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From negative to positive integration? European state aid control through soft and hard law

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From Negative to Positive Integration?

European State Aid Control Through Soft and Hard Law

Michael Blauburger



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Abstract

European state aid control, a part of competition policy, typically follows the logic of negative integration. It significantly constrains the potential for Member States to distort competition by reducing their ability to subsidize industry. In addition, this paper argues, ambiguous Treaty rules and heterogeneous Member States' preferences have enabled the European Commission to act as a supranational entrepreneur, not only enforcing the prohibition of distortive state aid, but also developing its own vision of "good" state aid policy. In order to prevent or to settle political conflict about individual decisions, the Commission has sought to establish more general criteria for the state aid which it still deems admissible. These criteria have been codified into a complex system of soft law and, more recently, hard state aid law. The Commission has thus created positive integration "from above" and increasingly influences the objectives of national state aid policies.

Zusammenfassung

Als Teil der europäischen Wettbewerbspolitik folgt die Beihilfekontrolle der Logik negativer Integration. Sie beschränkt die Möglichkeiten der Mitgliedstaaten erheblich, Unternehmen zu subventionieren und so den Wettbewerb zu verzerren. Darüber hinaus, so das Argument des Papiers, konnte die Europäische Kommission aufgrund auslegungsbedürftiger Vertragsregeln und angesichts heterogener Interessen der Mitgliedstaaten als supranationaler Entrepreneur handeln und hat dabei nicht nur das Verbot wettbewerbsverzerrender Beihilfen durchgesetzt, sondern auch ihre eigene Vision „guter“ Beihilfepolitik entwickelt. Um politische Konflikte über Einzelentscheidungen zu vermeiden beziehungsweise beizulegen, hat die Kommission schrittweise allgemeine Kriterien für zulässige staatliche Beihilfen formuliert. Diese Kriterien wurden zu einem komplexen System von weichem und neuerlich auch hartem Beihilferecht ausdifferenziert. Die Kommission hat dadurch positive Integration „von oben“ geschaffen und beeinflusst zunehmend die Ziele staatlicher Beihilfepolitik.

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1 Introduction

The objectives of national state aid policies are increasingly predetermined at the European level. In its 2005 *State Aid Action Plan* (SAAP), for example, the European Commission calls for a “modernised state aid policy in the context of the Lisbon strategy for growth and jobs” and sets out its own vision of “key priorities” for national state aid policy (European Commission 2005). At the national level, empirical evidence indicates a considerable convergence of state aid policies towards so-called “horizontal” objectives (as opposed to sectoral objectives). Based on comparative data from the EU State Aid Scoreboard, the Commission concludes: “The clear move towards ‘better targeted aid’ continues with almost two thirds of Member States now awarding more than 90 percent of their aid to horizontal objectives” (European Commission 2007c: 4).

This trend of convergence is puzzling, as major contributions to integration theory would lead us to see it as both undesirable and unlikely. European competition policy, including state aid control, is typically regarded to constitute one of the core areas of negative integration – aiming at eliminating distortions of competition rather than harmonizing national economic policies (cf. Scharpf 1999: 49; Wallace 2005: 80). Economically liberal authors have persistently argued for the primacy of such market-making goals in the process of European integration (Majone 1996, 2005: 143–161; Streit/Müssler 1995). According to their view, European competences in the field of state aid are restricted to the protection of competition and do not permit European intervention in favor of specific targets of national state aid policy (Danwitz 2000: 16). While Scharpf is critical of economic liberalism, he provides an institutional explanation as to why we observe this asymmetry of European integration, privileging negative over positive integration goals. On the one hand, Treaty rules on market freedoms and competition policy have been progressively interpreted by non-majoritarian, supranational actors: the Commission and the European Courts. On the other hand, majority or unanimity requirements in the Council and in the European Parliament make it relatively difficult to reach agreement upon secondary rules, mostly those related to issues of positive integration (Scharpf 1999: 52f., 70f.).

How then do we explain the evolution of an increasingly complex system of European rules on specific state aid objectives and, accordingly, the convergence of domestic budgetary policies towards the objectives defined at the European level? This paper argues that *ambiguous Treaty rules and heterogeneous Member States’ preferences have enabled the Commission to act as a supranational entrepreneur, not only enforcing the prohibition of distortive state aid, but also partially creating positive integration “from above.”*

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From the beginnings of the integration process, European Treaty rules have constituted a rather vague compromise between different, often conflicting views on national state aid policy and its supranational control. In balancing the general prohibition on state aid against possible exceptions, the Commission has always had to assess, at least implicitly, not only the effects that a certain state aid measure would have on competition, but also its potential contributions to other policy goals such as competitiveness or cohesion. The Commission has therefore sought to establish more general criteria for the state aid measures that it deems compatible with the common market, in order to prevent or to settle political conflict about individual state aid decisions. By codifying these criteria into a complex system of soft law and, more recently, hard law, the Commission has not only shielded itself from political pressure and reduced its workload in individual cases, but has also developed a more or less explicit model of what it considers to be “good” state aid policy.

The paper has three parts, with the first (Section 2) describing the institutional situation in the field of state aid, the actors involved, and their potentially conflicting interests. European Treaty rules on state aid control essentially constitute a compromise – aiming for undistorted competition while acknowledging the potentially welcome effects of state aid – and they leave the European Commission with considerable discretion in balancing these different goals against each other. The second part (Section 3) will develop the main argument: that given the vagueness of European Treaty rules and the initial unwillingness of the Council to agree upon secondary legislation, the Commission has made a virtue of necessity and developed state aid control via soft law. Formally, this soft law binds only the Commission itself – in practice, however, it defines positive criteria for national state aid policies compatible with the common market and leaves little room for Member State aid policies which deviate from these criteria. The concluding section will summarize the major findings and discuss the limits of positive integration from above.

2 State aid control and state aid policy in conflict

European Treaty law appears to allocate clear competences in the field of state aid between two main actors. On the one hand, the Commission has the task to *control* national state aid in order to prevent distortions of competition in the internal market. On the other hand, it remains the Member States’ exclusive competence to design and to execute their individual aid *policies*, as long as they do not violate European competition law. In terms of positive vs. negative integration, the Commission’s role seems to be confined to the latter.

In practice, however, this distinction is far from clear-cut. Article 87 of the EC Treaty strikes a sensitive balance between a general prohibition of state aid and possible excep-

tions. In interpreting and applying these Treaty rules, the Commission often gets into direct conflict with the Member States. First, the scope of the state aid prohibition and the procedure of its enforcement are contested. Second, the possibility to except certain state aid measures from the general prohibition gives rise to conflict about how much autonomy remains when designing national state aid policies. It is this second type of conflict – arising not only between the Commission and EU Member States, but also within the Commission – which is increasingly predetermined by means of soft and hard state aid law.

The Treaty rules

In contrast to cartel or merger control, state aid rules govern Member states' budgetary policies rather than the behavior of enterprises (Ehlermann 1995: 3; Smith 1998: 57). Outside the EU, no comparable system of state aid control exists as a part of competition policy (Ehlermann/Goyette 2006; Schenk 2006). European state aid control is therefore often considered to be "the most original of the EU's competition policies" (Cini/McGowan 1998: 135; Thielemann 1999: 405). Articles 87–89 of the EC Treaty, which have remained almost unchanged since their incorporation into the original Treaty of Rome (cf. Wishlade 2003: 3), rest on a particularly sensitive compromise. They balance between the liberal vision of an integrated market and the Member States' prerogative to intervene in their own economies (Immenga/Mestmäcker 2007: 834f.; Hobe 2000: 19). Even more than EC Treaty rules in general, European state aid rules need to be interpreted in order to be applicable (Heidenhain 2003: 193f.; Immenga/Mestmäcker 2007: 890f.).

Article 87(1) of the EC Treaty generally *prohibits*:

any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods ... insofar as it affects trade between Member States.

Yet European Treaty rules do not absolutely prohibit state aid. Articles 87(2) and, more importantly in practice, 87(3) of the EC Treaty provide the *exceptions* to the rule, thereby leaving room for maneuver on national state aid policies. Article 87(3) of the EC Treaty lists certain categories of aid that "*may be considered to be compatible with the common market*":

- (a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- (c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

- (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest.

Most secondary rules of soft and hard state aid law, which will be dealt with in Section 3 of this paper, are an interpretation of these exceptions. In an increasingly complex system of “communications,” “guidelines” and “frameworks,” the Commission has codified its own standards for assessing certain categories of state aid. Formally, these rules are not binding upon the Member States, and for this reason they are constantly referred to as soft rules “which, in principle, have no legally binding force but which nevertheless may have practical effects” (Snyder 1994: 198; Senden 2004: 112; Cini 2001; Aldestam 2004; European Commission 2007a). In contrast, hard state aid law that exempts certain categories of state aid from European control is based on Article 89 of the EC Treaty and has direct effect.

As becomes clear from the above cited provisions, EC Treaty rules on state aid leave plenty of room for dispute. Even though both issues are interlinked, we may broadly distinguish between two sets of conflicts: (1) conflicts about the scope of the state aid prohibition and its enforcement, i.e. the *depth of negative integration* and (2) conflicts about the admissible exceptions to this prohibition, i.e. *Member States’ remaining possibilities* to design their individual state aid policies.

Conflicts about the prohibition of state aid

With regard to conflicts about the state aid prohibition, the literature stresses the important role played by the European Court of Justice (ECJ) in empowering the Commission against the resistance of Member States (Smith 1998; Lehmkuhl 2008). For a long time, state aid control was seen as the “poor relative” of European cartel and merger control (Hansen/Van Ysendyck/Zuhlke 2004: 182). While the Member States had agreed, in principle, on the need for supranational state aid control, each of them had an incentive to deviate from common state aid discipline, particularly in times of economic crisis (Lavdas/Mendrinou 1995: 29f.; Mathijsen 1972). The Commission’s instruments to overcome this “prisoner’s dilemma” situation (Wolf 2005: 56) were yet to be developed.

Member States initially circumvented European state aid control by resorting to “creative” forms of state aid. Rather than granting direct subsidies, they conceded tax privileges, abstained from collecting social security contributions or sold public property under market value in order to favor particular enterprises. Reacting to this, the Commission interpreted the scope of the state aid prohibition broadly, including not just advantages from direct grants but also other, more indirect forms having the same aid effect (Plender 2003). Although in most cases the ECJ supported the Commission’s Treaty

interpretations, it also defined clear limits on European state aid control. For example, the ECJ ruled in its 2001 *PreussenElektra* judgment that regulatory privileges not involving any budgetary burden for the state were not covered by the state aid prohibition (Koenig/Kühling/Ritter 2005: 121f.).

Member States also informed the Commission only selectively about new state aid measures or simply ignored the Commission's prohibitions, without significant risk. Based on an earlier ECJ ruling, however, the Commission started in 1983 to oblige Member States to recover illegally granted state aid from the benefiting enterprises (Smith 1998: 64). Moreover, by mobilizing competitors to complain about state aid beneficiaries, the Commission gained information independently from national policy makers, making it less likely that state aid could be granted secretly (Smith 1998: 63, 2001: 224).

Arguably, state aid control today is more deeply integrated than had been foreseen by the Member States when the Treaties of Rome were drafted, and in most cases non-compliance with European state aid rules is too costly to be an option (Smith 1998: 61). By adopting the Procedural Regulation No. 659/1999, the Member States finally accepted their obligation not to grant state aid without prior Commission consent and acknowledged the Commission's competence to order recovery of illegal aid.

The link between the two different sets of conflicts on state aid control and state aid policy now becomes clear: the harder it gets for the Member States to circumvent European state aid control and the costlier it gets to simply ignore it, the more politically salient becomes the question of which types of state aid are still considered to be admissible in the common market.

Conflicts about admissible state aid

The conflicts about the admissible exceptions to the state aid prohibition revolve around the remaining opportunities Member States have to design their own state aid policies. Which types of state aid can still be justified as compatible with the internal market, even if they distort competition? Who will determine the compatibility of certain types of state aid, and by what standards?

The potential for conflicts of interest regarding admissible state aid is immense. State aid policy can be justified for reasons of both allocative efficiency and redistributive justice. The economics of when state aid is likely to increase allocative efficiency by correcting a particular market failure are far from uncontroversial (Friederiszick/Röller/Verouden 2006: 13–15; Koenig/Füg 2005). Just how far state aid should serve redistributive goals is not an economic or legal question; the answer rests largely on political considerations (Friederiszick/Röller/Verouden 2006: 15–19). What's more, efficiency (or social welfare) and social justice can have very different meanings depending on what

the word “social” refers to. A measure that looks efficient from a national point of view does not necessarily enhance European welfare if it produces negative externalities in other Member States. A region that seems relatively rich compared to other European countries can be among the poorer regions of the country it belongs to: depending on the applicable standard of social justice, this region might qualify for redistributive state aid. In the same way, prohibiting state aid to a big European enterprise might be necessary to protect competition in the internal market, even though it might put the enterprise at a disadvantage when competing on a global scale.

The ambiguity of EC Treaty law reflects this diversity of interests. In practice, however, it provides little guidance on how to balance the goal of undistorted competition against the efficiency and equity considerations of national policy makers (e.g. referring to admissible state aid for “the development of *certain economic activities* or of *certain economic areas*,” emphasis added).

Even within the Commission, the potential positive effects of national state aid are controversial. State aid control affects many different policies – represented by different DGs (Directorates General) in the Commission – and thus conflicts with Community goals other than just competition (Cini/McGowan 1998: 42–45). For example, the DG for Regional Policy (DG REGIO) has repeatedly criticized the DG for Competition (DG COMP) for marginalizing the positive, redistributive aspects of regional state aid (Lavdas/Mendrinou 1999: 40; Cini/McGowan 1998: 147). As a result, the revision of soft law on regional aid has been synchronized with the planning period for the Structural Funds and the criteria for designating eligible regions have been partly harmonized (Wishlade 1993, 1998: 354f., 2003: 145–179). The DG Enterprise and Industry (DG ENTR) has been pushing for a less restrictive approach towards state aid to promote investment in research, development, and innovation (Maincent/Navarro 2006: 46–48). Depending on whether Commission officials are charged primarily with executive or administrative tasks, they will be more or less open to political considerations beyond their own portfolio (Cini/McGowan 1998: 45). Finally, the Legal Service internally controls the legal compatibility of Commission drafts with the Treaty law and has a “reputation for caution ... trying to restrain Commission activism” (Cini/McGowan 1998: 44).

Despite these internal conflicts, the Commission tries to speak with one voice in its negotiations with Member States. Drafts of new or revised state aid rules are discussed internally before the Member States are consulted. Once a common Commission position is defined, it is defended in objective terms (“common interest,” “win-win developments,” European Commission 2005) and the potential for conflict is de-emphasized. For example, in its reports on competition policy the Commission has repeatedly denied conflicts or contradictions between competition policy on the one side and regional or industrial policy on the other side (European Commission 1991: pt. 78, 1972: pt. 45). Moreover, while Article 87(3)(c) of the EC Treaty establishes a negative condition, requiring admissible aid not to distort competition “to an extent contrary to the common

interest,” a positive interpretation of “common interest” dominates in practice: “State aid may be declared compatible with the Treaty provided it fulfils clearly defined *objectives of common interest* and does not distort intra-community competition and trade to an extent contrary to the common interest” (European Commission 2005: 4, emphasis in the original document; see also Gross 2003: 64).

With regard to questions above, it is therefore fair to assume that the Commission’s position is the following: first, it sees itself as competent to decide conflicts about which types of state aid are still admissible and enjoys significant discretion in doing so (“*may be considered to be compatible*”, Article 87[3] of the EC Treaty, emphasis added). Second, according to the Commission, admissible state aid has to be justified with reference to European rather than national standards. Both positions are also supported by the rulings of the European courts (Heidenhain 2003: 193f.).

The Member States’ positions on state aid policies vary considerably more than even within the Commission. Similarly to the Commission’s DGs, divisions exist between different ministries. Unsurprisingly, ministries of finance tend to be less positive about state aid than will other ministries entrusted to promote industrial or regional development. More importantly, industrial policy traditions greatly differ between EU Member States, ranging from countries with very restrictive state aid policies to other countries in which state aid is not only used to address market failures but also for redistributive purposes (Dylla 1998). For example, state aid levels in the Netherlands or in the UK have consistently been clearly below the EU average; Estonia hardly has any state aid policy at all. In their comment on the SAAP, UK officials advocate a more restrictive approach towards state aid policy and argue “that State aid is generally *only* justified as a response to market failure” (United Kingdom 2005: 2, emphasis in the original document). Countries like Sweden or Denmark grant significant amounts of state aid, targeted almost exclusively towards goals of market correction, e.g. towards measures of environmental protection. Since reunification, German state aid policy has been largely redistributive, supporting regional development and industrial restructuring in the new *Länder* (Schütte/Hix 1995). Similarities exist between German state aid policy after reunification and the policy of some new Member States such as Poland (European Commission 2007c). Polish authorities have criticized the Commission for not giving enough consideration to the particular economic and social conditions of its transition economy (Poland 2005).

Member States vary greatly in their opinions on which types of state aid should still be admissible in the internal market. In contrast to the different DGs, EU Member States do not establish a common position before entering consultations on new state aid rules proposed by the Commission. However heterogeneous these state aid policy traditions may be, we can broadly distinguish two phases of Member States’ positions on the Commission’s competence to decide conflicts about admissible aid. Member States originally contested the Commission’s efforts to establish general criteria for admissible state aid, and the Council rejected the proposed secondary legislation (Lavdas/Mendrinou 1999:

29f.). Given the tightening of European state aid control since the late 1980s, however, Member States have adopted a more positive attitude towards European rules on admissible aid. Such rules at least improve legal certainty about which possibilities for national state aid policies remain.

Before we analyze this historical development in greater detail in the next section, Table 1 illustrates some of the possible trade-offs and dividing lines between different actors' policy priorities in the field of state aid:

Table 1 Multiple policy goals in the field of state aid

	Policy function		
	Market making	Market correction	Redistribution
Specific goal	Competition	Competitiveness	Cohesion
State aid policy	State aid prohibition	R&D aid, SME aid	Regional aid
Commission	DG COMP	DG ENTR	DG REGIO
Member States	Netherlands, Estonia	Sweden, Denmark	Germany, Poland
Enterprises	Competitors	State aid beneficiaries	

3 Conflict management through soft and hard law

The vagueness of the EC Treaty rules creates many conflicts between state aid control and state aid policy. At the same time, the need for interpretation of the Treaty rules and the heterogeneity of Member states' interests have become major sources of the Commission's power.

In its first Report on Competition Policy, the Commission deplored the lack of a real framework to guide its control of state aid (European Commission 1971: pt. 138). After the Council refused to agree upon secondary legislation, the Commission started to develop this framework via *soft law*. By binding itself to soft law, the Commission has become less exposed to political conflicts about individual state aid measures. Soft state aid law mainly concretizes the Commission's approach towards possible exceptions to the state aid prohibition. In developing its soft law, the Commission has increasingly defined positive European standards of what it considers to be "good" state aid policy. In addition, the Commission has created ways to make its soft law practically binding upon Member States. Statistical data shows that Member States increasingly adapt their state aid policies to the Commission's standards. It took until 1998 for the Commission and the Council to agree to secondary legislation on state aid control. Since then, previously soft rules have gradually been transformed into directly applicable regulations which exempt certain categories of state aid from Commission control. Thus, possible exceptions to the state aid prohibition become harmonized at the European level.

Making a virtue of necessity

Soft law was not the Commission's first choice in the area of state aid control. On the basis of Article 89 of the EC Treaty, the Council may – on proposal by the Commission and after consulting the European Parliament – adopt secondary legislation on European state aid control. Two early Commission draft regulations, however, on the procedure of European state aid control and on the exemption of certain categories of regional aid, were blocked by the Council in 1966 and 1972 (Lavdas/Mendrinou 1995, 1999: 29f.; Evans 1997). At a time of economic decline when Member States were increasingly subsidizing their own industries, state aid control was “both imperative and impossible” (Cini/McGowan 1998: 143).

In reaction to the Council's unwillingness to agree upon secondary legislation, the Commission changed its approach in favor of “a flexible strategy of enforcement aiming at utilising the absence of a Council Regulation in the direction of gradually forming a practice founded on the Commission's political sense of possible impact” (Lavdas/Mendrinou 1999: 30). Along with individual state aid decisions, soft law became the main instrument of this strategy.

The legal basis of soft state aid law has been controversial for a long time (Schütterle 1995: 393f.; Aldestam 2004). As a result of an ECJ judgement on the transparency directive, European secondary rules must explicitly refer to a legal basis in order to bind the Member States.¹ The soft law terminology has been even less clear, as we can find Community frameworks and guidelines, Commission communications, recommendations, notices, decisions, and letters, as well as revisions, corrigenda, and amendments to the respective documents. Today, the Commission has simplified its terminology and constantly refers to its state aid frameworks and guidelines as “appropriate measures” in the sense of Article 88(1) of the EC Treaty. Based on this Treaty provision and without explicit approval by the Member States, however, soft law only has the status of a non-binding Commission *recommendation*. Formally, soft law only binds the Commission itself in its decision-making on state aid cases (Mestmäcker/Schweitzer 2004: 1108f.). The Commission also remains free to revise its soft law whenever this is seen to be “required by the progressive development or by the functioning of the common market” (Article 88[1] of the EC Treaty, Schütterle 1995: 394).

Reacting to the Council's initial refusal to adopt secondary legislation, and unanticipated by the Member states, the Commission has made a virtue of necessity. Most authors as well as Commission officials themselves stress the procedural improvements resulting from state aid soft law. In contrast to a pure case-by-case approach, the soft-law approach has increased time-effectiveness, legal certainty and transparency of Commission control (Rawlinson 1993; Cini 2001: 199; Lehmkuhl 2008: 143f.). By binding itself to soft law, the Commission has also decreased its exposure to political pressure in

1 Case C-325/91 *France v. Commission* [1993] ECR I-3283, 16 June 1993.

individual state aid decisions: “The Commission needs rules to discipline itself. Rules are the best safeguard against political decisions which, if they were to proliferate, would destroy all state aid control” (Rawlinson 1993: 58). At the same time, soft law allows for more discretion and flexibility in developing the rules than a rigid hard law approach (Cini 2001: 199, 205).

What has been noted less prominently, however, is the substantive aspect of these rules. In dealing with the exceptions to the state aid prohibition, they “imply a positive ... dimension to the policy which has in practice proved extremely controversial” (Cini/McGowan 1998: 18; Kerber 1998). Conflicts of interest do not disappear from the field of state aid control; instead, they are partly shifted from the control of individual state aid measures to the design or revision of soft state aid rules. Essentially, soft and hard state aid rules are conflict-solving devices, harmonizing the standards of admissible state aid.

Defining positive criteria of state aid policy

State aid policy is still a national competence. A major compendium on European state aid law starts by highlighting this aspect (Quigley 2003: 2):

It should be noted at the outset that there has been no attempt to harmonize national rules governing the award of State aid. Aid is granted by the Member States in accordance with relevant national law and policy. ... Rather, EC intervention in the field of State aid is largely negative in nature.

Yet the Commission’s soft law mainly deals with the exceptions to the state aid prohibition, thereby explicitly addressing questions of state aid policy. The Commission’s *State Aid Action Plan* calls for “less and better targeted state aid,” referring to a similar plea of the Stockholm European Council in 2001 (European Commission 2005). Large parts of the document focus on positively defining “better targeted aid” rather than on tightening state aid control (“less aid”). The introductory chapter puts state aid policy in the “context of the Lisbon strategy for growth and jobs” (ibid.: 3–8). The core chapter lists “key priorities” of state aid policy such as “targeting innovation and R&D to strengthen the knowledge society,” “creating a better business climate and stimulating entrepreneurship” and “encouraging an environmentally sustainable future” (ibid.: 8–12). The concluding chapter outlines the main steps for revising soft and hard law on admissible state aid (ibid.: 12–18). This approach is not new, however, but rather a continuation of the Commission’s efforts to regulate possible exceptions to the state aid prohibition.

The early Commission soft law built on the wording of the Treaty provisions on compatible state aid, in particular on Article 87(3)(c) of the EC Treaty. This provision was interpreted to mean that compatible state aid should be targeted towards specific sectors

(“certain economic activities”) or specific regions (“certain economic areas”). Starting with the textiles and clothing industry in 1971, the Commission further developed its control criteria for state aid to the coal industry in 1973, followed by fibers and steel in 1977. Primary guidelines on regional state aid have been applied by the Commission since 1972 (Rawlinson 1993: 54). In order not to weaken its own control, however, the Commission has been rather hesitant to design rules on other categories of compatible aid. An exception has been the framework on environmental aid, first issued in 1975.

It was not until state aid control was tightened in the second half of the 1980s (see Cini/McGowan 1998: 144–146) that new soft law was developed. By clarifying the rules, and thus increasing legal certainty for permissible types of state aid, the Commission provided incentives to bring national state aid policies in line with its own priorities. The first framework on state aid for research and development (R&D) in 1986 marked a shift within the Commission towards such a more positive approach to state aid control (Cini/McGowan 1998: 154). The framework was later expanded in order to include “innovation-related aid,” which was justified by explicit reference to the Lisbon objectives (European Commission 2006a). The promotion of SMEs became a major concern within the context of European state aid control in the late 1980s (Lavdas/Mendrinou 1995, 1999). Today, many state aid rules include more generous exceptions for SMEs than for large enterprises. When the guidelines on environmental aid were reviewed recently, the Commission asked in its questionnaire to interested parties whether additional categories such as aid for the “safety of civilians and their environment” or for the “health of consumers” should be introduced (European Commission 2007b). The final version of the guidelines significantly raises the threshold for admissible environmental aid, and this move is justified by explicit reference to the “Energy and Climate Change package” of the Commission (European Commission 2008).

These aid categories do not follow from the wording of the Treaty provisions (Mestmäcker/Schweitzer 2004: 1110) – they rather indicate the evolution of the Commission’s own state aid policy priorities.

An overview of soft law on possible exceptions to the state aid prohibition as it is currently applied by the Commission is given in Table 2.

Table 2 Soft law on possible exceptions to the state aid prohibition

General rules	– Regional investments
	– Research, development, and innovation
	– Environmental protection
	– Risk capital
	– Rescue and restructuring of firms in difficulty
Sector-specific rules	– Broadcasting
	– Cinematographic and other audiovisual works
	– Electricity (stranded costs)
	– Postal services
	– Shipbuilding
	– Steel
	– Synthetic fibers (motor vehicles industry)

The types of state aid which are not sector-specific have been gradually subsumed under the term “horizontal aid.” At the same time, horizontal aid has become largely synonymous with “good” or “modern” state aid that is in line with the Commission’s own priorities. First of all, horizontal aid is regarded as being less distortive to competition than sectoral aid (Friederiszick/Röller/Verouden 2006: 27). More importantly, it contributes to the Commission’s own market-correcting or redistributive policy goals, and therefore can be linked to an objective of “common interest.”

Regional aid control provides a telling example of how national state aid policies increasingly have to adjust to the Commission’s positive interpretation of the “common interest.” Earlier guidelines on national regional aid were already less concerned with distortions of competition or trade between Member States and more “with the *substance* of regional policy” (Wishlade 2003: 89, emphasis in the original text). Regional aid was seen as a legitimate instrument to improve cohesion. However, the guidelines represented a compromise between two different views of cohesion, namely national cohesion and intra-Community cohesion. Regions which were seriously underdeveloped relative to the Community average could receive state aid based on Article 87(3) (a) of the EC Treaty; regions which were disadvantaged in relation to their national average were eligible for state aid on the basis of Article 87(3)(c) of the EC Treaty. In a “non-paper” preparing the revision of the regional aid guidelines for the period 2007–2013, the Commission proposed to phase out entirely the second category of aid and only allow regional aid that contributes to the objective of intra-Community cohesion (Battista 2005). This proposal met with strong opposition from some of the richer Member States, expressed in a joint letter from the UK, France, Germany and Austria to Commissioner Kroes. Eventually, the Commission had to make concessions to these Member States, but the possibilities to grant regional aid with national cohesion objectives have nonetheless been significantly constrained (Fothergill 2006: 10–19).

By defining criteria of well-targeted state aid at the European level, the Commission increases the burden of proof on the Member States. Since the Commission itself largely assumes that any state aid measure will distort competition (Röller 2005: 44; Wishlade 2003: 10), the Member States must prove the compatibility of their state aid policies with the soft law criteria or risk lengthy and uncertain control procedures. In the SAAP, the Commission explicitly requires the Member States “to provide the necessary evidence in this respect, prior to any implementation of the envisaged measure” (European Commission 2005: 6). This could make proving the compatibility of state aid even more demanding for the Member states: the SAAP advocates a “refined economic approach” to state aid control, which not only requires the identification of a clear objective of common interests in order to get Commission approval, but also demands that state aid be more efficient than alternative instruments in reaching its goal (ibid.: 6).

The German government was very critical of this proposition: “In the opinion of the Federal government, the Commission possesses the competence neither to allocate resources nor to harmonise legal and financial policies nor to evaluate the success of na-

tional state aid policies” (Bundesregierung der Bundesrepublik Deutschland 2005: 2). Nevertheless, the Commission has since introduced a so-called “incentive test” into new soft law provisions, according to which the Member States must prove that a certain state aid measure “enables the beneficiary to carry out activities or projects which it would not have carried out as such in the absence of the aid” in order to get Commission approval (Evans/Nyssens 2007: 4).

Binding the Member States

In order to have a real impact on national state aid policies, the Commission needed to find ways to make its soft law practically binding for the Member States. This section describes the two mechanisms by which the Commission has largely achieved this goal: (1) soft law can be enforced indirectly via individual state aid decisions; and (2) Member States can be forced into explicit approval of soft state aid rules which then become formally binding. Commission statistics show that since the early 1990s, Member States’ aid policies have partially converged towards “less and better targeted state aid.”

The Commission imposes its soft law on the Member States through individual state aid decisions. While soft law binds only the Commission itself, Commission decisions on individual state aid cases are binding for the Member States. Member States still have the right to draw up new state aid measures that do not match the Commission criteria set out in its soft law; most likely, however, the Commission will then either force Member States to adapt the state aid measure in question, following investigation under its soft rules, or it will come to a negative decision on the measure and prohibit its implementation (Gross 2003: 103). If Member States are unwilling to adapt their measures, the Commission has created significant negative incentives for the potential beneficiaries of state aid. Just the threat to prolong its control procedure and to order the possible recovery of illegal aid creates significant legal uncertainty for the firms, and this uncertainty may be sufficient to discourage them from demanding potentially inadmissible aid in the first place. The low rate of negative Commission decisions on state aid thus does not prove the ineffectiveness of European state aid control. Rather, Member States often anticipate Commission control and try to frame their state aid measures in a way that fits the criteria positively defined in state aid soft law (Smith 1996; Dylla 1997: 12f.).²

Many Commission state aid decisions, particularly negative ones, are challenged in the European Courts. The most prominent Commission “defeats” relate to questions re-

2 This is most obvious in the case of so-called state aid schemes, i.e. national programs involving a multitude of state aid measures but which require Commission notification and approval only once. Very often, e.g. in the case of regional investment programs, these state aid schemes constitute a more or less comprehensive transposition of the Commission’s soft rules into national law.

garding the scope of state aid control, as in the *PreussenElektra* case mentioned above. Crucially, however, the Courts largely abstain from reassessing the economic and social reasoning underlying the Commission's state aid decisions (Gross 2003: 57f.). They may reject a state aid decision if they find that the Commission has not correctly applied its own soft law (Lehmkuhl 2008: 145), yet this is a source of power, rather than a weakness of the Commission, as it increases the credibility of the self-binding rules (Smith 1998: 66f.). If the Commission becomes dissatisfied with existing soft law, it may be obliged to apply it to the individual case at hand. For the future, however, it can propose new rules whenever this is seen to be "required by the progressive development or by the functioning of the common market" (Article 88[1] of the EC Treaty).

The Commission has also developed a second mechanism to force Member States to explicitly approve its soft law on state aid, and even to adapt existing state aid measures that were declared compatible with the revised rules in the past. If a Member State refuses to accept the revised soft law, the Commission threatens to open formal investigations into all existing state aid measures that fall under the new rules: "[t]his will normally have the effect of forcing the Member State concerned to accept the Commission's policy" (Quigley 2003: 282f.). The Commission has had repeated success with this strategy, e.g. getting the approval of Spain and Germany for its framework on state aid to the motor vehicle industry (Cini 2001: 201f) and forcing Sweden to accept the revision of this framework (Quigley 2003: 284). The most recent conflict in which the Commission resorted to this strategy concerned the revised guidelines on regional aid. After winning the approval of 24 EU Member States, with only Germany refusing to accept the new rules, the Commission opened an investigation into all German regional aid schemes (European Commission 2006b). The title of the Commission's press release – "formal investigation *against* Germany" (emphasis added) – already reveals the punitive character of this measure. In individual state aid cases, the Commission usually uses more neutral language ("investigations into") and emphasizes that opening a formal investigation does not prejudice its final decision on whether the proposed aid is admissible. As for the new guidelines on regional aid, the Commission closed its formal investigation once Germany had finally approved the revised rules.

These examples show the limits of this Commission strategy: only if a broad majority of Member States agree with its soft law can the Commission credibly threaten individual Member States and force them into final approval. In order to build a broad consensus, the Commission consults Member States in "multilateral meetings" during the development process for soft state aid law. The status of these meetings is similar to that of the consultation of the Advisory Committee on State Aid under the Procedural Regulation: the Commission has the final say. The guidelines for regional state aid in the period 2000–2006, for example, were discussed in three multilateral meetings. Even after the last multilateral meeting, an important modification was introduced by the Commission into the final document, without prior coordination with the Member States (Méndez/Wishlade/Yuill 2006: 593).

Sooner or later, the Commission's soft law becomes practically binding even for the minority of Member States who initially refuse approval. From the Commission's point of view, state aid soft law is therefore no less binding than traditional secondary legislation:

The force of written precedents in the Commission is such that, once decided, rules in whatever form become, in practice, binding on the Commission, and hence on their addressees, the Member States, to whom they are applied in the Commission's day-to-day aid control work. (Rawlinson 1993: 59)

This Commission standpoint has become most obvious in the accession negotiations with the Central and Eastern European countries. According to the third Copenhagen criterion, the candidate countries must prove their ability to take on the obligations of membership which follow from the *acquis communautaire* in order to become EU Member States. In the field of state aid control, the *acquis* has been defined very broadly, as based on Article 87 of the EC Treaty and including "the present and future secondary legislation, frameworks, guidelines and other relevant administrative acts in force in the Community, as well as the case law"³ of the European Courts (Schütterle 2002: 582; Cremona 2003: 270).

In order to evaluate national state aid policies in the light of the goals of "less and better targeted" state aid, the Commission has developed two broad indicators. The amount of state aid in relation to the GDP is called the *state aid level*. As for the *state aid objectives*, the Commission distinguishes between sectoral and horizontal state aid.⁴ The goal of reducing state aid levels is being met: data from the EU State Aid Scoreboard clearly indicates a drop in national state aid expenditures since the early 1990s (see Table 3). From 1993 to 2006, the average aid level in EU Member States declined to less than half of its original value.⁵ Earlier studies on EU Member States' aid policies come to the same conclusions and often attribute the reduction of overall state aid levels to the impact of European state aid control (Smith 1996: 575; Wolf 2005: 87; Aydin 2007). More importantly for the argument of this paper, we can observe a clear redirection of state aid towards horizontal objectives, and thus an alignment of national state aid policies with the Commission's policy goals. Furthermore, while the reduction of overall state

3 This phrase is included in Article 2 of all implementing rules on state aid control that have been decided upon by the respective Association Councils with the Central and Eastern European countries.

4 The Commission's methodology in comparing sectoral and horizontal aid makes even clearer what is considered to be "bad" or "good" state aid. The rules for rescue and restructuring aid do not discriminate between sectors – however, this type of state aid is regarded as particularly distortive to competition and is therefore counted as sectoral aid. In contrast, regional aid is mostly counted as horizontal aid, although it discriminates between different regions. For the Commission's methodology, see: http://ec.europa.eu/comm/competition/state_aid/studies_reports/conceptual_remarks.html (accessed 14 September 2007).

5 The deviations in 1997 can be explained by one large individual state aid measure (Röller/Friederiszick 2006).

Table 3 EU State Aid Scoreboard on state aid levels and objectives, 1992–2006

	Year	Total aid as % of GDP	Horizontal aid as % of total aid	Horizontal aid in billion €
EU-12	1992	0.8	52.2	34.3
	1993	0.8	48.9	32.3
	1994	0.8	45.3	27.4
EU-15	1995	0.7	54.7	32.1
	1996	0.7	54.8	31.9
	1997	0.9	39.1	30.8
	1998	0.6	57.7	28.9
	1999	0.4	67.1	27.0
	2000	0.4	69.6	29.6
	2001	0.5	67.2	30.8
	2002	0.5	66.9	33.9
	2003	0.4	79.3	33.0
EU-25	2004	0.4	76.3	36.2
	2005	0.4	82.9	39.2
	2006	0.4	85.2	40.8

aid levels seems to have reached its limits, the trend towards higher shares of horizontal state aid is still ongoing. Since 1999, we can observe an absolute rise in state aid towards horizontal objectives.

Transforming mature soft law into hard law

It was only in 1998 that the Commission and the Council agreed to adopt secondary legislation on state aid control. For about 25 years, the Commission had not made any attempt to move beyond soft state aid law. This development, however, was only partly due to the Council's original unwillingness to adopt secondary legislation. When, in 1990, the Italian Council presidency proposed an initiative towards secondary legislation on state aid control, it was the Commission that refused to submit a new draft regulation (Smith 2001: 220). The Commission suspected that some Member States aimed to weaken state aid control by involving themselves more deeply in state aid regulation (Gross 2003: 128).

The main reason why the Commission reconsidered its position towards hard state aid law in 1996 was increased workload (Mederer 1996; Smith 1998). The number of investigations had risen due to the expanded scope of state aid control, more systematic notifications by Member States of their state aid measures, and more frequent complaints from enterprises about illegal state aid (Mederer 1996: 12f.). Because of its limited human resources, the Commission had to get rid of minor state aid cases in order to concentrate on the most important and difficult ones. Moreover, soft law had become "sufficiently precise" in some areas to be applied in a more decentralized way (ibid.: 13).

Table 4 State aid measures under the block exemptions regulations, 2001–2007

	2001	2002	2003	2004	2005	2006	2007*
SME	102	123	139	149	197	183	246
Training	48	80	55	79	69	57	86
Employment	–	–	8	21	26	35	27
Agriculture	–	–	–	72	88	119	307
Fishery	–	–	–	1	22	24	0
Regional	–	–	–	–	–	–	154
Total	150	203	202	322	401	418	820

* Until 09/2007.

Based on the Enabling Regulation No. 994/1998, the Commission has now adopted several Block Exemption Regulations (BERs) which allow Member States to implement certain state aid measures without *ex ante* approval by the Commission. To a large extent, these BERs consist of previously soft state aid rules. As in the case of soft law, the Commission enjoys autonomy in the design of these rules – only the Advisory Committee on State Aid has to be consulted. The first generation of BERs concerned SME (small and medium-sized enterprises) aid, training aid, employment aid and small amounts of state aid – so-called *de minimis* aid. The second generation of BERs specifically addressed state aid in the agriculture and fishery sectors. In 2006, the Commission mostly exempted regional investment aid. Currently, an additional BER on environmental aid is being debated and consultations have been launched on a general BER, integrating the regulations into one document and including risk capital and innovation aid for SMEs.

Exempting state aid from *ex ante* control does not only reduce the Commission's workload, it also gives back some autonomy to the Member States – as long as their state aid policies are in line with the BERs' criteria. By exempting certain types of state aid, the Commission creates further incentives to adjust national policies to its own state aid priorities. The Commission explicitly states that BERs are designed to “facilitate the possibilities for Member States to grant subsidies that clearly fulfill horizontal objectives in line with the European Union's Lisbon objectives (such as environmental protection, or promotion of research and development)” (European Commission 2007a).

A Commission report to the European Parliament and the Council shows that Member States increasingly resort to state aid measures falling under the BERs (European Commission 2006c, 2007c: 33). The number of state aid measures which need to be presented to and approved by the Commission has decreased significantly in areas in which BERs exist; accordingly, the number of registered measures under the BERs has constantly risen (see Table 4). EU enlargement has reinforced this development. Comments on the Commission announcement to exempt additional categories of aid have been largely positive: drafting a general BER and raising the limit for *de minimis* aid were among the Commission propositions in the SAAP which received the most support (European Commission 2006d: 6f.).




Conclusion: The limits of positive integration from above

European state aid control has moved beyond purely negative integration (cf. Mederer 2003: 987). The Commission has been the major driving force of this process, through its interpretation of the EC Treaty provisions and its development of soft and hard rules on admissible state aid. Today, BERs are as close to positive integration as state aid control can possibly get, with regard to their form as well as their content. They harmonize the possible exceptions to the state aid prohibition in Article 87 (1) of the EC Treaty (Kerber 1998: 51; Gross 2003: 104). Many potential conflicts about weighing the goal of undistorted competition against other goals of state aid policy, therefore, no longer arise at the European level in individual state aid cases. It has been shown that EU Member States increasingly resort to state aid measures falling under the BERs, and that their state aid policies are converging towards the horizontal objectives advocated by the Commission.

Two factors have been responsible for the Commission's ability to act as a supranational entrepreneur of positive integration: vague Treaty rules and heterogeneous Member States' interests. EC Treaty rules reflect the conflicting policy goals in the field of state aid and they entrust the Commission to balance them in concrete cases. The ECJ has limited the scope of European state aid control and checks the Commission's practices for procedural correctness, but it largely follows a policy of "judicial self-restraint" (Heidenhain 2003: 193; Immenga/Mestmäcker 2007: 890f.) with regard to the underlying assessment of admissible state aid. Member States' conflicting views on national state aid policies meant that they were initially unwilling to agree upon secondary rules, and later were unable to counter the Commission's increasingly complex and detailed vision of "good" state aid policy (Cini/McGowan 1998: 123). Essentially, the Commission's strategy can be described as one of "lesser evil" (Schmidt 2000: 50) from the Member States' perspective. Compared to case-by-case control, state aid soft law has improved legal certainty, and rather than being exclusively oriented toward competition, it left some scope for the design of national state aid policies. Compared to the remaining uncertainties under soft law, particularly those arising from lengthy Commission investigations, directly applicable BERs further clarify the remaining possibilities of national policy makers and relieve them from burdensome notification procedures. In exchange, the Commission gains influence on national state aid policies.

Where, however, are the limits on this positive integration from above? First of all, and most importantly, European state aid rules do not establish a full-fledged European state aid policy (see Table 5). The Commission cannot oblige national governments to spend state aid on particular purposes, i.e. to implement a harmonized state aid policy. The ultimate decision to grant state aid remains a national competence, and Member States still enjoy significant choice between different types of admissible aid when it comes to the specific state aid targets.

Table 5 European state aid control between the poles of negative and positive integration

Negative integration		Positive integration
	European state aid control	
<ul style="list-style-type: none">– State aid prohibition– Only exception: undistortive state aid	 <ul style="list-style-type: none">State aid prohibition (not absolute); harmonization of possible exceptions (admissible aid) 	<ul style="list-style-type: none">– Harmonization of national state aid policies– Community aid

Furthermore, within this system of harmonized exceptions to the state aid prohibition, Member States still have two options to influence the substance and the degree of positive integration in the field of state aid.

First, as has already been mentioned, the Commission cannot issue soft law or BERs against strong opposition from numerous Member States. It must build as broad a consensus as possible during the process of rule-making. The revision of the guidelines on regional aid illustrates this point: after opposition from France, Germany and the UK, the Commission had to modify its original proposal. Yet there is good reason to interpret the Commission's first draft as strategically radical, drafted to ensure that a compromise would still have a clear impact on Member States' regional aid policies (Fothergill 2006: 15). Another example shows the limits of the Commission's autonomy more clearly: because state aid to firms in financial difficulties heavily distorts competition, the Commission advocates strict limitations on these measures (Mestmäcker/Schweitzer 2004: 1125f.). Nevertheless, Member States continue to grant such aid, even though the amounts are decreasing (European Commission 2006e). This is reflected in the guidelines on rescue and restructuring aid which are often criticized as being too lenient (Nicolaidis/Kekelekis 2005). In this case, it is the Commission which has apparently accepted the "lesser evil" of the existing rules rather than outright non-compliance with stricter rules.

Second, depending on the (im)precision of secondary rules, Member States can adjust their national policies rhetorically rather than substantively to the Commission's criteria. The less precise the Commission's rules on admissible state aid, the easier it becomes for Member States to justify distortive state aid on this basis. In the past, the regional aid guidelines have sometimes been considered to create such loopholes (Dylla 1997, 1998). Whether the recently adopted framework on research, development and innovation aid is sufficiently precise remains to be seen; the new category of innovation aid has been particularly criticized for its lack of precision (Ehricke 2005). Thus, by pushing even further towards a harmonization of admissible state aid, i.e. in the direction of positive integration, the Commission might run the risk of undermining the negative integration it has achieved so far.

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