

Chapter 1

The State Aid Framework Within the European System. Evolution of Legislation and Objectives



Contents

1.1	The Combination of the State and the Market in the Legal and Economic Development of the European Legal System	2
1.1.1	The Social Market Economy in the European Project	5
1.1.2	The Market and Competition. Mutual Instrumentality and Flexibility of the Notions	8
1.2	Competition Rules. State Aid	10
1.2.1	The Rules on State Aid in the Treaty. Framework	12
1.2.2	The Construction of the State Aid Framework. The Role of the European Commission	13
1.3	The Development of the State Aid Framework in European Policy. The Historical Phases	16
1.3.1	The Modernisation of the State Aid Framework	19
1.3.2	The State Aid Framework During the Covid-19 Emergency. The Current Phase	22
1.4	State Aid Prohibited Under Article 107(1) TFEU. Negative Integration	23
1.4.1	The Definition of Prohibited Aid	24
1.4.1.1	Notion of Undertaking and Economic Activity	26
1.4.1.2	State Origin	27
1.4.1.3	Advantage	28
1.4.1.4	Selectivity	29
1.4.1.5	The Effect on Trade Between Member States and the Distortion of Competition	33
1.5	Permitted Aid. Positive Integration	36
1.5.1	Aid Permitted de jure	38
1.5.2	Aid Allowed on a Discretionary Basis	39
1.5.3	Assessment of the Compatibility of the Aid. The Economic Method	40
1.5.4	Aid Permitted Without Prior Notification	41
1.5.4.1	Regional Aid	43
1.5.4.2	Sectoral and Horizontal Aid	44
1.5.4.3	<i>De minimis</i> Aid	44
1.6	The Implementation of the State Aid Framework and the Protection of Rights	45
1.6.1	The Development of the Procedural Framework. Public and Private Enforcement	47
1.6.2	The Stages and the General Principles	49
1.6.2.1	Monitoring of New and Existing State Aid	49
1.6.2.2	Recovery of Aid	50
1.6.2.3	The Protection of Rights	51
1.7	Concluding Remarks	52
	Bibliography	53

Abstract The essential characteristics of State aid legislation and its basic values are highlighted, shedding light on the fact that this legal framework is a fundamental meeting point between the two ideological components that lay at the foundation of the European Union: the liberal ideology and the ideology of the social market economy.

The substantive and procedural aspects of the framework are analysed, thereby making clear the significant regulatory developments that have occurred in State aid and its central role in the economic policy of the Union and the Member States.

1.1 The Combination of the State and the Market in the Legal and Economic Development of the European Legal System

State aid consists of a bundle of rules and principles which have been influenced by the economic and legal development of the European system.

This is an area which has changed its point of balance and the structure of its rules over time to become a legal framework which is always in step with the legislative changes and the lines of economic policy which the European Union has developed over time.

In this respect, as will be shown, the development of State aid reflects the economic and legal evolution of the process of European integration.

The State aid rules govern an area which is central to the EU economic project: the role of the State in the market or the relationship between the State and the market.

The State-market equation contains important and fundamental considerations which have dictated the guidelines of economic policy and the relationship between the economy and the law during the last century.

The term *market* generally refers to an economic area in which the rules and balances are decided independently by the operation of various factors involved in the production and distribution cycle.

The term *State*, for its part, refers to the recognition of a more or less intensive role of public regulation allowing intervention in the market in order to direct choices and to protect certain legal values.

The values that are historically considered to be a prerogative of the State (and therefore of regulation) and that emerge in the State-market equation are those social values understood as the primary rights of every individual and guaranteed in every democratic society.

In the debate between the State and the market, liberal views argue that the State must not intervene in the market, the socialist argument favours a central role for the State as a market regulator in the interests of society at large, and holders of intermediate views recognise that there is a coordinating role between the State

and the market of varying intensity depending on the various underlying theoretical approaches.

In this regard, the field of State aid appears to be an immediate and coherent implementation of the guidelines laid down by European policy setting out directly the changes of perspective that the Union has decided to adopt in the development of the Community project.

Understanding this path requires an analysis taking the birth of the European project as its starting point.

The project of European integration began in the middle of the last century with the aim of creating a single market through economic cohesion and free trade.

The direction taken by the initial European project was based on the classical principles of economic liberalism.¹

The opening up of national markets and their interaction would lead to growth in the European economy, harmony between Countries and an improvement in the standard of living of Europeans.

These values were to ensure peace and security between States, avoiding new armed conflicts in Europe.

Europe would become stronger in comparison with other countries in the world by becoming a unified economic structure.

From 1950 onwards, a project was put in motion to achieve those objectives, first with the signing of a Treaty covering limited economic sectors (ECSC Treaty²) and, subsequently, with the signing of further specific treaties and a general Treaty involving the whole European economy (the EEC Treaty in 1957³).

When the European Treaty was being signed, an important choice to be made arose: either to adopt a common social policy as a precondition for market integration or to implement only market integration, to the entire exclusion of a common social policy.⁴

The second approach was adopted, although the first option has always remained (albeit as a minor aspect) as part of the various stages of European policy.

The basic approach of the EEC Treaty and of the first stage of European policy is therefore based on the principles of economic liberalism, within which the market must operate freely without the State imposing conditions.⁵

The choice in favour of the liberal approach was justified for many reasons.

¹The principles of economic liberalism are those expressed in the classical economy school of thought whose main exponents have been Smith A., Ricardo D. and Malthus T.R. See Barber (1988), *passim*; Denis (1990), Vol. 1 (from Plato to Ricardo).

²The Treaty establishing the European Coal and Steel Community (ECSC) of 18 April 1951.

³The Treaty establishing the European Atomic Energy Community (EURATOM) and the European Economic Community (EEC) both established by the Treaty of Rome of 25 March 1957.

⁴See Giubboni (2009), p. 2.

⁵The reference is to the principles of economic liberalism of the classical economy. See Bedeschi (2015), p. 113.

The first reason was the fact that the European Community has a sectoral nature, since it was set up essentially for the creation of a single market governed by economic freedoms.

The view was therefore taken, not least in order to avoid the emergence of new conflicts between States, that the best choice was to leave the market free to operate according to its own rules and mechanisms. Economic balance was to be found within the market itself in a natural and unregulated way.

The European Community thus acquired its legitimacy as an economic system aimed at the free movement of inputs and the protection of competition independently of the democratic institutions of all the Member States.⁶

The second reason lies in the fact that the States themselves sought to retain full sovereignty over social and redistribution policies. The latter had to be reserved for national democratic political processes. In this regard, the Treaties establishing the European Community recognised the Member States as having full freedom of action in relation to social policies.

It should also be borne in mind that social policies arose essentially in the period immediately following the Second World War; social policies were still therefore in an embryonic stage within the various European States and would only go on to develop at a later stage.

After an initial phase when those principles were established, very difficult issues arose which required a rethink and encouraged greater expansion of the social policy approach from the position to which it had been relegated as being marginal to the initial project.

The creation of a single market began to reach significant limits because of differences in economic development and the social situation between the various European areas.

Failure to correct these inequalities would have resulted in a project based on inequality and poorly aligned with the principles of pure competition that had lain behind the Community project.

Against this background, the principles of subsidiarity and economic cohesion were affirmed in the 1970s and some 'functionalist' regulations were enacted, especially in the field of labour law, aimed at ensuring a minimum of social standards in the protection of workers' rights.⁷

There was a need to provide for Community action to correct all cases where the market threatens a crisis of social values.

As a matter of fact, it was noted that the market itself was not in a position, on its own, to guarantee economic freedoms and healthy competition.

At this stage, the European Union slowly embarked on a route to affirm social rights within it, and the social dimension began to take root in the common market.

⁶See Jeorges (2004), p. 461; Giubboni (2009), p. 4.

⁷See D'Antona (1996), p. 22.

The Single European Act marked the beginning of a new phase in which the regulation of social values was brought within the scope of EU action.⁸

That historic moment redefined the single market as a European social area within which to implement targeted coordination and convergence policies for the general improvement in living conditions.⁹

The Maastricht Treaty¹⁰ and the Treaty of Amsterdam¹¹ strengthened the social dimension of the European Union and provided for economic and social cohesion, equality, solidarity, employment, health, the environment and public services as central elements of the European project.

The Treaty of Lisbon represented the final step of particular significance of this historic process.¹²

Article 3(3) of the Treaty on the European Union provided that ‘*[t]he Union shall establish an internal market. It shall work for the sustainable development of Europe based on balanced economic growth and price stability, a highly competitive social market economy, aiming at full employment and social progress, and a high level of protection and improvement of the quality of the environment*’.

At the same time, Protocol No 27 on the internal market and competition (intended to complete Article 3(3)) defined the internal market as a system in which competition is pure and not distorted.

A new legal framework was thus established, which is the one currently in force.

The Treaty states that the internal market is based on the principles of the social market economy and the Protocols then state that the market is a system based purely on competition.

The formula used to define the purpose of the market points to an important school of thought which corresponds to the minority socialist component proposed when finalising the Treaty establishing the European Economic Community.

The concept of a social market economy therefore is at the base of the development of the regulation of the State of social values in the European Community.

1.1.1 The Social Market Economy in the European Project

The 2007 Treaty of Lisbon changed the way in which the objectives of the single market and competition were expressed.

⁸The Single European Act (SEA) was signed on 17 February 1986.

⁹See Barbera (2000), *passim*.

¹⁰The Treaty of Maastricht on the European Union was signed on 7 February 1992.

¹¹The Treaty of Amsterdam was signed on 2 September 1997.

¹²The Treaty of Lisbon was signed on 13 December 2007. After that date, the European Union succeeded to the European Community and the Treaties have been revised, resulting in the Treaty on the European Union (TEU), the Treaty on the Functioning of the European Union (TFEU).

The market and competition remain linked in their definition in Protocol No 27 and Article 3(3) of the TEU.

However, the market and competition are qualified according to the principles of the highly competitive social market economy which aims at full employment, social progress and a high level of protection of and improvement in the quality of the environment.

The expression ‘social market economy’ is deemed to recall the significant minority socialist component which was involved in the drawing up of the Treaty establishing the EEC in 1957.

The school of thought that played a role in the formation of the Community project originated in Germany in 1900 and was defined as Ordoliberalism of the Freiburg School.¹³

The creation of the European Community received wisdom from this school of thought and is in every sense part of the European historical background and tradition.

This is in fact a philosophy that has slowly evolved within the Community until eventually being enshrined in the Treaty of Lisbon and being acknowledged with legal recognition.

The current view is that the social market economy represents a founding value of the European Union.¹⁴

The social market economy is a model of development that guarantees market freedom and social justice.

The premise of this view in the legal literature is that the full self-realisation of an individual and the social justice of a State cannot occur unless a free market is first guaranteed.

According to such thinking, the market economy is the best way to ensure people’s economic well-being and freedom.¹⁵

The competitive market represents the most appropriate system for the economic and social development of peoples.

The market, however, fails to achieve these objectives if it is left to itself; the market structurally tends to favour domination by the economically stronger players and to generate various forms of inequality.

In general, in fact, the market (if it is not regulated) produces a result where oligopolistic forces prevail over economically weaker classes.

It therefore appears necessary to develop instruments that mark out an approach to economic freedoms and build a sense of a community engaged in economic activity.

¹³This school had among its main exponents: Eucken W., Muller-Armack A., Erhard L., Ropke W.; Mijsch L., Bohm F., GroBmann-Doert H. See Felice (2008); Forte et al. (2012); Various Authors (edited by P. Nemo & J. Petitot) (2006), *passim*.

¹⁴See Somma (2009), p. 4.

¹⁵See Libertini (2014), p. 32.

The theory of the social market economy therefore considers it necessary to define a public power that guarantees the proper functioning of the market by protecting social values where they are absent or of low level.

The public authority must perform a 'framework' or 'systemic' regulation function, namely it must lay down waypoints and guidelines. In other words, what is required is a regulatory power exercised from above that implements coordination policies without squeezing freedoms or making choices on behalf of undertakings.

The most important issues that need to be addressed at a higher level are:

- the guarantee of a regime based purely on competition, which means the need of: avoiding the formation of cartels or monopolistic structures, implementing a price control policy and creating efficient social structures for the protection of workers. Competition is defined by the co-existence of these factors. The co-existence of these factors qualifies a market as being in line with the principles of social economy;
- the need for fiscal policy that guarantees a balanced budget and the redistribution of wealth;
- a monetary policy controlled by the Central Bank.

The doctrine of the social market economy also recognises a fundamental role for all levels of society on the basis of the general principle of subsidiarity.

In that regard, the present line of thinking is at an intermediate point between markedly liberal theories and Catholic theories.

The collective structures that are closest to the problems are those that are most capable of defining targeted policies and making efficient choices.

Market correction must therefore take place on two levels: a higher level aimed at coordinating issues of greater importance and general social impact; and a lower level aimed at implementing solutions.

In this way, a synthesis is delineated between the regulatory intervention of the State and the public authority and the responses originating from below in accordance with the principle of subsidiarity.¹⁶

In that regard, this doctrine disapproves of a choice being made midway between economic liberalism and State dirigism.

The legal transposition of the social market economy therefore carries with it many consequences.

The market complies with social principles of distributive justice which are intended to be implemented by the European Union and individual States.

In this context, the market becomes a place of justice, since it is created by a social system to which the whole economy must conform.

An analysis of the content of this economic doctrine shows that the social market economy is an important aspiration of the European Union, which in many respects has yet to be truly defined.

However, one fact is undeniable.

¹⁶See Felice (2008), p. 75.

Thanks to the approval of the Treaty of Lisbon, two directions have been followed for the initial implementation of the principles of the social market economy, beyond the policy of the third sector or social enterprise.

The rules governing services of general economic interest are being strengthened and the framework for State aid is being reinforced.

In fact, State aid represented the field in which the doctrine of the social market economy has been tested in recent years.

1.1.2 The Market and Competition. Mutual Instrumentality and Flexibility of the Notions

The modification of the initial theoretical approaches and the extension of the limits of the European project are factors that could have been achieved in the face of certain characteristics which were acknowledged to the two general concepts that underpin the Community architecture: market and competition.

Market and competition are characterised by a relationship of mutual instrumentality and by a flexibility of content.

As will be set out in more detail below, the content of these concepts has been defined on the basis of the stages of historical moments, existing legislation and, above all, their interpretation by the Court of Justice and their implementation by the European Commission.

In the first phase of Community activity, the European project was based on two general objectives: the achievement of the single market and the implementation of a system of healthy competition in the single market.

Those objectives defined the values of economic liberalism on the basis of which the market must compete on equal terms while observing economic freedoms and the rules of pure competition.

Market and competition remained central also in subsequent historical stages and their importance was moreover confirmed by the transposition into law of the social market economy, enshrining the stable need to maintain a highly competitive market.

It may therefore be clearly underlined that the objective of creating a single market has always been central to European policy, in every successive version of the Treaties.

The single market is the engine of European integration¹⁷ and the various steps that have been taken over time have always brought about important progress in this regard.

The single market project has remained the same but has adapted its content in line with changes over time, increasing its scope for action.

¹⁷See Daniele (2012), p. 7.

The single market has acquired an ever-greater extension and an ever-deeper dimension, moving by dint of the evolution of European policy from a principally economic level to a one of legal integration and of social and environmental cohesion.

Over the years, the concept of market has changed and this has had an effect on the single market project.

The concept of market is still set to change and adapt to the times, while remaining at the heart and the objective of the European Union's activity.

This explains why a definition of market is never found in the various European Treaties.

It is, in fact, as suggested above, a flexible concept destined to be defined in accordance with its historical context.

The same considerations apply to the concept of competition.

From the scheme underlying the Treaty establishing the European Community and all successive versions of the Treaties it emerges that the objective of the single market can be pursued through the recognition of economic freedoms and the guarantee of competition.

Competition should be instrumental in the pursuit of the single market, but in many cases the relationship has been reversed as the discipline of the single market has become instrumental in the pursuit of healthy competition.

Over time, a biunivocal relationship has thus been created: the single market and competition are an inseparable combination where the market operates on the basis of healthy competition and competition is the objective of the single market.

This relationship has also been confirmed in terms of legislation in the latest versions of the Treaty: Article 3(1)(b) of the TFEU confers on the Union exclusive competence in the field of competition and, in particular, in '*the establishing of the competition rules necessary for the functioning of the internal market*'.

The concept of competition—in the same way as that of market and for the same reasons—also has a flexibility of content.

This concept adapts to the times, to legal regulations and to market requirements.

In that regard, the concepts of market and competition offer a flexibility of content and mutual instrumentality: both concepts are destined to influence each other and to widen and enrich their content in step with the evolution of European policy.

This consideration makes the activity of the Union and its *objectives structurally inexhaustible*, as they are based on flexible definitions and specific aims that will emerge and will become necessary during European economic integration.

The flexibility of those concepts has made possible the significant growth that the field of State aid has achieved.

The State aid regime is indeed a field which has come about as a means of protecting competition and with the aim of creating the single market.

State aid has based its substantive rules and significant changes in interpretation on the concepts of competition and the market.

1.2 Competition Rules. State Aid

Competition plays a central role in the general policy of the European Union and within the structure of the Treaties.

The regulation of competition has always fallen under the exclusive competence of the European Union and is now regulated by Article 3(1)(b) of the TFEU.

The provisions specifically dealing with competition in the Treaty on the European Union are currently found in Chapter I of Title VII of the TFEU which governs the ‘rules on competition’.

Chapter I contains Articles 101–109 TFEU and consists of two sections:

- Section 1, Rules Applying to undertakings (Article 101–106 TFEU);
- Section 2, Aid Granted by States (Articles 107 to 109 TFEU).

The first section contains rules aimed at undertakings that provide for significant means of prohibiting certain conduct.

In general, these rules provide that undertakings and businessmen cannot unilaterally decide to alter market conditions through agreements, concerted practices and decisions by associations of undertakings.

That section lays down a fundamental regulatory framework for the European competition regime, from the material standpoint.

The need for an open market in which everyone can enter without barriers or discrimination is indeed a universal prerogative maintained by the European Union throughout its various historical stages and economic policy developments.

These provisions represent the ‘private sector’ element of the TFEU provisions on free movement and aim to prevent undertakings behaviour altering market unity in the knowledge that both States and undertakings must behave in a sense that is compliant with the European project.¹⁸

Section II (Articles 107–109 of the TFEU¹⁹) contains the rules on public aid granted to undertakings, referred to as the guidelines on State aid for undertakings, which are the subject of this monograph.

The State aid rules are addressed to the Member States and constitute an important focal point of European policy relating to the role of the State in the market economy.

State intervention in the economy, as mentioned earlier, is a classic theme reflected in a large number of theoretical studies.

In general terms, Article 345 TFEU mentions the principle of neutrality with respect to the rules in Member States governing the system of public and private property ownership in force, thus establishing the principle that State intervention in the economy is possible. To the contrary, any State intervention in economic activity and in the market capable of distorting competition and trade is prohibited.

¹⁸See Daniele (2012), *passim*.

¹⁹Formerly: Articles 87–89 of the Treaty of Nice; Articles 92–94 of the Treaty of Rome.

In this regard, the European Union has adopted, in the first instance, a basic philosophy that the State must not influence the market by altering the rules of competition.

The rules on State aid have been extensively applied by the European institutions and have been the subject of numerous academic studies, including in the area of taxation, in view of the growing importance they have always had in the process of European integration.

State aid rules have, over time, taken on a general and decisive role in regulating competition on the basis of the lines of economic policy adopted by the European Union.

More specifically, the State aid rules prohibit Member States from granting economic support to certain national undertakings or production of certain goods such as to have the effect of distorting competition and altering trade between Member States.

The aim of those rules was intended to ban State aid to undertakings, thereby affirming the principle that undertakings must carry on business using their own resources.²⁰

That principle stands in defence of national competition and provides protection for domestic and foreign undertakings in order to contribute, at any event, to competition in the European area as a whole. In fact, as shown by its historical evolution, the rules were put in place in order to counter the anti-competitive dynamics triggered by each State in order to favour national products and production of certain goods.²¹

The content of this principle is essentially interpreted under two aspects.

To facilitate the survival of all undertakings on the market by ensuring pure and undistorted competition at national level. To that end, in general the State must not provide support to certain undertakings or economic sectors by altering competition at national level.

To defend the possibility of foreign undertakings entering the domestic market. Supporting certain domestic undertakings would, in fact, amount to a protectionist policy that would prevent foreign undertakings from accessing the national market, thereby undermining the principle of competition.

The State aid framework thus protect the proper allocation of economic resources at both national and European level, affirming the economic principles of free movement set out by the European Union.

In this regard, it has always been held at European level that the role of competition rules, and in particular of State aid rules, must be to ensure *pari passu* conditions between undertakings in the European market.

In this way, the State aid framework is aligned with the liberal values of the market economy inasmuch as it enables entrepreneurs to compete on equal terms

²⁰See Brittan (1992), p. 5.

²¹See Triggiani (1989), p. 3; Plender (2005), p. 4; Quattrocchi (2020), p. 2.

within the European territory, promoting pure competition that is not distorted by State intervention in favour of certain players.

The aim of pure and undistorted competition is an objective which has been consistently pursued throughout the development of those rules and it continues to maintain its central role, including in respect of the principles of the social market economy.

1.2.1 The Rules on State Aid in the Treaty. Framework

Nowadays, the State aid framework is constituted by a powerful regulatory and interpretative apparatus consisting of TFEU provisions, Council and European Commission regulations, European Commission decisions, Court of Justice rulings, European Commission Communications and Guidelines, European general principles and national implementing regulations.

It is possible to understand this apparatus by analysing the TFEU provisions which contain the general substantive and procedural rules of the framework.

In particular, the legal basis for the rules on State aid to undertakings is set out in Articles 107, 108 and 109 TFEU.

The rules cover all forms of economic aid granted by the State to undertakings or to the production of certain goods.

Article 107(1) provides for the prohibition of State aid and defines the concept of prohibited aid.

Article 107(2) and (3), on the other hand, identify aid which is allowed *de jure* and aid which may be discretionally granted, laying down the conditions which allow a State to introduce subsidy measures addressed to undertakings.

These are provisions which, in the initial structure of the Treaty, introduced derogations from the general principle.

The proper application of this framework is entrusted to the European Commission.

In particular, the European Commission has exclusive competence in the prior assessment and authorisation of permitted aid. In exceptional circumstances, this competence may also be exercised by the Council.²²

In this regard, Article 108 TFEU requires Member States to notify the European Commission in advance of newly introduced State aid, and such a notification is followed by a procedure for verifying its compatibility and the possibility of authorising it.

The European Commission is also granted with (permanent) general competence to verify the compatibility of the aid existing at the date of the creation of the European Community.

²²See Article 108 (2) TFEU.

Article 108 TFEU provides for a monitoring procedure, the implementing rules for which are now laid down in Commission Regulation (EC) No 794/2004 of 21 April 2004.²³

However, Article 109 enables the Council, on a proposal from the European Commission, to adopt regulations in order to lay down the conditions or categories of aid which are exempted from the authorisation or monitoring procedure.

Furthermore, the Commission—on the basis of Article 108(4) TFEU—may adopt regulations relating to categories of aid exempted from authorisation based on what is provided for by the Council.

On the basis of these latter Articles at the end of the 1990s important regulations were adopted—in view of the importance and centrality of the subject—which authorised the Commission to identify types of aid which were to be exempt from the obligation of prior notification.

The Treaty thus laid down *the fundamental lines of the framework* which may be summarised as follows:

- prohibition of State aid to undertakings (Article 107(1) TFEU);
- possible derogation from the prohibition on State aid (Article 107(2) and (3) TFEU);
- exclusive competence of the European Commission for the authorisation of permitted aid (Article 108 TFEU);
- competence of the European Commission and the Council for the adoption of regulations identifying aid exempted from the obligation of prior notification (Articles 108 and 109 TFEU).

It is based on that structure and by means of an impressive interpretative and legislative activity which has followed the line of development in European thinking that the powerful body of rules on State aid has been constructed over time.

1.2.2 The Construction of the State Aid Framework. The Role of the European Commission

The construction of the European State aid framework is the result, in particular, of a significant amount of legislative activity carried out by the Council and the European Commission, of an interpretative and implementing activity on the part of the European Commission, and of judicial activity carried out by the Court of First Instance and the Court of Justice.

Those institutions have operated within the limits of their respective powers and functions and on the basis of the competences conferred on them under the Treaty.

²³Previously, that procedure had been governed by Council Regulation (EC) No 659/1999 of 22 March 1999.

The framework thus includes: regulations, decisions of the European Commission, Communications and Guidelines of the European Commission, and judgments of the General Court and of the Court of Justice.

While acknowledging the crucial importance that each European institution has had in establishing this regulatory framework, it must be pointed out that the European Commission has played a leading role in creating the current regime.

In constantly pursuing a hermeneutical approach, the European Commission has taken on a fundamental role in its development over time and in the choice of economic policy objectives that have been implemented under the State aid rules.

So far as the State aid provisions are concerned, in fact, the basic framework pursuant to the Treaty was established throughout the whole of the first phase of Community by indirect and secondary activity, as has also been the case, albeit to a lesser extent, in other competition-related provisions.

The Treaty, as stated in the previous section, only provides the basic rules of State aid legislation.

On this regulatory basis the European Commission has built detailed and complex rules making use mainly of Guidelines and Communications.

The initial construction of the State aid framework was implemented through a *soft law* approach, or non-binding guidelines.

The European Commission, in applying the rules, has pursued three main avenues:

- the determination of prohibited aid;
- the determination of permitted aid;
- the procedures for implementing the rules, with particular emphasis on procedures to recover prohibited aid.

In following that approach, the two positions of the Council expressed in Regulation (EC) No 994/98 of 7 May 1998 (on the scope of application of the prohibition on State aid) and Regulation (EC) No 659/1999 of 22 March 1999 (laying down detailed rules for the application of Article 108 TFEU on the procedure for the notification and recovery of State aid) constituted an important initial legislative definition of the State aid framework.

In this way, the entire *soft-law* apparatus (enacted over 40 years of the European Commission's enforcement of the rules) and the detailed legislation (which over the years had been enacted by the Council on some marginal aspects) have been incorporated into a more appropriate institutional framework.

On the basis of those two Regulations, the Council has periodically expressed official positions and issued further legislative acts.

The importance of these legislative acts of the Council does not put in question the central role of the European Commission in the construction of the State aid framework, and it is still, to date, deemed the institution entrusted with the interpretation and application of the State aid rules.

The central role of the European Commission within the State aid framework highlights two important and mutually complementary considerations.

The process of implementing the State aid regime and, in particular, identifying the core values of European economic policy on State intervention in the economy has been mainly in the hands of a body which acts as the executive power of the European Union. It should be borne in mind that the European Commission, within the structure of the Treaty, is the executive body which is responsible for monitoring compliance with the Treaty and with all European acts.

The Commission's acts, which are an expression of *soft law*, which for years have provided a pervasive and timely body of rules in the field, have subsequently found their way into Council legislative acts, which very rarely deviated from the decisions taken by the European Commission.

Doubts have therefore been raised as to the appropriateness of selection and choice of values underlying the State aid framework.

That consideration has taken on greater significance not least in relation to the steady growth of the importance of State aid in the European balances.²⁴

Moreover, from another point of view it is clear that this way of working has meant a rapid and successful adaptation of that field to regulatory, social and economic developments.

In this way, the European Commission has contributed to the great success that the State aid framework has had in the European project, providing it with dynamism and keeping it in step with constant developments in the European Union.

State aid has thus been able to fulfil its potential as far as possible, adapting itself to the needs of the times and to the needs of competition and the single market.

Thus what developed in the first phase of European activity was a legal framework which took the form of administrative guidelines and case law, whose content was very effective in terms of its content and entirely consistent with the Union's institutional legal framework and the role of the European Commission.

This approach has remained largely unchanged, confirming the already consolidated structures.

The Council issues regulations which are based on the European Commission's interpretative and regulatory experience, which continues to play a central role in establishing the general structures for State aid.

Over time, the three axes of the State aid framework—as derived from the interpretative activity of the Commission—have not changed, although they have expanded their boundaries and their content.

In this regard there still remains a three-element split of the legal framework; such a split will also be followed in this chapter and in this monograph, and will be set out as follows:

- the rules governing prohibited aid;
- the rules governing permitted aid;

²⁴See Pistone (2018), p. 25.

- the implementing rules (which include notification obligations, authorisation procedures and compatibility checks and recovery of State aid) and the protection of rights by the courts.

These are three important elements which have been decisive in terms of the content of the framework.

1.3 The Development of the State Aid Framework in European Policy. The Historical Phases

The important role of the State aid framework is linked to the various historical stages of the European Union's activity and to the gradual implementation of the objectives relating to the single market.

The State aid framework has not always had that level of importance for European policy. Furthermore, it is underlined that the various elements of the rules themselves have had a different line of development over time, while always remaining linked to the needs of the market and to the political direction at the relevant historical moment.

The central role played by the framework is an undeniable achievement of European policy over the last thirty years. During this period, State aid legislation has also gained increasing importance in tax matters.

In that regard, authoritative academic writing identifies four important phases of the State aid framework in which the rules of the market and the legal regulation of social values have been combined in various ways, giving a different direction to the Community policy on aid to undertakings.²⁵

The first phase was from 1957 to 1980. During this period, the application of the rules on State aid did not have a decisive effect on the European landscape.

The European Union's attention was focused on the establishment of the common market through the removal of customs borders, while within the various European States there was a strong need for economic recovery from the crisis resulting from the war.

In this context, Europe's focus was primarily on understanding the importance of the State aid framework and the obligation to notify the Commission of aid in advance.

In that context, two opposing trends developed.

Most of the work on State aid was mainly on the issue of prohibited aid and set the lines for the first phase of implementation of the rules.

The European system was intended to counter State interventions in the economy in accordance with the liberal concepts on which the European Union is based. This

²⁵See Tosato (2011), p. 3.

thus led to an initial major production of guidance instruments on the concept of prohibited aid.

But this trend appears to have been held in check by the need to support state policies aimed at economic recovery in sectors that were very depressed and outside the market. State subsidies were introduced in this context, in respect of which the European Commission limited itself to providing some guidelines. This gave rise to the first common guidelines on sectoral aid and regional aid, providing a European position on the various policies implemented by the Member States to promote the national recovery of certain economic sectors.

In view of the importance for there to be an economic recovery and the as-yet limited knowledge of the European rules on competition and aid, the European Commission was not particularly strict on the State aid front.

In that period, the Member States were able to implement policies to support the economy and employment without any particular European opposition or constraints.

The State aid arrangements began gradually, taking into account that the body of rules constituted a novel framework, one which the Member States had to be allowed to become used to.

The period from 1980 to 1995 was an important first stage of the single market project, culminating in the Maastricht Treaty and the effective abolition of customs borders.

In this context, it was crucial to defend the newly established market.

State intervention in the economy thus began to be regulated more effectively.

The place of State aid became more central, especially in the case of prohibited aid, on which the European Commission focussed its attention in that period.

In this context, the need for any national aid to be compatible with European rules arises and the interests of protecting the market took precedence over individual national interests in the protection and defence of social values.

In this stage, it was prohibition of aid, which was frequently applied by the European Commission, which amounted to an intense policy of opposing State intervention in the economy.

This approach showed some rigidity and was too strict, especially when many *eastern* European countries joined the European Union and needed a targeted development policy to achieve a level of economic and social cohesion equal to that of the other European countries.

European interests began gradually changing from an exclusively defensive approach to competition in the market through a policy of standing against aid to arrive at a position aimed at the instrumental use of permitted aid.

The mechanism of permitted aid, thus preferred, began on its path of virtuous growth.

The social dimension of Europe took on general importance and the social market economy is enshrined in law in the wording of Article 3 TEU.

Cohesion between economic policy and social policy resulted in the promotion of very important values such as health, the environment, equality and employment.

In that phase, the scope of the State aid legal framework was significantly readjusted.

As discussed in Sect. 1.1 above, the basic premise of the social market economy is that the full self-realisation of an individual and the social justice of a State cannot occur unless a free market under pure competition conditions is first guaranteed.

The market, however, fails to achieve these objectives if it is left to itself; the market structurally tends to favour domination by the economically stronger players and to generate various forms of inequality.

In general, in fact, the market (if it is not regulated) produces a result where oligopolistic forces prevail over economically weaker classes.

It therefore appears necessary to develop instruments that mark out an approach to economic freedoms and build a sense of a community engaged in economic activity.

Abiding by the school of thought of the social market economy, competition is therefore a result which is achieved by removing relative economic and social inequalities in the various sectors or geographical areas of the market.

In accordance with this ideology, competition becomes the result that can be achieved in the face of a planned policy of social and economic cohesion which is possible thanks to the instrumentalisation of permitted aid.

In other words, social values may be promoted through the introduction of permitted aid which, according to that logic, becomes instrumental in safeguarding competition in the market.

The category of permitted aid was firmly planted in the European scenario with the approval of block exemption regulations, which codified a general and homogeneous aid framework for economic and social development.

The European Commission assessed the different requirements of aid more flexibly by balancing social interests and economic interests.

The European Union's point of view was definitively changed and the State aid framework extended its horizons.

The new function of the State aid rules thus consisted of prohibited aid and permitted aid kept in a state of balance decided by the European Union.

At that moment, the two trends of European State aid policy were developed: negative harmonisation through prohibited aid and positive harmonisation through permitted aid.

These are convergent policies aimed at achieving a unified objective: competition in the market.

Permitted aid thus became a category complementing that of prohibited aid.

The fourth phase of the development of the State aid framework was one which put the whole evolution of the European system on its mettle by testing the validity and effectiveness of this regulatory framework.

The economic crisis that affected Europe from 2008 raised serious doubts about the State aid rules and also led some countries to consider the possibility of suspending the entire system.

In this context, the State aid system has proved itself and has succeeded with some carefully targeted measures to safeguard the interests of society and the market.

In the acute economic crisis, State aid became a key tool for resolving market failures and promoting economically virtuous behaviour.

At that historic moment, the European Commission was joined by the Council, which played a very active role, supporting the new political trend that is currently underway, namely: the modernisation of State aid, or the policy of adapting it to the general objectives of the European Union.

The role of State aid as a support framework to prevent market failures was confirmed during the Covid-19 emergency, as will be shown in the following sections.

The implementing guidelines for State aid have also been modified during those historical stages.

In that context, as will be discussed specifically in Section 6, a general philosophy of shared implementation of the State aid framework, referred to as *public and private enforcement* took over a model based on the monitoring of aid by the European Commission.

Under *public and private enforcement*, both public bodies and private entities are called upon to monitor the lawfulness of State aid according to each of their roles in the Member State and in the market.

This is also part of the modernisation of the State aid framework, and this is to be understood in light of the current importance of this issue.

1.3.1 The Modernisation of the State Aid Framework

The last frontier of the development of State aid framework is what is referred to as modernisation policy.

This means action aimed at a comprehensive review of State aid in order to make it more efficient and more effective for the European context.²⁶

It involves adapting State aid to become a project inspired by the social market economy, based on the acknowledgement of the central role of State aid in order to achieve the social and economic objectives of the European Union.

The aims behind the modernisation policy are explained in a Communication of the European Commission, entitled '*EU State Aid Modernisation*', which contains general considerations and realigns State aid to address the problems arising from the economic crisis.²⁷

The aim of the policy is to review the State aid framework in order to make it fit for the current political and economic circumstances.

²⁶Nascimbene (2018), pp. 1–14.

²⁷Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: EU State Aid Modernisation (SAM), COM(2012) 209 final.

The Modernisation Plan aims to implement a smart, sustainable and inclusive economy in Europe through the achievement of a high level of employment, productivity and social cohesion.

In this context, the European Commission acknowledges that State aid plays a fundamental role in protecting and strengthening the single market.

The economic crisis which has been experienced in Europe in 2008/2010 put under the spotlight very serious problems: a significant economic and social disparity between Countries, the scarcity of State resources, and the need for these resources to be invested for social growth and budgetary consolidation.

One of the most useful tools for States to pursue those objectives is aid, which allows direct expenditure or tax incentives to use public expenditure in line with social growth in order to create pure competition.

What is therefore necessary is a policy which enables State aid to fulfil that function as the best option.

The approach adopted by the European Commission also confirms the central role of fiscal issues in European State aid policy.

In this regard, the modernisation policy makes clear the link between State aid and the economic and social problems of the European Union, describing State aid as a useful instrument for solving those problems and enhancing growth.

State aid thus becomes an instrument which is physiologically intended to be used to deal with market problems.

The modernisation of State aid began with the State Aid Action Plan 2005/2009²⁸ and involved the substantive framework and implementation.²⁹

It may be said that the work of modernisation followed three important tenets:

- transparency through the adoption of the economic method;
- simplification of procedures;
- strengthening public and private enforcement.

The essential principle of this policy is to discourage States from according prohibited aid and to encourage them to distribute permitted aid.

Innovation aid, aid for economic growth and environmental aid are considered central to the European project.

The principle is that properly distributed aid is a means of achieving worthy objectives, while prohibited aid is seriously harmful to the market and to competition.

That objective makes clear the reason for the choice of adopting an economic approach to the issue of aid.

The economic method consists in the development of objective criteria for the precise assessment of the positive and negative effects of the aid on the market.

²⁸See State aid Action Plan. Less and better targeted state aid in a road map for State Aid reform 2005–2009, Brussels, 7 of June 2005.

²⁹Pesaresi and Peduzzi (2018), p. 17.