Opinions and comments

Public service compensation in practice: Commission package on State aid for Services of General Economic Interest

Lars Peter SVANE, Directorate-General Competition, unit I-1

Introduction

One of the first initiatives within the Framework of the State Aid Action Plan has been the launch of the Commission package on state aid and the financing of public service, so-called services of general economic interest, on 13 July 2005.

In its July 2003 Altmark judgment, the Court stated that public service compensation is not state aid if it fulfils four conditions: The public service should be clearly defined; the parameters of the compensation should be objective and established in advance; the compensation cannot exceed costs; and the company in charge of the mission should be either chosen through public procurement which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, or, if not, the costs of providing the public service must be based on the costs of a typical, well-run undertaking.

Where these conditions are met, there is no state aid, and no notification is therefore necessary. But since a large share of public service compensation probably does not meet the Altmark criteria, notably because no tender has been made — the fourth criterion — this could result in the illegality, due to lack of notification, of an enormous number of public compensation schemes.

In order to reduce the burden of notification and provide guidance, the Commission presented a draft package on Services of General Economic Interest and public service compensation in early 2004, which, after consultation with Member States, the European Parliament and the other EU institutions has now been adopted. The Commission package is based on Article 86 EC, the legal basis for Decisions on Services of General Economic Interest. The package consists of a Commission Decision, a Framework and a modification of the Transparency Directive.

The Commission Decision limits the notification burden on Member States, by exempting all public service compensation that respect certain substantive conditions (and in particular the absence of overcompensation) and whose amounts are under a certain threshold: € 30 million EUR compensation, € 100 million turnover. Further, it completely exempts hospitals and social housing from notification, since the amounts of compensation for these two types of public service would fall above the threshold in almost all cases, and therefore create an enormous notification burden. The Decision proposed thereby drastically reduces the notification burden on Member States and would increase legal certainty for many public service financing schemes.

Where public service compensation does not meet the substantive criteria or goes above the thresholds foreseen in the Commission Decision, and the notification obligation therefore remains, the guidelines issued in the proposed Community Framework for Public Service Compensation should give guidance to the Member States and their public authorities on how the Commission will assess their compatibility. These guidelines constitute a codification of the existing Commission practice in applying Article 86.2 EC.

Finally, the package modifies the existing Transparency Directive to ensure clear separation of the operators’ public service costs and costs for commercial services, to enable clear assessment of the costs of public services.

Simplification and clarification

The objective with the current package is to set up a framework which will guarantee the financing of public service, and at the same time avoid unnecessary distortion of competition. With the Package, the Commission accepts the compensation necessary for running public service, but on the other hand does not justify over-compensation, which would increase the risk of cross-subsidies, often influencing already liberalised markets.

In reality tenders are not widely used for selecting public service providers, particularly for small services of general economic interest in municipalities. According to the 4th criterion of the Altmark...
judgment (1), the compensation for many small services could therefore be state aid, since presumably they often exceed the ‘average costs of a well-run company’. The adopted package offers a pragmatic, non-bureaucratic solution to this by exempting such state aids from the notification requirement as long as compensation is not higher than the cost of providing the public service. Compensation not exceeding the actual costs of providing the public service is seen as compatible with the Treaty, without going into a discussion on the efficiency of the organisation carrying out the public service. The Commission is concentrating on the most distortive forms of state aid, while avoiding to meddle unnecessarily in essential small local and regional services. While this eases the notification burden substantially, it does not mean that clear overcompensation below the thresholds is not still illegal state aid. And although notification is limited to larger amounts of compensation, there may well be cases in practice where competitors will point to potential overcompensation and raise complaints.

Hospitals and social housing are entirely exempted from the notification obligation: running a hospital, or real estate investments for social housing, results in very high amounts of aid per undertaking. This means that aid would almost always be above thresholds, and almost all hospitals would have to be notified to the Commission, a huge bureaucratic burden. The risk of the money not going to a public service is limited, since compensation for public hospitals and social housing quite clearly goes to the cost of providing a public service.

Of course this does not mean that Member States can freely grant state aid: the exemption from notification granted for smaller amounts of aid, hospitals and social housing by the Decision only applies if all the conditions are met, in particular no over-compensation and a clearly defined public service mission. The modified Transparency Directive helps to ensure that any commercial (non-public-service) activities would have to be accounted for separately, to avoid cross-subsidies.

It will remain a task for the Member States to define what ‘public service’ includes, as well as how they want to provide these services. Public authorities can issue a tender for specific services, and thereby ensure that their citizens get the quality they would like at the best possible price. If the Member State, municipality or region wants to, it can decide to issue a tender for some of the services provided e.g. by public hospitals today. The public authorities can of course also decide to continue providing the public service entirely itself in this case through public hospitals. Where the costs of providing the public service are not excessive, this will most likely be compatible with the state aid rules. Private hospitals may also be in charge of public service missions, and private hospitals can therefore receive the same compensation for carrying out public service — and benefit from the exemption from notification in the Decision.

Evolutionary nature of ‘Services of General Economic Interest’

The concept of public service or services of general economic interest is a dynamic concept. Member States define in detail what public service includes at local, regional or national level. The number of areas included in the scope of public service has clearly evolved, as the political and quality demands on public service have evolved. Utilities such as telecommunications, gas and electricity are now organised in a way where different providers compete, while still using the same network. The guaranteed provision of public service remains one of the core tasks of public authorities, although the scope of public services and the way public authorities choose to organise their provision has evolved.

Not all public services are economic, but it is not straightforward to reach a ‘once and for all’ definition of what is an economic activity and what is not. For core state areas such as national security and defence there are some clear limitations. While the Court of Justice has set these limits case by case (2), and has also exempted e.g. primary schools from the scope of ‘economic activity’, almost all other activities will be considered as economic, whether profit-making or not (3). The competition rules should encompass all economic activity that can potentially affect the internal market, competition policy looks at all economic activity affecting trade and at prohibiting potentially distorting subsidies. The scope of these rules also includes not-for-profit activities. This ensures that while public service should be guaranteed for citizens, the way public service is organised does not distort competition through e.g. subsidies between the public service activities and non-public-service activities of a company operating in both fields. One important part of this control is therefore an a priori definition of the public service in question, and the parameters for its provision, before the granting of a contract, in-house or through a public tender. Last but not least, there must be a guarantee


that compensation for the public service does not exceed the costs of providing it. Thereby potential distortion of the market is prevented, while public service provision can still be ensured — at the quality level decided by the public authority in its contract with the provider.

However, the fact that the activity in question is an economic activity does not necessarily mean that state aid rules apply. For many small public services the risk of distortion of the market is so limited that the Commission does not see a need for control. The de minimis rules of the state aid competition rules mean that very small amounts — less than € 100 000 over three years — are directly exempted from the scope of the state aid rules. According to the Regulation on the application of Articles 87 and 88 of the EC Treaty to de minimis aid (1) this amount is due to be increased in 2006.

Further, with the introduction of relatively high thresholds for notification in the Article 86 Decision, it is clearly indicated that the Commission considers most small and local public services as having a very limited risk of distorting competition. While this does not exclude overcompensation and hereby illegal state aid below the thresholds, it does indicate that it is the larger amounts of public service compensation that will be the primary focus of the Commission’s interest.

While the undertakings entrusted with the tasks are subject to competition rules in general, the Treaty rules clearly underline that the competition rules apply only as long as this does not obstruct accomplishment of public service tasks. The Treaty’s Article 86(2) seeks to protect the provision of public services, while at the same time underlining that in most cases competition rules do apply.

**Member States choose how to organise public service**

Public service is organised in each of the Member States at the local, regional or national level according to decisions taken there. Each society takes its own decisions on how to organise public services, by the public service itself or through tenders or outsourcing of the tasks. There has been some evolution over the last decades in which tasks are carried out by the public authorities itself, and which services are outsourced to private entities. But the most important core of the right to decide how to organise public services remains: it is up to Member States and their public authorities to define the quality level and through that the cost level of public services for their citizens. Certain sectors such as network services are clearly affected by the liberalisation policies of the European Community, such as e.g. electricity and gas. However, within the limits of this legislation, the provision and organisation can be organised in the way chosen by the Member State authorities. This can be done through tenders or through clear definitions of the public service, its parameters and its costs. The Commission limits itself to controlling that the compensation paid out for public service does not exceed the costs of providing this service.

**Network liberalisation and Public Service Obligations (PSOs)**

A number of sectors of the European economy have already been liberalised, such as air transport, telecommunications, gas and electricity, and the process continues with postal services liberalisation and rail transport liberalisation. While the economic advantages for consumers now having a choice between different providers can be a clear benefit, not least for the improvement in customer-friendliness of the service providers but also through the possibility to shop around for a better price, a minimum public service level must be ensured for all citizens. This has been ensured through the legislation for all sectors being liberalised, to guarantee a continued provision of high quality public service for all citizens no matter what their geographical location would be. Some Member States have gone further than others in ensuring a high basic level of public utilities at a limited price. Funds granted from Member States to expand e.g. broadband networks to outlying areas may be considered included in the scope of Services of General Economic Interest, where Member States wish to ensure that a high level of public service can be guaranteed for all citizens, also in outlying areas (2).

**Public Service Compensation and Public Procurement**

With the package adopted, the Member States and local authorities can continue to grant the public support needed for well-functioning services of general economic interest, and in most if not all cases there will be no problem with the competition rules.

The experience of Member States, local municipalities, as well as the opinions issued by the Euro-

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European Parliament, the Committee of Regions and the Economic and Social Committee underlines that an important part of the practical issues with public service compensation lies in the public procurement rules. The degree to which Member State and local authorities are required to launch a public tender are defined in the public procurement rules, which set the thresholds for when a public contract must be tendered (1). The future interpretation of the public procurement rules will be an important element in defining to which degree public services will be provided by public authorities themselves or through contractors bidding for a tender. Local authorities play an important role when interpreting the tender rules for all public service contracts.

In the Court’s July 2003 Altmark judgment two possible scenarios are mentioned: When public contracts are made through a tender, and when they are not. When a tender is used, this guarantees that the relevant quality defined in the tender is procured at the lowest price offered. When no tender is launched, on the contrary, no such guarantee exists. As long as Member States respect the tender rules, in most cases this will ensure no overcompensation takes place, thereby preventing distortions through e.g. cross-subsidies. Where there is no tender, the need of clearly spelling out what the public service includes becomes a crucial way to make control that compensation does not exceed costs possible. The Commission does limit itself to control abuse, and only obliges Member States to notify compensation of SGEI when the amounts are higher than € 30 million or the turnover over € 100 million, or where not all the conditions in the Decision are met, notably no overcompensation.

It is unlikely that all Member States will be very keen to oblige local authorities to use tender procedures for all public service contracts. It is also clear that many municipalities enjoy the freedom of being able to choose their own providers in most cases. From a state aid point of view, this is normally not a problem, since in most cases it can be assumed that the compensation for the public service does not exceed costs. But in case a municipality chooses a provider for a large contract, and it becomes clear that the contract has not been given to a provider that can carry it out at the market price, the possibility of a complaint still exists.

Commercial providers of public service may often be interested in bidding for the contracts, when they feel they would have been able to get the contracts had there been a tender. These companies have an own interest in complaining where these contracts do not become available, to increase their own business, but are often holding back. Some crucial public services will no doubt be kept in-house by regions and municipalities, but it is unlikely that the already enormous market for commercial providers of public service will not grow substantially over the next decades, in most cases to the benefit of both the consumer and the tax-payer.

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(1) Directives 2004/17/EC and 2004/18/EC define the thresholds for Public Procurement obligation for different types of Services.