THE IMPORTANCE OF THE STATE AIDS RULES OF THE EUROPEAN UNION IN THE CONTEXT OF THE GLOBAL FINANCIAL AND ECONOMIC CRISIS

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During the last seven years, the European Union, as well as the rest of the world, had to face the dramatic impact of the global financial and economic crisis. The crisis did not originate in Europe, but arrived from the United States. However, two peculiarities of the EU context characterized and amplified its effects, profoundly shacking the economy, with terrific social shock.

On the one hand, the ambivalent position of the EU member states in front of the enhanced globalization of world business. They do not held the starring role; contrary to previous cases of expansion of world trade, frequently led by the European powers, with their wide colonial empires. The ongoing globalization changed radically former equilibriums and in many sectors, the European industry lost competitiveness and jobs. Consequently, the economy of several EU countries was already weakened before the crisis and needed significant structural reforms to regain efficiency.

On the other hand, the institutional system of the European Union is not the same of a classic federal state. In particular, within the monetary union (*EMU*), the members share a single currency (the *euro*) and a single central bank (the *ECB*), but their fiscal and economic policies were, at the beginning of the global crisis, still largely decided and implemented at national level. Each country is responsible for its own public debt, whose level and sustainability vary from one state to another. Moreover, there is no univocal interpretation of the relevant legal provisions concerning the role and the powers of the ECB, as well as on the limits and potential of the EMU itself. Therefore, the crisis represented an unprecedented, uncertain challenge for the European Union's reaction capacity.

The global financial crisis started, in 2007, in the American housing market. It reached an unexpected severe level in September 2008, when the well-known global financial service firm Lehman Brothers went into bankruptcy. This event showed an effective danger of collapse for a number of other prominent financial institutions. Due to the interconnections of the financial markets around the world, the USA crisis fast became global, affecting banks and financial institutions in several countries of all continents.

Within the European Union, the member states' governments intervened massively to help and rescue the troubled assets of several financial institutions operating on their territories. Different instruments were used, involving public resources: forms of state guarantees, loans at preferential rate, injections

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of fresh public money and even acquisitions (i.e. nationalizations).

The competition rules of the Treaty on the Functioning of the EU (*TFEU*), consider such interventions as 'state aids' to undertakings operating on the free market. Thus, EU law *prima facie* prohibits them all. However, the European Commission interpreted the relevant rules in a flexible way, making legally possible for EU member states to support the financial sector (and later, the so-called real economy), heavily affected by the global crisis.

Two key objectives inspired the rationale of this approach, aimed at avoiding the infringement of EU law. First, ensuring the stability of the financial system, notably by preserving the banking sector from the concrete danger of a downfall. Second, preventing unnecessary or disproportionate distortions of competition among financial institutions, within the European 'single market'.

The Commission, acting in its capacity of competition authority, behaved in strict coherence with the general EU action against the global crisis, led by the European Council and carried on by Commission itself, the *Ecofin* Council and the ECB. In that frame, the TFEU rules concerning state aids were the first instrument activated at EU level to contrast some of the effects of the crisis.

According to the Commission, the systemic risk triggered by the global financial crisis in Europe could justify the application of Article 107, (3), (b) TFEU, which allows the approval of a state aid measure "*to remedy a serious disturbance in the economy of a Member State*". This interpretation goes beyond the literal reading of the Treaty provision; which seems to imply that the "serious disturbance" should occur only in a single EU country. However, since it was never challenged in a court, it remains fully valid; also considering that, the Court of Justice recognizes to the Commission a wide discretional power when applying competition rules.

The European Commission laid down, in several acts, the conditions for the approval of national state aid schemes, set up in favor of the financial sector, in order to face the global crisis. The relevant procedural rules were also adapted, for allowing the indispensable prompt response. In particular, the Commission issued a set of notices (the so-called "*Crisis Communications*")[1], indicating: its interpretative rationale, the concrete state measures deemed as acceptable during the global crisis, the conditions to admit such measures, and what should be required to each financial institution in exchange of the government assistance.

The fundamental target of most measures adopted by the member states of the European Union was to strengthen the solidity of the financial institutions and to restore their access to liquidity, notably by improving interbank lending. For this purpose, the government

[1] The Commission's *Crisis Communications* (e.g. the Banking Communication, the Recapitalization Communication, the Impaired Assets Communication, and the Restructuring Communication) are available at http://ec.europa.eu/competition/state_aid/legislation/temporary.html. They have been repeatedly amended or even replaced (this is the case of the 2008 Banking Communication) to adapt to the evolution of the crisis.

intervention aims helping the reestablishment of mutual trust among market actors. Furthermore, several national legislations provided mechanisms able, if needed, to rescue the financial operators in major difficulties.

The legal framework set up by the Commission preserved only to a certain extent the normal procedural provisions, on the application of state aids rules. Therefore, it is required to the EU countries, wanting to implement the measures mentioned and described in the 'communications', to notify their state aid draft schemes to the Commission. However, in derogation to the ordinary procedure, once approved the project of the basic law, there is no more need to notify any individual aid granted in accordance with it.

The EU national governments asked for the approval of many state aid schemes for banks and other financial institutions. According to the *Scoreboard* of state aids to the financial sector, published by the European Commission, "*between 1 October 2008 and 1 October 2013, the Commission took more than 400 decisions authorizing aid schemes for banks*". The Commission also calculated that, in the period 2008-2012, "*the overall volume of aid used for capital support (recapitalization and asset relief measures) amounted to € 591.9 billion (4.6 % of EU 2012 GDP)*"; in the same period, the public money granted for state guarantees and other liquidity measures amounted to € 534.5 billion (4.1 % of EU 2012 GDP).

The global crisis, while affecting first the financial sector, had also a significant impact on the European real economy. Because of their crisis, banks started deleveraging and became much more risk-averse. Furthermore, the financial crisis scared consumers, who greatly reduced their spending. Consequently, the European countries had to face a rapid collapse in demand, a huge decrease of investments and a widespread recession.

Therefore, it was necessary to adopt further measures in order to restore a normal lending activity to firms (others than the financial ones) suffering from the credit squeeze. The European Commission, again, applied the EU state aids rules, in a way that allowed stimulating the financial sector onward borrowing capacity.

At the end of 2008, the Commission set forth a notice, known as *Temporary Framework* for state aids aimed at supporting companies' access to finance during the global crisis[2]. It describes a number of specific instruments that considered compatible and admissible, for a certain period, pursuant to Article 107, (3), (b) TFEU. In compliance with the principle of proportionality, the Commission paid attention to the causality with the global crisis and to the need to ensure a minimal distortive effect on competition. Thus, state aids could be granted just for a limited period (i.e. until the end of 2010) and only to sound firms which were not

[2] The Commission updated the 2008 Temporary Framework several times, authorizing certain national measures, until the end of 2011 (Communication of the Commission *Temporary Union framework for State aid measures to support access to finance in the current financial and economic crisis*, O.J. [2011] C 6/5). As to the procedure, the project of the basic aid scheme had to be notified and approved by the Commission, but there was no further need to notify individual grants made under the schemes.

in difficulties before 1 July 2008, but entered into trouble because of the global crisis.

The Temporary Framework referred to several possible national measures, like: lump sums of aid to cover investments or working capital, subsidized guarantees for loans at a rate premium below the normal market one, subsidized interest rate applicable to loans, direct loans from the state at lower interest rates, risk capital injections for SMEs. The Commission authorized them via an explicit derogation to some of its 'block exemption' regulations. For example, the so-called *De Minimis* Regulation[3] was amended, allowing the national public authorities to freely grant, during one year, this type of small state aids up to higher individual threshold (euro 500,000, instead of the usual one of euro 200,000).

The Temporary Framework proved to be a useful tool for member states permitting them to give a certain relief to the real economy. The European Commission's figures[4], about its concrete impact for the years 2008-2010, tell that 73 state aid schemes were approved and that the (*de minimis*) grant of euro 500,000 was the most used measure[5]. Germany (78% of the total amount authorized) was, by far, the country most widely using this measure and therefore, getting the greatest competitive benefit from it. This shows a meaningful example of a direct advantage enjoyed by the German industry, during the global crisis.

In the light of the above and from a more general point of view, it is worth noting that the most relevant provisions of the EMU might emphasize a dangerous disparity among the EU member states.

Those respecting the relevant parameters for annual deficit (3% of national GDP) and public debt (60% of national GDP), are free from macroeconomic constraints and therefore, have more room in their budget for spending public money to support the economy and the market actors; no rule of the EMU limits them in that respect. On the contrary, the countries whose public accounts figures are close to the above-mentioned parameters or beyond and the countries submitted to a formal 'excessive deficit procedure', have little or no chance to inject public funds into their national economy and to grant any form of state aid.

This situation could be deeply detrimental for free competition. The only instrument and barrier against a possible drift is the rigorous application of the TFEU state aids rules. It allows a strict control on national governments' industrial policies and on their capacity to

[3] Regulation no. 1998/2006, [2006] O.J. L 379/5, now replaced by the Regulation no. 140772013, [2013] O.J. L 352/9.

[4] See the impact analysis and the figures published in 2011 in the Commission Staff Working Paper: *The effects of temporary State aid rules adopted in the context of the financial and economic crisis*. Available at http://ec.europa.eu/competition/publications/reports/temporary_stateaid_rules_en.html.

[5] According to the Commission's *Scoreboard* of state aids to the real economy, the total volume of state aids approved under the Temporary Framework, during the period 2009-2011, amounts to euro 82,9 billion. See at http://ec.europa.eu/competition/state_aid/scoreboard/financial_economic_crisis_aid_en.html.

spend public resources, notably in favor of companies operating on their territory.

The European Commission has the duty to carry on systematically this surveillance, if needed stimulated by appropriate complaints. A severe action of this kind may prevent effective and potential distortion of competition within the EU internal market.

During the first years of the global crisis, the European Commission authorized EU national governments to set up state aids measures, in order to avoid breakdowns of banks and other financial institutions and to give some relief to the real economy in the countries. Nearly all of them made large use of the open attitude of the EU competition authority.

However, the costs for the national budgets were dreadfully high. National public debts and deficits went up substantially and the average public debt, in the Eurozone, speedily rose from 66,4% of its GDP in 2007, to 85.8% in 2011 (in 2013 it reached 90.9% of the Eurozone's GDP)[6].

Such an increasingly difficult situation highlighted the asymmetries and the macroeconomic imbalances among the members of the EMU. The existing EU and EMU provision did not allow enough guarantee and most actions were still in the hands of each member state. Therefore, financial markets started wondering about the effective sustainability of public debt of several countries and about the solvency of European government bonds, previously considered almost risk free. International investors became less willing to continue buying national debt titles or accepted to do so, only in front of interest rates much higher than before the crisis.

Consequently, within the European Union, the global financial crisis turned into an unprecedented sovereign debt crisis. The countries with big public debt and/or unsustainable annual deficit, were the most hit and in danger of collapsing if unable to keep borrowing from the financial markets[7].

Given that many EU countries needed immediate focused assistance and that the legal framework of the EMU did not provide effective tools for it, the EU institutions and the national government had to agree upon some concerted and innovative actions. Between 2011 and 2013, they adopted a

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[6] The relevant figures are published by Eurostat; see: *General government gross debt annual data*, available at http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&language=en&pcode=teina225. According to the *Eurostat supplementary table for the financial crisis* published in October 2014, the impact of support measures for financial institutions on government deficit in the Eurozone and in the European Union, raised between 2008 and 2010, it slightly decreased in 2011, and raised again in 2012 and 2013. See the detailed figures at http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/Background-note-fin-crisis-Oct-2014-final.pdf).

[7] For example, Ireland, while coming from several years of economic boom, went into dramatic problems when its government had to intervene to rescue the country's largest banks by issuing a blanket guarantee for their liabilities and to recapitalize them using a significant amount of public money. The terrific costs of these interventions exacerbated the annual budget deficit, with a very negative knock-on effect on the level of the national public debt and on its overall sustainability.

number of rules to strengthen the EMU, as well as innovative financial instruments to safeguards the states[8]. These initiatives, flanked by the action of the ECB, granted the integrity and the stability of the Eurozone and ultimately, of the entire European Union.

The terrible experience confirmed that financial markets are global; thus, the likelihood of contagion is worldwide high. Within the European Union, it became clearer the interdependence of the economies of the various member states, especially (but not only) those having the same currency. This brings to a sort of inherent, automatic sharing of strengths and liabilities, of risks and opportunities.

Such an interlinked situation undoubtedly requires a strong and well-functioning common institutional framework, and a constant, strict and wise application of EU law. In particular, while apparently unrelated, the competition rules of the TFUE and the macroeconomic provisions of the EMU proved to be both useful against the great variety of detrimental effects caused by the global crisis.

Therefore, it is indispensable that all the EU institutions reach and maintain a high degree of awareness and attention, in order to grant, at the level of the European Union, the most effective action, needed by citizens and markets. National governments must continue keeping sounds budgets and carrying on the appropriate structural reforms[9]. At the same time, the European Commission has to guarantee and preserve a severe equilibrium between the evident opportunity to allow a fear public founded support to the economy and the duty to exclude any unjustified restriction to free competition or an unduly alteration of the correct level playing field among market actors.

[8] See for example: the EU regulations and directives of the so-called 'Six Pack' (making the excessive deficit procedure more rigorous and requiring annual budget equilibrium to each country) and 'Two Pack' (setting up a system of ex ante control on national draft budget laws), the 'Fiscal Compact' treaty (codifying most of the EMU Stability and Growth Pact provisions), the new rules for the European Banking Union, and the financial instruments to provide lending assistance to the states (notably the ESM, European Stability Mechanism).

[9] See a useful catalogue of the structural reform needed by each EU country and recommended by the European Council, in European Commission *2014 Semester: Country-specific recommendations. Building Growth*, COM(2014) 400 final.