

Juridiska Institutionen  
Handelshögskolan vid Göteborgs Universitet

**Integration**

**of**

**Environmental Considerations**

**in**

**EC State Aid regulation**

Christine Chi  
Juris Kandidatprogrammet  
Tillämpade studier, 20 poäng  
VT 2004

Handledare: Filip Bladini  
Juridiska Institutionen vid  
Göteborgs Universitet

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## **Abbreviations**

ECJ – European Court of Justice

ECSC – European Coal and Steel Community

EEC – European Economic Community

LPG – Liquefied petroleum gas

OECD – Organisation for Economic Co-operation and Development

OJ - Official Journal of the European Communities

SMEs – Small and medium sized entities

SEA – Single European Act

## Chapter 1: Introduction

### 1.1 Aims and Questions in issue

The role of environmental protection has grown over the last decades, nationally as well as globally. Environmental damage and exploitation are a large concern for today's society and this can be seen in the increased amount of conventions on the area. Despite this, environmental legislation is when compared to other laws relatively new and it is not always given the space it needs. Competition law is for example, considered as very important and the question is whether environmental considerations can even uphold themselves with such areas.

There has always been a tension between competition and environmental protection but it came to the fore with the arrival of the environmental agreement<sup>1</sup> as a policy instrument and the never-ending governmental aid given for environmental purposes. This development gave rise to questions such as how EC competition law should react to environmental agreements that protects the environment but restricts competition, or how the prohibition of state aid in Article 87 of the EC Treaty is to be applied to cases where such aids are granted for environmental purposes even though it distorts competition.<sup>2</sup> These problems are not easy to solve, but integration is nevertheless required according to Article 6 of the EC Treaty.

Competition is often seen as bad for environmental protection, but is it really that simple? We cannot ignore the fact that competition is a very powerful driving force which makes and have made economies endeavour for better solutions in order to make profits. New technology, or lower costs for environmental protection is appreciated and sometimes also necessary for the implementation of environmental legislation. The Kyoto protocol is a good example of this complex of interrelated problems. This convention was rejected by the US basically because of the costs involved and the costs on the competition situation. With a good integration of competition and environmental protection, problems like those might be solved.

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<sup>1</sup> An environmental agreement is an agreement between different companies or between a group of companies and a public authority on an environmental matter.

<sup>2</sup> Vedder, Hans: *Competition Law and Environmental Protection in Europe; Towards Sustainability?*, Europa Law Publishing, Groningen 2003, pp. 3-4. (henceforth referred to as Vedder)

The aim of this dissertation is to discuss the integration of environmental concerns and competition in the area of state aid in the EC regulation. I will also consider whether or not the integration which has developed, is the best possible for both areas.

## **1.2 Outline, delimitation and method**

The integration of environmental concerns and EC competition law is an interesting area of law, which has been the subject of considerable changes over the last couple of years. It would have been engaging to penetrate the entire EC competition regulation for this discussion, but this dissertation will have its emphasis on the State Aid regulation in Article 87-89 of the EC Treaty. Dominant position, concerted practices etc. are areas of competition law which are well-known and it is therefore I have chosen to concentrate on the relatively unexplored State Aid regulation.

I will in the introductory chapter discuss the subject of integration, which will be directed by Article 6 of the EC Treaty, as well as case law in the area. This will be followed by a broad summary of the theory of competition, in order to give a background to the position it has and has had in our society. Chapter 3 will furthermore look into the role of environmental protection and its development. I will thereafter describe the complex of problems considering state aid and environmental protection. A report of the state aid regulation in Article 87 of the EC Treaty will thereafter be given in chapter 5 and 6. Chapter 7 will deal with the Community Guidelines on State aid for environmental protection, the dissertation will finally end with an analysis in chapter 8. The problems in the area will furthermore be exemplified through the whole dissertation by the Swedish energy taxation scheme.

## **Chapter 2: Integration**

### **2.1 Overview**

Article 3 of the EC Treaty states that the activities of the Community shall aim to comply with the purposes set out in Article 2, i.e. the promotion of substantial and non-inflationary growth and a high level of protection and the improvement of the quality of the environment. It is

furthermore held that the Community shall have a policy in the sphere of environment protection, Article 3(l), as well as “a system ensuring that competition in the internal market is not distorted”, Article 3(h). The question is how and why these totally different aims are supposed to integrate with each other. I will in the following text describe the integration principle in Article 6 of the EC Treaty and if it’s ambiguous. I will furthermore give examples of how conflicts have been dealt with in practice.

## **2.2 The integration – Article 6 and case-law**

“Environmental protection requirements must be integrated into the definition and implementation of the Community policies and activities referred to in Article 3, in particular with a view to promoting sustainable development.”

This integration principle which can be found in Article 6 of the EC Treaty, was introduced into the Treaty by the Single European Act 1987. It has become more forceful during the years and is today regarded as one of the most important principles of EC law. But what does the principle mean for the Community’s environmental protection and why is it important?

The integration principle has created a legally binding obligation for the Community institutions to integrate environmental considerations into other Community areas. Environmental concerns must, with other words, be taken into account and that means furthermore that respect must be given to environmental protection. It is, however, difficult to know what is to be integrated. The Treaty refers to “environmental protection requirements”, but there is no definition of that concept. It does furthermore not explain how to do with conflicting policies, nor if one policy area have priority before another.<sup>3</sup>

Despite all the ambiguity due to the wording, the aim of the Article is indisputable: To reach sustainable development. This can only be achieved, according to Hans Vedder, when both economic development as well as environmental considerations is satisfied.<sup>4</sup> As Vedder put it:

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<sup>3</sup> Jans, J. H: *European Environmental Law*, volume 2, Europa Law Publishing, Groningen August 2000, pp. 17-18. (henceforth referred to as Jans)

<sup>4</sup> Jans, pp. 17-18, Vedder, pp. 13-16.

“Sustainable development does not mean a return to the early hominid way of life even though that will undoubtedly mean less environmental degradation. The other extreme, unmitigated economic growth and financial profit, certainly also falls outside the scope of sustainable development. Sustainable development is all about finding a *modus vivendi* for economic growth and environmental protection.”<sup>5</sup>

The significance of the integration principle can be questioned, but it has nevertheless made a difference. It forces the Community institutions to take the environment into account when making decisions, also in regard to competition regulations. The aim in this complex of problems is simply, to find a balanced relationship between economic growth and environmental protection. This has for example been done by the ECJ in the ADBHU<sup>6</sup> case where Community legislation for the protection of the environment resulted in trade restrictions. The Court used the principle of proportionality to resolve these problems with conflicting policies and found that this kind of restriction of trade was acceptable, as long as the measures were not discriminatory and did not entail restrictions that went beyond what was strictly necessary for the protection of the environment.<sup>7</sup>

## **Chapter 3: Competition Policy, Economics and Environmental protection**

### **3.1 Introduction**

Governments normally accomplish protection of the environment by using legislation, information, economic or market based tools. These actions normally mean extra costs i.e. other costs than production costs. If a plant has to install an extra filter in order to meet new and more stringent governmental emission standards, they will have to pay for what they consider - extra expenses. These costs will therefore be incorporated in the products and have an effect on the competitive situation on a market. Hence, there is a connection between competition and environmental law and policy. This relationship can also lead to a connection between *competition law and policy* on the one hand and the *environmental law and policy* on the other. That is for example the situation when a government grants subsidies in order to

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<sup>5</sup> Vedder, p. 14.

<sup>6</sup> Case 240/83, ADBHU [1985] ECR 531.

<sup>7</sup> Jans, pp. 19-23, Vedder pp. 13-19.



compensate the industry for the extra costs resulting from environmental regulation. Such aid will most probably fall under the prohibition of State Aid in Article 87 of the EC Treaty, but the aid might also be necessary for the environmental protection and to maintain international competition.<sup>8</sup>

The next chapter will discuss the theory of competition in order to give a background to the competition law and policy, which is of current interest in the EC. The role of environmental protection in the market theory will be discussed, along with an overview of the different approaches to environmental protection which exists today will be given.

### 3.2 Free competition

What is free competition? Adam Smith, an economist and philosopher who lived between 1723 and 1790, laid down the intellectual framework that explained the free market.<sup>9</sup> He was the first to describe the competitive process and to envisage that a market would function optimally if there were *free competition*. Stigler, another economist, distinguished five prerequisites for this concept, videlicet:

- Independent behaviour of competitors.
- A sufficiently large number of competitors so as to eliminate extraordinary profits.
- Economic entities must have sufficient knowledge of the market.
- Freedom from social pressure so that this knowledge can be followed without compromise.
- Sufficient time for production factors to re-allocate.<sup>10</sup>

Smith and Stigler may call this *free competition*, other economists have also referred to this situation as *perfect competition*. The foundation is nevertheless the same. A *perfect/free market* is achieved when all competitors are on the same competitive level. This is meant to be when economic resources are allocated between different goods and services in a way which give everyone the same opportunity. A producer will in that circumstance expand his

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<sup>8</sup> Vedder, p. 45.

<sup>9</sup> More about Adam Smith see Lucidcafé's Library <http://www.lucidcafe.com/library/96jun/smith.html> 2004-04-25

<sup>10</sup> Vedder, pp. 21-22.

production for as long as it is privately profitable to do so, this also means that consumers can obtain the goods or services at the lowest price where supply equals demand. As a result the products will be produced at the lowest costs possible, since the producer in a market of perfect competition can not sell for a higher price. A price will simply never rise above cost. A further benefit of competition, according to these theories, is that it is thought to encourage producers to constantly innovate and develop new products as part of striving for the consumers.<sup>11</sup>

*Perfect/free competition* does however not exist. Smith envisaged the problems which could hinder free competition from fully functioning or existing in the first place, primarily for two reasons. Firstly, governmental policy could stand in the way of free competition and secondly, individuals behaviour on the market.<sup>12</sup>

### **3.3 The role of Environmental protection in the market theory**

There are many different doctrines and schools of thought which discuss the concept of competition, but there is nevertheless not *one* definition that is universally accepted. The US competition authorities for instance rely on economic welfare as the ultimate objective of competition policy, they are therefore less strict with larger companies because of the economies of scale that are possible in such enterprises, whereas the European Commission is more concerned with maintaining competition itself. Whatever the concept includes, the main point is to ensure welfare. The question, however, is how to handle areas of the economy where competition does not achieve optimal results. The truth is, despite what the theories claim, that the free market can not itself deal with all the problems a society gives rise to. Natural monopolies are one of these problems and negative externality another.<sup>13</sup>

Environmental damage is a negative externality, i.e. a cost which is not borne by the original parties to a transaction. E.g. you buy a pen and the chemicals from the factory flow into the river next to someone's house causing him or her to suffer 'private negative externality' and damaging water quality for everyone, 'social negative externality'. The result of conduct to

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<sup>11</sup> Whish, R: *Competition Law*, Fourth edition", The Bath Press, Bath 2001, pp. 1-5 (henceforth referred to as Whish) and Vedder, pp. 20-23.

<sup>12</sup> Vedder, pp. 21-25.

<sup>13</sup> Vedder, pp. 38-40.

prevent this negative externality is, however, not visible. A consumer who buys environmental friendly products can for example not see the direct result of his conduct in the environment nor can the company which recycles. It is therefore hard to encourage them to behave in an environmentally friendly way. These costs can be on the other hand be internalised, i.e. make the original parties to the transaction pay for them. Whether this would be good for competition or not depends on the cost to competition. It would for example maybe be cheaper to set up public water cleaning stations which are more cost effective than every factory having one.<sup>14</sup>

Recycling is for example one of the areas of environmental protection which involve large sunk costs, due to the large collection network for used products required for the activity. These large costs cannot be covered by a single company, they are therefore normally covered by organisations that tend to have the properties of a monopoly and monopolies restrain competition. Many consumers are furthermore not willing to pay the extra cost which environmental protection involves and *one* free rider<sup>15</sup> could stop the parties from protecting the environment. The obvious solution to the free rider problem would be to set up a controlling mechanism. This controlling mechanism may though itself have some anti-competitive effects. A possibility to solve these problems is to internalise the costs in the product from the beginning and competition can in that case be achieved even in the aspect of environmental protection.<sup>16</sup>

### **3.4 The development of Environmental Protection**

European environmental law has been at the centre of significant change over the past decades. It has gone from being a minor aspect in the Community to becoming one of its fundamental cornerstones. The knowledge gained from the development of the European environmental laws is therefore of great importance in order to understand the principles, reasons and measures used for environmental protection today.

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<sup>14</sup> Vedder, pp. 37-38.

<sup>15</sup> A free rider is an economic actor who benefits from a (collective) good without paying for it.

<sup>16</sup> Vedder, pp. 38-40.

### 3.4.1 The regulatory approach

Environmental problems were basically not seen as significant at the time of the Community's establishment. The first environmental phase started as late as the entry into force of the original version of the EEC Treaty 1958 and continued until 1972. There was no legislation particularly for the protection of the environment during this time, but despite this there were decisions which protected the environment. The aim of those decisions was, however, not to protect the environment, they were actually made incidentally due to the accomplishment of the common market. There were for example, Directive 67/548<sup>17</sup> related to the classification, packaging and labelling of dangerous preparations and Directive 70/157<sup>18</sup> related to the permissible sound level and the exhaust system of motor vehicles. It was during the preparation of the UN Conference of the "Human Environment"<sup>19</sup> that the Community's view of environmental problems changed. The participating countries of the Conference agreed to work towards an improved quality and standard of life where non-material values were taken into consideration. It was under these circumstances the Union realised that it was necessary to draw up guidelines for an environmental action program within the Community. The real starting point for Community environmental legislation can therefore be said to have come first from the Conference 1972. The first environmental action program emerged 1973 as a product of this conference and lasted until 1976. It came to draw up the fundamental principles for the Unions environmental policy. The use of environmental action programs is still in use, and the Community has since the first one adopted another five action programs.<sup>20</sup>

"Environmental protection" was a term which was not expressly mentioned in the days of the EEC Treaty. It came despite of this, to be included in the aim of Article 2 EEC Treaty and subject to the Community's decision-making. The background to this development can be found in the wording of the first environmental action program. It held that environmental protection could become the subject of Community decision-making by an extensive interpretation of "economic expansion", which is expressly included as an aim in Article 2 of the old EEC Treaty. At this time the EEC Treaty lacked a legal basis for the Community to handle questions concerning the environment, it did not have any competence in that area.

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<sup>17</sup> OJ 1967 L 196/I, amended many times since then.

<sup>18</sup> OJ 1971 L 42, later amended.

<sup>19</sup> U.N. Document A/Conf. 48/14 and Corr. 1, *report of the United Nations Conference on Human Environment*, held at Stockholm June 5-16, 1972.

Directives and regulations were nevertheless adopted during this time through Article 100 and 235<sup>21</sup>, but there were no Community legislation that solely protected the environment. Article 100 permitted environmental measures which had to be taken due to a proper functioning of the common market, but more far-reaching environmental measures could not be taken under this provision. Article 235 on the other hand was used and can still be used as a “catch-all” provision. The article gives the Community the right to take action even if the Treaty has not provided the necessary powers, if the measure is necessary in order to attain the course of the operation of the common market and the Community objectives.<sup>22</sup>

In this period of development, environmental protection has mostly been achieved through the “command and control” instruments. Regulation has been the most important tool to protect the environment, but it has also given implications on the level of the application of competition law and affected competition itself. The benefit of using regulatory instruments is, however, shown to be limited.<sup>23</sup>

### **3.4.2 Towards market-based instruments**

The Community’s environmental policy was in the 1970s and early 1980s mainly concerned with setting and implementing standards for the main parameters of the environment, but it did move from a narrow view of considering environmental protection as only restriction of pollution, to also see the *prevention* of pollution and the *integration* of environmental policy in other policies of the Community, as environmental protection<sup>24</sup> The next phase of the Community’s environmental policy came with the SEA 1987. For the first time, objectives of the Community’s environmental policy were enclosed in the Treaty and articles for the protection of the environment emerged. Article 130r, 130s, 130t, 100a(3) and 100a(4)<sup>25</sup> were all specially designed provisions for this purpose. The polluter pays principle<sup>26</sup> was confirmed in the new provisions, but its meaning came to have a larger influence on the Community legislated then only as a principle that affected the areas the environmental articles protected.

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<sup>20</sup>Jans, p. 3 and Mahmoudi, S: *EU:s miljö rätt*, second edition, Nordstedts Juridik AB, Stockholm 2003 (henceforth Mahmoudi), pp. 37-39.

<sup>21</sup> Now Article 94 and 308.

<sup>22</sup> Jans, pp. 3-7.

<sup>23</sup> Vedder, pp. 45-47.

<sup>24</sup> Mahmoudi, pp. 40-41.

<sup>25</sup> Now Articles 174, 175, 176, 95(3) and 95(4) EC Treaty.

It called for the integration of the requirements of environmental protection to be included in the definition and implementation of the Community's other policies, and it stressed the need for prevention.<sup>27</sup> The use of Article 100 and 235 were through the significant change in this environmental phase, seldom used for environmental purposes after this. Article 235 is nevertheless still used in exceptional cases when there are no other legal possibilities to base environmental measures on.<sup>28</sup>

The fifth environmental action program was adopted almost a year after the introduction of the Maastricht Treaty 1993. It was heavily influenced by the improvements of the Treaty and did therefore introduce many new ways of attacking environmental problems. The main aim was to go towards a sustainable development, i.e. that the economic development in the Community should take place in relation to the environment. In practice this means an optimal use of recycling and reuse in order to prevent natural resources to exhaust. The list of the content of the fifth program can be made very long, but among the aims worth mentioning are: integration of environmental consideration in other policies, wider range of economic and market tools, enforcement and use of the legislation, increased awareness and international co-operation, sustainable production- and consumption patterns, shared responsibility and partnership as well as the promotion of local and regional initiatives.<sup>29</sup> The fifth environmental action program "Towards Sustainability" ended on the 31st of December 2000 and was followed up by the sixth environmental action program which has been planned for the period of 2001-2010. This environmental action program also recognises the importance of using market-based tools.<sup>30</sup>

This change acknowledges that the traditional approach, based almost exclusively on regulation and particularly standards, has not been fully satisfactory. The command and control regulation focused on curing the degeneration of the environment by imposing certain behaviour on the actors. The effectiveness of these kinds of instruments is lower than that of instruments that actively involve private actors, since it lack incentive for the companies to go beyond what has been prescribed. Market based instruments are on the other hand generally

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<sup>26</sup> The polluter pays principle will be explained in chapter 3.4.3.

<sup>27</sup> Community guidelines on State aid for environmental protection OJ 1994 C 72/03 (henceforth referred to as 1994 Guidelines)

<sup>28</sup> Jans, p.7.

<sup>29</sup> Mahamoudi, pp. 41-44 and OJ 1994 C 72/03.

<sup>30</sup> The sixth environmental action program, "Our Future - Our Choice, Brussels KOM(2001)31 2001/0029 (COD).

considered to be better, since they use the companies knowledge of where to achieve a given environmental improvement at the lowest costs. The aim of introducing the new instruments was simply to increase the flexibility to achieve the desired environmental objectives in a certain situation. This shift in environmental policy from command and control to more market-based instruments can therefore be said to be the result of the wish to internalise external costs.<sup>31</sup>

### 3.4.3 The polluter pays principle

The OECD was the first to endorse the polluter pays principle. The principle created in the 1970s, necessitated that the polluter should carry the cost of pollution caused in production or consumption. The purpose was simply to internalise the economic cost of environmental damage in the products – meaning that the polluter have to bear the full cost to meet environmental regulations and standards. The principle is created for the economic purpose to ensure an optimal allocation of means of production and to achieve a maximum value of production.<sup>32</sup>

The polluter pays principle is one of the cornerstones of Community environmental policy. It was important for the Unions environmental concerns even before it was incorporated into the Treaty. The aim of the polluter pays principle is, of course, to make the polluter pay, but also to encourage polluters to reduce pollution and endeavour to find less polluting products or technologies. This is done in practice by imposing environmental charges for production that has negative effects on the environment.<sup>33</sup>

Environmental costs can be internalised at a number of different levels. One possibility would be to internalise environmental costs at the moment of disposal. This would for example mean that the consumer has to pay a sort of waste tax when dumping. Another possibility would be to internalise these costs at the production or pre-production stage, as for example as a raw

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<sup>31</sup> Vedder, pp. 47-49 and Mahmoudi, pp. 42-44.

<sup>32</sup> Humphreys, M. (2001) The Polluter Pays Principle in Transport Policy. *The European Law Review*, **26**(5), pp. 451-467. (henceforth referred to as Humphreys); Birnie, P. W. and Boyle, A. E.: *International Law and The Environment*, Cornwall: T.J. International Ltd 2002, pp.92-95. (henceforth referred to as Birnie) and Lefeber, R.: *Transboundary Environmental Interference and the Origin of State Liability*, The Netherlands: Kluwer Law International 1996, pp. 1-4. (henceforth referred to as Lefeber)

<sup>33</sup> Jans, pp. 37-39.

material tax. Both methods could lead to negative effects, such as the consumer dumping the waste illegally or the process to be too costly for the producers. The aim is, however, that through charges or other market initiatives to guide producers to choose a more environmental friendly way of production. The optimal would be to use the producers' knowledge with regard to the methods of production, the product itself and the methods of recycling to find this way.<sup>34</sup>

The Swedish Government introduced an energy- and carbon dioxide tax system for just this purpose - to guide producers to choose a more environmental friendly way of production. Evaluations from this initiative have shown that it has strongly contributed to the reduction of greenhouse gases. Sweden's third national report about climate change estimated the discharge 2010 to be 15-20 per cent *lower* by using this system compared to the system used 1990. That corresponds to approximately 10 million ton carbon dioxide. The problem is that the competition is affected when no harmonised tax rate for carbon dioxide exists in the EC today. Aid where, however, given as tax relief to some sectors of the Swedish industry in order to maintain competition on the international market.<sup>35</sup> A measure which actually decreases the effectiveness of the tax system and is against the aim of the polluter pays principle. Finally, the polluter pays principle means in practical terms simply that environmental protection should not depend on aid schemes or place the burden of fighting pollution on the society.<sup>36</sup>

## **Chapter 4: State aid and Environmental consideration**

### **4.1 Overview**

Aid raises interesting questions regarding both environmental and competition policy. There is a strong connection between the wish to minimise the interference in the market economy and the development of the environmental principle, which states that the polluter should pay. The existing environmental policy tries as far as possible to integrate the environmental protection costs in the product. There are nevertheless circumstances where it is not possible

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<sup>34</sup> Vedder, p. 11

<sup>35</sup> The Swedish energy taxation scheme will be further discussed in chapter 4.3.



to fully integrate the costs, and aid of temporary nature can therefore be given in order to facilitate the undertakings adaptation to standards. This has been taken into account in the State aid regulation which through the application and guidelines for Article 87(3)(c) permits certain environmental aid. There are, however, also other areas of the State aid regulation which covers environmental aid. These areas are for example, aid to promote cultural and heritage conservation, aid to restore the nature after disasters, aid of common European interest etc.<sup>37</sup>

The question is how to give aid in a way that gives positive benefits to both competition and environmental protection. It is furthermore important to remember that aid is actually not always to the benefit of the environmental protection, it can in fact in some cases have harmful effects. The purpose is therefore in the following text to see how aid can work as an incentive for firms to improve standards or to make further investments to reduce pollution from their plants, without interfering too much with competition.<sup>38</sup>

#### **4.2 The purpose of aid**

Aid has for a long time been utilised as an important environmental tool due to many different reasons. Governments use either sticks or carrots to change firms' behaviour. Sticks are for example more stringent regulation. These kinds of changes are, however, normally met with objections from firms. Carrots on the other hand, videlicet subsidies are more acceptable. Even though the result of both measures can turn out to be the same governments tend to use the latter in order to have the companies on their side. This goes hand in hand with the fact that producers are normally politically well organised and they therefore have both the intention and the power to influence the policy-making process.<sup>39</sup>

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<sup>36</sup> Remiss av Skattnedsättningskommitténs betänkande "Svåra skatter" (SOU 2003:38) Dnr Fi2003/2414 and Jans, pp. 37-39.

<sup>37</sup> Vedder, pp. 20-25; Gandy, Matthew: *Recycling and Waste*, 1<sup>st</sup> edition, Awebury Ashgate Publishing, London 1993, p. 25 (henceforth referred to as Gandy); Community guidelines on State aid for environmental protection OJ 2001 C 37/03 (henceforth referred to as 2001 Guidelines; Speech by Jean-Francoias Pons, Vice president of the Competition authority, Madrid 20<sup>th</sup> September 2001 and Article 87 EC.

<sup>38</sup> 2001 Guidelines.

<sup>39</sup> Kim, H, (2000) "Subsidy, Polluter Pays Principle and Financial Assistance among Countires", *Journal of World Trade*, 34(6), pp. 115-141. (henceforth referred to as Kim)

The benefits of aid are that it can sometimes deal with encouraging production which gives rise to external benefit. One example is environmental aid given to the production of energy from renewable sources. The use of these sources, for example biomass which is an organic matter and includes material such as wood, plants and animal waste, emit carbon dioxide when they are combusted. Emissions that would have been emitted even if the tree was not used as fuel but decomposed. Use of fossil fuels is on the other hand increasing the total amount of carbon in the atmosphere, which would not have been emitted if the fuel was not used.<sup>40</sup>

At the same time this kind of aid can, according to Kim, be negative for the environment. Such subsidy generally includes environmental control costs, i.e. the cost of firms reducing pollution, such as installing and operating pollution reduction facilities, changing progress or raw materials and would therefore only encourage firms to be environmental friendly up to the level where the firm's abatement costs are equal to the subsidy. The firm will not be influenced to constantly reduce pollution to decrease the cost of the tax.<sup>41</sup>

### **4.3 The Swedish energy taxation scheme**

It is important to remember that aid can also be given for measures which are negative for the environment. As mentioned earlier, some parts of the Swedish industry are favoured by a degree of relief from the carbon dioxide tax, a total relief of fossil fuels tax and electricity tax existing in Sweden. Different tax rates are used depending on which sector a company belongs to. The industry is at present divided into three sectors:

- Industry sector, i.e. agriculture, forestry, manufacturing industry, green house nourishment, water mill, mine industry and mineral extraction.
- Energy sector, i.e. electricity, gas, heat and water supply.
- Remaining sector, i.e. building activity, public service, transport and other services.

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<sup>40</sup> Motion till riksdagen 2003/04:mp009 ML av Ingegerd Saarinen (mp) med anledning av prop. 2003/04:42 Torv och elcertifikat.

<sup>41</sup> Kim, pp. 115-141.

The differentiation has resulted in the “remaining sector” paying 100 per cent of the carbon dioxide tax, whereas the “industry sector” is only liable for 25 per cent. In addition the 0,8 per cent rule, which is applicable to the entire industry sector, states that a further reduction is given for the part of the tax that exceeds 0,8 per cent of the selling value. That means that only 24 per cent is paid for the surplus. Then there is the 1,2 per cent rule which is only applicable for some industries, i.e. the manufactures of other mineral substances than metals. These companies are not paying any carbon dioxide tax for the part of the tax which exceed 1,2 per cent of the selling value. In regard to the fossil fuels and electricity taxation all sectors except the manufacturing industry is liable; they are on the other hand totally exempt from the tax. This differentiated tax system has been accepted for a period of time but the opinion of its justification has changed with the Adria-Wien case<sup>42</sup>. The ECJ simply stated that it is state aid to pick out certain sectors of the industry and to give them tax benefits. The Commission is also unwilling to authorise all these measures under Article 87(3)(c).<sup>43</sup>

## **Chapter 5: The State aid regulation**

### **5.1 Introduction**

State aid poses a threat to the Community interest of a system of undistorted competition and interferes with the functioning of the single market, Article 3(g) of the EC Treaty. The fear is that State aid can create a market where products are no longer manufactured where conditions are most favourable, but where the company can receive the highest amount of aid. That would among other things create a situation where products no longer compete under the same conditions and restrain the free movement of goods. The Community therefore finds that there is a need to scrutinise aid.<sup>44</sup>

Even if State aid can hinder competition in the Community, it is nevertheless a vital instrument of economic and social policy for the Member States. They can use these instruments to influence the economic health of a region or whole sectors of the economy,

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<sup>42</sup> Case C-143/99 Adria-Wien Pipeline GmbH, Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten, REG 2001 s. I-8365.

<sup>43</sup> SOU:38 pp. 19-21.

especially in times of economic difficulty and high unemployment. State aid is therefore a sensitive area, which requires a balancing of the interest of the Member States and of the Community.<sup>45</sup>

## 5.2 Framework

Article 87(1) of the EC Treaty prohibits any aid granted by a Member State which distorts competition by favouring certain undertakings, in so far as it affects trade between Member States. The provisions of the article do therefore not cover non-profit-making activities of a charitable, social or cultural nature or Community aid granted by the EU itself.<sup>46</sup>

Due to the derogations provided for in the Treaty or by the Council acting under powers granted by the Treaty, Articles 87(2) and 87(3) give an opportunity for the Member States to protect a number of legitimate economic and social goals. Article 87(2) lists categories of aid which *is compatible* with the common market and Article 87(3) lays down aids which *may be compatible* with the common market after an examination. Other categories of aid may be specified by decision of the Council or acting by qualified majority on a proposal by the Commission.<sup>47</sup>

## 5.3 Components of Article 87(1)

Article 87(1) does not, as I mentioned above, prohibit all State aid and I will therefore go through the four criteria which all need to be fulfilled to constitute unlawful aid. These are:

- Aid granted by the State or through State resources
- Distortion of competition
- Support for particular undertakings or spheres of commercial activity

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<sup>44</sup> Beudenbacher, C: "A Brief Guide to European State Aid Law", Kluwer Law International, Hague 1997, pp. 1-4 (henceforth referred to as Beudenbacher) and Steiner, J and Woods, L: Textbook on EC Law, eight edition, Ashford Colour Press Ltd, Gosport, Hants 2003, p. 280. (henceforth referred to as Steiner)

<sup>45</sup> Beudenbacher, pp. 1-4 and Steiner, p. 280.

<sup>46</sup> Beudenbacher, pp. 1-4

- Effect on trade between Member States

### 5.3.1 The Concept of an “Aid”

What is State aid? Article 87(1) contains a ban on any State aid which is incompatible with the common market, but the Treaty leaves the term undefined. This has on the other hand made it possible for the ECJ to interpret the term flexible and to bring it into line with social development. In an early ruling<sup>48</sup> the ECJ had an opportunity in respect of Article 4(c) ECSC Treaty to define the terms aid and subsidy. Subsidies were considered as payments in money or in kind which are made to an undertaking for its support and which are outside the remuneration the undertakings receives from purchasers or users of the goods and services produced. Aid on the other hand was defined as a measure used to reduce charges normally borne by an undertaking. Despite this judgement there is no conclusive definition for the terms that have been agreed on so far. There is on the other hand a widespread conception that the notion of aid is more extensive than that of subsidy, since aid does not only cover positive benefits but also negative.<sup>49</sup>

Positive benefits have been concluded to involve measures such as: any grant or advantage from the public authorities; certain unmarketlike advantages belonging to the state which improves the economic situation of the undertaking in comparison with other undertakings, the payment of a part or the whole cost of production by someone other than the purchaser; a benefit which the recipient would not otherwise have received “in the normal course”, or intervention which mitigate the charges which are normally borne by the undertakings themselves. Negative benefits on the other hand are for example exemption from charges, deduction from a tax debt or of an amount equivalent to a certain percentage of purchasing and production costs, preferential discount rates, sureties, the lump-sum of taxation of income, or extended possibilities of depreciation for certain investments. The definition of State aid is however broad and the list above is not exhaustive.<sup>50</sup>

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<sup>47</sup> Evans, A: “European Community Law of State Aid”, Clarendon Press, Oxford 1997, pp. 1-26 (henceforth referred to as Evans) and Simon, S. (1999) “Recent developments in State aid policy”, *European Economy, State Aid and the Single Market*, 3, p. 46 (henceforth referred to as Simon) and Steiner, pp. 281-282.

<sup>48</sup> ECR 1961, p. 3 – De Gezamenlijke Steenkolemijnen in Limburg v. High Authority

<sup>49</sup> Simon, p. 46 and Beudenbacher, pp. 6-9.

<sup>50</sup> Evans, pp. 27-28 and Beudenbacher, pp. 6-8.

Despite the aspects written above the ECJ has still not fully defined the concept of aid. The court has according to Vedder consistently refused to do so and instead adopt an effect-based approach in the light of the objective of Article 87 and the objective is to attain and maintain a level playing field throughout the common market. The characteristic features of State aid are therefore in the Courts opinion its favouring effect, such as an improvement of the competitiveness of their industries compared to their competitors.<sup>51</sup> This is stated in the *Deufil* case<sup>52</sup>:

“Article 92 [Now Article 87] does not therefore distinguish between the measures of state intervention concerned by reference to their causes or their aims but defines them in relation to their effects [...]”.

In the “Family Allowances in the Textile Sector” ruling<sup>53</sup> the ECJ rejected the Italian governments argument that the reduction of a relief was a question of social and fiscal nature and therefore not subject to the State aid provisions. The Court pointed out that Article 87(1) defines aid through the effect of the measures concerned, not on the basis of its reason. The undertaking in the case did, despite the reason of the aid, benefit from an advantage and it was therefore unlawful. On the other hand, measures that cannot be seen as giving a preferential effect cannot fall under the prohibition of State aid. An examples of that is State measures such as support for public campaigns to increase environmental awareness and provide specific information about, for example, selective waste collection, conservation of natural resources or environmental friendly products. Aid for these kinds of purposes is normally too general and does therefore not benefit a particular undertaking or spheres of commercial activity. There is no preferential effect and it is not incompatible with the common market.<sup>54</sup>

In accordance with this effect-based approach the Court has consistently held that an intervention made by governmental authorities which reduces a cost, normally carried by the companies is considered to be aid. On the other hand, the ECJ has also concluded that public

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<sup>51</sup> Beudenbacher, pp. 8-9 and Vedder p. 280.

<sup>52</sup> Case 310/85, *Deufil v. Commission (Deufil)*, [1987] ECR 901, para. 8.

<sup>53</sup> Case 173/73, *Italy v. Commission (Italian textiles)*, [1974] ECR 709.

<sup>54</sup> Beudenbacher, pp. 9-11; Evans, p. 39 and 1994 Guidelines

acquisition is not an aid, if the same investment would have been done under normal market conditions.<sup>55</sup>

### 5.3.2 Aid granted by the State or through State resources

The second element “aid granted by a member state or through state resources in any form whatsoever” is a statement of a very broad scope. The distinction made in the provision between “aid granted by the State” or aid granted “through State resources” does not signify that all advantages granted by the State is to constitute aid, it is merely intended to bring within the definition both advantages. The content of “aid granted by the State” can be read through the wording. The second part of the sentence “through state resources in any form whatsoever” is on the other hand more complex. This comprehends state measures transferred from the state to other parties *and* any measure whereby the state exerts its influence to confer an advantage on other parties without a transfer of public funds being necessary. State aid under Article 87(1) may therefore be granted through State institutions, agencies, State-owned private entities or even private undertakings. It is with other words not necessary that the aid is *directly* paid out of public funds, as long as the State plays a part in initiating or approving the aid and that the aid can be deduced from public resources. The ECJ stated in one case<sup>56</sup> where national rules permitted a lower salary then the minimum to be paid to foreign seamen, not to constitute State aid, even though the lower wages benefited the boat companies in that specific country. This since the advantage of the aid did not originate from State resources.<sup>57</sup>

The Court did, however, in *Preussen Elektra*<sup>58</sup>, interpret the alternative contained in Article 87(1) in a different matter. The case concerned the question of whether or not an obligation to purchase green electricity at a minimum price, higher than the economic value of the electricity was to be consider a state aid. This obligation was obviously conferring an advantage to the producers of renewable electricity, but the Court found that there was no aid due to the fact that no public funds were transferred. The Court did furthermore reject a

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<sup>55</sup> Case C-159/01 *Koungariket Nederländerna mot Europeiska gemenskapernas kommission*, Case 30/59, *De Gezamenlijke Steenkolemijnen in Limburg mot höga myndigheten*, Case C-200/97 *Ecotrade*.

<sup>55</sup> Case N 702/95 and N 175/96 *Servola SpA*.

<sup>56</sup> Cases C-72 and 73/91, *Firma Sloma Neptun Schiffahrts AG v. Seebetriebsrat Bodo Ziesemer of Sloman Neptun Schiffahrts AG*.

<sup>57</sup> Case C-379/98 *Preussen Elektra AG v. Schleswag AG*, point 58; *Vedder* p. 28 and *Steiner*, p. 288-89.

<sup>58</sup> Case C-379/98 *Preussen-Elektra AG v. Schleswag AG*.

proposal by the Commission to establish a useful effect rule for state aids. It simply refused to see that this obligation could be connected to a governmental reduction in the income of tax, and reductions or exemptions from taxation schemes do normally constitute state aid. Despite this judgement, Vedder says that this should not be taken to mean that Article 87(1) now has its wings clipped. He means that this judgement only shifted the focus from the question whether or not a transfer of public funds is necessary to the question of what constitute “public funds”. This could now be said to coincide to a large degree with what the state consist of, and the concept of state is very broad. Private as well as public bodies that are under the control of the state will therefore fall within the ambit of Article 87(1).<sup>59</sup>

The State can in certain circumstances make use of independent private companies to carry out its activities. It is easy to prove the connection to the State in the cases where the agencies are acting as intermediaries to promote the States activities. In one preliminary ruling from the ECJ<sup>60</sup> the Court had the opportunity to deal with this situation. The competent Federal office in the case levied a charge on imported citrus juice in order to finance the sale and export of its own countries agricultural products. The ECJ did in its judgement not distinguish between a State institution and an institution set up to grant aid, the important concern was whether aid had been provided out of State resources, and it had. A more difficult situation is, however, when an undertaking is not directly financed by State resources but finances itself through means of compulsory contributions. The situation where a provider of State aid is incorporated under private law does, however, not mean that they are not bound by the prohibition under Article 87(1). It is not rare that the State has substantial shares in the capital of private banks. This can constitute an infringement of Article 87(1), if the State or its geographical entities use these credit institutions to grant certain companies particularly favourable interest rates. The ECJ found for example in *Van der Kooy*<sup>61</sup> that preferential tariffs for gas charged by the private company constituted aid. This what with all certainty due to the fact that the authorities in the Netherlands held 50 per cent of the shares and had a 50 per cent representation in the supervisory board together with the possibility for the authorities to veto tariff decisions. An interesting question appearing from this kind of judgements is, what amount of control that is required, for the funds administered by such private entity to constitute state resources.<sup>62</sup>

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<sup>59</sup> Vedder, pp. 281-284.

<sup>60</sup> ECR 1977, p. 585 – *Steinike und Weinlig v. Germany*

<sup>61</sup> Case 67/85, *Kwekerij Gebroeders Van der Kooy et al. v. Commission*, [1985] ECR 1315., point 33-37.

<sup>62</sup> Beudenbacher, pp. 16-17; Case C-379/98 *Preussen-Elektra AG v. Schleswag AG and Vedder*, pp. 281-284.



This issue was addressed in the “Family Allowances in the Textile Sector”<sup>63</sup> ruling. The Italian government had in this case argued that the partial exemption of an industry from social contributions should not be regarded as State aid or aid granted through State resources, since the loss of the revenue was covered by the employer’s contributions to the unemployment insurance. The Court on the other hand, found that the funds were financed through compulsory contributions according to national law and that for this reason, such aid must be construed as state-financed even if the administration of the fund is assigned to non-governmental bodies. Two important requirements may be distilled through this judgement. Firstly, in order to constitute state aid, the entity must be funded by compulsory contributions imposed by legislation and secondly, the management by the entity of the funds must also take place in accordance with the provisions of the legislation. The third requirement came later with the *Commission v. France*<sup>64</sup> case and held that the grant of funds must be subject to approval by the public authorities. The conclusion that can be made from these cases are that even purely private funds can constitute state resources even though they are not actually collected by the state, if the three requirements above are fulfilled.<sup>65</sup>

The conclusion of the text written above is that all these bodies are capable of giving State aid: geographical State entities such as provinces, regions, departments, associations of local authorities, and local authorities; corporations under public law, associations or other legal entities of public law; equalisation and support institutions set up by government order. This view is supported by both academic literature and case law, which agree that legal status, or the degree of freedom for self-determination granted to the institutions, are of no significance when determining State aid.<sup>66</sup>

### **5.3.3 Distortion of competition**

The third element requires incompatible aid to threaten to distort or actually distort competition. The interpretation of distortion in Article 87(1) must, however, be interpreted differently from Article 81(1). This follows by the fact that Article 81(1) aims at controlling

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<sup>63</sup> Case 173/73, *Italy v. Commission (Italian textiles)*, [1974] ECR 709, point 16.

<sup>64</sup> Case 290/83, *Commission v. France*, [1985] ECR 439, point 15.

<sup>65</sup> Beudenbacher, pp. 16-17 and Vedder, pp. 284-285.

<sup>66</sup> Beudenbacher, pp. 15-16.

the activities of private economic entities, whereas Article 87(1) sanctions State behaviour.<sup>67</sup> In the “Family Allowances in the Textile Sector” case the Court examined the concept of distortion in Article 87(1) by comparing the competitive situation before and after the state measures.<sup>68</sup>

“[...] the point of departure must necessarily be the competitive position existing within the common market before the adoption of the measure in issue. This position is the result of numerous factors having varying effects on production costs in the different member states [...] unilateral modification of a particular factor of the cost of production in a given sector of the economy of a member state may have the effect of disturbing the existing equilibrium”.

The character of incompatible State aid is therefore that it changes the process of competition and interferes with the competitive relation between undertakings or spheres of commercial activity by improving a specific undertakings’ competitiveness. That means that an aid given to a firm which as a result ends up in a better competitive position compared to its’ competitors, distorts competition, if the aid would not have been given under normal market conditions. The Court found in *Ladbroke*<sup>69</sup> that the decision made by the French Minister to allow *Pari Mutuel Urbain* to defer payment of parts of the State’s shares of levies on bets taken on horse races gave the company a financial advantages towards its competitors, which did not enjoy the same the same right to procrastinate payments of levies. This action gave, according to the Court, the organisation an improved position on the market of bet taking both at home and abroad.<sup>70</sup>

As in Article 81(1) the application of Article 87(1) does not require an actual distortion, a potential distortion is sufficient. It must be recalled that even small amounts of aid can be liable to affect the competition and trade between Member States, where there is a strong competition in which undertakings receiving that aid operates. Even though the court has taken this approach, the Commission has chosen to take a more generous route. It has issued a Notice on the de minimis rule for State aid in 1996 [1996] OJ C-68/9, which states that small amounts of aid will not foul the State aid rules.<sup>71</sup>

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<sup>67</sup> Beudenbacher, p. 22.

<sup>68</sup> Case 173/73, *Italy v. Commission (Italian textiles)*, [1974] ECR 709, point 17.

<sup>69</sup> Case T-67/94 *Ladbroke Racing v. Commission* [1998] ECR II-1.

<sup>70</sup> Beudenbacher, p. 22.

<sup>71</sup> Case C-351/98, *Vlaams Gewest v. Commission*; *Steiner*, p. 289 and *Beudenbacher*, p. 22.

### 5.3.4 Support for particular undertakings or spheres of commercial activity

The fourth element requires the aid to favour certain firms or the production of certain goods. This requirement is furthermore closely connected to the third element, that competition must be distorted, which is helpful in order to distinguish general measures from state aids. If the aid is not benefiting a selective group of undertakings or sphere of commercial activity it will not distort competition either.<sup>72</sup>

The important point in this criteria is that the measures is directed to a particular undertaking, this means that measures favouring all undertakings in a Member State without any distinction and without any prejudice to competition is not unlawful according to Article 87(1). The ban on aid is only meant to prevent a certain undertaking to get preferential treatment, not to regulate competition between Member States. Measures of general economic policy such as base rate reductions or currency devaluations to stimulate the national economy or export earnings are therefore not considered as unlawful aid in Article 87(1).<sup>73</sup>

There is a distinction made between general measures and general aid schemes. General measures are not related to a specific branch of industry or a specific company and will therefore normally fall outside the scope of Article 87(1). In a similar way, aid schemes which do not involve any discretion in the administration, will not constitute unlawful aid. The ECJ stated the issue in the DMT case<sup>74</sup>:

“It follows from the wording of Article 92(1) [Now Article 87(1)] of the Treaty that general measures which do not favour only certain undertakings or the production of only certain goods do not fall within that provision. By contrast, where the body granting financial assistance enjoys a degree of latitude which enables it to choose the beneficiaries or the conditions under which the financial assistance is provided, that assistance cannot be considered to be to general in nature”.

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<sup>72</sup> Vedder, pp. 292-295.

<sup>73</sup> Beudenbacher, pp. 18-20

<sup>74</sup> Case C-256/97, Déménagements-Manutention Transport SA (DMT), [1999] ECR I-3913, point 27.

The authority's discretion to grant aid can therefore be seen as a major factor leading to this favouring effect, but this view is, however, questioned in the *Adria-Wien* case<sup>75</sup>. The ECJ considered here that it was state aid to favour certain sectors of industry by giving them tax benefits which other parts could not gain, even though there were objective criteria for the exemption which left no discretionary room for the authorities. In the cases where it does fall under the prohibition in Article 87(1), they will be assessed on their merits and may be authorised if they are; applied without discrimination as to the origin, do not exceed 100% of the environmental costs and do not conflict with other provisions of the Treaty. Aid to increase general environmental awareness is another measure that does not fall within Article 87(1). Aid to repair past damages to the environment do on the other hand fall within the scope of Article 87(1) and do according to the new Guideline of 2001 constitute state aid, but these aspects will be further dealt with under the chapter of guidelines.<sup>76</sup>

### **5.3.5 Effect on trade between Member States**

“When state aid strengthens the position of an undertaking compared with other undertakings competing in intra-community trade the latter must be regarded as affected by that aid.”<sup>77</sup>

As can be seen from the Courts statement in the ruling above, the fifth element of state aid is that the measure must readily affect intra-community trade. Even though this requirement is theoretically important the Commission and the ECJ tend to regard it as being of secondary importance. The opinion is simply that the existence of a distortion of competition also implies an obstruction of inter-state trade.<sup>78</sup>

The criteria of effect on trade between Member States are fulfilled if a measure makes it more difficult for another Member State to break into the national market. The circumstance that the aid receiver is not even active as an exporter or that the company exports almost its' whole production outside the Community does not matter, it can still be regarded as affecting intra-community trade. Aid of relatively small importance or the fact that the beneficiary is small or

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<sup>75</sup> Case C-143/99 *Adria-Wien Pipeline GmbH, Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten*, REG 2001 s. I-8365.

<sup>76</sup> Vedder, pp. 293-295; 1994 Guidelines and Jans, pp. 298-299.

<sup>77</sup> Case 730/79, *Phillip Morris v. Commission*, [1980] ECR 2671, point II.

<sup>78</sup> Beudenbacher, pp. 25-27.

that its' part of the market is finite do not matter either. The ECJ has not adopted a de minimis rule with regard to Article 87 even though the Commission has.<sup>79</sup>

#### **5.4 The practical application of the State Aid regulation**

The Commission is responsible for the application of the state aid regulation. It can according to article 88(2) decide a return of state measures it finds incompatible with the common market, or if aid is abused , decide that the Member State in question shall annul or change its' aid measures within a time limit. If the Member State does not follow its' decision, it can assigned the issue straight to the ECJ. There is, however, a possibility for the Member State to appeal a Commission decision to the ECJ within two months.<sup>80</sup>

Article 88(3) states an obligation for Member States to notify all new measures which it finds fulfil the provision in Article 87(1) and all changes of existing aid measures. The decision as to whether or not the measure affects trade between Member States and the question of authorisation is entirely a issue for the Commission. An authorised aid must furthermore have a legal support in the Commissions Guidelines.<sup>81</sup>

### **Chapter 6: Exempted and exemptible aid - Article 87(2) and Article (3)**

#### **6.1 Overview**

Sometimes aid may be lawful even if it obstructs and distorts competition between Member States. Article 87(2) contains aid permitted per se, whereas Article 87(3) permits aid systems which compatibility can be ensured by the Commission or by the Council. These aids are with other words considered to be compatible or may be considered compatible with the common market. Even though the main aspect of the EC Treaty is the maximisation of competition, other objects are considered and in some circumstances given preference. Article 81(3) for

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<sup>79</sup> Beudenbacher, pp. 25-27, Vedder, pp.295-296, se also chapter 5.3.3 about the Commission's Notice on the de minimis rule for State aid in 1996 [1996] OJ C-68/9.

<sup>80</sup> SOU 2003:38, pp. 437-438.

<sup>81</sup> SOU 2003:38, pp. 437-438. See also the European Unions homepage [http://europa.eu.int/comm/competition/citizen\\_stateaid\\_en.html](http://europa.eu.int/comm/competition/citizen_stateaid_en.html) 2003-11-29

example, permits certain restrictive agreements if the benefits achieved will exceed those which would result from undistorted competition. Article 86(2) permits a relief from the competition rules to public undertakings entrusted with tasks of general economic interest, if that is necessary to carry out the performance. With this background Article 87(2) and (3) can be seen as permitting aid which promotes Community objectives. The national interest of a Member State to obtain aid is, however, not sufficient. The Community's general policy must gain positive advantages for the Commission to permit the aid.<sup>82</sup>

The difference between the second paragraph and the third, is the fact that the Commission in the second paragraph is only authorised to decide whether or not the state measure falls within the wording of one of the three types of state aid mentioned there. There is no room for discretion. In paragraph three on the other hand the Commission has a wide margin of discretion in deciding whether or not one of the four exemptions listed there applies to a state aid scheme.<sup>83</sup> Due to subject area of this paper, I will not go through the provision of Article 87(2) in detail, the concentration will be on the exemption for aid having a social character, Article 87(2)(a), and aid granted to compensate the damages caused by natural disasters. For similar reasons I will only go through the "European interest exemption" in 87(3)(b) and sectoral aid exemption in 87(3)(c).

## **6.2 Aid having a social character - Article 87(2)(a)**

Article 87(2)(a) consist of an exemption from the prohibition in 87(1), if the aid is of a social character. Vedder has interpreted the criteria of "social" to the fact that aid must be granted to individual consumers and not that it is intended to limit the scope of the aid measures. The purpose of the provision relates to the means of the aid more than the objectives of the national measures. The aid must furthermore have a specific effect to a certain group of consumers and be non-discriminating. It is also important that it, when given, do not result in an unequal treatment depending on the origin of the products. If it does, it will be considered as an infringement of Article 87(1). This exemption gives, either directly or indirectly a

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<sup>82</sup> Evans, pp. 107-110 and Beudenbacher, pp. 27-28.

<sup>83</sup> Case T-55/99, Plan Renove Industrial, [2000] ECR II-3207, point 109 & 110 and Evans, pp. 107-110 and Beudenbacher, pp. 27-28.

preferential effect to certain undertakings or certain goods, but this possible distortion of competition is accepted.<sup>84</sup>

There is, however, little case law in regard to Article 87(2)(a). The Court could furthermore not in the only case<sup>85</sup> regarding the article in a satisfactory way discuss the requirements, since the referring judge had neglected to provide the necessary details. Despite the lack of clear outlines for the use of Article 87(2)(a) in the Court's case-law, the Commission has used the Article in many environmental cases. One of them is the German *Catalytic converter* case where a tax exemption for consumers who bought cars with catalytic converters was qualified under Article 87(2)(a), provided that it was not hindering the free movements of goods in Article 28 EC.<sup>86</sup> In the Commission's 1994 Guidelines on State Aid for Environmental Protection it stated in paragraph 3.5 that measures that encourage the purchase of environmentally friendly products will not constitute aid in the first place, because they do not confer a "tangible financial benefit" upon one or more undertakings.

### **6.3 Aid to compensate damages caused by natural disasters - Article 87(2)(b)**

It is clear that only damages caused by natural disasters or exceptional circumstances can fall within the scope of Article 87(2)(b). This means that also aid to prevent reoccurrence of natural disasters most probably will fall outside the provision. The importance of this Article is therefore limited and environmental considerations may even play a negative role in this respect. Some environmental damages, such as flooding is a result of human exposure in the nature. Excessive logging and the development of entire mountain ranges into ski slopes are examples of actions which will greatly reduce the capacity of these mountainsides to absorb water, thus increasing the risk of floods in downstream areas. This kind of damage would give right to aid under this provision, but in a justice and environmental protection respect these costs should be borne by the polluter. There is, however the Water Framework Directive<sup>87</sup> which can be helpful in this respect.<sup>88</sup>

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<sup>84</sup> Beudenbacher, pp. 27-29 and Vedder, p. 297.

<sup>85</sup> Case 52/76, Luigi Benedetti v. Munari Filli, [1977] ECR 163, point 19.

<sup>86</sup> Vedder, pp. 297-298.

<sup>87</sup> Directive 2000/60 Establishing a framework for Community action in the field of water policy. OJ 2000 L327/1.

#### **6.4 Aid for important projects of common European interest - Article 87(3)(b)**

This subparagraph of the article contains two completely different rationales for exemption, but the focus will only be on the first ground, aid granted “to promote the existence of an important project of common European interest”. The question of whether or not a project is to be considered as important involves a great deal of discretion and is therefore not really answerable. There are, however, documents which describe what a project of “common European interest” is. The ECJ stated in *Glaverbel*<sup>89</sup>

“that a project may not be described as being of common European interest for the purposes of Article 92(3)(b) [now Article 87(3)(b), JHJ] unless it forms part of a transnational European programme supported jointly by a number of governments of the Member States, or arises from concerted action by a number of Member States to combat a common threat...”

This means that two or more Member States have to have a direct interest in the project in order for the aid to be permitted. Aid was therefore not permitted in the *Glaverbel* case - the connection between the aid and the improvement of the environmental situation through a transnational action did not immediately come clear. The Court said furthermore that common threat of this definition could also be environmental pollution. Projects to improve the energy supply; project to develop new industries; projects of basic research; the creation of new infrastructures; the establishment of telecommunications systems, sewage plants, dam construction, waste disposal plants etc are therefore all examples of projects that have been object for the exemption under Article 87(3)(b).<sup>90</sup>

The possibility for permitting environmental aid under the “European interest” provision is nevertheless limited. The old guidelines for State aid, formulated by the Commission, concerned the application of the exemption in Article 87(3)(b). It gave the impression that it was difficult to achieve an exemption under this provision for any reason, but that it was virtually impossible to have environmental protection aid approved under Article 87(3)(b) when the criteria of “European interest” was not met. A further exemption was introduced in the Commissions IVth Competition Report.<sup>91</sup> It held that environmental aid could be

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<sup>88</sup> Vedder, p. 299 and Beudenbacher, p. 29.

<sup>89</sup> Case 62/87, *Glaverbel*, [1988] ECR 1573.

<sup>90</sup> Beudenbacher, pp. 34-36 and Vedder, pp. 299-300.

<sup>91</sup> Point 182.



permitted in order to maintain international competition. This could be the case when a Member State has a higher environmental protection, such as the carbon dioxide taxation in Sweden. In the Swedish case companies suffer from higher production costs which will show in the price of the product and result in disadvantage on the international market. The “normal” ground of granting environmental aid is now, however, to be found in Article 87(3)(c), since environmental aid under Article 87(3)(b) is today only granted in order to “promote the execution of important projects of common European interest which are of an environmental priority and will often have beneficial effects beyond the frontiers of the Member State or States concerned”.<sup>92</sup>

## **Chapter 7: Community guidelines on State aid for environmental protection**

### **7.1 Background**

The use of environmental subsidies increased in the European Union in the 1970’s and the Commission found it necessary to provide some guidance, as to its position on the role of environmental concerns in the rules on state aid. The Commission seems to always have done this from a twofold perspective of the polluter pays principle and the need to ensure undistorted competition. Its view for a solution to this problem, has been and still is, to apply the polluter pays principle fully and to completely internalise environmental costs. The fact is nevertheless that state aid overturns the internalisation. The Commission has thus recognised the importance of regional environmental aids from both an environmental and a competition point of view.<sup>93</sup>

As a result of this development, the Commission set out its stands with regard to environmental subsidies in nine paragraphs in the Fourth Annual Competition Report 1971.<sup>94</sup> With too much optimism the Commission believed in a fully internalised polluter pays principle and a completely internalisation of environmental costs to be completed in a transitional period of six years. This state aid policy was going to distinguish between two different stands. The Commission had one view in regard to environmental aid during the

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<sup>92</sup> Jans, pp. 300-306.

<sup>93</sup> Commission IVth, Competition Report (1974) para. 176 and Vedder p. 176.

<sup>94</sup> Commission, IVth. Competition Report (1974) point 176-183.

transitional period and one policy for aid granted after or during the transitional period which did not fulfil the requirements. State aid during the transitional period had to qualify under Article 87(3)(b), as aid necessary for the execution of “important projects of common European interest”. It furthermore had to fulfil the three following requirements:

- 1) It had to be *necessary* for new major obligations relating to environmental protection.
- 2) It had to be granted for the financing of *additional investments* in plants already in operation.
- 3) It had to be of a *specified degressive maximum* aid percentage set by the Commission.

For environmental aid which exceeded the limits set out above, the Commission decided that they were only going to be granted in cases where sudden major changes in environmental obligations would create difficulties for the equilibrium in a certain region or industry. It created with other words an exception to the strict rules of aid in situations where international competition could be seriously handicapped due to new environmental standards. This framework was, however, actually only defined for the assessment of environmental investment aid and operating aid came therefore to fall outside the scope of these guidelines.<sup>95</sup>

The Commission realised in 1980 that it's' goal to implement the polluter pays principle in six years was proven to be overly optimistic and an additional transitional period was therefore given for this assessment. Environmental aid was therefore allowed for another six year period. This kind of aid exempted under Article 87(3)(b), investment aid, was only granted for the adaptation of plants in operation for two years before the entry into force of the new standards and did not exceed 15%. A reporting obligation was furthermore introduced, but the Commission continued to remain silent with regard to environmental operating aids.<sup>96</sup>

In 1986 the Commission finally saw that its' transitional approach was not going to happen. The need for environmental protection as well as the protection of the competition was there to stay. The Commission therefore decided that the 1980's Guideline was going to apply for

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<sup>95</sup> Vedder, pp. 301-302.

<sup>96</sup> Commission, Xth. Competition Report (1980), point 24 and 26, and Vedder p. 302.

the period of the fourth Environmental Action Programme until 1992. It was first in 1994 a new Guideline for environmental aid emerged.<sup>97</sup>

The largest difference between the 1994 Guidelines and the previous ones was the character. The 1994 Guidelines was in comparison much more comprehensive, more precise and there were for the first time rules governing operating aids and horizontal measures. The Guidelines distinguished primarily the following forms of environmental aid:

- 1) Aid for investment
- 2) Aid for increasing environmental awareness
- 3) Operating aid

The legal basis for the granting of environmental aid changed from Article 87(3)(b) into Article 87(3)(c), “aid to facilitate the development of certain activities [...] where such aid does not adversely affect trading conditions to an extent contrary to the common interest”. The Commission furthermore allowed state aid schemes under Article 87(3)(b) at higher rates in order to contribute to important projects of common European interest. A review of the 1994 Guidelines occurred in 1996, but no changes were made. Many expirations later it came to end first the 31th of December 2000.<sup>98</sup>

In 1998 the Council adopted Regulation 994/98<sup>99</sup> which gave the Commission the right to adopt block exemption regulations in the field of state aids. There is even an explicit rule which allows for a Commission block exemption regulation for state aid in the field of environmental protection.<sup>100</sup> Despite of this development a new edition of the Guidelines were issued in February 2001 and not a block exemption regulation. Vedder argues that this might depend on the fact that environmental protection is constantly giving us new challenges. An example is the carbon dioxide reductions in the Kyoto protocol. Climate change was largely unknown 1994, whereas it today is on of the largest issues in environmental protection. In this

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<sup>97</sup> Vedder, p. 302.

<sup>98</sup> Vedder, p. 303 and Jans, pp. 301-302.

<sup>99</sup> Regulation NO. 994/98 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal state aid, OJ 1998 L 142/1.

<sup>100</sup> Regulation 994/98, Article 1(1) sub(a) under (iii)

aspect, block exemptions might never be the right tool for the protection of the environment.<sup>101</sup>

## **7.2 The 2001 Environmental aid Guidelines**

Once again the *new* guidelines came to be even more precise and to comprise a larger perspective of aid than the last ones. The 2001 Environmental aid Guidelines came to be a 11 chapter, twelve pages and one annex long guidance for the granting of environmental aid. I will in the following text go through the Guidelines chapter by chapter.

### **7.2.1 Introductory chapters**

In the first chapter of the Guidelines, chapter A, the two main principles of environmental aids are set out. The integration principle in Article 6 and the polluter pays principle. In the evaluation of the fifth environmental action program it was noted that it was clear that damages to the environment gave costs to the society. Environmental protection can in the light of this generate benefits in the form of economic growth, employment and competitiveness, but it is still hard to implement the full application of the polluter pays principle. It is also important to remember that aid is actually against the polluter pays principle. What the Guidelines are trying to inform, is that aid can nevertheless be justified in two circumstances:

- 1) When there are no other solutions. The costs can not be fully internalised and aid therefore represents a temporary second-best solution which can provide an incentive for firms to adopt environmental standards.
- 2) Where aid can be used as incentive for companies to improve on standards or to go beyond what is required by them.<sup>102</sup>

This is a significant change from the 1994 Guidelines, where aid was granted in order to facilitate for firms to comply with compulsory standards. This is, however, not permitted

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<sup>101</sup> Vedder, p. 304.

<sup>102</sup> 2001 Guidelines Chapter C.

anymore with the exception for SMEs.<sup>103</sup> Another new aspect the Guidelines introduced was that state aid was only going to be permitted when it is:<sup>104</sup>

“[...] necessary to ensure environmental protection and sustainable development without having disproportionate effects on competition and economic growth”.

The content of this statement is, first of all, that the competition on the market shall be ensured together with the completion of the single market and the increased competitiveness in the firms and secondly, that the environmental protection shall be integrated into the definition and implementation of competition policy, especially to promote sustainable development but also in order to internalise environmental costs.<sup>105</sup>

The Commission devoted a special paragraph in regard to the energy sector. In this part special attention is given to the problem of exemptions or reductions in eco-taxation schemes. They are regarded as operating aid but may nevertheless be considered necessary for the acceptability and thus adoption or continuation of eco-taxation schemes. This kind of reduction or exemption may be allowed for a period of 10 years. The Commission also stated its reiterated positive stance for measures to promote renewable energy and the combined production of heat and energy.<sup>106</sup>

The definitions and the scope of the Guidelines are set out in chapter B. A number of changes have been introduced. Aid for environmental training for example fell within the scope of the 1994 Guidelines, whereas the 2001 Guidelines do not consider the measure as aid at all. The scope of the 2001 Guidelines regards furthermore aid in all areas covered by the EC Treaty which protects the environment. This includes all sectors, but excludes the field covered by the Community guidelines for State aid in the agriculture sector. State aid for research and development in the environmental sector is another area which is not covered by these Guidelines, but in the Community framework for State aid for research and development.<sup>107</sup>

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<sup>103</sup> 1994 Guidelines, point 2.3 A and 2001 Guidelines, point 20.

<sup>104</sup> 2001 Guidelines, point 5.

<sup>105</sup> 2001 Guidelines, point 3-17 and Vedder pp. 304-305.

<sup>106</sup> 2001 Guidelines, point 22-24.

<sup>107</sup> 2001 Guidelines, point 7.

The general conditions for the granting of environmental aid are put down in chapter E. As in the 1994 Guidelines, the Commission has divided its policy in three areas: investment aid, aid for horizontal measures and operating aid.

### **7.2.2 Investment aid**

Investment aid is regulated under paragraph E.1 in the Guidelines. The notion of “eligible costs” seems to be particularly important due to the fact that investment aid is described as a percentage of these costs. According to paragraph 37 in the Guidelines, eligible costs, are extra investments costs necessary to reach the environmental goals. With regard to renewable energy, eligible costs are those extra costs compared to the situation where it would have used conventionally produced energy. In the situation where no standards exists, eligible costs are considered to be investment costs necessary to achieve a higher level of environmental protection than the firm could have achieved without any environmental aid. Benefits coming from this extra investment, such as increased production capacity, will nevertheless have to be detracted from the eligible costs. These investments must furthermore lead to actual improvements in the environmental performance, i.e. go beyond what is provided by Community standards and not just constitute general investments that any responsible company should do. In Hoffman-La Roche<sup>108</sup> the Commission considered aid in order to combat water and air pollution to be justified on the basis of the Guidelines, whereas the measures granted with a view of reducing the risk of a serious accident was considered as general measures.<sup>109</sup>

The following table comprehends percentages of costs which can be granted environmental aid.<sup>110</sup>

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<sup>108</sup> Commission Decision 98/251, Hoffman-La Roche (Orlistat), OJ 1998 L 103/28.

<sup>109</sup> Commission Decision 98/251, Hoffman-La Roche (Orlistat), OJ 1998 L 103/28, pp. 33-35 and 2001 Guidelines, point 37.

<sup>110</sup> The table is taken from Vedder, p. 307.

Type of aid	Basic rate	Bonus	Special remarks
Adaptation of SMEs to new standards	15%		Only for three years following adoption of new standards
<ul style="list-style-type: none"> <li>- Improve on Community standards</li> <li>- Investment in absence of Community standards</li> <li>- Investments to comply with national standards going beyond Community standards</li> </ul>	30%	+10% for SMEs	
Energy saving measures	40%	+10% for SMEs	
Combined production of heat and electricity	40%	+10% for SMEs	
Promotion of renewable sources of energy	40%	+10% when they serve the needs of an entire Community +10% for SMEs	Up to 100% can be allowed in which case no further aid may be granted
Land rehabilitation	100%, plus 15% of the cost of the work		If identifiable and able to bear the costs, the polluter should pay and no aid may be granted
Relocation of firms	30%	10% for SMEs	<ul style="list-style-type: none"> <li>- Only when relocating from an urban area or Natura 2000 where the activity was lawfully carried out,</li> <li>- The relocation was ordered by a public authority on environmental grounds, and the strictest standards apply in the new location</li> </ul>

As can be seen in this table, SMEs are permitted aid under the Guidelines for the adoption of new mandatory standards. The 1994 guidelines permitted this kind of aid to all undertakings, but the new one from 2001 changed the rules. Aid for this purpose is now only permitted for SMEs for a period of three years. This aid can furthermore only be granted up to the level of 15% of the eligible cost. There is, however, a problem arising from this authorisation. Most Community environmental legislations are in the form of directives, which means that they need to be implemented in order to apply in the Member States. SMEs can therefore receive aid for the adoption of rules that might not have been transposed into national law or rules that have not even entered into force. Another aspect, is that this actually requires the SMEs to pay attention to the activities in Brussels, which they due to their size might not be suited for.<sup>111</sup>

Another interesting aspect is the favourable position of energy related installations which most certainly has its background to the Kyoto protocol. It is, however, only renewable energy installations that serve the need of an entire community which qualify for an extra 10 per cent bonus. Finally, these Guidelines of 2001 contains clear and relatively unambiguous guidance in the cases concerning land rehabilitation and plant relocation, which is a step forward compared to the case-by-case approach under the 1994 guidelines. The Commission did not find that measures for rehabilitation for pollution where the polluter could not be found to constitute aid in the old guidelines, whereas it is today. There is, however, not a significant difference due to the fact that the Commission allows 100 per cent of the eligible costs plus 15 per cent of the cost of the work to be funded. The change of wording in the Guidelines can therefore be said to only have given a procedural difference, since the aid will most certainly be authorised. Of larger importance is however the fact that the Commission leaves the decision as to whether or not persons are responsible for the pollution, to the national legislature and judiciary. This discretion can lead to serious distortion of competition and differences in regimes according to which polluters can be held responsible. The investment aid guidelines have nevertheless become much clearer, especially in relation to the energy related investment where the 1994 Guidelines treated the question under the category of investments exceeding standards or where no standards exist.

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<sup>111</sup> Vedder, p. 308.



### 7.2.3 Aid for horizontal measures

Aid for horizontal measures was as a basic approach not considered as aid under the 1994 Guidelines, but this view has changed. The chapter has therefore become more substantially concise in the Guidelines of 2001. Even though the guidelines have narrowed the breadth of this chapter it still treats the SMEs in a favourable way. The Commission seems to be of the view that “advisory/consultancy services play an important part in helping SMEs to make progress in environmental protection”<sup>112</sup> and they may therefore be granted aid in accordance with Regulation 70/2001 in order to stay up with to date with the environmental developments in Europe.<sup>113</sup>

### 7.2.4 Operating aid

Even though there have been a progress in the environmental area for reducing pollution and in introducing cleaner technologies, there are still many costs for activities which damage the environment that are not passed on to the product. Member States have tried to handle that situation through internalising some of these costs and benefits through taxes or through charges for environmental services, on the one hand, and through subsidies, on the other. Cost-related charges for environmental services, such as taxes and charges, are in line with the polluter pays principle, but it may nevertheless be necessary to delay the full charging, this due to the competition under the transition time, since many firms can simply not stand this new financial burden and will need a temporarily relief in order to survive and compete with other firms which governments do not have such measures. This kind of relief is operating aid.<sup>114</sup>

The Guidelines distinguish between two different kinds of operating aid, one which concerns the waste management and energy saving and the other which regulate any aid in the form of tax reductions or exemptions. The Commission first deals with operating aid for waste management and energy saving, which is only permitted where it is shown to be absolutely necessary. It should furthermore be strictly limited to the compensation for extra production

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<sup>112</sup> 2001 Guidelines, point 41.

<sup>113</sup> Regulation 70/2001 on the application of Articles 87 and 88 of the EC Treaty to state aid for small and medium-sized enterprises, OJ 2001 L 10/33.

<sup>114</sup> 1994 Guidelines, point 1.5.3 and 2001 Guidelines, point E.3.4

costs and the aid must be temporarily and as a general rule degressive. Sometimes temporarily relief from environmental taxes can nevertheless be permitted under these provisions, if it is necessary to offset losses in competitiveness, particularly at international level. This is for example the case for operating aid for the management of industrial waste where aid is authorised if there are no harmonisation or if there are stricter national rules. Aid will in that case be permitted for five years maximum and to be either degressive or non-degressive.<sup>115</sup>

It has been hard for firms of renewable energy sources to compete effectively with the conventional produced energy and it is therefore possible under these guidelines to achieve operating aid. The first option of receiving operating aid comes from the difference between the production cost of renewable energy and the market price of the form of power concerned. The second alternative concerns the use of biomass, which is a renewable source of energy which requires relatively little investment but brings higher operating costs. If the Member States can show that the aggregate cost after plant depreciation is still higher than the market prices of energy, the Commission will consider permitting aid. Aid is in the third case actually not given because of the need of it, rather as a bonus. Operating aid will in this situation be the difference between what external costs that has been avoided through the use of this energy production way compared to a plant operating with conventional forms of energy. Besides these alternatives Member States may also grant operating aid in accordance with the general rules governing aid. The Commission finds furthermore that operating aid is justified for the combined production of electric power and heat, if the obligations for the same area required for investment aid are fulfilled. This kind of aid is granted to firms which distribute electric power and heat to the public, where the costs of producing such electric power or heat exceed its market price.<sup>116</sup>

The second form of operating aid concerns tax reductions or exemptions and the Commission have been confronted with many eco-taxation schemes since the adoption of the 1994 Guidelines. This experience has now been put down in the Guidelines of 2001. When Member States of environmental protection decides to adopt taxes for some certain activities, they may deem it, as mentioned above, necessary to give some firms temporarily exemption, especially when there are no harmonisation on the Community level or since some firms might risk to loose international competitiveness. The rules in the guideline separate two

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<sup>115</sup> 2001 Guidelines, point 42-46.

<sup>116</sup> 2001 Guidelines, point 58-65 and E.3.4

different kinds of aid in the form of taxes or exemptions; tax levied as a result of Community directive and a new tax introduced by the Member State. Two situations can furthermore appear if a tax is levied due to a Community directive. The first situation is when the Member State applies a tax higher than the minimum rate required by the Community, but makes an exemption by letting some firms pay less, but the tax is nevertheless at least equal with the minimum rate set by the directive. This kind of aid might be justified in the Commission opinion, since the higher taxation makes it possible for the firms to adopt higher environmental protection in order to reduce the tax and that will influence companies to act in a more environmental friendly way. The second situation is when the Member State uses the minimum taxation rate laid down in the directive, but then grants an exemption to certain companies. In that case, these firms do not even pay the minimum rate required by the Community. If this kind of exemption is not authorised according to the directive in question, it is incompatible with Article 87(1). On the other hand, if it is permitted, the Commission has to decide if it is in line with Article 87(1) and if it is necessary and not disproportional in the light of Community objectives pursued. If an exemption is made, it must be strictly limited in time.<sup>117</sup>

These strict guidelines have [its] their background in the Commission's wish to ascertain that the reductions do not undermine the objectives of the schemes. A number of criteria's must therefore be satisfied before such operating aid may be granted.

### **7.3 State aid regulation and the Swedish energy taxation scheme**

The Swedish energy- and carbon dioxide taxation scheme is considered as State aid. It fulfils all the requirements in Article 87(1). The tax relief is granted by the State and the benefit is only given to some sectors of the industry. The beneficiaries are furthermore companies which are active on a product market which involve inter-state trade. The measure can therefore distort competition. The tax relief has nevertheless been authorised by the Commission at several different occasions as environmental aid.<sup>118</sup>

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<sup>117</sup> 1994 Guidelines, point 3.4; 2001 Guidelines, point 47-49 and E.3.4; and Vedder p. 310.

<sup>118</sup> N 255/96 and N 742/96 – Sweden (EGT C 71, 7.3.1997, s. 10); NN 72/A/2000 and NN 71/A/2000 – Sweden (EGT C 117, 21.4.2001, s. 19).

The Swedish government has once again notified the Commission for the authorisation of the energy taxation scheme. The Commission has in its proceedings dealt with three different taxes, i.e. the carbon dioxide tax, tax on fossil fuels and tax on electricity. It did, however, consider that there was a strong connection between the carbon dioxide tax and the tax on fossil fuels and there are therefore examined together. There are, as mentioned earlier, three exceptions concerning the carbon dioxide taxation scheme.<sup>119</sup> A general relief of 25 % for the manufacturing sector, the 0, 8 per cent rule and the 1, 2 per cent rule. There are furthermore a total relief for the manufacturing sector in regard to national tax on fossil fuels and electricity.<sup>120</sup>

The carbon dioxide relief as well as the total relief of tax on fossil fuels for the manufacturing sector were both considered as measures which had a considerable positive effect on environmental protection, which are required for operating aid to be granted according to point 51.1 in the 2001 Guidelines. It is furthermore thought to contribute to the national goal to reduce the carbon dioxide by 22, 5% 2010.<sup>121</sup>

Fuel	Share of carbon dioxide tax paid	Share of fossil fuel tax paid	Share of total tax paid 2003
Oil	25 %	0 %	19 %
Natural gas	25 %	0 %	22 %
LPG	25 %	0 %	24 %
Coal/Coke	25 %	0 %	22 %

The Council directive 92/82/EEG<sup>122</sup> sets out a tax for mineral oils whereas the Swedish taxation scheme gives the manufacturing sector a total relief from taxation of fossil fuels. This taxation scheme is, however, examined together with the carbon dioxide tax and a minimum tax of 19 % is therefore still paid. The requirement that minimum Community tax must be paid in point 51.1 b are therefore fulfilled. The other requirement in this point, i.e. that a considerable part of the national tax must be paid, here 22 %, is also accomplished according to the Commission. It is furthermore required in point 51.2 b in the 2001 Guidelines that the tax exemptions were decided before the tax came in force. The exemptions in this case were

<sup>119</sup> See chapter 4.3

<sup>120</sup> NN 3/B/01 – OJ C 189/6 9.8.2003

<sup>121</sup> NN 3/B/01 – OJ C 189/6 9.8.2003, point 3.2.2

made before Sweden's entrance into the European Union 1995 and the requirement is therefore fulfilled. The Commission therefore stated in its partial decision the 11<sup>th</sup> December 2002 once again that this scheme was to consider as state aid compatible with Article 87(3)(c). The total taxation relief for electricity for the manufacturing sector is on the other hand under investigation.

#### **7.4 The role of environmental considerations in other sectors and guidelines**

As stated in chapter K of the Guidelines the Commission considers itself under an obligation to integrate environmental considerations into other guidelines and frameworks as well. This kind of action has been taken even before the 2001 Environmental Guidelines, for example in the Community Guidelines for State aid in the agriculture sector from 2000 where a whole chapter was devoted to environmental aid.<sup>123</sup>

The Agriculture aid Guidelines contain a similar “integration-provision” to what can be found in the 2001 Environmental Guidelines. The Commission cites Article 6 in section 3.9 to come to the conclusion that it covers both the competition as well as the agricultural policy of the Community. It is furthermore on the basis of this which the Commission requires particular attention to be given to environmental issues, even in cases where the aid schemes are not specifically concerned with that subject. What is important, however, is to show that the effects of certain aid schemes do not run counter to Community Environmental protection legislation or otherwise cause environmental damage.<sup>124</sup>

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<sup>122</sup> EGT L 316, 31.10.1992, s. 19

<sup>123</sup> Community Guidelines on State aid in the agriculture sector, OJ 2000 C 28/2. (henceforth referred to as the Agricultural aid Guidelines)

<sup>124</sup> Agricultural aid Guidelines

## Chapter 8: Analysis

### 8.1 Overview

The question in focus has been whether or not there has been an integration of environmental concern in EC State aid regulation and also to what extent. I will in the following parts of the dissertation summarise the content as well as making an analysis of the information that have been discussed.

Environmental law is compared to other areas of legislation very new but it has, however, been given more space during the years that have passed. The development has also given rise to stricter environmental standards, which in its turn have been negative for competition. Environmental legislation is furthermore often implemented on a national level, which means that strict environmental regulation will affect international competition.<sup>125</sup>

The ECJ has in many situations stated that the Competition rules of the EC Treaty have to be interpreted in the light of two provisions, i.e. the aim to create a market with undistorted competition as held in Article 3(1)(g) and according to the objectives in Article 2. No specific definition of undistorted competition is nevertheless to be found in the Treaty. The Commission and the Court have, however, defined this concept to mean an “effective” or “workable” competition.<sup>126</sup>

“The requirement that contained in Article 3 and 85 of the EEC Treaty [Now Articles 3(1)(g) and 81 EC] that competition shall not be distorted implies that existence on the market of WORKABLE COMPETITION, that is to say the degree of competition necessary to ensure the observance of the basic requirements and the attainment of the objectives of the Treaty, in particular the creation of a single market achieving conditions similar to those of a domestic market.”[Emphasis added]<sup>127</sup>

This term of “workable competition” is, however, not so well defined as it appears to be here and too much weight should not be put on this statement. It is nevertheless interesting and

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<sup>125</sup> Vedder, pp. 45-47.

<sup>126</sup> Vedder, p. 90

may at least give some guidance to how to distinguish a distorted market. The conclusion drawn from this description is that there is an obligation to maintain an effective or workable competition. That does, however, not mean that every restriction is forbidden and that is where environmental considerations come into the picture. I think that this statement, even though it was made for the implementation of Article 81, can be applied to the concept of competition in Article 87.

The aim of the integration is quite simply to find a balance between competition and environmental protection in order to reach the goal of sustainable development. The problem has been to find *that* model where weight is given to both areas. It has furthermore been a question of what tools to use. Should the governments use the command and control instruments, the market tools or try to find a way to internalise the costs in the products? Competition regulation have always been seen as the villain to environmental considerations, and that also in regard to the State aid regulation, but it is not that simple. Aid is not always good for the environment as pointed out in Chapter 4 and it may in some circumstances even be negative for environmental protection. It can for example take away the incentive for undertakings to find better ways of production.

## **8.2 Summary of the State Aid regulation**

At first sight the State aid regulation seem to be very strict. The wording of the provision seems to cover all benefits that can be deduced from the State. The Preussen Elektra case has probably changed this opinion, even if Vedder do not think that that means that Article 87 has had its' wings clipped. That judgement did, however, benefit environmental protection, in that sense that Member States are now allowed to introduce regulation that forces private undertakings to buy environmental friendly electricity from renewable energy producers. This measure will probably also encourage more producers to produce environmental friendly energy, due to the fact that there are profits to gain in the system. Article 87(2)(a), aid having a social character, does in my opinion also benefit the environmental protection. As mentioned earlier, the Commission permitted a tax exemption in the German *Catalytic converter* case which gained consumers who chose to buy cars with catalytic converters, i.e.

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<sup>127</sup> Case 26/76, Metro I, [1977] ECR 1875, point 20.

cars that were more environmental friendly.<sup>128</sup> The environmental benefit from Article 87(2)(b) can on the other hand be questioned. The purpose is to grant aid to compensate damages caused by natural disasters, but as mentioned before, these disasters can be a result from the exploitation of nature by humans.

It can in my opinion not be questioned that environmental considerations have been taken into account in the State aid regulations, due to the Guidelines of Environmental aid. The purpose of some of these directions can on the other hand be confusing. It is not always clear why aid can be permitted, since there are in some circumstances no visible extra costs that struck companies for a production in a more environmental friendly way. One of those situations are the guidelines for operating aid for energy saving. Energy saving would generally involve measures targeting the loss of energy during a process or measures aimed at making the whole process more energy efficient. These measures would according to Vedder “pay themselves back” due to the lower energy consumption. Investment aid can in this respect be seen as necessary, but operating aid is a totally different story. What would the higher operating costs from a more efficient installation come from?<sup>129</sup> There is furthermore a possibility for industries to receive aid for the amount of costs that the more environmental friendly production has spared the Community in form of external costs, even though there are no extra costs for the firms. This measure can on the other hand be seen to encourage firms to stake on the production of renewable energy instead of using conventional methods. Another aspects that attract attention is the possibility for SMEs to receive aid for rules that are not yet adopted or in force. There is furthermore a danger of leaving the decision to whom to consider as a polluter to the Member States, *which* may if anything give rise to different interpretations and distort competition.

There have also been good guidelines, one is for example the possibility for SMEs to receive aid for advisory/consultancy services in order to stay up to date with the environmental developments in Europe. Another is the change made under the 2001 Guidelines which states that only SMEs can qualify for investment aid in order to adapt to compulsory Community standards, whereas larger companies could qualify as well under the 1994 guidelines. This

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<sup>128</sup> Vedder, pp. 297-298.

<sup>129</sup> 2001 Guidelines point 42-46.



change shows that the Commission has taken a new approach to environmental aid and is working towards an internalisation of environmental costs.<sup>130</sup>

The Swedish energy taxation scheme is on the other hand an example of an assessment which is not fully internalising environmental costs in the product. The carbon dioxide tax and the tax on fossil fuels have been introduced to the market with the aim to reduce the emissions of carbon dioxide, but in the same time the most energy efficient companies are relieved from a full taxation. This is a measure which the Commission authorises as environmental aid compatible with the common market, even though the exemption itself does not benefit the environment. The aid is on competition grounds and not environmental. The total tax exemption for manufacturing companies were on the other hand not authorised by the Commission on the ground that it did not fulfil the requirements in point 51.1. b in the 2001 Guidelines, i.e. that a *considerable* amount of the national tax were paid. The justification seems to be that an environmental taxation with partial exemptions is better than no taxation at all.

### **8.3 An obligation to not fund environmentally damaging projects?**

The last chapter of the 2001 Environmental aid Guidelines refers to the integration principle and gives as a result an obligation for the Commission to integrate environmental concerns into its state aids policy in every sector. A similar provision can as mentioned earlier be found in the Agricultural aid Guidelines. The Commission states furthermore in both guidelines that notifications “should in the future contain an assessment of the expected environmental impact of the activity aided”.<sup>131</sup> This gives, according to Vedder, rise to a more general question in how far environmental considerations may play a negative role in the process of the application of the state aid rules. As he puts it:

“to what extent can a negative environmental impact assessment [...] actually allow or even oblige the Commission to declare the aid incompatible with common market even though from a competition perspective there are no objections?”<sup>132</sup>

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<sup>130</sup> 2001 Guidelines and Vedder, pp. 308-309.

<sup>131</sup> 2001 Guidelines, chapter K and Community Guidelines on State aid in the agriculture sector OJ 2000 C 28/2, section 3.9.

<sup>132</sup> Vedder, p. 318.

Article 87 do at first sight not appear to allow for such negative role, but in the same time we have also seen that Article 6 puts the Commission under an obligation to at least consider the environmental impact on the decisions it takes. The first step to answer this question comes from the criterion that state aid is *incompatible with the common market*. The objectives of Article 87 is to bring about and maintain the common market, but a common market does not exist where there are only an area with free movement but together with a number of well-defined environmental objectives as can be seen in Articles 2 and 3 EC. This thought seems to have underlined the Commissions statements in the Agriculture aid Guidelines where it held that:

“All environmental aid schemes in the agricultural sector should be compatible with the objectives of Community environmental policy. In particular, aid schemes which fail to give sufficient priority to the elimination of pollution at source, or to the correct application of the polluter pays principle cannot considered compatible with the common interest, and therefore cannot be authorised by the Commission”<sup>133</sup>

This statement is largely qualified by the fact that it applies to environmental aid schemes only. The fact that it refers to the common interest is, however, powerful. This statement is therefore clearly capable of being applied outside the agricultural sector and with regard to all aids, but a similar statement was nevertheless not incorporated into the 2001 Guidelines. It is, however, submitted that the Commission has the possibility to refuse authorisation of aid schemes that run counter to Community environmental protection requirements in general, just as it considers itself under an obligation to not fund environmentally damaging projects with Community funds.<sup>134</sup>

#### **8.4 Integration?**

Vedder argues that environmental considerations have more or less played a modest role with regard to nearly every provision of Community competition law. The question is, however, if this more or less modest role has lead to an integration of environmental concerns in EC State

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<sup>133</sup> Agricultural aid Guidelines, OJ 2000 C 28/2, para. 5.1.3.

<sup>134</sup> Vedder, p. 318.

aid regulation. It is in order to answer this question, important to remember the fact that an integration requires *both* environmental and competition considerations to be taken into account. A conclusion based on my earlier discussion.<sup>135</sup>

Is integration the way to make both environmental protection and competition law function in the best possible way for their individual aims? Probably not. The best way of protecting the environment would be to return to the early hominid way of life and the best competition conditions would be gained from a policy which promote unmitigated economic growth and financial profit. Neither of these alternatives would function in today's society and neither would promote the search of sustainable development. The difficulty is therefore to find a relationship between these two areas where they are both working towards the same goal – sustainable development. The environment has to take some damages and the authorities have to accept that competition can be hindered in some circumstances. Competition law allows, as mentioned above, restrictions or distortions of competition insofar as they are necessary to bring about the internalisation of environmental costs. The only way for competition law to really contribute to the objective of achieving sustainable development and an integration is therefore to make environmental friendly product compete with other products.<sup>136</sup>

What exactly does this integration required by Article 6 EC mean? A strictly legal reasoning can not provide an answer to this question, but it can on the other hand be answered through the discovery of the concepts of external costs and internalisation of external costs. The first term regards the situations where environmental costs have not been taken into account in the decisions made by economic actors. The second term, internalisation of economic costs, is that environmental degradation is a quantifiable cost for the polluter just as any other product cost. Internalisation of environmental costs includes the danger for the company in terms of consumers switching to competitors if the price of the product rises. A successful internalisation of environmental costs therefore depends more on changing consumers' preferences rather than producers' preferences, since a certain number of consumers may be willing to bear these extra costs, others not. There is today not a fully integrated market and it depends on consumers as well as governments. An internalisation of environmental costs could for example be possible if all States had the same environmental protection, but that is not the case. The Swedish energy taxation scheme is a good example of this. The Swedish

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<sup>135</sup> Vedder, p. 321.

<sup>136</sup> Vedder, p. 430.

companies would suffer from loss in competitiveness without these tax reliefs since many firms from countries do not have this regulation.

An interesting aspect of this whole complex mass of interrelated problem is that the Swedish government actually finds it strenuous that their energy measures are considered as state aid, even though it is compatible state aid under Article 87(3)(c). The point is that, as long as the measures falls under the provisions of Article 87(1), all changes of *significant* value has to be notified to the Commission, which means a decreased flexibility. It is therefore the Swedish government now is making plans for a new energy taxation scheme which cannot be considered as state aid.<sup>137</sup>

## 8.5 Conclusion

So, have environmental considerations been taken into account with regard to the State aid regulation? There are actually no legal arguments for the Court and the Commission to take environmental considerations into account in applying the competition rules addressed at Member States. There are for example no references to environmental considerations in Article 87(3) EC, but that has nevertheless not kept the Commission from exempting state aids on exclusively environmental grounds. The Commission seems furthermore to be more lenient for environmental justifications brought forward by Member States, compared to its' approach to environmental considerations forwarded by undertakings. The different treatment is probably due the Commissions perception of environmental policy. According to this approach environmental policy is to be conducted by Member States authorities and not primarily the matter of private companies.

The role of environmental concerns in EC competition law therefore differs widely between the various provisions. Vedder is of the opinion that environmental considerations have been taken with regard to Article 87 and environmental aid. He argues this position firstly by saying that these concerns can allow for an exemption on the basis of Article 87(3)(c). Secondly, that the Commissions practise concerning operating aid is clearly aimed at bringing about an internalisation, by recognising that some compensations may be necessary in order to make the internalisation process acceptable in the first place, but also by limiting the

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<sup>137</sup> SOU 2003:38

duration of the compensation. Thirdly, environmental benefits can themselves warrant an exemption. More stringent national rules almost always give right to an exemption and therefore a right to aid.

Does this mean that environmental considerations are always taken into account in the State aid regulation? Maybe not. There are environmental considerations in the regulation, but I think the considerations are limited to those environmental issues that are considered as most important today. Such areas are for example the climate change and the Kyoto protocol. The objectives of European environmental law is listed in the first paragraph of Article 174 and it refers to the preserving, protecting and improving the quality of the environment, protecting human health, prudent and rational utilisation of natural resources and promoting measures at international level to deal with regional or world-wide environmental problems. These objectives are the same as the ones stipulated in the sixth Environmental action program, which aim is to contribute to a global reduction in emissions of greenhouse gases, to work towards a high quality of life as well as to improve resource efficiency in order to spare natural resources. I therefore suspect that other environmental considerations besides the ones regarding climate change are somewhat neglected. Support for this opinion might be found in the increased amount of aid granted to the energy sector, whether in support of energy saving or to promote the use of new or renewable sources of energy.<sup>138</sup>

Despite some uncertainties, I believe that environmental considerations are to an ever increasing extent being integrated into the EC state aid regulation.

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<sup>138</sup> 2001 Guidelines, point 27

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