

STATE AIDS POLICY IN THE EU:
WITH SPECIFIC REFERENCE TO THE BANKING SECTOR
IN THE POST 2008 CRISIS

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ABSTRACT

STATE AIDS POLICY IN THE EU: WITH SPECIFIC REFERENCE TO THE BANKING SECTOR IN THE POST 2008 CRISIS

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This thesis analyzes the state aids policy in EU especially by taking the post-2008 crisis implementations in the banking sector into consideration. The main goal of the thesis is to examine the questions about how the EU directs the considerably strict state aids policy in the crisis term and whether or not there has been a turn in state aids policy tradition during the crisis. For this purpose, the study, first, evaluates the competition policy as the umbrella title for state aids policy, the definition and components of state aids and international rapprochements to state aids policy. Then, the tradition of state aids policy in EU is explained by taking the history and sources of this policy into consideration. Under the light of this advance information, actions of the Union during the post-2008 financial crisis related to the banking sector are tried to be evaluated. State aids implementations in general, attitudes in crisis periods and recent efforts in legislation processes about state aids in Turkey as a candidate country make it worth to link the subject of state aids in Turkey with the study as a subordinate title.

Keywords: Competition Policy, State Aids, State Aids Policy In EU, State Aids In Turkey

ÖZ

AB'DE DEVLET YARDIMLARI POLİTİKASI: 2008 KRİZİ SONRASI BANKACILIK SEKTÖRÜ BAĞLAMINDA

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Bu tez, özellikle 2008 krizi sonrası bankacılık sektöründeki uygulamaları göz önünde bulundurarak AB devlet yardımları politikasını analiz etmektedir. Tezin esas amacı, AB'nin son derece katı olan devlet yardımları politikasını kriz sürecinde ne şekilde yönlendirdiği ve bu süreçte devlet yardımları politikası geleneğinden herhangi bir sapma gösterip göstermediği sorularının incelenmesidir. Bu amaçla, çalışma öncelikle devlet yardımlarının üst başlığı olan rekabet politikasını, devlet yardımları tanımını ve unsurlarını ve devlet yardımları politikasına yönelik uluslararası yaklaşımları değerlendirmektedir. Sonrasında, AB devlet yardımları politikası geleneği, tarihi ve kaynakları göz önünde bulundurularak anlatılmıştır. Bu ön bilgiler ışığında, Birliğin 2008 finansal krizi sonrasında bankacılık sektörüne ilişkin olarak aldığı aksiyonlar değerlendirilmeye çalışılmıştır. Aday ülke olarak Türkiye'deki devlet yardımları uygulamaları, kriz süreçlerindeki tutumlar ve son dönemde devlet yardımları konusunda yasama işlemlerine ilişkin çabalar, Türkiye'deki devlet yardımları konusunun çalışmayla ikincil bir başlık olarak ilişkilendirilmesini değerli kılmıştır.

Anahtar Kelimeler: Rekabet Politikası, Devlet Yardımları, AB'de Devlet Yardımları, Türkiye'de Devlet Yardımları

Aile olmak güzel şey,
Evlad olmak, abla olmak, eş olmak ve anne olmak ...
Hepsinde ayrı ayrı BEN olmak ve her seferinde yeniden BİZ olmak...
Canım Anneme ve Babama, sevgili kardeşlerime, biricik aşkım eşime ve hayatımın
en büyük anlamı bebeğim Nilüfer'ime...

Beni anlamlandıran
AİLEME...

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LIST OF ABBREVIATIONS

ASCM	The Agreement on Subsidies and Countervailing Measures
BRSA	Banking Regulation and Supervision Agency
EC	European Community
ECSC	European Coal and Steel Community
EEA	European Economic Area
EEC	European Economic Community
EFTA	The European Free Trade Association
EU	European Union
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GBER	General Block Exemption Regulation
NTBs	Non-Tariff Barriers
OECD	Organization for Economic Cooperation and Development
R&D	Research and Development
R&D&I	Research and Development and Innovation
R&R	Rescuing and Restructuring
SAAP	State Aid Action Plan

SCM	Subsidies and Countervailing Measures
SMEs	Small and Medium Sized Enterprises
SPO	State Planning Organization
TCA	Turkish Competition Authority
TEC	The Treaty of the European Communities
TEU	The Treaty of the European Union
TFEU	The Treaty of the Functioning of the European Union
WTO	World Trade Organization

CHAPTER 1

INTRODUCTION

Changing power balances are shaped by economic strength of the actors in all phases of the history. Abilities of these actors to determine the rules of the game and to conduct it reflect in policies regulated by them. In today's globalized world, competition policy is an essential requirement to achieve and maintain a strong market economy determining the existence and power of countries. These countries are volunteers to comply with the agreements stating competition rules to protect and sustain their existence in international trade sphere. Because of all these concerns, competition regulations are formed at national, international and supranational levels. Preventing any restriction or distortion to competition sustained in the economy is the main goal of these policies.

Among the instruments of competition policy, state aid regulations have an important place as state being the most determinist over the economy is the party of the state aid action. State aids are used by governments to achieve financial, social and political goals. They are made through state resources without remuneration, favour an economic actor and threaten or even distort the competition. Because of these features, it is important to regulate the state aid area to protect national or international trade and competition.

In understanding the state aids policy as a subtitle of competition policy, first of all, the terms and theoretical process of competition and competition policy are tried to

be explained and then state aid concept and international approaches are going to be examined.

In this study state aids are examined as a part of competition policy from the viewpoints of EU implementations and Turkey's standpoint as a candidate for membership to EU. Discussion will be narrowed down on the basis of the current financial crisis especially on banking sector mostly affected by the crisis all over the world.

The 2008 financial crisis being the deepest recession since the Great Depression of 1930s and affecting the countries all over the World is worth studying in terms of state aids as state interventions to the markets are remarkable stands in the forefront. European Union has been the most active actor of the crisis scene through its early precautions regulating state aids to protect the financial and reel sector.

It was the anticipated reaction that the states will intervene in markets to protect their economy. It is obvious that in addition to their distorting effects to competition, state aids are also the tools to save the economy .Especially the predictions about the possibility of the situation to get worse and the state interventions to differ among Member States would cause state aid races and therefore have to be controlled by a unified monitoring system. Only in this way, trade and competition in the Common Market would be saved.

The financial sector initiating and trailing the crisis is at the core of the problem. This is mainly because of its inevitable influence on real sector and economic

power of countries as a whole. Aids directed to the sector aim, first, stabilization and, then, restoration. Therefore, the banking sector is taken into consideration in terms of state aids implementations.

In Turkish case, state aids are regulated and processed by different institutions. Although the liabilities for EU membership stipulates a strong, transparent and effective monitoring and supervising system, there have not been a formation to achieve this requirement. In spite of this absence criticized in all Progress Reports, there has neither been an ended legislation about the control of state aids nor an institution established to realize this duty. Although it is not the main aim of this study, the state aid implementations with lack of control mechanism and current situation of Turkey as being in the EU candidacy period are going to be evaluated by taking into consideration the liabilities about harmonization and realized state aid measures during the last two crisis terms.

The main aim of the study is, by considering the state aid regulations made in the period of post-2008 financial crisis and targeting the banking sector, to examine the questions about how the EU directs the considerably strict state aids policy in the crisis term and whether or not there has been a turn in state aids policy tradition during the crisis period.

CHAPTER 2

POLITICAL ANALYSIS OF STATE AIDS AS PART OF COMPETITION POLICY

2.1 Competition Policy In General

Competition and competition policy are not the same things. However, understanding the former is crucial, and it starts with economics and economists. Understanding the latter means one has to deal with politics, because it states that make public policies, and political interests and institutions that determine their implementation in practice.¹

Adam Smith was the first theorist defining the process of “invisible hand” and stating this term on the base of market and competition systems. Smith brought liberal thought in the foreground as a converse thesis of centralist and interventionist politics of mercantilism. Accordingly, freedom is the main requirement to provide liberalization of individual and to make him/her have his/her own right to decision. To afford this requirement free market economy and free competition theses have developed.²

Competition is conventionally treated as the dominant dynamic element and regulatory mechanism within the market economy systems. It operates, in Smith’s

¹ DOERN, G. Bruce; WILKS, Stephen; *Comparative Competition Policy: National Institutions in a Global Market*. Oxford: Clarendon Press, 1996, p.9

² DPT, *Rekabet Hukuku ve Politikası Özel İhtisas Komisyonu raporu*. Ankara., Kasım 1994, p.7

vivid image, as an ‘invisible hand’, surreptitiously and ultimately benignly, coordinating transactions within the market economy. The concept of competition has become something of a universal nostrum and a handmaiden to the process of liberalization and the spread of market principles to all walks of life. In analysis of economic activity, therefore, more competition is generally thought to be desirable and impediments to competition undesirable.³ A precondition for a successful market economy is the existence of an effective competition policy.⁴ Competition policy can be defined as the set of policies and laws which ensure that competition in the market place is not restricted in such a way as to reduce economic welfare.⁵

Competition policy consists of those policies and actions of the state intended to prevent certain restraints of trade by private firms. Stated more positively, it is policy intended to promote rivalry among firms, buyers and sellers through actions in areas of activity such as mergers, abuse of dominance, cartels, conspiracies in restraint of trade, misleading advertising, and related criminal and economic offences that are held to be anti-competitive. For mainstream economists, the overall purpose of competition policy is to protect competition as a means of allocating scarce resources and thus of producing allocative and other types of efficiency. At the same time, competitive markets also tend to be less concentrated and thus economic power is also diffused. Allocative efficiency in turn maximizes economic welfare. For political scientists, even if the above analytical logic is

³ DOERN & WILKS 1996, 10-11.

⁴ HAY, D., “The Assessment: Competition Policy”, *Oxford Review of Economic Policy*. 1993; v.9 no:2 http://oxrep.oxfordjournals.org/cgi/pdf_extract/9/2/1: 1-26, p.1.

⁵ MOTTA, M., *Competition Policy: Theory and Practice*, Cambridge University Press, 2004, p.30.

accepted, there is also an interest in how antitrust policy is forged out of the ideologies and pressures of big business and organized capitalism, and in how the state enacts measures to reassure small businesses and consumers.⁶

Competition policy is a corner stone of economic policy in a market economy, founded on well-defined property rights and freedom of contract, supported by policies aiming at stable money, a high level of employment and social security. The objectives and means of competition policy have been subject to various controversies. On one side there are ardent followers of the gospel of economic freedom as exemplified by the slogan 'Laissez faire, laissez passer'. They consider economic freedom and the ensuing competition as ends in themselves. On the other side there are those considering competition policy as a constituent part of an interventionist industrial policy aiming at establishing market structures and enticing enterprises to behave in a way conducive to the enhancement of economic welfare. Within this range of diverging opinions four objectives to be pursued by competition policy may be identified;⁷

- Establishing a competitive order as an end in itself to safeguard economic freedom
- Maintaining a competitive order to foster economic efficiency and technological and economic progress

⁶ DOERN & WILKS 1996, p.7-8.

⁷ NEUMANN, M., *Competition Policy - History, Theory and Practice*, Edward Elgar Pub., Northampton MA, 2001, p.1.

- Providing for a level playing field of fair competition, which implies prohibition of deceptive and fraudulent practices, threat, extortion and blackmail as well as unfair advantages through government subsidies
- Maintaining a decentralized structure of supply because small and medium-sized enterprises are considered as the backbone of a democratic society.

The development during the last third of the 19th century gave rise to the conclusion that a laissez-faire stance of economic policy would lead up to undermining a competitive order by the formation of trusts and cartels and thus to the eventual elimination of economic freedom. Therefore maintaining a competitive order by prohibiting restraints of competition was deemed as an objective to be pursued irrespective of the impact on economic efficiency.⁸

To be sure, as emphasized by Joseph Shumpeter (1942), competition entails ‘creative destruction’ by displacing existing products and methods of production by new ones. Hence, from day to day, there are both winners and losers. Still, in the long run, all can become winners unless the right to participate in market activities is curtailed. Freedom to join the competitive process must therefore be safeguarded by law.⁹

Safeguarding economic freedom, as propounded by John Stuart Mill, must not be confused with laissez-faire. Laissez-faire provides scope for a dominant firm or a cartel to interfere with the liberty of other people and may eventually eliminate

⁸ Ibid, p.1.

⁹ Ibid, p.3

economic freedom altogether. Therefore competition policy must be geared to prohibit the abuse of economic power.¹⁰

With falling from favour of industrial policy in the 1980s, and the reduction of trade barriers in the early 1990s, global economic policy attention has begun to focus on competition policy. Linked to concerns about effective market access once goods and services have crossed borders, competition policies and institutions dealing with restrictive business practices are being made subject to close international scrutiny.¹¹

2.2 Theoretical Approaches to State Aids

The issue of State aids (or subsidies) in an international perspective is a permanent source of conflicts because it is at the junction of three opposite views — the mercantilist attitude, the pure trade theory and the political economy approach. First, in a mercantilist perspective focusing on exports and domestic producers (to the detriment of imports and domestic consumers), that subsidies increase imports or reduce exports of the trading partners of the subsidizing country is ‘unfair’ competition. Firms under foreign subsidy pressures feel that they cannot ‘compete with foreign governments’ and they lobby for ‘countervailing’ those foreign subsidies. Second, the pure trade theory has two stands. It underlines the fact that subsidised imports from trading partners are a benefit for the consumers of the importing country. And it shows that subsidies are among the least distorting

¹⁰ Ibid, p.5

¹¹ DOERN & WILKS 1996, p.8

instruments for solving a long list of problems. In particular, they are less distorting than tariffs or non-tariff barriers (NTBs). If public action favouring a particular activity is desired or if there is a need to compensate for economic distortions, then subsidized production funded by general taxation is likely to be the best instrument to be used. Lastly, the third view based on a political economy approach stresses the fact that State aids are easily captured by vested interests for their own agenda — hence becoming a source of waste of scarce economic resources. This approach explains the wide reluctance among economists to support subsidies and their perception that State aids should be constrained for domestic reasons — in sharp contrast with the first view which focuses on disciplines to be imposed on foreign subsidies and with the second view suggesting the use of subsidies for many purposes.¹²

The neo-classical and the strategic trade theories are aggregated into the ‘pure trade’ theory because they both provide arguments for using subsidies in certain well-defined circumstances. In this sense, they both differ from the ‘political economy’ approach which focuses on the limits of subsidizing.¹³

The pure trade theory approach shows that subsidies constitute a better instrument of intervention than trade measures (like tariffs) for problems not directly related to trade flows. It suggests a friendly — at least an open-minded — approach to State aids, but it ignores the capacity of pressure groups to capture the government.

¹² MESSERLIN P., "External Aspects of State Aids", *State Aid and the Single Market*, European Economy No:3., EC 1999, 161-189, p.161.

¹³ Ibid, p.162.

Lobbies can obtain subsidies under conditions quite different from those carefully circumscribed by the various components of the pure trade theory.¹⁴

On the other hand, the political economy literature focuses on the likelihood of a protectionist capture of a subsidy policy, leading to a great reluctance to use subsidies. First, it recognizes that subsidies can be easily used for other goals than their official purpose when they are not well monitored. Even when they are well monitored, subsidies may add to the firms' global resources to an extent which does not match their intended purpose -hence being the source of gains to unknown beneficiaries.¹⁵

2.3 Definition and Components of State Aids

State aids are the product of a protective kind of politics conducted as a result of economic and social pressures depending on increasing unemployment and decreasing growth rate affected by economic crisis.¹⁶ State aid is one of the tools used to intervene in economy in achieving macro economic goals in frame of general economy politics of the countries like growth, full employment, balance of payments adjustment or achieving industrial, technological, environmental, social

¹⁴ Ibid, p.162.

¹⁵ Ibid, p.163.

¹⁶ AŞÇIOĞLU ÖZ Gamze, *Avrupa Topluluğu ve Türk Rekabet Hukukunda Hâkim Durumun Kötüye Kullanılması*, Rekabet Kurumu Lisansüstü Tez Serisi No: 4, Ankara, 2000, p.17.

and regional political targets.¹⁷ There are different but similar definitions of the term in the literature.

İneci defines state aids as the aids made in any way and without expecting something in return for the aims like; affecting a specific enterprise, production, production method, production or proceeding subject; supporting and protecting the producers; contributing to the development of competitive strength; providing the development of a region by influencing the establishment place.¹⁸

Another definition given by Köksal is that state aids are the all kinds of aids made through state resources to public or private enterprises.¹⁹

It is possible to classify the impacts of state aids on the economy according to the form of providing financial resources to the programs by the state and supporting format. State aids have the similar economic effects of any fiscal policy tools in terms of financing methods. In practice, their influences are on ‘operating decisions’ and ‘resources allocation’.²⁰

As a tool of sectoral politics, the state can support the sectors having difficulty because of intensive competition or being newly founded. So that, it is aimed for the

¹⁷ KÖKSAL, T., “Avrupa Birliği’ne Tam Üyelik Sürecinde Türkiye’de Devlet Yardımlarının Hukuki Çerçevesi”, *Rekabet Dergisi*, Rekabet Kurumu, Sayı:7, Ankara, Temmuz-Agustos-Eylül 2001, p.3.

¹⁸ İNECİ Barbaros, *Avrupa Topluluğu ve Türkiye’de Sübvansiyonlar*, İstanbul Sanayi Odası ve Marmara Ün. Avrupa Topluluğu Enstitüsü, İstanbul, 1993, p.4.

¹⁹ KÖKSAL, T., *Avrupa Birliği ve Türkiye’nin Devlet Yardımları Sistemlerinin Uyumlaştırılması*, Etki Yayıncılık, Ankara, 2002 a, p.4.

²⁰ LEBLEBİCİ, F., *Devlet Yardımları Uygulamasının Maliyeti Ve Ekonomik Göstergelerle Mukayesesi*, İktisadi Sektörler Ve Koordinasyon Genel Müdürlüğü Sanayi Dairesi Başkanlığı, DPT Yayınları, Aralık 2002, p.3.

industries to accommodate the changing conditions, provide employment by carrying the production or contribute to the balance of payments by increasing the competition strength in internal and outside markets.²¹

Another aim tried to be realized by the state is to remove the inter-regional development differences and imbalances. The state is attempting to make the regions which are underdeveloped and not profitable to invest, attractive for private sector and by the way achieve the industrial activities in these regions.²²

Subsidies are associated with economic inefficiency. In economic theory, only in the context of the theories of externalities and market failure have exceptional conditions for the provision of subsidies been identified.²³

Economic theory shows that subsidies, in the presence of market distortions, can restore efficiency. However, it also shows how subsidies often introduce distortions and therefore welfare losses into the domestic and the global economy. Certain countries may for example try to protect their domestic production through subsidies and deter foreign competition from entering the market in order to shift profits from abroad to the home industry. The resulting distortions of trade can lead

²¹ Ibid, .p.5.

²² Ibid, .p.5.

²³ MURPHY, M., PRETSCHKER, U., “Public Support to Industry”, *The OECD Observer*, No:204, February 1997, p.17.

to retaliatory measures and counter-subsidization which may be a source of further inefficiency²⁴

However, as a result of industry policy interventions, support measures became widespread by the end of the 1970s. Support to ailing industries and to weak enterprises continued and was complemented by various financial incentives offered to manufacturing industry under the banner of new policies. Public support for industrial research and development (R&D) and innovation also increased strongly. The international 'subsidy race' in high-tech industries such as aircraft, space, computers and semiconductors repeatedly attracted public attention.²⁵

During the 1980s, policy discussions began to focus on industrial support for several reasons:²⁶

- First, many of these support programs contributed relatively little to structural adjustment;
- Second, the burden on public budget increased; and
- Third, although trade policies succeeded in reducing tariffs and other border measures, support measures continued to distort national and international competition and trade, and as the globalization of economies and markets accelerated, they became a priority issue on the international agenda.

²⁴ BUELENS, C., GARNIER, G., MEIKLEJOHN, R., *The economic analysis of state aid: Some open question*, European Economy, Economic Papers, Number 286 – September 2007, p.6

²⁵ MURPHY & PRETSCHKER 1997, p.17.

²⁶ Ibid, p.17.

Although the two terms ‘state aids’ and ‘subsidies’ are used synonymous in many definitions and approaches of the literature, it is important to recognize the differentiation made by the Court of Justice in its decision for the case *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority (1961)*. Accordingly;

A subsidy is normally defined as a payment in cash or in kind made in support of an undertaking other than the payment by the purchaser or consumer for the goods or services which it produces. An aid is a very similar concept, which however, places emphasis on its purpose and seems especially devised for a particular objective which can not normally be achieved without outside help. The concept of an aid is wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in strict meaning of the word, are similar in character and have the same effect.²⁷

2.4 International Rapprochement to State Aids

2.4.1 Organization for Economic Cooperation and Development (OECD)

OECD brings three possible definitions of what constitutes a “subsidy”, “aid”, “assistance” or “support”.

According to OECD, there is no widely accepted definition of what constitutes a subsidy. However, the definitions that are used have in common that a subsidy is

- a government policy which
- affects competition in a market by favouring certain firms or sectors, and which

²⁷ Case 30/59, *De Gezamenlijke Steenkolenmijnen in Limburg v High Authority*, 1961

- thereby reduces overall welfare.²⁸

Under the first approach, a firm is said to be “favored” by reference to the situation faced by the other firms in an industry. For example, a firm would be said to be benefited or favored if it received a higher level of financial transfers, lower taxes, greater benefit from public goods or fewer environmental or regulatory controls than its competitors in its market.²⁹

This approach has the primary advantage that it encompasses a range of different forms of policy competition, which distort competition and might therefore reduce overall welfare. This approach highlights for consideration competition-distorting policies, which might otherwise go unnoticed.³⁰

The main drawback with this approach is that by focusing only on differences in policies across firms, it fails to capture policies, which are uniformly pursued by all governments even when those policies are undesirable from a global welfare perspective.³¹

Another drawback with this approach is that by “spreading the net widely” it catches not only policies which reduce overall welfare, but a large ranges of policies which enhance welfare. Therefore, in order to determine whether a particular

²⁸ OECD, “Competition Policy in Subsidies and State Aid”, *Series Roundtables on Competition Policy*, No:36, Paris, 2001, p.18.

²⁹ Ibid, p.28.

³⁰ Ibid, p.28.

³¹ Ibid, p.28.

competition-distorting policy fulfils all of the criteria for a subsidy, it is necessary to in addition determine whether the policy reduces overall welfare.³²

Secondly, as the previous approach had the drawback that it did not capture policies that were uniformly pursued by all governments, even when those policies were collectively harmful, it is necessary to adopt some form of exogenous standard for defining when a firm is favoured (rather than a *relative* standard). One way to do that is to focus on financial transfers from the state and to use as a baseline the level of financial transfers to or from other firms in the same country (as opposed to in the same market). A firm would then be said to be benefited or favoured if it received a tax break or a financial handout different from other firms in the same country. This is essentially the approach adopted by the European Commission in its control of state aid.³³

This approach is claimed to have several advantages. First, this approach captures targeted financial handouts (or targeted tax breaks) to individual firms, even if these policies are pursued by all governments simultaneously. In this respect, therefore, its coverage is broader than the first approach. This approach also has the advantage that it makes it harder for the government to discriminate between firms competing in domestic markets and firms competing in international markets in tax and financial transfer policies. Finally, this approach also has the significant advantage

³² Ibid, p.29.

³³ Ibid, p.29.

that it identifies policies which are highly likely to reduce overall welfare (at least in the majority of industries).³⁴

There are several drawbacks with this approach. Because the definition is not based on competition principles, some distortions of competition will not be covered by this definition. Another drawback with this approach is that it is narrow and does not capture the various other forms of policy competition, which do not involve government financial transfers, such as differences in regulatory regimes or the provision of public goods.³⁵

A third possible approach is to define as a baseline some measure of prices for the inputs and outputs of the firms in an industry. Earlier we mentioned that when the markets affected by a government policy have well-defined market prices, detection of a competition distortion is more straightforward – a competition distortion arises when the firm sells output firm at above-market prices or buys inputs at below-market prices. In other words, in industries with widely-traded goods, it might be possible to determine a set of benchmark “world” prices for those goods and then compare the prices paid or received by individual firms to detect whether or not that firm is favoured.³⁶

This approach has the advantage that it captures a broader range of policies than the second approach above. In particular, this approach would capture not just financial

³⁴ Ibid, p.29.

³⁵ Ibid, p.30.

³⁶ Ibid, p.30.

transfers to firms, but also the “assistance” a firm receives as a result of tariff barriers or other border measures.³⁷

Government support and industrial subsidies are defined by the OECD to cover all measures of financial support from central or sub-central government to manufacturing industry which result in a net cost to government.³⁸

To analyze government support, the OECD classified it in ten categories, identified by their objectives:³⁹ These are aids granted in relation to:

- sectoral policies
- crisis aid
- R&D and technological innovation
- regional development
- general investment incentives
- support to small and medium-sized enterprises (SMEs)
- labour and training
- exports and foreign trade
- energy-efficiency
- environmental protection.

³⁷ Ibid, p.30.

³⁸ MURPHY & PRETSCHKER 1997, p.11.

³⁹ Ibid, p.11.

2.4.2 World Trade Organization (WTO)

The WTO began life on 1 January 1995, but its trading system is half a century older. Since 1948, the General Agreement on Tariffs and Trade (GATT) had provided the rules for the system. From 1948 to 1994, the GATT provided the rules for much of world trade and presided over periods that saw some of the highest growth rates in international commerce. It seemed well-established, but throughout those 47 years, it was a provisional agreement and organization. The last and largest GATT round, was the Uruguay Round which lasted from 1986 to 1994 and led to the WTO's creation. Whereas GATT had mainly dealt with trade in goods, the WTO and its agreements now cover trade in services, and in traded inventions, creations and designs (intellectual property).⁴⁰

Three important level can be seen in history of subsidies rapprochement of WTO;

- GATT 1947
- The 1979 GATT Subsidies Code
- The Uruguay Negotiations and The Agreement on Subsidies and Countervailing Measures

The GATT 1947 addressed only subsidies that operate “directly or indirectly to increase exports”, and merely required contracting parties to notify the GATT of any such subsidies, and to discuss with other Contracting Parties the possibility of

⁴⁰ Understanding The WTO: Basics, *What is the World Trade Organization?*
http://www.wto.org/english/thewto_e/whatis_e/tif_e/fact1_e.htm (accessed April 16, 2009)

limiting them where they caused or threatened serious prejudice to the interests of those contracting parties.⁴¹

By the time of Tokyo Round of tariff negotiations, the use of subsidies and countervailing duties had become a more contentious issue. In part as a result of the lowering of tariffs, the use of non-tariff barriers and the impact of subsidies raised the level of interest in developing discipline over the use of both subsidies and countervailing duty procedures. The outcome of the Round was the 1979 Subsidies Code, which contained a “two-track” approach. The first track instituted disciplines for imposing countervailing duties, including detailed requirements for an injury finding, while the second track contained disciplines on the use of subsidies. The Code prohibited the use of export subsidies. However that prohibition did not apply to export subsidies for primary products and developing countries were also exempted from the prohibition.⁴²

It soon became clear that the 1979 Subsidies Code had not resolved the problems of subsidies and countervailing measures. As a result, the Uruguay Round of negotiations was launched with a mandate to improve GATT disciplines relating to all subsidies and countervailing measures that affect international trade.⁴³

⁴¹ CLARKE, P.A. and HORLICK G.N., “The Agreement on Subsidies and Countervailing Measures”, *The World Trade Organization: Legal, Economic and Political Analysis*, Volume 1, ed. MACRORY, P.F.J., APPLETON, A.E. and PLUMMER, M.G., Springer, 2005, p.681.

⁴² Ibid, p.683.

⁴³ Ibid, p.684.

The WTO's agreements are often called the Final Act of the 1986 —1994 Uruguay Round of trade negotiations.⁴⁴ As a part of these agreements, The Agreement on Subsidies and Countervailing Measures (“ASCM” or “Agreement”) interprets and expands on the subsidies and countervailing duty portions of Article VI and Article XVI of the “GATT 1994”.⁴⁵

The SCM Agreement presents several new features as compared with the previous discipline of the Tokyo Code. Unlike the Tokyo Subsidies Code, it is binding on all WTO Members. For the first time a comprehensive definition of subsidy is introduced along with the concept of specificity. The actual discipline of subsidies is different according to their category (prohibited, actionable, or non-actionable). The SCM Agreement provides for a special, more favourable treatment, such as grace periods and exemptions, for developing countries and economies in transition. Notification and surveillance procedures are enhanced.⁴⁶

Subsidies are explicitly regulated also in the Agreement on Trade in Services (GATS). Any member that considers itself to be adversely affected by a subsidy of another member can request consultations.⁴⁷

One of the most significant characteristics of the regulation of subsidies in the GATT first and in the WTO afterwards is the ‘taxonomy approach’: subsidies are

⁴⁴ Legal texts: the WTO agreements, http://www.wto.org/english/docs_e/legal_e/ursum_e.htm#kAgreement (accessed April 15, 2009)

⁴⁵ CLARKE & HORLICK 2005, p.681.

⁴⁶ RUBINI, L., “The International Context of EC State Aid Law and Policy: The Regulation of Subsidies in the WTO”, *The Law Of State Aid in the European Union*, ed. BIONDI, A., EECKHOUT, P. and FLYNN, J., Oxford University Pres, NY, 2004, p.152.

⁴⁷ Ibid, p.153.

divided into various categories in accordance to the different impact they allegedly produce on international trade.⁴⁸ These categories are;

1. Prohibited subsidies:

This category includes two types of subsidies:

- Subsidies contingent, in law or in fact, whether solely or as one of several conditions, upon export performance, including those included in the ‘illustrative list of export subsidies’ annexed to the SCM agreement (‘export subsidies’); and
- Subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods(‘local-content subsidies’).(SCM Art 3.1)⁴⁹

Prohibited subsidies are those that require the recipient to meet certain export targets or to use domestic goods instead of imported goods. These can be challenged under the WTO dispute settlement procedure and, if that procedure confirms that the subsidy is prohibited, the subsidy must be withdrawn immediately. If domestic producers are hurt by imports of subsidized products countervailing duty can be imposed.⁵⁰

⁴⁸ Ibid, p.175.

⁴⁹ Ibid, p.176.

⁵⁰ BIGGAR, Darryl R., “Competition Policy in Subsidies and State Aid” (November 12, 2001). Org. for Economic Co-operation & Dev., *Best Practice Roundtables on Competition Policy* No. 36, p.20.

2. Actionable subsidies:

Subsidies are ‘actionable’ if they cause ‘adverse effects’ to the interests of other Members. Article 5 SCM provides:

no Member should cause, through the use of any subsidy [...] adverse effects to the interest of other Members, ie:

- (a) injury to the domestic industry of another Member;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994;
- (c) serious prejudice to the interest of another Member.⁵¹

In the case of actionable subsidies the complaining country has to show that the subsidy has an adverse effect on its interests, otherwise the subsidy is permitted. The interests of a country may be hurt if its exporters must compete against subsidized firms in other countries or if its domestic industry must compete against subsidized imports. If the WTO dispute settlement body rules that the subsidy does have an adverse effect, the subsidy must be withdrawn or the adverse effect must be removed.⁵²

3. Non-actionable subsidies:

Originally, the SCM Agreement provided that some types of subsidies were neither actionable nor countervailable because they were non-distortive or because they served economic and social objectives of overriding importance. However, this category lapsed in the year 2000 as it was not possible to reach a consensus to

⁵¹ RUBINI 2004, p.180.

⁵² BIGGAR 2001, p.20.

extend their application, mainly because of developing countries' concerns about the alleged imbalance of those provisions in favour of developed countries.⁵³

A subsidy is non-actionable if it is not "specific". In determining whether or not a subsidy is specific the following factors are to be taken into account:⁵⁴

- whether the rules governing the subsidy or its administration limit access to certain enterprises;
- whether the subsidy is administered under explicit, objective criteria for eligibility;
- and the exercise of discretion by the administering authority.⁵⁵

2.4.3 The European Free Trade Association (EFTA)

EFTA was founded in 1960 on the premise of free trade as a means of achieving growth and prosperity amongst seven founding members – Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom as well as promoting closer economic co-operation between the Western European countries. EFTA has seen several changes in membership. Finland became an associate member in 1961 and a full member in 1986. Iceland joined in 1970 and Liechtenstein in 1991. Denmark and the United Kingdom left EFTA to become members of the European Communities (EC) in 1973. Portugal joined the EC in 1986 as did Austria, Sweden and Finland in 1995. Today,

⁵³ RUBINI 2004, p.185.

⁵⁴ BIGGAR 2001, p.20.

⁵⁵ *ibid*, p.20.

only Iceland, Norway, Switzerland, and Liechtenstein remain members of EFTA (of which only Norway and Switzerland are the only remaining founding members)⁵⁶

The EFTA countries wished to contribute to the expansion of trade in the world at large. Based on these overall goals, EFTA today maintains the management of the EFTA Convention (intra-EFTA trade), the Agreement on European Economic Area (the EEA Agreement) (EFTA-EU relations), and the EFTA Free Trade Agreements (third country relations).⁵⁷

The immediate aim of the EFTA Convention was to provide a framework for the liberalisation of trade in goods amongst its Member States.⁵⁸ The Convention abstracts the ‘state aid’ subject. Accordingly; the rights and obligations of the Member States relating to State aid shall be based on the related articles of the GATT 1994 and the WTO Agreement on Subsidies and Countervailing Measures.

In the 1970s the EFTA States concluded free trade agreements with the EC; in 1994 the Agreement on the European Economic Area (EEA Agreement) entered into force.^{59 60}

⁵⁶ A Short Introduction to 50 Years of Efta
<http://www.efta.int/~media/Files/Publications/Fact%20sheets/General%20EFTA%20fact%20sheets/efta-50-years.ashx> (accessed April 19, 2009)

⁵⁷ <http://www.efta.int/content/efta-secretariat/content/about-efta/aboutefta> (accessed April 19, 2009)

⁵⁸ <http://www.efta.int/content/efta-secretariat/content/about-efta/aboutefta> (accessed April 19, 2009)

⁵⁹ Three of the EFTA countries are part of the European Union Internal Market through this agreement, while the fourth, Switzerland, opted to conclude bilateral agreements with the EU.

⁶⁰ <http://www.efta.int/content/efta-secretariat/content/about-efta/aboutefta> (accessed April 19, 2009)

The main rule in Article 61 of the EEA Agreement is that aid granted through State resources which distorts or threatens to distort competition and affects trade between the EEA Contracting Parties is incompatible with the EEA Agreement. The second and third paragraphs of Article 61 add certain exception clauses to this main rule.⁶¹

In the field of state aid, the powers to control the EFTA States that are members to the EEA Agreement are vested with the EFTA Surveillance Authority.⁶²

An EFTA State shall not put into effect a new aid measure before the Authority has approved it. State aid plans must, therefore, be notified to the EFTA Surveillance Authority prior to implementation. The Authority must then assess whether such a plan constitutes State aid and, if it does, examine whether it is eligible for exemption.⁶³

Protocol 26⁶⁴ to the EEA Agreement stipulates that the EFTA Surveillance Authority is entrusted with equivalent powers and similar functions to those of the European Commission in the field of state aid. Furthermore, Protocol 27⁶⁵ to the EEA Agreement lays down the principles according to which the Authority and the

⁶¹ <http://www.eftasurv.int/fieldsOfWork/fieldStateAid/> (accessed April 19, 2009)

⁶² RYDELSKI, M.S., "The EEA State Aid Regime", *The Law Of State Aid in the European Union*, ed. BIONDI, A., EECKHOUT, P. and FLYNN, J., Oxford University Press, 2005: 189-204, p.189.

⁶³ <http://www.eftasurv.int/fieldsOfWork/fieldStateAid/> (accessed April 19, 2009)

⁶⁴ Protocol 26 on the powers and functions of the EFTA Surveillance Authority in the field of State Aid

⁶⁵ Protocol 27 on co-operation in the field of State Aid

Commission shall co-operate in order to ensure a uniform application of the state aid rules.⁶⁶

2.4.4 European Union (EU)

Although the European Union is a supranational body having the authority to enforce the Member States in implementing the binding and obligatory rules, it would not be improper to mention its state aids policy among international rapprochements as its regulations are modeled by many international organizations. But as more details on state aids policy in EU is going to be explained in next chapter, it is just cited here as a title.

2.5 Conclusion

The states which have the objectives to realize and save market economy try to protect competitive market structure. They ensure competition in the market through competition policy. State aids take an important place among the main concerns of competition policy. They are effective tools of governments to intervene in economy. Although this intervention may be justified by governments to achieve their economic, social or political goals, its side effects on competition cannot be ignored. Governments' peerless rights to access in economic sources and their potential ability to control economic actors and actions make any support by the states automatically distortive to competition. Therefore, state aids policy should

⁶⁶ <http://www.eftasurv.int/fieldsofwork/fieldstateaid/> (accessed April 19, 2009)

be shaped with the consideration of the negative effects on competition as well as aimed positive effects on social and economic lives.

Although many states volunteer to form the rules of the competition among the firms, they mostly abstain from regulating state aids, which is a useful intervention mechanism for them. This situation is not only a threat to internal markets of countries but also to the trade market of the globalized world. Because, without a regulation, the whole trade market in the world would become open to serious damage of subsidy races of states. Therefore, many international organizations try to set up conciliations among member states on this issue.

The European Union is the most effective organization regulating state aids. It is possible to say that this success results from its supranational structure. This structure makes its rules more binding on Member States than any other international organizations and also forms a model regulation for them.

CHAPTER 3

STATE AIDS IN EUROPEAN UNION COMPETITION POLICY

3.1 Competition Laws in the European Union

The starting point of supra-national competition law in Europe was the series of pro-competitive measures adopted by France, Germany, Italy and the Benelux countries in the 1951 Treaty of Paris, which created the European Coal and Steel Community (ECSC). This Treaty prohibits trade barriers as well as discriminatory and other restrictive practices capable of distorting competition among the six countries which were later to become the founding members of the European Economic Community (EEC).⁶⁷

There are two main reasons behind the introduction of competition policy measures in the Treaty of Paris. The first one is again related to the desire of diminishing the danger of German power by making available to the other European countries such essential inputs as coal and steel. The prohibition of discriminatory practices might also be seen as a way to guarantee equal access to these basic resources. The second reason is that the principle of free competition was beginning to be appreciated as the only viable way to attain an efficient functioning of the market, also in view of the success of the US economy which had continuously relied upon anti-trust rules

⁶⁷ MOTTA, M., *Competition Policy: Theory and Practice*, Cambridge University Press, 2004, p.13.

(Goyder, 1993:19).⁶⁸ Free competition was thus preferred to a centralized organization of markets, even though the High Authority was authorized to intervene in case serious market imbalances arose.⁶⁹

The Treaty of the Functioning of the European Union (thereinafter TFEU) (ex.The Treaty of the European Communities-TEC) deals with competition issues in Articles 101 to 109 (ex.81 to 89).⁷⁰ However, the logic of free competition is enunciated by Article 3(1)(g), which calls for the institution of “a system ensuring that competition in the internal market is not distorted”. Furthermore, one of the major reasons behind the adoption of competition rules under the Treaty of Paris was to avoid discrimination on national grounds. Article 18 (ex.12) confirms that this is also one of the basic principles in the TFEU, and it has applications well beyond the rules on competition alone (Goyder, 1993:26).⁷¹ Therefore, one of the main objectives in European competition policy is the elimination in the economic system of any discrimination based on national grounds.⁷²

Social reasons are also taken into account in European competition policy. It is certain that social and political considerations influence the way in which

⁶⁸ GOYDER, D G; *EC Competition Law*; Oxford : Clarendon Press; 1993: Quoted by MOTTA 2004, p13.

⁶⁹ MOTTA 2004, p.13.

⁷⁰ The Treaty of Amsterdam renumbered Articles 92 to 94 to Articles 87 to 89 and recently by the Treaty of Lisbon coming into force on 1 December 2009, the Treaty of European Community was renamed as the Treaty of the Functioning of the European Union (TFEU) and the core articles about state aid was renumbered as 107 to 109. Therefore the name of the Treaty and the articles 87 to 89 are converted in the text to the Treaty of the Functioning of the European Union (TFEU) and 107 to 109 different from the original forms of the quotations.

⁷¹ GOYDER, D G; *EC Competition Law*; Oxford : Clarendon Press; 1993: Quoted by MOTTA 2004, p13.

⁷² Ibid, p.14

competition policy is implemented: competition can be sacrificed when the social costs of it might be too high, since many firms might exit an industry under conditions of over-capacity, which would result in considerable job losses. Even if in the long-run a restructuring of the industry would be beneficial, in the short-run there might exist considerable costs that a government might want to avoid for political and social reasons.⁷³

Another element, which affects competition policy in Europe is the importance accorded by the Commission to small and medium-sized enterprises (SMEs). These firms often receive favorable treatment. For instance, the EC looks favorably upon state aid given to SMEs in the form of subsidized loans, R&D support, financial guarantees and other assistance.⁷⁴

The favorable treatment accorded to small and medium firms finds its rationale in the *de minimis* rule, namely that little harm can be done by firms which are of limited size. Accordingly, it is not efficient for the EC to use resources on agreements which are likely to have little impact on competition and welfare.⁷⁵

3.2 European Union State Aids Policy

Trade among EU Countries can be considered internal rather than international; following this, subsidy-related issues affecting trade between the Member States are dealt with as part of competition policy. At the same time, the Member States retain

⁷³ Ibid, p.15.

⁷⁴ Ibid, p.16.

⁷⁵ Ibid, p.17.

a degree of autonomy over economic policy, and markets remain to some extent compartmentalized along national lines. Also key to the consideration of subsidy control within the EU is that the Community is not just a trade agreement; half a century of European integration has not only increased the interdependency of markets, but has also entailed the development of a range of flanking policies in areas such as competitiveness, economic and social cohesion, environmental protection and research and innovation. These characteristics mean that EU subsidy discipline has been shaped by a combination of forces: economic efficiency and ‘unfair’ trade considerations, of course, but also the demands of market integration and the wider economic and social aspirations of the Community reflected in the need to balance a range of Treaty objectives.⁷⁶

The trade policy literature concerning subsidies focuses on export or production subsidies. However, in the EU export aid is forbidden, while production subsidies are only permissible in a narrow range of circumstances. On the other hand, with increasing mobility of capital, the practice of granting subsidies aimed at attracting or retaining footloose investments has become widespread both in the EU and in the rest of the world.⁷⁷

In the European Union a system of state aid control has existed since the origin of the European Communities in the fifties. Both the Treaty establishing the European Coal and Steel Community (signed in Paris on 18 April 1951) and the Treaty

⁷⁶ WISHLADE, *Fiona G., Regional State Aid and Competition Policy in the European Union*, Kluwer Law International, The Hague, 2003, p.32-33.

⁷⁷ BUELENS, GARNIER and MEIKLEJOHN 2007, p.3

establishing the European Communities (signed in Rome on 25 March 1957) contain rules governing the granting of subsidies / aid by Member States.⁷⁸

However, until the early 1970s the issue of State aids did not take on especial importance. It began to do so after the recession of 1974 and 1975, and particularly after 1980, when the considerable growth of aid led to a very marked rise in cases referred to the Commission. The Commission tried to ease this increasing workload by establishing criteria for application of the ground rules and procedures, which it decided should be made public in the form of various types of texts: framework documents, communications, guidelines, sometimes just letters, but also directives and regulations. But this piecemeal approach at the purely administrative level did not provide sufficient legal certainty or clear and effective administrative management. Legislation was therefore needed, and was adopted in 1998 for the ground rules and 1999 for the procedural rules.⁷⁹

In view of the new challenges of monetary union and enlargement, which will increase the need for strict aid control, the Council adopted a regulation in May 1998, which enables the Commission to grant group exemptions for certain categories of State aid. Group exemptions allow the Commission to declare certain categories of aid compatible with the common market and exempt Member States from the obligation to notify if they fulfill the criteria for compatibility established by the Commission. These categories are the horizontal aids (small and medium-sized enterprises, research and development, environmental protection, employment

⁷⁸ OECD, 2001, p.155.

⁷⁹ http://www.europarl.europa.eu/factsheets/3_3_3_en.htm (accessed September 12, 2009)

and training), regional aid and *de minimis* aid. The regulation will thus enable the Commission to concentrate control on the ‘essentials’ by simplifying and clarifying existing rules and exerting stricter control on the most important cases.⁸⁰

In addition, the Council recently adopted a regulation containing procedural rules. This regulation also aims at improving the effectiveness of State aid control by codifying the existing practice of the Commission and the jurisprudence of the Court of Justice on the application of Article 108 of The TFEU⁸¹. However, it also contains a number of innovations. Under the title ‘Monitoring’ the Commission is granted the power to make on-site inspections and obtain information from the company concerned directly, should there be serious doubts whether conditional decisions were being complied with.⁸²

Measures are considered to be State aid within the meaning of the related article of TFEU if they fulfill the following conditions;⁸³

- granted by a Member State or through State resources.
- favouring certain undertakings or the production of certain goods.
- it affects trade between Member States.
- it distorts or threatens to distort competition.

⁸⁰ SIMON, S., “Recent Developments in State Aid Policy”, *State Aid and the Single Market*, EC European Economy No:3., EC 1999., p.46.

⁸¹ Detailed information about the Articles will be given in following titles. So it is useful to state just as an explanatory note that Article 108 (ex. Article 88 of TEC) of the Treaty sets out the procedure for the examination of state aid measures by the Commission.

⁸² SIMON 1999, p.46.

⁸³ OECD 2001, p.155.

3.3 Sources of State Aids Regime in the European Union

It is possible to unite the competitive distorting kind of actions aiming or causing prevention, limitation or abolition of competition in the market under two main groups. The se are;⁸⁴

- Distortion of the competition as a result of direct or indirect intervention of the state to the markets as a regulator or an actor of the market by using various tools
- Distortion of the competition as a result of interaction among firms.

State aids are the examples of the first group of actions. Although the motivation factor behind state aids is not directly related with competition, they may cause serious disturbance on it.

State aids rules being in scope of EU competition policy serve three purposes of this policy;⁸⁵

- Elimination of all of the obstacles limiting the free movement in the market
- Formation of a competitive market structure in the common market
- Formation of a market system where the consumer can get maximum utility.

State aids policy is in a close relation with European economy politics observing the system in which market economy and common market is aimed. Existence of an

⁸⁴ İNAN, N., “Rekabetin Korunması ve AB”, *Rekabetin Korunması Hakkında Kanun ve AB Rekabet Politikasına Uyum*, Avrupa Birliği El Kitabı, Merkez Bankası Yayını, Ankara 1995, p.249-250:quated by AŞÇIOĞLU ÖZ 2000, p.16

⁸⁵ AŞÇIOĞLU ÖZ 2000, p.36.

effective competition law and in consequence state aids regulations as a part of this law is carrying a huge importance to reach these aims.

3.3.1 Scope and Authority

EU state aid rules are not a mechanism providing state aid but a tool of the Committee keeping national state aid regulations of member states under control in accordance with the main goal.⁸⁶

The European Union's state aid policy regulates the grant of subsidies by national and sub-national authorities on the grounds that aid of this sort can, at least potentially, distort competition between the EU's member states. The policy has been characterized by three distinctive features: its centrality to the single European market objective; its absence of formal legislation; and its political sensitivity. Resting on a strict notification requirement which has become something of a burden for the Commission, the policy regulates both regional and sectoral aids, as well as those that are horizontal in application and it rules on both individual grants of aid and on aid schemes which establish national frameworks of subsidization. The Commission was endowed with discretion and a monopoly of enforcement in this field by the TFEU. But even though the formal instruments of state aid control

⁸⁶ KÖKSAL 2002, p.293.

were laid out in the 1957 Treaty of Rome, it was only in the mid-1980s that enforcement became a Commission priority.⁸⁷

The European Commission ensures the correct application of state aid rules as a part of EU competition regulations. This involves mainly monitoring and when necessary blocking the implementations. To do this, the Commission has a wide range of inspection and enforcement powers.

Until 1997 there was practically no Council legislation at all in this policy area. Commission policy derived from the Treaty, from Court Judgments and from the Commission's own rules and experience, and while Article 109 [ex.89] did allow the Council of Ministers to issue state aid regulations which might add flesh to the bare bones of the Treaty, this was dependent upon a Commission proposal (Sinnaeve, 1998).⁸⁸ Until the late 1990s no such regulation was agreed by the Council and after 1972 no proposals were made by the Commission. As a result, the Council has been seated very much on the sidelines of what was and still remains a Commission policy.⁸⁹

Community supervision of state aid is based on a system of ex ante authorization. Under this system, Member States are required to inform ("ex ante notification") the Commission of any plan to grant or alter state aid and they are not allowed to

⁸⁷ CINI, Michelle; *From Soft Law to Hard Law? Discretion and Rule-making in the Commissions State Aid Regime*; European Forum Series; RSC No. 2000/35; Robert Schuman Centre for Advanced Studies, p.7.

⁸⁸ SINNAEVE, A; "The Commission's Proposal for a regulation on state aid procedures"; *Competition Policy Newsletter*; No.2, June 1998: Quoted by CINI, p.8

⁸⁹ CINI, p.8.

put such aid into effect before it has been authorized by the Commission (“standstill-principle”). Under the Treaty, the Commission is given the competence to determine whether or not the notified aid measure constitutes state aid in the sense of Article 107(1) of the Treaty, and if it does, whether or not it qualifies for exemption under Article 107(2) or (3) of the Treaty. Member States cannot grant any state aid unless it has been notified and authorized by the Commission. Any aid, which is granted in absence of Commission approval, is automatically classified as “unlawful aid”. Under the present procedural rules, the Commission is under the obligation to order the recovery from the beneficiaries of any unlawful aid that is found to be incompatible with the common market. Moreover, the European Courts have recognized that national judges are competent to decide whether the notification procedures have been complied with and if not, to order recovery of the aid and recovery of the relevant interest.⁹⁰

3.3.2 Relevant European Union Law on State Aids

The positive law about state aids in EU is composed of related articles of TFEU, regulations issued by the Commission and the Council, directives, communications and guidances prepared by the Commission and decisions of the Commission, the Court of Justice, the General Court and National Courts.

Treaty provisions may be classified as core provisions and other relevant provisions. Core provisions consist of Articles 107, 108 and 109 of TFEU. Other

⁹⁰ Vademecum-Community Law on State Aid, p.13
http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf
(accessed May30, 2009)

relevant provisions are; Article 3 of the Treaty of the European Union (TEU), Articles 3, 4, 5, 6 (ex. Article 3 of TEC for four of the new articles), 14 (ex. Article 16 of TEC), 42 (ex. Article 36 of TEC), 50(1), 50(2)(h) (ex. Article 44 of TEC), 93 (ex. Article 73 of TEC), 106 (ex. Article 86 of TEC), 119 (ex. Article 4 of TEC) and 346 (ex. Article 296 of TEC) of the TFEU.

Regulations of the Council are;

- Procedural regulation⁹¹
- Enabling regulation⁹²

Regulations of the Commission are;

- Implementing regulation⁹³
- De Minimis aid⁹⁴
- General Block Exemption Regulation (GBER)⁹⁵

There is just one directive issued by the Commission about ‘transparency of financial relations between member states and public undertakings’⁹⁶.

⁹¹ Council Regulation (EC) No 659/1999 of 22 March 1999, OJ L 83, 27.03.1999, p. 1

⁹² Council Regulation (EC) No 994/98 of 7 May 1998, OJ L 142, 14.05.1998, p. 1

⁹³ Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999

⁹⁴ Commission Regulation (EC) No 1998/2006 of 15 December 2006, OJ L 379, 28.12.2006, p. 5

⁹⁵ Commission Regulation (EC) No 800/2008 of 6 August 2008, OJ L 214, 9.8.2008, p. 3-47

⁹⁶ Commission Directive 2006/111/EC of 16 November 2006, OJ L 318, 17.11.2006, p. 17

There are many notices, frameworks, guidances, information sheets and communications issued by the Commission about the state aids area. Among these the communications about ‘temporary rules established in response to the economic and financial crisis’ will be mentioned in next chapter. Other relevant documents about horizontal rules will not be mentioned here as their main concerns are also consistent in GBER. ‘Sector specific rules’ and ‘specific aid instruments’ are also omitted from the contents of this study to maintain the integrity of main subject.

Finally decisions of the Commission and courts both at national and Union levels form the case law base for the state aids policy in EU. In the next chapter relevant case decisions of the Commission will be given as examples of Commission decisions especially for the crisis circumstances.

3.3.2.1 State Aid Review under Articles 107-109 of TFEU

The legal basis of policy and action on state aids in the European Union has remained substantially unchanged since the Treaty of Rome, the key provisions are Articles 107 to 109.⁹⁷

Article 107 provides for a general prohibition of state aids insofar as they affect trade between the Member States, but then goes on to identify those aids which are compatible with the Treaty and those aids which may be compatible with the Treaty.⁹⁸

⁹⁷ WISHLADE 2003, p.3.

⁹⁸ Ibid, p.4.

Article 107(1) states that:

Save as otherwise provided in the Treaties, any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market.⁹⁹

Article 107(1) contains cumulative conditions which a measure must satisfy in order to be classified a state aid. Aid must be granted by the State or through state resources, confer an advantage upon beneficiaries that carry out an economic activity, it must favor certain undertakings and does be selective, and it must distort competition and affect intra-Community trade. Both the Commission and national courts may classify a measure as state aid.¹⁰⁰

An extremely wide-ranging ban covers:¹⁰¹

- not only aid granted directly by the Member States but also aid that uses state resources, which includes any agencies that might distribute aid on the basis of government funding, such as local authorities, public establishments and various statutory organizations;
- resources "in any form whatsoever", which means not only non-repayable subsidies but also loans on favorable terms and low-interest loans, and forms

⁹⁹ Consolidated version of the Treaty on the Functioning of the European Union - PART THREE: UNION POLICIES AND INTERNAL ACTIONS - TITLE VII: COMMON RULES ON COMPETITION, TAXATION AND APPROXIMATION OF LAWS - Chapter 1: Rules on competition - Section 2: Aids granted by States - Article 107 (ex Article 87 TEC)
http://ec.europa.eu/competition/state_aid/legislation/provisions.html

¹⁰⁰ SCHÜTTE, M., "The Notion of State Aid", *The EC State Aid Regime: Distortive Effects of State Aid on Competition and Trade*, ed. RYDELSKI, M.S., Cameron May, London, 2006: 23-49, p.24.

¹⁰¹ http://www.europarl.europa.eu/factsheets/3_3_3_en.htm (accessed September 12, 2009)

of subsidy in which the donated element is less apparent, such as duty and tax exemptions, loan guarantees, the supply of goods or services on preferential terms and even public shareholdings in companies, which:

- distort or merely threaten to distort competition,
- and are granted not only to undertakings but also to favour the production of certain goods. (This includes support to a specific industry.) However, the aid must be such as to "affect trade between Member States", which rules out any aid that only has internal consequences within a Member State.

Although the notion of state aid under EC law is indeed very wide, it should be noticed that certain measures are not caught by Article 107(1), although they may have an effect on the competitive position of enterprises. The main categories of measures falling outside the scope of EC state aid control are the following:¹⁰²

- **General measures**; Only selective measures, which favour certain enterprises or certain sectors within a Member State, can constitute state aid. Measures which apply to all enterprises in all sectors within that Member State, without any discretionary power of the State to grant them, do not fulfill the selectivity criterion and constitute so-called "general measures". If a Member State, for instance, decides to lower the rate of corporate taxes for all enterprises, this is a measure of general economic policy, not caught by the state aid rules. Furthermore, measures which contain elements of

¹⁰² OECD, 2001, p.157.

selectivity may fall outside of the scope of the state aid rules if the differentiation is justified by the nature or general scheme of the system. In this regard, the progressive nature of an income tax scale or profit tax scale is justified by the redistributive purpose of the tax.

- ***The provision of public goods***: Although the provision of public goods has an effect on enterprises (e.g. availability of qualified workers, good communication and transport facilities etc.), it does not fall under the definition of state aid.
- ***Regulatory measures not involving state resources***: Regulatory regimes in Member States can definitely have an important effect on the costs and competitive position of enterprises. Nevertheless they are not caught by the state aid rules if they do not involve state resources. For example, the level of environmental standards, the strictness of controls, the provisions of labour law and social protection of workers, etc. are not caught by the state aid rules.

The second paragraph (Article 107(2)), indicates those aids that are de jure exempted from the general ban stated in the 1st paragraph of the Article. Three categories of aid are identified. In broad terms, these are: aids of a 'social' nature; aids related to the damage caused by natural disasters; and aids to parts of the Federal Republic of Germany affected by the division of Germany.¹⁰³

¹⁰³ WISHLADE 2003, p.4.

Some exemptions are stated as possible in some circumstances, under Article 107(3). Such exemptions "may be considered" and hence are not automatic.¹⁰⁴ This system of discretionary exemptions confers upon the European Commission the power to assess whether aid can be considered to fall under one of the exemptions and is therefore compatible with the common market. The Commission enjoys here a wide margin of discretion to take a range of social, economic and policy considerations into account and to adapt its rules to the evolution of the common market and the Community objectives. However, the basic principle in the Commission's policy remains the same: aid can only be authorized if it contributes to the achievement of a Community objective in such a way that the distortion of competition is justifiable (principle of compensatory justification)¹⁰⁵. The exemptions evaluated under Article 107 (3) cover:

- aid to underdeveloped regions,
- aid to promote the execution of a major project of European interest or remedy a serious disturbance in the economy of a Member State,
- aid to facilitate the development of certain economic activities or areas, provided it does not adversely affect trading conditions to an extent contrary to the common interest,
- aid to promote culture and heritage conservation,
- other categories as may be specified by the Council.

¹⁰⁴ http://www.europarl.europa.eu/factsheets/3_3_3_en.htm (accessed September 12, 2009)

¹⁰⁵ OECD,2001,p.159

As with the substantive provision in Article 107, equally Article 108 describes the procedures in very broad terms. Member States and undertakings concerned had therefore to rely on case law from the ECJ and soft law measures from the Commission in order to obtain more guidance on the interpretation of this provision.¹⁰⁶

Under the Article 108 of TFEU, the European Commission is the key authority for state aid policy and control. The Commission defines the rules under which aid can be found to be compatible with the common market and carries out the examination of cases, subject to control by the European Court of Justice. The examination of a case is launched either following a notification or, where the notification rules have been infringed, on the basis of a complaint or ex officio. The Commission can thus at any time start to examine an aid measure granted illegally. If it considers that the aid measure or the aid scheme is incompatible with the common market, it will order the Member State to recover it from the beneficiary. The Member State has then to take all necessary measures to ensure that the aid sum, including interest from the payment until the date of recovery, is reimbursed.¹⁰⁷

¹⁰⁶ RYDELSKI 2006, p.18.

¹⁰⁷ OECD, 2001, p.159.

The procedure under Article 108 is conceived as;¹⁰⁸

a. Review of existing aid, under Article 108(1)

This means aid that already existed before the common market was created, or aid already authorized by the Commission. The Commission carries out the review in conjunction with the Member State concerned and may suggest that it take certain action. If it finds that the aid is not compatible with the common market, it initiates infringement proceedings, although this does not have the effect of suspending application of the aid schemes concerned.

b. Treatment of new aid, under Article 108(3)

New aid must be notified in advance: Member States are required to inform the Commission of any plans to grant or alter aid, so that it can submit comments. It follows that the Member States do not have the right to put these plans into effect if they have not received Commission authorization, and that aid granted through plans which have not been notified is illegal and must be repaid. If the Commission considers that an aid plan is incompatible with the common market it initiates infringement proceedings, which suspends application of the measures proposed until there is a final decision.

¹⁰⁸ http://www.europarl.europa.eu/factsheets/3_3_3_en.htm (accessed September 12, 2009)

c. Infringement proceedings, under Article 108(2)

- The Commission formally serves notice on the Member State charged with the offence, requiring it to comment within a given period (normally one month).
- If the comments fail to satisfy the Commission, the latter may decide that the State must alter or abolish the aid within a given period (normally two months).
- If the Member State fails to comply with the Commission decision by the deadline, the Commission, or any other interested State, may refer the matter to the Court of Justice.
- The State concerned may itself apply to the Court within the specified period.
- At the same time, the Member State concerned may apply to the Council for a decision on whether the aid is compatible with the common market. Such an application results in suspension of any infringement proceedings under way, but if the Council has not made its attitude known within three months, the Commission has to give a decision.

In terms of procedure, giving facility in application is also taken into consideration and in the Treaty the Council is enabled to make regulations on a proposal from the Commission regarding the application of Article 107 and Article 108.¹⁰⁹

¹⁰⁹ ÖZKARABÜBER, M.M., *Avrupa Birliği ve Türkiye’de Devlet Yardımlarının Kontrolü, Rekabet Kurumu*, Ankara,2003, p.18.

Accordingly, Article 109 states that;

The Council, on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 107 and 108 and may in particular determine the conditions in which Article 108(3) shall apply and the categories of aid exempted from this procedure. ”¹¹⁰

There are also some other Articles in which aids are mentioned.¹¹¹

Article 42(2) (ex. Article 36 TEC) about agriculture and fisheries states that:

The Council, on a proposal from the Commission, may authorize the granting of aid

- (a) for the protection of enterprises handicapped by structural or natural conditions;
- (b) within the framework of economic development

Article 50 (2) (ex Article 44 TEC) about right of establishment states that:

2. The European Parliament, the Council and the Commission shall carry out the duties devolving upon them under the preceding provisions, in particular:

- (h) by satisfying themselves that the conditions of establishment are not distorted by aids granted by Member States.

Article 93 (ex Article 73 TEC) about transportation states that:

Aids shall be compatible with the Treaties if they meet the needs of coordination of transport or if they represent reimbursement for the discharge of certain obligations inherent in the concept of a public service.

Article 106 (ex Article 86 TEC) (1) and (2) about undertakings states that:

¹¹⁰ Consolidated version of the Treaty on the Functioning of the European Union
http://ec.europa.eu/competition/state_aid/legislation/provisions.html (accessed March 15, 2010)

¹¹¹ Consolidated version of the Treaty on the Functioning of the European Union
http://ec.europa.eu/competition/state_aid/legislation/provisions.html (accessed March 15, 2010)

1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.
2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union.

3.3.2.2 Regulations and Directives

The Council adopted two regulations in the field of state aids; one enabling the Commission to grant group exemptions for certain categories of State aid and one as ‘procedural regulation’ improving the effectiveness of State aid control. The first of these (‘Council Regulation No 994/98 on the application of Article 107 (ex. Article 87) and 108 (ex Article 88) of the Treaty to certain categories of horizontal state aid’, OJ L 142, 14.5.1998) aims to reduce the administrative burden on both Member States and the Commission, thereby enabling the Commission to concentrate on the most important state aid cases.¹¹²

As the second one, Regulation 659/99, adopted on 22 March 1999,, incorporates a number of existing practices. It seeks to clarify and rationalize these, in particular by specifying the deadlines applicable to the various stages of the process and by setting strict rules on the suspension and recovery of aid incompatible with the

¹¹² MEIKLEJOHN, R., “Introduction and Synopsis”, *State Aid and the Single Market*, EC European Economy No:3., EC 1999, p.10.

Treaty. It establishes the Commission's methods of investigation (in particular, making provision for on-site monitoring visits) and the Member States' obligation to cooperate (in particular through annual reports on all existing aid systems). It tries to improve the effectiveness of State aid control by codifying not only the existing practice of the Commission but also the jurisprudence of the Court of Justice on the application of Article 108.¹¹³

However, it also contains a number of innovations. Under the title 'Monitoring' the Commission is granted the power to make on-site inspections and obtain information from the company concerned directly, should there be serious doubts whether conditional decisions were being complied with.¹¹⁴

With the Council Regulation No 994/98 of 7 May 1998, the Commission was enabled to adopt so-called "*block exemption regulations*" for state aids. With these regulations, the Commission can declare some categories of state aid compatible with the Treaty if they fulfill certain conditions, thus exempting them from the requirement of prior notification and Commission approval. In the past, the Commission has adopted several block exemption regulations.¹¹⁵ These regulations are;

¹¹³ http://www.europarl.europa.eu/factsheets/3_3_3_en.htm (accessed September 12, 2009)

¹¹⁴ SIMON 1999, p.46.

¹¹⁵ Vademecum-Community Law on State Aid, p.13
http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf (accessed May30, 2009).

- Training Aid¹¹⁶
- Small and Medium-sized Enterprises (SME) Aid¹¹⁷
- Employment Aid¹¹⁸
- Regional Aid¹¹⁹

Group exemptions allow the Commission to declare certain categories of aid compatible with the common market and exempt Member States from the obligation to notify if they fulfill the criteria for compatibility established by the Commission. These categories are the horizontal aids (small and medium-sized enterprises, research and development, environmental protection, employment and training), regional aid and *de minimis* aid. The regulation will thus enable the Commission to concentrate control on the ‘essentials’ by simplifying and clarifying existing rules and exerting stricter control on the most important cases.¹²⁰

Existing Block Exemption Regulations mentioned above have been superseded by a new GBER (Commission Regulation No 800/2008 of 6 August 2008) which unifies the existing legal framework and introduces further new types of measures which are exempted from the notification obligation. As a result, Member States are able

¹¹⁶ Commission Regulation No 68/2001 of 12 January 2001 OJL10, 13.01.2001, p.20-29

¹¹⁷ Commission Regulation No 70/2001 of 12 January 2001 OJL10, 13.01.2001, p. 33-42

¹¹⁸ Commission Regulation No 2204/2002 of 12 December 2002 OJL337,13.12.2002, p.3-14

¹¹⁹ Commission Regulation (EC) No 1628/2006 of 24 October 2006 OJL 302 of 01.11.2006, p.29

¹²⁰ SIMON 1999, p.46.

to grant aid that meets the conditions laid down in the GBER without the need for giving prior notification to and securing the agreement of the Commission.¹²¹

The GBER reduces the administration involved in granting state aid by increasing the number of categories of state aid which do not need to be notified to the Commission and by consolidating into one text and harmonizing the rules previously existing in five separate Regulations.¹²²

Categories of aid authorized under the GBER are;¹²³

- Small and medium-sized enterprises aid
- Aid in the form of risk capital
- Aid for promoting female entrepreneurship
- Aid for Research & Development & Innovation (R&D&I)
- Environmental aid
- Regional aid
- Training aid
- Aid for disadvantaged and disabled workers

¹²¹ Vademecum-Community Law on State Aid, p.13
http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf
(accessed May30, 2009)

¹²² EU State Aid Policy: General Block Exemption Regulation
http://ec.europa.eu/competition/state_aid/legislation/gber_citizen_summary_sheet_en.pdf
(accessed March 18, 2010)

¹²³ EU State Aid Policy: General Block Exemption Regulation
http://ec.europa.eu/competition/state_aid/legislation/gber_citizen_summary_sheet_en.pdf
(accessed March 18, 2010)

The *de minimis* regulation (Commission Regulation No 1998/2006 of 15 December 2006) had already introduced a major simplification by exempting small subsidies from the obligation to notify them in advance for clearance by the Commission under EC Treaty state aid rules.¹²⁴ This regulation codifying the application of the *de minimis* rule establishes that aid to an enterprise that is below the threshold of €200,000 over a period of three fiscal years and that respects certain conditions, does not constitute state aid in the sense of Article 107(1) of the Treaty, since it is deemed not to affect trade or distort competition. Therefore, any such measure does not need to be notified.¹²⁵

In 2005, the Commission adopted the State Aid Action Plan ('the SAAP'). The SAAP announced that the Commission would improve procedures and thereby better administer state aid control, notably through "more predictable timelines; clear steps in the procedure; [...] higher transparency; encouraging a higher quality of notifications and discouraging incomplete notifications...".¹²⁶

The Action Plan outlines an assessment procedure based on balancing the positive impact of a state aid against its potential negative side-effects. The procedure consists of three steps for evaluating the positive effects of a state aid, three for assessing the negative, anti-competitive effects. In the first three steps, the

¹²⁴ CLERC, E. WOLSKA, K.S., MOLINERO, M.F. and BERGEAU, O., "The Simplification Package in State Aid: Notice on Simplified Procedure and Best Practices Code", *Competition policy newsletter 2009-2* http://ec.europa.eu/competition/publications/cpn/cpn2009_2_2.pdf (accessed March 22, 2010), p.1.

¹²⁵ Vademecum-Community Law on State Aid, p.13 http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf (accessed May30, 2009).

¹²⁶ CLERC et al. 2009, p.1.

Commission asks (i) whether an objective of common interest has been accurately identified, (ii) whether state aid is an appropriate instrument for achieving the objective and (iii) whether the aid creates the necessary incentives and is proportionate. Implicitly, it is assumed that objectives of common interest are normally related to remedying market failures, although equity considerations and merit goods may also be taken into account. To assess the anti-competitive effects, the Commission considers (i) the procedure followed by the Member State to select beneficiaries, (ii) the characteristics of the market and the beneficiary and (iii) the amount and type of aid. The Action Plan does not specify how – i.e. according to what welfare function - the positive and negative effects will be balanced.¹²⁷

The Simplification Package adopted in April 2009, which entered into force on 1 September 2009, should therefore be analyzed in the context of this overall modernization of State aid rules and procedures, as announced in the SAAP. It consists of two components: the Simplified Procedure Notice¹²⁸ and the Best Practices Code¹²⁹. The Simplified Procedure Notice applies to ‘straightforward’ cases, including cases falling within ‘standard assessment’ sections of existing frameworks and guidelines (but outside the scope of the GBER) and cases which are firmly in line with constant Commission decision-making practice. Such straightforward cases will then be decided upon within an accelerated timeframe of one month after notification. The Best Practices Code applies to all other notified

¹²⁷ Buelens, Garnier and Meiklejohn 2007, p.3

¹²⁸ OJ C 136/3, 16.06.2009, p. 3-12.

¹²⁹ OJ C 136/4, 16.06.2009, p. 13-20.

State aid cases, whether they are novel, technically complex, or simply not immediately in conformity, at first sight, with State aid rules. It provides guidance on the day-today conduct of State aid proceedings and it aims to ensure speedier, more transparent and predictable handling of State aid cases. Currently, it takes six months, on average, for the Commission to adopt decisions based on a preliminary investigation of notified measures, and twenty months if the Commission opens a formal in-depth investigation. Such time-lines, and the lack of predictability regarding the likely timing of decisions on individual cases, are not sufficiently adapted to the needs of modern business. The Simplification Package therefore offers, within the existing legal framework of Regulation 659/1999, a joint commitment by the Commission and Member States to improve the transparency and predictability of State aid procedures and to shorten their duration.¹³⁰

3.3.2.3 Review Procedure of the Commission

The Community's system of control of state aid requires Member States to notify their aid schemes to the Commission and obtain its authorization before they implement them.¹³¹

It is the Member State concerned (central authorities), which must notify planned aid measures, through their Permanent Representation. In order to speed up treatment, the Commission has drawn up standard notification forms for most types of aid. A dedicated software ("SANI") has been made available to Member States to

¹³⁰ CLERC et al. 2009, p.1-2

¹³¹ NICOLAIDES,P., KEKELEKIS,M., BUYSKES, P., *State aid policy in the European Community: a guide for practitioners*, Kluwer Law International, Netherland,2005, p.54

facilitate and accelerate the notification process. If the notification is incomplete, the Commission will request further information. The Member State concerned is usually given 20 days to supply this information.¹³²

There are a number of exceptions from the notification requirement;¹³³

- In case of *de minimis* aid
- For aid measures covered by an authorized aid scheme
- Aid covered by group exemption regulations

The Commission has two months within which to examine the proposed aid. The two-month period runs from the date that the Commission has received all the information it needs to assess the case and the notification can be considered as complete. This examination will normally be concluded either by a “decision not to raise objections” or by a “decision to initiate Article 108(2) proceedings”:¹³⁴

If the Commission decides not to raise any objection, the aid measure concerned can be implemented.¹³⁵

The Commission initiates Article 108(2) proceedings if it has doubts about the compatibility of the notified aid measure with the common market. In such cases,

¹³² Vademecum-Community Law on State Aid, p.14
http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf
(accessed May30, 2009).

¹³³ NICOLAIDES, KEKELEKIS and BUYSKES 2005, p.59

¹³⁴ Vademecum-Community Law on State Aid, p.14
http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf
(accessed May30, 2009)

¹³⁵ Ibid, p.14.

the Commission opens a “formal investigation”. It publishes a description of the aid in the Official Journal and on its website and invites the Member State concerned and interested parties to comment. At the end of the enquiry, the Commission adopts a final decision. This may be either positive (aid can be implemented), negative (aid can not be implemented) or positive, but subject to stated conditions (aid can be implemented if certain conditions are met). The indicative maximum time-limit foreseen for such an enquiry is 18 months.¹³⁶

The Commission could probably not refuse to authorize a State aid, complying with all the conditions defined in the relevant State aid rules, for the sole reason that the objective could also be achieved in a different, perhaps even more efficient way. The choices made by Member States are the result of a variety of political, economic and other considerations. It is not the Commission’s task of competence to intervene in these decisions, as long as the State aid rules, which should within their scope ensure that the distortion of competition is kept to a minimum, are respected.¹³⁷

All decisions are subject to review by the Court of Justice under Article 263 (ex. Article 230 of TEC) of the Treaty. National courts also play a role (for the specific

¹³⁶ Ibid, p.14.

¹³⁷ OECD 2001, p.162

scenarios about unlawful aids and negative decisions of the Commission) with respect to enforcement of Commission recovery decisions.¹³⁸

3.3.2.4 Court Decisions

Apart from Commission decisions, case law about state aids is formed by the decisions of the Court of Justice (the Court), the General Court¹³⁹ and national courts of Member States.

The Court of Justice and the General Court

At present the Court of Justice (the Court) has a general supervisory role as regards the legality of all measures adopted by the Community institutions. This jurisdiction is conferred by the Article 263 and is equivalent to both judicial review and constitutional review. This role is shared with the *General Court*. At present the demarcation between their respective spheres of jurisdiction is determined by the identity of the plaintiff who challenges the Community measure. Where an action is brought by a private party, that is, a natural or legal person (including a sub-national government entity), the *General Court* has jurisdiction; the Court has jurisdiction

¹³⁸ Vademecum-Community Law on State Aid, p.14
http://ec.europa.eu/competition/state_aid/studies_reports/vademecum_on_rules_09_2008_en.pdf (accessed May30, 2009)

¹³⁹ From its inception on 1 January 1989 to 30 November 2009, the General Court was known as the *Court of First Instance*.

where the action is brought by a Member State or by another Community institution.¹⁴⁰

In order to avoid duplication of judicial effort and, more importantly, the risk of conflicting simultaneous judgments, one of the two Courts will suspend the procedures in the actions pending before it, leaving it to the other Court to issue judgment in the case(s) before it. Normally it is the Court that suspends its procedures. However it is possible for the *General Court* to surrender jurisdiction over an action brought by a private person, allowing the case to be transferred to the Court and to be joined to parallel proceedings commenced by a Member State.¹⁴¹

*National Courts*¹⁴²

On 4 April 2009, the Commission adopted its new Notice on the enforcement of state aid law by national courts ('the new Notice'). The new Notice replaces the former cooperation Notice dating back to 1995. The main purpose of the new Notice is to inform national courts and third parties of the remedies available in the event of a breach of state aid rules and to provide them with guidance as to the practical application of those remedies. In addition, the Commission is seeking to develop its cooperation with national courts by introducing more practical tools to support national judges in their daily work. This consists of requests for the

¹⁴⁰ FLYNN, L., "Remedies in the European Courts", *The Law Of State Aid in the European Union*, ed. BIONDI, A., EECKHOUT, P. and FLYNN, J., Oxford University Press, NY, 2004, p.283-284.

¹⁴¹ Ibid, p.284.

¹⁴² LESSENICH, C.,and BERANGER, T., "The Commission notice on the enforcement of State aid law by national courts", *Competition policy newsletter 2009-2*, p.1-5
http://ec.europa.eu/competition/publications/cpn/cpn2009_2_3.pdf (accessed March 22, 2010).

transmission of information in the possession of the Commission and/or requests for Commission opinions on the application of state aid rules.

One of the most important novelties of the new Notice is that, compared to its predecessor, it contains much more detailed guidance on the role of national courts in dealing with unlawful state aid. The new Notice, addresses the role of national courts in different scenarios, namely:

- actions aimed at preventing the payment of unlawful aid
- actions aimed at the recovery of unlawful aid already granted
- actions for the compensation of damage suffered as a result of the unlawful aid
- actions aimed at interim measures against unlawful aid

The new Notice also addresses the role of national courts in scenarios where the Commission has already adopted a negative decision obliging the Member State to recover the aid from the beneficiary. In such circumstances, beneficiaries frequently ask national courts to review the legality of recovery orders issued by the national authorities or to suspend their implementation. The new Notice recalls the general principle that an action at national level cannot be used to question the validity of the Commission's negative decision where this decision could have been challenged before the Community courts.

The new Notice introduces two distinct mechanisms for the Commission's cooperation with national courts. National courts can either ask the Commission to

provide information in its possession or ask for a Commission opinion on the application of the state aid rules.

3.4 Conclusion

Since the beginning of the EU history, competition subject has been critically important in terms of realizing the goals to set up and to maintain the market economy and common market. The supranational structure has provided the facility to be effective on the competition implementations of the Member States. The same situation is valid for the issue of state aids as part of the competition policy.

It is crucial to attend to the point that EU has a state aids mechanism but just as a supervisor not as a provider. In this context, it has just one concern which is to protect the competitive market economy. It is away from the difficulty caused by the reluctance to control its own grants usable for any needed social, political or economic purpose. Therefore, unlike any other governments, it may be evaluated as another convenience.

It is an important point that the Union has a strict mechanism monitoring and supervising the implementations of state aids rules. Although there is no act on state aids, rules taking root from treaties, regulations, directives, communications, guidances and case law have the same mandatory and binding implications on the states.

Articles 107-109 of TFEU as the core provisions draw the frame by defining state aids, setting the conditions of these aids, specifying the compatible and potentially

compatible aids and determining the authority. Such a detailed scope of these three articles gives a clue about the strict standing of the Union on the issue.

Although the European Commission is the key authority for state aids control, it is not the only institution responsible for maintaining the order in this arena. In policy making about aids the Council and the Parliament are authorized by the provisions of the TFEU. Courts at both the national and supranational levels are parts of the monitoring mechanism. By looking at the recent regulations, it may be supposed that the cooperation between supranational and national institutions about the monitoring issue is increasing.

CHAPTER 4

STATE AIDS IN THE EUROPEAN UNION IN POST-2008 FINANCIAL CRISIS WITH SPECIFIC REFERENCE TO THE BANKING SECTOR

4.1 Regulations about State Aids in Post-2008 Financial Crisis

4.1.1 Regulations for the Financial Sector

At the beginning of the autumn 2008, the financial crisis hit the economies of EU Member States in a systemic manner. Many EU governments took measures to support financial stability, to restore confidence in the financial markets and to minimize the risk of a serious credit crunch. In the field of competition policy – and of State aid control in particular – the role of the Commission has been to support financial stability by promptly giving legal certainty to the measures taken by Member States. The Commission also contributed to maintaining a level playing field and ensuring that national measures would not simply export problems to other Member States.¹⁴³

The Council has also emphasized the necessity of maintaining the application of competition rules. The Commission must ensure a level playing field for European

¹⁴³ Report From The Commission, Report on Competition Policy 2008, Brussels, 23.7.2009, p.14, http://ec.europa.eu/competition/publications/annual_report/2008/en.pdf (accessed September 9, 2009)

businesses and prevent Member States engaging in subsidy races which would be unsustainable and detrimental to the EU as a whole.¹⁴⁴

The EU's competition policy played a central role in finding solutions to the financial crisis. In compliance with State aid rules, the Commission approved and coordinated Member States' extraordinary measures taken to safeguard financial stability, such as the guarantee umbrellas, recapitalization measures and *ad hoc* rescue and restructuring measures in favour of individual financial institutions. It set out the conditions for granting these special state aids and monitored if these conditions and the relevant EC Treaty rules were being observed. The Commission oversight was aimed at maintaining the level playing field by limiting as much as possible competitive distortions, fighting protectionism and preserving the functioning of the Single Market.¹⁴⁵

Since the beginning of this crisis, Member States have announced unprecedented support measures for the financial sector, ranging from increased (or even unlimited) deposit guarantees, inter-bank credit guarantees, direct capital injections and partial nationalization through to individual rescue packages. Many of these measures fall under European State aid rules.¹⁴⁶ So the Commission introduced

¹⁴⁴ CAMPO, M., "The new State aid temporary framework", *Competition Policy Newsletter*, 2009-1, http://ec.europa.eu/competition/publications/cpn/2009_1_6.pdf (accessed March 22, 2010)

¹⁴⁵ Commission Staff Working Document, European Financial Integration Report 2009, p.21, http://www.ecb.europa.eu/events/pdf/conferences/ws_eucom_ecb/efir_report_2009_en.pdf?9748630d5ab64bbd871d48c98e8d174a (accessed March 22, 2010)

¹⁴⁶ Competition Policy Newsletter; 2008 - Special edition focusing on the reform of State aid rules, http://ec.europa.eu/competition/publications/cpn/2008_special_sa.pdf (accessed March 22, 2010)

several crisis-specific communications¹⁴⁷ to assess state aids granted to financial institutions.

In its Communications, the Commission recognized that the severity of the crisis justified the granting of aid under Article 107(3)(b) of TFEU which allows aid ‘to remedy a serious disturbance in the economy of a Member State’. It also set out a framework for the provision of public guarantees, recapitalization measures, and impaired asset relief, whether granted by States to individual banks or as part of a wider national scheme.¹⁴⁸

The importance of maintaining State aid rules was confirmed again in the Communication adopted by the Commission on 26 November 2008, *A European Economic Recovery Plan* (“the Recovery Plan”). This document constitutes a global action plan to drive Europe’s recovery from the current financial crisis. This plan rests on two pillars:¹⁴⁹

¹⁴⁷ ‘Communication from the Commission on the application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis’ (the **‘Banking Communication’**), 25 October 2008; OJ 2008 C 270, 25.10.2008, p. 9; ‘Communication from the Commission on the recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition’ (the **‘Recapitalisation Communication’**); 15 January 2009; OJ C 10, 15.1.2009, p. 2-8; ‘Communication from the Commission on the treatment of impaired assets in the Community banking sector’ (the **‘Impaired Assets Communication’**), 26 March 2009; OJ C 72, 26.3.2009, p. 1; ‘Communication from the Commission on the return to viability and the assessment of restructuring measures in the financial sector in the current crisis under the State aid rules’ (the **‘Restructuring Communication’**), 19 August 2009. OJ C 195, 19.8.2009, p.10-11

¹⁴⁸ ADLER,A., KAVANAGH,J. and UGRYUMOV,A., “State Aid to Banks in the Financial Crisis: The Past and the Future”, *Journal of European Competition Law & Practice*, 2010, Vol. 1, No. 1, <http://jeclap.oxfordjournals.org/cgi/reprint/1/1/66> (accessed April 22, 2010)

¹⁴⁹ CAMPO,M., The new State aid temporary framework, Competition Policy Newsletter, 2009-1, http://ec.europa.eu/competition/publications/cpn/2009_1_6.pdf

- a boost to purchasing power that increases demand and confidence in the economy; and
- immediate actions that will boost long-term competitiveness, such as investing in a greener economy through technology.

Although issued specifically in response to the crisis and only for aid granted to financial institutions, the Communications are based on the same three general principles set out in the 2004 ‘Community Guidelines on State aid for rescuing and restructuring firms in difficulty’ (the ‘R&R guidelines’). Those principles require the following.¹⁵⁰

- Restoration of long-term viability—the aid should lead to the restoration of viability of the beneficiary in the longer term without State aid.
- Avoidance of undue distortions to competition—the aid should be accompanied, to the extent possible, by measures to minimize distortions to competition.
- Ensuring appropriate burden sharing—the aid should be limited to the minimum required and accompanied by adequate burden-sharing.

While the Commission is applying the general framework and tools designed for dealing with aid granted to failing firms, it recognizes that the problems faced by banks in current circumstances are substantially different. For one, the ‘traditional’ R&R guidelines addressed the problem of how to deal with a single failing firm,

¹⁵⁰ ADLER,A., KAVANAGH,J. and UGRYUMOV,A., “State Aid to Banks in the Financial Crisis: The Past and the Future”, *Journal of European Competition Law & Practice*, 2010, Vol. 1, No. 1, <http://jeclap.oxfordjournals.org/cgi/reprint/1/1/66> (accessed April 22, 2010)

while the new crisis-specific Communications are attempting to deal with problems in an entire sector.¹⁵¹

Contents and main principles of these Communications are tried to be summarized as follows:

4.1.1.1 The Banking Communication

While the exceptional circumstances prevailing at the moment have to be duly taken into account when applying the State aid rules to measures addressing the crisis in the financial markets the Commission has to ensure that such measures do not generate unnecessary distortions of competitions between financial institutions operating in the market or negative spillover effects on other Member States. It is the purpose of this Communication to provide guidance on the criteria relevant for the compatibility with the Treaty of general schemes as well as individual cases of application of such schemes and ad hoc cases of systemic relevance. In applying these criteria to measures taken by Member States, the Commission will proceed with the swiftness that is necessary to ensure legal certainty and to restore confidence in financial markets.¹⁵²

In order to assist Member States in their efforts to design support schemes that are in line with State aid rules, the European Commission has published the Communication on how the State aid rules apply to measures taken in relation to financial institutions in the context of the current global financial crisis. The

¹⁵¹ Ibid

¹⁵² OJ 2008 C 270, 25.10.2008, p. 9

Commission acknowledges in this Communication the exceptional circumstances and the systemic risks inherent to a financial crisis and takes them into account when dealing with support schemes. Coordinated action by Member States and the Commission has ensured that support measures could be implemented with minimal spillover effects and distortions of competition.¹⁵³

The European Commission published this guidance on how Member States can best support financial institutions in the current financial crisis whilst respecting EU state aid rules and so avoiding excessive distortions of competition. The guidance is based in particular on EC Treaty rules allowing for aid to remedy a serious disturbance in the economy of a Member State (Article 87.3.b of the EC Treaty).¹⁵⁴

The Commission's guidance (in the form of a Communication) indicates how the Commission intends to apply EC Treaty state aid rules to state support schemes and individual assistance for financial institutions in the current crisis.¹⁵⁵

Given the scale of the crisis, now also endangering fundamentally sound banks, the high degree of integration and interdependence of European financial markets, and the drastic repercussions of the potential failure of a systemically relevant financial institution further exacerbating the crisis, the Commission recognizes that Member States may consider it necessary to adopt appropriate measures to safeguard the

¹⁵³ Competition Policy Newsletter; 2008 - Special edition focusing on the reform of State aid rules, http://ec.europa.eu/competition/publications/cpn/2008_special_sa.pdf (accessed March 22, 2010)

¹⁵⁴ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1495&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed April 10, 2010)

¹⁵⁵ Ibid

stability of the financial system. Due to the particular nature of the current problems in the financial sector such measures may have to extend beyond the stabilization of individual financial institutions and include general schemes.¹⁵⁶

Support schemes such as guarantees or recapitalization schemes can be cleared by the Commission very quickly if they fulfill conditions which guarantee that they are well-targeted and proportionate to the objective of stabilizing financial markets and contain certain safeguards against unnecessary negative effects on competition. The specific conditions include:¹⁵⁷

- Non-discriminatory access in order to protect the functioning of the Single Market by making sure that eligibility for a support scheme is not based on nationality
- State commitments to be limited in time in such a way that it is ensured that support can be provided as long as it is necessary to cope with the current turmoil in financial markets but will be reviewed and adjusted or terminated as soon as improved market conditions so permit
- State support to be clearly defined and limited in scope to what is necessary to address the acute crisis in financial markets while excluding unjustified benefits for shareholders of financial institutions at the taxpayer's expense
- An appropriate contribution of the private sector by way of an adequate remuneration for the introduction of general support schemes (such as a

¹⁵⁶ OJ 2008 C 270, 25.10.2008, p. 8

¹⁵⁷ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1495&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed April 10, 2010)

guarantee scheme) and the coverage by the private sector of at least a significant part of the cost of assistance granted

- Sufficient behavioural rules for beneficiaries that prevent an abuse of state support, like for example expansion and aggressive market strategies on the back of a state guarantee
- An appropriate follow-up by structural adjustment measures for the financial sector as a whole and/or by restructuring individual financial institutions that had to rely on state intervention.

The observance of these principles, including in individual aid measures, will have to be ensured by Member States and will be monitored by the Commission. The Commission is available to advise Member States, on the basis of this guidance, on how best to tailor national measures to comply with EU state aid rules in advance of finalization of a particular scheme.¹⁵⁸

4.1.1.2 The Recapitalization Communication

The Banking Communication recognizes that recapitalization schemes are one of the key measures that Member States can take to preserve the stability and proper functioning of financial markets. It is recognized that recapitalization contributes to financial stability and restores confidence needed for inter-bank lending, ensures

¹⁵⁸ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1495&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed April 10, 2010)

lending to real economy, and may provide a solution for financial institutions facing insolvency.¹⁵⁹

The assessment of any recapitalization scheme or measure must take into account possible distortions of competition at three different levels.¹⁶⁰

- Ensuring fair competition between Member States
- Ensuring fair competition between banks.
- Ensuring a return to normal market functioning

Any proposed recapitalization has cumulative competitive effects at each of these three levels. However, a balance must be struck between these competition concerns and the objectives of restoring financial stability, ensuring lending to the real economy and dealing with the risk of insolvency. On the one hand, banks must have sufficiently favourable terms of access to capital in order to make the recapitalization as effective as necessary. On the other hand, the conditions tied to any recapitalization measure should ensure a level playing field and, in the longer-term, a return to normal market conditions. State interventions should therefore be proportionate and temporary and should be designed in a way that provides incentives for banks to redeem the State as soon as market circumstances permit, in order for a competitive and efficient European banking sector to emerge from the crisis. Market-oriented pricing of capital injections would be the best safeguard

¹⁵⁹ SCHMITT, J.P. and BINDER, U.; *State Aid: European Commission Issues Communication on Recapitalization of Financial Institutions*
<http://www.thefreelibrary.com/State+Aid:+European+Commission+Issues+Communication+on+...-a0190716507> (accessed April 16, 2010)

¹⁶⁰ OJ C 10, 15.1.2009, p. 2-8

against unjustified disparities in the level of capitalization and improper use of such capital. In all cases, Member States should ensure that any recapitalization of a bank is based on genuine need.¹⁶¹

The balance to be achieved between financial stability and competition objectives underlines the importance of the distinction between fundamentally sound, well-performing banks on one hand and distressed, less-performing banks on the other.¹⁶²

4.1.1.3 The Impaired Assets Communication

The Communication takes account of the recommendations of the European Central Bank and takes into account the extensive discussions with Member States over the last two months on the appropriate way to deal with impaired assets. It addresses the rationale for asset relief as a measure to safeguard financial stability and underpin bank lending; the longer-term considerations of banking-sector viability and budgetary sustainability to be taken into account when considering asset relief measures; and the need for a common and coordinated EU approach to asset relief, notably to ensure a level playing field.¹⁶³

This Communication focuses on issues to be addressed by Member States in considering, designing and implementing asset relief measures. At a general level,

¹⁶¹ OJ C 10, 15.1.2009, p. 2-8

¹⁶² OJ C 10, 15.1.2009, p. 2-8

¹⁶³ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/322&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed April 10, 2010)

those issues include the rationale for asset relief as a measure to safeguard financial stability and underpin bank lending, the longer-term considerations of banking-sector viability and budgetary sustainability to be taken into account when considering asset relief measures and the need for a common and coordinated Community approach to asset relief, notably to ensure a level playing field.¹⁶⁴

The guidance for the application of the State aid rules is based on a number of principles:¹⁶⁵

- full transparency and disclosure of impairments, which has to be done prior to government intervention;
- coordinated approach to the identification of assets eligible for asset relief measures through development of eligible categories of assets ("baskets");
- coordinated approach to valuation of assets ex-ante, based on common principles such as valuation based on real economic value (rather than market value), implemented by independent experts and certified by bank supervisors,
- validation by the Commission of the valuation of the assets, in the framework of the State aid procedures on the basis of uniform assessment criteria;
- adequate burden-sharing of the costs related to impaired asset between the shareholders, the creditors and the State,

¹⁶⁴ OJ C 72, 26.3.2009, p. 1

¹⁶⁵ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/322&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed April 10, 2010)

- adequate remuneration for the State, at least equivalent to the remuneration of State capital
- coverage of the losses incurred from the valuation of the assets at real-economic-value by the bank benefiting from the scheme
- aligning incentives for banks to participate in asset relief with public policy objectives, through an enrolment window limited to six months during which the banks would be able to come forward with impaired assets;
- management of assets subject to relief so as to avoid conflicts of interests; appropriate restructuring including measures to remedy competition distortion, following a case by case assessment and taking into account the total aid received through recapitalization, guarantees or asset relief, with a view to the long-term viability and normal functioning of the European banking industry.

The design of the asset relief scheme, be it asset purchase, insurance, swap, guarantee or hybrid models, is the responsibility of the Member State. Their treatment from the State aid point of view will however be subject to uniform assessment criteria, which should maintain a level playing field. The Commission approval for asset relief measures will be granted for a period of six months, and conditional on the commitment to present details of the valuation of the impaired

assets, as well as an viability assessment and restructuring plan for each beneficiary institution within 3 months from its accession to the asset relief programme.¹⁶⁶

4.1.1.4 The Restructuring Communication

The Commission has to deal with a large number of individual cases of bank restructuring, which follow from bank rescue aid measures approved on the condition that a restructuring plan would be submitted within six months. In order to foster transparency, predictability and equality of treatment between Member States, the Commission has issued guidelines to clarify its approach, the criteria it will base its assessment upon and the type of information required to guide this assessment. These guidelines are based on Article 107 of TFEU, which authorizes state aid in case of a serious disturbance in the economy. They will be temporary and apply until the end of 2010. After that date, the normal rules on rescue and restructuring, based on Article 107.3(c) of TFEU of the Treaty (aid for the development of certain economic activities or areas where such aid does not adversely affect trading conditions to an extent contrary to the common interest) should resume.¹⁶⁷

This Communication explains how the Commission will examine aid for the restructuring of banks in the current crisis, taking into account the need to modulate past practice in the light of the nature and the global scale of the crisis, the systemic

¹⁶⁶ <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/322&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed April 10, 2010)

¹⁶⁷ Press Release No: IP/09/1180
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1180&format=HTML&aged=0&language=EN&guiLanguage=en> (accessed April 15, 2010)

role of the banking sector for the whole economy, and the systemic effects which may arise from the need of a number of banks to restructure within the same period:¹⁶⁸

- The restructuring plan will need to include a thorough diagnosis of the bank's problems. In order to devise sustainable strategies for the restoration of viability, banks will therefore be required to stress test their business. This first step in the restoration of viability should be based on common parameters which will build to the extent possible on appropriate methodologies agreed at Community level. Banks will also be required, where applicable, to disclose impaired assets.
- Given the overriding goal of financial stability and the prevailing difficult economic outlook throughout the Community, special attention will be given to the design of a restructuring plan, and in particular to ensuring a sufficiently flexible and realistic timing of the necessary implementation steps. Where the immediate implementation of structural measures is not possible due to market circumstances, intermediate behavioural safeguards should be considered.
- The Commission will apply the basic principle of appropriate burden sharing between Member States and the beneficiary banks with the overall situation of the financial sector in mind. Where significant burden sharing is not immediately possible due to market circumstances at the time of the

¹⁶⁸ OJ C 195, 19.8.2009, p.10-11

rescue, this should be addressed at a later stage of the implementation of the restructuring plan.

- Measures to limit distortion of competition by a rescued bank in the same Member State or in other Member States should be designed in a way that limits any disadvantage to other banks while taking into account the fact that the systemic nature of the current crisis has required very widespread State intervention in the sector.
- Provision of additional aid during the restructuring period should remain a possibility if justified by reasons of financial stability. Any additional aid should remain limited to the minimum necessary to ensure viability.

4.1.2 Regulations for the Real Sector

By the end of 2008, the impact of the crisis in the real economy was becoming more obvious, feeding into a serious downturn affecting businesses and jobs. As a consequence and following the announcement of the Recovery Plan, the Commission adopted on 17 December 2008, in record time, a new Temporary framework containing additional State aid measures aimed at facilitating companies' access to finance. This Communication¹⁶⁹ thus focuses on the “economic crisis” and its effects on the real economy.¹⁷⁰

¹⁶⁹ Communication from the commission - Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis; OJ C 83 of 07.04.2009, p. 1

¹⁷⁰ CAMPO,M., “The new State aid temporary framework”, *Competition Policy Newsletter, 2009-1*, http://ec.europa.eu/competition/publications/cpn/2009_1_6.pdf (accessed March 22, 2010)

By this Communication, the Member states are temporarily enabled to grant state aids under specific conditions caused by the financial crisis.

The financial crisis has a deep impact mainly on the banking sector. It is accepted by the Union that the sectors need to be supported at national level in such a circumstance but to protect market economy and common market coordination among Member States is a must.

The financial sector should be supported to maintain that banks can carry on their normal lending activities. By this way not only the financial sector is normalized but also the real sector is saved from the worsening effects of the crisis.

This framework prepared in light of these view points focused on three objectives:¹⁷¹

- to immediately unblock bank lending, thereby preserving continuity in companies' access to finance;
- to ensure that limited amounts of aid reach the recipients in the most rapid and effective way;
- to encourage companies to continue investing in a sustainable future, including the development of green products.

This approach is fully in line with the Council requirement that application of the competition rules be maintained. The Commission did not modify the existing State

¹⁷¹ Ibid

aid rules but provided additional possibilities for granting State aid tailored to exceptional circumstances.¹⁷²

The Commission applies this Communication from 17 December 2008, the date on which it agreed in principle its content, having regard to the financial and economic context which required immediate action. This Communication is justified by the current exceptional and transitory financing problems related to the banking crisis and will not be applied after 31 December 2010. After consulting Member States, the Commission may review it before that date on the basis of important competition policy or economic considerations.¹⁷³

This is because the Commission has considered that the current global crisis requires extraordinary policy responses but for a limited period of time. The proposed measures are strictly linked to the crisis and would not be justified under different circumstances.¹⁷⁴

There are two other communications amending this Communication. The first amendment¹⁷⁵ regulates a separate compatible limited amount of aids applicable to undertakings active in the primary production of agricultural products as the former communication did not include the aids for these undertakings. On the other hand, while the previous Framework had limited the calculation of the maximum loan just

¹⁷² Ibid

¹⁷³ OJ C 83 of 07.04.2009, p. 1

¹⁷⁴ CAMPO, M., “The new State aid temporary framework”, *Competition Policy Newsletter, 2009-1*, http://ec.europa.eu/competition/publications/cpn/2009_1_6.pdf (accessed March 22, 2010)

¹⁷⁵ OJ C 261 of 31.10.2009, p. 2

on the basis of the total annual wage bill of the beneficiary for 2008, the second amendment¹⁷⁶ brought the option to determine this amount also on the basis of the annual EU 27 average labour costs,

4.2 Relevant Case Examples

The consistent methodology set out in the guidance documents mentioned above has enabled the rapid design and approval of a large number of national schemes and individual measures to tackle the crisis, whilst avoiding harmful economic imbalances between banks and between Member States.¹⁷⁷

Since the beginning of the crisis effects in Europe, 150 cases related with the financial sector have been the object of a Commission decision under Article 107(3)(b) of TFEU on aid to remedy a serious disturbance in the economy. 47 of these cases are ad hoc cases*, 24 are individual application cases** and 79 are about aid schemes***.^{178 179}

¹⁷⁶ OJ C 303 of 15.12.2009, p. 6

¹⁷⁷ Report From The Commission, Report on Competition Policy 2008, Brussels, 23.7.2009, p.14, http://ec.europa.eu/competition/publications/annual_report/2008/en.pdf (accessed September 9, 2009)

¹⁷⁸ Between the dates 01.07.2008-15.04.2010

¹⁷⁹ There are three types of these cases;

***Ad Hoc Case** (aid not granted on the basis of an already approved scheme);

****Individual Applications of the scheme** (aid granted on the basis of an already approved scheme for which the Commission requested the individual notification while approving the scheme);

*****Schemes** (acts of abstract and general character, on the basis of which individual aid awards may be made to undertakings without the necessity of notifying individually to the Commission).

A few important cases of each type may be mentioned here as examples. Each case is selected by attending their specific importance in equivalents. The example of ad hoc cases is one of the first cases of the type notified in crisis term, it is also referred as a good guide for following interventions aiming to strengthen the financial sector. The example of individual application case is selected as it is one of the first decisions about a financial institution damaged by the financial crisis. The scheme type's example is also a preliminary case of its category. It displays the Commissions role of monitoring and supervising the Member States' granting activities in crisis term. Finally apart from the case types, one more example is thought appropriate to mention to draw the attention to the Commission's rapprochement about nationalization.

4.2.1 Liquidity Support Scheme for Banks in Denmark

As an ad hoc case, by its decision dated October 10th 2008 , the European Commission approved under EC Treaty state aid rules a Danish scheme¹⁸⁰ aimed at restoring confidence in the Danish financial markets in order to remedy a serious disturbance in the economy of Denmark. The scheme would provide liquidity facilities for banks operating in Denmark and protect depositors and ordinary creditors in case of insolvency. The Commission found the scheme to be compatible with EU state aid rules because it is the most appropriate means to address the risk of a severe disturbance in the Danish economy, while keeping potential distortions of competition to a minimum through effective safeguard mechanisms. The

¹⁸⁰ Liquidity support scheme for banks in Denmark, Case No: NN 51/2008, Decision date: 10.10.2008

Commission took into particular account that the guarantee scheme is limited to fundamentally sound financial institutions while insolvent banks need to be immediately unwound, that it is open to all banks established in Denmark but that it requires a significant financial contribution which ensures that an adequate premium is paid for the guarantee. Moreover, the scheme ensures that the participating banks can neither on an individual nor on an aggregate level significantly expand their activities, as measured against established benchmarks. The scheme will remain in force for two years.¹⁸¹

According to Competition Commissioner Neelie Kroes this scheme is an excellent example of the type of intervention that can strengthen financial markets in the current financial turmoil, without making the situation worse in other countries.¹⁸²

4.2.2 Capital Injection into Commerzbank

The case of capital injection into Commerzbank¹⁸³ is an important example of individual application case type. By this case, the Commission approved the EUR 18 billion recapitalization of Commerzbank AG ("Commerzbank"). It was one of the first decisions the Commission has taken on a restructuring case originating from the financial crisis. It anticipated what was subsequently set out in the Commission Communication on the return to viability and the assessment of

¹⁸¹ Pres Release no: IP/08/1483
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1483> (accessed April 15, 2010)

¹⁸² Ibid

¹⁸³ Capital injection into Commerzbank, Case No: N 244/2009 Decision date: 07.05.2009

restructuring measures in the financial sector in the current crisis under the State aid rules ("the Restructuring Communication").¹⁸⁴

On the basis of the German financial crisis scheme, Germany already granted €8 billion of capital to the bank in December 2008 and intends to grant another €10 billion of capital. Germany notified this second tranche to the Commission for reasons of legal certainty so that the Commission could verify the compatibility of the measure with state aid rules. On the basis of the notified plans, the Commission is satisfied that Commerzbank's long term viability has been demonstrated, and that the aid is kept to the minimum and will not lead to undue distortions of competition. It has therefore declared the aid compatible.¹⁸⁵

4.2.3 Guarantee Scheme for Banks in Ireland

The case of 'Guarantee scheme for banks in Ireland'¹⁸⁶ is an important example of scheme type as it laid out the Commission's role in crisis period.

The Irish announcement to cover only six Irish banks by a state guarantee scheme presented a serious risk of a large outflow of capital from non-eligible competitors operating in Ireland. Upon the Commission's insistence the Irish Government confirmed within days that the guarantee scheme would be available to all banks

¹⁸⁴ GENNER, J., LIENEMEYER, M., WALKNER, C., "The Commerzbank recapitalisation decision: providing legal certainty in times of crisis and guidance for future restructuring", *Competition Policy Newsletter 2009-2*, http://ec.europa.eu/competition/publications/cpn/cpn_2009_2.html (accessed March 22, 2010)

¹⁸⁵ Pres Release no: IP/09/711 <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/711> (accessed April 15, 2010)

¹⁸⁶ Guarantee scheme for banks in Ireland, Case No: NN48/2008, Decision Date: 13.10.2008

with subsidiaries or branches in Ireland with a significant presence in the domestic economy.¹⁸⁷

The scheme intended to stabilize the financial markets in Ireland by providing guarantees was approved by the Commission on 13.10.2008. The Commission found the revised scheme to be compatible with EU state aid rules, because it was an appropriate means to remedy a serious disturbance in the Irish economy (Article 87.3.b of the EC Treaty), while avoiding unnecessary distortions of competition. In particular, it now provides for non-discriminatory access to banks with systemic relevance for the Irish economy, regardless of their origin, fair remuneration of the guarantee, is limited in time and contains appropriate safeguards to avoid abuses.

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4.2.4 Nationalization of Anglo Irish Bank

Finally, apart from the examples of case types, another important decision is worth to mention in this study as it provide the approach of the Commission about the concept of nationalization.

The European Commission raised no objections, under EC Treaty State aid rules, to the change of ownership of Anglo Irish Bank¹⁸⁹. The Irish authorities notified the

¹⁸⁷ State Aid Scoreboard, Autumn 2009 Update, Facts and figures on State aid in the EU Member States,p.39
http://ec.europa.eu/competition/state_aid/studies_reports/annex_2009_autumn_en.pdf (accessed April 4, 2010)
http://ec.europa.eu/competition/state_aid/studies_reports/annex_2009_autumn_en.pdf

¹⁸⁸ Pres Release no: IP/08/1497
<http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1497> (accessed April 15, 2010)

¹⁸⁹ Nationalisation of Anglo Irish Bank, Case No: N 61/2009 Decision date: 16.02.2009

taking into public ownership of Anglo Irish Bank for reasons of legal certainty. According to the Commission's decision, the act of nationalisation as such involves no aid. The European Commission considers that the purchase of existing shares and the takeover of assets, when these are not accompanied by a capital injection, assumption of liabilities or other state measures, do not favour the financial institution, inasmuch as they amount to a mere change of ownership. Therefore, they do not constitute state aid.¹⁹⁰

Being nationalized, the Anglo Irish bank has been subject of one recapitalization case¹⁹¹ and one restructuring case¹⁹². The change in its ownership did not affect any level of these following cases.

4.3 Conclusion

When the 2008 financial crisis hit the European economy, the Union could act in a quick manner to take the necessary measures. In doing this, mainly the Commission as the key authority issued several communications to guide the Member States and dealt with many related cases.

In fact, these communications are also the products of the normative tradition of the Union in the area of competition. Differently, the rules set up by these

¹⁹⁰ Pres Release no: IP/09/271 <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/271> (accessed April 15, 2010)

¹⁹¹ Recapitalisation of Anglo Irish Bank, Case No: N 356/2009 Decision date: 26.06.2009

¹⁹² Restructuring of Anglo Irish Bank, Case No: C 11/2010 Decision date: 31.03.2010

communications have been designed temporarily and specific to sectors in order to focus on the solutions against the crisis problems.

As the origin of the crisis began to develop in financial sector the communications have mostly formed to address this sector's problems. Even the communication of temporary framework focusing on real sector contributes to the healthy progressing of financial sector by supporting the continuity in the lending process.

When the cases during the crisis period are overviewed, drastic increase in notification number can be interpreted as a clear indicator of the predicted trend in the way of granting state aids. So Commission's immediate actions towards softening strict state aids rules in a controlled manner against this trend can be considered to be an accurate strategy. In this way potential imbalances could be avoided among the financial institutions and among the Member States.

CHAPTER 5

STATE AIDS POLICY IN TURKEY

5.1 Harmonization with the EU Competition Law in the Subject of State Aids

Predicted in Ankara Agreement (1963), which is the base of the relations between Turkey and EU, the convergence period of economy and trade was strengthened by the decision no 1/95 of the EC-Turkey Association Council founding Customs Union (the decision 1/95 is going to be used thereafter) and gained a political and social dimension following the Helsinki decision recognizing Turkey's candidacy in 1999. After all these developments, Turkey committed the liabilities about harmonization of legislation to provide consistency to economic and social systems.¹⁹³

According to the Article 16 of the Ankara Agreement concluded by Turkey and EU, contracting parties accept to apply competition provisions in their partnership relations. Similarly, in the Article 43 of the Additional Protocol it is estimated that

¹⁹³ Devlet Yardımlarının İzlenmesi ve Denetlenmesi. Hakkında Kanun Tasarısıp.10. www.basbakanlik.gov.tr/docs/kkgm/kanuntasarilari/devletyardimi.doc (accessed April 22, 2010)

the Association Council shall determine the conditions and principles of application mentioned in the Articles 107 and 108 of TFEU.¹⁹⁴

Adoption of legislation compatible with the *acquis communautaire* in the areas of competition and state aids is the liability of Turkey according to the decision 1/95 determining the application conditions of Customs Union.¹⁹⁵

In the articles of the decision 1/95 related to the convergence of competition rules, it is stated that Turkey would align all aids -given for textile and clothing industry before the execution of this decision and other aids apart from this sector in two years from the execution date- with the principles of articles 107 and 108 of TFEU and notify them to the Committee.¹⁹⁶

The state aid provisions take place under the Chapter IV- Section II of the decision. Competition rules of Customs Union are regulated in the articles from 32 to 38.

Article 34 of the decision 1/95, parallel to Article 107 of TFEU, bars Turkey and the EU Member States from providing state resources to aid undertakings or economic sectors where doing so “distorts or threatens to distort competition ... between the Community and Turkey.” Although this Article is part of the “Competition” section of the Agreement, state aids are treated differently from the

¹⁹⁴ MÜFTÜOĞLU, M. T. Ve T. KÖKSAL, (2000), “Avrupa Birliği’ne Tam üyelik Sürecinde Türkiye’de Rekabet Hukuku ve Politikası”, *Yeni Türkiye*, Kasım- Aralık 2000, Sayı36: 1160

¹⁹⁵ KUTLU, E., HACIKÖYLÜ, C., “State Aids In Turkey And The European Union Countries In The Process of Full Membership To The European Union”, *Sosyal Bilimler Dergisi 2007/1*, p.385 <http://ideas.repec.org/a/and/journal/v7y2007i1p367-390.html> (accessed April 18, 2010)

¹⁹⁶ Devlet Yardımlarının İzlenmesi ve Denetlenmesi. Hakkında Kanun Tasarısıp.10. www.basbakanlik.gov.tr/docs/kkgm/kanuntasarilari/devletyardimi.doc (accessed April 22, 2010)

substantive antitrust provisions found in Articles 101 and 102 of TFEU. The decision 1/95 required Turkey to adopt the competition provisions in these articles as part of its own positive law, but imposes no such obligation for the state aid provision. Instead, under Article 39(2) of the decision, Turkey must “adapt” all of its existing aid schemes to EU standards, and comply generally with the notification and guidelines procedures established by the EU to control aid by Member States. In another important respect, however, the antitrust and state aids provisions are treated alike. Article 37 of the Agreement requires that Turkey adopt, within two years after the effective date of the Agreement, the “necessary rules” for the implementation of the provisions relating to both antitrust and state aid.¹⁹⁷

Same article also indicates that until the Article 34 is adopted, the provisions of the GATT Subsidies Code shall be applied as the rules for the implementation of this article. This situation means that supervision and control of state aids may be based on different tenets than that of EU legislation and jurisprudence. In addition, in Article 38 it is stated that, in the absence of such rules mentioned in Article 37, and if such practice causes or threatens to cause serious prejudice to the interest of the other Party or material injury to its domestic industry, it may take appropriate measures after consultation within the Joint Customs Union Committee or after 45 working days following referral for such consultation.¹⁹⁸

¹⁹⁷ OECD, *Country Studies, Turkey - Peer Review of Competition Law and Policy* 2005, p.30, <http://www.oecd.org/dataoecd/26/7/34645128.pdf> (accessed April 18, 2010)

¹⁹⁸ ÖZKARABÜBER 2003, p.66

Under the title of “Approximation of Legislation”, Article 39 of the decision states that Turkey should prepare legislation in the field of state aids compatible with that of the European Community, and apply them effectively. In this context, establishment of a competition authority is also mentioned under this article.

In the free trade agreement between Turkey and European Coal and Steel Community (ECSC) it is stated that any kind of public aid apart from those excepted in articles 7 and 8, is accepted inadaptable with the process of the Agreement to the extent of its effectiveness on trade and also aids given for tthe production of the products determined in the product list annex of the Agreement has to be notified to the Committee.¹⁹⁹

Accession Partnership Documents published on 8 March 2001²⁰⁰, 14 April 2003²⁰¹, 23 January 2006²⁰² and 18 February 2008²⁰³ also set the observed lacks about state aid concern. Accordingly, all of the documents emphasize the adaptation of a state aid law in order to provide transparency and monitoring requirements. Last three of the documents also mention about the need for an independent state aid monitoring

¹⁹⁹ Devlet Yardımlarının İzlenmesi ve Denetlenmesi. Hakkında Kanun Tasarısıp.10. www.basbakanlik.gov.tr/docs/kkgm/kanuntasarilari/devletyardimi.doc (accessed April 22, 2010)

²⁰⁰ http://www.abgs.gov.tr/files/AB_Iliskileri/Tur_En_Realitons/Apd/Turkey_APD_2001.pdf (accessed April 14, 2010)

²⁰¹ http://www.abgs.gov.tr/files/AB_Iliskileri/Tur_En_Realitons/Apd/Turkey_APD_2003.pdf (accessed April 14, 2010)

²⁰² http://www.abgs.gov.tr/files/AB_Iliskileri/Tur_En_Realitons/Apd/Turkey_APD_2006.pdf (accessed April 14, 2010)

²⁰³ http://www.abgs.gov.tr/files/AB_Iliskileri/Tur_En_Realitons/Apd/Turkey_APD_2008.pdf (accessed April 14, 2010)

authority. 2008 document indicates following points as medium term priority of competition subject;

- align secondary legislation in the State aid field
- ensure transparency in the area of state aid in line with existing bilateral commitments.
- inform the Community of all aid schemes in force
- notify in advance any individual aid to be granted.

In the National Programme of Turkey for the Adoption of the EU Acquis-2008²⁰⁴, legislation date of state aid law is expected as 2009,.Establishment of the State Aid Monitoring and Supervision Authority is also planned in 2009 following the mentioned legislation process. Alignment of secondary legislation in the state aid field is given 2 years duration between 2009-2011.

The Accession Partnership Document-2008 prepared by the Commission to determine the requirements of Turkey for the period passed until full membership and the National Programme arranged by Turkey in response to this document set the way and time of fulfillment of liabilities. State aid is one of the subjects which has to be regulated parallel to EU applications stated in decision no 1/95 of Association Council, Accession Partnership Document and National Programme.²⁰⁵

²⁰⁴ <http://www.abgs.gov.tr/index.php?p=42260&l=2> (accessed April 14, 2010)

²⁰⁵ Devlet Yardımlarının İzlenmesi ve Denetlenmesi. Hakkında Kanun Tasarısı.10. www.basbakanlik.gov.tr/docs/kkgm/kanuntasarilari/devletyardimi.doc (accessed April 22, 2010)

In the 2008 Regular Progress Report for Turkey²⁰⁶, which is the recent one, stagnation of state aid circumstance is mentioned indifferent from the previous reports. This is because; Turkey has not adopted the state aid legislation nor set up an operationally independent state aid monitoring authority although these requirements have been requested since the beginning of the process. Another negative ascertainment is that Turkey has not prepared the state aid inventory and has not reported on state schemes, as required by the transparency commitments.

5.2 Draft Law on the Surveillance and Supervision of State Aids²⁰⁷

In Turkey, state aids are identified and executed separately by different institutions, in scope of various regulations. Modification of existing regulations of these institutions on the basis of European legislation is not sufficient to set up a state aid system appropriate to EU state aid rules. Achieving the consistency in this subject would be possible with the establishment of an effective monitoring and supervision system to litigate the state aid applications in all over the country.

Based on this requirement, a few draft bills about state aids have been prepared in various terms but could not be become laws. During the formation of these drafts, discussions have mostly concentrated on the subject of monitoring and supervising authority.

²⁰⁶ http://www.abgs.gov.tr/files/AB_Iliskileri/Tur_En_Realitons/Progress/turkey_progress_report_2008.pdf (accessed April 14, 2010)

²⁰⁷ Devlet Yardımlarının İzlenmesi ve Denetlenmesi. Hakkında Kanun Tasarısı.10. www.basbakanlik.gov.tr/docs/kkgm/kanuntasarilari/devletyardimi.doc (accessed April 22, 2010)

The 2003 version of the drafts envisaged the State Planning Organization (SPO) as the responsible authority. Accordingly, a Directorate General for state aids within the SPO would be established, along with a State Aid Monitoring and Supervising Board that would have power to render judgments on the propriety of particular state aid programs. The Turkish Competition Authority (TCA) filed comments objecting to the bill on the grounds that primary authority to control anticompetitive aids should not be assigned to any agency that has responsibility for planning aid programs. The TCA argued that it is best suited for the task, since it is an independent agency with experience in assessing anticompetitive effects.²⁰⁸

According to the recent Draft Law prepared on the Surveillance and Supervision of State Aids²⁰⁹, a State Aid Monitoring and Supervision Board is to be constituted. To conduct the secretariat activities of the Board and to process the operations related with the application of the Law, a new service unit named Directorate General of State aids is to be formed within the body of Undersecretariat of Treasury.

Mainly, the aids distorting or threatening the competition are determined in accordance with the agreements between Turkey and EU, exceptions and their conditions are depicted and rules and conditions about these issues are settled. Following the functioning of the Board and the Directorate General, primarily

²⁰⁸ OECD 2005, p.30-31.

²⁰⁹ The DraftLaw presented to the Assembly Presidency on 25.02.2010 is debated in the Planning and Budget Committee (as the primary commission) and the EU Harmonization Committee (as the secondary commission) since 05.03.2010.

secondary legislation about state aids are going to be prepared by these units consistent with the principals of related regulations of EU.

Observing and reporting of the application results are also anticipated in the Draft Law together with the harmonization of state aids in Turkey with the rules of EU. Therefore, it is required that the institutions responsible with the execution of state aid applications restructure the systems of data preparation, processing and saving appropriate to the functioning of these activities and in line with the predetermined standards. By this way, countability of these aid measures applied by different institutions would be supplied, effectiveness of allocation in public resources would be increased, transparency and accountability would be satisfied and repeated practices would be eliminated.

By the Law, regulation of the procedures and essentials related with the monitoring and supervision of aids is predicted through the determination of principles and elements related with state aids in frame of the provisions existing in the agreements between Turkey and EU.

In the first article, agriculture, fisheries and services sectors are to be omitted from the scope of the Law as they are not mentioned in scope of the decision 1/95. (This provision is important in terms of the continuity of the lack in monitoring and supervision of possible state aids oriented to the banking sector especially in crisis times, as it is a branch of service sector.)

There is a specific and essential point among the definitions stated in Article 2. State aid is defined to the extent that it affects the trade between Turkey and EU. It is a different rapprochement of the Competition Law which is in fact the roof concept of state aids issue. Similarly the Competition Law is a result of convergence process to EU. However, such a discrimination whether the action distort the trade between Turkey and EU does not take place in its formation or execution. The practical result of such a provision stated in the Draft Law would be an appearance of a gap to monitor and supervise the state aids made in and affecting internal market. Existence of this gap does not change the current situation for state aids which does not have any influence on trade between Turkey and EU but may distort or threaten internal competition system. And again failures like lack of transparency, openness to politization, misuse or ineffective use of state resources and unaccountability of state authority will continue to exist.

Group exemptions and de minimis rule are also mentioned in the Draft Law parallel to the EU applications. General economic and financial measures are also excluded from the scope of the draft.

The State Aid Monitoring and Supervision Board composed of 6 members and a president is set up and it is predicted that the members of the Board are composed of the delegates of the Ministry of Finance, Ministry of Industry and Trade, State Planning Organization, Undersecretariat of Treasury, Undersecretariat of Foreign Trade and Turkish Competition Authority who have knowledge and experience

about state aids. Presidency of the Board is executed by the Director General of State Aids.

The Board is charged, responsible and authorized to arrange the related legislation, investigate the compatibility of notified aids, monitor and supervise the aids and meet the notification obligations sourced from several agreements to European Commission and other related authorities.

Opened cases against the decisions of the Board are handled immediately in Council of State as a court of first instance to make the decisions given by the Board definite in case of objection,

To monitor and supervise the state aids, notification obligation is brought. Before the execution of a regulation related with an aid scheme or individual application, the institutions warranting the aids have to notify to the Board and be approved by it for the purpose of providing the affirmation in scope of the Law.

The Board may give following decisions after the first evaluation;

- Decision does not constitute state aid
- Compatible state aid so it can be implemented
- Decision to initiate an investigation towards the compatibility of the aid

After the investigation, the Board may give decisions;

- compatible state aid,
- incompatible state aid,

- compatible after arrangements
- omitting from the scope of state aids
- applying the aid depending upon the conditions determined by the Board.

The party providing the aid has to act in accordance with the decision of the Board. It may also withdraw the notification during the first evaluation or investigation phases, before the decision is sealed.

Later on the decision is made as compatible and applicable state aid, if the situation is ascertained that information given about the aid is not correct, or fail of compatibility of the aid in following period of the decision comes into being, the Board may withdraw its decision and restart the investigation phase. If the information asked by the Board is not provided, it may give the decision according to the existing data. Illegal aids have to be recovered by the decision of the Board. Recovery of the aid is subject to 10 years timeout limit.

For the formation of administrative structure, education of the mentioned personnel and arrangement and execution of regulations, a nine month period is determined.

5.3 Crisis Management and State Aid Outlook in Turkish Banking Sector

Effects of the global financial crisis on Turkish Banking Sector remained relatively limited compared to its peers in developed and other emerging countries. Turkish Banking Sector passed through a comprehensive restructuring phase following the crisis in 2001. Within the scope of this restructuring program, state banks were restructured, regulatory and supervisory framework was improved, capital base of

the sector was strengthened, troubled banks were eliminated from the system, whereby the sector became more immune to potential future crises.²¹⁰

After the 2001 crisis, the frame of restructuring program of banking sector²¹¹ was designated as;

- Removing the Public Banks being the component of instability
- Having and conserving a strong capital frame
- Maintaining the cost effectiveness
- Constructing the effective surveillance and supervision structure
- Providing market discipline and transparency

Restructuring was processed in three pillar (Public banks, The Savings Deposit Insurance Fund-SDIF banks and private banks)²¹² of Turkish Banking Sector.

Public banks restructured through following measures;

- Liquidation of duty loss
- Derogation of short term liabilities
- Strengthening the capital frame

²¹⁰ YÜCE,B.C., *Küresel Finansal Kriz ve Türk Bankacılık Sektörü*, http://www.mgmt.boun.edu.tr/images/stories/dokumanlar/leaders/Issue_010/09-008.pdf (accessed April 12, 2010)

²¹¹ BRSA, *From Crisis to Financial Stability (Turkey Experience)*, Working Paper (Revised Second Edition), December 29, 2009, http://www.bddk.gov.tr/WebSitesi/english/Reports/Working_Papers/7429CrisisToStability.pdf (accessed March 29, 2010)

²¹² COŞKUN,Y.S., BALATAN, Z., *Küresel Mali Krizin Bankacılık Sektörüne Etkileri ve Türk Bankacılık Sektörünün Veri Zarflama Analizi ile Bilançoya Dayalı Mali Etkinlik Analizi*,p.23-25, 7-8 May 2009, <http://www.tcmb.gov.tr/> (accessed April 18, 2010)

- Modifications in operational origins

Problems about SDIF banks were tried to be solved through;

- Abalienation, revocation and liquidation
- Strengthening the position of the banks by issuing special arrangement treasury bonds on specific dates
- Treatment of short positions of the banks
- Modifications in operational origins

Private banking system reorganized by the amendments to the Banking Law. Main titles of these amendments can be summarized as follows;

- Expected requirements to institute a bank were made difficult
- Borders of credit and affiliate were changed
- Ratios of share holders and of abalienation shares were changed
- Personal responsibilities of bank partners and directors were increased
- Administrative and judicial offenses and punishments were reregulated
- Authorization about establishment and removal of Special Financial Corporates was left to Banking Regulation and Supervision Agency (BRSA)
- A regulation about reserve requirements was prepared
- Borders of foreign currency position was determined
- Alteration about establishment, activity, merger and acquisition of the banks was made
- It was decided the banks to scheme consolidated financial reports

- Application of international finance standards was strengthened
- Authorization of SDIF was reregulated
- Deposit insurance was limited to 50 billion (new) Turkish Liras.

During the process of this restructuring program, an important regulation amendment was realized in terms of Banking Law and Competition Law No.4054. Accordingly, mergers and acquisitions in the banking sector are excluded from the Board's jurisdiction under the Competition Law. This provision of the new Banking Law, adopted in May 2001, is the only explicit statutory exclusion from the Competition Law. The extraordinary general economic crisis that resulted from problems in the national banking sector is cited as the justification for this step. The time and added complication of a competition policy review were evidently considered too great a burden, in view of the extent of the systemic problems requiring immediate action.²¹³

Certainly the program has had very positive effects on the sector and the economy to recover previous crisis' troubles and to mitigate the impacts of current crisis. But if there would have been a settled state aid control system, some of the other interventions apart from mergers and acquisitions might also be analyzed in terms of distortive effects on competition. There is no doubt that such an application would provide much more transparency, depolitization and clearance.

²¹³ OECD, *Country Studies, Turkey - Turkey - The Role of Competition Policy in Regulatory Reform 2002*, <http://www.oecd.org/dataoecd/3/0/27068413.pdf> (accessed April 18, 2010)

Although the regulations and actions shaped by this restructuring program have excessively saved the sector from negative effects of current global crisis, new and additional measures oriented to financial and reel sectors have also been introduced. These can be summarized as,²¹⁴

- Liquidity supports
- Tax supports
- Employment supports
- Investment supports
- Regulations about credit and guarantee warranted to producers and exporters
- Regulations about credit utilization and credit cards
- R&D supports

Among these measures, liquidity supports are the set of actions and regulations planning on the banking sector directly while others were edited mainly for reel sector. Liquidity supports include the measures taken by the Central Bank to increase the foreign exchange and TL liquidity. On the other hand, to strengthen the equity capital structure of the banking sector, dividend distribution has been limited and this activity is subjected to the approval of the BRSA.²¹⁵

²¹⁴ Küresel Mali Krize Karşı Politika Tedbirleri, 10 Ağustos 2009, Hazine Müsteşarlığı, http://www.hazine.gov.tr/doc/Guncel/Politika_Tedbirleri.pdf (accessed October 11, 2009)

²¹⁵ Ibid

Broadly, there have been four main types of state intervention to the banking sector; guarantees of liabilities, recapitalization of schemes, nationalization and Central Bank liquidity assistance. In the Communication -The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis – European Commission stated that ‘general measures open to all comparable market players’ on equal terms are likely to be outside the scope of the state aid rules. Therefore state aids in banks either;²¹⁶

- Do not constitute state aid, which is most likely to be the case for Central Bank liquidity assistance, deposit guarantee schemes, and interventions that satisfy the Market Economy Investor test²¹⁷ because they are made on market terms, or
- Do constitute state aid, which is most likely to be the case for guarantees of liabilities and recapitalization schemes, when they are selective in their support and are aimed at rescuing otherwise insolvent banks. Under ‘normal’ conditions this type of support is classed as rescue aid for the first six months, and qualifies as restructuring aid if it persists for longer. Usually, restructuring aid must be accompanied by a plan for restructuring to solve the problem that led to insolvency.

²¹⁶ State Aid and the Banking Crisis,
http://www.oxera.com/cmsDocuments/Agenda_October08/State%20aid%20and%20the%20banking%20crisis.pdf (accessed March 30, 2010)

²¹⁷ The Market Economy Investor test is the method questioning a state investment whether the state acts as a shareholder like any private investor observing its profit or its aim is to intervene in and direct the sector.

When the Turkish applications after two crisis are evaluated from this perspective, the actions taken for 2001 crisis can be evaluated as having state aid characteristics while during the current global crisis there has not been any measure similar to the state aids applied in EU banking sector. Instead, general measures have been preferred as any specific aid has not been needed by the banking sector yet.

5.4 Conclusion

Harmonization of the legislation concerning competition and state aids with the *acquis communautaire* is the liability of Turkey according to the decision 1/95. Although Turkey has an incontestable success in the competition area, state aids could not get its share out of this development. It may be considered a natural hesitation as state aids are important tools for governments.

Although there are different state aids implementations achieved by different institutions in scope of their own regulations, there is not a unified and general state aids policy. Moreover, in existing state aids regulations, no mechanism is projected about monitoring and supervising the state aids. Despite the fact that this situation is criticized by the Union in all Progress Reports, Turkey has not taken a concrete step, yet.

Previous and current draft bills have given the monitoring and supervising authority to different institutions. Although the state aids issue is a part of the competition policy, it is a remarkable condition that the Competition Authority is not thought to be given the monitoring and supervising responsibility. Rather than that, the

institutions which cannot act independently from governments' politics are preferred. This may be interpreted as the indicator of the governments' reluctance to be supervised.

Recently prepared *Draft Law on the Surveillance and Supervision of State Aids* has important points to attend. First of all it does not cover the aids affecting just internal trade and competition. In the Draft Law, state aid is defined to the extent the aid affects the trade between Turkey and the EU. Secondly, the Draft does not include the services sector as it is not mentioned in decision no 1/95. All these mean that even if this Draft becomes a law, authority gap for aids made to the banking sector will continue.

The banking sector in Turkey is seen better than its peers in Europe during the crisis term. Therefore no aid like those in the Union was made during this period. In fact, this is because of the implications of measures taken in the previous crisis term, which are very similar to currently existing aids to financial sector in the EU. However, because of the lack of a controlling system, none of these aids would be evaluated in terms of necessity, cost-benefit analysis, transparency, effectiveness or accountability.

CHAPTER 6

CONCLUSION

The unique structure of the EU as a supranational body regulates and protects the market economy and the common market through its binding regulations. Being one of them, the competition law ensures the prevention of any kind of discrimination among the Member States based on national grounds. Such discrimination can easily arise as a result of state aid implementations.

This, however, should not mean announcing the state aids as totally bad for the economy. In fact, they are among the important tools of governments to achieve social, political and economic goals. The only handicap is the openness to misdirection, inefficiency of source usage or politization. So the system forming and regulating the state aids has to be transparent and so accountable. To provide this, obligatory regulations have to be edited. In addition, controlling and monitoring mechanisms have to be actualized and sanctions should be put into motion.

The EU having a strict competition tradition, has taken the same decisive action for the implementation of state aids policy. This resolution shows its reflection in current crisis time in terms of taking action to stabilize and recover the economic difficulty.

Although the global financial crisis has spread rapidly, the EU authorities have taken the required precaution in a same quick manner. Since the beginning of the crisis effects, many new regulations has been prepared and put into effect. In addition to already existing state aid regulations, new and temporary –i.e. being in force for the period of crisis- regulations have been formed which are especially affecting the banking sector being the core of the crisis. Since the effects of the crisis have been observed in the last quarter of 2008, about 150 cases notified to the Commission for the main objective of ‘remedy for a serious disturbance in the economy’ and for 139 of them the decision ‘not to raise objection’ was given.

This situation and all of the efforts in determining temporary regulations show the realistic viewpoint of the Union according to which requirement to these aids is not ignored at all despite the distortive effects of state aids and intolerance of the Union about them,.

In the case of Turkey, a surprising scene is confronted with. Despite all the criticisms emphasized in Progress Reports about fulfillment of liabilities to set up a state aids system which has been looked for since the decision no 1/95 of the EC-Turkey Association Council founding Customs Union was enforced, there is neither a legislation nor an independent authority monitoring and supervising state aids.

There have been several draft law attempts but none of them have been able to become a law yet.

Current *Draft Law on the Surveillance and Supervision of State Aids* has a few important points to attend.

First of all, the definition of state aid covers just the grants affecting the trade between Turkey and the EU. Therefore, the state aids out of this scope would be put out of the supervision process. This would provide governments with freedom to act in internal granting processes. This may be criticized by those willing more transparency and accountability in governance while another section justifying and accepting state aids as indispensable tools of governments to achieve their goals supports the situation.

Secondly the Draft Law excludes the service sector as it does not take place in the decision 1/95. Thereby, state aids to banking sector are also left out of the scope. As the financial sector being in an organic link with the real sector is the backbone of the economies, distortions to the competition among financial institutions have much more effects on the economy. In addition, aids to the banking sector as the faith-based institution group needs a closer monitoring. Especially in the systems, like that of Turkey including public banks having a big share in the sector and private banks tending to increase their risk exposure everyday in terms of competitiveness, state aids need to be monitored and supervised rigorously.

In fact, state aids systems of the EU and Turkey are not comparable as one is a supranational body having very strict state aids policy and tradition while the other is a state which approaches state aids as political tools so abstaining from strict regulations restricting its mobility. But when implementations of crisis periods are evaluated, similarities and differences enable to make a few comments.

Primarily, the difficult exam of the Union about the crisis term has not been finalized yet, so it is too early to talk about the success of its crisis term implementations. But it is a fact that its immediate intervention could prevent national subsidy races and different state aids applications in the Member States which would result in serious distortions and imbalances in the competition and subsequently the market economy. Therefore, whether or not the Union is going to pass this exam, its actions are definitely strategic and are the products of its strict competition policy tradition without a deviation.

Secondly, Turkey's success in recent crisis term is mostly due to the implementations of the previous crisis term and those implementations were realized without a state aids policy. Although this situation is more desirable by the governments, lack of transparency and accountability does not meet the requirements of good governance.

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