replace the temporary 2009 rules when the present rules expire.<sup>33</sup> For measures to curb *illegal* aids in the current crisis, an approach which suggests itself here which has already been addressed by the Commission<sup>34</sup> is a greater use of private enforcement of state aids rules. Essentially this process is available when an aid is paid without notification and prior approval – and this is needed OR when it has been deemed unlawful but not repaid.

At present a firm can go to a court to challenge a state aid

1. If it has been deemed incompatible by the Commission but not withdrawn, though we assume that this has to be in the national court where the aid is paid.
2. Or if the aid is alleged to be unlawful even though it has not yet been declared incompatible by the Commission. This can be because
  - a. It is a state aid that has not been notified even though it should have been
  - b. Aid has been notified but not yet approved

A national court can rule there has been an unlawful in effect unauthorised state aid but not whether it would have been declared compatible if reviewed. The Commission must review both whether something is an aid AND if so whether it is compatible with the rules. This process is longer. A national court can rule against an aid even if it has been notified but not yet approved.

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<sup>33</sup> “Communication from the Commission — Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis” 2009/C 83/01. THE FINANCIAL CRISIS, ITS IMPACT ON THE REAL ECONOMY AND THE NEED FOR TEMPORARY MEASURES.

<sup>34</sup> Commission notice on the enforcement of State aid law by national courts. (2009/C 85/01)

Also aggrieved competitor can go to national court if it thinks aid deemed incompatible by Commission has not been repaid. It may be able to demand compensation if it has suffered.

As we noted, in principle, state aids cannot be paid unless the aid has both been notified to, and approved by the Commission. However as we also note above there are certain classes of aid that do not have to be notified in advance, namely those that are pre-authorised under the a general block exemption or are part of a pre-notified scheme. Empirical studies have revealed that the use of private challenges has been very limited, apparently largely confined to competitors seeking equivalent support. But in many cases aid has been withdrawn rather than increased in coverage after successful challenge.

In a Commission sponsored 2006 study no cases were found where a complainant firm had gained such equivalent compensation. Commissioner Neelie Kroes argues that EC law itself is in fact clear but the 2006 Commission study found underutilisation is “*due to the diversity of Member States' procedural and substantive rules applicable to situations involving the grant of State aid and the uncertainties (cost risks, uncertain outcome) resulting from the absence of uniform procedures with a clear legal basis.*”<sup>35</sup>

Three ways in which private enforcement could be strengthened suggest themselves to us.

- expanding the scope for challenge
- clarifying the basic EU rules within the existing framework
- increasing harmonisation across Member States of access to courts in cases where private action is, in principle, possible.

The material we have discussed above suggests that the scope for challenges is somewhat limited. Where an aid must be approved it can be challenged merely for being introduced without approval. But most state aid is not scrutinised on an individual basis; therefore the opportunities to bring a case on the grounds that it has

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<sup>35</sup> <http://vlex.com/vid/recommendations-comparative-analysis-455381>

not been approved are fewer. The aggrieved competitor would have to be able to show that an aid was not covered by the exemption claimed.

The Commission has been extending the application of state aid rules in recent years into areas such as “Services of general economic Interest” for example local transport. There is extensive jurisprudence notably in the Altmark case (2003) where one bus company challenged the right of another to be given an exclusive contract to provide subsidised local buses.<sup>36</sup> And similarly in the MacBrayne case<sup>37</sup> where the Commission partially rejected UK contracts containing subsidies for local ferry services in Scotland. In some cases private action has also been important. The *Ambulanz Glockner*<sup>38</sup> case illustrates this. Essentially a private firm contested the right of a local authority to give an exclusive contract for local ambulance services, initially before the German Courts and then to the ECJ.

For present purposes the emerging jurisprudence shows a delicate balance between the ability to support public services even when contracted out and the need to avoid unnecessary state aids.<sup>39</sup> It may be that this area for private challenge in the realm of service provision needs to be thought through more thoroughly if it is not to cause backlash against the Single Market at a local level as the Viking and Laval cases show.<sup>40</sup> Expanding the ease of private challenges to state action may be extremely unpopular unless it is tied restricted to tying down the scope of possibilities. There may be a trade off between consolidating the firmness of the right to take private action and the need for political discretion.

The quotation from Neelie Kroes suggests that she believes the substantive rules are clear enough in the mind of the Commission. She implies but does not state that they

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<sup>36</sup> See <http://www.wilmerhale.com/files/Publication/4d8b76c7-422c-4e48-9075-d32f04f9c9f5/Presentation/PublicationAttachment/f2a30d3d-f1f1-4cb9-bb21-26cef59f7b21/EC%20Bulletin072903.pdf>

<sup>37</sup> [http://ec.europa.eu/competition/state\\_aid/legislation/faq\\_sieg\\_en.pdf](http://ec.europa.eu/competition/state_aid/legislation/faq_sieg_en.pdf)  
<sup>37</sup> [http://www.stateaidscotland.gov.uk/state\\_aid/SA\\_NewsLetter.jsp;jsessionid=CA223B1C27895116E00458D0A3F29A0B?pContentID=1458&p\\_applic=CCC&p\\_service=Content.show&](http://www.stateaidscotland.gov.uk/state_aid/SA_NewsLetter.jsp;jsessionid=CA223B1C27895116E00458D0A3F29A0B?pContentID=1458&p_applic=CCC&p_service=Content.show&)

<sup>38</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:61999J0475:EN:HTML#I1;>  
<http://curia.europa.eu/jurisp/cgi-bin/gettext.pl?lang=en&num=79989482C19990475&doc=T&ouvert=T&seance=CONCL>

<sup>39</sup> [http://ec.europa.eu/competition/state\\_aid/legislation/faq\\_sieg\\_en.pdf](http://ec.europa.eu/competition/state_aid/legislation/faq_sieg_en.pdf)

<sup>40</sup> Cases C-438/05 and C-3341/05. See <http://www.eurofound.europa.eu/areas/industrialrelations/dictionary/definitions/VIKINGCASE.htm>

are also broad enough. The most appropriate avenue for action would therefore seem to be to clarify processes and procedures for action in national courts in those cases where a challenge is possible. This would seem most likely to be when a MS is unfairly taking advantage of the rules to bypass scrutiny. We might also want to consider ways in which the reaction to the German Opel decision could have been different if there had been a direct opportunity for affected parties other than Member States to provide input to the Commission, or press them to act or to ask for a stay on actions by Member States through the courts.

In the medium term it is clear that there is a need to re-think the Temporary Framework which expires in Dec 2010. Should this be part of the Monti rebalancing exercise? The idea of “Industrial Policy” or an expansion of the globalisation fund is being considered. Is there a need for a Community level instrument for restructuring and intervention along the lines of the Treaty of Paris (1951) which established extensive social rules for the Coal & Steel Community? It would however be, to put it mildly, very challenging to imagine a scheme which overcame all the pitfalls.

Could one see for example an EU level industrial policy fund to deal with cases like Opel precisely so that in the event of a need for capacity reduction this did not automatically fall on those MS least willing or able to offer state aid?<sup>41</sup> It is worth noting that the main objection of the Commission to the Magna deal seems to have been that it was not open to other bidders. What would have happened if the German government had said from the outset that anyone could have the same aid so long as they complied with the same conditions as agreed by Magna/Sberbank?

The crisis has revealed that the existing framework is well designed to assist in a situation where all governments are eager to accept a brake on their ability to give in to lobbying. However, when the pressure becomes too great or Member States are convinced that the circumstances justify direct intervention, the Commission is under extreme pressure to approve whatever emergency measures the Member States feel forced to implement. Now, any rule based system will crack especially in the truly exceptional circumstance we saw in 2008/2009. However the EU system is not

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<sup>41</sup> <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/09/460>

designed to admit political discretion being exercised by the Commission and that makes it potentially more brittle in such exceptional circumstances.

One can only return for now to the starting imperative that the better designed macro-stimuli are, the less will be pressure for sectoral aid and the lower the cost per job created or preserved.

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