Luiss
School of European Political Economy

Unprecedented State Intervention:

A Review of State Aid to Combat Covid-19 on the First Anniversary of the European Commission's 2020 "Temporary Framework"

Phedon Nicolaides

Policy Brief 4/2021

LUISS

March 3, 2021

Unprecedented State Intervention:
A Review of State Aid to Combat Covid-19 on the First Anniversary of the European Commission's 2020 "Temporary Framework"

Phedon Nicolaides[1]

Abstract

EU Member States have granted very large amounts of state aid to counteract the impact of the covid-19 pandemic and the economic dislocation it has caused. This Policy Brief is a first attempt to calculate the number of measures implemented by Member States and the amount of state aid they dispensed to businesses in the period from March 2020 to February 2021. The aid appears to have provided much needed liquidity, but it may have also kept alive zombie companies.

In addition, the General Court of the EU delivered the first judgments on covid-19 related state aid. It has found national measures limiting the aid to companies licensed by national regulators to be compatible with EU law on the grounds that such a limitation is necessary and proportional for the purpose of ensuring that aid is used effectively by financially healthy companies. This Policy Brief argues that the exclusion of financially unviable companies and the proper use of state aid can also be achieved through better designed measures.

Keywords: State aid, covid-19, Temporary Framework, Article 107(2)(b) TFEU, Article 107(3)(b) TFEU, compensation for damage, serious economic disturbance.

[1] Professor, University of Maastricht; Visiting Professor, Luiss University, Rome, and College of Europe, Bruges.

1. Introduction: Unprecedented state intervention

Policy Brief 13/2020, "State Aid to Combat Covid-19", which was published a year ago, provided a short table with all the 29 state aid measures that had been approved by the European Commission when the pandemic emergency was declared.[2] A year later, on 1 March 2021, the number stands at 437. If one includes modifications to already approved measures, the total number rises to 683. That is a high number by any standards. It reflects the severity of the crisis and the havoc it has wreaked on the European economy.

The purpose of this Policy Brief is threefold. First, it traces the evolution of the European Commission's "Temporary Framework" and the expanding range of instruments that may be used by Member States to alleviate the impact of covid-19. Second, it provides a statistical overview of the number and type of state aid measures that have been implemented during the past year by Member States. As far as I am aware, this is the first publication that attempts to provide a comprehensive count of both aid measures and aid amounts across the EU. Third, it examines the first two judgments of the General Court on covid-19 related cases and considers their implications.

This Policy Brief covers only public funding that is classified as state aid. Other public funding that supports measures dealing with covid-19 is not included in the statistics that will be presented in the following sections. State aid is any public funding that satisfies the criteria laid down in Article 107(1) of the Treaty on the Functioning of the European Union [TFEU].

As will be seen, not only have Member States intervened multiple times in their economies during the past 12 months to pull back businesses from the brink of collapse, but they have done so by injecting huge amounts of money in the economy using many different instruments such as outright grants, guarantees, interest subsidies, trade credit insurance, capital injections, and tax and social security deferrals.

Whether this massive intervention has worked must await a proper ex post evaluation once the pandemic is over. So far the evidence is that the intervention has prevented a steep recession and that the European economies are growing again. According to Eurostat data released on 18 January 2021, the quarterly rate of GDP growth in the last quarter of 2020 for EU27 was 12%. This was the sharpest increase since the time series was started in 1995![3] However, not all credit should go to national measures. For the Eurozone, the ECB's Pandemic Emergency Purchase Programme of EUR 1850 billion must have had a positive impact too. Therefore, a thorough ex post evaluation must also disentangle the effect of state aid from that of other interventions both at national and supranational level.

[2] The Policy Brief 13/2020 can be accessed at:
https://sep.luiss.it/sites/sep.luiss.it/files/State%20Aid%20to%20Combat%20Covid-19.pdf
[3] See Eurostat, Quarterly National Accounts, January 2021. It can be accessed at:
https://ec.europa.eu/eurostat/statistics-explained/pdfscache/22418.pdf

Together with the good news in the short term there is also some bad news for the longer term. Government deficit has exceeded by far the threshold of -3% of GDP. In the second quarter of 2020 it stood at a historic high of -12% but in the third quarter of 2020 it dropped to -6% of GDP. This is an improvement but still the massive expenditure to support businesses has already raised public debt ratios for EU27 to 90% of GDP. This is 50% higher than the threshold of 60% of GDP.[4] Ultimately, the new debt will have to be repaid.

There is a concern that the huge amount of state aid that has been pumped into the European economies has either created so-called "zombie" companies [dependent on public subsidies] or has kept companies that were about to fail artificially alive. Once the intervention ends, these companies will eventually go bankrupt, necessitating another state intervention to deal with the new wave of unemployed persons.

Every year new companies are created and old companies exit the market by being wound down or by failing and declaring bankruptcy. It has already been observed that this normal business cycle was interrupted in 2020. Insolvencies in Europe and across the OECD members were sharply down in 2020.[5] This has been attributed to the "lifting" effect of state aid. Even some companies that were financially healthy before the outbreak of the pandemic may not be able to repay their debt, as the post-covid-19 marketplace will be different, requiring new business models. Not all companies may be able to make the transition successfully.[6]

In conclusion, the long-term effectiveness of the state aid that has been injected into European economies is likely to remain largely unknown for another couple of years. In the meantime, the sections that follow identify the major changes in the Commission's Temporary Framework, list the expanding armoury of instruments that may be used by Member States, attempt to make a first count of the amount of state aid across the EU and warn of distortionary evolution in case law, ironically in the name of preventing discriminatory treatment.

2. The evolving Temporary Framework

The so-called Temporary Framework was adopted by the European Commission on 19 March 2020.[7] It was just nine pages long and initially allowed state aid to be granted in the form of just four instruments: grants, loan guarantees, interest rate subsidies for loans and export credit insurance. The Temporary

[4] See Eurostat, Government Finance Statistics, 21 January 2021. It can be accessed at: https://ec.europa.eu/eurostat/statistics-explained/index.php/Government_finance_statistics_-_quarterly_data#Evolution_of_deficit_and_debt

[5] See S. Djankov, E. Zhang As COVID rages, bankruptcy cases fall, 4 February 2021, voxeu. It can be accessed at: https://voxeu.org/article/covid-rages-bankruptcy-cases-fall

[6] See L. Demmou, S. Calligaris, G. Franco, D. Dlugosch, M. Adalet McGowan, S. Sakha, Insolvency and debt overhang following the COVID-19 outbreak: Assessment of risks and policy responses, 22 January 2021, voxeu. It can be accessed at: https://voxeu.org/article/insolvency-and-debt-overhang-following-covid-19-outbreak

[7] DG Competition of the European Commission has a special website with all the versions of the Temporary Framework. It can be accessed at: https://ec.europa.eu/competition/state_aid/what_is_new/covid_19.html

Framework was supposed to stay in force until 31 December 2020. The maximum allowable amount of grants was EUR 800,000. For guarantees and interest rate subsidies, the underlying loans were capped at 25% of turnover or double the annual wage bill. In addition, borrowers had to pay a minimum rate of premium or a risk margin on top of a base rate interest [linked to IBOR]. These rates varied between 50bp and 200bp, depending on the credit rating of the borrower and whether it was an SME or a large enterprise.

Now, after five amendments on 3 April 2020, 8 May 2020, 29 June 2020, 13 October 2020 and 28 January 2021, the Temporary Framework has been extended to 35 pages, the ceilings on aid amounts have been raised and it its duration has been prolonged until 31 December 2021. The range of instruments has been expanded significantly, offering Member States a choice out of 11 options: grants [up to EUR 1.8 million], guarantees, interest rate subsidies, short-term export credit insurance, covid-19 related R&D [aid ceiling: 80% of eligible costs], investment aid for testing and upscaling infrastructures [aid ceiling: 75% of eligible costs], investment aid for the production of COVID-19 relevant products [aid ceiling: 80% of eligible costs], deferrals of tax and/or of social security contributions [end date: not later than 31 December 2022], wage subsidies [monthly aid ceiling: 80% of monthly wage bill], recapitalisations, uncovered fixed costs [aid ceiling: 70% of uncovered fixed costs up to a maximum of EUR 10 million/undertaking].

3. A review of the state aid granted in the period March 2020 – February 2021

All the statistics which are presented in this section have been compiled by the author on the basis of information provided by DG Competition on two sites: the list of state aid cases by date[8] and the list of approved covid-19 measures.[9]

The first state aid measure approved by the Commission on the basis of the Temporary Framework was on 21 March 2020 [SA.56708]. It had been notified by Denmark a few days before the Commission formally adopted the Temporary Framework.

Between then and 28 February 2021, the Commission approved a total of 683 measures, made up of 437 primary measures and 246 modifications of those primary measures. Most modifications concern extension of the duration of already approved measures, widening of the categories of eligible beneficiaries or increase of budgeted amounts.

The estimated total amount of state aid for the EU27 plus the UK, based on the author's calculations, is about EUR 2524 billion. This is a huge amount when bearing in mind that at the last count, as indicated

[8] The list can be accessed at: https://ec.europa.eu/competition/elojade/isef/index.cfm?fuseaction=dsp_sa_by_date
[9] This list can be accessed at:
https://ec.europa.eu/competition/state_aid/what_is_new/State_aid_decisions_TF_and_107_2b_107_3b_107_3c.pdf

in the Commission's 2019 State Aid Scoreboard, the total annual amount of aid granted to manufacturing and services was a mere EUR 121 billion [2018].[10]

The estimated state aid amount of EUR 2525 billion for covid-19 related measures is both an underestimate and an overestimate, but for different reasons. It is an underestimate because the Commission decisions approving certain measures, especially those linked to guarantees, do not indicate any predetermined budgets. It can also be an overestimate because Member States notified to the Commission maximum budgeted amounts. According to Commission officials, the budgeted amounts so far exceed the amounts of aid actually dispensed to companies.

In terms of the legal bases of the aid, about EUR 50 billion or 2% is based on Article 107(2)(b) TFEU, EUR 2460 billion or 97% is based on Article 107(3)(b) TFEU and EUR 15 billion or less than 1% is based on Article 107(3)(c) TFEU. Article 107(2)(b) allows aid for compensation for damage incurred as a result of an "exceptional occurrence", Article 107(3)(b) allows aid to remedy a serious economic disturbance, while Article 107(3)(c) allows aid for the development of certain economic activities such as research for covid-19 or covid-19 related products. Covid-19 qualifies both as an exceptional occurrence and serious economic disturbance.

It is obvious that Member States have used aid overwhelmingly in order to "remedy a serious economic disturbance" by providing much-needed liquidity to companies that have been hit hard by the collapse in demand and the successive bouts of lockdown.

The Commission approved 22 measures to support research in covid-19 [Article 107(3)(c)], 52 measures for compensation of damage caused by covid-19 [Article 107(2)(b)] and 366 measures that provide liquidity in the form of grants, guarantees, loans and capital [Article 107(3)(b)]. All these measures are "primary"; i.e. they do not include modifications to already approved schemes.

Member States have used state aid granted in compliance with the Temporary Framework for multiple purposes: 1) to implement schemes open to many sectors, types and size of companies, or 2) to target specific sectors affected seriously by the corona virus such as transport, travel, hospitality, entertainment, culture, or 3) to support specific regions such as islands or tourist destinations, or 4) to support specific sectors in specific regions such as potato growers in Flanders.

Aid granted as a form of compensation for damage, based on Article 107(2)(b), is not covered by the Temporary Framework because the TFEU declares such aid to be compatible with the internal market. Although the Commission has no discretion in assessing its compatibility, nonetheless it still has to notify to the Commission so that it can verify its conformity with the requirements of the Treaty. In fact, the Treaty does not say anything else apart from that the aid may be granted to "make good the damage caused by a natural disaster or an exceptional occurrence". However, ample case law on the issue of compensation has clarified that such aid must satisfy three simple criteria: 1) a natural disaster or an

[10] The 2019 edition of the State Aid Scoreboard can be accessed at: https://ec.europa.eu/competition/state_aid/scoreboard/index_en.html

exceptional occurrence must have happened; 2) the natural disaster or the exceptional occurrence must have caused the alleged damage; 3) the aid may not exceed the amount of the damage.[11] At first glance, these criteria are indeed simple. They do not require any balancing of the positive and negative effects of state aid. Yet, as we will see in the next section, the first two judgments on the application of the Temporary Framework and on state aid that compensates for the damage caused by covid-19 have raised new but fundamental questions concerning the extent to which aid may be limited to companies which have close links with the national economy.

As shown in Table 1 below, the number of measures implemented by different Member States varies widely. This does not mean that the higher the number, the larger the amount of aid, because the budgets for the various measures may be small. Some Member States have granted large amounts in the context of just a handful of schemes, while other Member States have granted small amounts in multiple schemes.

Table 1 makes visible the wide variation in the number of interventions by Member States, ranging from a low of seven for Spain to a high of 35 for Italy. A small group of just five Member States [i.e. 18%] accounts for more than a third of all measures [about 35%]. Table 1 also indicates that while the average number of aid measures per Member State [including the UK] is a bit less than 16, the mode is only 11. This is because 11 Member States [i.e. 39%] have implemented 11 or fewer measures.

Table 1: Number of state aid measures per Member State

Number of aid measures	Member State	Total number of aid measures
35	IT	35
33	DK	33
29	BE, CZ	58
26	PL	26
20	DE	20
19	LT	19
18	NL	18
17	FR, HU, SI	51
15	EL, RO	30
14	BG, LV	28
13	EE, LU	26
12	IE, MT, SE	36
11	AT, CY, PT, SK, UK	55
10	HR	10
9	FI	9
7	ES	7
		Total: 437

[11] See T-259/20, Ryanair v Commission, EU:T:2021:92, paragraph 24.

Not surprisingly, the amount of aid also varies significantly across Member States. According to a report by the European Parliament published on 17 December 2020, the large Member States have granted more aid both in absolute terms, as expected, and in relative terms, as a percentage of their GDP.[12] The most serious finding of the report is that there is a discrepancy between the damage caused by covid-19, in terms of loss of GDP, and the amount of aid granted to remedy the damage. Although for the EU28 as a whole there was a mild correlation between GDP loss and amount of state aid, some Member States [DE, DK, EE, FI, NL, SE, SI, SK] granted more aid, relative to others, than the damage they suffered. [p.27] However, the true economic impact of covid-19 related state aid has not yet been assessed rigorously.

The rest of this Policy Brief examines an important question raised by two recent judgments on covid-19 related state aid: the extent to which Member States may limit the aid to companies with close links with the national economy.

4. State aid only for companies closely linked to the national economy?

The Court of Justice has made it amply clear that state aid that violates fundamental principles such as that of non-discrimination is not compatible with the internal market.[13] It follows that state aid that discriminates against companies from other Member States cannot be found by the Commission to be compatible with the internal market.

This creates a dilemma for Member States. It is reasonable that if Member States are to use their taxpayers' money to support companies, the benefits from that intervention should remain in the national economy.

In the two cases which are reviewed in this section, the General Court found national measures that were limited to airlines licensed locally not to be discriminatory. I will argue that the General Court failed to ask the fundamental question whether the measures in question could have been equally effective and less distortionary had they been designed in a way that the intervention addressed more closely and directly the damage and the disturbance caused by covid-19.

On 17 February 2021, the General Court of the EU delivered two judgments on cases brought by Ryanair against Swedish and French measures for the support of their airlines. Both judgments rejected Ryanair's applications for annulment of the corresponding Commission decisions authorising the aid. The judgments were in case T-238/20, Ryanair v Commission[14] concerning the Swedish measure

[12] Jan van Hove, Impact of state aid on competition and competitiveness during the COVID-19 pandemic: an early assessment, European Parliament, December 2020. It can be accessed at: http://www.europarl.europa.eu/RegData/etudes/STUD/2020/658214/IPOL_STU(2020)658214_EN.pdf

[13] See the judgment in case C-594/18 P, Austria v Commission, EU:C:2020:742.

[14] The full text of the judgment can be accessed at:

SA.56812 and T-259/20, Ryanair v Commission[15] concerning the French measure SA.56765. The legal basis for the aid in the Swedish case was Article 107(3)(b) TFEU, while in the French case it was Article 107(2)(b) TFEU.

The judgments are important. They are the very first to consider covid-19 related aid and the 2020 Temporary Framework. More significantly, they interpret the appropriateness and proportionality of aid granted on the basis of Articles 107(2)(b) and 107(3)(b). Past judgments concerning Article 107(2)(b) focused largely on the nature of the alleged exceptional occurrence and on the link between the exceptional occurrence and the damage incurred, while judgments concerning Article 107(3)(b) in the context of the 2008 financial crisis dealt mostly with the notion of "serious disturbance" and the extent of the discretion of the Commission. The two judgments also examined whether aid could be limited to airlines licensed in Sweden or France without violating the principle of non-discrimination.

4.1 Compliance with Article 107(3)(b): T-238/20, Ryanair v Commission (SA.56812) [Sweden][16]

The Swedish measure provided guarantees for loans taken by airlines that were either holding licences in Sweden or carrying out their main business in Sweden.

Ryanair put forth four pleas. First, it alleged infringement of the principles of non-discrimination on grounds of nationality and of free movement of services. Second, it contended that the Commission failed to weigh the beneficial effects of the aid against its adverse effects on trade. Third, it argued that its procedural rights under Article 108(2) TFEU were violated. Fourth, it claimed that the Commission failed to provide reasons for its decision. This Policy Brief examines only the first plea.

The General Court began its analysis by interpreting the concepts of licence and registration of airlines. "(25) Firstly, the term 'Swedish licence' refers to a licence issued under Article 3 of Regulation No 1008/2008 by the Swedish authorities." "(26) Secondly, under Article 2(26) of Regulation No 1008/2008, the 'principal place of business' is defined as the head office or registered office of an EU air carrier in the Member … The notion of a principal place of business, in practice, corresponds to the registered office of that carrier … It is therefore true, as the applicant maintains, that for a given legal entity that regulation permits the establishment of only one principal place of business and, consequently, the issuing of only one licence by the authorities of the Member State on whose territory that principal place of business is located. It is nevertheless open to an airline, …, to acquire a number of licences by creating a number of separate legal entities, for example by setting up subsidiaries." "(27)

http://curia.europa.eu/juris/document/document.jsf?text=&docid=237881&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=612039

[15] The full text of the judgment can be accessed at: http://curia.europa.eu/juris/document/document.jsf?text=&docid=237882&pageIndex=0&doclang=en&mode=lst&dir=&occ=first&part=1&cid=612190

[16] The full text of the Commission decision can be accessed at: https://ec.europa.eu/competition/state_aid/cases1/202016/285407_2147916_112_2.pdf

Thirdly, … one of the eligibility criteria for the aid scheme at issue is the holding of a Swedish licence as at 1 January 2020, that is to say, before the Covid-19 pandemic was recognised."

Then the General Court recalled that state aid may not violate any other EU principles. "(29) It is clear from the general scheme of the Treaty that the procedure under Article 108 TFEU must never produce a result which is contrary to the specific provisions of the Treaty. Therefore, the Commission cannot declare State aid, certain conditions of which contravene other provisions of the Treaty, to be compatible with the internal market. Similarly, State aid, certain conditions of which contravene the general principles of EU law, such as the principle of equal treatment, cannot be declared by the Commission to be compatible with the internal market".

A question often asked by public authorities is, "How can I ensure that aid goes only to companies that contribute to the national economy?" Since discrimination on the basis of nationality of ownership or place of registration is not allowed, it is very important for Member States to design their measures explicitly to address a market failure in their economy or territory. In this way, they can objectively and legally limit the aid to undertakings that have a link with the country and can contribute to remedying the market failure. Any restrictions on eligibility must be objectively justified by the purpose of the aid. This is easy for some kinds of aid, such as regional investment aid which may be granted only for investments in eligible regions, but tricky for other kinds such as aid for risk finance or R&D. For this kind of aid, Member States may not go beyond requiring aid applicants to have local presence. But the form of the local presence must be left to undertakings to decide [e.g. representative office, fully capitalised subsidiary, etc].

In this connection, the General Court went on to note that "(30) in the present case, it has to be said that one of the eligibility criteria, that of holding a Swedish licence, results in a difference in treatment for airlines whose principal place of business is in Sweden, so as to be able to benefit from a loan guaranteed by the State, and for those whose principal place of business is in another Member State and which operate in Sweden, to Sweden and from Sweden under the freedom to provide services and the freedom of establishment, which are not so entitled."

"(31) Even if, …, that difference in treatment may amount to discrimination within the meaning of the first paragraph of Article 18 TFEU, it should be made clear that, under that provision, any discrimination on grounds of nationality is prohibited within the scope of application of the Treaties 'without prejudice to any special provisions contained therein'. Therefore, it is important to ascertain whether that difference in treatment is permitted under Article 107(3)(b) TFEU, which is the legal basis for the contested decision. That examination requires, first, that the objective of the aid scheme at issue satisfies the requirements of that provision and, secondly, that the conditions for granting the aid do not go beyond what is necessary to achieve that objective." [The General Court did not cite any case law on this point.]

"(32) That scheme thus aims to remedy the serious disturbance in the Swedish economy caused by the Covid-19 pandemic, …, which corresponds to one of the situations covered by Article 107(3)(b) TFEU, by

securing Sweden's connectivity. The aid scheme at issue, …, ensures that airlines 'with a Swedish license that are important to secure connectivity in Sweden' have sufficient liquidity and those airlines 'that have a link with Sweden and play a role in securing the connectivity of Sweden' are indeed defined by the fact that they hold a Swedish licence, but also, as the Commission and the Kingdom of Sweden point out, by the fact that they operate regular flights in Sweden, to Sweden and from Sweden."

In the paragraph above, the Court quoted the text of paragraph 43 of the Commission's decision. The aim of the limitation of aid to airlines licensed or having their principal place of business in Sweden was to ensure a link with the economy for the purposes of ensuring connectivity.

But there is a logical weakness in this approach. A contribution to connectivity can also be made by an airline not licensed or having its principal place of business in Sweden. Of course, if the aid measure were opened to any airline flying to/from or within Sweden, there would be a problem of how the guaranteed loans supported only flights to/from or within Sweden. But, as I will explain below, that is a design problem, not a legal problem.

The General Court ignored that logical weakness and went on to find that, "(33) since the existence both of a serious disturbance in the Swedish economy as a result of the Covid-19 pandemic and of the significant adverse effects it has had on aviation in Sweden, and therefore on air services in the territory of that Member State, has been established to the requisite legal standard in the contested decision, the objective of the aid scheme at issue satisfies the conditions laid down in Article 107(3)(b) TFEU."

With respect to the requirement that the aid does not go beyond what is necessary to achieve the objective of the aid scheme, the Court made the following observations.

The Court first referred to the provisions of the Temporary Framework on guarantees and agreed with Sweden that "(37) the aid scheme at issue intended to introduce an incentive measure aimed at the banking sector, in line with paragraph 5 of the Temporary Framework, by issuing a State guarantee for new loans".

Ryanair counter-argued that the Commission decision had not indicated that it was necessary to grant the aid only to those airlines holding a Swedish licence. The Court rejected that argument.

"(40) First, with regard to the appropriateness of the aid scheme at issue, bearing in mind the fact that that scheme takes the form of State guarantees which make it possible for banking institutions to grant loans for a maximum period of six years, it is normal for the Member State concerned to seek to ensure that the airlines eligible for the guarantee have a stable presence, in order for them to be present on Swedish territory to honour the loans granted, so that the State guarantee is used as little as possible. The criterion of holding a Swedish licence, in so far as it requires the principal place of business of the airlines to be on Swedish territory, ensures at least the administrative and financial stability of the presence of those airlines, so that the authorities of the Member State granting the aid may control the manner in which that aid is used by the recipients, which would not have been the case if the Kingdom

of Sweden had adopted another criterion allowing the eligibility of other airlines operating on Swedish territory as mere service providers, like the applicant, which service provision, by definition, could cease at very short notice, if not immediately."

The reasoning of the Court in paragraph 40 is problematic. First, as a matter of fact, Ryanair is in a better financial health than any Swedish airline. Second, there is no obvious or logical connection between presence in Sweden and ability to honour the loans. Third, there is also no obvious or logical connection between holding a Swedish licence and administrative and financial stability. Fourth, I hasten to acknowledge that it was in Sweden's interests to ensure that the guaranteed loans supported flights to/from or within Sweden and the continuity of flight services in its territory. But it seems to me that that legitimate objective could be secured by imposing an obligation on beneficiary airlines, first, to show how the loans were used exclusively to support Swedish-related services and, second, to require them to maintain their services for the duration of the pandemic. Of course, these requirement could have increased the administrative complexity and cost of the measure, but EU law does not allow Member States to discriminate simply because it is administratively convenient or cheaper to do so.

"(41) Secondly, those conditions for granting the aid reflect the possibility and the obligation for the Swedish authorities to carry out financial checks of the recipients. Such a possibility and such an obligation exist only for those airlines which hold a Swedish licence, because the Swedish authorities alone are competent to monitor the financial situation of those airlines in accordance with the obligations arising, in particular, under Article 5 and Article 8(2) of Regulation No 1008/2008, as was stated in paragraph 43 of the contested decision. However, the Swedish authorities have no power under that regulation to monitor the financial situation of airlines which do not have a Swedish licence."

The reasoning in this paragraph conflates the responsibilities of Sweden as an air transport regulator and as an aid grantor. For the latter role, the monitoring by the lenders or through regularly submitted certified accounts could have been sufficient. After all, this is how the correct use of aid is ensured across the EU. The Commission, in decision 2010/13 concerning risk finance, prohibited a German measure limiting aid only to investors headquartered in Germany, which is equivalent to the place where airlines are licensed. The German authorities claimed that the limitation was necessary in order for them to be able to monitor the financial situation of the investors. The Commission argued that the financial situation of investors established in other Member States could be verified through i) voluntary submissions, ii) independent audits, or iii) information obtained from other regulators in the context of mutual assistance which is very well possible in EU-wide networks of regulators.[17]

"(42) Thirdly, while it is true that the Court considered that, in practice, the concept of principal place of business corresponded to that of a registered office (see paragraph 26 above) and that a change of registered office could be made relatively quickly, it should not be forgotten that Article 2(26) of Regulation No 1008/2008 contains other details, in particular in relation to the fact that continued airworthiness management must be carried out from the location of the principal place of business, that

[17] See Commission Decision of 30 September 2009 on aid scheme No C2/09 which Germany intends to grant to modernise the general conditions for capital investments. Published in OJ L 6, 9 January 2010, pp. 32-45.

is to say, in the present case, in Sweden. … Those provisions create reciprocal regulatory obligations between airlines holding a Swedish licence and the Swedish authorities, and thus a specific, stable link between them that adequately satisfies the conditions laid down in Article 107(3)(b) TFEU, which require that the aid addresses a serious disturbance in the economy of the Member State concerned."

Once more, the Court conflates regulatory functions with aid-granting responsibility.

Nonetheless, the Court concluded that "(44) by limiting eligibility for the aid to only those airlines which hold a Swedish licence, to the exclusion of those operating charter flights, as a result of the stable reciprocal links which tie them to the Swedish economy, the aid scheme at issue is appropriate for achieving the objective of remedying the serious disturbance in the economy of that Member State."

Then the Court examined whether the measure was proportional. It, first, "(45) noted that, in order to secure Sweden's connectivity, the double requirement of a Swedish licence and air services in Swedish territory through regular flights is the most appropriate for guaranteeing that the presence of an airline on that territory is permanent, by ensuring that, as a result of that licence, the principal place of business of that airline will be in that territory and that it will intend to stay there, bearing in mind the regular air routes mentioned above."

Please note that there is no requirement in EU law that an airline must carry out business or substantial business in the country of its registration. Article 2(26) of Regulation 1008/2008 states: "'principal place of business' means the head office or registered office of a Community air carrier in the Member State within which the principal financial functions and operational control, including continued airworthiness management, of the Community air carrier are exercised". In other words, the place of registration is where control is exercised, not where an airline mostly operates. Ryanair, for example, carries out the bulk of its operations outside Ireland which is the country of its registration.

But the Court also made the following important observation. "(46) The airlines which hold a Swedish licence were responsible for 98% of the domestic passenger traffic and 84% of the domestic freight transport in 2019, which is a key piece of information bearing in mind the size and geography of that Member State. With regard to the share of passenger air traffic within the European Union going to Sweden and coming from Sweden, in 2019, 49% of that was carried out by operators holding a Swedish licence."

I think that these statistics show that had the measure been properly designed to require beneficiaries to demonstrate how the loans supported Swedish services and connectivity in Sweden, it would have been as effective without having to rely on the discriminatory condition of holding a Swedish licence. For this reason, this condition of eligibility violates the principle of proportionality, as there can be less distortionary means of ensuring stability of service. "The conditions for granting the aid" did "go beyond what is necessary to achieve that objective".

In this connection, however, the Court stated that "(53) according to the case-law, it is not for the Commission to make a decision in the abstract on every alternative measure conceivable since, although the Member State concerned must set out in detail the reasons for adopting the aid scheme at issue, in particular in relation to the eligibility criteria used, it is not required to prove, positively, that no other conceivable measure, which by definition would be hypothetical, could better achieve the intended objective. Although that Member State is not under any such obligation, the applicant is not entitled to ask the Court to require the Commission to take the place of the national authorities in that task of normative prospecting in order to examine every alternative measure possible".

Indeed, the case law does not require proof that no other less restrictive measure exists. But the Commission is obliged to ask Member States to demonstrate that the eligibility criteria are appropriate for the objectives of the aid measure in question. What is the link between holding a Swedish licence and ensuring continuity of service?

The Court concluded that "(56) the Commission therefore approved an aid scheme which actually aims to remedy the serious disturbance in the economy of a Member State and which, under its conditions for granting the aid, does not go beyond what was necessary to achieve the objective of that scheme." "(57) The objective of the aid scheme at issue satisfies the requirements of the derogation laid down in Article 107(3)(b) TFEU and that the conditions for granting the aid do not go beyond what is necessary to achieve that objective."

4.2 Compliance with Article 107(2)(b): T-259/20, Ryanair v Commission (SA.56765) [France][18]

The French measure, similarly to the Swedish measure, was limited to airlines licensed in France. However, it differed from the Swedish measure in two respects. First, instead of loan guarantees, it granted aid in the form of deferral of the payment of civil aviation tax and solidarity tax on airline tickets during the period from March to December 2020. Second, its purpose was to compensate airlines for losses they had incurred as a result of travel restrictions and, for this reason, it was based on Article 107(2)(b), instead of Article 107(3)(b).

Ryanair put forth the same four pleas as in the Swedish case: infringement of the principles of non-discrimination and free provision of services, violation of the principle of proportionality, infringement of its procedural rights and failure of the Commission to explain its reasoning. As before, this Policy Brief examines only the first plea.

The General Court began by recalling the relevant case law. "(23) As provided in Article 107(2)(b) TFEU, 'the following shall be compatible with the internal market … (b) aid to make good the damage caused

[18] The text of the Commission decision, in French, can be accessed at: https://ec.europa.eu/competition/state_aid/cases1/202017/285237_2150596_52_7.pdf

by natural disasters or exceptional occurrences'. It is clear in that regard from the case-law that that provision covers aid which is, in law, compatible with the internal market, provided that it satisfies certain objective criteria. It follows that the Commission is bound, where those criteria are satisfied, to declare such aid compatible with the internal market, and that it has no discretion in that regard."

"(24) Therefore, only economic damage caused by natural disasters or exceptional occurrences may be compensated for under that provision. There must be a direct link between the damage caused by the exceptional occurrence and the State aid and as precise an assessment as possible must be made of the damage suffered".

The General Court found that "(26) in the present case, it is indisputable that the Covid-19 pandemic constitutes an exceptional occurrence within the meaning of Article 107(2)(b) TFEU … There is therefore an unbroken causal link between the exceptional occurrence and the damage."

Then the General Court proceeded to examine whether the limitation of aid to airlines holding a French licence was discriminatory, making the aid incompatible with the internal market. It followed the same line of reasoning as in the Swedish case and sought to ascertain "(32) whether that difference in treatment is permitted under Article 107(2)(b) TFEU, which is the legal basis for the contested decision. That examination requires, first, that the objective of the aid scheme at issue satisfies the requirements of that provision and, secondly, that the conditions for granting the aid do not go beyond what is necessary to achieve that objective."

"(33) With regard to the objective of the aid scheme at issue, it should be stated that, in accordance with the wording of Article 107(2)(b) TFEU, it is, in general, to make good the damage in the air transport sector resulting from the exceptional occurrence in question. Consequently, the specific purpose of the aid scheme at issue is not the overall preservation of the structure of the aviation sector, …, but rather, …, to alleviate, by the grant of a deferral, the financial burden of airlines hit hard by the travel restrictions and lockdown measures taken by the French Republic in order to deal with the Covid-19 pandemic".

"(34) The Court considers that, …, the objective of the aid scheme at issue satisfies the conditions laid down in Article 107(2)(b) TFEU."

"(35) With regard to ensuring that the conditions for granting the aid do not go beyond what is necessary to achieve the objective of the aid scheme at issue and to satisfy the conditions laid down in Article 107(2)(b) TFEU, the following observations should be made."

"(37) The compensation for the damage is not made by taking the nationality of the victims of the damage as the chief factor for allocation as such, but in fact requires an institutional link with the place where the damage caused by the travel restrictions and lockdown arose, namely the principal place of business, since the criterion to be eligible for the aid scheme in question is the issuing of a French licence, which presupposes that the airline's principal place of business is in France. … The criterion of holding a French licence, in so far as it requires the principal place of business of the airlines to be on

French territory, ensures at least the administrative and financial stability of the presence of those airlines, so that the authorities of the Member State granting the aid may control the manner in which that aid is used by the recipients, which would not have been the case if the French Republic had adopted another criterion allowing the eligibility of other airlines operating on French territory under a licence delivered by another Member State".

It is very unclear why and how "administrative and financial stability" is linked to the damage that airlines suffered and how French authorities could "control the manner in which that aid is used by the recipients" apart from ensuring that the aid compensated the operating losses from the lockdown. For this purpose, aid granting authorities check information on costs. This does not correspond to the place of licence.

"(38) Secondly, the conditions for granting the aid, which are in the nature of a tax measure, reflect the possibility and the obligation for the French authorities to carry out financial checks of the recipients. Such a possibility and such an obligation exist only for those airlines which hold a French licence because the French authorities alone are competent to monitor the financial situation of those airlines in accordance with the obligations arising, in particular, under Article 5 and Article 8(2) of Regulation No 1008/2008" ..., the French authorities have no power under that regulation to monitor the financial situation of airlines which do not have a French licence."

Once more, we see the Court conflating regulatory powers with aid-granting tasks. The problem of monitoring can be overcome with submission of certified accounts by the airlines.

"(39) Regulation No 1008/2008 ... create[s] reciprocal regulatory obligations between airlines holding a French licence and the French authorities and thus a specific, stable link between them that adequately satisfies the conditions laid down in Article 107(2)(b) TFEU, which require that the aid address the damage caused by exceptional occurrences."

Article 107(2)(b) requires that the aid applicant demonstrates that it has suffered a loss as a result of the pandemic and the restrictions on air travel. Being licensed in France is irrelevant to proving loss. For example, a freight airline may not have suffered any significant loss as demand for certain air services has increased due to the exponential growth of online shopping. This means that that freight airline cannot be eligible for compensation since it cannot prove it suffered any loss. Since the requirement for holding a French licence does not provide proof, it only excludes potential aid recipients.

"(40) The French Republic sought, in essence, to ensure a permanent link between it and the airlines benefiting from the deferral". "(41) By limiting eligibility for the aid only to those airlines which hold a French licence, as a result of the stable reciprocal links which tie them to the French economy, the aid scheme at issue is appropriate for achieving the objective of making good the damage caused by an exceptional occurrence within the meaning of Article 107(2)(b) TFEU."

It is indeed reasonable for France to compensate French airlines and not airlines of other nationalities. The problem is how to do that on the basis of objective criteria. And indeed, it is possible to do so with a better designed measure. Since the aim of the measure was to compensate for losses so as to prevent bankruptcy, France could have limited eligibility to those airlines that derived a certain percentage of their income from the French market and which, as a consequence, suffered losses above a certain threshold from restrictions imposed by the French government. This establishes a direct link, as Article 107(2)(b) requires, between the pandemic and the restrictions, on the one hand, and the operating losses, on the other. Since it falls within the discretion of Member States to define the extent of the damage they want to compensate, foreign airlines whose operations in France would correspond to a small part of their overall activities would not be eligible for compensation. Interestingly, when the Court dealt with the issue of proportionality immediately below, it attached significance to the extent of airline losses in France without realising that perhaps that line of reasoning undermined the logic of limiting the aid only to airlines licensed in France. Although in practice being licensed in France probably correlates with the extent of operations of an airline in France, there is no inseparable link between the two.

When the Court turned its attention to the condition of proportionality, it "(43) found that, in applying the criterion of a French licence, the Member State concerned, taking into account, ..., the fact that the Member States do not have unlimited resources, reserved the benefit of the aid scheme at issue to the airlines which were most severely affected by the travel restrictions and lockdown measures adopted by that Member State, which took effect, by definition, on its territory." [This paragraph also contains data on the operations of various airlines in France.]

"(44) Those figures establish that the eligible airlines are proportionately much more severely affected than the applicant".

So the use of actual data was possible to determine which airline would need to be compensated.

Then the Court repeated the same reasoning as in the Swedish case that it was not for the Commission to make a decision in the abstract on every alternative measure conceivable, nor were Member States required to prove that no other conceivable measure could achieve the intended objective better or more effectively. But as argued earlier, the Commission is obliged to examine the link between the eligibility criteria and the objective of the measure in order to prevent unnecessary discrimination or unnecessary distortion.

The General Court concluded that the "(49) aid scheme ... actually aims to make good the damage caused by the exceptional occurrence constituted by the onset of the Covid-19 pandemic and the travel restriction and lockdown measures adopted by the French Republic in reaction to the pandemic, and ...under its conditions for granting the aid, does not go beyond what was necessary to achieve the objective of that scheme. It must therefore be held that..., the consequences of that scheme, in that the French authorities limited its scope to airlines which hold a French licence, do not infringe the first paragraph of Article 18 TFEU solely because the scheme favours airlines which have their principal

place of business on French territory." "(50) The aid scheme at issue satisfies the requirements of the derogation laid down in Article 107(2)(b) TFEU".

In conclusion, the first two judgments on covid-19 related state aid endorse the approach of the Commission and the rules laid down in the Temporary Framework. However, the judgments also appear to allow Member States to limit state aid to airlines which are licensed by national regulators. According to the reasoning of the General Court, this is how Member States can ensure that the aid is used for the purpose it is granted – i.e. to compensate for the damage or to remedy the serious disturbance caused by covid-19 – and to prevent aid from being wasted on inefficient companies or from creating zombie companies. However, as argued in this section, Member States can ensure proper use of state aid through other means, without having to limit the aid to companies licensed by their own authorities.

Conclusions

EU Member States have granted very large amounts of state aid to counteract the impact of the covid-19 pandemic and the economic dislocation it has caused. The aid appears to have provided much needed liquidity, but it may have also kept alive zombie companies.

The General Court of the EU has found national measures limiting the aid to companies licensed by national regulators compatible with EU law on the grounds that such a limitation is necessary and proportional for the purpose of ensuring that aid is used effectively by financially healthy companies. This Policy Brief has argued that the exclusion of financially unviable companies and the proper use of state aid can also be achieved through better designed measures.