SERVICES OF GENERAL INTEREST

THE CURRENT LEGAL FRAMEWORK AND PROPOSALS FOR REVISION

Brief notes for the hearing on 11 June 2003 before the Committee on Economic and Monetary Affairs at the European Parliament, Brussels

by Matthew Parish[1]

As a point of ideology, should the European Union be committed to monetarism, or to socialism, or to any other economic model? Whatever one's political convictions, the answer to that question must be no. The European Union is composed of members with significantly different economic and political traditions. This will be all the more true upon expansion eastwards. It must therefore be a sufficiently broad church to accommodate a variety of different positions on the spectrum of economic opinion between interventionism and liberalism.

Services of general interest (in what follows, abbreviated to "**SGIs**") fall squarely within the parameters of the politico-economic debate between these two poles. To what extent should a hospital, school, television channel, urban transport network or similar be left to the mercy of the maw of market forces? Or: to what extent should such services be held down by the withering hand of the state? Does private sector involvement make SGIs more efficient (and therefore less of a drain on the taxpayer and the economy as a whole)? Does state ownership / intervention produce morally fairer or socially more propitious results? How should such competing interests be weighed in the balance?

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Indeed the politico-economic debate I have identified might be seen as a debate about the proper scope of the notion of an SGI. It is implicit in the very idea of an SGI that the "general interest" should override private commercial interest. There is something important about an SGI which means that it cannot be left to the market forces maelstrom. An SGI's development must be guided by factors beyond the private interests of the individuals who control or own it, whether that aim is achieved by public ownership, regulation or intervention. Therefore the economic liberal will say that fewer things are SGIs - fewer things need public control; whereas the economic interventionist will say that more things are SGIs. At the extreme poles, a free market economist will say that there are no SGIs, whereas an anti-market socialist will say that every economic activity is an SGI.

Why diversity is necessary

Where a common approach can be agreed upon throughout the EU in relation to a given SGI, and that agreement enacted into legislation, there is no problem. For example, there is no reason, in theory, why every member state in the EU could not organise ownership and management of railway networks in the same way and under the same legal framework.

However, in practice, agreement on a common approach is extremely hard to come by. Each European nation, coloured by its own history and political traditions, has its own views on the appropriate degree of regulation of SGIs, corresponding to sociological traits in different cultures as broad as individualism versus collectivism, high public service standards versus low taxes, and hierarchical versus "flat" management structures.

State economic activity is one of the most difficult areas for any federation to legislate on across the board. Federal law in the United States of America does not seek to regulate its individual states' economic activities by applying equivalent principles to every state. The European Union, with its far broader cultural and socio-economic diversity, is even less likely to achieve such an aim. The political and economic debates between left and right are inevitably inconclusive, and, indeed, have ebbed and flowed with the tide of recent history. Diversity of views in debates about SGIs is inevitable.

I therefore suggest that the EU should aim for the following political framework for SGIs:

(a) The European Union, being a broad and therefore necessarily tolerant church of nations, should not be ideologically committed in debates about the proper scope of SGIs;

(b) where Community-wide agreement can be reached in any such debate, a common approach can be prescribed in statute by the legislative organs of the EU;

(c) where Community-wide agreement cannot be reached, there should be flexibility between member states on economic policy so that each member state can, in accordance with the democratic will of its population, make its own decisions on where it sits within such debates. There should be "subsidiarity" for SGIs.

The first question I ask in this note is whether EC law as it currently stands is sufficient to achieve these objectives. I answer this question "no". I then ask how the law ought to be changed to allow these objectives to be more adequately achieved.

How EC law hinders diversity

In the absence of a specific EC-wide directive or regulation prescribing how a given SGI is to be financed, how does the background EC treaty law touch upon the operation of SGIs?

Superficially, there appears to be no issue; the EC treaty expressly preserves the right of individual member states to decide whether, and if so to what extent, their economies are mixed. Article 295 EC provides that

> "This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership".

If a member state wants to run its economy on lines that include substantial public ownership of, support of or investment in commercial and other assets - in other words if that member state regards more things as SGIs than another, economically more liberal, member state - then the Treaty will not interfere with that political choice. Right-wing / left-wing political decisions are classical cases of subsidiarity.

However, the problem is the EC law of state aid. State aid is prohibited by Article 87(1) EC as being incompatible with the common market. It says that

> "any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, insofar as it affects trade with member states",

be incompatible with the Common Market unless it falls into one of the categories of exemption listed later in the Article. The problem with the definition contained in Article 87(1) EC is that, on its face, it is so wide as to prohibit virtually any state economic activity at all. "Affect[ing] trade with member states" is interpreted very liberally as a legal test and is therefore very easily satisfied[2]. There is a very low *de minimis* threshold[3]. Article 87(1) turns out to be a blanket prohibition on SGIs. The exemptions contained later in the article are extremely restricted in their scope and have been interpreted strictly by the Court of Justice[4]. For the most part, use of these exemptions requires the approval of either the Commission or the Council.

The European Commission's solution to the stranglehold on state economic activity which Article 87(1) appears to entail has been to distinguish state "aid" from other sorts of state economic activity, by means of a test called the private investor principle[5]. If what the state is doing satisfies the criteria a private investor would set itself for making an investment, then the economic activity is not "aid" and therefore escapes the ambit of Article 87(1).

There are two principal problems with this test[6].

(1) There is no definitive or predictable answer to the question of what a private investor would do in any particular circumstances. Private investors' behaviour is not rational. It can vary as wildly as, or even more wildly than, the sorts of behaviour one might ascribe to a "public service" motivation. The private investor principle

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[2] In C-102/87 *France v Commission (FIM)* [1988] ECR 4067 it was held that this test would be satisfied if an aid was capable of affecting trade between member states, notwithstanding that it did not in fact do so. This principle is echoed in jurisprudence on Articles 81 and 82 EC (prohibiting anti-competitive agreements and abuse of a dominant market position respectively).

[3] Regulation 69/2001 sets a qualified *de minimis* threshold of €100,000 over a three year period.

[4] C-730/79 *Philip Morris v Commission* [1980] ECR 2671 at 2701, per Advocate General Capotorti.

[5] The cases in which this test was first granted explicit legal sanction by the Court of Justice were C-234/84 *Belgium v Commission (Meura)* [1986] ECR 2263 and C-40/85 *Belgium v Commission (Boch)* [1986] ECR 2321.

[6] These two issues are expanded upon in some detail in my article *On the Private Investor Principle*, referred to in footnote 1 above.

therefore becomes a tool by the use of which the Commission can wield arbitrary discretion in accordance with the dictates of political convenience, immune from supervision by the European Courts. It is not desirable for any public authority, national or international, to hold arbitrary power. It offends against the principle of separation of powers posited in political theory as far back as Rousseau. If a public body has unchecked discretion, arbitrary and therefore not susceptible to supervision by another arm of the public administration (in this case the European Courts), then that power is susceptible to being exercised incompetently or without proper theoretical direction; or at worst, abuse.

(2) The test requires public bodies to act as private ones would. They are required to be influenced by the sorts of motive that would influence private bodies. But from the perspective of SGIs, there is no point in that. The very point of an SGI, as defined above, is that it is an area of socio-economic activity where the general interest requires that some guiding force is imposed above and beyond the blind hand of the free market. The private investor principle turns governments into private sector companies, leaving no room for SGIs. Pushed to its logical conclusion, the private investor principle binds the EU to a *laissez-faire* view of the proper role of government in the economy. It leaves no room for a genuine debate to take place within each member state between the differing poles of argument about the benefits of state economic intervention.

How does the law need to be changed?

The law of state aid, as expressed in Article 87(1) EC, is too oppressive. It places too onerous a fetter on the discretion of member states to engage in economic activities. The law needs to be rolled back, but not in the way the Commission has suggested so far (using the private investor principle).

Most critically in this context, the law needs to be reframed in a way to allow subsidiarity for SGIs. As the law currently stands, virtually any SGI might, in principle, be "aid" and therefore subject to Community control and/or prohibition. Regional government subsidises an urban transport network; central government invests in a publicly owned hospital to build a new ward; a local authority contracts with a private builder to create new streetlights in a dark part of a town centre. All these things may in principle be classified as "aid", because government investment in such projects will be for public service purposes and will therefore, *ex*

hypothesi, fail the private investor test. The EC law of state aid as it currently stands works only because the Commission has an unfettered discretion in deciding which state economic activities it interferes with on the basis of being "aid", and which state economic activities it overlooks.

To consider how the EC law of state aid might be reframed to avoid the pitfalls suggested above, it is necessary to return to first principles and consider what mischief the law of state aid is intended to prevent. The EU is, above all, an economic union premised on the notion of a common market and a "level playing field": company A in France should be free to sell its wares in Germany with hindrances or fetters no more substantial than German company B would bear in selling its own equivalent goods there. State economic activity can create bumps in that level playing field. The example that comes most obviously to mind is (for example) state subsidies to a national industry. If a British car manufacturer receives subsidies from the UK government, then a French car manufacturer will find it difficult to penetrate the British manufacturer's market: the French company will not be able to sell equivalent cars as cheaply.

Yet in pursuing the objective of keeping the playing field flat, SGIs present one with an immediate theoretical problem. Any state economic activity in the field of SGIs is likely to create a distortion in the common market. The resources of governments are, in general, disproportionately larger than those of private companies, and, out of deference to their electorates whose votes national politicians rely upon for re-election, they are liable to act in the national interest of the states they represent. When they decide to act in the field of SGIs, they may well therefore do so in a way that creates a bump in the playing field.

Take, for example, a publicly owned railway company[7]. The state wishes to open a new railway line, (for example) to alleviate traffic congestion in a recently developed urban conurbation. So it grants the railway company a long-term low interest loan on uncommercial terms, with which to finance the new project. This is classic "state aid"[8], and it distorts competition because other companies have to go to banks to get their loans, and therefore have to endure commercial terms. Yet without it, the new railway line would not be built.

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[7] Whether the company in receipt of the aid is publicly or privately owned is in fact irrelevant for the purposes of the law of state aid.

[8] See eg C-323/82 *Intermills* [1984] ECR 3809; C-84/82 *Textiles* [1983] ECR 1451 at 1500-1501 per Advocate General Slynn.

The Community has to accept that SGIs are, to a degree, inconsistent with the common market. Given inevitable differences between member states about the proper extent of state involvement in SGIs, the best that can be done is to define SGIs and to carve them out of the law of state aid. If Community-wide agreement on the proper scope of any particular SGI can be reached, then consensual legislation can prescribe how investment in such SGIs will be regulated across the Community. Where such agreement cannot be reached, the Community can do little better than to accept subsidiarity on SGIs and to leave member states with large measures of discretion in pursuing them, accepting the inevitability of some anti-competitive consequences as a result.

That is not to say, however, that each member state's SGI initiatives should not be monitored by the Community. A notification regime, requiring each member state to inform the Commission of SGI activities and their potentially anti-competitive consequences, may be put in force. The Commission might therefore be able to take remedial measures to correct the worst excesses of anti-competitive SGI activities. It is difficult to prescribe general principles on which the Commission might do this, but it is often clear in individual cases what sort of influences the Commission may wish to bring to bear to minimise the anti-competitive consequences of any particular SGI practice.

For instance, the Commission might require non-discriminatory measures in government tenders for private sector contracts relating to SGIs. It is right that an undertaking from any member state should have a fair chance to bid for a contract relating to an SGI in another state. Such a principle might be enshrined in legislation initiated by the Commission. Indeed a raft of general financing principles for SGIs could be promulgated in Community legislation.

The proper generic legal approach to SGIs is, in my view, therefore:

(1) Agree between member states an exclusive EC-wide definition of SGIs.

(2) Exclude the operation of Article 87(1) EC to all state economic activities falling within that definition[9].

[9] This has already happened for some SGIs. Article 73 of the Treaty of Amsterdam appears to carve out transport from the principles of the law of state aid. Its legal effect has yet to be tested in the European Courts.

(3) Impose a Commission notification regime for all state economic activities falling within that definition.

(4) Give the Commission periodic "rebalancing powers" to take remedial measures to counter anti-competitive consequences of SGI operations.

(5) Some anti-competitive consequences of SGI economic activity may be addressed by Commission legislation prescribing financing principles for SGIs.

(6) Where Community-wide agreement on the proper scope of any particular SGI can be reached, formalise the common approach in comprehensive EC legislation (regulation or directive as appropriate).

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