1. Introduction

The financial crisis that initially affected the banking sector has in turn had an impact on the real economy. A squeeze on credit, falls in house prices and tumbling stock markets are all aggravating a slump in consumer confidence, consumption and investment. Economic growth has dropped to about 1% in 2008 in the EU, down from just below 3% in 2007, and according to the latest economic forecasts real GDP is expected to fall in 2009 by at least 2%.

This dire economic situation raises significant challenges for competition policy. First, and most directly, there is a risk that governments may want to go it alone and wage a subsidy race to rescue national companies and jobs. Governments may also be tempted to relax antitrust or merger rules. For instance, they may want to allow a merger with negative effects on competition if it is perceived as necessary to assist a firm in difficulty. They may also want to favour the creation of national champions, despite possible negative impact on consumer welfare, if such firms are perceived as being in a better position to withstand the present economic difficulties.

However, relaxing competition rules, whether in the State aid or merger area, would actually worsen the problem, because it would harm consumers, impede necessary adjustments by keeping inefficient companies in business and ultimately delay the recovery. Historical experience provides ample evidence that suspending competition rules, even temporarily, would have major negative consequences: recent research (2) shows that, during the 1930s, some measures, such as allowing firms to collude if they agreed to raise wages, prevented price adjustment, were counterproductive and may have delayed recovery by several years.

When implementing its competition policy, the Commission needs to address the following issue: how to ensure an effective and coherent public response to the crisis while at the same time minimising the risks of distortions of competition. When doing so, the Commission has a significant advantage: unlike most jurisdictions, EU competition policy not only enables the Commission to act firmly against distortions of competition caused by the behaviour of companies. It is also empowered to effectively control the impact of State interventions on competition by ensuring that a State subsidy race does not create disproportionate and unnecessary distortions of competition.

With this well-established range of tools, the Commission is therefore well placed to address the competition-related problems raised by the economic crisis in a comprehensive and effective way. Some adjustments in order to adapt these instruments to the seriousness and specificities of the crisis have been necessary. However, as explained below, these adaptations have respected the essential principles of the EU competition policy. In view of the specificities of State aid and merger control, this article will explain in turn how the Commission uses its instruments to tackle the effects of the crisis on the real economy.

2. EU State aid control — part of the solution

The rules on State aid in the EC Treaty are meant to address the fact that, when considering State aid measures, national governments often do not consider possible negative spill-over effects on competition and trade in the single market. Such State aid may distort competition between European businesses and undermine Europe’s single market against the common European interest.

The EC Treaty thus establishes the principle that State aid which distorts or threatens to distort competition is prohibited in so far as it affects trade between Member States. However, State aid which contributes to well-defined objectives of common European interest without unduly distorting competition between undertakings and trade between Member States may be granted. (3)

When designing general State aid rules and/or assessing State aid cases, the Commission balances the negative effects on trade and competition in the common market with its positive effects in terms of

(1) This is a shortened version of the European Commission note to the OECD Competition and Financial Markets roundtable on Real Economy — The Challenge of Competition Policy in Periods of Retrenchment. The full version of this contribution may be found at http://ec.europa.eu/competition/international/multilateral/2009_feb_roundtable3.pdf


(3) Article 87 of the EC Treaty.
contributing to the achievement of well-defined objectives of common interest. Balancing these effects takes into account the impact of the aid on the social welfare of the EU. For that purpose, the Commission has established a “balancing test” which consists of the following questions:

(1) Is the aid measure aimed at a well-defined objective of common interest (for example, growth, employment, regional cohesion, environment, energy security)?

(2) Is the aid well designed to deliver the objective of common interest, that is to say, does the proposed aid address the market failure or another objective?

   (a) Is State aid an appropriate policy instrument?

   (b) Is there an incentive effect, i.e. does the aid change the behaviour of undertakings?

   (c) Is the aid measure proportionate, i.e. could the same change in behaviour be obtained with less aid?

(3) Are the distortions of competition and effect on trade limited, so that the overall balance is positive?

On this basis, the Commission has elaborated detailed rules explaining under what conditions (e.g. eligible costs, intensity of aid, and nature of the beneficiaries) a Member State can grant aid to its undertakings. These rules cover a wide range of categories of aid: for example aid for research, innovation, environmental protection, regional development, development of SMEs, training, employment, risk capital, rescue and restructuring of firms in difficulty.

2.1 Existing State aid rules: a good basis to tackle recessions

On the one hand, the existing State aid rules provide a good basis for Member States’ response to the crisis along the lines of the European recovery plan, in particular as regards the focus on smart investments. For instance, the general block exemption regulation allows Member States to provide investment aid to SMEs. It also authorises support for training, a key element for competitiveness and critically important in times of rising unemployment when new skills need to be developed. In the same vein, support is allowed for R&D projects that would not be undertaken without aid. In addition, the Community guidelines on State aid to promote risk capital facilitate the financing of innovative and fast-growing SMEs and the guidelines on State aid for environmental protection allow investment aid for companies to improve their environmental performance and save energy.

On the other hand, to prevent a harmful State aid race, the EU has strict rules on rescue and restructuring aid for firms in difficulty, limiting the distortion vis-à-vis healthy firms. Thus, aid to rescue or restructure a company can only be granted once for the same enterprise in order to avoid repeated interventions to keep certain enterprises in the market. Furthermore, restructuring aid is conditional upon implementation of a restructuring plan and seeking to restore the long-term viability of the company. The beneficiary of the aid must make a real contribution toward the cost of its restructuring. In addition, to limit the distortions of competition, the Commission imposes compensatory measures in the form of divestitures of assets, reductions in capacity or market presence or reductions of entry barriers.

Thus, the State aid rules in place before the recession already provided a good framework to tackle the impact of the financial crisis on the real economy, by targeting smart investments and restricting the use and negative effects of rescue aid. However, the Commission came to the conclusion that these existing rules were not sufficient to address the increasingly acute impact of financial turmoil on the real economy. That is why it adopted a temporary framework addressing this problem.

2.2 New temporary framework: responding to the exceptional credit squeeze

As a consequence of the crisis in financial markets, banks have become much more risk averse than in previous years, and as a result much less willing to provide financing. This tightening of credit conditions not only affects weak companies, it can also have an impact on healthy companies, which find themselves facing a sudden shortage or even complete lack of private funding, whether loans or risk capital. It is easy to see how this can have disastrous effects on the real economy, on investments and on employment at EU level.

Therefore, in addition to the two communications on State aid to financial institutions in response to the financial crisis, the Commission also adopted a “temporary framework for State aid measures to support access to finance in the current financial and economic crisis” (the “temporary framework”) in response to the growing effects of the crisis on the real economy. The new rules target the specificities and the expected temporary nature of credit tightening while fully respecting the general principles and philosophy of the balancing test.

The temporary framework is designed to reduce the negative effects of the financial crisis in the real economy and, to that end, pursues three objectives: first, to immediately unblock bank lending and thereby help to provide continuity in companies’ access to finance; second, to ensure that limited amounts of aid reach the recipients in the most rapid and effective way; third, to encourage companies to continue investing in a sustainable future, including the development of green products. Its legal basis is Article 87(3)(b) of the EC Treaty. This is a rarely used provision, which is directly linked to the current financial crisis since it allows the Commission to declare compatible with the common market aid “to remedy a serious disturbance in the economy of a Member State”.

The temporary framework provides for a number of new measures that can be applied by Member States for a limited period of time, until the end of 2010, as well as a number of limited temporary derogations from existing State aid rules. More specifically, the temporary framework allows Member States to provide the following types of aid:

- a lump sum of up to €500 000 per company for the next two years in aid to cover investments and/or working capital,
- subsidised guarantees for loans at a reduced premium,
- aid in the form of subsidised interest rates,
- subsidised loans for the production of green products (meeting environmental protection standards early or going beyond such standards),
- a risk capital injection for SMEs of up to €2.5 million per year (instead of the current €1.5 million) under certain conditions.

The aid measures that are authorised under the temporary framework are clearly tailored to address difficulties stemming from financial turmoil by lowering the costs of credit (through subsidised interest rates), facilitating access to credit (through subsidised guarantees for loans) or equity (through more general provisions on State aid to risk capital) and relieving smaller firms from financial difficulties (through the €500 000 lump sum).

Furthermore, in line with the balancing test, the Commission has ensured that the allowed aid measures are proportionate to the objectives pursued and designed to minimise the impact on competition. Thus, the temporary framework favours SMEs, since, under a well-established principle of EU competition policy, aid to SMEs is considered to be less distortive of competition at EU level. For instance, SMEs are the only beneficiaries of the temporary framework’s provisions concerning risk capital injections. With regard to investment aid and subsidised guarantees, they benefit from higher aid intensity. As to the lump sum of €500 000, it will clearly be of more importance to relatively small firms than to large ones.

In addition, the temporary framework is not applicable to companies that were in difficulties before 1 July 2008. Companies whose difficulties date from before the financial crisis must address their structural problems exclusively on the basis of the general rules regarding rescue and restructuring aid, described above. However, as explained in the introduction, a number of companies may find themselves under stress despite having a sound business plan: the temporary framework can help to relieve their temporary financial difficulties. This set of rules regarding firms in difficulties is precisely devised to ensure that overprotective aid measures devised by Member States would not revitalise structurally failing firms to the detriment of competition and healthier firms.

Finally, as indicated by its title, any effect of the temporary framework will be limited in time since it is only applicable until 31 December 2010.

3. Merger control and the crisis in the real economy

There is a legitimate expectation that the effects of the economic crisis should be taken into account in full when applying competition rules. However, this must not imply that competition and in particular merger rules should be relaxed or set aside during a crisis situation in order to support specific undertakings. Rather, proper application of competition and merger rules will ultimately ensure the protection of consumer welfare. The EU Merger Regulation provides an efficient and flexible tool for this purpose. On the one hand, it provides mechanisms to prevent Member States, in pursuit of goals incompatible with those of ensuring undistorted competition, from unduly interfering with the EU merger control process while at the same time recognising their powers to protect their legitimate interests. On the other hand, it provides an efficient and flexible instrument to scrutinise mergers also in rapidly evolving markets.

3.1 The Commission’s powers to maintain undistorted competition

The Commission has exclusive jurisdiction under the Merger Regulation to assess the competition impact of mergers with a Community dimension. In recent years, there have nevertheless been attempts made by several Member States to intervene to prevent or restrict the acquisition of domestic companies by companies from other Member States in cases of mergers with a Community dimension. Some of
these interventions have involved the direct use of State powers, others have taken more indirect forms. The temptation on the part of some Member States to promote national champions has been particularly visible in the past few years. It is conceivable that this trend may gather momentum as a result of the recession and the financial crisis.

However, the goal of achieving undistorted competition must not be undermined by efforts to create national champions to the detriment of pro-competitive domestic or cross-border mergers. Experience has demonstrated that engineering the creation or protection of “national champions” is not the way to succeed as firms that do not face competitive pressures may have an incentive to reduce output, stop innovating and cut jobs, all at the expense of taxpayers.

In Article 21 of the Merger Regulation, the Commission has at its disposal an effective tool to address such actions by Member States. This provision gives the Commission exclusive jurisdiction to assess the competition impact of mergers with a Community dimension. It stipulates that the Merger Regulation alone applies to concentrations with a Community dimension and that the Commission has sole jurisdiction to review such concentrations, and as a consequence that no Member State may apply its national legislation on competition to any concentration that has a Community dimension.

Also, the Member States are prevented from circumventing the Commission’s exclusive jurisdiction by disguising their pursuit of another supposed public interest. Article 21(4) provides that “Member States may take appropriate measures to protect legitimate interests other than those taken into consideration by this Regulation and compatible with the general principles and other provisions of Community law”. Such legitimate interests include but are not limited to public security, plurality of the media and prudential rules. Any other public interest must be communicated to the Commission by the Member State concerned and is to be recognised by the Commission after an assessment of its compatibility with the general principles and other provisions of Community law. Any industrial policy at Member State level which has the objective or effect of favouring national champions to the detriment of single market principles would not be considered legitimate by the Commission. Until recently, Article 21 had only occasionally been applied. However, in the last three years, the Commission has adopted more decisions under Article 21 than in the previous 15 years since the entry into force of the Merger Regulation. These experiences have demonstrated that Article 21 has proven an efficient tool in fighting protectionism.

3.2 The EC Merger Regulation is a tool that can also take rapidly evolving markets into account

When assessing the competition impact of a merger, the Merger Regulation allows the Commission to take into account rapidly evolving market conditions. In procedural terms, rescue mergers may require rapid reaction by the Commission in order to enable at least partly the immediate implementation of transactions. If appropriate in the particular case, the Commission can exceptionally accommodate this by granting a derogation from the standstill obligation pending the merger review. In substantive terms, the assessment under the Merger Regulation is flexible enough to take into account a rapidly evolving economic environment and, where applicable, the failing firm defence.

The failing firm defence allows the Commission to take into account the financial difficulties of a merging firm and its potential exit from the market when assessing the effects of the merger on competition. So far, no merging parties have relied on the failing firm defence in any of the merger cases notified to the Commission in the course of the current crisis.

To conclude on this issue, this analysis has shown, and experience has confirmed, that the EC Merger Regulation constitutes an appropriate and sufficiently flexible tool for merger control enforcement also in severe market conditions. The overall objective pursued by the Commission in applying this instrument is to ensure that competitive and well-functioning market structures are maintained not only today but also in the medium to long term.

4. Conclusion

The EU’s experience in the State aid and merger field demonstrates the importance of a coordinated approach to State aid and merger control in order to avoid a damaging subsidy race or national industrial policies geared to the promotion or protection of national champions. Lessons that are valid for the EU and its Member States are equally true for the world economy. This is why a coordinated international approach to these policies would be an essential element in the global fight against this major recession.