

State Aid Given by Local Government Which Distorts Competition

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Abstract

The Albanian local government has a financial autonomy that is guaranteed by the Constitution and other important legal acts. This implies the right to grant subsidies, loans, define rates of taxes, to sale land or to exercises other rights in the ambit of their financial authority. On the other hand, part of the Stabilization and Association Agreement (SAA) Albania has with the European Union, is the prohibition of state aid that distort competition. Article 71 of the SAA states that any state aid contrary to this agreement shall be assessed on the basis of criteria arising from the application of Article 87 of the EC Treaty and the interpretative instruments adopted by the EU institutions for the application of Article 87 of the EC Treaty. The right interpretation of the notion of state aid that distorts competition, as developed by the European Court of Justice and EU Commission's documents, should be taken into consideration in order to avoid that, the local government, in exercising the financial authority would grant an aid that distort competition and infringe the Stabilization and Association Agreement.

Keywords: local government , financial autonomy, taxes, sales, state aid.

Introduction

One of the main principles of local government is the principle of subsidiary, *i.e.* effective governance nearer the people. The local authorities governed by this principle may give aid to some enterprises that are in difficulty by giving them subsidies, because it deems these enterprises to be important for the development of the region, or because they may concern an R&D project. Local authorities may finance an enterprise or undertaking that is engaged in cultural activities, or in the conservation of regional or national heritage. On the other hand, the aid given by the local government may distort competition between undertakings and businesses, by favouring a selected undertaking or business over others. The aid given by local authorities may also affect trade by increasing the production of certain products, namely those produced by the undertaking the recipient of the aid, to the detriment of others. The aim of this paper is to set out some general guidelines on finding equilibrium between local government intervention in the businesses of the region it controls and state aid rules. The paper is divided

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into two parts and each part into two main subsections. In the first part the Albanian legal framework on financial autonomy of local government and the legal framework that prohibits state aid that distort competition will be analysed. In the second part the legal framework of the European Union and the European Court of Justice's jurisprudence on state aid will briefly be analysed, as will two cases relating to state aid given by local government.

A. The Albanian Legal Framework on the Financial Autonomy of the Local Government and State Aid

I. The Albanian Legal Framework on the Financial Autonomy of the Local Government

The Albanian Constitution of November 1998 provided a special chapter on local government and important principles of its functions, powers and its relationships with other institutions, mainly the public administration. Article 108/1 of the Albanian Constitution provides that local government in the Republic of Albania is based on the principles of the decentralization of power and local autonomy. Article 108/3 defines communes and municipalities as the basic units of local government.

In 1999 Albania ratified the *European Charter for Local Autonomy*,¹ which provided some legal principles as well as guarantees for the political, legal, administrative and financial autonomy of local governments. In January 2000, the government approved the *National Decentralization Strategy*. The objective of this strategy is to take full advantage of the opportunity provided by the new Constitution to create, promote and implement a new vision of local government. Some of the main objective areas covered by this Strategy were the Framework of local government organization, central-local government fiscal relations, the operation of local public property and enterprises etc. In the same year the Law "*On the Organization and Functioning of Local Government*", No. 8652, dated 31 July 2000 (hereinafter referred as the Law on Local Government), was enacted. Its objective is to create a functional system by determining clearly four components of local government: functions and responsibilities, finances, properties and organizational structures. This law has important provisions on the principles governing local governments (municipalities/communes and regions), explains the typology of the local government functions (exclusive, shared, delegated), has articles on the financial authority of local governments (*i.e.*, budgeting and fiscal), internal organization and allocation of authority, territorial reorganization of local governments, and concludes with a timetable for implementation of the law.

Article 8 of Law on the Local Government sets out the exclusive rights of the local government, from which it can easily be discerned that most of them are of a financial nature. Thus, the local government has:

1 Law No. 8548 "On the ratification of the European Charter of Local Autonomy", dated 23 November 1999, Official Journal 32, p. 1230.

1. *Property rights.* Here are included the right to exercise property rights, the right to purchase, sell or rent its movable and immovable property or use its property, as well as to exercise other rights in the manner set out in the law. The property rights are exercised by the respective regional council, and they may not be delegated to anybody else.
2. *Right to fiscal autonomy.* Local governments may obtain revenues and make expenditures relating to the execution of their functions. Local government units have the right to set taxes and fees in compliance with the legislation in force and the interest of the community. Local governments have the right to adopt and carry out their budgets.
3. *Economic development rights.* Local governments have the right to undertake any initiative for economic development in the interest of their residents, provided that these activities do not run counter to the fundamental direction of economic policies of the State. The major part of revenues from the economic activities of local governments shall be used to support the carrying out of public functions. The economic activity of local government units is regulated by legislation on economic activities.

Article 10 of the Law on Local Government sets out the exclusive rights of the local government. In point II of this article we can see the rights of a financial nature, under the label “Local Economic development” rights. Here are included the preparation of programmes for local economic development; the regulation and functioning of public market places and trade networks; small business development; as well as the carrying out of promotional activities, such as fairs and advertisement in public places; the performance of services in support of local economic development, such as information, necessary structures and infrastructure; veterinary services; and the protection and development of local forests, pastures and natural resources of a local nature.

Furthermore, Chapter V of the Law, including Articles 15 to 22, is dedicated to local government finance. Article 15, beyond sanctioning the principle of the fiscal self-sufficiency of local governments guaranteed by the national fiscal policy, provides the technical measure for the achievement of this important principle, which is developed further in other articles in this Chapter. Thus, it provides that local governments have the right to adopt, carry and administered annually, but in compliance with Law No. 8379, dated 29 July 1998 “*On the drafting and execution of the State Budget of the Republic of Albania*”. Local government units are financed by the revenues from locally derived taxes and fees, funds transferred from central government and funds derived from shared national taxes, which are provided for by law. Meanwhile, to meet the requirements for the provision of shared and delegated functions, the central government is obliged to provide local governments with funds that are sufficient for the achievement of these functions.

Then Articles 16, 17 and 18 of the Law on Local Government provided for three main important means of financing local government, respectively by revenues derived from the municipalities and communes, revenues derived from national sources, and revenues derived from the regions. Two main revenue

streams derived from the municipalities and communes are *local taxes*, such as local taxes and levies on movable and immovable property, as well as on the transactions conducted on the basis of them; local taxes and levies on the economic activity of small businesses and on hotel residency, restaurants, bars and other services; local taxes and levies on personal income derived from donations, inheritances, wills, and from local lotteries, and *local fees*, *i.e.* fees for the public services offered by them; fees for the right to use local public property; or fees for the the issuing of licences, permits, authorizations and the issue of other documentation, at the discretion of local government.² The Law on Local government gives wide discretion and autonomy to the communes and municipalities to set the level of local fees, and determine the manner of collection of local tariffs and their administration in compliance with policies and general principles defined in the normative acts of central government.³

Lastly, it is important to mention that the financial autonomy of Local Government in Albania is supported by a wide range of other laws, such as Law No. 8435 dated 28 December 1998 On the Tax System in the Republic of Albania, Law No. 8334 dated 13 May 1998 On some amendments to the Law No. 7805, Law No. 8713 dated 15 December 2000 On Amendments to the law 8435 dated 28 December 1998, Law No. 8560 dated 22 December 1999 On Income Tax Procedures in the Republic of Albania, Law No. 8511 dated 15 July 1999 On Amendments to law 7805 dated 16 March 1994, Law No. 7805 dated 16 March 1994 On the Property Tax in the Republic of Albania, Law No. 7930 dated 11 May 1995 On Amendments to law 7805 dated 16 March 1994 *et al.*

We may conclude by saying that the financial autonomy of local government is well sanctioned and guaranteed by an accurate and broad legal framework, which enables local governments to finance themselves and have an independent budget for achieving their legal duties and objectives. Anyhow, experts have provided evidence of difficulties in the proper implementation of the legal framework, linking this with the low capacities of government at the local level, with the lack of sufficient resources in most communes, particularly in the mountainous rural areas, with the tendency of wealth to concentrate in a few, large urban areas, with poor citizen participation in community affairs, with the strong dominance of political interests over the community interest, and with a strong tradition of a centralized state.⁴ There is still much to do, and the raising of the capacities of local government is an important objective for attaining the standard of decentralization of a European democratic state.

II. *The Albanian Legal Framework on State Aid*

Albania has entered into international obligations regarding the granting of state aid in the country, its monitoring, and international reporting. The international agreements which have so far served as a legal basis for Albania in administering

2 The Law on Local Government, Art.15/2, 15/3.

3 The Law on Local Government, Art.15/4.

4 "Local Government Budgeting: Albania", Alma Gu rraj, Artan Hoxha, Auron Pasha, Genc Ruli, Qamil Talka, Irma Tanku, Tirane , p. 146.

state aid are the EU-Albania Stabilisation and Association Agreement (hereinafter referred as the SAA),⁵ the November 2007 European Partnership Decision,⁶ the WTO Subsidies and Countervailing Measures Agreement⁷ and the CEFTA (2006) Agreement.⁸ Albania being a state with a fragile market economy, the implementation of state aid measures is important so that it can comply with the best international trade practices and principles, and particularly with the rules of the European Union, the market of which we aim to be integrated with in the near future.

Article 71 of the SAA, "Competition and other economic provisions", deals with the full application in Albania of EC Treaty rules on state aid. In essence, it requires Albania (after a specified transitional period) to apply EU rules and regulations in the area of state aid in full. The main provisions of Article 71 of the SAA pertaining to state aid can be summarised as follows:

1. Any state aid which distorts or threatens to distort competition by favouring certain undertakings or certain products is incompatible with the SAA in so far as such state aid *may affect trade* between the EU and Albania;
2. Any state aid contrary to Article 71 shall be assessed on the basis of criteria arising from the application of Article 87 of the EC Treaty and the interpretative instruments adopted by the EU institutions for the application of Article 87 of the EC Treaty;⁹

In compliance with its international obligations, Albania has enacted a full legal framework regarding state aid. Law No. 9374, of 21 April 2005 "On State Aid" (hereinafter referred as the Law on State Aid), amended in 2009, and three implementing regulations,¹⁰ approved by the Council of Ministers decisions since January 2006 regulate the subject.

The Law "On State Aid" provides for the establishment of responsible structures for controlling state aid in Albania – the State Aid Department (SAD in the Ministry for Economy, Trade and Energy (METE) and the State Aid Commission

5 Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Albania, of the other part, signed on 12 June 2006 and entered into force in 1 April 2009. Interim Agreement on Trade and trade-related matters between the European Community, of the one part, and the Republic of Albania, of the other part, OJ L 239 of 1 September 2006, was in force from 2006 until the SAA came into force.

6 EU Council Decision on the principles, priorities and conditions contained in the European Partnership with Albania and repealing Decision 2006/54/EC, COM(2007) 656 final of 6 November 2007.

7 Subsidies and Countervailing Measures Agreement, 1994: GATT Secretariat (1994): The Results of the Uruguay Round of Multilateral Trade Negotiations, the Legal Texts, Geneva, "Subsidies and Countervailing Measures Agreement", pp. 264-314.

8 Central and Eastern Europe Free Trade Agreement (2006) – Agreement on Amendment of and Accession to the Central European Free Trade Agreement (CEFTA 2006) at <www.stability-pact.org/wt2/TradeCEFTA2006.asp>.

9 Decision of the Council of Ministers, No. 630, date 11/06/2009 "On Approval of State Aid Annual Report 2008", Official Journal 107, p. 5239.

10 The Regulation on procedures and notification forms, the Regulation on regional aid and the Regulation on rescue and restructuring aid.

(SAC). The legal tasks of the State Aid Department and the State Aid Commission's competences, together with their operational reporting responsibilities, constitute an approach that ensures the operational independence required by Article 71, point 4 of the Stabilisation and Association Agreement during the transitional stage (Art. 37, point 4, of the Interim Agreement).¹¹

The State Aid Commission was formally established by Council of Ministers Decision No. 182 of 21 March 2006. The State Aid Commission, composed of five members and chaired by the minister in charge of economic affairs, is the decision-making body for state aid. The Commission is responsible for assessing and authorizing state-aid schemes and individual aid on the basis of proposals from the State Aid Department of the METE. Providers must notify the State Aid Department of any plan to grant state aid, the State Aid Commission must give its approval before any aid can be granted. The Commission's decisions must be taken within sixty calendar days following the receipt of a completed notification. If the Commission finds the aid to be unlawful, it can issue an injunction to suspend the aid and order the recovery of any payment made to the beneficiary. The amount recovered, together with interest, is added to the budget of the aid provider. Furthermore, the Law On State Aid obliges all aid providers to report to the Department all existing aid schemes within six months of their entry into force. The authorities indicate that these schemes are notified, listed, and assessed by the State Aid Commission, which takes a decision in each case with respect to compatibility with the Law. The overall report on the inventory of state-aid schemes was approved by Council of Ministers Decision No. 45 of 16 January 2008.

The State Aid Department was established by Prime Ministerial Order No. 79, of 26 March 2004. The general tasks of the Department include drafting the legal framework (including any future amendments, new regulations, guidelines, etc); identifying and analysing the economic and legal aspects of state aid schemes and individual aids, as well as preparing all investigative reports for particular cases and providing input into the decision-making of the SAC by means of policy analyses on the compilation and development of regional and sectoral policies.¹²

For the further approximation of Albanian legislation with the *acquis*, some changes were made to Law No. 9374, dated 21 April 2005. Law No. 10 183, dated 29 October 2009 "On some changes and amendments to law 9374, dated 21 April 2005 "On State Aid" (hereinafter referred to as the "New law on State Aid"), which reflect some of the developments in EU state aid policy during the period 2005-2009, and consist of changes in the intensity of state aid regarding training and workers in difficulty or with disabilities by applying the same values set out in the Regulation No. 800/2008 EC.

11 Decision of the Council of Ministers of Albania, Nr. 1023, date 09 July 2008, "On Approval of State Aid Annual Report 2007", Official Journal 120, pp. 5291-5292.

12 Decision of the CoM, No. 1023, *supra*, p. 5292. In 2008, SAC approved the guideline "On state aid in the form of public service compensation" and "On the methodology used for analysing standard costs in granting state aid, specifically for short term export credit insurance" for the better application of its competences provided in the Law on State Aid.

Since the legal framework on state aid is obligatory not only for the central government and its entities, but also for local government, and due to the fact that this legal framework is drafted and should be implemented in accordance with the European Union framework on state aid and its practice, knowledges of the last is deemed necessary. This is the reason the second part of this paper will be an overview of the EU's legal framework on state aid, supplemented by practical cases when state aid is granted by a local authority.

B. The EU Legal Framework and Practice on State Aid Granted by Local Authority

I *The Notion of State Aid: The Test Consisting of Five Indicators*

The main provision in the EC Treaty dealing with the control of state aid is Article 87 EC, which specifies a two-stage approach. First, with a view to establishing *jurisdiction*, one must assess whether a specific state measure constitutes "state aid" within the meaning of Article 87(1). Only such state measures are subject to EU state aid control. Secondly, there is the assessment of *compatibility*, to assess whether the aid measure can be allowed under the provisions of the EC Treaty.¹³ Article 87(1) of the Treaty reads:

"Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market."

Academics, basing themselves on the ECJ's jurisprudence, have articulated 5 criteria to identify whether a state aid is within the ambit of Article 87(1) EC Treaty:¹⁴ (i) aid must be granted by the state or through state resources; (ii) that aid must confer an advantage on the recipients; (iii) the advantage must favour certain (selected) undertakings or economic activities; (iv) the aid must affect trade between Member States; and (v) the aid must distort competition in the common market. The general assessment is that these criteria are cumulative in nature, which means that they must all exist together in order for a state aid to be held incompatible with the Treaty.

1. *Aid Must Be Granted by the State or by Means of State Resources*

The concept of "Member State" in Article 87(1) EC has been broadly interpreted. The ECJ in Case 248/84, *Germany v. Commission*, held that even aid granted by regional and local bodies of the Member States, whatever their status and their

13 H.W. Friederiszick, L.-H. Röller & V. Verouden, *European State Aid Control: An economic framework*, MIIT Press, 28 September 2006, p. 3

14 P. Nicolaidis, M. Kekelelis & M. Kleis, "State Aid policy in the European Community", *Principle and Practices*, 2nd ed, International, 2008, p. 10; P. Graig, cited in note 7; G. Tessauro, *Diritto Comunitario*, CEDAM, 3rd ed., 2003, p. 747.

description, is considered state aid for the purpose of the application of the EC Treaty.¹⁵ This interpretation stems from the fact that Community law is not concerned with the internal organization of a Member State and the distribution of power therein; whether it is a federal state or a unitary state, a Member State has the obligation to secure the application of the Community provisions in its territory and to respect and follow the Community's objectives. The same *ratio* applies regarding the relationship between Community law and the Member States' regulations on state aid. The application of Article 87 EC could be interfered with if respect for this provision were to rely only on the central administration. If regional and local bodies were to grant aid irrespective of the proviso to Article 87, the application of Community law on state aids would never be universal within the European Community.¹⁶

The Court went further in its judgment C-78/76, *Steinike and Weinlig*, where it held that it was not necessary to distinguish between aid that was granted directly by the state or indirectly by public or private bodies established or appointed by the state to administer the aid.¹⁷ This means that Article 87(1) applies to aid that is granted at the discretion of the state and covers the transfer of resources without its being necessary to make a distinction between whether the aid is granted by the agents of the state or by enterprises controlled by the state, or the state itself.¹⁸ The term "aid granted by the State" is very broad, and it covers public or private bodies which are directly or indirectly connected with the state, because the latter is present on their governing boards, or because the state possesses its own shares in them, or because the state has a power of surveillance over them, and the aid must still be 'imputable' to the state. This 'set of indicators', supplemented by criteria such as the undertaking's integration into the structures of the public administration, the nature of its activities and the exercise of those activities on the market in normal conditions of competition with private operators, the intensity of the supervision of the public authorities over the management of the undertaking, 'or any other indicator showing, in a particular case, an involvement by the public authorities in the adoption of a measure or the unlikelihood of their not being involved',¹⁹ is mentioned by the ECJ as elements that determine that the aid is imputable to the state.

On the other hand, in order for there to be a transfer of public resources the measure should have an impact on the budget of the public authority, or it should affect the assets or liabilities of a public authority. In other words aid must have budgetary consequences for the government.²⁰ The advantage conferred by the

15 Case 248/84, *Federal Republic of Germany v. Commission*, 1987, ECR 4013, para. 17.

16 Even in the First Report on Competition Policy in 1971, the Commission stressed that "the local authorities can often grant such aid, which is also State aid within the meaning of Art. 92 of the EEC Treaty".

17 Case 78/76, *Firma Steinike und Weinlig v. Federal Republic of Germany* [1977] ECR 595, para. 21.

18 Case C-290/83, *Commission v. French Republic*, 1985 ECR 439, at para. 14.

19 W. Sauter & H. Schepel, 'State' and 'market' in the competition and free movement case law of the EU courts, Tilburg university, 2007, p. 176.

20 Nicolaides *et al.*, 2008, p. 12.

state in order for aid to be counted as such must be supported by state resources not only in terms of actual but also of potential financial liabilities. This means that it is not only the reduced budget of the state that should be taken into account to determine that there has been a transfer from state resources, but also its potential reduced budget; for example, a loss in tax revenue is synonymous with public spending in the form of tax expenditure.²¹ Somewhat contrary to the precise wording of the Treaty, the ECJ's jurisprudence has made it clear²² that "aid granted by the state *and* through transfer of state resources" are cumulative and not alternative requirements.²³ As results from the case law these are two separate and cumulative conditions: *the measure must be imputable to the state,*²⁴ *and it must entail a transfer of state resources.* If only one of these conditions is met, the measure will not be considered state aid.

2. Aid Must Confer an Advantage on the Recipient

Regarding the notion of "advantage", the ECJ ruled that the concept of aid covers a wide range of measures, such as subsidies, grants, loans or guarantees given by the state. Thus, in general terms, aid constitutes an advantage conferred on an undertaking by the public authorities without payment or against a payment which corresponds only to a minimal extent to the figure at which the advantage can be valued (*positive intervention*). A definition of this kind covers the allocation of resources and the grant of relief on charges that the firm would otherwise have to bear, enabling it to make a saving (*see Case C-290/83, Commission v. France* above). Furthermore, even those measures that mitigate the charges an undertaking would normally bear, such as the supply of goods or services at a preferential rate or loans and dividends on invested public capital, a reduction in social security contribution, tax exemptions, as well as anything the state gives up without objective reason, such as products and services it sells at excessively low prices, and anything the state gives away without objective reason, such as products and services it purchases at excessively high prices, would be considered state aid

21 See Commission notice on the application of State Aid rules to measures relating to direct business taxation, OJ C 384, 10 December 1998, para.10.

22 For the matter of fact the ECJ case law on this issue has been controversial. First in *Van Tiggele* the ECJ required the existence of a financial burden on the public budget in order for there to be a breach of Art. 87(1). Then in Case 290/83, *Commission v. French Republic*, Case C- 57/86 *Hellenic Republic v. Commission*, and Case C-387/92, *Banka di Credito Industrial* the Court took the opposite view and held that a measure may constitute aid within the meaning of Art. 87 (1) although it did not involve a transfer of State resources. Further, starting from *SlomanNeptun*, following with *Kirsammer-Hack*, *Viscido*, *Ecotrade* and *Piaggio*, and especially *PreussenElektra*, the Court affirmed that the criterion of aid "granted by the State" goes together with the "through state resources"-criterion. For further information see F. Caka, *The State aid and Competition: An analysis of the Albanian legislation and practise on state aid in the light of article 87 of the treaty of European Union*, Master's Thesis, January 2011.

23 F. Wishlade & R. Michie, "Pandora's box and the Delphic oracles: EU cohesion policy and state aid compliance", European Policy Research Paper, 2009, p. 5.

24 Formally, the Community's resources are not State resources; however the legal service of the Commission has confirmed that once the Structural Funds come under the control of Member State, they become state resources and the decision on how they are used are attributable to the State. See Wishlade 2009, note 43.

under Article 87(1) (so-called *negative intervention*).²⁵ Furthermore in *Danske Busvognmaend v. Commission*²⁶ the ECJ ruled:

“Article 87(1) EC is aimed merely at prohibiting advantages for certain undertakings and the concept of aid covers only measures which lighten the burdens normally assumed in an undertaking’s budget and which are to be regarded as an economic advantage which the recipient undertaking would not have obtained under normal market conditions.”

As in other areas of Community law, the European Court has taken an effects-based approach. A measure will be deemed to be an “advantage” pursuant this article when it improves the position of the undertaking in comparison with its competitors, or when it lightens the budgetary burdens which the undertaking would be obliged to bear in normal market conditions. Moreover, the Court found that if the *effect* of a particular measure was to benefit a particular undertaking or category of goods, then it should be regarded as an aid, even if a benefit was *not* the primary intention of the measure.²⁷

3. *The Advantage Must Favour Certain (Selected) Undertakings or Economic Activities*

Aid is selective if it applies to a particular type of activity, a sector of the economy, a particular geographical area or to firms with the same characteristics (such as small and medium-sized enterprises).²⁸

M. Aldestam labels the selection criteria as material selectivity, geographical or other criteria of selectivity. Material selectivity is considered to be an aid addressed to certain sectors, or aid with the effect of benefiting certain sectors, specific undertakings, or undertakings in a certain industry. The Court²⁹ and the Commission³⁰ have made it clear that even an aid programme which covers the whole economy of a Member State can fall within the ambit of Article 87(1); geographical selectivity is considered an aid addressed to certain undertakings in a specific region or in a selected area. Other selectivity criteria, *i.e.* aid granted to a group of undertakings receiving aid, may have other features in common than belonging to the same sector or being situated in the same region.

25 See Nicolaides *et al.*, 2008, p. 21-22 and P. Craig & G. de Burca, *EU Law, Cases and Materials*, Oxford University Press, 2008, p. 1087, G. Tessauro, 2003, p. 747.

26 Case T-157/01, *Danske Busvognmaend v. Commission*, 2004 ECR II-917, para 57.

27 F. Wishlade, “When are state tax advantage state aid and when are they general measures”, Regional and Industrial Policy Research Paper, Number 20, European Policies Research Centre University of Strathclyde, Glasgow, United Kingdom, June 1997, p. 7.

28 Wishlade, 1997, p. 10.

29 Case 248/84, *Federal Republic of Germany v. Commission* [1987] ECR 4013, para. 18; Case C-143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten* [2001] ECR I-8365.

30 Commission Decision concerning Case E/1/98 of 18 December 1998 regarding a proposal for appropriate measures under Art. 93(1) of the EC Treaty concerning the International Financial Service Centre and Shannon customs-free airport zone, OJ C 395, 18 December 1998, pp. 14-18.

4. *Aid Must Affect Trade Between Member States*

According to the case law of the Court, when state financial 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.³¹ The effect of Community intra-trade could be defined as an artificial decrease in the imports, or an artificial increase in the exports, or vice versa, as a decrease in the exports and an increase in the imports of the undertaking that receives the state aid in comparison with its competitors. Thus, it refers to a situation in which the competitive position and the intra-trade exchange of goods and services for the undertaking which receives the state aid are increased and are decreased for the other competitors that do not receive this state aid.³²

However, as in other disciplines of law, in the ambit of state aid, too, the principle *de minimis non curat lex*” comes into play. For this reason the Commission is engaged in drafting guidelines on the thresholds below which and other conditions in which aid is deemed to be *de minimis* and as such be excluded from the application of Article 87(1).³³

5. *Aid Must Distort Competition in the Common Market*

The Court in *Belgium v. Commission* stated that “competition is distorted, if the aid in question strengthens the competitive position of the recipient...in relation to its rivals”.³⁴ This means that the Court will consider the position of the relevant company prior to the receipt of the aid, and, if this has been improved, then Article 87 will have been met.³⁵ It is irrelevant that the aid recipient may have suffered from other disadvantages and that the aid merely sought to alleviate those disadvantages.³⁶ Thus, the distortive effects are assessed, even in cases when the aid does not in absolute terms improve the position of the undertaking with respect to its competitive position, but rather puts the beneficiary undertaking into an equal position with the other undertakings which operate in other Member States of the Union.³⁷

Furthermore, the article catches even those measures that “threaten to distort competition”, so every state measure that actually or potentially distorts

31 Case 730/79, *Philip Morris v. Commission* [1980] ECR 2671, para. 11.

32 See Baudenbacher, *op.cit, ibid.*

33 See Commission Regulation (EC) No. 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid, Official Journal L 379, 28 December 2006.

34 Case 234/84, *Belgium v. Commission*, 1986 ECR 2263, para. 22.

35 See Craig & De Burca, 2008, p. 1092.

36 See Nicolaides *et al.*, 2008, p. 40, para. 4.

37 In Case 173/73, the Court assessed as incompatible an aid designed to reduce the social charges on employers in the textile industry, even though the State alleged that in this way the undertaking was put into the same position as its competitors, which were not subject to this social burden. AG Warner, in his opinion stated that it is sufficient that the reduction in costs due to the reduction in social charges has improved the competitiveness of the undertaking and distorted competition.

competition in trade between Member states will be contrary to the Treaty.³⁸ The provision, by considering as incompatible with the Treaty also those measures that threaten to distort competition, prohibits all measures which, even though by their own characteristics could not alter normal competition, are capable of altering it. This does not mean that there is any general assumption on the basis of which any measure is automatically incompatible with the Treaty, so far as it grants an advantage to the undertaking; but it should rather be examined for its effect on competition, and for whether it has altered or may alter the normal conditions of competition between undertakings. The Court of Justice has clearly stated that the Commission has the obligation to prove, case by case, that public intervention in favour of an undertaking has in fact or may have genuinely distorted competition.

II. *Financial Autonomy and State Aid*

1. *State Aid and Tax Reduction*

This part of the paper aims to analyze how the scope of financial autonomy of the local government, or other infra-state entities in a Member State, can be limited by the rules of state aid. Local government can reduce taxes in a territory or sell and buy land, by giving an advantage to specific undertakings or sectors that lay in its jurisdiction, but this can amount in geographical selectivity, which is prohibited by Article 87(1) EC.

Article 87(1) EC prohibits state aid “favouring certain undertakings or the production of certain goods” in comparison with others which are in a legal and factual situation that is comparable in the light of the objective pursued by the measure in question: that is to say, selective aid. In assessing the selectivity of a measure it is important to determine the reference framework where the undertakings operate, i.e. whether the reference framework is the whole territory of a Member State, or a particular geographical area within the Member State. This has a particular importance in the case of a tax measures, since the very existence of an advantage may be established only when compared with ‘normal’ taxation levied on undertakings operating in similar legal and factual conditions. Case C-88/03, *Portuguese Republic v. Commission of the European Communities (Azores)*, is a landmark case in this regard because it draws important guidelines in defining the framework reference in cases of aid given by infra-state entities and whether a measure taken by a infra-state body is selective or not.

38 In Case C 148/04, *Unicredito Italiano v. Agencie delle Entrate*, 2005, ECR, para. 54 the Court stated, “Article 87 (1) EC provides that the threat of distortion of competition is sufficient. It is not therefore necessary to establish that the aid has a real effect on trade between Member States and that competition is actually being distorted, but only to examine whether the aid is liable to affect such trade and competition”.

In the *Azores*³⁹ case, the legislative body of the Azores Region enacted a regional legislative decree⁴⁰ adapting the national tax system to the region's specific characteristics. Decree No. 33/99/A included, in particular, a section concerning reductions in the rates of income and corporation tax. Those reductions were applied automatically to all economic operators, and they were intended, inter alia, to allow undertakings in the Azores to overcome the structural handicaps resulting from their location on islands on the periphery of the Community. For that purpose, all entities subject to income or corporation tax in the Azores Region enjoyed a reduction in the rate of personal income tax of 20% (15% for 1999) and a reduction in the rate of corporation tax of 30%.⁴¹ The question posed here is whether the aid given by the state, in this case the local government, was selective in character and as such contrary to Article 87(1) EC. The Court held the determination whether a constituted selective aid required an examination of whether that measure constituted an advantage for certain undertakings in comparison with others which were in a comparable legal and factual situation. In this connection the Court stated:

“Thus, in order to determine the selectivity of a measure adopted by an infra-State body which seeks to establish in one part only of the territory of a Member State a tax rate which is lower than the rate in force in the rest of that State it is appropriate to examine whether that measure was adopted by that body in the exercise of powers sufficiently autonomous vis-à-vis the central power and, if appropriate, to examine whether that measure indeed applies to all the undertakings established in or all production of goods on the territory coming within the competence of that body.”⁴²

Thus the Court clearly held that the reference framework in cases of regional measure is not the territory of the Member State as a whole, but rather the geographical area when the infra-state entity exercises its power, provided that the infra-state body that adopted the measure is sufficient autonomous from the central government.

To reach a conclusion on the autonomous powers of an infra-state body to reduce taxes in a certain territory, the Court, based on the reasoning of the Advocate General, stipulated three criteria:

1. The decision must, first of all, have been taken by a regional or local authority which has, from a constitutional point of view, political and administrative status separate from that of the central government. (institutional autonomy)

39 Case C-88/03, *Portuguese Republic v. Commission of the European Communities*, 26 September 2006, ECR I-07115

40 Regional Legislative Decree No. 2/99/A of 20 January 1999, as amended by Regional Legislative Decree No. 33/99/A of 30 December 1999, hereinafter referred as 'Decree No. 2/99/A'.

41 Case C-88/03, *Portuguese Republic v. Commission of the European Communities*, paras. 13-14.

42 Case C-88/03, *Portuguese Republic v. Commission of the European Communities*, para 62.

2. Next, it must have been adopted without the central government being able directly to intervene as regards its content. (procedural autonomy)
3. Finally, the financial consequences of a reduction in the national tax rate for undertakings in the region must not be offset by aid or subsidies from other regions or central government (financial autonomy).⁴³

The Court ruled that, although the Constitution of the Portuguese Republic guaranteed to the autonomous region of the Azores its own political and administrative status and its own self-government institutions which have the power to exercise their own fiscal competence and adapt national fiscal provisions to regional specificities,⁴⁴ the two other conditions cited above had not been fulfilled. The Court held that the decision to reduce the regional tax burden by exercising its power to reduce tax rates on revenue and the fulfilment of its task of correcting inequalities deriving from insularity were inextricably linked and depended, from the financial point of view, on budgetary transfers managed by central government,⁴⁵ and thus affirmed that the reductions in the tax rates at issue were selective.⁴⁶

2. *The Sale of Land of Public Authorities and Methods of Price Calculation*

During its investigations into state aid, on a number of occasions in recent years the Commission has dealt with sales of publicly owned land and buildings in order to establish whether there was an element of state aid in favour of the buyers. In order to make transparent its general approach with regard to the problem of state aid through such sales and to reduce the number of cases it has to examine, in 1997 the Commission adopted a Communication on state aid elements in sales of land and buildings by public authorities.⁴⁷ This Communication specifies conditions under which the sale of land and buildings by public bodies does not involve state aid: this is the case when the transaction is at a price that conforms to the market value, calculated on the basis of normal economic activity.⁴⁸ The Communication sanctions four main principles on this regard: principles for sales through an unconditional bidding procedure, sales without an unconditional bidding procedure, the principle of notification, and finally a principle on the review of the complaints regarding the sale of land and state aid.

The Communication distinguishes between two basic principles: sale via an 'unconditional bidding procedure' (an *open, non-discriminatory and unconditional contracting procedure*) and sale without this unconditional bidding procedure. Under the first principle, the bidding procedure ensures that the sale takes place

43 Case C-88/03, *Portuguese Republic v. Commission of the European Union*, paras. 66-67.

44 Case C-88/03, *Portuguese Republic v. Commission of the European Union*, para. 70.

45 Case C-88/03, *Portuguese Republic v. Commission of the European Union*, para. 77.

46 See also Case C-211/04, *Gibraltar* and Joined Cases C-428/06, C-434/06, *UGT-Rioja et al.*

47 Commission Communication on State aid elements in sales of land and buildings by public authorities (97/C 209/03), OJ C 209, 10 July 1997.

48 Dr. Ir. D.A. Groetelaers, Dr. M.E.A. Haffner, Drs. H.M.H. van der Heijden, Prof. Dr. W.K. Kort-hals Altes & Dr. T. Tasan-Kok, *Providing cheap land for social housing: Violation of state aid rule of Single European Market?*, OTB Research Institute for Housing, Urban and Mobility Studies of the Delft University of Technology, The Netherlands, p. 3.

at the market price; under the second, a valuation is required in order to arrive at a market price.⁴⁹ Thus, a sale of land and buildings following a sufficiently well-publicised, open and unconditional bidding procedure, comparable to an auction, accepting the best or only bid is by definition at market value and consequently does not contain state aid.⁵⁰ If public authorities intend not to use this procedure, an independent evaluation should be carried out by one or more independent asset valuers prior to the sale negotiations in order to establish the market value on the basis of generally accepted market indicators and valuation standards. The market price thus established is the minimum purchase price that can be agreed without granting state aid.⁵¹ Furthermore, for sales without an unconditional bidding procedure the Communication has provided a margin of appreciation and special obligations and the possible costs of the state authorities.⁵²

Regarding the application of this Communication to local authorities we can refer to Dr. Ir. D.A. Groetelaers *et al.*:

“It may therefore be concluded that the European regulations on competition and state aid apply if a municipality fails to employ market prices for land it buys, sells, leases or rents out. The Communication appears to be directed principally towards the sale of government property, and not the issue of land on which to build. According to the Communication, then, there are only two methods by which a market price for a land supply can be determined: an unconditional bidding procedure, or a valuation”⁵³

A recent case that interpreted this Communication was Case C-239/09, *Seydaland Vereinigte Agrarbetriebe v. BVVG (Seydaland)*.⁵⁴ The applicant was a company operating in the agro-industrial sector. By contract dated 18 December 2007, BVVG⁵⁵ sold land for agricultural use to Seydaland. The total selling price was € 245,907.91, of which agricultural land accounted for € 210,810.18. As it considered that the price it had paid was excessive, Seydaland sought reimbursement of part of the selling price of the land, claiming that, calculated on the basis of the

49 *Ibid.*

50 Commission Communication on State aid elements in sales of land and buildings by public authorities (97/C 209/03), OJ C 209, 10 July 1997, p. 2.

51 Commission Communication on State aid elements in sales of land and buildings by public authorities (97/C 209/03), OJ C 209, 10 July 1997, p. 3.

52 Thus for example the Communication states that if, after a reasonable effort to sell the land and buildings at their market value, it is clear that the value set by the valuer cannot be obtained, a divergence of up to 5 % from that value can be deemed to be in line with market conditions. If, after a further reasonable time, it is clear that the land and buildings cannot be sold at the value set by the valuer less this 5 % margin, a new valuation may be carried out. For costs and other obligations see further Commission Communication on State aid elements in sales of land and buildings by public authorities, *supra*, pp. 4 and 5.

53 Groetelaers, *et al.*, *op cit.*, p. 4.

54 In Case C-239/09, *Seydaland Vereinigte Agrarbetriebe GmbH & Co. KG v. BVVG Bodenverwertungs- und -verwaltungs GmbH*, Judgment of 1 July 2009, OJ C 55, 19 February 2011, pp. 7-8.

55 BVVG is a wholly-owned subsidiary of the Bundesanstalt für vereinigungsbedingte Sonderaufgaben (the federal body responsible for special tasks connected with German reunification), responsible for the privatisation of agricultural and forestry land.

regional reference valuations, that selling price was only € 146,850.24. After the refusal of the request by the BVVG, Seydaland brought an action before the Landgericht Berlin (Berlin Regional Court) seeking reimbursement. According to Seydaland, BVVG ought to have calculated the selling price of the land at issue on the basis of the regional reference valuations, or to have referred to the valuation committee pursuant to paragraph 5(1) of the Land Purchase Order of 20 December 1995.⁵⁶ The main question raised before the the Landgericht Berlin, which was referred to the European Court of Justice by way of preliminary ruling, was whether Article 87 EC must be interpreted as precluding national legislation laying down calculation methods for determining the value of agricultural and forestry land being offered for sale by public authorities in the context of a privatisation programme, such as those laid down in German law.

First, the Court acknowledged that, in relation to the sale by public authorities of land or buildings to an undertaking or to an individual involved in an economic activity, such as agriculture or forestry, there might be elements of state aid, in particular where the sale is not made at market value, that is to say, where it is not sold at the price which a private investor, operating in normal competitive conditions, would have been able to agree.⁵⁷

Furthermore, it stated that, where the national law establishes rules for calculating the market value of land for its sale by public authorities, the application of those rules must, in order to comply with Article 87 EC, lead in all cases to a price as close as possible to the market value. As that market value is theoretical, except in the case of sales where the highest bid is accepted, a margin for variation on the price obtained as compared with the theoretical price must be allowed, as the Commission correctly states in Title II, point 2(b), of the Communication. Next, it stressed that only a sale accepting the highest bid or the determination of the price by an expert is suitable for establishing the market value of a piece of land.⁵⁸

The Court, based on the Advocate's General Opinion, expressed in its paragraph 47, ruled that the answer to the question referred was that Article 87 EC must be interpreted as not precluding a provision of national law laying down calculation methods for determining the value of agricultural and forestry land, offered for sale by public authorities in the context of a privatisation plan, to the extent that those methods provide for the updating of prices, where prices for such land are rising sharply, so that the price actually paid by the purchaser reflects, in so far as is possible, the market value of that land.⁵⁹

Although at last the Court acknowledged that it is a competence of the national courts to examine the methods and procedure of prices evaluation, set in the national law, and to find whether it is consistent with Article 87 EC, it stressed that it cannot be ruled out that, in certain instances, the method laid

56 Case 239/09, *Seydaland Vereinigte Agrarbetriebe GmbH & Co. KG v. BVVG Bodenverwertungs- und -verwaltungs GmbH*, paras. 20-21.

57 *Ibid.*, para. 34.

58 See *ibid.* Paras. 35-38.

59 *Ibid.*, para. 54.

down in that provision of national law may lead to a result far removed from market value.⁶⁰

It is clear that the principles set out in the *Seydayland* case, regarding the methods and procedure of price evaluation in cases of sales of public property, apply also when the sale is made by local authorities. A recent case where a local authority, the City of Orleans, was engaged in sales of public property, led to the ECJ judgment of 2 September 2010 in C-290/07 P, *Commission v. Scott SA*⁶¹ considering a long-running state aid dispute arising out of a public land sale to Scott in France.

Scott SA, a French subsidiary of an American company, together with the Département du Loiret and the City of Orléans, entrusted to the Société d'économie mixte pour l'équipement du Loiret ('Sempel') the task of carrying out all the studies and work necessary to enable the construction of a manufacturing plant in France, a plot of approximately 68 hectares. The land in question had been sold to Sempel, by the City of Orléans, which had itself acquired it earlier through three transactions: 30 hectares in 1975, 32.5 hectares in 1984 and 5.5 hectares in 1987. At the end of 1987 Sempel on the other hand sold to Scott SA 48 hectares of this land. In May 1988 an investigation started into whether the land was sold to Scott SA at a reduced price, below the market price, and whether the transaction thus qualified as state aid contrary to Article 87(1)

According to the *Saydayland* case and the Commission Communication mentioned above land sales by public authorities can include state aid if the purchase price is lower than the market price and therefore confers an advantage to the buyer.

In this case the Commission found that the sale of the land had taken place at a preferential purchase price and therefore included unlawful state aid so that it was declared incompatible with the common market. In circumstances where there was neither an unconditional bidding procedure nor an expert appointed to determine the market price of the land, the Commission, in order to determine what could have been the market price in 1987 of the land at issue, considered the costs incurred by the City of Orléans in acquiring that land and carrying out the improvements required for the construction of Scott's factory. The Commission proceeded to compare the market price of a similar parcel of land with the price actually paid by Scott and reached the conclusion that there had been a breach of Article 87(1).

The CFI annulled the Commission's decision, holding that the Commission had breached its duty to exercise due diligence by, first, relying on a cost-based method and applying this method to the facts of the case and, secondly, not taking into account additional information provided by Scott during the administrative proceedings.

On appeal, the ECJ annulled the CFI's judgment and referred the case back to the CFI. The ECJ emphasised that:

60 *Ibid.*, paras. 52-53.

61 Case C-290/07, *European Commission v. Scott SA*, Département du Loiret, French Republic, Judgment of the Court (First Chamber) 2 September 2010, OJ C 288, 23 October 2010, pp. 6-7.

“Commission has broad discretion when performing complex economic assessments and the limits of judicial review in these assessments. Judicial review of the Commission’s complex economic assessments is limited to verifying whether first, the rules on procedure and on the statement of reasons have been complied with, second, whether the facts have been accurately stated and last, if here has been any manifest error of assessment or misuse of powers.”

The *Saydayland* and *Scott SA* cases are interesting as regards the issue whether land sold by central or local government is at a preferential price, below the market price, and as such constitutes state aid contrary to the common market. They describe the procedures of market price evaluation and the bodies responsible for evaluating the market price. The set of conditions mentioned above and set out in these two cases should be taken into consideration by all the Member States’ institutions susceptible to making land sales.

C. A Final Remark

In 2009 the Stabilization and Association Agreement between the European Union and Albania entered into force. This Agreement has important provisions relating to trade between the contracting parties. Regarding the protection of fair competition the Agreement prohibits state aid that would distort competition. The Agreement itself does not define what is a “state aid”, but stipulates that the European instruments of EU Treaty interpretation should be used to evaluate whether a state aid should be prohibited. This is why a special part of this article focused on the European Union’s legal framework on state aid, the European Court of Justice’s jurisprudence on state aid and the European Commission’s Communications in this regard.

It is clear from this article that even local authorities should be careful when they grant subsidies, loans, define rates of taxes, sell land or exercise other rights in the ambit of their financial authority. A tax rate in a specific region that is lower than the tax rate in other part of the territory of a state or the sale of land to a business below market price may constitute state aid and therefore should be prohibited. This means that if the (financial) autonomy of the local government is defined as the right to take independent decisions within the ambit permitted by the Constitution and the law, it should be redefined by adding as an outline “border” of this autonomy, apart from the law and the Constitution, the European Union’s legal framework on state aid.