



Product market reforms, the business environment and state interventions in the Euro area

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Competition

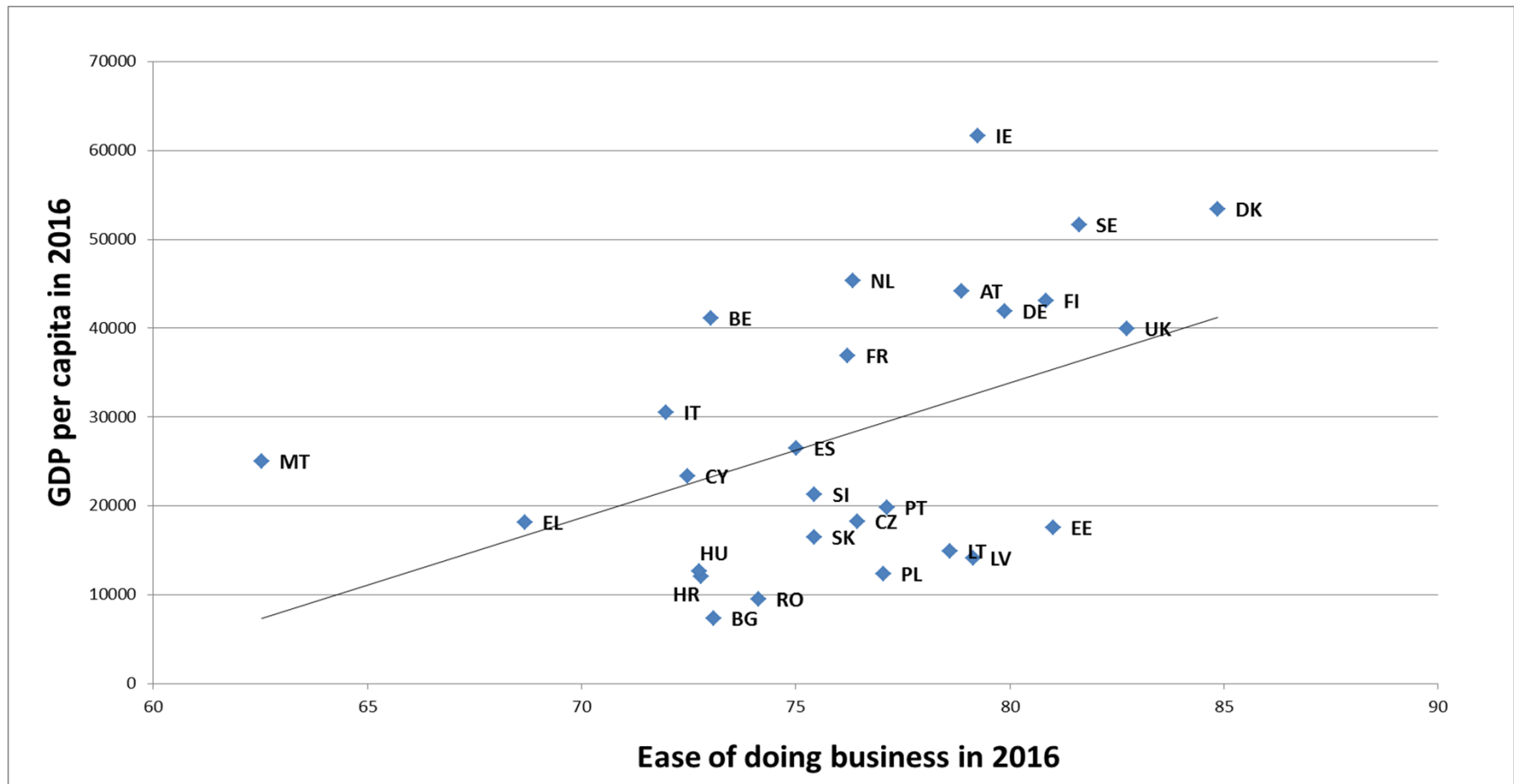


Outline

1. The importance of a pro-competitive business environment and product market regulation for the euro area
2. State interventions in product markets
3. Example: (De-)regulation and competition in air transport
4. State interventions: competition, trust and transparency
5. Pushing the reform agenda forward
6. Background slides

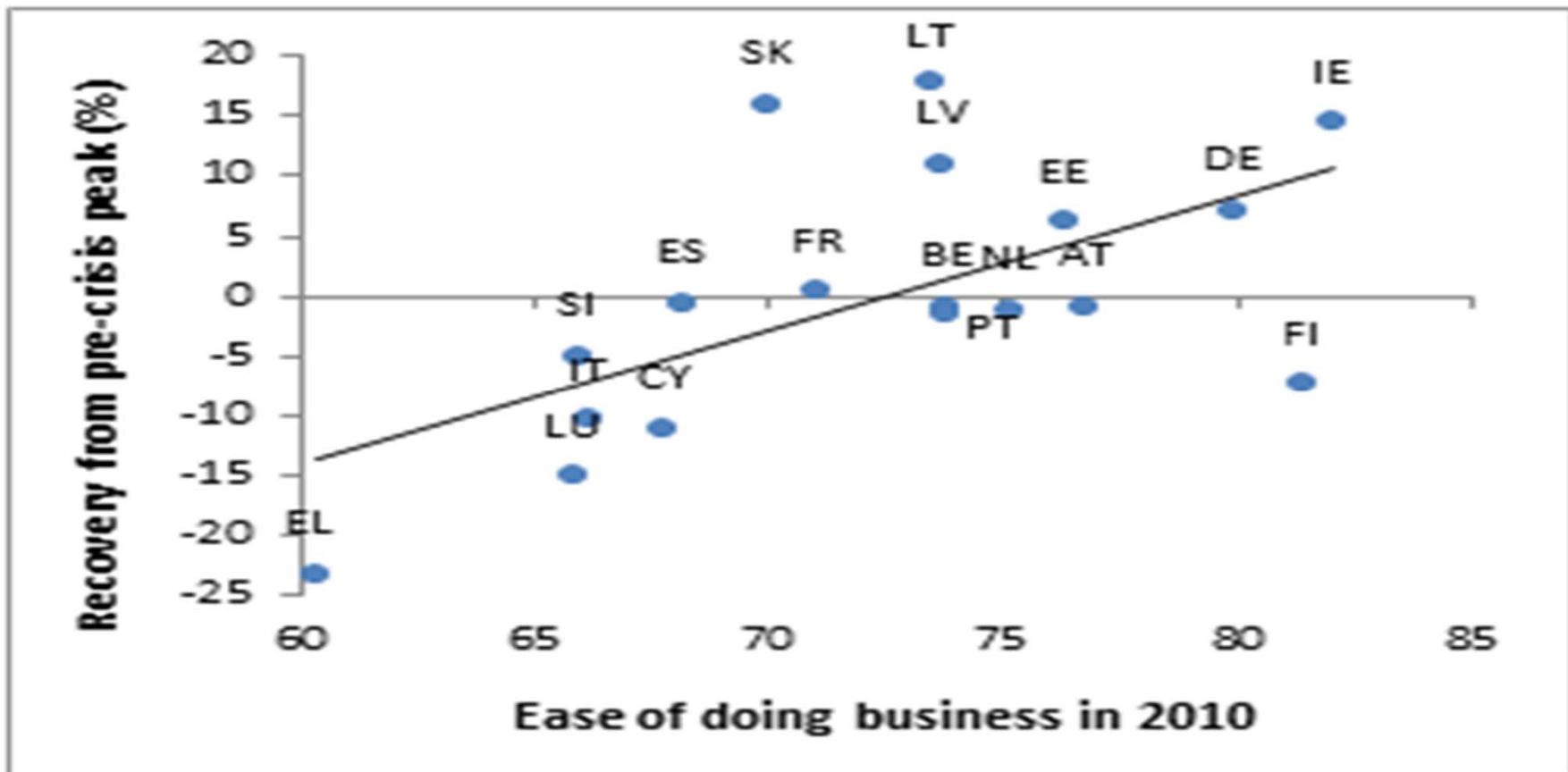


Business environment and GDP



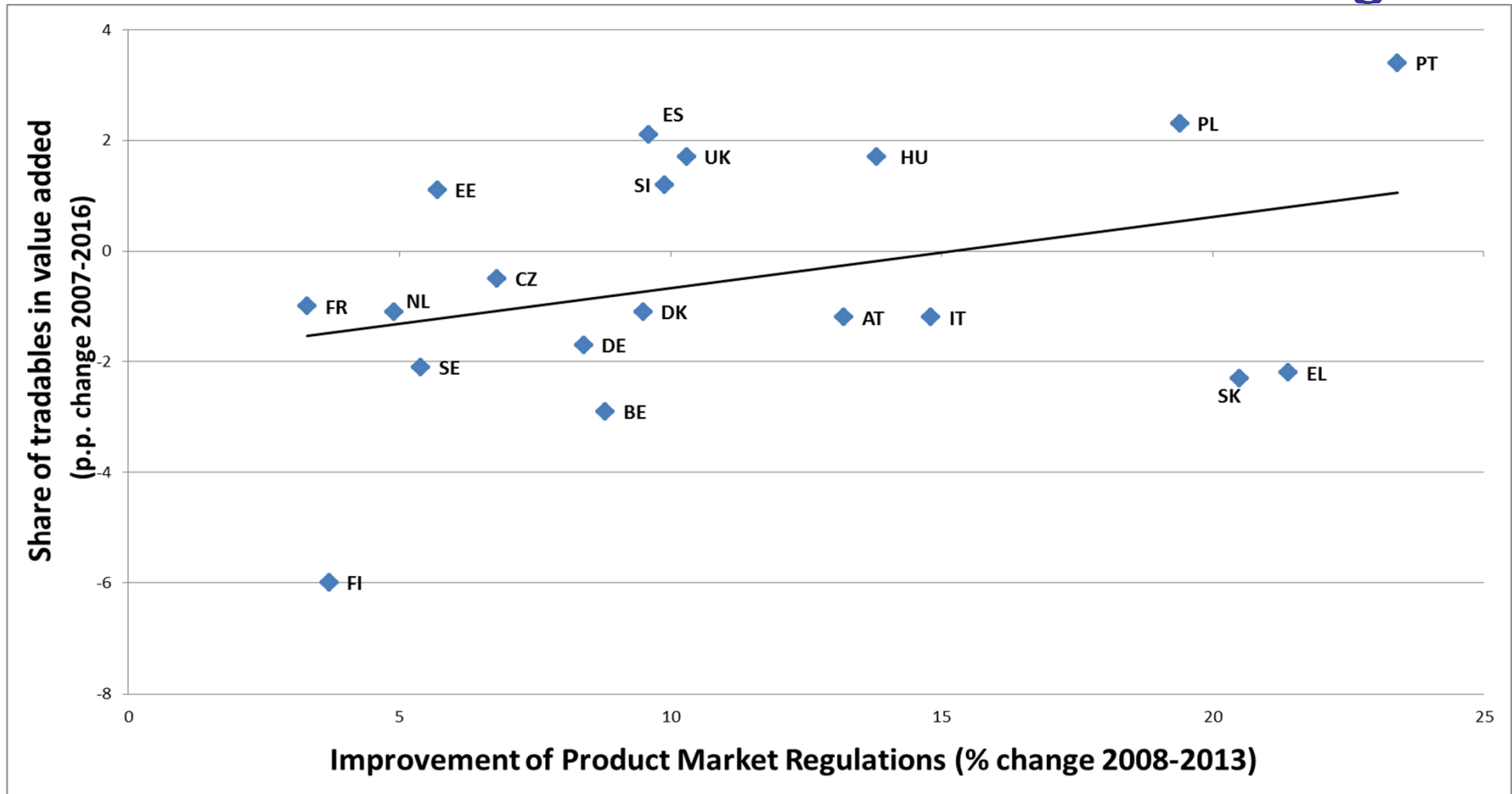
Source: Eurostat, World Bank

Business environment and resilience



Source: European Commission, World Bank

Business environment and structural change



Source: Eurostat, OECD



State interventions in product markets: issues

Might be necessary to deliver services which the market will not deliver on its own (most efficiently done through competitive allocation)

However:

- Motivation for direct interventions sometimes not clearly grounded in economic rationale
- State owned enterprises can be rather inefficient (depends on governance + tasks)
- Risk that saving failed enterprises stifle required reallocation of resources by not exiting
- How to deal with rent-seeking behaviour



State interventions in product markets: EU-level rules and disciplines

In some cases the market rules are defined at EU level – EU regulation – but often with considerable discretion for Member States; business environment: largely for MS to set.

Competition rules (notably State Aid discipline): rely on enforcement involving Commission and Competition Agencies: effective but State Aid control applies only when measures are selective and affect trade in EU

SGP; excessive deficit rules, MIP, conditionality in structural funds – not suited to deal with individual interventions, but provide a "macro" constraint;

European Semester (CSRs): advisory + calibration issues



State interventions in product markets: State Aid rules

Selective subsidies for companies with competition/trade implications are limited by conditions:

- Aid is in principle not allowed, unless clear "**common interest objective**" (e.g. banking crisis, R&D&I spillovers)
- The state measure should be **necessary**: Is there a market failure? Are markets not functioning on their own? Are subsidies the best response?
- Aid should be **proportionate** + have an **incentive effect**: only equal to the minimum required to trigger investment (i.e. no windfall profits)
- Commission has exclusive decision-making powers on "**compatibility**" – functions as a Competition Authority



(De-)regulation and competition in air transport

EU liberalisation	Market developments	Key State aid principles (2014)	Selected State aid interventions
<p>From protected national aviation markets to a competitive single market</p>	<p>Emergence of low-cost carriers (market share of passenger seats topped incumbents' in 2012)</p> <p>From 1995 to 2014, number of passenger-kilometres for air transport grew by 74%</p>	<p>Burden Sharing required to limit moral hazard created by R&R</p> <p>Incremental cost approach for contracts to airlines</p>	<p>Airlines: Cyprus Airways, Malev (HU), Estonian Air stopped operations <i>(No realistic perspective of becoming viable without continued state support)</i></p>
<p>The first (1987) and the second (1990) 'packages' started to relax the rules governing fares and capacities. In 1992, the 'third package' removed all remaining commercial restrictions for European airlines</p>	<p>In 2017 there are almost eight times as many routes as there were in 1992</p> <p>The minimum price of a trip from Milan to Paris has come down more than 90% since 1992; general price developments in air transport more favourable than for any other transport mode</p> <p>As a result of emergence of LCCs, high competitive pressures between airports</p>	<p>Ex-ante lump sum for operating aid (up to 2024 only!)</p> <p>Competitive analysis in catchment area: no duplication of infrastructure allowed</p> <p>Demonstration of genuine market failure or the case for social cohesion</p>	<p>Airports: Zweibrucken (DE) closed and Gdynia (PL) development not allowed <i>(Both airports close to existing airports with spare capacity; assumptions in business plans highly unrealistic)</i></p>



State Interventions: competition, trust and transparency (I)

- The crisis has drawn attention to aggressive corporate tax planning practices
- Direct taxation falls within the competence of the Member States, but must be consistent with Union law – therefore falls under State aid control
- The Commission decided to look deeper into the matter and opened several investigations (e.g. Starbucks, Apple, Amazon, Engie, Belgian Excess profit)
- All cases: significant selective reduction in corporate tax bill; often between 75% and 99% of taxes due; cases shed unprecedented transparency on mechanisms that hitherto were protected by fiscal secrecy
- Ultimately, all companies, big or small, should pay their fair share of tax where their profits are earned so that they can compete on equal terms
- Corporate behaviour and tax facilitation has undermined public trust
- Real momentum to reform corporation taxation frameworks and ensure greater transparency



State Interventions: competition, trust and transparency (II)

- Zombie firms crowd out growth of efficient firms (rise in 3.5% share in zombie firms is associated with 1.2% decline in labour productivity across industries)
- SOEs on average less productive, negative impact on allocative efficiency and on State budgets; SOEs tend to receive restructuring aid more often than private competitors: more than 40% of non-financial Rescue and Restructuring aid decisions since 1999 concerns SOEs
- The complexity of financial relations between public authorities and SOEs requires transparency (e.g. implied unlimited guarantees, exemptions from bankruptcy procedures); key issue is governance not ownership *per se*.
- Significant share of complaints received by DG COMP concerns SOEs as alleged beneficiaries of illegal aid; often clusters in a given Member State.



Pushing the reform agenda forward (i)

- A lot can be done at Member State level:
 - Huge potential to improve the business environment, product markets, role of the State
 - Transparency, role of Courts of Auditors, evaluation
 - National checks through competition rules on State interventions; e.g. DK ("national" state aid control, Dutch legislation)
- National measures but adjustment potential and resilience of EA economies are essential for Euro Area; so how to co-ordinate?



Pushing the reform agenda forward (ii)

How to support these reforms at EU/EA level:

- Advisory (EU Semester)
- Conditionality (Structural Funds, Cohesion) and MIP
- Support through joint ownership and (co-)financing (Structural Funds and SRSP)

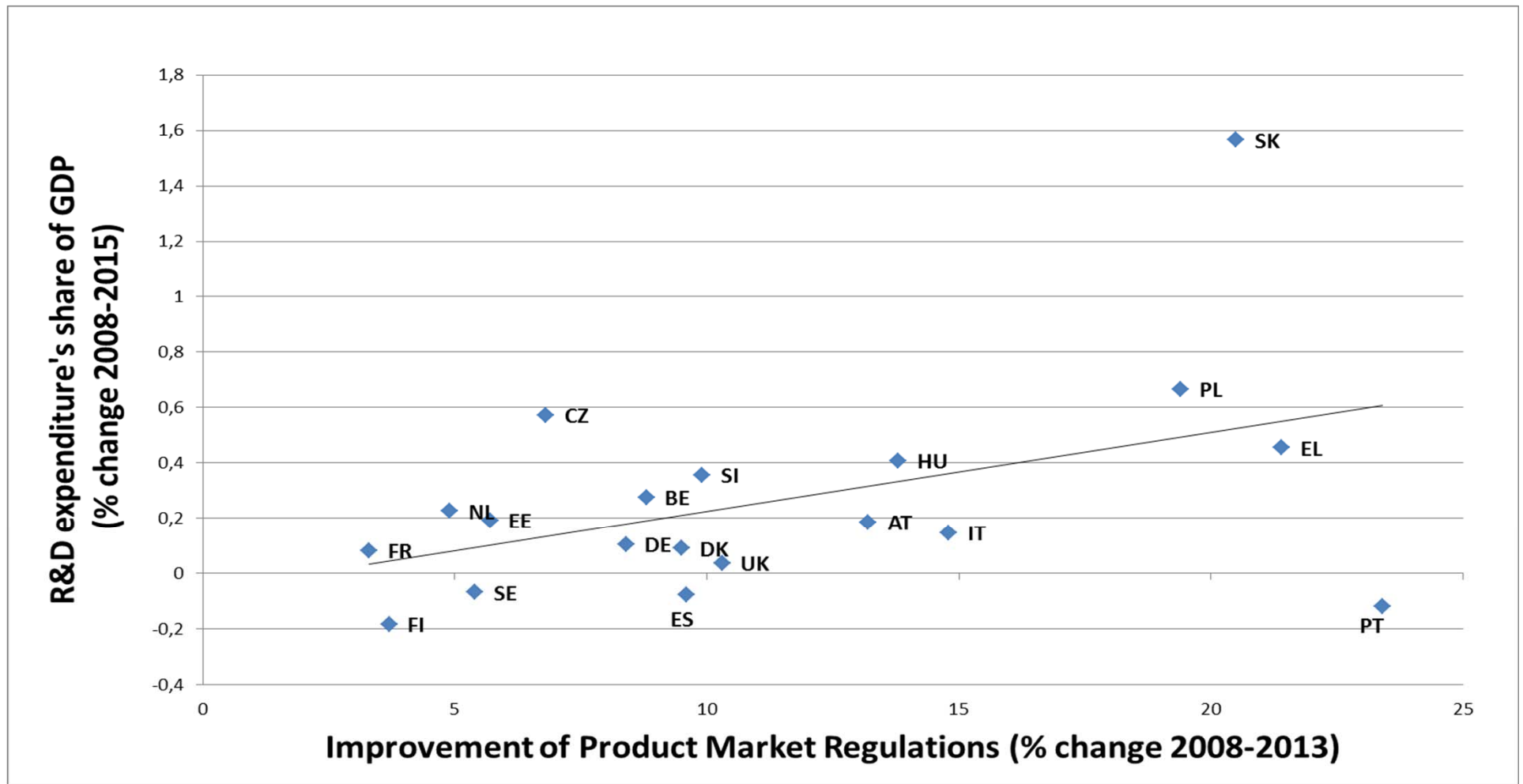
Important complementary role of:

- Harmonisation at EU level (internal market; taxation (ex: ATP))
- Enforcement of Internal Market and Competition rules: implementation on the ground is the name of the game



Background slides

Business environment and R&D expenditure



Source: Eurostat, OECD



Inclusive growth, trust and fairness

Globalization, liberalization, restructuring have side effects: issue of unequal sharing of benefits

Important to tackle this: IMF study (1pp increase in the income share top 20% reduces growth by 0.08pp over 5 years / Increase in the income share of the bottom 20% boosts growth)

How? support low-skill workers, ensure level-playing field (fair competition), limit rent-seeking behavior, tackle tax evasion



State aid modernisation: a new balance of responsibilities between EU and MS

- State aid control -> EU exclusive competence strongly impacting national policies
- Balance to be found between common rules and implementation in the MS -> joint responsibility
- Increasing use of 'block exemption' -> MS can implement 'good aid' measures without notification
- Commission active in ex post controls and in ensuring transparency and evaluation to the benefit of citizens (information and public spending control)
- Member States' administrations reinforced to ensure compliance, also through Commission support
- Commission can focus on cases with larger impact on the internal market ("big on big")