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The refined economic approach in state aid law: a policy perspective

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Ladies and Gentlemen, dear friends and colleagues,

Thank you for your kind welcome. This third annual conference of the Global Competition Law Centre is tackling a most pertinent theme: the economic analysis of state aid. I'm delighted that you, and notably Massimo Merola and Jacques Derenne, have ventured into this field and have brought together such a fine audience today.

I can see from the programme that you have ambitious objectives. In fact, you will cover practically the entire spectrum of state aid analysis. I'd like to focus my own small contribution to this important debate on the reasons why we need economic analysis in state aid law, and how the Commission is going about it.

Competition drives competitiveness – but there are cases where markets fail

My starting point will come as no surprise to you! As we all know, it is competition, and not state intervention or public funding, that drives competitiveness. It is competition that gets companies to invest in knowledge and innovation and forces them to stay fit, efficient and effective. This is why state aid is in principle prohibited by our European treaties. Unless, of course, it is well targeted to genuine common interest objectives in areas where markets alone would fail to deliver.

I spend a lot of time repeating this simple message. But just look at all the neo-nationalist reflexes, neo-protectionist temptations and neo-interventionist rhetoric we are confronted with these days! It sometimes feels like this basic wisdom needs re-inventing, or at least re-iterating, every single day.

So first and foremost we need to trust in the market. Of course, the story does not end here – I'm enough of a politician to know that governments have an important role too. Not in picking what may – or may not – be winners. But instead in creating the right conditions for markets to deliver the growth and jobs we all need.

In fact, as the Aho report demonstrated, for example as regards lead-markets, much of what governments can and indeed should do, is not about throwing money at companies. Instead, they should look to smart regulation and standard-setting, including less regulation wherever possible. They should look to smart procurement and investment in general infrastructure or education. To smart measures which will go much further to create the right conditions for business to flourish than any amount of state aid ever can.

But economic reality is what it is – and it cannot be denied that markets sometimes fail. This is where state aid has its proper place in the wider policy agenda, as one of the tools - but by far not the most important - that governments have to stimulate competitiveness.

So, state aids policy is all about markets, actors on markets and State intervention in markets. This is why we need economic analysis in state aids – and this is our starting point for State aids reform.

The State Aid Action Plan: using refined economic analysis to reform State aid policy

Last year's State Aid Action Plan began the most ambitious review of state aid instruments and policy the EU has ever seen. The talk has been of "less and better aid" for quite too long – and with the Action Plan we aim to move from "talking the talk" to "walking the walk". One of our key messages is a new focus on a refined economic approach to improve our policy.

Not a revolution

I emphasise the word "refinement" becauses state aid policy has not suddenly discovered economics like some hitherto unknown parallel universe! Of course not! State aid is as intrinsically linked with economic reasoning as any other area of competition law. Economics has always underpinned our traditional analysis of whether or not a measure is state aid, and if it is compatible.

In the US, they say that economists keep the lawyers honest and vice versa. I see no tension between the legal and the economic approach. Our objective is always the same: take the right decision, as close as possible to reality, and with the best possible factual underpinning! The State Aid Action Plan did not need to 'revolutionise' the legal framework, nor upset existing jurisprudence. In fact, it only aims at making the Commission's practice more explicit – and yes, a bit more professional and a bit more up to date.

Introduce more and better economic tools

This is why the State Aid Action Plan announced that economic analysis should be refined, and that it should be used as a tool for reform. Just as was done in antitrust and mergers, we want now to develop and enhance the economic tools that we in the Commission use to analyse state aid cases.

And outside the Commission too, I'm delighted that state aid has now found its rightful place on the map of academic economists. Professor Roeller, who recently stepped down as our Chief Economist, told me that he considered this a major achievement of his tenure. I take this opportunity to thank him for all his excellent work with the Commission! Let me also welcome Professor Damien Neven as his successor. He and his team will have a crucial role to play in implementing our policy.

The ball is well and truly rolling now. A series of studies and articles have recently been published. More academic research is under way. Today's conference will generate further interest in State aid economics – and I have even been told you are planning to edit a book. Let's hope it becomes a best-seller! All this is very welcome, and it will help us to further refine the economic tools we need for our policy.

Better targeting

What then do we need 'refined economics' for? First and foremost, to support our wider policy objectives. The State Aid Action Plan argued that subsidies could be used pro-actively to support growth and jobs, by better targeting aid at the market failures to be corrected, through horizontal instruments like R&D and Innovation aid, Risk Capital aid, or targeted support for SMEs. A refined economic analysis can help in identifying real market failures and then in assessing the actual effects of a measure, both in terms of its positive impact, but also as concerns its negative effects on competition and trade.

Focus on important cases

Second, and as a consequence, a refined economic analysis can help us draw the line between a priori problematic cases and those which give less reason for concern. We should avoid unneeded bureaucracy by not requiring that insignificant cases, like local swimming pools or zoos, are notified. Economic analysis will therefore also guide us in drawing up the future General Block Exemption.

Implementing the refined economic approach

So that's our rationale for using refined economics in state aid. Stakeholder reactions have been enormously supportive, although there's also been a bit of the healthy scepticism we experienced when we made the same step in antitrust and mergers. But as they say, the proof of the pudding is in the eating. Let me therefore turn to how we are implementing our refined economic approach.

In the rules

Over the last year, the Commission has produced a number of documents which put more flesh on the bones of refined economics. Our Communication of September 2005 clarified what we call the 'balancing test' in the new area of State Aid to Innovation. The resulting rules have been enshrined in our draft Framework on Research, Development and Innovation, which has just been launched into second stakeholder consultation.

Along with the recently adopted Guidelines for State aid to Risk Capital for SMEs, this constitutes a package to increase economic efficiency in support of the Lisbon agenda. The texts demonstrate how analysis of market failures can be used to design better rules, by identifying state aid measures that can be considered a priori compatible, even in completely novel areas like innovation – thereby keeping state aid law abreast with economic progress and needs.

Both texts are clearly based on the refined economic approach:

- First, they implement the balancing test. They explain how the positive effects of risk capital measures or aid to research and innovation can be weighed against potential crowding-out or other negative effects on competition and trade;
- Second, they clearly spell out that it is market failures, like imperfect or asymmetric information, positive externalities or public goods which prevent the market from optimising the levels of risk capital or of research and innovation 'produced' by private companies;
- Third, they justify the conditions for compatibility. In so doing, they distinguish between a lighter and a more detailed assessment, depending on the risks of distortion of competition and trade. The rules clearly explain in which limited number of cases a detailed assessment will take place, and which criteria the Commission will use. Let me re-assure you here, if need be: this will not impose an excessive burden on Member States and companies! The information we intend to request is just what any self-respecting company will itself gather and analyse when deciding whether to invest a large amount of money in research or innovation.

All in all, the refined economic approach brings more clarity to our rules, better explains the Commission's reasoning, and thereby gives better guidance to stakeholders. We will use the same approach when reviewing other sets of rules under the State Aid Action Plan, and our next concrete target is state aid for Environmental Protection.

… and case by case

So we're adapting the rulebook. But what about our practice in individual cases? Well, here too the refined economic approach has become a standard feature. We have had extensive internal debate on how the balancing test should be used, whether it would change our practice and make it more lenient or more restrictive, whether we need more tools to do the job properly and so on. We have even revisited some of our old cases, to see whether they would be decided differently. And we have benefited from a number of recent studies, by the Commission's Group of European Policy Advisors, the UK's Office of Fair Trading, and others.

On this basis, my Directorate General has developed an internal methodology to support the work of case handlers. Internal training is helping embed the refined economic approach in the reality of daily practice. You can see the first results in our recent decisions - for example, in the area of broadband (be it Appingedam or the Irish Metropolitan Area Network), or digital television in Berlin-Brandenburg, or even training aid to large motor companies.

We are committed to applying a refined economic approach consistently and across the board. So when some Member States' call for state aid rules which reflect the so-called external aspects of competitiveness, my response is again based on economics rather than on politics.

I'm not willing to take it for granted that more state aid – matching aid, or 'globalization aid' - is the solution. When you actually look at the economic impact of state aid on investment decisions, you are forced to conclude that aid is at best the Number 5 or 6 criterion on any investor's list: business is much more interested in skilled labour, stable framework conditions, good infrastructure and efficient administration (no red tape!). State aid can never compensate for structural deficiencies – but perhaps it is sometimes easier for politicians to throw money at lame duck companies than to accept responsibility for addressing the real problems.

Ladies and Gentlemen,

A renewed focus on economics is driving the development of tools which are crucial to the success of state aid reform. The Commission has started to use these tools, and considerable work has already been done.

Of course, economic refinement is an on-going process. Our primary concern is therefore to constantly improve our practice. In that, we rely on stakeholders outside the Brussels ring-road to tell us what is going right, and where we can get better.

That is why it really has been my pleasure to be here to open today's conference. And that is why I would encourage you to continue the discussions long after today and to stay in touch with my Directorate General. Please help us deliver the modern, professional approach to State aid analysis which has such an important part to play in the delivery of economic growth and jobs in Europe.

Thank you for your attention!