

# State Aid and public services in Europe – the limitations of the EC package<sup>1</sup>

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## 1. Introduction

This critique of the EC package of proposals on state aid and the implications for public services consists of three main sections.

- a presentation of the historical and legal context, and their impact on the expansion of private sector activity in the market for public services
- a critical analysis of the proposals themselves
- a final section contrasting the route of encouraging competitive tendering with the possibility of exempting public services operating in the general interest

## 2. History and development

### 2.1. Level competition in international trade

The rationale for Article 87 concerning state aid was to prohibit state subsidies that would give the company(ies) of a particular country an unfair advantage in the common market of the EU against companies from other member states without such a subsidy. Thus state aid is aid which ‘distorts competition by favouring certain undertakings’, and is said to be incompatible ‘as far as it affects trade between member states’ (Art 87.1)

For example, if Belgium subsidised a local car factory, that would give the factory a competitive advantage in selling its cars, anywhere in Europe, against non-subsidised factories in Netherlands or Ireland. Because the issue related to a member state trying to gain an unfair advantage for its national companies against the companies of other countries, it was also rational to assign special authority to the supra-national body, the European Commission, to resolve disputes over when aid could be permitted because of public policy and public interest – for example economic development, cohesion, and employment.

While the boundaries between the commercial and public sectors remained clear, the state aid provisions could be seen as regulating a specific area of public policy – industrial policy – rather than affecting public services in general across the board.

### 2.2. Development in relation to public services

During the 1980s and 1990s there were two key developments which changed the impact of these provisions. These were the growing importance of private companies in the state aid processes; and the growth of policies favouring privatisation or at least corporatisation of some public services which had previously been carried out in-house.

The state aid rules give the EC itself considerable power, and private companies came to realise the possibilities for improving their own position by encouraging further use of these powers. Whereas in the 1980s, the majority of responses and comments on Commission proposals and decisions came from member states, by the mid-1990s private companies were making four times as many responses as the member states, invariably arguing that the state aid distorted competition and should be disallowed, and the arguments used by the companies were often reflected in the final decisions of the Commission.<sup>2</sup> The state aid regime was described by one observer as “*no longer controlled exclusively or principally in the interests being operated less in the interest of other member states, but also, and perhaps even more so, in the interest of the competitors of the intended beneficiaries of the aid*”.<sup>3</sup> The companies thus began to exercise more influence over the direction of EC policy, with public services being seen as an increasingly interesting area.<sup>4</sup>

Privatisation policies were also developed in the 1980s and 1990s, which encouraged the view that public services was a market that could be opened up much more for private business. Since public expenditure is invariably involved in public services, the state aid rules provided a mechanism of very general application for opening up these markets. This was further reinforced by the growth of corporatisation, creating arms

length public sector companies to replace previous in-house or special entities, which was itself partly stimulated by a wish to comply with constraints on general government borrowing, including the EU's own convergence criteria for monetary union. These corporatised entities could be identified as organisations separate from the public authorities which owned them, and thus in receipt of finance – or aid – from the public authority itself.

The combination of these factors enabled state aid rules to become a tool for private companies to use to obtain more business in public services. A good example of this is the role of these rules in a series of actions by private companies in relation to municipal operators in the water sector in Italy in 1997 and 1998.

In 1990, the Italian government passed a new law encouraging municipal companies with the special status of “aziende municipalizzate” into joint stock companies (SpA): the law provided for income tax concessions and soft loans as incentives to do this. Following a new law on water in Italy in 1994 (the “legge Galli”), the water sector in Italy started to be restructured, with the possibility of continued municipal operations or privatization. In 1997 an Italian association of private water distributors lodged a complaint with the EC under state aid provisions of the treaty, against the incentives provided under the 1990 law: although the relevant sectors were not open to competition at the time, the EC ruled that this was unfair state aid.<sup>5</sup> In 1997 and 1998 private water companies brought other court cases in Italy: one (successful) case claiming that municipalities could not choose as partners companies owned by other municipalities, without offering the partnership contract for competitive tendering<sup>6</sup>; another (unsuccessful) case argued that municipally-owned companies (SpAs) should not be allowed to operate outside the territory of the municipality which owns them<sup>7</sup>. And in 1997 private companies successfully blocked a take-over bid from AMGA, Genoa's municipal utility, for a privately-owned water company operating in the Genoa area, Acquedotto De Ferrari Galleria<sup>8</sup>.

Thus the use of the state aid laws can be seen as part of a wider corporate strategy to improve the market position of private companies vis-à-vis municipal companies. Moreover, the contest is not between companies from different countries – the private companies involved in the above cases came from both inside Italy and outside – but between the private and public sector.

### 2.3. Impact on public services and public finance

Such cases can seriously constrain the capacity of member states to decide for themselves how best to structure the public sector in order to achieve public policy objectives. If a public authority chooses to provide a service through a municipal or state company, then any finance provided by the state to those companies can be claimed to be state aid, with the onus of proof effectively residing on the public authority to justify the finance provided.<sup>9</sup> The powers given to the Commission create further problems of uncertainty about whether any given example of state aid will be ruled inadmissible.

The impact is so wide because in principle, the financing of any public service can be challenged under the rules. A UK government minister for example has expressed concern over the impact on health services, and also supported giving unconditional priority to the needs of the service: “The position of many health and education facilities similarly remains unclear and needs to be clarified. If it proves impossible, for example, to maintain the line (which we support) that publicly funded hospitals and other deliverers of health services are not caught by the State aid rules at all, the Commission should block exempt public funding for health services provided to meet a public need.”<sup>10</sup>

The EU's rules on state aid have even affected the public services policies of neighbouring countries which are not member states, by incorporation into trade agreements. One example is the agreement on the European Economic Area (EEA) which extends the EU Single Market to countries of the European Free Trade Association (EFTA) and incorporates the wording of the EU article 87 on state aid (EEA article 61).<sup>11</sup> In 1999 Norway's system of regional variations in social security contributions was declared unlawful, because it was ruled that this system conferred direct competitive advantages on undertakings in the favoured regions compared to undertakings located elsewhere.<sup>12</sup>

## 2.4. The criteria

The application of the state aid rules should have been restricted by the various criteria implied in articles 86 and 87. The services under 86 are described as services of general *economic* interest, and so it may be expected that other ‘non-economic’ services are not covered – depending on the interpretation of ‘economic’. The application of article 87 is limited by ‘insofar as it affects trade between member states’, and so one might expect that financing of local public services, for example, would always be exempt. However, these limitations have not in practice had any significant effect in limiting the application of the state aid rules.

### 2.4.1. Economic activity and state subsidies in public services

The criterion developed by the ECJ to decide if a service is ‘economic’ is very broad: any activity is economic if it involves offering some service or product in return for some remuneration. This captures a very large percentage of public services, since public services are increasingly organised through contracts where there is some kind of charge to users – for example prescription charges or university fees – or where one public authority provides a service to another public authority, for which it is paid. If there any such contracts or charges in a service, then it is likely that the courts will interpret it as an economic activity.

Apart from charges, the other way of financing public services is through public finance mechanisms - raising money through taxes and distributing it to public authorities, without a contract requiring a specific service in return. The ECJ has ruled that it is an essential characteristic of public bodies that they should receive this kind of public finance: otherwise, “if there is a specific consideration for the state to finance an entity, such as a contractual nexus, the Court of Justice suggested that the dependency ties are not sufficiently close .... Such a relationship is analogous to the dependency that exists in normal commercial relations formed by reciprocal contracts... The existence of a contract between the parties, apart from the specific considerations for funding, indicates strongly supply substitutability, in the sense that the entity receiving the funding faces competition in the relevant markets”<sup>13</sup>. In the same case, the ECJ also noted that public finance is very similar to subsidies<sup>14</sup> – and thus to the concept of state aid.

This conceptual framework creates an impossible position for public services which are financed through mixed mechanisms – as is increasingly the case. If there is any public finance provided to a publicly owned undertaking, then that is equivalent to state aid; but if the service involves any charges, or any contracts with that undertaking, then it is a service of economic interest, and in principle relevant to trade between states. This was noted by CEMR in their comments on the original 2004 proposals: “it seems to CEMR that the European Commission acts on two assumptions: Public financial contribution for services of general economic interest, even for services delivered by public utilities, generally constitutes state aid; [and] Public authorities often or in general over-compensate SGEIs.”<sup>15</sup>

### 2.4.2. Interference with international trade

This issue is important to the treaty provisions: 87-1 says state aid is only incompatible “insofar as it affects trade between Member States”, and 86-2 limits the exemption for state aid for SGEI by saying that “the development of trade must not be affected to such an extent as would be contrary to the interests of the Community.”

The ECJ however has made it trivially easy to meet this requirement, so that any service involving charges is deemed to affect trade between member states. A good illustration of this is the Altmark case itself<sup>16</sup>, which concerned a bus service in the Stendal region of Germany, a service which seems of only local interest, not subject to compulsory liberalisation under EC law, and thus, one might think, it is for the people of the region to decide whether they wish to open the service to private competition. But according to the Altmark judgment, neither size nor local autonomy prevent it from affecting international trade: however small and local the service is “there is no threshold or percentage below which it may be considered that trade between Member States is not affected” (Altmark, para 81).

As for evidence of any actual effect, the court was content to use the theoretical argument that if the bus company was given state aid “the supply of transport services by that undertaking may for that reason be maintained or increased with the result that undertakings established in other Member States have less

chance of providing their transport services in the market in that Member State” (Altmark, para 77). It then claimed that this is “not merely hypothetical” on the grounds that some transport services in some countries are liberalised - “as appears in particular from the observations of the Commission, several Member States have since 1995 started to open certain transport markets to competition from undertakings established in other Member States, so that a number of undertakings are already offering their urban, suburban or regional transport services in Member States other than their State of origin.” (Altmark, para 79). This seems to mean that aid for any undertaking whatsoever can affect international trade because in theory it might help the undertaking do other things which in theory firms from other countries might want to compete for.

The European Commission, by contrast, has been prepared to adopt a more realistic approach, accepting that size does matter, and so has introduced a “de minimis” rule which effectively excludes aid below a certain amount from the application of articles 87 and 88 (this also has the advantage of reducing administrative burdens on the Commission). And the Commission has been prepared to accept that funding can be protected so that it does not distort competition: in June 2005 it approved state aid by France to invest in a new international TV channel. It decided that the project was SGEI, and that the investment was indeed state aid, but that it was not distortive because “the project offered sufficient guarantees against the risk of distortion of competition, for example by preventing unjustified transfers of public funds to France Television and TF1, who will be shareholders in the future channel.”<sup>17</sup>

## 2.5. Unequal playing field: private loss leaders and cross-subsidies

The state aid rules, and the transparency requirements, are intended to prevent a public sector body from being able to submit tenders which are subsidized by public money, and so have an unfair advantage, unrelated to its merits as a contractor, over other competing private organizations.

However, there is no corresponding provision to prevent the use of cross-subsidies by private sector groups. ‘Loss leaders’ are examples of bids benefiting from such cross-subsidies, where the private group uses profits, taken from other contracts or other parts of the group, to part-finance the costs that would be incurred by the contract. Such bids are a common technique for gaining market share in some sectors, including services such as waste management, where there are frequently choices between public and private provision. This was done by all major refuse collection contractors entering the UK market under the Thatcher compulsory tendering regime in 1989 (and, in the other direction, by Vivendi in 2000, when it loaded all the debts of its acquisitions in telecoms and media onto its existing concessions in water, waste and other public services).

Yet the twin rationales for state aid rules – to avoid distorting competition, and to promote greater efficiency in public expenditure decisions – both apply just as strongly against loss leaders by the private sector. Equivalent provisions could require publication by companies of separate accounts for all contracts obtained as a result of public tenders, which would also improve public accountability, or enable public authorities to examine company books.

## 2.6. Encouraging state aid for PPPs

One current problem of state aid which is not addressed by the current package is the problem of state guarantees providing financial comfort to private companies involved in public-private partnerships (PPPs), such as the projects under the UK’s private finance initiative (PFI). The EC’s silence on this issue is surprising, as it is a growing area of public finance in relation to commercial companies with obvious risks of distorting competition and the provision of public services. The EC’s silence is also in contrast to the concerns expressed by the International Monetary Fund (IMF), which has warned that government guarantees for PPPs are an extra burden on public finance and may often involve ‘over-compensation’ : “...resort to guarantees to secure private financing can expose the government to hidden and often higher costs than traditional public financing... it is also possible that the government overprices risk and overcompensates the private sector for taking it on, which would raise the cost of PPPs relative to direct public investment”<sup>1</sup>.

<sup>1</sup> International Monetary Fund Public-Private Partnerships March 12, 2004 p.14  
<http://www.imf.org/external/np/fad/2004/pifp/eng/031204.htm>

The EC is certainly aware of this problem and the relevance of the state aid provisions. In 2004 the EC ruled that Poland's proposed compensation to private electricity generating companies for abolishing over-expensive power purchase agreements (PPAs) was illegal state aid.<sup>18</sup> According to the EC the compensation was unjustifiable because the PPAs themselves were unacceptable forms of state aid, providing long-term government guarantees - for 20 years or more - above and beyond any reasonable market arrangement. The electricity companies thus gained a significant commercial advantage from these PPAs: "evidenced by the fact that they could borrow as much as €5 billion from financial institutions. This tends to indicate that these institutions considered that, although the PPAs could not be qualified as guarantees in a legal meaning, they constituted securities from the economic point of view, as the operators had the certainty granted by the State to recover a fixed amount of money during a very long term."<sup>19</sup>

The silence may be explained by the EC's desire to encourage PPPs. This has been clear for a number of years: Commissioner Bolkestein, in a speech on PPPs<sup>20</sup> in November 2002, in which he stated that EU legislation needed to be reviewed to facilitate the greater role of the private sector in public services. A paper on PPPs produced, by DG Regio in 2003, relating to PPPs in the accession countries in water and transport, sought simply to set out ways in which public finance – especially from the EC's own funds – could be used in PPPs.<sup>21</sup> In 2004 a conference was organised in Frankfurt to discuss the role of government grants as a source of finance for PPPs, where the development banks, businesses and EC representatives shared a common objective of trying to ensure that some of the expected €22billion available to new member states between 2005 and 2007 would be available to PPPs.

### 3. The EC package

The package of proposals includes three elements:

- the State Aid Action Plan: Less and better targeted state aid: a roadmap for state aid reform 2005-2009
- Draft Commission Decision on the application of Article 86(2) of the Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest
- Community Framework for State Aid in the Form of Public Service Compensation

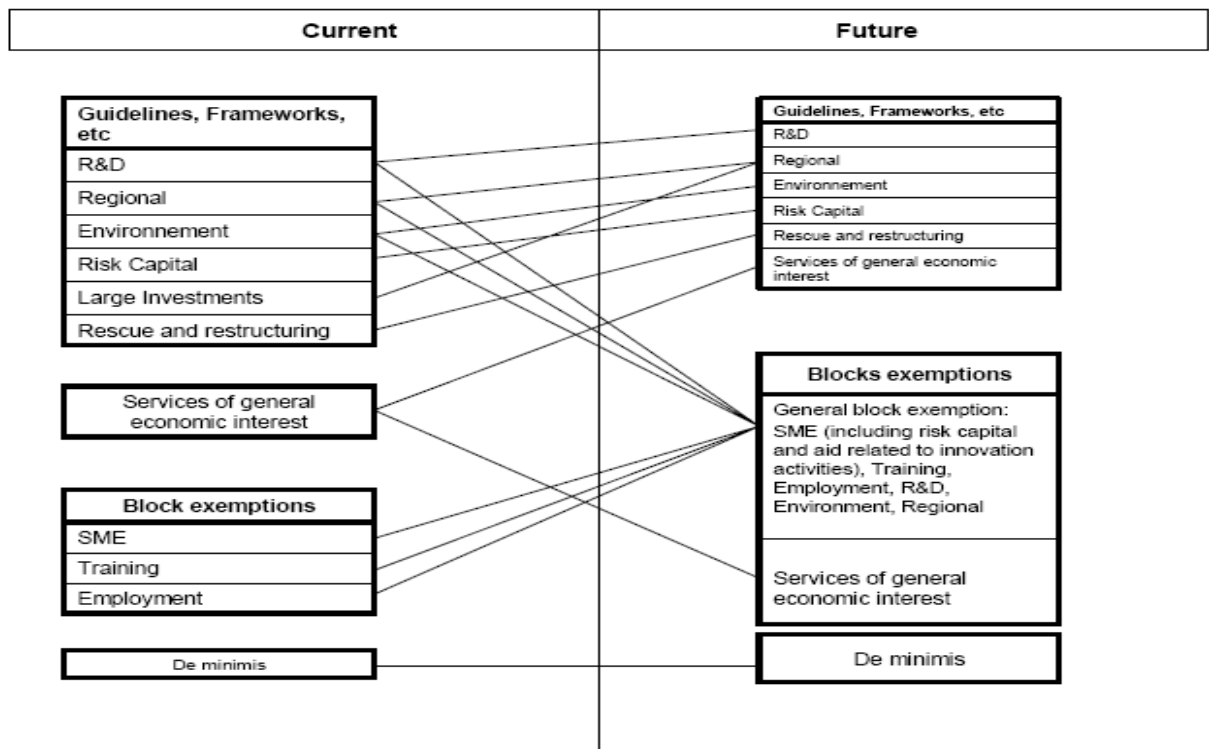
All documents are available at [http://europa.eu.int/comm/competition/state\\_aid/others/action\\_plan/](http://europa.eu.int/comm/competition/state_aid/others/action_plan/)

The decision effectively sets out the conditions under which state aid for SGEI is automatically acceptable, and does not have to be pre-notified, and is not subject to the conditions laid down in the Altmark judgment. All other state aid for SGEI is deemed to be state aid and has to be pre-notified unless it satisfies the Altmark criteria as interpreted by the EC in the framework.

#### 3.1. Action plan

The structure of the Action Plan provides a move away from ad hoc decision-making by the EC towards creating a system of rules which are better known and more consistent. The impact on services of general economic interest (SGEI) is now covered under two broad headings: guidelines and framework, and specific exemptions (see diagram). The framework category is shared with major policy areas such as research and development, regional policy, and environment: the block exemptions category also includes aid for small and medium enterprises, training and employment. This is a helpful development because it enables discussion of the general principles which make SGEI special, and also allows for services which would be damaged by application of the state aid rules to be protected by specific measures.

**Figure 2: EXPECTED MAJOR CHANGES TO THE ARCHITECTURE**



However, the framework presents some key principles which remain problematic for the financing of public services. These principles include: an overall aim to reduce state aid; a general commitment to preferring market mechanisms to public finance; and the proposed use of ‘market failure’ as a core criterion for deciding if state aid is justified. While the document as a whole is clearly focussed on the context of industrial policy, the principles nevertheless have wider implications for public service financing.

The first of these is apparent in the title of the framework – “less and better targeted state aid”, which announces a general commitment to reducing the use of public finance subsidies. The paper justifies this by reference to the European Council decisions: “The European Council of March 2005 has called on Member States to continue working towards a reduction in the general level of State aid, while making allowance for any market failures.” (para 14), but this cannot be allowed to imply a general objective for reducing public finance for public services.

The second problematic principle is the use the concept of market failures in assessing whether state aid is justified and the best solution available: “One key element is the analysis of market failures, such as externalities, imperfect information or coordination problems, which may be reasons why the markets do not achieve desired objectives of common interest, in particular if they are of an economic nature. In those cases, identifying the market failure at stake will help evaluate better whether state aid could be justified and acceptable, would represent the most appropriate solution, and how it should be implemented to achieve the desired objective without distorting competition and trade to an extent contrary to the common interest.” (para 23).

However, it is extremely contentious to identify market failures as the only legitimate grounds for the use of public finance – a large literature, and a large body of political argument, indicates that this is not accepted as a general limitation on the justifications for public spending on a service.

The third problem arises with the assumption that public finance is always an inferior solution. The framework states this quite explicitly: “Before resorting to State aid, which is in general only the second best option to achieve optimal allocation of resources, it should be verified whether other less distortive measures

could remedy the market failure.” (para 23). Once again, in the area of public services, this position is highly contentious, both analytically and politically: in areas such as health services for example there is overwhelming evidence that systems based on public finance are both more efficient and effective than systems based on markets. Indeed, the EC itself is clearly aware of the range of arguments on this issue: the green paper on services of general interest included an interesting section discussing the principles of public financing, including solidarity: *“Other relevant criteria for selecting a financing mechanism, such as its efficiency or its redistributive effects, are currently not taken into account in Community legislation. Neither have the effects of the selected mechanism on the long-term investment of providers of services and infrastructure and on security of supply been specifically considered....”*<sup>22</sup>

### 3.2. The decision

The decision sets out proposed criteria for exemption from the state aid rules. These fall into two categories: ‘de minimis’ conditions, and specific sectoral rules, which provide specific exemption for support for hospitals, social housing, and some air and sea transport subsidies.

The de minimis proposals (paras 14 and 15) are justified on the grounds that small-scale services do not affect inter-state trade. The limits are set low, however: annual turnover of €100million, or aid of €30million, and would still mean that many local public services would be subject to justification under the Altmark criteria.

The specific exemptions are made for “Hospitals and undertakings in charge of social housing... if the services performed are qualified as services of general economic interest by the Member States.” (para 16). There is no clear justification for why this list is so limited: it could be extended much more widely to many more public services. Indeed, its own internal criterion implies a much wider and simpler principle, which would simply exempt all services which “are qualified as services of general economic interest by the Member States”.

Moreover, the exemptions are made conditional on a list of requirements which themselves echo the Altmark criteria, requiring specification of the nature and the duration of the public service obligations, the undertakings and territory concerned; the nature of any exclusive or special rights assigned to the undertaking; the parameters for calculating, controlling and reviewing the compensation; and the arrangements for avoiding and repaying any overcompensation (article 4). This imposes an administrative burden which seems especially inappropriate for services exempted under a de minimis rule, and the requirements are analogous to the specifications required for tendering under the procurement procedures, thus opening the possibility that the exemptions will apply automatically if the work is tendered, but only subject to administrative efforts if it is not tendered.

### 3.3. The framework

The framework document is of great interest, in the light of the continuing debate about the need for a framework directive on services of general interest. Such a framework could resolve the many problems involved in the interface between public services and the competition and market rules of the EU. However, the framework proposed by the EC has a much narrower function, and is in effect an extended application of the Altmark criteria.

There is a correct acknowledgement that “with the exception of the sectors where there are Community rules governing the matter, Member States have a wide margin of discretion regarding the nature of services that could be classified as being services of general economic interest.” (para 2.2) This could be built on to construct a framework based on the principle of subsidiarity that decisions by competent authorities which would be automatically valid, but the EC appears to be reluctant to allow such general powers and claims, somewhat contradictorily, a residual power for the Commission even in this area: “the Commission’s task is to ensure that these provisions are applied without manifest error as regards definition of SGEIs”. This power is not clear and could lead to considerable confusion.

The rest of the proposals consist of a broad endorsement of the Altmark principles. As noted below, these



requirements to specify the precise nature of the obligations, the parameters for calculating the compensation, and demonstration that the compensation is reasonable by reference to a 'typical' undertaking, are all requirements which would be met almost by default if a service is subject to open competitive tender, and requires an equivalent amount of administrative work if not tendered.

#### 4. Future possibilities: compulsory tendering or special status for public services

The proposals clearly recognize that some broad exemptions of scale of sector need to be made to protect public services, but equally continue with the perspective that competitive markets are best for SGEI also. Beyond an assessment of the practical effects of these proposals they can be seen as raising the possibility of two different ways forward.

One core thrust of the proposals, and the judgments and decisions which preceded them, is that all problems can be avoided if all service delivery is submitted to tender.

The alternative approach is to give stronger weight to the subsidiarity principle, and give precedence to the decisions on public services made by public authorities.

##### 4.1. Requiring tendering

The paradigm now being used is that of competitive tendering under the procurement directives. The Altmark judgment itself specified that the fourth criterion – demonstrating the reasonableness of the state subsidy – is automatically fulfilled if the service has been subjected to competitive tender; if not it has to demonstrate that it is as efficient as a 'well-run company', which is an uncertain requirement. The effect is that there is a very strong incentive for public authorities to submit every subsidized service to tender, because that is the simplest way of meeting the Altmark criterion. Otherwise, the EU institutions effectively impose substantial transaction costs on a public authority, to justify the level of aid by reference to some benchmarking criteria, which may be further subjected to scrutiny by the EC.

The Altmark decision makes competitive tendering even more attractive because the procurement process effectively ensures that the first two criteria are met as well: the definition of the public service obligation (condition 1) has to be made as part of a contract specification; the advance specification of the calculation of subsidy have to be specified (condition 2) in order to obtain comparable tenders. Altmark's third condition, concerning proportionality of the aid, may also be most simply demonstrated through competitive tendering, arguing that the competitive process will always effectively discount any excess and return it to the public authority or to users of the service through lower charges.

The Altmark conditions is part of a long line of EC proposals to make competitive tendering more normal and increase the practical pressures on public authorities to tender services by default as a way of gaining validity. In its Laeken report on services of general interest, the EC suggested that aid would be deemed compatible if "*a service of general economic interest was attributed as a result of a fair, transparent and non-discriminatory procedure...provided that the procedure was effectively competitive*" and that a criterion for compatibility "*could be the provision of a service of general economic interest attributed in a fair, transparent, non-discriminatory and competitive tendering procedure.*"<sup>23</sup> This not only conforms with the ideological norms of current policies, but is also, as suggested by one commentator, an extremely convenient way of relieving the Commission of investigative work.<sup>24</sup>

Further pressure for tendering has come since, from a number of sources. In the 2004 green paper on PPPs, the Commission gratuitously claimed (para 63) that work has to be submitted to compulsory tendering before it can be assigned to arms-length public entities, asserting that: "*Only entities that fulfil these two conditions at the same time [subject to the same kind of control as an in-house entity, and carrying out the essential part of its work for the authority] may be treated as equivalent to "in-house" entities in relation to the contracting body and have tasks entrusted to them without a competitive procedure.*"

The ECJ also uses competitive tendering as a key indicator of whether SGEI can claim exemption under 86-2. According to a 2005 judgment concerning the Swedish pharmacy system, state aid for SGEI “cannot be justified under Article 86(2) EC in the absence of a selection system that excludes any discrimination against medicinal preparations from other Member States”, and so ruled against a purchasing system because it “makes no provision for a purchasing plan or for a system of ‘calls for tenders’ within the framework of which producers whose products are not selected would be entitled to be apprised of the reasons for the selection decision.”<sup>25</sup>

The report on state aid prepared by the rapporteur to the European Parliament also proposed that competitive tendering become the only criterion for exemption from the state aid rules. This was strongly opposed by organisations representing municipalities, cities, public service operators and public service unions; CEMR stated that: “By calling for compulsory tendering to be the exclusive criterion in order to be exempt from the state aid regime, the Parliament makes the European Commission’s proposal totally meaningless since this proposal only aims to cover cases where no tender has taken place”<sup>26</sup>, and EuroCities, CEEP and EPSU warned that the proposal “exceeds the provisions of Community law and goes against the principle of local self-government”<sup>27</sup>. This opposition was successful, in that the proposal was not in fact adopted by the Commission. The current proposals may nevertheless create a similar powerful pressure in the same direction, because tendering is such an attractive alternative to becoming embroiled in a state aid case.

The pressures for greater tendering have been characterised as part of a general ideological shift in the structure of the state in relation to public services: “Traditionally, the function of the state as a public service provider has been linked with ownership of the relevant assets. The integral characteristics of privately financed projects reveal the degree that the state and its organs are prepared to drift..... towards contractualised governance”<sup>28</sup>. One problem with this process is that private companies may end up with substantial powers in services of general interest, and then escape the regulation that is imposed on public authorities. In such cases, the ECJ has begun to rule that even private companies should be treated as public authorities for the purpose of the procurement rules, for example, because the functions they were carrying out were functions of general interest specified by the state.<sup>29</sup> In developing these arguments, the ECJ is at least recognising that the objectives and functions of public services make a difference to the legal rules which should be applied.

#### 4.2. Public interest objectives and choices

The EC claims that it is treating public and private sectors equally by ensuring that each can compete on equal terms for the same contracts. This ignores however a fundamental difference between public authorities and private companies, recognized by EC law in the procurement directives, in which *a 'body governed by public law' means any body: (a) established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character.*<sup>30</sup> Such public bodies may secondarily operate commercially, looking for business in competition with private companies, but remain defined by their primary objective of meeting needs in the general interest.

Equality of treatment should therefore properly mean equality of status for these public interest objectives, so that public authorities are free to decide the best way of achieving those objectives, including the higher level choice of whether to use contract or control procedures. One way of establishing this point is to seek to establish a distinction between, on the one hand, services of general interest (SGI) which are not economic, but are designed to meet the ‘general interest’ objectives of public bodies; and, on the other hand, services of general *economic* interest (SGEI) as defined in the EU treaty. This involves maintaining a difficult dividing line, as noted in a research paper for the European parliament in 2005: “*Any given activity may be carried out either as a private service or as a public service e.g. teaching, surgery; and public services may be delivered through a range of different modalities, including both commercial and noncommercial operations; so neither the activity nor the modality is capable of being used alone to define the scope of SGI in the EU.*”<sup>31</sup>

In view of these problems, the core concept of the public or general interest could be reinstated at the centre of the issue, so that the rules for avoiding competition being distorted by state aid should be restricted to sectors outside those which have been decided to be of such public importance as to require public services,

and so: *“The starting point should be the concept of the general interest as defined collectively (politically) through democratic processes by public authorities in the Member States.”* <sup>32</sup>

#### 4.3. General exemption for public policy objectives?

The simplest approach would thus be to provide a general exemption for state aid which is provided as part of any public service in pursuit of public policy.

This is the clear view expressed in a number of responses to the consultation on the EC white paper on services of general interest.<sup>33</sup> The Association Of The Provinces Of The Netherlands proposed that: *“a block exemption for regional and local services will be helpful here. In view of their regional and local character, these services are not, or hardly ever, distorting trade between Member States.”* ; the UK’s Local Government International Bureau argued that: *“reasonable financial assistance for genuine social purposes, whether delivered by an SGEI or an SGI, is acceptable, and needs to be excluded from the state aids regime.....”* and proposed as a new rule that *“the provisions of the constitution in relation to competition and state aids shall not apply to the provisions of SGIs and SGEIs save to the extent necessary to combat breaches of the principles of proper operation and delivery of such services.”* .

In fact, the EU has already agreed to the application of such a broad provision, in the context of its trade agreement with South Africa. That agreement incorporates a restriction on state aid, in order to ensure a level playing field in commercial trade, in terms which are very close to the wording of article 87 but with a crucial further addition:

*“Insofar as it may affect trade between the [European] Community and South Africa, public aid favouring certain firms or the production of certain goods, which distorts or threatens to distort competition, **and which does not support a specific public policy objective or objectives of either party**, is incompatible with the proper functioning of this agreement”*[emphasis added]<sup>34</sup>.

This creates a very simple and general criterion which protects public expenditure in pursuit of public policy objectives from being treated as state aid – whether or not it distorts competition. <sup>35</sup>

**Annexe 1. Treaty text****• Article 86 (ex Article 90)**

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.

2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.

3. The Commission shall ensure the application of the provisions of this Article and shall, where necessary, address appropriate directives or decisions to Member States.

**• Article 87 (ex Article 92)**

1. Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade between Member States, be incompatible with the common market.

2. The following shall be compatible with the common market:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, insofar as such aid is required in order to compensate for the economic disadvantages caused by that division.

3. The following may be considered to be compatible with the common market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;

(e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

**• Article 88 (ex Article 93)**

1. The Commission shall, in cooperation with Member States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the common market.

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2. If, after giving notice to the parties concerned to submit their comments, the Commission

finds that aid granted by a State or through State resources is not compatible with the common market having regard to Article 87, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission.

If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 226 and 227, refer the matter to the Court of Justice direct.

On application by a Member State, the Council may, acting unanimously, decide that aid which that State is granting or intends to grant shall be considered to be compatible with the common market, in derogation from the provisions of Article 87 or from the regulations provided for in Article 89, if such a decision is justified by exceptional circumstances. If, as regards the aid in question, the Commission has already initiated the procedure provided for in the first subparagraph of this paragraph, the fact that the State concerned has made its application to the Council shall have the effect of suspending that procedure until the Council has made its attitude known.

If, however, the Council has not made its attitude known within three months of the said application being made, the Commission shall give its decision on the case.

3.Ú The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.

Article 89 (ex Article 94)

The Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 87 and 88 and may in particular determine the conditions in which Article 88(3) shall apply and the categories of aid exempted from this procedure.

- **Article 73 (ex Article 77)**

Aids shall be compatible with this Treaty if they meet the needs of coordination of transport or if they represent reimbursement for the discharge of certain obligations inherent in the concept of a public service.

## 5. Notes

- <sup>1</sup> This report was commissioned by the European Federation of Public Service Unions (EPSU) [www.epsu.org](http://www.epsu.org). The report reflects the views and analysis of the author.
- <sup>2</sup> Mitchell P. Smith “Autonomy by the Rules: the [European Commission and the development of state aid policy]” *Journal of Common Market Studies* Vol 36 No. 1 March 1998
- <sup>3</sup> Ehlermann C. “State Aid control in the European union – success or failure?” *Fordham International Law Journal* pp 1212-1229; quoted in Mitchell P. Smith *Journal of Common Market Studies* Vol 36 No. 1 March 1998
- <sup>4</sup> Mitchell P. Smith “Autonomy by the Rules: the [European Commission and the development of state aid policy]” *Journal of Common Market Studies* Vol 36 No. 1 March 1998
- <sup>5</sup> State Aid: Italy Told To Recover Aid Granted To Public Companies. *Europe Energy* 605 - June 14, 2002
- <sup>6</sup> *Il Sole 24 Ore*, 3 March 1998. The Italian State Council ruled in favour of the private companies in February 1998 (decision 192/98)
- <sup>7</sup> This case was rejected by the regional administrative tribunal (TAR, *Tribunale Amministrativo Regionale*) of Abruzzo in July 1998.
- <sup>8</sup> *Il Sole 24 Ore*, 29 April 1998.
- <sup>9</sup>
- <sup>10</sup> Butler speech DTI UK seminar 14/7/5
- <sup>11</sup> François-Xavier Camenen. 12 March 2002. State Aid in The European Economic Area. European Parliament, Directorate General For Research, Direction A, Division For Economic, Monetary And Budgetary Affairs
- <sup>12</sup> EFTA Court Judgement of 20 May 1999 in Case E-6/98, concerning an action for annulment brought by the Government of Norway against a decision of the Surveillance Authority (Decision 165/98. Quoted in Camenen 2002
- <sup>13</sup> Christopher H. Bovis. Financing Services of General Interest in the EU: How do Public Procurement and State Aids Interact to Demarcate between Market Forces and Protection? *European Law Journal*, Vol. 11, No. 1, January 2005, pp. 89
- <sup>14</sup> Case C-380/98, *The Queen and H.M. Treasury, ex parte University of Cambridge* [2000] ECR 8035. Quoted in : Christopher H. Bovis. Financing Services of General Interest in the EU: How do Public Procurement and State Aids Interact to Demarcate between Market Forces and Protection? *European Law Journal*, Vol. 11, No. 1, January 2005, pp. 89
- <sup>15</sup> Council Of European Municipalities And Regions. CEMR Position paper September 2004. Response to the Monti package on rules governing compensation for public service obligations
- <sup>16</sup> Case C-280/00, *Altmark Trans GmbH, Regierungspräsidium Magdeburg and Nahverkehrsgesellschaft Altmark GmbH* ECR I-7747 2003 <http://curia.eu.int/jurisp/cgi-bin/gettext.pl?lang=en&num=79969275C19000280&doc=T&ouvert=T&seance=ARRET&where=#Footnote1>
- <sup>17</sup> Agence France Presse June 7, 2005. EU gives greenlight to CNN a la francaise
- <sup>18</sup> The Polish Electricity Market: Investment Context. Joshua C. House. Stanford University, Program on Energy and Sustainable Development Working Paper #31 August 2004 <http://pesd.stanford.edu>
- <sup>19</sup> Monti challenges Poland’s €4bn PPA compensation scheme. *Power in Europe* Issue 419 / 16 February 2004 p.1
- <sup>20</sup> Speech by Commissioner Frits Bolkestein Member of the European Commission in charge of the Internal Market and Taxation, at the 3d annual Public-Private Partnership Global Summit Holland, Noordijk, 08 November 2002: “European Commission’s current policy on public-private partnerships and its future projects” [http://europa.eu.int/comm/internal\\_market/en/speeches/021108-bolkestein\\_en.htm](http://europa.eu.int/comm/internal_market/en/speeches/021108-bolkestein_en.htm)
- <sup>21</sup> European Commission, Directorate-General Regional Policy, “Guidelines for Successful Public – Private Partnerships”, March 2003, [http://europa.eu.int/comm/regional\\_policy/sources/docgener/guides/ppp/ppp\\_en.pdf](http://europa.eu.int/comm/regional_policy/sources/docgener/guides/ppp/ppp_en.pdf)
- <sup>22</sup> Green Paper On Services Of General Interest COM(2003) 270 Final Paras 91 and 92, annexe paras 62 and 63 [Europa.Eu.Int/Comm/Secretariat\\_General/Services\\_General\\_Interest/Docs/Com\\_2003\\_270\\_Fi\\_En.Pdf](http://europa.eu.int/Comm/Secretariat_General/Services_General_Interest/Docs/Com_2003_270_Fi_En.Pdf)
- <sup>23</sup> Brussels, 17.10.2001 COM(2001) 598 final REPORT TO THE LAEKEN EUROPEAN COUNCIL Services of General Interest paras 19, 29 [http://europa.eu.int/eur-lex/en/com/rpt/2001/com2001\\_0598en01.pdf](http://europa.eu.int/eur-lex/en/com/rpt/2001/com2001_0598en01.pdf)
- <sup>24</sup> Erika Szyszczak. Financing Services of General Economic Interest.. *Modern Law Review* (2004) 67(6) MLR 982-1011. <http://www.ingentaconnect.com/content/bpl/mlr/2004/00000067/00000006/art00006>. Footnote 45: “Presumably the Commission sees open tendering as a process of relieving the Commission of investigative work”.
- <sup>25</sup> ECJ C-438/02 Judgment 2005-05-31 Hanner Free movement of goods <http://curia.eu.int/jurisp/cgi-bin/form.pl?lang=en&Submit=Submit&docj=docj&numaff=&datefs=&datefe=&nomusuel=&domaine=&mots=%22general+economic+interest%22&resmax=100> paras 43, 49
- <sup>26</sup> State aid and public service compensation report : CEMR calls on Parliament to drop compulsory tendering, to double financial threshold and to exempt social services 17/02/2005 - [http://www.ccre.org/communiqués\\_de\\_presse\\_detail\\_en.htm?ID=76](http://www.ccre.org/communiqués_de_presse_detail_en.htm?ID=76)

<sup>27</sup> Appeal to Members of the European Parliament from cities, local SGEI providers and public services unions. Joint press release – Brussels 21 February 2005

[http://www.epsu.org/IMG/pdf/Joint\\_Press\\_Release\\_In\\_t\\_Veld\\_Report\\_EN.pdf](http://www.epsu.org/IMG/pdf/Joint_Press_Release_In_t_Veld_Report_EN.pdf)

<sup>28</sup> Christopher H. Bovis. Financing Services of General Interest in the EU: How do Public Procurement and State Aids Interact to Demarcate between Market Forces and Protection? *European Law Journal*, Vol. 11, No. 1, January 2005, pp. 79–109.

<sup>29</sup> See Cases C-353/96 *Commission v Ireland* and C-306/97 *Connemara Machine Turf Co Ltd v Coillte Teoranta*, [1998] ECR I-8565. See also Case C-323/96 *Commission v Kingdom of Belgium*, [1998] ECR I-5063. Quoted in Bovis (2005)

<sup>30</sup> Public Procurement Directive (2004/18/EC) Article 1 (9)

<sup>31</sup> Gabriel Obermann. Services of General Interest in the Internal Market. European Parliament Project No. IP/A/IMCO/ST/2004-12 February 2005.

<sup>32</sup> Gabriel Obermann. Services of General Interest in the Internal Market. European Parliament Project No. IP/A/IMCO/ST/2004-12 February 2005.

<sup>33</sup> ‘Key points from the report of the consultation on the EU Green Paper on Services of General Interest’ (EC May 2003)

<sup>34</sup> Agreement on Trade Development and Cooperation between the EC and its member states and the Republic of South Africa, OJ 1999, L311, Art. 41, quoted in Cremona 2003 p.285

<sup>35</sup> This clause may have been inserted because negotiators were made aware of the South African government’s policies of financial support for the development of enterprises involving black Africans, as a form of positive discrimination to reverse the effects of apartheid: such financial support would surely otherwise have been threatened by the unamended wording of the EU treaty.