1

Introduction

Subsidies and other forms of public intervention are tools in the politician's toolkit, which governments and local authorities often resort to in pursuit of objectives that they have been elected to achieve. Yet, the presence of the EU rules on State aid control determines the shape, and limits the availability, of such tools. State aid law is an intrusive policy, which places significant constraints on decision-making at every level of government. Moreover, State aid law affects, and to a certain extent is itself the expression of, fundamental political choices; choices which may not be immediately apparent, or may not be systematically articulated, but which underlie an entire spectrum of legal concepts and principles. Such choices concern the respective roles of the State and the market, the desirability or otherwise of competition between jurisdictions, or the appropriate balance between market and nonmarket concerns. To the extent that these choices are crystallised into law, they become part of the EU's economic constitution.

While large sections of internal market law have been examined in their constitutional dimensions, the emergence of academic interest in the constitutional implications of State aid law is a relatively recent development.[1] The special appeal offered by this section of EU law lies in the fact that it represents a microcosm in which many of the themes that colour the debate on internal market law converge, and, at the same time, it is a distinct area characterised by a unique set of rules, principles and concepts, all of which contribute to determine the evolution of the European economic constitution. The book's specific focus is on the case law that defines the boundaries of the legal notion of State aid under Article 107(1) of the Treaty on the Functioning of the European Union (TFEU), a jurisprudence that has been dissected in its manifold aspects, but which continues to present a number of stimulating questions in light of its wider constitutional implications. As the freedom that governments enjoy to mould the economic destinies of their countries is affected by the answers that are given to questions on the boundaries of State aid, these are, plainly, constitutional questions.

The book is divided in three parts. Part I sets the scene by laying out the constitutional framework which informs the rest of the book. Chapter two fleshes

[1] The term 'internal market' is used throughout this book to include State aid law. As made clear by the Protocol on the Internal Market and Competition annexed to the Lisbon Treaty, 'the internal market as set out in Article 3 of the Treaty on European Union includes a system ensuring that competition is not distorted'.

out the concept of economic constitution and explains its usefulness for the book's purposes, while chapter three plots the position of State aid within this constitution by comparing the main features of the State aid regime to the main features of free movement and antitrust law. Part II then moves on to examine some fundamental issues in the interpretation of the notion of State aid. It does this by considering how State aid law takes account of the role of the State as market participant, in chapter four, and of the State as regulator, in chapter five. Part III considers two areas of interpretation that allow us to explore in greater depth some of the themes identified in previous sections of the book: the issue of regional tax autonomy (in chapter six) and the question of public service funding (chapter seven).

The term economic constitution is not used here as a form of homage to the ordo-liberal pedigree of the concept. Instead, it serves two purposes. The first is to emphasise the constitutional nature of the EU's primary economic law. The constraints on public (and private) power that it sets are subject to the constitutional principles that apply across EU law, and are the object of interpretation by the Court of Justice, which gives substance to often anaemic primary law provisions. The second purpose is to bring to light the material aspect of the constitution; in other words, to identify the EU's long-term orientation as to the role of the State in the economy. Whether this constitution expresses a particular philosophy of political economy, an overarching ideology, a neo-liberal *pensée unique*, or, rather, it is an open-ended project that accommodates a plurality of approaches to political economy, is a matter of intense discussion among scholars. This book proceeds from the view that the legitimacy of EU law rests on its ability to deliver a single market which does not undermine the capacity of Member States to pursue redistributive policies, and to preserve the delicate balance between EU law supremacy and national concerns regarding their constitutional spaces. The arduous balance between market and nonmarket values, between EU and national competences and their respective constitutional spaces, is very much a necessity of the current stage of integration, which is characterised by an asymmetry between economic integration on the one hand, and redistributive policies, on the other. The advanced level of economic integration achieved so far through the single market has not been matched by an equivalent level of integration in redistributive policies; this is so because the prospect of political integration, a precondition for progress towards greater integration in such policies, is enveloped in a thick mist.[2] This, however, does not mean that economic integration has no bearing on redistributive policies and on policies that embody nonmarket values. On the contrary, spillover into the latter policies and values is an intrinsic consequence of advanced market integration. The

[2] This is not to diminish the importance of EU social policy, however. For a recent overview, see C Barnard, 'EU "Social" Policy: From Employment Law to Labour Market Reform' in P Craig and G de Búrca (eds), *The Evolution of EU Law*, 2nd edn (Oxford, Oxford University Press, 2011).

EU's legitimacy crucially turns on the manner in which it deals with this kind of spillover.

It may seem surprising that a study on the boundaries of State aid should contemplate questions of legitimacy. After all, when one considers the output legitimacy of State aid and, more generally, of the law of the single market, the arguments in favour of EU action seem compelling.[3] According to a highly influential view, the output legitimacy of economic integration rests on the transnational nature of the problems that it addresses, and on the inadequacy of national political systems to offer solutions to problems with transnational dimensions.[4] On one account, in particular, the EU is a 'regulatory state', as it rectifies market failures that cannot adequately be resolved by 'majoritarian' institutions, but are best dealt with when delegated to agencies that are endowed with independence and technical expertise.[5] Non-majoritarian agencies are better placed to play this role as they are not prone to capture by the short-term interests of the majority, but are able to secure both the long-term interests of the majority, and the interests of minorities. Moreover, the existence of negative cross-border externalities and commitment problems that arise in economic and trade-related matters make the upward delegation to supranational institutions an attractive solution both from the perspective of the EU's legitimacy and of the Member States' own legitimacy, as delegation to the EU cures the legitimacy issues caused by the inability of Member States to offer adequate solutions to problems with transnational dimensions. On this view, legitimacy questions are virtually absent in areas relating purely to economic integration, since decisions taken in these areas do not concern redistribution, but yield, instead, Pareto-efficient solutions, outcomes in which there are some winners, but—crucially—no losers. Given the lack of redistributive outcomes, so goes the theory, such areas have a low level of political salience—public opinion is virtually indifferent to them.[6]

Yet these views, and, in particular, the idea that the areas covered by economic integration lack political salience and elude political contestation, which was never without its challengers, have been seriously undermined by recent events.[7] One need only think of the debate on legislative proposals for a Services Directive, or the fallout from the *Viking* and *Laval* case law,[8] both instances in which the

[3] For an account of legitimacy in the EU and of 'output legitimacy' in particular, see F Scharpf, *Governing in Europe. Effective and Democratic?* (Oxford, Oxford University Press, 1999). Output legitimacy denotes the ability of institutions to deliver outcomes that satisfy citizens' preferences.

[4] GD Majone, 'The Rise of the Regulatory State in Europe' (1994) 17 *West European Politics* 77; A Menon and S Weatherill, 'Transnational Legitimacy in a Globalising World: How the European Union Rescues its States' (2008) 31 *Western Union Politics* 397.

[5] Majone, 'The Rise of the Regulatory State in Europe' (n 4).

[6] A Moravcsik, 'In Defense of the "Democratic Deficit". Reassessing Legitimacy in the European Union' (2002) 40 *Journal of Common Market Studies* 603.

[7] A Follesdal and S Hix, 'Why There is a Democratic Deficit in the EU: A Response to Majone and Moravcsik' (2006) 44 *Journal of Common Market Studies* 533.

[8] Case C-438/05 *Viking Line* [2007] ECR I-10779; C-341/05 *Laval un Partneri Ltd v Svenska Byggnadsarbetareförbundet and others* [2007] ECR I-11767.

interests of free trade, on the one hand, and the rights and interests protected by employment policy and industrial relations law, on the other, came to be seen as antagonists; or, again, the ongoing political repercussions of the euro-zone crisis, which have exposed the consequences of the lack of a comprehensive political debate behind fundamental aspects of monetary union, and have further demonstrated the relevance to public opinion of matters that were previously regarded as lacking salience. As all these events reveal, policies, decisions, or legislation emanating from the EU may, at least at the level of perceptions, create winners and losers, and it is wrong to assume that economic regulation can be completely insulated from the surrounding social and political context.

Still, the fact that EU policy is subject to contestation does not necessarily mean that constitutional adjudication by the European courts should give rise to questions of legitimacy. Unease with certain aspects of EU policy, or disgruntlement with isolated rulings of the Court of Justice does not affect the Court's legitimacy. Regardless of the Court's standing in public opinion, a matter of questionable verifiability, there is little doubt that its jurisprudence, through the elaboration of concepts and principles, such as mutual recognition, that have been central to the success of the single market, has contributed to the output legitimacy of the European project.[9] Yet, if that is the case, then it is plausible to assume that the Court's contribution could also be in the opposite direction. Individual cases are not sufficient to undermine the legitimacy of the Court's constitutional authority; however, the cumulative effect of the Court's interpretation of different treaty provisions may be a gradual erosion of the EU's output legitimacy. If constitutional adjudication is to avoid becoming inextricably linked to the EU's legitimacy crisis, where internal market law intercepts sensitive aspects of national competence, careful judicial handling commends itself to the Court.

Granted, there is little doubt that the Court is ill-placed to address the fundamental limitations which stem from the (above-mentioned) asymmetry between economic, social and political integration that characterises European integration in its current form. Such limitations may only be rectified through the European political process.[10] Moreover, the Court is unable to prevent spillover of economic integration into noneconomic/nonmarket areas. Yet, the Court's role consists in ensuring that its jurisprudence justifies the perception that such spillover effects are contained and managed in accordance with a transparent and predictable set of principles. A certain degree of sacrifice to nonmarket interests and to the exercise of national competences is an inevitable consequence of

[9] On the question of the Court's legitimacy, see D Kelemen, 'The Political Foundations of Judicial Independence in the European Union' (2012) 12 *Journal of European Public Policy* 43.

[10] Which, of course, does not necessarily mean that the European political process is currently capable of doing so. Note that 'European' is used here in all its ambivalence: it means at EU, or at Member State level, or both. Of course, this book makes no claims as to how this particular nut is to be cracked.

market integration; yet to be accepted, sacrifices of this sort should be justified by reasoning that is able to command widespread acceptance.

State aid law is not immune from these considerations. While rulings such as *Azores* or *Altmark* may not have produced controversies with the same resonance in public opinion as *Viking* and *Laval*, they have, nonetheless, caused keen interest among governments and parliaments both at national and at regional levels across Europe.[11] Unsurprisingly so, as they address politically sensitive questions that relate to the extent to which fiscal powers can be devolved from central governments to sub-national governments, or how public services should be run. Both cases, in other words, relate to constitutional questions, as they ultimately concern the relative status of market and nonmarket values in EU law, and the scope for national regulatory autonomy and national constitutional identities under EU law. For these reasons, the constitutional framework sketched out in chapter two is essential to understanding the themes with which the book is threaded.

While chapter two concerns the broader constitutional picture, and leaves State aid law to one side, State aid law makes a first appearance in chapter three, which considers its distinctiveness within the European economic constitution. The chapter compares and contrasts the State aid regime with other areas of internal market law (free movement and 'antitrust law'). It finds that, behind a unity of purpose, and despite the remark that both areas fall within the wider category of 'competition law', State aid appears to share little with antitrust law in the way in which market analysis is approached. The empirical questions that characterise antitrust law are virtually absent in State aid law. In part, this can be attributed to the fact that, unlike antitrust law, much of State aid law concerns regulatory measures which, by their nature, do not lend themselves to (the same type of) market analysis that applies to measures whose effects on individual undertakings may be more readily identifiable. In this latter sense, the absence of an empirical approach is reminiscent of the Court's approach to the concept of distortion of competition in the case law on the preconditions for harmonising legislation under Article 114 TFEU.

Another significant discrepancy emerges from this inquiry. While free movement law, and the principle of mutual recognition in particular, may be said to lay down the conditions for a process of regulatory competition between Member States to emerge, albeit with a number of safeguards for national regulatory autonomy, the State aid provisions have the opposite effect. The effect of the EU's State aid regime is, in fact, to limit the extent to which Member States may employ subsidies or selective regulation (and taxation in particular) to attract business activity to their jurisdiction.

What emerges from this analysis is a body of law which may be described as giving rise to both a form of negative integration and to a form of positive

[11] Case C-88/03 *Portugal v Commission (Azores)* [2006] ECR I-7115; Case 280/00 *Altmark Trans GmbH, Regierungspräsidium Magdeburg v Nahverkergesellschaft Altmark GmbH* [2003] ECR I-7747.

integration. The deregulatory effect associated with negative integration, which derives from the general prohibition of State aid, is accompanied by the exercise on the part of the Commission of a set of powers which are designed to ensure that State intervention is channelled towards objectives that are perceived as priorities from an EU perspective.

Once this framework in place, Part II goes on to address the case law on the definition of State aid through an analytical model which juxtaposes cases involving Member States acting as market participants, and cases involving Member States acting as regulators. This dichotomy throws light on the different legal standards that apply to each of the two categories of State actions and on the significance of these in terms of the values that they appear to further. It also highlights the effects of State aid law on the separation between State and market, and on the extent to which Member States remain free to pursue regulatory (or tax) competition. Chapter four examines cases in which Member States act as market participants. The central notion in this case law is the market operator principle, which acts as a boundary marker between subsidies and normal market transactions. The way in which the principle operates consists in comparing the conduct of a State to that of a private investor, seller, or lender operating under normal market circumstances. Where the conduct of the State deviates from this benchmark of behaviour, it is deemed to create an advantage in favour of the undertaking(s) concerned. This standard of conduct dictated by State aid law prompts Member States to adopt the logic of economic efficiency in areas that would not necessarily be subject to it. In doing so, it appears to reveal EU State aid as a strongly market-orientated policy which is committed to the liberal principle of the separation between the State and the market. Moreover, the chapter questions the apparent neutrality of EU law regarding State versus private ownership of economic activity. It, instead, argues that the approach of EU law is one of substantive equality. Critics who argue that the market operator test embodies a neo-liberal view of the respective role of the State and the market may have a point. However, as the concluding part of the chapter shows, the Court seems prepared to eschew a mechanistic approach to the separation between State and market in cases that display a strong public interest dimension.

The distinction between market participation and regulation is not free from difficulty. While recent case law has attempted to provide some clarity on the scope of the market operator test by employing the concept of economic activity to trace a dividing line, it has not cleared the ground from potential difficulties. Chapter five argues that, in adopting this approach, the General Court appears to have neglected the rationale for excluding regulatory measures from the scope of the market operator principle. The State aid case law has consistently regarded regulation as forming part of the normal costs of an undertaking, and has adopted a presumption that State intervention that alters the regulatory framework in which undertakings operate is distortionary. This is why, where the State acts in its regulatory capacity, the relevant question is not whether its behaviour conforms

to the rationality of an investor, or a creditor, but whether regulatory intervention is asymmetric in its effects.

Determining whether regulation has asymmetric effects, whether it is 'selective', is, however, an arduous task. The difficulties derive from the fact that regulation often produces asymmetries, and, therefore, EU law must take a view on which asymmetry is a normal effect of regulation, and which is a distortion caused by State intervention. The case law struggles under the competing demands of pragmatism and of legal certainty. The same difficulties arise in relation to another legal test that has emerged from the Court's case law, which exploits a textual ambiguity in Article 107(1) TFEU in order to create a legal safe-haven for sensitive areas of domestic legislative competence, such as employment law or energy policy. There is a certain degree of formalism involved in tracing bright lines of this sort. Yet, the solutions that have so far been advanced in the literature are perhaps more problematic than a refinement and recalibration of the Court's existing case law.

Part III brings into focus two areas that offer insights into the way in which the relationship between State aid law and (domestic) nonmarket values can be addressed in the case law. Chapter six considers whether, and under which conditions, tax measures that have a regional (sub-national) scope should be treated as State aid. There is no straightforward answer to this question, as, clearly, the regional scope of a measure cannot automatically lead to the conclusion that there is a State aid; to do so would result in suppressing a crucial aspect of regional autonomy, in contravention of the EU Treaty's renewed commitment to national constitutional identity and regional autonomy enshrined in Article 4(2) of the Treaty on European Union (TEU). At the same time, however, the standard approach to the definition of State aid, and EU law orthodoxy, would imply the irrelevance of internal constitutional arrangements. While this chapter finds the Court's approach to be consistent with the view that internal market law should not undermine national constitutional identity, it also argues that this solution is not entirely without consequences as far as tax (and regulatory) competition is concerned.

Chapter seven completes this picture by examining how the Court has attempted to reconcile a thorough application of the State aid rules with EU law's commitment to Services of General Economic Interest (SGEIs). The reasons why this area of EU State aid law commends itself to our attention are obviously linked to the significance of SGEIs to the objective of a 'highly competitive social market economy';[12] they are, in other words, part and parcel of the attempt by EU law to reconcile market integration and the pursuit of efficiency and competitiveness with the pursuit of social aims. Yet, as the chapter makes clear, any attempt to characterise the internal market as an economy endowed with a unified approach to nonmarket values is confronted with a fragmented reality made up of distinct

[12] Article 3(3) Treaty on European Union.

approaches to public service values. With its emphasis on domestic competence to define SGEIs, the Lisbon Treaty seems to have taken stock of this reality. Moreover, both the Commission and the EU Courts now appear to recognise that national competence in this area represents a limit to the prescriptive nature of the significant regulatory constraints imposed through the application of State aid law to public service compensation.