THE IMPACT OF STATE AID ON PUBLIC DEFICIT

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The present paper comprises relevant aspects regarding the state aid and budgetary policy. The aim of the study is to examine to what extent state aid measures that distort competition can affect the budgetary deficit. In order to highlight the relation between the two indicators, we will focus on the following elements that will be developed separately:

1. State aid: concept, types of measures, policy developments;

2. General consolidated budgetary deficit;

3. Correlation between state aid and budgetary deficit in Romania and European Union.

Key words: state aid, public deficit, public budgets

State Aid : Concept

State aid is a member state's financial aid to business which meets all the criteria in Article 87(1) of the European Community Treaty. Article 87(2) of the EC Treaty declares that state aid, in whatever form, which could distort competition and affect trade by favouring certain undertakings or the production of certain goods, is incompatible with the common market, unless the EC Treaty allows otherwise.

The key criteria provided by Article 87(1) are presented below:

1. State aid is granted by state or through state resources. State resources include public funds administered by the member state through central, regional, local or other public or private bodies designated or controlled by the state. It includes indirect benefits such as tax exemptions that affect the public budget.
2. State aid favours certain undertakings or production of certain goods. It aids an undertaking, i.e. an entity engaged in an economic activity. Economic activity is activity for which there is a market in comparable goods or services. It can include voluntary and non profit making public or private bodies such as charities or universities when they engage in activities which have commercial competitors. It includes self employed traders, but generally not employees as long as the aid does not benefit the employers, private individuals or households. The aid is available to certain undertakings but not others in the member state, it selects individual business, sectors, areas, sizes of business or production of certain goods. In other words, a benefit available to all kinds of business is not state aid, but a general measure.
3. State aid constitutes an advantage granted to undertakings. These benefits can be measured using the economic methodology.
4. State aid distorts or threatens to distort competition and may affect trade between member states. Almost all selective aids will have potential to distort competition – regardless of the scale of potential distortion or market share of the aid recipient. Most products and services are traded between member states and therefore aid for selective business is capable of affecting the competitive structure inside the Community by eliminating or threatening to eliminate a competitor operating within the Community that does not benefit from the state aid measure.

The conclusion is that the existence of state aid is based on the sum of these four criteria. For a better understanding, we define the state aid function taking into account the factors presented above, namely x1, x2, x3 and x4 in this order, where:

$$f_1(x)=\begin{cases}0, \text{if the aid is not granted through state resources}\\ \\ 1, \text{if the aid is granted through state resources}\end{cases}$$

$$f_2(x)=\begin{cases}0, \text{if the criteria of specificity is not fulfilled}\\ \\ 1, \text{if the criteria of specificity is fulfilled}\end{cases}$$

$$f_3(x)=\begin{cases}0, \text{if a commercial advantage is not granted}\\ \\ 1, \text{if a commercial advantage is granted}\end{cases}$$

$$f_4(x)=\begin{cases}0, \text{if the trade between member states is not distorted}\\ \\ 1, \text{if the trade between member states is distorted}\end{cases}$$

We have: $f(x_1, x_2, x_3, x_4) = \prod_{i=1}^{4} f_i(x_i)$

As a consequence, we can have state aid if the four conditions are satisfied, that means: $f(x_1, x_2, x_3, x_4) = 1$, if $f_i(x_i) = 1$, for any value of i belonging to the interval of {1,2,3,4}.

If $f(x_1, x_2, x_3, x_4) = 0$ (for at least one value of i belonging to the interval mentioned before, the function $f_i(x_i) = 0$), there is at least one condition that is not fulfilled and, consequently, there is not state aid.

The four conditions are relevant in the state aid analyze. However, in practice, the degree of competitiveness on the relevant market can influence significantly the state aid assessment.

State aid: Types of measures

The notion of state aid doesn't only comprise contributions in the form of pure capital, but also includes tax relief, certain depreciation rules, parafiscal levies on goods imported from other member states, acquisition and sale on favourable conditions, such as the sale of real property, loans granted on favourable conditions, relief regarding interest rates, tax exemptions, price differentiations, warranties, social contributions, if certain companies or certain forms of production thereby achieve an advantage.

All these measures have a direct impact on the difference between public revenues and expenses that is budgetary deficit.

State aid: Policy developments

In the internal market with an increased competition, the member states are more inclined to grant subsidies, rather than tax exemptions. Moreover, the removal of technical barriers to trade and tax harmonization contribute to an increase in the volume of subsidies. The evaluation and the controlling mechanisms are carried out in a wider geographical perspective.

The trend registered in the last 10 years regarding the volume of state aid granted has shown a progressive decrease of this indicator. The method used to quantify the global state aid allocated by member states is known as Scoreboard Technique.

The strict control of state aid is one of the European Commission responsibility. In considering proposed state aid, the Commission is guided by criteria in published frameworks and guidelines that apply to particular aid categories or purposes and in all member states.

General consolidated budgetary deficit

The Romanian economic policies that will be implemented during the year 2008 aim to ensure the objectives accomplish that was assumed in the process of European integration. The budgetary revenues will continue the increasing trend between 2006-2007, as a result of a favourable cyclical position as well as the improvement in the collection of revenues.

The general consolidated budget comprises federal budgets, local budgets, social security budgets and others that rule financial public flows. The consolidation is required in order to avoid double records of economic operations between the components of the public budget.The items that should be eliminated are:

- the transfers between different levels of public administration,
- capital reimbursements for the account of public debt.

Correlation between state aid and budgetary deficit in European Union

Analysing the budgetary deficits registered in the member states, by means of Eurostat, and comparing the results with those obtained for state aid, we can formulate the following conclusions:

- The state aid had a general constant trend, slowly decreasing, without significant changes. The exceptions were recorded in Poland (2003) and France (1997). The general trend can be explained taking into account the Commission policy in order to control and monitor state aid. 2. State aid represents a percent of at most 5 percent of GDP. A percentage higher than 2% can cause serious macroeconomic imbalance by reducing public revenues or/and increasing public fund allocations.
- The budgetary deficit must be smaller than 3% of GDP, according to the criterion established by the Maastricht Treaty. The limit imposed hasn't determined a constant trend in the value of budgetary deficit. This is due to the differences within the fiscal policy of each member state. As a consequence, there are significant variations recorded in the trend of public deficit for the last 10 years.
- State aids imply a financial effort from state budget, local budget, social security budget, unemployment budget or health assurance budget. It is evident that budgets are affected by state aids because budgetary revenues are smaller or expenditures are higher. In this way, the deficit is higher in absence of other variable factors.