The European Community and State aids to industry

European File

One of the fundamental principles of the European common market is free circulation of goods between Community Member States. This has many advantages both for consumers and industry but it requires that competition between firms is not upset by State aids to industry liberally granted by some member countries.

The current worsening economic recession encourages governments and, in some cases regional authorities, to increase subsidies to companies. By giving aids to the firms that are most threatened by the crisis and by structural change, governments hope to safeguard jobs and prevent a rise in unemployment. Seen from this viewpoint, national aids might appear justified. But the European Treaties forbid them: aids granted by member governments or from national resources to industry — whether public or private — are incompatible with the notion of a common market. The Treaties do allow for exceptions and a range of legal national aids has been defined over the past 25 years. But planned State aids, about which the European Commission has to be told in advance, are often fundamentally modified and sometimes simply rejected. Why?

One of the basic aims of the Community is to encourage harmonious economic development throughout the common market. State aids may threaten this objective.

☐ The European Commission has to ensure that the laws of competition are not abused. Firms must cope with the ups and downs of the market on their own. State aid can be harmful because it allows the beneficiary to offer more favourable prices and conditions than its competitors in other member countries both in its domestic market and at Community level, thereby putting its rivals at an unfair disadvantage.

Commission of the European Communities
Directorate-General for Information,
Rue de la Loi 200 - B-1049 Brussels

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- ☐ The resulting distortion of competition could encourage other Member States to take similar action to protect their industries from losing orders and suffering increased unemployment. This could, in turn, provoke a costly 'auction' of aids, whose effectiveness, in terms of helping the firms concerned, is doubtful.

- ☐ When it is not linked to a restructuring programme, State aid ties up factors of production in the least productive areas and slows down industrial modernization crucial for international competitivity. It also tends to be inflationary: State aid puts a burden on public spending and therefore increases taxes on other sectors of the economy; it can result in a transfer of resources without any return, even in the long term; it shields firms from the impact of increased production costs, which in turn contributes to delays in modernizing plant.

Distortion of competition, wastage of public funds, neutralizing each other's national aids, increasing inflation without any counterbalancing benefit to the Community from increased economic activity or higher growth rates: these are reasons enough to justify Community principles and strict controls on all the State subsidies that have emerged during the economic crisis.

Article 92 of the Treaty of Rome states clearly: '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, in so far as it affects trade between Member States, be incompatible with the common market.'

The Treaty goes on to distinguish:

- ☐ aids which are 'compatible with the common market': 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; aid to make good damage caused by natural disasters; aid granted to certain areas of Germany to compensate for the economic disadvantages caused by the division of the country.

- ☐ aids which 'may be considered compatible with the common market', either because they are specified by a qualified majority of the Council of Ministers, acting on a proposal from the Commission, or because they:

  - promote the economic development of areas where the standard of living is abnormally low or where there is serious under-employment;

  - promote the execution of an important project of common interest or remedy a serious disturbance in the economy of a Member State;

  - facilitate the development of certain economic activities or areas, where such aid does not adversely affect trading conditions to the extent where it is contrary to the common interest.

Article 93 requires Member States to notify the European Commission about proposed aids and existing subsidies. The Commission can either authorize the aid, ask for it to be modified or refuse to allow it. If the government concerned does not comply with the ruling, the Commission, or any other interested Member State, can go to the European Court of Justice. However, in the case of an application by a Member State, the Council of Ministers, acting unanimously, can break the rule and authorize aid if exceptional circumstances justify such a decision.

Over the years, Commission decisions and Court of Justice rulings have defined more and more precisely the conditions for evaluating State aids.

Commission action is primarily aimed at holding the common market together and ensuring that Member States plans and aid instruments respect the legitimate interests of their partners and contribute to harmonious economic growth throughout the Community.

During a recession, when competition alone is not always sufficient to bring about desired structural changes, clearly governments will resort increasingly to State aids. But the Commission will examine proposed subsidies very rigorously, in line with the Treaty of Rome. In a ruling delivered in 1980, the Court of Justice stressed that the Commission's power of approval could only be exercised where the aid envisaged contributes to the achievement of Community objectives and interests as laid down in the Treaty.

Commission decisions on State aids [1]

Year	Total	Of which		Aids forbidden
		uncontested aids [2]	aids examined	
1970	21	15	6	1
1971	18	11	7	3
1972	35	24	11	3
1973	22	15	7	4
1974	35	20	15	—
1975	45	29	16	2
1976	47	33	14	2
1977	112	99	13	1
1978	137	118	19	—
1979	133	79	54	3
1980	105	72	33	2
1981	141	79	62	14

[1] Excluding agriculture and fisheries.
[2] In most cases, after negotiation and modification of proposals originally submitted.

The Commission told the European Parliament in October 1981 that it always respects three basic principles when examining planned State aids:

- ☐ State aid must not lead to the transfer of industrial difficulties or unemployment from one Member State to another or several others;

- ☐ it must enable the beneficiary to achieve or to return to, economic viability, so that, within a certain timescale, it can pursue its business normally without financial support from the State;

- ☐ it must be sufficiently transparent and the Commission must be able to constantly verify that it complies with stated objectives.

Different types of aid and Commission action

Only aids to industrial and commercial enterprises are considered here. However, national aids to agriculture also have to be referred to the European Commission in advance and are subject to the same controls.

- ☐ *Aids for regional projects.* In this field, the Commission has a number of concerns: to concentrate efforts on problem regions to compensate for their economic disadvantages; to prevent aids given to companies based in relatively prosperous regions from upsetting competition and the working of the common market against the general interest; to ensure that aid is linked to new investment or job creation and is only granted to viable firms, who will become capable of competing without financial backing from the State in time. To achieve these objectives, the Commission laid down guidelines in 1975 which were subsequently strengthened in 1979. These guidelines, which the Commission refers to when examining proposed aids, mean that regional subsidies must respect ceilings which differ according to the situation in the various regions; they must also take account of regional peculiarities and sectoral repercussions and must also be sufficiently transparent to allow effective monitoring.

- ☐ *Sectoral aids.* In May 1978, the Commission defined its policy by declaring that State aids were permissible, if one took into account the degree of structural change taking place, when free market forces were hindering progress towards the Community's economic and social objectives, or preventing them from being achieved within an acceptable time span or at an acceptable social cost. Starting from this principle, the Commission set down the following criteria: sectoral aids must be limited to cases where the position of the industry concerned renders them necessary; they must contribute to the solution of structural problems and to the restoration of viability to a sector, rather than the maintenance of the status quo and the delaying of crucial decisions and changes; resources can be made available to alleviate the social and economic costs of changes under certain circumstances and under very strict conditions; apart from very short-term subsidies, aids must be degressive and clearly linked to restructuring in the sector concerned; their size should be proportional to the size of the problems to be resolved.

  Aids apply to every industrial sector but some are obviously more affected than others:

- shipbuilding: in April 1981, the Council of Ministers approved a fifth directive covering national aids and improved efficiency in Community shipyards. The directive favours cuts in capacity, the merging of firms, their modernization and their rationalization. The Commission has examined a great number of aid programmes in the sector. In a related area, ship repairs, it ruled in 1979, that aids would only be permitted in exceptional cases, provided they were linked to restructuring programmes leading to a reduction in capacity.

- textiles and clothing: the seriousness of the crisis affecting this major labour-intensive industry has prompted member governments to step up national aid. The Commission plans to introduce a monitoring system to check aids granted and the progress of restructuring plans. It has already examined a large number of national plans. Since 1977, the Commission has forbidden aids to the synthetic fibres industry (acrylic fibres, polyester, polyamide) that would increase capacity. This ban was extended for another two years in July 1981.

- leather goods and shoes: supply difficulties for raw materials, new competition from third countries and constraints imposed by pollution prevention are weakening companies at a time when structural change is urgently needed. The Commission allows certain aids that are clearly in line with this objective.

- car industry: the economic importance of this sector, which is currently facing severe competition from outside the Community, has prompted the Commission to accept a number of national aids aimed at restructuring. Here too, a system for monitoring aids needs to be introduced to ensure discipline between the Member States, to promote modernization and to prevent surplus production capacity from developing.

- paper and board: this sector is suffering from supply difficulties, strong external competition and a sharp drop in consumption. The Commission therefore allows aids which are aimed at reorienting the industry towards specialization, but opposes any which could create new production capacity.

- steel: in August 1981, with the unanimous consent of the Member States, the European Commission introduced a code governing aids in this sector between now and 1985. Under the code, aids must be linked to a restructuring programme; they must not contribute to any increase in capacity (already in surplus) in plants where output is not growing; they must be degressive, of limited duration, at a level and volume proportional to restructuring, provoke no distortion of competition, be transparent and be referred to the European Commission in advance. Emergency aid and 'rescue' packages have been banned since the beginning of 1982. A rigorous system for controlling subsidies completes the aid code.

- growth sectors: in current or potential growth sectors, the Commission, taking into account the need to prevent duplication and distortions of competition, recognizes that aids can contribute to improving the industrial structure of the

Community, helping Europe to catch up with its external competitors. This view is all the more justified in the case of high and new technology industries — information technologies, aeronautical engineering, new energy forms, etc. — where economic risks are higher both from the point of view of technological choices and international competition.

☐ *General aids.* Many aids do not directly affect either a particular region or a particular industrial sector. The incidence of these aids can be quite high, in terms of firms covered by 'general economic expansion' or 'modernization of the domestic economy' or 'restructuring of companies in difficulty'.

In general, these aids do not comply with Community rules for four reasons: in the absence of any sectoral or regional element, they are not included in the exceptions listed in Article 93; they do not allow the Commission to evaluate their effects on competition and trade; they could upset rules laid down for regional and sectoral aids; they could create unjustifiable differences in treatment between Member States. But realizing that some Member States need some sort of subsidies, the Commission has accepted some general aid programmes on condition that they fit in with sectoral and regional schemes that reflect Community needs or that the most sizeable aids are referred to the Commission in advance.

Some more specific 'horizontal' (as opposed to sectoral) support measures for industry also get the Commission's go ahead. The new harsh environment in which the world economy finds itself, often justifies stimulatory measures to maintain the long-term competitivity of European industry. The Commission therefore takes a positive attitude towards certain subsidies which are aimed at common objectives like research and development, environmental protection, energy conservation and so on. While distortions of competition have to be limited, it has to be remembered that national aids do stimulate industrial development, both by injecting vitality into industries producing new goods and equipment and by boosting productivity in industry as a whole, primarily by introducing new technologies. This is particularly true for aids to:

- research and development: in its 1981 report on industrial innovation, the Commission stressed that the economic future of the Community depends largely on its capacity to bring in new technology. Given the economic costs and risks involved, the Commission takes a generally favourable view of public aids that stimulate the research needed by industry, although care must be taken to ensure that aids do not simply cover normal modernization costs that companies should bear themselves.

- energy: here too, Community objectives are a priority. The Commission can authorize certain aids, in particular those aimed at cutting the Community's dependence on external supplies.

- environment: the Commission has established a Community framework which, under certain conditions, would allow aids for pollution prevention until December 1986. In the longer term, the Community adheres to the 'polluter pays' principle. State aids can only be granted for a limited period and in exceptional circumstances, when public intervention is the only way to prevent social and economic problems emerging in particular sectors or regions that cannot afford the required level of investment.

- small and medium-sized businesses: bearing in mind the role that these firms often play in economic initiatives and innovation, the Commission tends to favour specific aid projects for them.

Two types of aid deserve a special mention. These are:

- employment: given the current economic and social situation, the Commission accepts aid that creates jobs. Aid aimed at maintaining jobs is permissible when it is linked to restructuring plans re-establishing the viability of the company concerned. Aids which simply preserve the status quo are not allowed.

- exports to the Community market: these aids obviously run directly counter to the very principle of the common market. For this reason, the Commission is particularly careful to ensure that no aid of this kind is granted to companies.

△

By banning or controlling State aids on a common basis, the European Commission, with the support of the European Court of Justice, can put an end to distortions of competition and can help Member States avoid the expense of increasing national aid programmes. Moreover, the Commission can strengthen coordination of national policies at regional and sectoral level and thus promote restructuring in industry and a better convergence of European economies ■

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Commission of the European Communities

Information offices (countries fully or partially English speaking*)

Ireland	39 Molesworth Street, Dublin 2 – Tel. 71 22 44
United Kingdom	20 Kensington Palace Gardens, London W8 4QQ – Tel. 727 80 90 – 4 Cathedral Road, Cardiff CF1 9SG – Tel. 37 16 31 – 7 Alva Street, Edinburgh EH2 4PH – Tel. 225 20 58 – Windsor House, 9/15 Bedford Street, Belfast BT2 7 EG – Tel. 40 708
Australia	Capitol Centre, Franklin Street, P.O. Box 609, Manuka 2603, Canberra A.C.T. - Tel. 95-50 00
Canada	Association House (suite 1110), 350 Sparks Street, Ottawa Ont. KIR 7SB – Tel. 238 64 64
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