

CONCEPTUALISING STATE AID IN THE EUROPEAN UNION
(NB. Draft version only; comments very welcome)

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Contents

Abstract

1. Introduction

2. The European Community Definition

2.1 State Aid in the Treaties

2.1.1 State Aid in the EC Treaty

2.1.2 State Aid in the ECSC Treaty

2.2 The Procedural Aspect

2.3 The Case Law

2.4 The Concepts of the 'State' and its 'Resources'

2.5 A Note Concerning State Aid and Ownership

2.6 The Evolution of State Aid Policy

2.7 A Note on State Aid in the EC Policy Perspective: Industrial Policy to Competition Policy(?) to Trade Policy

3. Some alternative definitions of state aid

3.1 The OECD

3.2 GATT/WTO

3.2.1 A brief note on the relationship between GATT/WTO and the EU

3.2.2 Subsidies in the post-Tokyo-pre-Uruguay Round GATT

3.2.3 Subsidies in the post-Uruguay Round GATT/WTO

4. Conclusions

Bibliography

ABSTRACT

This paper aims to achieve an adequate discussion of the concept of state aid in the European Union, covering its definitional, procedural, case law and wider policy aspects. With regard to the definition of state aid, this paper concentrates on that employed by the European Commission, and discusses the (lack of) transparency of this definition. In searching for an definition of state aid that may be used in the EU context, the paper goes on to consider the procedural aspects of state aid, specifically the obligations placed on Member States by the EC Treaty and the strategy of the Commission in ensuring that these obligations are met. Following on from this some consideration is given to the case law surrounding state aid, in an attempt to shed some light on the EU definition of state aid post factum. The policy context of state aid is also explored, specifically in relation to the connections between its categorised variously as industrial policy, competition policy and trade policy, which seem to depend on the specific interests involved in the aid. Although the extent to which state aid may be meaningfully classified as competition policy seems limited, increasing globalisation does seem to be leading governments to take greater account of the extra-territorial effects of their aid measures than previously. Following on from this, and still in pursuit of a definition of state aid, consideration is given to the method employed in relation to aid by both the OECD and GATT/WTO. Conclusions are drawn which stress the persistent absence of ex ante definitions of aid, and call for future analysis in this area to engage in 'open exchange' between the disciplines of law, political science and economics, but also between the spheres of industrial, competition and trade policy.

1. Introduction

It is wise to begin any inquiry with a full discussion of the scope of the subject area and the terms to be used. Unfortunately in the case of state aid this could a truly full discussion of this nature could easily occupy an academic lifetime. Even then such a discussion would not be an easy task, since the institutions chiefly capable of providing such a definition - the Commission and the Court of Justice - have failed, and indeed persistently avoided, doing so. There do exist, however, some elements of a definition, largely in the form of positions adopted by these institutions in connection with particular cases, and in the course of this chapter we will attempt to draw out the most relevant of these. It should also become apparent through this exercise which areas of state aid are most lacking in clarity, and attempts will be made to advance some explanation for this.

An important, if small, section of this paper deals with the policy contexts within which state aid may be placed, discussing the implications of viewing aid issues from the perspective of industrial policy, competition policy and trade policy. Particular attention will be paid to the extent to which state aid, clearly an instrument of domestic industrial policy, can also be seen as belonging in the areas of competition policy and trade policy. And special consideration is paid to the applicability of insights regarding competition and trade policy areas to state aid.

In addition to considering the Community's approach to state aid, some attempts will be made briefly to introduce the definitions employed by GATT/WTO and the OECD, since these are organisations with which the Community (both *qua* Community, and through the Member States) is closely linked. While the OECD position is interesting more as a comparator, the GATT/WTO approach subsidies may prove to have a more direct effect on aid policy in the Community and the patterns of aid awards in the Member States. Although some conclusions will be drawn they will be more of a type aiming to synthesise the main points of the debate, since a fundamental 'inconclusiveness' is one of the principal characteristics of the Community's definition of state aid.

2. The European Community Definition

Within the European Union the task of defining state aid assumes a threefold character. When looking at government behaviour in a Member State's economy the questions to be asked are:

- is the government assisting its industry in any way?
- which of those measures of assistance are state aid?
- which of these state aid measures are incompatible with the Treaty?

Given that we can safely assume that all the Member State governments could be said to assist their industry (if only by, say, providing an education system) in this section we will concern ourselves with the criteria for deciding that a measure is state aid (rather than just government assistance) and when that aid is incompatible with the Treaty.

2.1 State Aid in the Treaties

The essential structure and the general direction of travel of the European Union was remarkably well-defined from its inception in 1952 by the Treaty of Rome, in conjunction with the already existing treaties establishing the European Coal and Steel Community and Euratom. Thus, in beginning to discern the attitude of the European Union, or rather the Commission in its role as 'guardian of the Treaties', to state aid to industry, a close examination of those primary legislative provisions is a logical starting point.

2.1.1. State Aid in the EC Treaty

The EC Treaty deals with state aid in Articles 92, 93, and 94. Article 92(1) makes clear that aid is considered as having the widest possible definition, and is prohibited, 'be it in any form whatsoever' as long as it can be proved to 'distort or threaten to distort' trade between Member State. These provisions on their own are relatively clear since there are no restrictions on form and since the trade distortion effects of a measure are relatively easy to measure. Indeed, as they stand, these provisions *could* encourage the Commission to outlaw virtually all state aid, since any interference of the state in the market could be argued to be distortionary¹, indeed in one

¹ This is certainly the view of the author. It also apparently carries some weight within the Commission (private communication from Commission official to the author, Autumn 1996). It should be noted, in anticipation of obvious criticism, that it is certainly possible for an aid to

sense it is precisely some level of distortion that the government is attempting to achieve by intervening. However, the Treaty goes on to weaken these provisions with the inclusion of the phrase, 'save as otherwise provided for in this Treaty', going on in Article 92(2) to list types of aid which *are* considered as 'compatible with the common market' and in Article 93(2) types of aid which *may* be considered compatible at the discretion of the Commission. Roughly, those areas receiving, or eligible to receive, approval include:

Those that *are* compatible:

- aid with a social character and granted to individual consumers without conditions relating to the origin of products purchased;
- aid dealing with the effects of natural disasters;
- aid granted to those areas of Germany (including the Neue Lander) affected by partition;²

and those that *may be* compatible:

- aid to promote economic development in areas with high unemployment and/or low standard of living;
- aid towards a project of 'common European interest' or 'to remedy a serious disturbance in the economy of a Member State';
- aids promoting the development of 'certain economic activities' or 'certain economic areas' as long as there is no adverse effect on intra-Community trade.
- aid promoting culture and heritage (in so far as this is in the Community interest);
- other categories of aid 'as specified by decision of the Council acting by qualified majority on a proposal from the Commission'.

Other possibilities for derogations are contained elsewhere in the Treaty. Article 42 gives the Council permission to authorise aid to those involved in the production of or trade in agriculture for the protection of 'enterprises handicapped by structural or natural conditions' and aid within

be awarded with the aim and effect of counteracting an already existing distortion in the market, but that this does not mean that such an aid is not distortionary, merely that it is 'counter-distortionary'.

² It should be noted that since re-unification this category of exemptions is the source of some dispute. The Commission are unhappy with the German government's broad interpretation of it, and have sought to tighten its scope.

‘the framework of economic development programmes’. Article 77 sets out that ‘aid shall be compatible with this Treaty if it meets the needs of co-ordination of transport or if it represents a reimbursement for the discharge of certain obligations inherent in the concept of a public service,’ and the Community’s aim of promoting the development of Trans-European Networks reinforces this (Twelfth Report on Competition Policy, pt 159).

Article 90 deals with public and other undertakings to which Member States grant ‘special or exclusive rights’ and specifically stipulates that they should be subject to the rules of the Treaty, ‘in particular to those provided for in Articles 85 to 94.’ It goes on to say that this application should be pursued only, ‘in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them,’ appearing to give the Member States a certain amount of leeway, but then takes pains to limit this flexibility by stating that, ‘the development of trade must not be affected to such an extent as would be contrary to the interests of the Community.’

From just these few extracts from the primary legislation of the Community there are already some conclusions that can be drawn about the general approach of the Commission to state aid. Firstly, any definition of state aid is conspicuous only by its absence. Secondly, the principal criterion laid down in the Treaty for the assessment of aid is that of Community objectives. Thus, either state aid will be allowed if it is thought that it will promote a Community objective, or will be prohibited if it will put one of these objectives in jeopardy. Crucially, there is no mention of economic optimality in these provisions. By the phrasing of the primary legislation of the Treaty the Commission is compelled to adopt a teleological approach to state aid, taking as its ultimate *telos* a close ‘Union of the peoples of Europe.’ Given that this is so, the absence of a hard and fast definition of aid in the Treaty becomes less surprising since the founding fathers were certainly aware that one of the vital conditions for successful integration was a responsive and flexible Commission (Mazey, 1992) such that to tie them down would restrict their effectiveness.

2.1.2 State Aid in the ECSC Treaty

Article 4 (ECSC) expressly forbids certain measures which are considered to be incompatible

with the Treaty, among them ‘subsidies or aid granted by States, or special charges imposed by States, in any form whatsoever.’ The key difference between the state aid provisions in this Treaty and those in the Treaty of Rome is that the ECSC Treaty contains no obvious provisions for derogations, thus apparently sets rather stricter standards. Indeed, in this way the definitional problem relating to state aid in areas covered by the ECSC Treaty seem to be limited to the question of what measures of government assistance are state aid. However, on closer inspection, derogations are permitted by the Treaty. The use of the phrase ‘...in order to encourage co-ordinated development of investment...’ gives an indication of the possibility for derogations where they are seen to contribute to this objective. This is confirmed later in the same article, when it lays down the actions appropriate, ‘if the High Authority finds that the financing of a programme or the operation of the installations therein planned would involve subsidies, aid, protection or discrimination *contrary to this Treaty*’ [emphasis added]. Thus, the High Authority was given the power to determine the compatibility of the aid with the objectives of the Treaty, similarly to the Commission in the EEC. Currently it is understood that derogations will only be granted for aid which provides research and development, which improves the environmental standards of existing plant, or which assists closure.

The ECSC Treaty also provides for the High Authority to issue notification requirements, though unlike under the Treaty of Rome states do not have a standing obligation to notify. Article 54 (ECSC) states that, ‘in order to encourage co-ordinated development of investment, the High Authority may, in accordance with Article 47, require undertakings to inform it of individual programmes in advance, either by special request addressed to the undertaking concerned or by a decision stating what kind and scale of programme must be communicated.’

It should be noted that, while there are formal differences between the approach to state aid adopted by the ECSC and that adopted by the EC, since the Merger Treaty (which came into force in 1967), the (single) European Commission has served as the body responsible for administering and safeguarding all three of the founding Treaties, and that since then state aid policy under the ECSC has been pursued in much the same way as that under the EC Treaty.

2.2 The Procedural Aspect

While ‘the procedural rules for applying Articles 92 and 93 have been developed in a piecemeal fashion by Commission decisions and judgements of the European Court of Justice’³ the basis for action on state aid is contained within Article 93 (EC). Although Article 93 splits the competence for state aid control in the Community between the Commission, the Member States *qua* Member States, and the Member States *qua* Council of Ministers, the founding fathers clearly awarded the greatest degree of control to the Commission, presumably because they would have agreed with the view of the present day Commission that:

‘Left to themselves, there is always the risk that Member States would use aids to try to export some of their economic problems. For example unfair subsidies in one country can lead to unemployment in another. Moreover, there is a very real danger that the combined effect of independently applied national policies would lead to incoherent, contradictory and unfair results at the Community level. Therefore only firm Community control can ensure that any benefits obtained from state aid outweigh the resulting distortions of competition.’
(Brittan, 1989a.)

There is certainly some truth in this view, particularly in the light of the limited success which the less stringent GATT/WTO regime has achieved in reducing subsidies. Evidence from the United States may also be cited in support of firm Commission control of aid, since in the US ‘subsidy wars’ (Winters, 1993) between states are a widely acknowledged problem (Thomas (1996)). Indeed, in Europe there have even been cases of such competition *within* Community Member States - in the UK it is not uncommon for companies proposing inward investment to ‘shop around’ between the various development corporations for the best deal.

The role of the Commission

Given that Article 93 lays the ground for an administrative procedure⁴ based on the four pillars

³ p23, Competition Law in the European Communities Volume IIA Rules Applicable to State Aid (CEC 1995).

⁴ For more on the procedural aspect of EC state aid, see Hancher, Ottervanger and Slot (1992).

of notification, preliminary assessment, full examination, and final decision (Lasok 1986), it cannot be doubted that responsibility for state aid rests very largely with the Commission since it is ultimately responsible for all except notification. The Commission has the power to recommend the alteration or cessation (within a given time period) of any new or existing aid which it finds to be incompatible with the Treaty, and if the Member State should fail to comply, the Commission may refer the case directly to the Court of Justice. Significantly, Article 93(3) contains the so-called 'stand-still clause' which has direct effect and states that, 'the Member State concerned shall not put its proposed measures into effect until this [investigation] has resulted in a final decision' which allows the prohibition of an aid measure until such time as it has been shown to be compatible with the Treaty.

In deciding the compatibility of an aid, the Commission first makes a *prima facie* assessment of the measure. If it is *prima facie* compatible, then a preliminary review of the effects of the aid suffices. If it appears to be cause for greater concern, the Commission initiates the 'contentious' phase of the review as laid out in Article 93(2). In this phase the Commission must, within a two month period,⁵ invite all interested parties to comment on the aid measure⁶ and then arrive at a decision on its compatibility with the Treaty. In deciding compatibility, the Commission must answer the following questions:

1. Does the aid fall into one of the categories of Article 92(2) which are *ipso facto* compatible with the Treaty?
2. Does the aid fall into one of the categories of Article 92(3), which may be compatible with the Treaty?
3. If ostensibly incompatible with the Treaty, can the Commission find specific compensatory justification for both the type and intensity of the aid?
4. If ostensibly compatible with the Treaty, is it contributing to a scheme which without the aid would not take place (analogous to the additionality principle)?

⁵ If the Commission exceeds this period it runs the risk of having its decision annulled by the Court. This happened in 1992 in the RSV when the Commission took 26 months to reach a decision and had its eventual repayment annulled by the Court, in spite of the fact that part of the delay had been caused by the non-cooperation of the Italian government. (Decision 92/329/EEC.)

⁶ In *British Aerospace* (Case C-294/90 judgement of 4 February 1992) the Court made clear that full consultation was a *conditio sine qua non* for a valid decision.

5. If the aid is ostensibly compatible with the Treaty, is it financed in an appropriate way (eg not by discriminatory parafiscal charges where the revenue raised by the levy is used within the same sector to which the levy was applied)?
6. If the aid is ostensibly compatible with the Treaty is it, overall, proportional?

In cases where the Commission is satisfied that the aid is compatible on most counts, it can issue a conditional decision, which instructs the Member States to alter the type and/or amount of aid such that compatibility will be ensured. The aid can only go ahead subject to these conditions being met (see Figure 1.1).

Though no such power exists in the Treaty, in the *Commission v. Germany*,⁷ the Court ruled that the Commission could order the repayment of any aid granted illegally, provided that the repayment order is proportional. Although Member States may complain against Commission decisions, including those related to repayment orders, challenges to repayment orders are rarely successful. States will not get far using the argument once advanced by the Italian government that repayment of aid will do little to restore an undistorted market situation and is therefore disproportionate.⁸ Neither may they use the argument that national laws forbid repayment of aid, as the Belgian government contended in 1989⁹ since the Court ruled that national laws could not be used as an excuse for non-compliance with Community decisions. Though it undoubtedly has advantages as a deterrent, there can be problems with the repayment remedy since it is often difficult to assess the true value of an aid, particularly one which was not awarded in the money terms, such as infrastructure improvements.

Though they must still be notified, there are simplified procedures for aid measures which fall under the *de minimis* rule, i.e. measures which fulfill the following cumulative criteria (Fourteenth Report on Competition Policy, pt 203):

1. The firm has a maximum of 100 employees;
2. The firm's turnover is less than 10mn ECU per year;

⁷ Case number 70/72 [1973] ECR 913.

⁸ Case number 305/89. ~~1989~~

⁹Case number C 74/89 Commission vs Belgium [1990] ECR I-492.

3. The intensity of the aid is less than 7.5%.

Since 1992, the Commission has said that any aid measures which total less than 50,000 ECU over a three year period, need not be notified at all (Twentieth Report on Competition Policy, pt 357). It is hoped that the development of such a *de minimis* rule will pre-empt any attempt by Member States to justify non-notification on the grounds that *they* did not consider the aid significant, thus maintaining Commission control in the area (Ross, 1989).

The role of the Member States, through the Council and individually

The Treaty also awards a certain amount of power to the Council of Ministers. Indeed, it is quite possible that the explicit procedural involvement of the Council was in direct recognition of the fact that the Commission's work on state aid is of a far higher degree of sensitivity than its work on mergers and anti-trust, since it involves the direct exercise of power over national (and local) governments rather than merely over firms. Article 93 provides for a Member State to apply to the Council to approve an aid measure either prior to or after its award; if the Council votes unanimously to approve the aid then it may be considered as compatible with the Treaty. Indeed, there is an incentive for States to apply to the Council since where such an application is made after the Commission has initiated Article 93 proceedings against the aid, the application to the Council has the effect of suspending them. Perhaps not least for this reason, the Council received many applications from aiding/aided bodies throughout the 1960s and 1970s. However, in the 1980s the Council's power in this area fell into desuetude, and there have been very few cases involving it since then.

Article 93 (3) also obliges the Member States to keep the Commission informed 'in sufficient time to enable it to submit its comments, of any plans to grant or alter aid.' This obligation to notify aid is crucial for the success of the Commission's policy,¹⁰ although it rather perversely seems to place the responsibility for determining whether a measure is a state aid with the Member States - something which may again be due to the sensitivity of the Commission's

¹⁰ Although it is impossible to tell what percentage of unnotified aid it represents, it is interesting to note that between 1986 and 1990, out of 2000 aid cases considered just 36 cases of unnotified aid came to the Commission's attention. (Figures from Reports on Competition Policy *inter alia*).

exercise of power directly over national (and local) governments in this area. While it is certainly true that the Commission usually enjoys the full cooperation of the Member States in fulfilling their obligation to notify, it does not always receive all the necessary information. This may be due to simple reluctance on the part of the Member State or, and perhaps more seriously, it may be because the Member State does not have this information available. It is not only for reasons of ideology that the Commission desperately seeks to encourage greater financial transparency in relations between governments and firms, and particularly with respect to state owned enterprises.¹¹ To be fully consistent with the general thrust of the Treaty the Commission should instead have investigative powers over the Member States - and indeed, this is one of the changes proposed in a joint initiative of DGIV and the Irish Government and it is currently under consideration.¹² However, the Member States do have some incentive to be truthful and notify all measures which they believe might be state aid, and that incentive depends on their belief in the Commission's capacity for discovering unnotified aid and taking harsh action upon it. And there is strong evidence that Member States' belief in the Commission's capacity to detect aid has increased over the past decade, since the Single European Act, the number of state aid notifications have increased significantly (see below).¹³ If an aid is awarded without notification and the Commission discovers it, then it may invoke the 'stand still clause' and immediately order the suspension of that aid. Unlike other aid cases, unnotified aid is illegal *ab initio* due to the Member State's violation of the notification obligation (Lasok (1986)). However, it is important to note that there is a significant difference between the illegality of an aid and its incompatibility with the Treaty - and it is only the latter that allows the Commission to prohibit

¹¹ It has done this notably through the 1980 Directive on transparency (Directive 80/723/EEC, amended by Directive 85/413/EEC), the substance of which was confirmed by the Court in the case *Aministrazione Autonoma dei Monopoli di Stato Commission v. Commission* (case number 118/85 1988 3 CMLR 255). However in *France v. Commission* (Case C-325/91) the Court did not allow the Commission to introduce an obligation for Member States annually to inform it of their financial dealings with public undertakings, as this would constitute an act with legal consequences thus breaching the principle of legal certainty.

¹² See *Financial Times* report of 14 November 1996, 'The Aidbusters' Charter'.

¹³ Some, such as Gatsios and Seabright (1989) argue that tightening state aid policy by bolstering the Commission's reputation might have a cost in terms of the overall effectiveness of regulation in the Community, where it is done at the expense of national regulatory regimes.

the measure.¹⁴

Article 94 provides the basis for any regulation which may be considered necessary for the proper implementation of Community policy on state aid to be adopted on a proposal from the Commission subject to approval by a qualified majority of the Council after consultation with the European Parliament. No such regulation has yet been adopted.

2.3 Case Law

Through the case law both of the Commission and of the Court of Justice the notion of state aid has frequently been discussed, and it perhaps through this means that most can be discovered about the Commission's view of aid. The existing case law certainly reinforces the impression acquired from the Treaties that state aid should be defined in as vague and inclusive a way as possible in order to give the Commission maximum discretion over measures which might have deleterious effects on political integration.

One of the ways in which the Commission exercises its discretion is through the use of the Community interest criterion, which permits aid on the grounds that it promotes one or more of the Community's objectives. And the Philip Morris case provides a good example of exactly how wide the Community interest criterion may be applied. In this now famous case the Commission refused to authorise aid from the Dutch government to the Philip Morris tobacco company for the construction of a factory in the Netherlands, giving as one of their reasons that the encouragement of tobacco companies was not in the Community interest.

The Deuil case¹⁵ is particularly illuminating, since in its judgement here the Court took a firmly

¹⁴ See cases C/198/91 Cook v. Commission (1993 ECR-I 2486) and C-255/91 Matra v. Commission (1993 ECR I 3203). In Boussac (case number 301/87, France v. Commission (Boussac)) the French government contended that the non-notified status of the aid should have no bearing on the Commission's decision over its compatibility with the Treaty. The Court did not support the French view, though it did not rule out the possibility that later repentance from a Member State might improve the Commission's view of the aid. (1990 ECR I-307.)

¹⁵ Case 310/85 ECR 901

ex post position, placing the emphasis squarely on the effects of the measure in question,¹⁶ avoiding any criteria-based definition:

‘Article 92 does not therefore distinguish between the measures of State intervention concerned by reference to their causes or their general aims, but defines them in relation to their effects The general objectives of the national rules forming the legal basis of the grant in aid are not themselves sufficient to put it outside the scope of Article 92.’

This clearly maximises the definition since there are certainly many more measures which have the effect of granting a gratuitous advantage to a firm, industrial sector or geographical area than would initially appear aimed at doing so. And similarly, there are aid measures which at first sight would appear compatible with the Treaty, but which on closer examination could be shown to be anti-*Communaautaire* (Gatsios and Seabright, 1989). Indeed there have been several cases where the Commission has relied on exactly this reasoning. The classic example of just such a measure is the Italian textiles case¹⁷ in which reductions in the national sickness insurance payments made by firms for women employees, whilst appearing to be a general, non-discriminatory measure, was found to be a covert aid to the ailing textile industry since this industry has a particularly high proportion of female workers. Indeed, Italy fell foul of this aspect of Commission policy on another occasion when attempting to make an apparently simple tax change, which in fact benefited only a single company - the state chemical company Montedison/Enimont.¹⁸

Case law also shows that the Commission is prepared to view government assistance which is

¹⁶ Doing so in contravention of previous case law, for example *Steenkolenmijnen vs High Authority* (Case 30/59; 1961 ECR I 19) in which a more *ex ante* approach was taken with the Court saying that: ‘A subsidy is usually defined as a payment in cash or kind, made in support of any undertaking, other than the payments by the purchaser or the consumer of the good or service which it produces. An aid is a very similar concept, which, however, places the emphasis on its *purpose* and seems *especially devised for a particular objective* which cannot normally be made without outside help’ [emphasis added].

¹⁷ Case No. 203/82 1983 ECR 2525

¹⁸ FIND REF.

'paid' for through the contributions of the firm in another area, as not being state aid. This was shown in Germany when the Government's assistance for the establishment of a Kimberley Clark paper factory in Meuthet-Moselle was not seen as aid since the firm would be contributing to the cost of the assistance through payment of local taxation (which the Land would not otherwise have received).¹⁹ However, the Commission does not seem to be particularly consistent in following this line. Again in Germany, the Commission successfully challenged a law which allowed tax payers who constructed or enlarged an industrial firm in a mining area to benefit from an investment grant of 10% of expenses of purchase and construction which would be received in the form of a reduction in income or corporation tax²⁰, in spite of the fact that the same argument could have been applied. The Commission has clearly, and rightly, stated that it does not consider the repayment by the state of taxes unlawfully levied as state aid unless the repayment results in any benefit for the firm/industry/region that would not have occurred in the normal fiscal course.²¹

Further, the Commission has shown that it can consider the sale of land or other assets at below the 'market price' to be state aid. This position was established in proceedings brought against the Berlin authorities for the sale of land to Daimler Benz and Sony GmbH.²²

The Leuwarder case²³ saw the Court significantly expand the definition of aid by reasoning that, since the Treaty referred to state aid 'in any form whatsoever' there could be no reasonable distinction, for the purposes of Article 92, between aid in the form of, say, a grant and aid in the form of state acquisition of company capital. This led Advocate General Sir Gordon Slynn to introduce what is now a concept fundamental in the classification of state aid, even beyond matters of state participation, namely the 'market investor principle':

¹⁹ ~~██████████~~ DECISION 92/35?

²⁰ Case 72/72 1973 ECR 813.

²¹ See the case of Amministrazione delle Finanze di Stato vs Denkavit Italiana, case number 14/78 1978 ECR 2497.

²² For Daimler Benz see OJ 1992 L 263/15; for Sony see OJ 1992 C 48/3.

²³ Cases number 296/82 and 318/82, 1985 3 CMLR 380.

‘The question is whether the purchase of shares by the State can be regarded as an investment for the purposes of obtaining income or capital appreciation, the aim of the ordinary investor, or whether it is merely a vehicle for providing financial support for a particular company.’

However, the market investor principle is rather difficult to adhere to. Not all investors in the market invest for clear profit motives, and even those who do may have very different time horizons and expectations. Even assuming a simple medium term profit motive, investors have heterogeneous views of risk, with some being extremely risk-averse while others more risk-loving. If a great many investors would not invest in a firm in which a Member State government proposed to inject capital, but a single risk-loving investor could be found who would place his money in the firm, would this intervention correspond with the principle? In attempting to address these questions the Commission has said that measures should only be considered illegal only, ‘when it is beyond reasonable doubt that there is no other plausible explanation for the provision of public funds than considering them as State aid’²⁴ which hardly makes the position clearer. A definitive solution to these problems may not be imminent, since the status of capital acquisitions as aid is unlikely to be clarified until the Commission is able to demonstrate other adequate justification for its decision.²⁵

A final way in which case law has maximised the Commission’s discretion in the use of its state aid policy is through the considerations given to the provision in the Treaty that for a state aid measure to be considered as incompatible with the Treaty it must, ‘distort or threaten to distort trade between Member States’ (Article 92). We have said before that the effects of a particular measure on the pattern of trade are not particularly difficult to calculate, however, a necessary stage in such calculations is to determine what exactly is the relevant market for the product affected, and this can be a somewhat contentious - as amply illustrated by cases under Articles 85 and 86. If the Commission took this approach to evaluating state aid it could easily find itself on one side of a time consuming and frustrating argument, the outcome of which might well limit

²⁴ In its Communication of October 1991 on the subject of public undertakings in the manufacturing sector, OJ C 1991 273/2.

²⁵ For a deeper discussion see Ross (1986).

its decision making power in that area. Thus it follows the view, as expressed by the Court in Phillip Morris²⁶ that, 'where a financial undertaking strengthens the position of an undertaking as compared with other undertakings competing in intra-Community trade the latter must be regarded as being affected by that aid' and in so doing very largely avoids the relevant market issue. (Hancher *et al*, 1991.)

2.4 The Concepts of the 'State' and its 'Resources'

Article 92 sets out the basis for the prohibition (subject to derogations) of '...any aid granted by a Member State or through State resources...' and this necessarily raises questions concerning the definition of the 'State' and what may or may not be considered as its 'resources'. The question is easy enough to resolve when the aid case under consideration involves a direct gift of money from central government, but few cases are so straightforward.

Nowhere in Community law has the state ever been defined, and so it is necessary to look to case law, both generally and specifically in relation to state aid, to discover how the concept has been interpreted. Generally the line of the Court on this issue has been rather confusing. As Hancher (1991) pointed out, the European Court of Justice has used terms such as 'state authority', 'emanation of the state' and 'organ of the state' apparently interchangeably. In *Foster v. British Gas Corporation*²⁷ it was decided that the (pre-privatisation) BGC was part of the state²⁸ on the basis of a test which stipulates that a body must: (a) provide a public service; (b) do so pursuant to a measure adopted by the state; (c) do so under the control of the state; (d) must possess special powers beyond those normally applicable in relations between individuals (Hartley (1994)). And in a similar ruling, the Court declared in the *Cofaz* case²⁹ that a tariff set by the Dutch gas company Gasunie for the sale of gas to ammonia producers in the Netherlands was

²⁶ Case 730-79 *op cit*.

²⁷ Case C-188/89 ~~W~~

²⁸ The status of the privatised utilities in the UK is yet to be established, although from this reasoning it seems that they might be seen as part of the state, particularly in the light of the peculiar regulatory positions.

²⁹ Case 169/84 [1986] ECR 391.

a state aid, as the Commission had argued, since the Dutch Ministry of Economic Affairs appointed one of the eight directors of the company and must approve its tariffs and therefore the company could be considered part of the state.

However, as Hancher points out the test used will clearly not suffice in all situations (such as those involving professional associations or universities) and EC law generally remains unclear on this subject. The status of the privatised utilities is particularly uncertain. It seems from the test used in the BGC case that they could certainly be considered as organs capable of giving state aid, since (at least in the UK) they operate under government granted licences, which confer on them public service obligations as well as special powers to meet them. However, until there has been a case involving one, it is not possible to say that the Commission agrees with this view. If the test used in BGC is interpreted extremely widely, it might also include those telecommunications operators, which (at least in the UK) operate under public sector licences granted by government. These licences impose on the companies universal service obligations and interconnections duties, and equip them with special powers (such as the right to lay cable under roads and pavements). And it could be argued that the government's power to enforce the licence conditions might constitute some kind of influence or control. Of course, it is unclear as to why a private telecoms operator in a competitive market would wish to give state aid, but consideration of the possibility does illustrate just how wide ranging the state aid rules could be if interpreted generously.

Case law seems to have established, unsurprisingly, that state holding companies are certainly considered as part of the 'state', and thus that measures introduced by them which violate the market investor principle are state aid. The Commission made quite clear that it would take this view in the cases *Italy v. Commission (Alfa Romeo)* and *Italy v. Commission (Eni Lanerossi)*,³⁰ in which it the state holding company Eni was held to have injected capital into financially unstable companies under conditions in which a market investor would not have done so. The Italian government countered the charge with the claim that the Commission's handling of the case was in violation of Articles 222 and 90 both of which seek to secure equal treatment by the Community of public and private firms. In its judgement, the European Court of Justice did go

³⁰ Case C-305/89 1991 ECR I 1635; case C-303/88 1991 ECR I 1433.

as far as to recognise that it may be considered normal for a parent company to bail out a subsidiary. However, ultimately it supported the Commission's action and its view of holding companies as part of the state machinery, saying that any injection of capital *by the state* into any firm without hope of profitability should be investigated under the terms of Article 92.

In the case of *Openbaar Ministerie of the Netherlands vs Van Tiggele*,³¹ Advocate General Capriorti expressed the opinion that for a measure to constitute state aid it must necessarily impose some form of financial burden on the state, either in the form of expenditure or else in terms of revenue foregone. The Commission, however, has not followed this relatively simple and practicable view particularly closely. The Commission has shown through case law that it is also prepared to consider as aid assistance which is derived from private sources as aid *where it is administered by or it is subject to the approval of* an organ of the state. This point was discussed in the *Commission v. France* (the so-called 'Poor French Farmers' case) in which the French government claimed that financial assistance to poor farmers did not constitute aid from state resources as it came from the accumulated surpluses of the Caisse Nationale de Credit Agricole (i.e. from private funds) and that the decision on allocation was taken by a panel on which state representatives were a minority. However, as the case progressed the Court found that in fact the recommendations of the panel did not become official until they had been sanctioned by public authorities and thus the assistance was state aid *regardless of the fact that the state had incurred no (significant) cost in bringing it about*.³²

A more contentious case relating to state resources is that of *Gebroeders van der Kooy*.³³ In this case, the Commission found that aid was given to these Dutch horticulturalists in the form of preferential tariffs from the Dutch gas provider, Gasunie - this being considered as aid because

³¹ Case 82/77 1978 ECR 25.

³² This rather broad view of what constitutes assistance by or through state resources was later confirmed in the case *Greece vs the Commission* (Case 57/86, judgement of 7 August 1988), in which the Commission judged interest rebates to be state aid, even though they were awarded by private banks. When the Greek government challenged the decision, the Commission contended that the measure has been introduced by the Bank of Greece, which they considered to be an organ of the state, and thus the aid had been granted through state resources.

³³ Case 67, 68, 76/84, [1988] ECR 219.

the Dutch government was a significant (though not majority) shareholder in Gasunie, and therefore would suffer some financial loss as a result of the preferential tariff structure. The source of the contention, though rests in the fact that the remedy chosen by the Commission in this case was that of full repayment of the aid, and not merely of the proportion corresponding to the shareholding of the Dutch government.

Interestingly, and particularly so given the state-like aspirations of the Community, the Court of Justice has found that aid given by or through Community resources does not fall under the remit of Article 92. In the case *Norddeutsches Vieh- und Fleisch Kontor*, it was contended that the Community tariff quotas of beef and veal to certain firms awarded them particular financial advantage, and therefore should be investigated as aid. The Court maintained that since the complaint concerned the allocation of Community resources this was a matter that could only be dealt with through the appropriate Community provisions, of which Article 92 was not one.³⁴

2.5 A Note Concerning State Aid and Ownership

There is an increasing number of strands of the Commission's policy on state aid which makes at least a brief consideration of the implications of aid policy for state ownership necessary at this stage.

The Commission has made clear (see above) that it considers state participation in company capital as a state aid only where this participation is undertaken in circumstances in which a market investor would not have chosen to participate. Thus, it seems that state ownership, as an extreme case of state participation in capital, cannot *per se* be considered as aid. However, were the a government to nationalise a firm for any other reason than that it considered it a good investment their actions could be considered as aid. This would be particularly so where the nationalisation was undertaken as a rescue package for a 'lame duck' firm, as was the case with the purchases of British Leyland and Meriden Motorcycles in the UK by the Heath Government.

³⁴ Although this case prompted Advocate General Verloren Van Themaat to suggest that a distinction be drawn between aid granted through state resources and aid granted by a Member States, the Court declined to follow this option.

The Commission has also been clear for some time that it regards measures by the state to secure preferential credit terms for firms as state aid. Indeed, DGIV has recently declared that state guarantees, which are fairly widespread in the EU, are to be considered automatically as state aid.³⁵ However, it seems indisputable that firms which are state owned (in whole or in part) will receive loans with lower interest rates (to reflect lower risk) and generally more favourable credit terms than those in the private sector. It is true that the Commission keeps a set of regularly updated 'reference rates' ('market' rates of interest under different conditions) against which the terms any loans may be compared, but this is far from satisfactory. State ownership may allow a firm a number of privileges indirectly, which will assist its application for credit; where state owned firms are large this may well be related to their (statutory) domestic market share. Thus, a loan may be offered to the company by a commercial bank at the market rate of interest given the firm's situation but that situation may be conferred by state ownership.

These apparent moves by the Commission towards a reconsideration of state ownership would not be quite so remarkable, if the Commission were not constrained by Article 222 (EC) to remain neutral on grounds of ownership; the Article states that: 'This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.' It seems then the Commission's case law and the necessities of its remit in this area, are taking into increasingly direct conflict with other areas of the Treaty. However, it should be stressed that the Commission's policies as discussed in this section are so far concerned only with the assessment of aid which may be awarded, and not the assessment of the current position of state owned firms in an attempt to assess the value of already existing aid. And such retrospection seems unlikely in the near future.

2.6 The Evolution of State Aid Policy

The words used in description almost invariably imply judgement, and in the definition of most concepts some kind of normative consensus is assumed, which may well change over time as

³⁵ See *Financial Times* report 11 November 1996, 'Loans: EU state-backed lending challenged'. This proposal is the subject of weighty opposition from Germany, however, since it would require large scale reforms of their banking sector because in the present system, the Landesbanke enjoy state guarantees as of right, which accounts for the high (often triple A) credit ratings they receive.

attitudes evolve (Connelly (1983)). Precisely such an evolution can be seen in the changing attitudes of the Commission to state aid, which have certainly altered in reflection of the changes in the 'normative consensus' on state intervention generally, and industrial policy in particular.

We have already noted how the Commission has tightened its views on state participation in company capital, and on state guarantees, and there are several other areas to which the Commission has become increasingly attentive. Just such an area is aid for exports to third countries which was initially not seen as incompatible with the Treaty since it was thought not to 'distort or threaten to distort intra-Community trade'. However, this view was based on an implicit assumption either that world markets have infinite capacity or that firms which compete for markets outside the Community do not compete for markets within it. It is quite obvious that neither of these assumptions holds true, and by the mid-1980s, probably prompted by the fierce competitive climate of the global recession, the Commission had realised that the indirect effects of this type of aid on intra-Community trade were probably significant.³⁶

The Commission's attitude to general aid measures has also evolved over time. In the 1950s and 1960s this type of aid was thought to do less damage than specific targeted measures since their effects were likely to be offset by other counterbalancing national aid and exchange rate fluctuations. However, gradually, since the 1970s, this type of aid has become less tolerated. It is now thought to be out of line with the Community aid requirements, since:

1. They do not involve any specific industries or firms and therefore do not qualify for any of the derogations under Article 92(2) and (3);
2. The Commission has no way of assessing the impact of that aid on competition and markets;
3. This aid can jeopardise Community level arrangements formulated for national industries; and
4. A state wishing to circumvent the state aid rules might disguise an incompatible specific aid as part of a general aid measure, thus leading it to escape inspection by the Commission. (Second Report on Competition Policy, pt 116.)

³⁶ See Twelfth Report on Competition Policy, pt 158.

Apart from expanding the scope of its activities in relation to state aid, the Commission has also made attempts to carry out its existing duties more thoroughly. We saw earlier that Article 93(1) obliges the Commission to monitor all existing systems of aid, and to rule on their compatibility with the Treaty or otherwise. However, partly due to force of workload, it was not until the late 1980s that, in pursuit of the truly Single Market, the Commission really began to make a concerted effort to fulfil this obligation. DGIV under Sir Leon Brittan began to produce (or be it rather erratically) 'surveys on state aid' (1989, 1990, 1992, 1996) which covered not only new notifications but also the results of questionnaires concerning existing aid. And in 1991, in the Twentieth Report on Competition Policy, explicitly emphasised the need for a more systematic approach to the monitoring of existing aid.

However, although in some areas the Commission's policy has become tighter, in other areas in its has become more tolerant. This apparent schizophrenia is due to the Commission's changing political priorities, and is exemplified by the Single European Act which came into force in 1987.

The SEA channelled the Community's energy towards creating a more genuinely Single European market through the erosion of barriers to trade, including state aid. However, at the same time, the SEA added new Titles to the Treaty and therefore new Community objectives which encouraged new derogations for aid, notably in the fields of environmental protection (through Title XVI, Article 130 r-t) and economic and social cohesion (through Title XIV, Article 130 a-e).³⁷

2.7 A Note on State Aid in the EC Policy Perspective: Industrial Policy to Competition Policy(?) to Trade Policy

So far we have considered state aid in the European Communities purely from a formal institutional point of view, taking a pragmatic approach to the definition by attempting to discover what different international (and supranational?) institutions say state aid is. However, it is simply not sufficient to consider only this formal aspect. While it is somewhat beyond the scope of this paper fully to consider the implications of the policy angle of state aid - with all their implications for national and European level policy processes - but we will attempt to raise

³⁷ For a fuller exposition of the relationship between state aid and regional policy see Frazer (1995).

some salient points in this section.

The impact of the creation of the European Coal and Steel Community in 1952 essentially brought state aid into existence. Previously a government's decision to award assistance to any industry had been solely a matter for their domestic industrial policy, but after the Treaty of Paris its signatories were bound to consider the views of the High Authority in relation to assistance measures to the coal and steel industries. This was the first step towards increasing the impact of other state's views on the domestic assistance decision - the beginning of state aid as a policy in the international sphere. With the creation of the EEC (and Euratom) in 1957, and very much along the same model as the ECSC, the internationalisation of state aid policy was expanded, since the European Commission was concerned not only with aid to the coal and steel industries but to *any* industry. Indeed, in many ways, the provisions for the control of state aid from the centralised (most supranational) European Commission, and the yielding to the Commission of the power to veto any state aid is an excellent example of effective pooling of sovereignty by the Member States. Although it must be noted, as we mentioned above, the extent to which the powers vested in the Commission were really effective in controlling state aid awards in the Community, let alone acting as a constraint on the policies of Member States was small at the beginning of the Community's life and did not really become particularly significant until the beginning of the Single Market Initiative in the mid-1980s.

Thus, through the European Communities state aid became - and in fact was born - an international issue. It must be noted that under the terms of the Treaty of Rome the provisions relating to aid are found under Title V on Common Rules on Competition, Taxation and Approximation of Laws, at the end of Chapter 1 on Rules on Competition, and that this might be considered rather odd. The other areas covered in Chapter 1 on this title, namely restrictive agreements and abuse of dominance, are undoubtedly the traditional areas of competition policy, state aid does not sit happily with them, something which reflects the different categorisation of aid by the Communities as compared to the more usual view of the constituent countries. Crucially, while the other, more traditional, aspects of the competition provisions involve scrutiny at the European level of firms within the Community, the provisions on state aid involve scrutiny by the European level of Community governments, and indeed it is on this point that the extreme sensitivity of state aid issues rests. Whereas the other elements of EC Competition

Policy are intended to work with and to complement the policies at the national level, the provisions on state aid are intended rather to constrain national policies, which are in any case conceived within a rather different conceptual framework. Indeed, state aid remains one of the very few ways in which the European level has direct control over Member States's fiscal policies, so this sensitivity should not at all be surprising.

The most obvious explanation for the positioning of the state provisions within the Treaty is that state aid does affect intra-Community competition, although it does seem that state aid could easily have been placed within various other Titles of the Treaty, most specifically Title XIII on Industry, or be split between the various other relevant Titles such as Social Policy, Transport, Agriculture etc.. Its classification as 'competition policy' can therefore be seen as somewhat arbitrary and therefore should not be taken as ontologically too significant; while general analyses of competition policy can offer insights into policy in the area of state aid, too much should not be read into them for state aid.

Figures show that the reduction of barriers to trade has its own momentum. As barriers have been brought down in recent years, the growth of world trade has exceeded that of national economies by an average of 2% (European Commission, 1995, *Competition Policy in the New Trade Order*). Trends towards globalisation of the world economy have given rise to a whole series of competition policy problems - international cartels, restrictive practices in transnational industries (e.g. air transport), world scale mergers, abuse of dominance on several national markets - which require cross-border co-operation if they are to be handled successfully and the effectiveness of competition policy maintained. It should not be at all surprising that similar problems, stemming from the multinational and transnational nature of a growing number of firms, also reinforce the need for co-ordination in the area of state aid. It has been acknowledged, for example, that the inability of domestic competition authorities to access information held abroad can seriously hinder their investigations. As we have already seen state aid is almost essentially an international concept such that increasing internationalisation, and the greater willingness of firms to shift production around the globe accentuates the need for co-operation in this area too. Although it should be stressed that in the case of state aid the greater extent of globalisation merely serves to exacerbate an existing problem, whereas in the case of competition policy it has brought about an additional qualitative dimension to the problem.

As trade grows and economies become more interconnected and interdependent it is also clear that the impact of the domestic policies of any particularly nation is felt more significantly in its trading partners who develop interests in the conduct of those policies. Such calls for increasing international co-ordination of competition policy, to prevent states competing with each other for investment and ultimately jobs³⁸ are certainly relevant for state aid - and would bring *both* conventional competition policy *and* state aid policy closer to trade policy. Indeed, precisely this type of links already exist between the European Union and the USA, Japan, Canada, Australia and New Zealand.³⁹

However, the details of the ways in which states are using the two policies to compete are rather different. While in the case of competition policy and regulation Member States compete downwards, as it were, lowering their regulatory requirements to entice business, in the case of state aid the competition is rather upwards, with states offering more aid to attract firms. Paradoxically then, while the competition/regulation regime may become more lax as states compete for the attentions of business, in the case of state aid this process of international competition bids up the levels of government intervention in the economy. Indeed the paradox is actually compounded if one considers that state aid, unless awarded for assistance with start-up costs, may be seen as increasing barriers to entry.

The benefits of international co-operation in both the area of state aid and competition policy/regulation with the aim of reducing competition between states work in the same way, though. The use of both these instruments to attract industry into a particular nation actually results in the export of that country's problems (slow growth and unemployment) to competitor nations and does so only at the expense of domestic taxpayers and consumers. Thus international co-operation while perhaps leading to lower growth and higher unemployment - though the success of such tactics in producing such benefits is debatable if all nations engage in them - does benefit those taxpayers and consumers. Indeed, in this area the categorisation of state aid as competition policy may prove useful. If one accepts that it is probably easier to

³⁸ See for example, European Commission DGIV (1995) *Competition Policy in the New Trade Order*

³⁹ For more information see, European Commission DGIV (1995) *Competition Policy in the New Trade Order* pp. 13-14.

extent co-operation in an area where it already exists than to begin co-operation anew, viewing state aid as competition policy may more easily facilitate co-operation in 'other' competition policy areas.

However, as we mentioned above, the use of competition policy insights should not be overdone - sometimes the insights drawn about the impact of globalisation on competition policy act conversely in respect of state aid.⁴⁰ A push towards liberalisation in competition policy (conventionally understood) has been noted⁴¹ because of the increasingly mobile nature of investment - but this mobility has the converse effect on state aid than it does on competition policy since it tends to stimulate greater state aid rather than less, more intervention rather than liberalisation. Should be more specific in their definition of competition policy and indeed of liberalisation. Some of the comments in this OECD piece are rather naive, hinging on the assumption that there is a general 'move to the market' such that 'greater liberalisation' indicates that governments are gradually accepting a pro-competition doctrine. It seems, especially if analysed in conjunction with the trends in state aid, that the reasoning may be rather more pragmatic, with governments doing what is necessary to encourage business, and specifically inward investment. Thus leading at the same time to greater state aid.

It will suffice to conclude this note by stressing that whatever the applicability of the insights drawn from the analysis of competition policy, specifically in the global context, to state aid, ultimately the implications of those insights will be quite different between the two areas of the policy. As we mentioned above, where as competition policy involves the regulation of *firms*, and perhaps the movement from regulation solely by national governments towards a greater input from trading partners, state aid policy involves the regulation of *governments*, and the possibility of a shift from self-regulation to regulation by trading partners perhaps via an international institution. The two are qualitatively different and anyone engaged in policy analysis must be aware of that difference, particularly when engaging in prescription.

3. Some alternative definitions of state aid

⁴⁰ See for example, Falconer and Sauve (1996)

⁴¹ For example, Falconer and Sauve (1996)

The European Community does not exist in a vacuum. Rather it is one of the world's largest international trading blocs and as such holds an important position in the global economy. It is therefore appropriate to examine definitions of state aid as employed by other organisations with which the Community, both as a Community and as individual Member States, comes into contact. Such an examination should demonstrate the existence of alternative perspectives on and illustrate some potential external constraints on the Community's view of aid.

3.1 The OECD

Since the OECD has no binding agreements on state aid, its opinions on related matters can only be of limited relevance for this research. In many ways, this is unfortunate because the OECD approach to state aid has much to commend it, not least in terms of its clarity and practicality. It is briefly presented here as a hopefully interesting comparator, and perhaps in the hope that the work conducted at the OECD will have some effect on the thinking within the Union and its Member States on state aid.

The reporting requirements of all participants in the OECD exercise on industrial support are contained in the booklet, 'Industrial Subsidies: A Reporting Manual' where industrial subsidies are defined quite clearly as: 'specific direct and indirect financial support measures of central or subcentral governments in favour of manufacturing industry resulting in a net cost to government' (OECD (1995) p. 14). Direct aid includes measures such as tax concessions and equity capital infusions, and indirect aid includes measures such as public supply of research and development, technological services to manufacturing firms, and public procurement of manufacturing (including defence) goods. 'Specific' measures are those accessible only by particular economic entities and are the main area of interest for the OECD - the exceptions to this rule being in the area of investment support where all schemes should be reported, and general schemes whose effects may be concentrated in particular sectors. It is clearly states that the exercise is concerned only with 'measures intended to compensate costs that would otherwise have to be borne by firms themselves should be reported' (OECD (1995) p. 13). Although it is concerned really only with support to manufacturing industries, the OECD also requests the report of subsidies to non-manufacturing industries where these are likely to have an impact on the manufacturing sector. This makes the scope of the OECD exercise rather wider than that of

the Commission whose surveys only deal with state aid to manufacturing industry and agriculture (although of course the Commission does investigate state aid in the services sector).

The 'public sector' is also defined rather more clearly by the OECD than by the European Commission. In the OECD exercise, 'the public sector is understood as central government and the layer immediately below (subcentral). Support measures in favour of the manufacturing industry managed through public or private intermediary institutions are also included.' (OECD, 1995, p. 12). Such institutions may include state owned firms, where state owned firms are any in which the government has a 'dominant influence' (OECD (1995) Annex V) and this might include the possession of a 'golden share', appointing a majority of directors, having a majority of votes on the board, owning a majority of shares or 'through other means' such as through via any intermediary institutions.

3.2 GATT/WTO

Although this thesis confines itself to discussing state aid within the European Union, since the EU and all its Member States are members of GATT/WTO it will be useful briefly to consider the GATT approach to subsidies since the GATT Agreements may well have the effect of acting as a constraint on state aid policy within the Union, both at the European level and in the Member States. For our purposes, the relevant periods of GATT/WTO are the post-Tokyo-pre-Uruguay and the post-Uruguay ones and it is the nature of the organisation's view of subsidies over these periods that will be noted here.

3.2.1. A brief note on the relationship between GATT/WTO and the EU

The relationship between GATT/WTO and the European Union, as opposed to its Member States, has been a rather uncomfortable one. As an international treaty which is binding on the Community, GATT is supposed to enjoy primacy over Community legislation. However, it is clear that the actual effect of GATT on the development of Community policies has been very small, perhaps 'because of the difficulties in its application both as a part of Community law and as a body of public international law' (Scott (1995), p. 149) - difficulties which the European

Court of Justice has exacerbated. The ability of GATT to bind the Community institutions was recognised by the Court in 1972 in the International Fruit cases⁴² although in the same cases the Court explicitly denied GATT direct effect thus rendering it beyond the scope of Article 177(EC),⁴³ and denying its use in one of the most frequently employed legal procedures in the Community. The Court has also 'sided' with other Community institutions against GATT, as it did in the Nakajima antidumping case through an interpretation of the GATT antidumping code designed to legitimise the rather tenuous reasoning of the Council. Additionally, the Court has recently ruled⁴⁴ that where Community law does not refer explicitly to GATT or stand in implementation of some aspect of GATT, it will not take account of GATT in its assessment, thus further reducing the role that the Agreement can play in Community proceedings.

It is also true that GATT has contributed to its own implementation problems significantly through a vastly inadequate system of dispute settlement, in which the defendant effectively had the power to block the proceedings against him at any point (Hudec in Schott (1990)). Indeed, the creation of a potentially more effective dispute settlement system⁴⁵ has been one of the most significant achievements of the Uruguay Round. This may well have important repercussions in the Community since the Court has cited the previously ineffective dispute settlement mechanism as a reason why the Agreement could not have direct effect (Scott (1995) p. 152).

3.2.2. Subsidies in the post-Tokyo-pre-Uruguay Round GATT

Articles VI, XVI, XXIII of the General Agreement on Trade and Tariffs deal with industrial subsidies. Since Article VI of the GATT deals mainly with anti-dumping and measures to

⁴² Joined cases 2/72 and 4/72 *International Fruit Company NV v. Produktschap voor Groeten en Fruit* [1972] ECR 1219.

⁴³ This said, the Court has permitted several direct challenges by private parties which have depended upon the use of GATT, e.g. *Case C-69/89 Nakajima All Precision Co. Ltd. v. Council* [1991] ECR I-2069; *Case C-105/90 Goldstar Co. Ltd. v. Council*; *Case C-188/88 NMB (Deutschland) GmbH, NMP Italia Srl and NMB (UK) Ltd. v. Commission* [1992] ECR I-1689.

⁴⁴ *Case C-280/93 Federal Republic of Germany v. Council (Bananas)* [1994] ECR I-4873.

⁴⁵ For more information see 'Understanding on the Rules and Procedures Governing the Settlement of Disputes' in WTO Agreement Annex 2. Also Schott (1996).

countervail its effects and Article XXIII deals with nullification and impairment, the main interest for us is with Article XVI which deals directly with subsidies. Its provisions, however are not precise, and it is easy to see why successive subsidy codes were required to achieve anything at all substantive. The Article obliges signatories to notify, ‘...any subsidy ... which operates directly or indirectly to increase the exports of any product from, or to reduce imports of any product into [another signatories’] territory’ [Article XVI, section A.1]. It goes on to make only the vaguest of stipulations in relation to subsidies, saying that ‘...contracting parties should seek to avoid the use of subsidies on the export of primary products’ and that if such subsidies are given the government in question should not secure for its country ‘... more than an equitable share of world export trade in that product’ [Article XVI, section B.3]. On subsidies other than to primary products, signatories are required to ‘... cease to grant either directly or indirectly any form of subsidy which results in the sale of such product for export at less than the comparable price charged for the like product to buyers in the domestic market’ [Article XVI, section B.4].

The GATT Subsidies Code as it stood immediately post-Tokyo⁴⁶ was positively platitudinous, and nowhere is there anything that could be interpreted as a definition of subsidy. Rather the approach was entirely effect-driven, and hence *ex post*. No form of subsidies was prohibited per se, signatories merely undertook not to use them ‘in a manner inconsistent with the provisions of this Agreement’ (Article 8.2), and that they, ‘would seek to avoid causing, through the use of any subsidy: (a) injury to the domestic industry of another signatory; (b) nullification or impairment of the benefits accruing directly or indirectly to another signatory of under the General Agreement; or (c) serious prejudice to the interests of another signatory’ (Article 8.3). Signatories are also asked when devising subsidies other than export subsidies to ‘take account of’ the effects that these measures are likely to have on trade (Article 11.2).

Neither was much attention was paid during Tokyo to the question of state resources. The closest consideration of the problems of deciding what constituted a measure of support from the state is found in a footnote which states that:

⁴⁶ For greater detail on the situation after the Tokyo Round see Barcelo (1980)

‘In this Agreement the term “subsidies” shall be deemed to include subsidies granted any government or any public body within the territory of a signatory. However, it is recognised that for signatories with different federal systems of government, there are different divisions of powers. Such signatories nonetheless accept the international consequences that may arise under this Agreement as a result of the granting of subsidies within their territories.’ (Note 22)

3.2.3. Subsidies in the post-Uruguay Round GATT

The GATT Uruguay Round was one of the most significant recent developments in world trade policy, not least because of the final agreement which was reached on the new Subsidies Code. The negotiations on the Subsidies Code have been widely acknowledged to have been some of the most troubled trade negotiations of our time, and the disagreements between the US, Canada and the EU were so fundamental that at times a consensus could not even be reached about whether there should be a new code at all let alone what its substance should be. The Agreement, however, perhaps surprisingly, did manage to make some notable progress. Importantly, it managed to answer a question that had been pointedly avoided by GATT up to that point, namely: what is a subsidy? Article 1 of the Agreement defined a subsidy as, ‘a financial contribution by a government or any public body within the territory of a Member’ or a private body which acts on its own behalf, that has the effect of conferring benefit on the recipient. This is clearly, and unsurprisingly, a broad definition and the financial contributions it mentions may include (Schott, 1996):

- (1) ‘direct transfers of funds or liabilities (e.g. grants, loans, equity infusions and loan guarantees);
- (2) forgone or uncollected government revenues (e.g. tax credits) other than agreed border tax adjustments;
- (3) provision of goods and services other than general infrastructure on concessional terms;
- (4) income and price supports.’

Similarly to the EU, the current GATT approach only concerns itself with ‘specific’ subsidies rather than general economy-wide measures (e.g. income tax cuts) which are deemed not to distort competition. Specific measures are those where ‘the granting authority, or the legislation

pursuant to which the granting authority operates, explicitly limits access ... to certain enterprises' (Article 2.1a) or where the subsidy is in practice only available to certain enterprises (even though in principle it may be freely available) (Article 2.1c). All export subsidies are seen as specific (Article 2.3) and an illustrative list is provided in Annex 1 of the agreement.

The Agreement adopted what has become known as the 'traffic light approach' which divides subsidies into three types: prohibited; actionable; and non-actionable. Prohibited subsidies⁴⁷ are all those which benefit non-agricultural products and that depend on export performance. All such subsidies which exist must be abolished, and no new subsidies of this type must be given. Also prohibited are subsidies the receipt of which depends on the use of domestic rather than imported goods.

The second group of subsidies is that of 'actionable subsidies'. These subsidies, in contrast to those related to exports, are actionable only if they may be shown to have 'adverse effects', namely: cause injury to the domestic industry of another Member; nullify or impair benefits of the GATT; cause 'serious prejudice' to the interests of another Member. Indeed, the Uruguay Round Agreement goes on to provide extensive guidelines on determining the effects on trade or subsidies, and in doing so tightens the pre-existing obligations (under the Tokyo Round) significantly. It is clear that the idea of 'serious prejudice' as an important addition to the Agreement. Serious prejudice exists when (Schott (1996) p. 89): 'the total *ad valorem* subsidisation of a product exceeds 5% of the recipients annual sales of that product, or 15% of the total invested funds for startup firms (Annex IV); subsidies cover operating losses of an industry or an enterprise, unless they are one time and non-recurrent measures to facilitate adjustment; governments provide direct debt forgiveness or grants for debt repayment; and the effect of the subsidy is to displace or impede imports from the home market, exports to a third country market, or undercut or suppress prices in the home market.'

⁴⁷ The Uruguay Round Agreement includes an appendix which lists prohibited subsidies. This list is identical to that of the Tokyo Round subsidies code, save for a revision of 'item (h)' which relates to 'the exemption, remission or deferral of prior stage indirect taxes'. The revision allows for taxes on fuels and other forms of energy which are used as inputs in production to be exempted, remitted or deferred as if they had been physically incorporated into the final product (see Annex II). This may be significant if it allows energy intensive industries to benefit from rebates on energy taxes (Schott (1996) p. 88).

The third and final category concerns non-actionable subsidies which are generally exempt from countervailing measures. The Agreement refers to three types of activities which may be considered as non-actionable, presumably on the grounds of their probably positive externalities. The first category is research and competitive development, where subsidies are permitted provided that they cover no more than 75% of certain specified costs of industrial research or 50% of certain specified costs of pre-competitive development. Additionally, the subsidy may be spent only on personnel, equipment, land, buildings and overhead costs; the subsidy may not be used to fund any commercial activity. The second category relates to regional aids to disadvantaged regions of a Member country. The assistance should be provided under a general(nonspecific) regional development framework, and the assistance should be awarded only to those areas which have either income per capita, household income per capita or GDP per capita less than 85% of the territory average, or that have an unemployment rate of at least 110% of the territory average. The third category concerns subsidies provided to support compliance of existing equipment with environmental standards. The assistance must be generally available to all firms able to adopt the new equipment or processes, it must be one time and non-recurrent, it must be no more than 20% of the costs of adaptation, and it must not be used to meet replacement or operating costs.

It should be noted, though, that the drafters of the Agreement were certainly aware of the potential for abuse of the non-actionable category. Article 8 contains a 'sunset' clause which states that the exemptions will be subject to review five years after the coming into force of the Agreement, allowing the possibility of its withdrawal or alteration if it fails to function as hoped. Article 9 states that non-actionable subsidies which have 'serious adverse effects' and which cause 'damage which would be difficult to repair' do give grounds for countervailing measures if the Member country concerned fails to modify the programme appropriately. A final safeguard against abuse of the non-actionable category is the monitoring undertaken of subsidies which fall into it. Each programme in this category must be notified before implementation, and notifications must be updated annually and Members can request their notification to be reviewed to check whether the conditions are being met. Any disputes relating to notifications are subject to binding arbitration.

Another new development from the Uruguay Round is the creation of the so-called 'Permanent

Group of Experts' who will assist in dispute settlements and provide advisory opinions to Member States. If so requested the PGE will provide an opinion as to whether a particular measure is indeed a subsidy, and moreover whether it is a prohibited subsidy. The opinion of the PGE is binding to all parties in the dispute. In addition to its role in disputed cases, the group may also provide confidential for any Member on the nature of any proposed or existing measure (Articles 24.3 and 24.4).

It is clear from all this, though, that while the Uruguay Round has certainly made clearer the definition of subsidy employed by GATT/WTO, the European Community's view of state aid remains well within these international limits. Although the Community may have fallen foul of the GATT/WTO requirements with relation to countervailing measures, and even more so anti-dumping duties (see for example Behboodi, 1994) its Member States, at least at the moment, in abiding by the Community rules should find themselves well within the limits of GATT/WTO. That said, the GATT approach to subsidies should certainly not be dismissed as irrelevant in the Union as it is clear that the organisation has far from fulfilled its potential (legally defined) as the policeman of world trade (see Scott (1995)). Although it has yet to show signs of doing so, in its new incarnation as the WTO, it could well make its presence in Europe more strongly felt in the near future.

4. Conclusion

It is difficult to imagine a more vague, less inclusive definition of state aid than that currently in force in the European Community, embracing as it does: direct subsidies; tax exemptions; preferential interest rates; guarantees or loans especially those on favourable terms; sale of land or buildings on favourable terms; indemnities against losses;⁴⁸ preferential ordering; preferential discount rates; dividend guarantees; deferral collection of fiscal and State guarantees, whether direct or indirect, to credit operators;⁴⁹ not to mention any other means having equivalent effect.

However, before concluding that the present (non)definition of state aid is in some way

⁴⁸ All the foregoing listed in OJ Special Edition 235, 1963.

⁴⁹ Preceding four types of aid added by Council document 20.502/IV/68.

inadequate, it is important to consider the question: adequate for what? The Commission is in no sense concerned with economic optimality, in the pursuit of which a precise definition and quantification methodology for state aid would be necessary, but rather is engaged in working towards the goals of the Treaty, in which case a vague definition of state aid which allows one to prohibit any measure which may damage the wider political aims is actually more adequate.⁵⁰ In fact, maintaining its discretion in the area of state aid is probably particularly important for the Commission, since it allows it a degree of influence over Member States' fiscal policies, with which it generally has very little to do. While the current definition of state aid in the Community is rather inadequate for researchers, governments, recipients of aid, and indeed anyone else interested in increasing the transparency of the Community's politico-legal structure, it is quite adequate for the Commission which because of it enjoys maximum leverage over Member States in this area.

Although its view of industrial subsidies is certainly clearer after the Uruguay Round, those seeking a transparent and unequivocal definition of state aid, will still be disappointed by that of the GATT/WTO. Although again, the main purpose of GATT/WTO, while having undeniable economic benefits, is unmistakably political and consists in the avoidance of international trade disputes (originally following the Cobden and Bright philosophy that this would reduce the risk of military conflict). With this in mind a possible explanation for the lack of precision of subsidies is that (similarly to the EC) it is part of a deliberate policy, to secure the maximum possible scope for the Agreement, since if a potential dispute is solved under the Agreement it is less likely to escalate into anything more serious. The rather more cynical explanation of the GATT/WTO approach would be that it simply represents the (very) lowest common denominator on which the signatories could agree.

The only approach to state aid which includes a precise and really useful definition of state aid, together with a reasonably comprehensive evaluation methodology is that of the OECD. It might be possible to explain this from the fact that the OECD has no enforcement powers with respect

⁵⁰ It is interesting to recall that the Court, which should be seeking to improve legal certainty, has not much improved the completeness of the definition of state aid in the Community. Some such as Capellitti (1987), would argue that this is because it follows the same integrationist philosophy as the Commission.

to state aid and, while there is a general consensus there that the use of aid measures should be more carefully justified, there is no move to prohibit aid and thus its Member States are happy to approve this approach to aid safe in the knowledge that they will not be bound to act by it. This is certainly partly true, but it does not wholly account for the difference in approaches. GATT/WTO, the EC and the OECD, have a very largely common membership, and it is perfectly permissible for countries who learn of the type and extent of aid activities from the OECD programme to use that information in a complaint within the framework of GATT/WTO or the EC. Thus, information volunteered in the OECD exercise carries no immunity, and therefore a great many of the OECD member countries are likely to have been equally sensitive to the approach adopted there as they would have been towards the approach in GATT/WTO or the Union. It should be accepted that because of the wider membership of GATT/WTO, agreement would probably be harder to reach there, but within the Community a more complete approach is achievable. Again, we return to the fact that, while the OECD exercise is more concerned with an economic analysis of industrial support, the European Commission is working towards a grander goal of political integration and simply sees its state aid policy in that light.

The policy angle, although only really noted in this paper, must not be ignored in considering issues surrounding state aid, and the policy area in which state aid is categorised can have serious implications for the type of the type of analysis employed and the factors taken into account. Indeed, one of the most important points made in this paper is that state aid can be considered variously as belonging to industrial policy, competition policy and/or trade policy. Although the links between state aid and competition policy, other than formally in the EC Treaty, are quite tenuous, the links between state aid *qua* industrial policy and state aid *qua* trade policy are very significant and becoming more so as trends towards globalisation continue. Indeed, the strengthening of these links are increasing the need, already strong in the field of state aid, for interdisciplinary co-operation. It is vital if there is to be complete analysis of state aid that there should be close liaison between lawyers, political scientists and economists, and also between practitioners involved in matters relating to industrial policy, trade policy and, especially in the context of EC law, competition policy. It seems an appropriate note to conclude on by saying that, while it does seem that precisely such an 'open exchange' (Feyerabend, 1987, p. 77) is something that this discussion hopes to achieve - and the organiser should be strongly commended for that - it should be stressed that further moves in this direction are necessary for

the adequate progression of research on state aid.

Bibliography

Abbreviations:

CMLR: Common Market Law Reports

CMLRev: Common Market Law Review

ECLR: European Competition Law Review

ECR: European Court Report

EER: European Economic Review

EIU: Economist Intelligence Unit

ELR: European Law Review

Ox REP: Oxford Review of Economic Policy

RoCP: Report on Competition Policy

SoSA: Survey on State Aid in the European Communities

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