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Aiding Car Producers in the EU: Money in Search of a Strategy

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Abstract This article investigates how the general principles of the Treaty have been applied to the car sector in the EU, where the soft law provisions are of particular interest. A detailed quantitative analysis from 1990 to 2008 highlights a reduction of aid over time. A shift from sectoral to "regional development" motives in granting aid to the sector is also observed in the last 10 years. However, sector specific aid is now less explicit but it remains important. Large amounts of public money are spent without a consistent strategy, reducing capacity in some cases, expanding it in others. The scarcity of public funds calls for a more focussed European policy for this industry.

Keywords automotive industry · state aid to business · EU competition policy

JEL classification L62 · L52 · L40

1 Introduction

Since the Lisbon European Council in March 2000, the guiding principle of EU state aid policy has been "less aid, better aid". The meaning of the phrase's first part is clear, but the idea of

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المنارة للاستشارات

“better” aid refers to a re-orientation of aid towards horizontal objectives (for example, regional development and training policy) and away from support for specific sectors. While horizontal aid is intended to correct market failures (too little spending in R&D or training activities) or with regional problems, sector-specific aid distorts the allocation of resources.[1] However, the European Commission’s competence is limited to the control of what member states do. It can limit or ban aid which is deemed incompatible with the common market in the sense specified by the Treaty, article 107,[2] but cannot pursue an explicit pro-active policy or “strategy”.

This raises several issues. The first concerns the combination of decentralised decisions with central control that characterizes state aid. How effective is this control? Is it grounded in a strategy? And can it turn national policies into a coherent European picture? The second issue is whether the double objective set in Lisbon has been achieved or pursued consistently. As we will see, the most critical point is the attempt to limit sector specific aids and to break the special relationship between governments and certain large firms. Finally, the existence of a strict rule to which there are numerous exceptions raises doubts about the effectiveness of the controls and indeed the credibility of competition policy in this area.

Analysis of state aid to the car sector is particularly relevant given the industry’s prominence in the policy debate.[3] The attention of the member states, and hence of the Commission, to the car sector is such that two specific framework agreements for state aid to the sector exist.[4] Although subsidies to this industry cannot be compared to those given to agriculture, financial services or transport, they are certainly large relative to other manufacturing sectors, and their distortive effect on competition and on the EU integration process is not negligible. Indeed, in many EU countries aid given to a national champion might initiate a subsidy race among EU member states, with negative effects on integration.

In this article we focus on EU state aid policy towards the sector, starting from an analysis of a dataset drawn from state aid cases, and then assessing how the interplay of member states’ policies and Commission control has contributed to the outcome. The control over state aid has only been effective in certain periods: considerable sums have been directed toward the car sector, decreasing capacity in some member states and increasing it in others, all with the support of the public purse. At the same time, the EU refuses to recognize that state aid policy represents even implicitly an industrial strategy. By so doing, the EU is able to avoid an open or critical discussion of its actions or their consequences.

The analysis draws on an original dataset of state aid to the car sector that we constructed directly from the EU Official Journal (for the period 1990–1999) and from the EU State Aid Scoreboard (from 2000). Although the official state aid figures do not record all the means of support given to the industry, ours is to the best of our knowledge the first attempt to

[1] Besley and Seabright (1999) and Martin and Valbonesi (2000) discuss the externalities generated by horizontal, regional and sectoral aids and inefficiencies arising from competition among governments. An updated analysis on these issues has been recently provided by Friederiszick et al. (2008).

[2] For discussion of the legal instruments available to the European Commission in regulating and controlling state aids, see Cini and McGowan (2008: ch.8).

[3] The sector is subject to a large and varied corpus of regulations. According to the European Automobile Manufacturers’ Association (ACEA), the automotive industry has to comply to more than 80 EU Directives and 115 international framework agreements. These standards have become stricter and stricter over time. Even in competition policy, the car sector is given special attention in the field of vertical restraints (see the block exemption regulation, BER 1400/2002) because producers’ concentration is such, that the concern for competition is particularly acute.

[4] For a detailed survey on the governments-industry relations in the automobile sector at national and EU level since 1945, see McLaughlin and Maloney (1999).

المنارة للاستشارات

measure the phenomenon. Over time, we observe a slowdown in the amount of aid granted. From 2000 onwards, aid to the industry increasingly has been labelled as regional development aid. Large disparities exist between states, with Germany, Italy and the new member states emerging as the most generous donors.

The discussion below is organised as follows. In section 2 we discuss some general features of the car sector in Europe. In section 3 we first present the specific frameworks adopted for the car sector and, using the data, we illustrate how the EU system has worked. In section 4 we investigate member states' behaviour in the framework of international competition. In section 5, we analyze the relationship between state aid control and industrial policy, with a particular focus on the recent crisis.

2 The car sector in Europe

Taking into account the direct production of motor vehicles production, as well as most of the components,[5] the automotive industry employs more than two million workers in the European Union (EU25). This amounts to around 7 % of the manufacturing industries' workforce and about 1 % of total employment. The total output of the car industry has continued to grow over the last thirty years, while employment has—due almost entirely to the new member states—remained almost stable. The relative weight of the sector within the EU economy in terms of employees has declined since the 1970s, when it accounted for close to 2 % of the total workforce. This decline is consistent with the shift towards services that has characterized Europe over the last three decades. Nonetheless, the relative share of the car industry within manufacturing has increased slightly, suggesting that the decline has been even more severe for other areas of manufacturing.

When we move from direct employment (including components) to an estimate of the number of jobs that depend *indirectly* on the sector, statistics become a lot less reliable. Dependency is hard to determine with any great precision. Estimates provided by the European Automobile Manufacturers Association (ACEA) put the number at about 10 million (ACEA 2009). However, this figure includes an extraordinary agglomeration of activities, such as recycling, sales, maintenance and repair of motor vehicles, road transport (passenger transport, taxi operations, freight transport), the construction of highways and roads, and more. In the 1989 Community Framework for state aid to the car sector, the European Commission claimed that around 10 % of EU employment depends on the car sector, a figure which in the 1997 Framework became 10 % of the active population,[6] with the complementary statement that ten jobs depend on each job in the car sector. However, the hard facts behind this impressive claim remain obscure.

On the supply side, the term "European car industry" may refer either to companies that have historically been owned by EU shareholders and that have headquarters in the EU—the traditional "national champions"—or more generally to plants located in EU countries, which may well belong to Asian or US companies.[7] If a government cares about employment, the latter is the most important one. All large member states play host to at least some

[5] This includes the Nace Rev. 2 sector 29, denominated "Manufacture of motor vehicles, trailers and semi-trailers", which include also bodies, parts and accessories, electrical and electronic equipment for motor vehicles and so on. The only major components which is not considered in this sector is tyres production.

[6] The definition includes both employed and unemployed.

[7] Many of these companies entered the EU market to circumvent quotas on car imports, which were in place in the 1993–2000 period for Japanese cars, as well as other restrictions (e.g., voluntary export restraints).

المنارة للاستشارات

of the about 250 production plants located in the EU. Germany is by far the most important producer.[8] By contrast, the industrial presence in countries with smaller markets is often negligible.[9]

Economic recession typically leads to sharp decreases in new car registrations, as durable goods are the first to be cut by consumers. Looking at the number of new car registrations for EU 15 countries, the 1993–1995 period was critical, showing a drop from 13 million new registrations to 11.5 millions. In the years that followed there has been a rapid rise in the number of registrations, with around 14.5 million registrations in 2001. After that peak, the number of new registrations decreased until 2007, since when it has decreased sharply. Moreover, as a highly capital intensive industry, car manufacturing is characterized by rigid production decisions. Sharp cuts in demand entail a massive under-utilization of production plants. The combination of cyclical demand and production rigidity makes employment very hard to protect, creating a strong basis for car producers to lobby for subsidies. The need to maintain productive capacity is likely to coincide with the government's concern to protect employment.

The industry has been considered "special" at least since the creation of the European Communities. Claims regarding the relevance in terms of direct and indirect jobs, its role in terms of patents,[10] and the symbolic role of car brands in economic development after World War II, have all been used to justify the large amount of state aid devoted to this specific industry. But is it really different from other manufacturing industries? The industry's value added and employment represent only about 1.7 % of value added and 1 % of total employment in 2009. What really distinguishes the car industry is the dominance of a small group of large firms. According to Eurostat (2008) it exhibits—with utilities and with oil and gas—one of the lowest shares of small and medium-sized enterprises among manufacturing sectors. In addition, these firms are quite old: most well-known brands have existed since the end of the nineteenth century—Opel in 1862, Peugeot in 1882, Renault in 1898, Fiat in 1899 —or the beginning of the twentieth—Rover in 1904, BMW in 1917, Citroën in 1919, Mercedes-Benz in 1926, Volvo in 1927, Volkswagen in 1937. Their leading role in industrial development has been recognize by governments, and their products have become symbols of the economic progress of the nation.[11] Arguably, these characteristics are what justify the special attention of governments.

3 State aid to the car sector in the EU, 1990–2008

Although Article 107 of the Treaty on the Functioning of the European Union (TFEU) states that government aid to business is incompatible with the common market, the same article lists a number of grounds on which subsidies are permitted (see Kassim and Lyons 2012). Exemptions, granted at the discretion of the European Commission, may allow aid which, with a limited effect on trade and competition among member states, aims at promoting projects of European interest, regional economic development in low income or high

[8] About 34 % of employees in the European car industry (EU 27) are employed in Germany. Data from Eurostat, latest available year is 2009.

[9] Bulgaria, Cyprus, Denmark, Greece, Ireland, Latvia, Lithuania, Luxembourg and Malta do not host production car plants (see www.acea.be).

[10] According to ACEA, about 5,900 new patents per year can be ascribed to the sector. Unfortunately no official statistics exist to substantiate such claim.

[11] The US attitude towards its three "giants" is not very different. See Luger (2000) for car producers-government relations in the US.

المنارة للاستشارات

unemployment areas, “certain economic activities”.[12] These discretionary exemptions have been enforced through a case-by-case evaluation by the Commission—a costly process, especially after the 2004 and 2007 enlargements. For much of its history, the Commission has operated in largely reactive mode, responding to periodic waves of subsidies granted by member governments to key industries or sectors in periods of economic crisis. In the car sector, the oil shock of the early 1980s and the subsequent recession gave rise to a subsidy race (Dancet and Rosenstock 1995). Governments were in similarly interventionist mode between 1993 and 1996, when a further round of subsidies were directed to the industry.

In the wake of these flourishes, the Commission attempted to introduce a degree of predictability by setting out its approach and principles. The 1989 “Community framework for state aid to the motor vehicle industry” (OJ C 123, 18.5.1989) represented the first systematic attempt to organize state aid analysis so as to make it compatible with a harmonious development of competition in the sector. The Commission aimed to increase the transparency of state aid to the sector and also to specify the conditions under which it might permit specific subsidies. This first Framework foresaw an obligation on the part of member governments to notify all proposed aid outside schemes that had already been approved, as well as aid within approved schemes where the total amount exceeded 12 million ECU. The Framework also included an invitation to inform the Commission about all aid decisions, which were to be collected in an annual report.

The Framework also set out a series of requirements that needed to be fulfilled by an aid if it were to be permitted. First, the aid in question should not help increase market share, and in some cases capacity cuts may be required. As for aid schemes with specific objectives, the framework struck a positive attitude towards regional aid, limited the use of R&D to subsidize any technological improvement (by distinguishing R&D spending from the introduction of new technologies), and specified that training aid could be allowed *per se* if not linked to new investments.

After 1993, however, a sharp drop in demand brought about a new subsidy race, and new controls were considered necessary. The Commission adopted a second Framework in 1997 (OJ C 279/1 15.09.1997). This scheme reflected a general evolution in the evaluation of training aid, regional aid and aid for the rescue and restructuring of firms in difficulty. For example, regional development aid requires (amongst other things) an evaluation similar to a cost-benefit analysis, including proof that a viable alternative exists, so that, absent the subsidy, the firm would develop the same project elsewhere.[13]

The Lisbon declaration, which called essentially for less, but better targeted aid, marked a major milestone the development of EU state aid policy. Although the discussion below explores how closely these principles have actually been applied in the car sector, it is important to acknowledge that the second part of the Lisbon formula is very much in keeping with the Commission’s traditional approach. The Treaty accepts aid directed towards “certain economic activities”—that is, certain sectors—but a preference for horizontal interventions, aimed at more general objectives such as regional development or training, was present in the first Framework on the car sector. As discussed below, however, the Lisbon objective has been accompanied by an apparent shift in policy, so that aid labelled as “sectoral” has almost disappeared.

[12] These exemptions are usually considered to have encouraged the Commission to adopt soft law provisions, which proliferated in the early 1990s (see Kassim and Lyons 2012; Cini 2000).

[13] An analogous evolution is marked by the “Multisectoral framework on regional aid for large investment projects” which was adopted shortly after (December 1997) and reviewed in 2002. The coexistence of the multisectoral with the sector-specific framework raises some questions, especially since given the size of car manufacturers investment projects are likely to fall within the scope of “large investment”.

المنارة للاستشارات

The real economic issue is the extent to which these attempts to frame state intervention have proved useful, and whether the interventions of the Commission and, even more problematic, of member governments have been consistent. The sections below look at the trend in total amounts of state aid to the sector, then analyze the cases approved in the 2000–2008 period.

3.1 The data

To respond to these questions, we have collected data from the state aid register of DG Competition for cases after 2000,[14] and from the Official Journal, the annual Report on Competition Policy, and other EU documents for the preceding years. The publicly-available information varies in quality over time. Early documents are less systematic and offer less information than recent ones, which are both more comprehensive and more precise. Before 1988 data was only published occasionally and was not reliable. Thus, our analysis begins at that year. The systematic comparison stops at 2008, as aid in the crisis period is not comparable to previous years. (A later section addresses state aid to the car sector since 2008 separately).

We look at the amount granted on the basis of the final decision published in the Official Journal of the European Communities. We report data on the total nominal amount granted. Whenever possible, we also include information on the discounted values.[15] When considering soft loans, we take the data on the gross grant equivalent.[16] All values reported in the tables are expressed in Euro/ECU. If the amount is reported in the official documentation in the national currency only, the exchange rate adopted is the annual average (data from Eurostat).

Since a decision on a state aid may take several years, it is difficult to choose a year of reference. We choose to attribute an aid to the year of the final decision, and not to the year in which the case was opened. We make an exception, however, for cases where the aid was granted before the decision. In these cases, we attribute the aid (if approved) to the year in which it was paid. The rationale is that we are interested in the time period in which the aid has been granted, either with or without a formal approval. Finally, we consider the form of the aid—for example, grant or soft loan—and, especially for recent cases, the "primary objective" as stated in the decision.

The data we present here concerns *approved* aid—that is, aid the Commission has declared compatible with the Treaty—which is explicitly directed to the car sector. Even when state aid is "primarily" targeted to horizontal objectives, it may explicitly be earmarked to a specific sector or firm. We include in our database only those amounts which have been reserved to one or more firms in the sector whatever the horizontal objective that justifies the scheme.[17]

Importantly, our data underestimates the total *support* effectively granted to the sector. At least three sources of state aid to firms in the car sectors are missing. First, only aid measures explicitly earmarked to car producers are included. However, car producers may have received aid under horizontal programmes that were approved as general measures, and directed toward several sectors (and not specifically to one). Similarly, although demand subsidies—for example, scrapping incentives—do not count formally as state aid because

[14] See http://ec.europa.eu/competition/state_aid/register/.

[15] Subsidies are often given over a set time period, and in recent years the discounted value is sometimes reported in the decision. Until the end of the 1990s, typically only the nominal amount appears, and the time period is often not reported, thus preventing computation of the discounted value.

[16] Where the value is not reported, we have computed it on the basis of the spread between the required interest rate (which could be nil) and the interest rate of the ECB for its main financing operations, as reported monthly in the Official Journal.

[17] In some cases, aid is earmarked to specific sectors, including the car industry, but the list of sectors is very long. These cases are not considered by our analysis.

المنارة للاستشارات

money is given to consumers, they are introduced specifically to support the sector. Finally, the European Investment Bank (EIB) is sometimes asked to target its funds to specific sectors. These programmes have not been included in the present analysis.

3.2 Total aid: less aid?

To what extent has the EU's commitment to the first part of the less-but-better-targeted-aid formula been realised in car manufacturing? Our data show that state aid in the EU-12 and the EU-15 has indeed decreased over time in absolute terms. In the 1990s it was not uncommon to see hundreds of millions paid out every year, but that changed in the following decade when state aid rarely touched the same levels. Moreover, as recent data is more accurate than the old, the actual decrease is probably even greater than reported here. Furthermore, as discussed below, the trend has been downward despite the accession of the Central and Eastern European states, which have been the largest beneficiaries of aid in recent years, not least because they contain many of the areas eligible for regional aid.

To put the data in Table 1 in context, it is useful to note that subsidies are likely to depend on levels of economic activity, and that they could be related to the level of demand.

To take this into account, Fig. 1 shows the ratio between the amounts of state aid and the value added of the sector (as a proxy for its size),[18] on the one hand, and on the other, the number of new car registrations as an indicator of demand. This data shows that over time state aid has indeed decreased, but that an increase in demand largely explains the downward trend. During the 1990s, the average ratio of aid over value added in the car sector was 0.72 %, a figure that fell to 0.14 % in 2000–08. At the same time, after 1997 demand in EU 15 rose sharply and has remained at a high level. Whether the decrease in aid is an effect of Lisbon or is simply due to higher levels of demand is open to debate. Whatever the case, a shift from direct subsidies to firms to subsidies to consumers (scrapping incentives), which are not considered state aid, may also have been a factor. Such schemes are now quite common, and are not usually blocked so long as they are not discriminatory. Moreover, they often involve greater sums than are granted as state aid.

Although data after 2008 are not strictly comparable to previous years, they show a clear increase in state aid as a way to compensate the sharp fall in car registrations. Controlling state aid appears to be easy only when demand is high.

3.3 Better aid or better packaging?

In investigating whether EU state aid policy since Lisbon has improved the *quality* of aid, it is useful to remember that in EU rhetoric *good* means "horizontal" while *bad* means "vertical" or "sectoral". Examining Commission decisions, it becomes apparent that, though sectoral aid was a stated objective of most state aid in the 1990, this has no longer been the case since 2000. Terms such as "sectoral development" or "aid to investments" magically disappeared, and regional aid suddenly became by far the most important declared objective of the state aid targeted to the car sector.

The change arises due to two factors. The first is that even before 2000, aid was frequently granted to plants, which were located in assisted regions. Given that the indication of the primary objective of the aid was not crucial, member states sometimes simply used "sectoral development" as a generic term, trusting that analyses would be based on the location of the plant and the specification of the assisted R&D project.

[18] The lack of comparable data on aid makes it impossible to go beyond 2008.

المنارة للاستشارات

Table 1 Total state aid to the car sector, 1990–2008 (Million €, 2000)

	Average 1990–94	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
EU12	1,105.4	377.4	769.5	57.2	263.1	310.3	90.9	342.9	563.2	123.8	43.3	123.4	13.4	23.5	80.7
EU15		393.7	779.4	57.2	264.8	310.3	90.9	342.9	563.2	154.4	52.9	132.4	20.0	23.5	80.7
EU25											52.9	132.4	63.7	171.2	152.1
EU27														172.0	248.3

Own elaboration from DG Competition and OJ EU information

المنارة للاستشارات

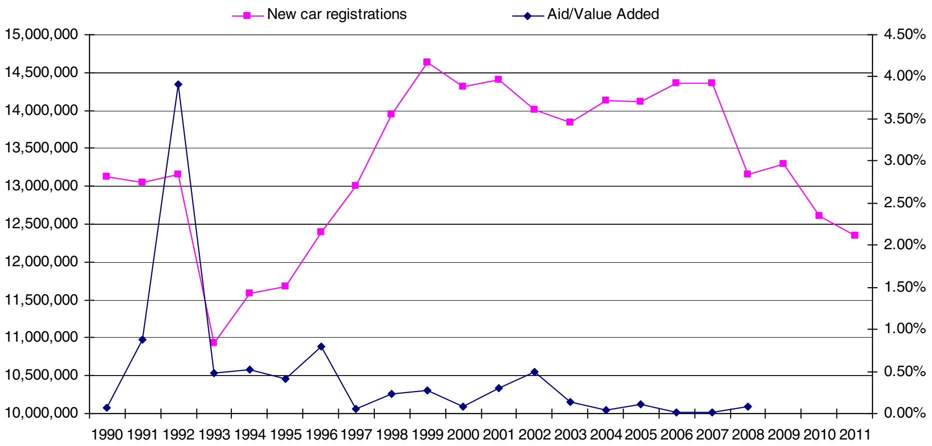

Fig. 1 State aid as a % of the sector's value added and new car registrations in EU 15, 1990–2008. Source: DG Competition and Eurostat

Second, the Commission has always accepted the idea that regional development policies could go through aid schemes which, instead of being anonymous or at least open to many firms, were explicitly meant for specific plants. Yet such an interpretation of regional policy, though standard for many years, is not obvious. The idea that state aid can be "horizontal" when it is not intended to benefit a certain territorial area, but targeted to a specific plant that happens to be located there, is somewhat paradoxical. Thus, the shift to aid measures which had a declared "primary" objective of horizontal nature has not changed the possibility for member states to target these measures in a very precise and specific way.

With respect to more recent cases, it is interesting to observe that the main declared objectives for aid to car plants are regional development, training and R&D. The largest number of cases (31) and 75 % of the total amount of aid (around 2 bn €), are granted to further regional development (see Table 2). Training is indicated as the primary objective in 28 cases, but the total amount granted under this heading is relatively small (about 223 M€) as compared to the 5 cases of aid for R&D which amount to 177 M€.

The two cases of rescue and restructuring are considerable in amount—about 82 M€—mainly due to support for the Polish firm, FSO (previously Daewoo), in the form of a state guarantee of a gross grant equivalent of 59 M€ and other measures amounting to around 14 M€. In the formal investigation of this aid, the Commission distinguished between subsidies granted before and after Poland's accession. The latter were investigated in the light of the 1999 guidelines on rescue and restructuring aid to assess whether they were "capable of restoring long term viability of the firm within a reasonable timescale and that the aid is limited to the minimum necessary and does not unduly distort competition".[19] It is interesting to note that this aid was authorised under the condition of a "production-sales-cap" where FSO was obliged to limit its annual production to 150 000 units until February 2011.[20]

[19] See Commission Press Release IP/05/64 of 19/01/2005.

[20] Conditions of this kind are often imposed. The idea is that firms should not take undue advantage of these subsidies at the expense of their rivals. The most immediate effect of such a cap is to limit the positive effects on consumers. However, the rationale for this safeguard for rivals of the beneficiary is the avoidance of subsidy races.

المنارة للاستشارات

Table 2 State aid to the car sector by primary objective, 2000/2008, Million €

Primary objective	N° of cases	Cumulated amount of nominal aid (Million €, 2000)
Employment	1	0.24
Environmental protection	1	10.18
R&D	5	176.94
Regional development	31	1,552.33
Rescue & Restructuring	2	82.00
Sectoral development	1	9.14
SME	1	3.62
Training	28	222.65
Total	70	2,057.10

Data from OJ and DG Competition, deflated values, base year is 2000

4 Member states and competition

What then are the determinants of state aid to the car sector? This section discusses the international aspect of state aid and competition, then considers subsidy provision in the global context in the US and in the EU.

4.1 The US factor: federal v. state subsidies

One of the main arguments in favour of state intervention is that "other countries do the same". As it is a likely starting point of subsidy races, it is important to examine the extent to which the Commission's leniency towards the car sector can be explained as retaliation *vis-à-vis* third countries. The international dimension of competition among car producers is evident. The motor vehicle industry is concentrated in the richer areas of the world; namely, the EU15, the USA and Japan, which in 2008 accounted for 20.7 %, 11.9 % and 15.8 % respectively of the world production of motor vehicles.[21] The main actors in the industry also come from the leading economies: in 2008 the largest company was Toyota, with a production over 9 million motor vehicles, followed by GM with 8.3 millions, Volkswagen with 6.5 million, and Ford with 5.4 millions.

There is little doubt that competition takes place in a global market, but it is not easy to assess whether in other countries governments support the car sector in the same way as EU member states. One of the reasons is that in the US, in particular, there is no clear definition of "state aid". Interventions at federal level are extremely rare, and confined to situations very close to what the EC defines as "rescue and restructuring aid".[22] However, states often subsidize firms as part of their local development policies. This confirms that the EU attention to state aid within a competition policy framework is quite unique (Cini and McGowan 2008).[23]

[21] Data from the International Organization of Motor Vehicle Manufacturers (www.oica.net). As in other segments of industry, however, former "emerging" economies have become significant in recent years. China produces around 13 % of the global supply of motor vehicles, and Brazil and India 4 % and 3 % respectively. Interestingly, in terms of the production of cars only, the US share of world production drops to 7.2 %, which is lower than China's 13 %.

[22] Notice that the US industry basically consists of three giants: Chrysler, Ford and GM.

[23] For a discussion of the US antitrust state action doctrine, see Martin and Valbonesi (2006, Section 5).

المنارة للاستشارات

Only two episodes of federal intervention are recorded in the US, and they were both bailouts. The first related to Chrysler in 1979, when public guarantees were provided for a 1.5 bn$ loan. As the operation entailed a 350 M$ return to the Government, it would not be considered to be "state aid" in the European sense, given that at least ex post market criteria were most likely met.[24] The second was the Automobile Industry Financing Program of 2008, when the federal commitment in equity and loans was about 50 bn$ for GM and 20 bn $ for Chrysler.

Comparison with the EU is extremely difficult. First, the relevant concept in the EU is the "gross grant equivalent". This is to assess when aid takes up the form of a direct grant, but is less so in the case of loan guarantees, and even more difficult to determine in equity participations. With no comparable monitoring system in the US, there is no official calculation similar to the EU notion of gross grant equivalent. Second, in these cases the federal authority acquires a stake in the companies, so that, at least for a period, the control of these companies falls into public hands. Such an eventuality has not occurred in the EU for at least 20 years.

Federal action is not, though, the only possible form of public intervention. States can also award subsidies. This is not immediately clear from the US Constitution, since the commerce clause reserves the right to regulate inter-state commerce to the central power,[25] which is interpreted as a way of prohibiting discriminatory development measures, such as taxes or subsidies, that might distort inter-state commerce. Violation of this clause is settled before the courts and outside the political system. However, it is now widely accepted that states can offer (substantial) subsidies to firms interested in investing in their territory. Indeed, procedures similar to an open auction take place among and within states, where companies make their investment decision depending on the package of infrastructure, direct subsidies, tax exemptions, training aid and so on offered in the various locations.

In the car sector, this has led to a not insubstantial re-location from the Detroit area to southern states, such as Alabama, Kentucky and Tennessee, where a number of companies have been attracted by low wages and substantial public incentives.[26] Unfortunately, no central record is kept of the sums invested by states.[27] However, they appear to be directed mainly towards new entrants—firms from the EU and Asia.

In summary, the US has a two-tier system. Direct federal interventions are focused on large rescue and restructuring operations, and managed according to criteria comparable to those followed by private investors. Interventions by states, by contrast, are part of regional development policy and not regarded as a competition policy issue.

4.2 Aid and the EU member states

In the international state aid game, EU member states act independently under the control of the European Commission. As Table 3 illustrates, there is considerable variation in their actions. The most generous countries have been Germany and Italy, which together cover around 42 % of the total amount of aid granted, followed by the UK with around 200 M€.

Unsurprisingly, the new member states as countries with traditions of centrally managed economics also feature among the highest spenders. Since their accession, the Czech

[24] See Luger (1999, p. 98–108). The author discusses the bailout along with the relevance of Chrysler's size in the economy, the firm's political influence and lobbying activities.
[25] Article I, Section 8, Clause 3.
[26] On these considerable shifts of production and assembly plants, see Klier and Rubenstein (2008).
[27] A relevant consequence is that—to the best of our knowledge—no reliable information on the amounts spent by the different states seems to exist.

المنارة للاستشارات

Table 3 State aid amount to the car sector by country, 2000/2008

Country	Nr of cases	Cumulated amount of nominal aid (Million €, 2000)	Average nr of employees	Aid per employee (€ 2000)
Austria	2	37.0	31,642	1,169.6
Belgium	12	89.0	48,989	1,816.5
Czech Republic	1	169.5	107,183	1,581.1
France	3	61.1	234,926	260.0
Germany	4	494.3	864,436	571.8
Hungary	1	71.4	43,782	1,631.3
Italy	8	371.6	170,518	2,179.2
Poland	6	86.7	111,607	777.1
Portugal	3	45.1	24,384	1,848.3
Romania	2	174.1	63,439	2,744.1
Slovakia	3	85.5	27,508	3,108.2
Spain	7	163.1	205,513	793.5
Sweden	2	17.5	205,513	85.2
United Kingdom	16	191.3	196,294	974.8
Total	70	2,057.1	2,335,734	880.7

Data from OJ and DG Competition, deflated values, base year is 2000

Republic, Hungary, Poland, Romania and the Slovak Republic have granted together aids to the sector for more than 580 M€. It is noteworthy that the high figure in Germany is largely accounted for by the huge subsidy—about 363 current M€—granted to the new BMW plant located in Leipzig in the territory of the former German Democratic Republic in 2002.

If we scale total aid by the number of employees (as shown in the last column in Table 3), Germany is not longer the most generous country. In the "old Europe", Italy heads the list. It is the only EU12 country comparable in terms of state aid to Romania or Slovakia.

4.3 The new national champions and employment

In the EU, the routines are relatively straightforward. Industrial lobbies, trade unions, local communities and others put member governments under pressure to grant subsidies, while the Commission tries to regulate the financial support offered by states. The effectiveness of the Commission's efforts is not always clear, but there are some notable successes (see below).

Member states historically sought through interventionist means to support and promote favoured firms or "national champions" (Hayward 1995). These firms, which were typically publicly owned, had a close and privileged relationship with government. In exchange for state support, they served public goals by, for example, providing employment opportunities in less developed areas of the country. Against the background of globalization, EU liberalization and the rise of economic neoliberalism, the national champions model has become increasingly difficult to sustain. To take one instance, with the development of open financial markets, large firms have become multinational in ownership and outlook.

Although they are no longer "national", firms may nonetheless significantly contribute to local employment. State subsidies will inevitably have consequences for competition, but it may be that competition among regions to attract investment and to protect jobs has become

المنارة للاستشارات

more important to governments than ensuring that firms compete with each other on a level playing field. The question of whether member governments have shifted from protecting national champions to attempting to attract any car manufacturer that creates employment within its national boundaries, however, is not straightforward to answer. Member states exhibit differing attitudes in this respect.

Italy's experience, where the car industry consists essentially of one large company, Fiat, which employs almost 70,000 people directly, is instructive in this regard. Fiat has been one of the main recipients of state aid in Europe over the last years and would have received even more had other applications not been rejected. The sums involved and the frequency with which aid was proposed reveals a determination on the part of government to help a firm beyond what local and contingent conditions would call for. For example, in 1997 Italy submitted no fewer than six applications to provide assistance to the company, and two (regional aid) were blocked by the Commission. In both the latter cases, regional aid was claimed for projects in an area, which had been declared eligible for assistance under Article 107(3)(c) of the EC Treaty *after* the beginning of the project for which the aid was to be given. The other four saw Fiat receive the sum total of 72,6 M€ in state aid.

In 2001 the Italian government sought to grant, Iveco, a subsidiary of Fiat, 16.1 M€, but the move was vetoed by the Commission. The project had been carried out between 1994 and 1999, the company applied for aid from Rome in 1996, and the request of the Italian government to the EC arrived in November 1999. Not surprisingly, the application did not pass the necessity test. However, Iveco received substantial compensation in 2003 under the heading of "regional aid", when a grant of 121.7 M€ was accepted by the Commission.

Another intriguing case, which casts doubt on the continued persistence of the national champions strategy, is one of the numerous subsidies that the Belgian government has given to plants of the Ford Motor Company in Belgium (a Ford plant in Genk; a Volvo plant in Gent). Since 2000, these plants have benefited from total subsidies of about 80 M€ in 2008 values, and this to support, at the end of 2008, around 9.500 jobs.[28] Even if it is not obvious that such an effort can really be justified by the wish to defend fewer than 2 % of the jobs of the Belgian manufacturing sector, it would be even harder to interpret the attempt to defend a US company as support for a national champion. In fact, in many cases a new notion of "champion" is emerging, which is no longer linked to traditional brands or the nationality of the main shareholders, but rather (more pragmatically) to whether a firm is prepared to create employment in a certain region.[29] Net of the tighter controls which are now standard, the willingness of member states to drum up the funds to provide subsidies to these firms is not much lower than the support previously shown to the old national champions.

5 The EU aid policy: control without a strategy?

What should be the aim and objectives of EU state aid policy? Following the seminal article by Brander and Spencer (1985), the economic literature has shown that subsidies to national firms competing in an international market typically lead to a reduction in social welfare if other countries adopt a similar policy. State aid also has negative effects on market

[28] Ford received 7.7 M€ in 2001 for training and further 45.1 M€ in 2003 for regional aid (renewal of a plant). At the end of 2003, Ford cut employment by 3,000. In 2006 and twice in 2008, Ford received training aid for 6.2 M€, 1 M€ and 0.8 M€. Volvo received aid for training for 6.5 M€ in 2003 and 3.5 M€ in 2008.

[29] The same applies to member countries that do not have established national producers (e.g. new member states such as Romania and Poland) or which no longer have them (e.g. the United Kingdom).

المنارة للاستشارات

integration (Martin and Valbonesi 2008), neutralizing the exit of less efficient firms—the concentration effect of the integration process—which, in turn, destroys an efficient specialization of production and a division of labour in the enlarged market. In countries where subsidies are granted, X-inefficiency can increase. There is no reason to expect that the winner picked by government will be the most efficient firm among those in trouble and, in a general equilibrium setting where different goods are produced, the disparity in treatment between firms in different sectors is likely to be welfare-reducing at national level.

Moreover, firm size matters. The larger the firm receiving the subsidy, the higher the potential distortion in competition in terms of pricing and of strategies to limit entry.

Even worse, Collie (2000) shows that, while each national government has an incentive to grant aid, the prohibition of subsidies would increase the welfare of all member states. Finally, Dewatripont and Seabright (2006) present EU-based evidence and show in practice and in theory the wastefulness of state aid granted by national politicians to improve their chances of re-election by signalling their commitment to supplying "public goods".

Absent externalities, the Commission's presumption that state aid should be subject to tight scrutiny and control rests on firm ground. However, the Treaty itself acknowledges that aid may be acceptable for the purposes of regional development, R&D, and training, provided that it does not interfere "too much" with competition.[30] As stressed recently by Vives (2009): "a tension is perceived between a competition approach (according to which aid to firms with no market power or not generating cross-border externalities should be allowed) and a more encompassing approach (where aid not targeted in general to remedy a market failure should be forbidden)".

Two questions now arise. The first is whether control by the Commission has proved effective. The second is whether, in its regulation of state aid, the Commission is or has been pursuing (or should pursue) a "strategy".

5.1 Effective control of fig leaves?

One way of analyzing the effectiveness of the EU policy is to examine the extent to which the Lisbon qualitative targets have been met. Our response is that the answer is mixed. As shown in the tables above, less aid is directed to the car sector, and most of it is now justified by regional development or training objectives. The real issue, however, is whether a reasonable balance between the conflicting objectives assigned to the Commission has been struck.

A key issue is how state aid to the car industry in pursuit of the horizontal objectives specified for exemption from the prohibition of state aid under the Treaty are analysed and evaluated by the Commission. With respect to training, the Commission examines the nature of the activities to be financed. If these activities are normally carried out by car producers, the aid is equivalent to operating aid, distorts competition, and should be prohibited. If training activities are "additional", going beyond what normal market considerations would imply, the aid is compatible with the Treaty. Such an assessment is not easy, especially in a sector where firms compete through the introduction of new models, and innovation is an essential element of survival. In many of the cases considered, increasing the employability of workers involved, and job creation or preservation are used as supporting arguments.

[30] The assessment of state aid control (i.e. how much distortion in the market is induced by the aid) is by itself an issue. Friederiszick et al. (2008) discuss an effects-based approach—essentially based on a general balancing test—to distinguish "good" from "bad" aid, but many features of the test still remain to be defined and its implementation seems to be cautiously case-by-case.

المنارة للاستشارات

Aid granted under the heading "regional development" is a greater cause for concern, since such measures support productive capacity, which has a direct impact on competition. As competition in the sector is at least continental, the benefit from state aid to a plant located in a less developed region should at least be traded off against the possible distortions to competition. The first effect is likely to be on the competitors' profits, which is a relevant issue if a level playing field is important. In addition, if there is already excess capacity in the sector, support for new plants might create problems for plants elsewhere in the EU.

The assessment of aid of this kind controls for the increase in the beneficiary's production capacity and market share induced by the aid. According to the guidelines on regional aid, the capacity created through the aid should remain below 5 % of the apparent consumption of the product at stake in the European economic area and the beneficiary's market share must remain below 25 % in all relevant product markets. Are these thresholds defined correctly for a sector where firms—even if located in EU less developed regions—face international competition?[31] Further, are the thresholds for regional development aid the right tool to evaluate the potential distortion to competition?

A more accurate measure is probably necessary. In *The State Aid Action Plan* (EU Commission 2005), the Commission presented a "balancing" test to analyse state aid cases. This test takes into account the following: market failures or issues of common interest in the objective pursued by the state aid; incentive effects arising from the subsidy; distortions on competition and trade; and balance between benefits and costs from state aid. The test applies common principles to evaluate each case, provided the subsidy alleviates the effects of a market failure ("efficiency objective") or produces outcomes which increase social/regional cohesion ("equity objective"). As highlighted by Neven and Verouden (2008), it has been mainly implemented in the evaluation of cases the area of R&D aid and in the provision of risk capital. However, there is no evidence of a genuine evaluation of the potential distorting effects of the aid for training or regional development objectives. To our knowledge, the "balancing" test has never been applied to evaluate cases in the car sector.

In several cases, the Commission has rejected proposed aid measures. A case in 1999 involving Italy was discussed above. In another example, Belgium tried to give about 6.5 M € to Ford Genk (regional aid) for transforming a plant in order to produce a new model without relocating production, but the Commission refused authorization. It appeared totally unclear as to why the aid was needed, given that no "economically viable alternative for the project" was proved to exist. The test for the necessity of regional aid led the subsidy to be blocked. In other two cases (Ford in 2006, Volvo in 2008) the amounts permitted were little more than half of what had been requested, because only part of the programme appeared to be above what the market would have justified.

Ford Bridgend (2002) and Daimler Berlin (2003) are other examples of cases withdrawn at the beginning of the century.[32] Few cases of refusals or withdrawals have been recorded in the last few years. Whether this is because only genuinely "good" aid schemes have been proposed since, or because member states have learned the new rules of the game, it is (again) hard to tell.

[31] In the new member states, which host a significant number of "objective 3 regions", a recent wave of aids benefitted firms, such as Daewoo, Hyunday, Ford and Mercedes Benz, which compete and sell their cars mostly in markets other than those where their plants are located.

[32] For Ford Bridgend see case C7/02 (ex N 577/01), withdrawn in August 2002¸The Daimler Berlin file is C64/02 (decision on 28/3/03).

المنارة للاستشارات

5.2 A coherent strategy?

The Commission's pure control power can be construed as a "negative" power that was not intended to shape industrial policy at the EU level. This is consistent with the view that "micro" sectoral policies are prerogatives of the member states. The 1997 Framework on the car industry states accordingly that: "The Commission does not intend, however, to impose an industrial strategy on the sector". However, this statement is somewhat extraordinary, especially since it is quickly followed by an acknowledgment that, in assessing rescue and restructuring aid: "As structural over-capacity in the motor vehicle industry is set to continue… the Commission will usually require a reduction in installed capacity". The very endorsement of an intervention, however, conditional on an adjustment in productive capacity, implies pursuit of an industrial strategy, since it is linked to a preferred vision of the car sector and possibly the entire manufacturing sector.

Despite the rhetoric, it is clear that the Commission does pursue a strategy, both in relation to industry and towards other aspects of state aid policy, such as regional development. The Commission's "Guidelines on National Regional Aid for 2007–2013" (2006/C 54/08), for example, state that: "regional aid should be granted under a multi-sectoral aid scheme which forms an integral part of a regional development strategy with clearly defined objectives". In other words, the Commission decides whether aid measures are part of a strategy, the objectives of which should be clearly specified. Presumably, these objectives need also to be evaluated.

Given that the Commission does not explicitly define an industrial policy, what is the industrial strategy that it implicitly pursues? The *Guidelines* set out an explicit condition: aid is permitted provided that the intervention is in line with what the Commission believes to be the general interest of the Union in the car industry. However, it is hard to identify any consistent or enduring content for that term. First, the Commission states repeatedly that the sector suffers from overcapacity, and calls for a reduction in capacity. Why overcapacity is problematic is unclear, since greater capacity is typically associated with more employment, greater production and lower prices. Second, it is widely believed that using state aid to expand capacity distorts market competition.[33] However, especially in less developed regions of Europe, state aid is used (with the Commission's blessing) to subsidize new plants for car production. The Commission, it seems, cannot reconcile regional development and sectoral policy imperatives. If the Commission had traded-off one policy goal in favour of another, there would be a number of negative decisions on aid to car plants located in least developed regions and large grants to other business in the same regions: the former decisions would be motivated by the sector's overcapacity and the latter by regional development aims. But this is not what we find.

Rather, large sums were authorised for projects that aimed to reduce productive capacity, while entirely new plants elsewhere were heavily subsidized, which would increase capacity. In December 2006, for example, Poland was permitted to grant state aid of 82 M€ to FSO on the ground that the project envisaged a reduction of capacity of about one third (from about

[33] It may be that an expansion of capacity will lead to a decrease in prices, and is thus in the interest of consumers, who are the ultimate beneficiaries of competition policy. However, an exhaustive examination of the impact of capacity reduction is beyond the scope of the current analysis.

المنارة للاستشارات

220.000 vehicles a year to about 150.000 a year). Next year, the Commission authorised subsidies for new plants in the Czech Republic (Hyunday, 194.5 M€) and in Slovakia (Kia, 32,4 M€).

The factors at work are easily explained. Member governments want to ensure the survival of car manufacturers or to support employment, while the Commission does not have the authority to deny such aid if, for example, a well-constructed project targets a less developed region of the EU. However, the tensions in the policy are obvious.

5.3 State aid in time of crisis

The car sector has experienced a significant fall in demand since the crisis broke in 2008. Despite massive state inducements (see below), new car registrations dropped from 15.6 millions in EU 27 in 2007 to 14.3 millions in 2008 (−8 %) and 14.2 millions in 2009.[34] Although the declared policy at the beginning of the crisis was towards greater transparency of state aid and a reduction in its administration, the modernization of state aid policies and the introduction of global bloc exemptions in August 2008 led to a considerable increase in the number of individual measures which do not need prior notification (EU Commission 2009). State aid increased in 2008, which led the Commission to adopt a temporary framework for the years 2009–10, which has allowed member states to grant more aid with fewer controls.[35]

This general trend has had a particular impact on the car sector, which has been singled out as a "strategic" sector by many countries. The Commission's approach to these claims has been generous. It has explicitly defended "a proactive stance to support the industry",[36] thereby paving the way to a number of specific interventions "to improve access to credit, to clarify the rules for granting state aid in the particular circumstances, to boost the demand for new vehicles through coordinated national action".

Since 2009, the bulk of state aid has been given under the temporary framework. Unsurprisingly, state aid has mainly taken the form of "defensive" loans and public guarantees, rather than grants for new projects. In a short period a sum of around 9 billion Euro has been granted in loans and guarantees,[37] but the aid content of these interventions is rarely shown in official documents. The only new investment recorded under the heading of regional development aid during that period has been in Hungary, where Mercedes/Daimler received about 111 M€ in public aid.[38]

The real battle between member states and the Commission has been to turn discriminatory into "open" measures, and again it is important to acknowledge that the Commission has been success. For example, France's attempt to introduce a

[34] As Fig. 1 shows, car registrations the EU15 in 2010–2011 are back to the levels of 1996–1997 (about 12,5 million cars).

[35] The "Temporary framework for State aid measures to support access to finance in the current financial and economic crisis" allows more generous short-term measures to boost demand and "smart investment" to yield higher but sustainable growth in the longer term. It has also raised the threshold for *de minimis* exceptions, made it easier to provide aid for "green" products, and simplified procedures. An underestimated consequence of such exemptions from the duty to notify or to provide details about the implementation of the schemes and their beneficiaries is that the actual amounts of total aid for the years 2009–10 will be possible to calculate only in very aggregate terms.

[36] See the Communication issued by the Commission on 25 February 2009.

[37] Among the main recipients, Renault and Peugeot (3 bn€ each in France), Opel in Germany (1.5 bn €), Ford in Romania (400 M€) and in Germany (200 M€), Saab in Sweden (400 M€) and Volvo (680 M€ in Sweden).

[38] Another major intervention was the 800 M€ given by Spain for grants and soft loans for R&D, environmental projects and training.

المنارة للاستشارات

scheme of state guarantees that was essentially directed towards French car producers was blocked by the Commission,[39] forcing Paris instead to adopt a non-discriminatory horizontal scheme (N23/2009).[40]

At the same time, the policy is not blemish-free. Lack of transparency is one problem, market distortion another. The German loan to Opel—a historically important brand, now part of the US group General Motors (GM)—was granted for a restructuring plan that entailed no plant closures in Germany. The bridge loan was quickly repaid and no further aid was given since GM stopped the sale process and eventually financed the restructuring on its own. Without this aid,[41] Opel would probably have been bought out by another producer and, in normal conditions, such a loan would not have been justified.

According to the estimates in Grigolon et al. (2012), the aid content of the different interventions undertaken for the car sector under the temporary framework amounts to about 1,2 billion € between 2009 and 2010. Adding these figures and "normal" aid, the conclusion is that in these 2 years total aid to the car industry has been comparable to the sum total spent in the entire period 2000–2008 (reported in Table 1).

Moreover, this sum does not include either the special effort made through the European Investment Bank (a sum total of 6.8 bn €, as estimated by the Commission at the beginning of 2009)[42] or the very significant demand side measures undertaken to support the demand for cars. Although demand side measures are not strictly speaking state aid, the policy debate clearly indicates that policies aimed at forcing an early retirement of old and polluting cars are mainly aimed at supporting the industry rather than helping consumers.

No fewer than 13 EU countries have implemented scrapping schemes, almost all utilising an environmental clause.[43] The sums involved in these programs were much higher than those officially labeled "state aid"—a sum total of about 8 bn € (5 bn€ in Germany, more than 1 bn € in France and Italy, about 400 M€ in Spain and the UK:).[44] Furthermore, the net burden of these schemes for the public purse should include the increase in taxes on profits and sales, which is rarely calculated.[45]

Although there is broad recognition that the sector needs restructuring and that excess capacity is widespread, European governments have kept pouring money into the sector during the crisis in order to support employment. The stringency of financial constraints, which have become clear at the end of the crisis, will most likely force member states to reconsider these policies. Whether this will bring about a more rational approach remains to be seen.

[39] Schemes targeted to the car sector (but with less discriminatory features) have also been approved in the UK (N71/2009) and in Germany (N27/2009). Programmes for subsidized interest rates on loans for "green products" (e.g., UK (N72/2009), France (N11/2009) and Spain (N140/2009)) have been designed in such a way that "environmentally friendly" cars are the only green products covered. See http://downloads.bbc.co.uk/news/nol/shared/bsp/hi/pdfs/22_04_09bud09_completereport_2591.pdf

[40] Notice that under this scheme the government has granted loans for 5 years, which in practice were repaid after 2 years, in April 2011.

[41] Grigolon et al. (2012) estimate the aid element as 220 million Euro.

[42] EIB loans were given even before the crisis, but increased considerably in 2009 and 2010 (BMW (26 %), Ford (21 %) and Daimler (12 %) being the largest loan beneficiaries).

[43] The effects of these schemes are usually considered positive, even considering intertemporal substitution effects in demand (Schiraldi 2011). It is interesting to notice that their impact on the environment is instead highly dubious. For instance, Sinn (2009) claims that the energy balance of the German scheme is most likely negative.

[44] See Global Insight (2010) for further details.

[45] Schiraldi (2011) indicates that in the Italian case until 2004 the net effect may well have been positive.

المنارة للاستشارات

6 Conclusion

Despite the adoption of a new approach at the Lisbon European Council, sector-specific interventions are still common, and point to a certain weakness of the Commission *vis-à-vis* the states. We agree with Cini and McGowan (2008) that the EC scrutiny has certainly improved in terms of transparency and credibility in enforcement. However, at times the main effects of this scrutiny seem to be that the member states have to submit more complex documents in support of their requests and that analyses of regional aid cases have become more and more accurate. But the Commission, by issuing detailed frameworks, has also given member states a clear benchmark: if a member government is reasonably certain that it passes the test as outlined in the framework, the aid cannot really be considered incompatible with EU rules. When "soft laws" become rigid, they may also become double-edged swords.

Moreover, our analysis has shown that in practice what qualifies as state aid to a specific sector may be difficult to detect and therefore to assess precisely, as it remains hidden under declarations that the primary objective of the aid is horizontal. Nevertheless, over time the amount of state aid has decreased, partly due to the control exercised by the Commission, partly because demand conditions have improved (at least until 2008), and partly, because members states have become smarter in crafting their requests.

The consequences have been negative for the credibility of competition policy rules, which are defined at EU level, but which member states often try to by-pass in the pursuit of national objectives. Whether what emerges is an "industrial policy" or is merely an aggregation of local lobbying efforts is a question that needs to be answered case-by-case.[46]

The effect of initiatives such as Lisbon's "less, but better aid" appears to be positive, if limited. Analysis of the data indicates that the decrease in state aid began well before Lisbon, so that the declaration appears to confirm an agreement which member states had already implemented.[47] On the question of quality, sectoral aid is still alive and kicking, although disguised under new labels. The new rules have proved effective in blocking some essentially protectionist initiatives, and in preventing states from submitting measures which do not match the new criteria.

The terms of the subsidy game are also changing, as in many countries "national champions" have been replaced by multinationals and long-established names have shifted production abroad.[48] It is therefore hard to share the optimism of McLaughlin and Maloney (1999), who contend that the Commission has "broken up long standing institutionalized government-industry relationships". On the one hand, the main driving force of the change has been the privatization of companies such as Renault, Rover or Alfa Romeo more than intervention by the Commission. On the other one, the aforementioned cases show that, while the Commission has certainly been partially successful in tightening its controls, the defence of plants as employment generators within national boundaries is as important as ever.

Nowadays, competition among regions seems more important to national governments than competition among firms. While state aid is considered a competition policy problem in the EU, where each national government typically supports its national champion, the US example stresses that industry subsidies are actually regional policy issues, where states

[46] EU dynamics are interesting to compare with the US. See Luger (2000).

[47] In Nicolini et al. (2012) we provide an econometric analysis of the determinants of state aid to the car sector from 1992 to 2008, showing that the Lisbon declaration did not bring about any drastic change in the aid policy.

[48] Fiat in Poland or Ford in Romania are two obvious examples.

المنارة للاستشارات

compete for investment, but where all firms are equally likely to be welcomed by States. As traditional firms are no longer confined within the original national borders, a convergence of EU policies towards this approach may emerge as an option.

Defining an optimal EU policy towards state aid remains extremely difficult. Although the economic literature suggests that governments should minimize subsidies to specific sectors, as long as member states remain free to support local investments subsidy races remain likely. Despite the Commission's scrutiny, vast amounts of public money are paid out every year to firms. This happens whether or not the Commission defines an explicit industrial policy, which remains a taboo. Advocating *laissez faire* is legitimate, but it would be at least a reasonable second-best to attempt to rationalize existing interventions.

One aim of the EU's approach should be to help restructuring a sector, where excess capacity has been acknowledged for long time. For example, the Commission could insist that regional investments should not necessarily focus on the car sector. The current crisis has made the problems of the sector more acute and controls more lax. Unfortunately, it has also made an overall restructuring of the sector less likely, as policies tend to defend existing jobs more than ever. In any case, the current state of affairs, whereby some member states spend public money to aid downsizing, while others spend even more money to encourage new plants, cannot be sustained.[49] With more and more stringent budget constraints and high unemployment, the lack of a consistent aid policy is likely to become part of the problem, rather than (as is sometimes claimed) part of its solution.

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[49] This is also true from the perspective of building an integrated market. There seems to be no self enforcing mechanism which may lead to lower subsidies, as countries with greater availability of public money will probably find it optimal to keep spending more.

المنارة للاستشارات

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