EU State Aid Regulation & Incentives for Forest Biodiversity Conservation

Study of the Constraints

by

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"In the long term, economic sustainability depends on ecological sustainability."[1]

1 Introduction

1.1 Economic Incentives to Preserve Biodiversity

Ecosystems provide society with necessary and irreplaceable services. Ecosystem services are the beneficial outcomes, for the natural environment or people, which result from ecosystem functions. These benefits arise from the regulating, supporting, provisioning and cultural services that biodiversity and ecosystems supply.[2] Together, these services provide critical life support functions, contributing to human health, well-being and economic growth.[3] Biodiversity[4] is essential for these services to stay in balance. Due to the increasing exploitation of natural resources and the resulting loss of species and ecosystem richness, nature conservation has become one of the most important sectors of environmental policy. Legislation, financing, economic control, and different combinations of these are essential measures in environmental protection. In the past years the use of new instruments, especially the incentive-based mechanisms, has increased remarkably.

Binding regulatory measures are the longest-established environmental policy option in the world. They set the baseline for minimum norms of protection typically including development restrictions, control of damaging activities, creation of protected areas and protection of certain habitat types and species. However, these "command and control" tools have limitations. They can generate strong opposition among the affected groups, take time to draft and adopt and be

[1] *"America's Living Oceans" Pew Oceans Report, 2003.*

[2] Provisioning services are the products obtained from ecosystems such as food, fuel, fresh water, and genetic resources; regulating services are the benefits obtained from the regulation of ecosystem processes such as air quality and climate regulation, and water purification. Cultural services refer to the nonmaterial benefits people obtain from ecosystems through, for example, recreation and aesthetic experiences; while supporting services are those that are necessary for the production of all other ecosystem services. Their impacts are often indirect or occur over a long time period. Examples include nutrient and water cycling, and photosynthesis. The Millenium Ecosystem Assessment 2005. Ecosystems and human well-being: Biodiversity synthesis. World Resources Istitute, Washington, DC.

[3] OECD 2010, p. 22.

[4] According to the Convention on Biological Diversity (Article 2): "Biological diversity" means the variability among living organisms from all sources including, inter alia, terrestrial, marine and other aquatic ecosystems and the ecological complexes of which they are part; this includes diversity within species, between species and of ecosystems. With respect to the concept of biodiversity as adopted by the Rio de Janeiro Convention in 1992, the biodiversity concept has similarities with concepts of nature and environment already used in different legal contexts. The main problem is to get hold of the criteria of biodiversity that are crucial order to prioritize biodiversity against e.g. the needs of forestry (*Hollo* 2007). That is because such forest management methods that would maximize timber revenue and biodiversity value at the same plot simultaneously do not exist, at least for boreal environment (*Horne* 2006, p. 170).

expensive and difficult to monitor, particularly if they go against general social norms about the use and conservation of nature. Because of their constraining and de-motivating character, purely restrictive regulatory measures neither provide a basis for active conservation of land nor encourage public participation or encourage innovation. They can even inadvertently discourage people from practising good stewardship. For example, many private landowners shudder at the thought of having an endangered species occupy their land, because they fear the government will limit their ability to use the land. In extreme cases, landowners might consider removing the endangered species to avoid the associated complications.[5]

Incentive measures, on the other hand, are designed to modify behaviour by encouraging private individuals, organisations and business to participate actively in conservation. Even the Convention on Biological Diversity (CBD) recognises their importance[6].[7] Positive incentives to motivate stakeholders can be economic (direct payments, tax reliefs) or non-economic (recognition, awards for outstanding performance, reputation). Disincentives internalize the costs of damage to biological resources to discourage activities that harm biodiversity.[8] The economic incentive measures are required to internalise the full costs of biodiversity loss in the activities that lead to this loss, and to provide the necessary information, support and incentives to sustainably use or conserve biological diversity.[9]

Forests are among Europe's most precious renewable resources. They are also of particular importance to European and global nature conservation by providing habitats for many rare plants, fungi, mosses and lichens.[10] The role of forests varies from one Member State to another and the forest policy falls within the sphere of competence of the Member States. As Finland is one of the most forested countries in the EU with 20 million hectares of forest[11], this study analyses the incentives for forest biodiversity conservation particularly from the Finnish perspective.

[5] *Vickerman* 1998.

[6] The Convention on Biological Diversity (CBD), Article 11: "Each Contracting Party shall, as far as possible and as appropriate, adopt economically and socially sound measures that act as incentives for the conservation and sustainable use of components of biological diversity".

[7] *Shine* 2005, p. 6.

[8] See eg. *Shine* 2005, p. 6.

[9] OECD 1999, p. 9.

[10] *Glover–Hollo* 2008, p. 23.

[11] Finnish Forest Research Institute 2009, p. 449. Finnish Statistical Yearbook of Forestry.

1.2 Biodiversity Conservation as a Responsibility of State

EU and Member States hold the primary responsibility for protecting biodiversity.[12] According to the Convention on Biological Diversity (CBD)[13], "states have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies, and the responsibility to ensure that activities within their jurisdiction or control, do not cause damage to the environment of other states or of areas beyond the limits of national jurisdiction".[14] State responsibility is elaborated on in other Articles of the CBD[15] and is usually flexibly expressed. This flexibility however, does not eliminate the fact that States are bound by the Charter of the United Nations and the principles of international law. Pursuant to the preamble of the Charter of the United Nations, states promote social progress and better standards of life in larger freedom, and reaffirm faith in fundamental human rights. Reaching these goals is not possible without proper environmental protection. Taking into account the ascertainment in the preamble of the CBD according to which the conservation of biological diversity is a common concern of humankind, states have but sovereign rights over their own biological resources, also responsibility for conserving their biological diversity and for using their biological resources in a sustainable manner. More generally, this can be called *the responsibility of a state to conserve biodiversity*.[16] All the obligations of the CBD are binding towards the European Union as well.[17] Pursuant to Council Decision concerning the conclusion of the Convention on Biological Diversity, the Union, alongside its Member States, has competence to take actions aiming at the protection of the environment.[18]

1.3 State Aid Challenges

The Millennium Ecosystem Assessment (MA) was carried out between 2001 and 2005 under the auspices of the United Nations and governed by a multistakeholder board that included representatives of international institutions, governments, indigenous peoples, non-governmental organizations (NGOs), and business. It set out to assess the consequences of ecosystem change for human well-being and to establish the scientific basis for actions needed to enhance the conservation and sustainable use of ecosystems and their contributions to

[12] *Kokko* 2003, p. 49.

[13] The Convention on biological diversity, United Nations 1992. (CBD) entered into force on 29 December 1993.

[14] CBD, Article 3.

[15] CBD, eg. Articles 4 and 15.

[16] *Kokko* 2003, p. 50.

[17] Article 1 of the 93/626/EEC: Council Decision of 25 October 1993 concerning the conclusion of the Convention on Biological Diversity OJ L 309 , 13/12/1993 p. 0001 – 0020.

[18] ANNEX B of the 93/626/EEC: Council Decision of 25 October 1993 concerning the conclusion of the Convention on Biological Diversity

human well-being. As a result of the MA, numerous remedies for biodiversity and ecosystem services were proposed.[19] Elimination of subsidies that promote excessive use of specific ecosystem services as well as correction of market failures in internalizing environmental externalities were considered promising intervention measures. The MA highlights that because many ecosystem services are not traded in markets, markets fail to provide appropriate signals that might otherwise contribute to the efficient allocation and sustainable use of the services. In countries with supportive institutions in place, market-based tools can be used to correct some market failures and internalize externalities, particularly with respect to provisioning ecosystem services.[20] Direct grants, subsidies and payments are the most common positive biodiversity policy incentives in the European context[21]. Other favoured incentives include contracts with certain land-use sectors.

As set out in the Lisbon strategy, a full internalization of environmental costs should be the ultimate target in European environmental policy. There are, however, many challenges in internalizing the externalities[22]: Internalizing negative externalities[23] will affect the revenue of the polluter negatively and is thus likely to lead to a loss of economic competitiveness. As a result, conservation remains insufficient. An even more important challenge follows from the positive externalities[24]. If the property rights were complete and exclusive covering all the aspects of forestland, any conservation values provided in the forest would constitute positive externalities. The conservation of biodiversity has, however, typical *public goods* character, which means that once the good is provided to one individual, it is provided to all simultaneously and enjoyment of the good by one individual does not reduce the benefits available to others. Hence, there is a temptation to free-ride on the provision of public goods by others. As a result, there is a lack of effective demand for public goods, implying that suppliers would be unlikely to cover their production costs. Market forces thus fail to supply public goods, even though their supply would enhance community welfare. This often leads to underinvestment in public goods relative to what would be socially optimal.[25]

[19]The Millenium Ecosystem Assessment 2005. Ecosystems and human well-being: Biodiversity synthesis. World Resources Istitute, Washington, DC.

[20] Ecosystems and human well-being: Biodiversity synthesis, p. 86.

[21] *Shine* 2005, p. 8.

[22] Externalities are said to exist when the activities of an individual, firm or other organisation have spillover effects on others and when these spillovers are not reflected in market price.

[23] When the production or consumption damages environmental goods without that damage being reflected in the prices of goods or services, there will arise *negative externalities*.

[24] For example farmers who live near a well maintained forest benefit from reduced erosion and flooding among from wells that do not run dry. Even though the farmers enjoy *positive externalities*, the forest owners cannot charge for these benefits.

[25] *Arentino et al.* 2001, p. 12.

These challenges consequently raise the question of whether the society should meet some costs of conservation on behalf of the general community. A well-designed incentive framework could thus ensure that public resources flow in ways that support conservation. Yet, there is a problem with society paying undertakings for actions that improve the environment. Unjust and selective advantages (e.g. direct grants and payments) to some undertakings decelerate the function of market forces, cause disorder in the common market, and may, more specifically, constitute *state aid* in the meaning of Article 107(1) of the Treaty on the Functioning on the European Union (TFEU)Such aid is, on principle, prohibited under the competition rules of the European Union.

The rules on state aid concern measures with which the public sector grants aid or other benefits to undertakings. The form of the aid is not significant. The definition of state aid is based on the interpretation of Article 107(1) TFEU, which establishes the general rule that state aid is forbidden, if 1) it is granted selectively to certain undertakings or for the production of certain goods, 2) it distorts competition or threatens to do so and 3) it affects trade between Member States. However, some aids of a social character and aid to make good damage caused by natural disasters, are exempted from this prohibition. In addition, the Commission has the power to grant exemptions in respect of aid promoting certain objectives that are of common interest tothe EU[26]. Environmental protection is such an objective.[27] Under certain terms and conditions environmental state aid may thus be compatible with the common market.

Competition is vital for sustaining an efficient economyand consequently to make use of Europe's growth potential to the benefit of the European citizens. In this context, efficiency refers to the extent to which welfare is optimised in a particular market or the economy at large. Market failure occurs , when regulation of the market does not produce an economically efficient outcome. Market failures may originatein high externalities the public goods nature of a given commodity. When markets do not produce economic efficiency, Member States or the Union may want to intervene, for example, by using state aid.[28] To be an efficient measure of a common interest (here: the conservation of biodiversity), state aid should correct the market failure and consolidate biodiversity values for society and for individuals.

It is claimed, that European environmental policy is more a battle of environmental markets than a solution of environmental problems. [29] Creating a market for biodiversity could well be one solution in harmonising the aims of competition and nature conservation, if new genuinely

[26] See closer the Article 107(3) TFEU.

[27] State aid policy safeguards competition in the Single Market and it is closely linked to many objectives of common interest, like services of general economic interest, regional and social cohesion, employment, research and development, *environmental protection* and the protection and promotion of cultural diversity. State Aid Action Plan 2005, point 15.

[28] State Aid Action Plan, p. 7.

[29] *Naskali–Hiedanpää–Suvantola* 2004, p. 24.

market-based measures, such as habitat banking and offset schemes[30], were utilised. However, as long as no market for biodiversity values exists, the market failure remains and has to somehow be corrected. Yet, it is not just a matter of existing market failures, but also a matter of governmental responsibility over the absolute value of maintaining a sustainable environment. The conservation of biodiversity values provides typical public goods, the benefit of which cannot be exclusive to the private forest owner. The EU and Member States hold the primary responsibility for protecting biodiversity. Thus, the governments should share some costs of biodiversity conservation on behalf of all citizens.[31]

1.4 The Structure of the Study

The goal of the study is to find out whether biodiversity conservation instruments and state aid rules are conflicting and, if so, in what ways. The research is completed through analysing the restrictions on the use of incentivizing biodiversity conservation instruments rising from EU`s state aid regulations (107 – 109 TFEU), More generally speaking, the aim is to examine the tension between the interest to support local undertakings in environmental conservation and the aim of liberalising the common market.

The aim of this study is thus to outline the main factors based on the relevant regulation, guidelines and case-law that define compatibility of certain incentive instruments with the EU's state aid regime. . Next, EU environmental policy is briefly described. In chapter three, EU state aid policy is analysed. After defining the concept of state aid, the aim is to find out whether the biodiversity conservation instrument can be considered state aid within the meaning of the 107 TFEU. In chapter four, the conditions for evaluating whether instruments that can be considered state aid, can still be compatible with the common market, are discussed. Then,Commissiondecisions on a few of the more important biodiversity conservation instruments, are introduced and analysed, in order to exemplify regulatory challenges and development needs. Finally, some conclusions about the regulation of positive incentives for biodiversity conservation are drawn with the aim of supporting future forest-biodiversity governance.

[30] **Habitat banking** is a market-like system where credits from actions beneficial for biodiversity can be purchased to offset the debit from environmental damage. Credits can be produced in advance of, and without ex-ante links to, the debits they compensate for, and stored over time" (*Eftec, IEEP et al.* 2010). Like any market-system, habitat banking and offsets require a relevant involvement of the national and regional levels of governance, to support the development and monitoring of the system. Typically habitat banking involves three key actors, "buyers" who seek ways to compensate the damage they cause, "sellers" who create credits with actions beneficial for biodiversity, and "regulators" who oversee the process (POLICYMIX – WP2 Review Habitat Banking and Offsets). Under a system of **biodiversity offsets**, land use change activities that have significant negative consequences for biodiversity are "taxed" through a requirement to compensate for all unavoidable biodiversity impacts. Revenues are collected to finance these biodiversity credits provided by the habitat bank (*Blom – Bergsma – Korteland* 2008).

[31] *Arentino et al.* 2001, p. 15.

2 EU Environmental Policy

2.1 Environment in the Treaties

Since environmental protection is the premise for authorisation of the use of state aid here, it is essential to know the basis for and the content of it in the EU regime. In the following, the essential environmental provisions will be analyzed to untwine their effect and meaning in the interpretation of environmental protection in the EU. Biodiversity protection is one central aspect of environmental protection. Among regulation on Natura 2000, the EU`s biodiversity policy is chiefly realised through certain programmes and communications. These will be introduced shortly in chapter 2.2. As a separate policy field, environmental policy will encounter challenges stemming from other policy fields. These challenges, and also the opportunities that environment creates, will be illustrated in chapter 2.3.

Under Article 3 of the Treaty on the European Union (TEU), the European Union should take measures to promote "a high level of protection and improvement of the quality of the environment". The EU environmental policy objectives, principles and policy aspects to be taken into account are all codified in the Article 191 TFEU. Article 191(1) defines the goals for the Union`s environmental policy[32] and Article 191(3) shows aspects, which the Union shall take account of, when preparing its policy on the environment. [33] Environmental policy is the only field in the EU that has its principles defined in the Treaty. These principles are mentioned in Article 191(2) TFEU and they will ultimately define the way in which the environment-related regulations are interpreted in the Union and Member States.

According to *the high level of protection principle*, European environmental policy shall aim at a high level of protection taking into account the diversity of condtions in the various regions of the Union. *The precautionary principle* holds that potential pollution should be pre-emptively avoided. *The prevention principle* allows action to be taken to protect the environment at an early stage. Prevention is, for instance, linked to the notion of deterrence and the idea that disincentives, such as penalties and civil liability, will cause actors to take greater care steering their behaviour to avoid the increased costs, thus preventing pollution from occurring.[34] With that in mind, also positive incentives could be seen as effective measures in preventing irreversible biodiversity loss.

[32] The environmental objectives to be pursued by the EU in the Article 191(1) TFEU are: preserving, protecting and improving the quality of the environment; protecting human health; prudent and rational utilisation of natural resources; promoting measures at international level to deal with regional or worldwide environmental problems, and in particular combating climate change.

[33] In preparing its policy on the environment, the Union shall take account of: available scientific and technical data, environmental conditions in the various regions of the Union, the potential benefits and costs of action or lack of action, the economic and social development of the Union as a whole and the balanced development of its regions.

[34] Environmental Law: A Handbook for Afghan Judges. United Nations Environment Programme 2009, p 13.

The polluter pays principle (PPP) is of particular importance in connection with state aid[35]. The essence of the PPP is that the person who introduces a pollutant should also be responsible for the removal of any sub-sequent pollution. This principle can displace other general principles, such as the right to property. The principle that the polluter has to pay is thoroughly based upon economics and is not punitive in character (although it could evolve into a principle of criminal law), but is rather restitutionary. True to its economic nature it operates consistently with the laws of the market and reduces costs to society as a whole. The PPP forces the polluter to internalise the costs associated with his or her production or consumption. Thus, it eliminates, at least in theory, the problem of free riders and over users. In theory, it leads to efficient cost allocation, because the costs of cleanup and benefits of pollution are closely related. [36]

PPP can be implemented either by setting mandatory environmental standards or by introducing market-based instruments. This "internalisation" of the external costs effectively pushes undertakings to minimise their environmental costs. In practice, however, there are certain challenges in internalising externalities: Internalising negative externalities will consequently raise the private costs borne by the polluters[37] and thereby negatively affect their revenue. Hence, there is a fear of losing economic competitiveness and jobs. This might further cause the industry to eventually move to less-regulated areas.[38] Another challenge concerns public goods i.e. goods which are beneficial for society, but which are not normally provided by the market given that it is difficult or impossible to exclude anyone from using the goods. Biodiversity conservation typically produces these kinds of goods[39]. For these reasons, in addition to regulation, Member States need positive economic incentives to facilitate the achievement of higher levels of environmental protection.[40] *The source principle* is related to the polluter pays principle as it simply states that any form of pollution should be treated as closely as possible to its source.

There are also certain general principles in the Treaties that have relevance in environmental protection. These (general) principles are essential in defining the position of environmental

[35] State aid may not be an appropriate instrument in the context of PPP for it would relieve the polluter from paying the cost of its pollution. See chapter 4.2.2.

[36] *Engle* 2009, p. 3.

[37] EU competition law applies only to undertakings. "It comprises all kinds of activities undertaken on an independent basis for remuneration, and the aim pursued is immaterial". Case C-41/90 Höfner and Elser v. Macrotron [1991] ECR I-1979, para 21.

[38] Moreover, since the generation of pollution is unevenly spread among industries and undertakings, the costs of any environmentally friendly regulation tend to be differentiated, not only between undertakings, but also between Member States. Member States may furthermore have a different appreciation of the need to introduce high environmental targets. Community Guidelines on State Aid for Environmental Protection, para 21.

[39] Even though the PPP has been confirmed as an environmental principle, the expansion of it on the biodiversity conservation needs still further clarification. See closer p 64 of this study.

[40] Community Guidelines on State Aid for Environmental Protection, points 19-22.

policy in relation to other Union policies and between the Union and Member States: The *integration principle* is one of the most important principles of EU law of relevance for environmental protection. According to Article 11 TFEU the requirement of environmental protection must be integrated into the definition and implementation of the Union`s policies and activities, in particular with a view to promoting sustainable development. The wording confers a duty on EU institutions to elaborate all policies in the service of sustainability, as an overall Treaty objective.[41] The integration principle is primarily meant to ensure that protection of the environment is taken into consideration when other decisions are being taken, for example, in the field of competition policy[42]. The principle would seem to include both *the environmental policy objectives*[43] and *the environmental principles*.

Article 5(3) TEU refers to the *principle of subsidiarity* according to which, in areas that do not fall within its exclusive competence, the Union shall act only if and so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale of effects of the proposed action, be better achieved at Union level. The institutions of the Union shall apply the principle of subsidiarity as laid down in the Protocol on the application of the principles of subsidiarity and proportionality. The Protocol states that action is justified where the issue under consideration has transnational aspects, which cannot be satisfactorily regulated by Member State action[44]. In general, action by the EU on transfrontier environmental matters (such as maintenance of biodiversity) would seem to pass the test of subsidiarity.[45] In light of subsidiarity principle, it may thus be legitimate to pose the question whether biodiversity conservation, to suffice, demands more stringent regulation at the European Union level.

Under the *principle of proportionality* (Article 5(4) TEU), the content and form of Union action should not exceed what is necessary to achieve the objectives of the Treaties. The European legislature must choose measures, which leave the greatest degree of freedom for national decisions. Directives should be preferred above regulation. Minimum standards should be used, whereby Member States are free to lay down stricter national standards. Non-binding instruments and voluntary codes of conduct should also be preferred, wherever possible[46]. Contrary to the principle of subsidiarity, the principle of proportionality could be *prima facie* taken to imply justification of national environmental measures -such as state aid. Yet, the

[41] *Bär–Kraemer* 1998, p. 318.

[42] *Jans–Vedder* 2008, p. 17.

[43] Preserving, protecting and improving the quality of the environment, protecting human health, prudent and rational utilisation of natural resources, and promoting measures at international level to deal with regional or world-wide environmental problems. Article 191(1) TFEU.

[44] Protocol on the Application of the Principles of Subsidiarity and Proportionality.

[45] *Jans–Vedder* 2008, p. 11 - 12.

[46] OJ C321/I Counsil Resolution on the drafting, implementation and enforcement of Community environmental law. *Jans–Vedder* 2008, p. 14 - 15.

concept of proportionality has proven to be particularly strong in relation to environmental measures, because it has allowed the Court to question the appropriateness of the very level of environmental protection determined by the Member States[47].[48]

2.2 The EU`s Biodiversity Policy

At the Union level, biodiversity objectives are essentially integrated in the Lisbon Strategy and the Sustainable Development Strategy[49]. The EU policy approach gives special attention to the protection of the Natura 2000 network of protected areas. Environmental action regarding areas outside Natura 2000 is provided for by dedicated nature policy (action for threatened species and connectivity of the Natura 2000) and by integration of biodiversity needs into agricultural, fisheries and other policies. The EU`s focus in the international arena has been on strengthening the Convention on Biological Diversity (CBD)[50] among other biodiversity-related agreements.[51] The Sixth Environment Action Programme[52] embraces a general environmental definition of policy, including strengthening the diversity of policy measures. It clearly

[47] See eg. Case 302/86 [1988] ECR 4607 *Danish Bottles* and C-203/96 [1998] ECR I-4075 *Dusseldorp*.

[48] *Notaro* 2001 p. 339.

[49] COM(2001) 264 final. *A Sustainable Europe for a Better World: A European Union Strategy for Sustainable Development.* This strategy provides an EU-wide policy framework to deliver sustainable development, i.e. to meet the needs of the present without compromising the ability of future generations to meet their own needs. It rests on four separate pillars: economic, social, environmental and global governance – which need to reinforce one another. Pursuant to *Commission`s Communication on 2009 Review of the European Union Strategy for Sustainable Development* (COM(2009) 400 final.) "evidence shows that the destruction of biodiversity is continuing at a worrying rate. Degradation of ecosystems not only reduces the quality of our lives and the lives of future generations, it also stands in the way of sustainable, long-term economic development". For that reason the focus should be taken on the EU's long-term goals in crucial areas, notably by intensifying environmental efforts for the protection of biodiversity, water and other natural resources.

[50] Many articles of the CBD have a clear economical connection. Article 6 recommends each contracting party to develop national strategies, plans or programmes for the conservation and sustainable use of biological diversity, and integrate the conservation and sustainable use of biological diversity into relevant sectoral or cross-sectoral plans, programmes and policies. Article 7 requires to identify processes and categories of activities which have or are likely to have significant adverse impacts on the conservation and sustainable use of biological diversity. Article 8 demands to regulate or manage biological resources important for the conservation of biological diversity and promote the protection of ecosystems, natural habitats and the maintenance of viable populations of species in natural surroundings. Article 10 prompts to integrate consideration of the conservation and sustainable use of biological resources into national decision-making. The most important in the light of innovative social and economical incentives is the article 11, which invites each contracting party to adopt economically and socially sound measures that act as incentives for the conservation and sustainable use of components of biological diversity.

[51] See COM(2006) 216 final. Halting the loss of biodiversity by 2010—and beyond: Sustaining ecosystem services for human well-being.

[52] COM(2001) 31 final. The Sixth Environment Action Programme of the European Community entitled "Environment 2010: Our Future, Our Choice".

emphasizes new measures that rest on voluntarism, flexibility, self-regulation, price guidance and other arrangements.

In May 2006, the European Commission adopted a communication on "Halting Biodiversity Loss by 2010 – and Beyond: Sustaining ecosystem services for human well-being". The Communication underlined the importance of biodiversity protection as a pre-requisite for sustainable development, as well as setting out a detailed EU Biodiversity Action Plan to achieve this. In March 2010, the EU Council agreed on a post-2010 vision and an ambitious new 2020 target for biodiversity to replace the expiring 2010 target. The new target aims to "halt the loss of biodiversity and the degradation of ecosystem services in the EU by 2020, restore them in so far as feasible, while stepping up the EU contribution to averting global biodiversity loss". The Council asked the Commission to develop a full-fledged strategy focused on a limited set of measurable sub-targets for different ecosystems, drivers of biodiversity loss, and response measures. This survey is intended to canvas opinions about the various policy options available to fine-tune the new strategy.[53]

Pursuant to the new ambitious "2050 vision", EU biodiversity and the ecosystem services it provides are protected, valued and appropriately restored for biodiversity's intrinsic value and for their essential contribution to human well-being and economic prosperity, and so that catastrophic changes caused by the loss of biodiversity are avoided, by 2050.[54]

2.3 Challenges and Opportunities

The EU has developed a comprehensive environmental policy over three decades. Despite obvious efforts and EU`s relatively high capacities, the actual impact of the EU environmental policy is considered far from satisfactory[55]. The reason for this is not only the poor implementation of EU environmental policies in the Member States but also the fact that progress in the environmental policy field is counteracted by developments in other policy fields[56]. Policies that lead to geographical expansion of different economic sectors and incentives that encourage greenhouse emission may cause huge losses for the biodiversity. Also the occidental agricultural aid is in large measure a perverse incentive from the aspect of biodiversity.[57] For example in Sweden, subsidisation of forest land drainage to increase timber production has led to the loss of over 30,000 hectares of wetlands annually[58]. The good farming

[53] See further at: http://ec.europa.eu/environment/consultations/biodecline.htm.

[54] COM(2011) 244 final.

[55] European Environment Agency, 1999.

[56] "In the EU – and in most of its Member States – sectoral polices such as agricultural policy, transport policy, energy policy, cohesion policy, fiscal policy and so on are formulated in disregard of their environmental impact." *Lenschow* 2005, p. 296.

[57] *Naskali–Hiedanpää–Suvantola* 2004, p. 72.

practice, which forms the basis for the cross-compliance requirements,[59] includes the requirement for "maintenance of the land in a good agricultural condition". This clearly has the aim to slow down the abandonment of farmland, but it also prevents afforestation in regions where forest and farmlands are alternative land uses.[60]

During the meeting of the European Council in Lisbon (2000), the Heads of State or Government launched a "Lisbon Strategy" aimed at making the European Union the most competitive economy in the world and achieving full employment by 2010. This strategy rests on three pillars, one of which is an environmental pillar. The environmental scope was added to the strategy at the Göteborg European Council meeting in June 2001. It draws attention to the fact that economic growth must be decoupled from the use of natural resources. The High Level Group chaired by Wim Kok has assessed the Lisbon Strategy. According to its analysis[61] promoting eco-efficient innovations is clearly a win-win opportunity that should be fully exploited in view of reaching the Lisbon goals. Innovations that lead to less pollution, less resource-intensive products and more efficiently managed resources support both growth and employment while at the same time offering opportunities to decouple economic growth from resource use and pollution.[62] On these grounds, European environmental policy seems to be more a battle of environmental markets than solution of environmental problems. Yet, the markets may also be part of the solution.[63]

In the international discourse the core idea of sustainable development is that environmental protection, economic growth, and social development are mutually compatible, rather than conflicting objectives.[64] As enshrined in State Aid Action Plan, environmental protection can be a source of competitive advantage for Europe, in addition to being essential as such by providing opportunities for innovation, new markets and increased competitiveness through resource efficiency and investment[65].

[58] *Bagri–Blockhus–Vorhies* 1999, p. 21-22.

[59] Cross-compliance is a mechanism that links direct payments to compliance by farmers with basic standards concerning the environment, food safety, animal and plant health and animal welfare, as well as the requirement of maintaining land in good agricultural and environmental condition.

[60] *Schmid, E., J. Balkovic and R. Skalsky*: Biophysical impact assessment of crop land management strategies in EU25 using EPIC. Carbon Sink Enhancement in Soils of Europe: Data Modelling, Verification. JRC Scientific and Technical Reports. S. V., L. Montanarella and P. Panagos, European Communities 2007, Luxembourg. P. 160-183.

[61] Facing the challenge: The Lisbon strategy for growth and employment.Report from the High Level Group chaired by *Wim Kok* 2004. P. 36-38.

[62] Report from the High Level Group chaired by *Wim Kok*, p. 36-37.

[63] *Naskali–Hiedanpää–Suvantola* 2004, p. 24.

[64] *Lenschow* 2005, p. 295-297.

[65] State Aid Action Plan—Less and better targeted state aid: a roadmap for state aid reform 2005-2009. COM(2005) 107 final.

The EU policies are under constant change. The latest notable one occured in December 2009 when the Lisbon Treaty entered into force. Although sustainable development and environmental protection have been included in previous treaties, the Treaty of Lisbon now sets out clear definitions, reinforcing the EU`s action in these fields. This could imply that environmental aspects have stronger effect in future state aid decisions as well.

3 When does the Measure constitute State Aid?

3.1 Introduction

When a Member State decides to increase the level of environmental protection, this will result in increased costs and thus a deterioration of the position of the national industry. Therefore no Member State will have an incentive to make the first move with the internalisation of environmental costs. State aid, for example in the form of direct grants and payments, may then be the most appropriate measure in helping the national industry towards higher protection. However, a measure constituting a grant of state aid within the meaning of Article 107(1) triggers a duty of notification to the Commission[66] according to Article 108(3). The Commission decides whether the proposed aid is compatible with the common market. Until the Commission has taken a final favourable decision, the Member State may not put its proposed measure into effect. For all the necessary aid measures to be duly notified, it is important to know the exact boundaries of state aid. This however is not self-evident, since the definition of state aid presents many difficulties. In the following, the concept of state aid in the meaning of Article 107(1) will be outlined as comprehensively as possible within the framework of this study. In chapter 3.2, the policy behind state aid regulation will be shortly introduced. The actual concept of state aid will be defined in chapter 3.3. Finally, chapter 3.4 presents a process of deductive reasoning to determine whether or not the above-mentioned key incentive-instruments constitute state aid within the meaning of Article 107(1).

[66] The European Commission is the executive branch of the European Union. The body is responsible for proposing legislation, implementing decisions, upholding the Union's treaties and the general day-to-day running of the Union. The European Commission has established a system of rules under which state aid is monitored and assessed in the European Union. The European Commission possesses strong investigative and decision-making powers. At the heart of these powers lies the notification procedure which the Member States have to follow. It is only after the approval by the Commission that an aid measure can be implemented. Moreover, the Commission has the power to recover incompatible state aid. Through these means, three Directorate-Generals are carrying out effective state aid control. The Commission aims at ensuring that all European companies operate on a level-playing field, where competitive companies succeed. It ascertains that government interventions do not interfere with the smooth functioning of the internal market or harm the competitiveness of EU companies. The Commission invites interested parties to submit comments through the Official Journal of the European Union when it has doubts about the compatibility of a proposed aid measure and opens a formal investigation procedure.

3.2 EU`s State Aid Policy

The single market constitutes the very heart of the EU, where it is seemingly all about regulationbringing down barriers to trade and simplifying existing rules to enable the free movement of people, goods, services and capital. These freedoms are enshrined in the TEU and form the basis for the single market. [67] Whereas the EU and Member States have shared competence in the principal area of the environment, the Union has exclusive competence in regulating competition in a manner necessary for securing the functioning of the internal market[68]. The idea behind EU competition policy is that a market-based economy is considered to provide the best guarantee for improving living conditions in the EU to the benefit of citizens, which is one of the primary objectives of the EU Treaty. It is essential to have functioning markets to provide consumers with the products at low prices. Competition also creates a business environment in which efficient and innovative companies are rewarded.[69] However, the Treaty allows exceptions to the ban on state aid where the proposed aid schemes may have a beneficial impact in overall EU terms.

The control of state aids is a unique feature of competition policy in the EU. The benefits of state aid control are clear. In many circumstances, subsidies can reduce economic welfare by weakening the incentives for firms to improve their efficiency and by enabling the less efficient to survive or even expand at the expense of the more efficient. The resulting distortions of trade can lead to friction between national governments and to retaliatory measures, which may be a source of further inefficiency. Furthermore, unless some supranational discipline is imposed, competition between governments to attract investment can lead to costly subsidy races. The EU's system of control, based on an agreed set of fundamental principles firmly anchored in the Treaties therefore makes an important contribution towards ensuring that the benefits of economic integration can be realised.[70]

State aid may becompatible with the Treaties provided it fulfils clearly defined objectives of common interest, like services of general economic interest, regional and social cohesion, employment, research and development, *environmental protection* or the protection and promotion of cultural diversity.[71] Since state aid measures can correct market failure and thereby improve the functioning of markets and enhance European competitiveness, they may be effective tools for achieving these objectives. In addition to being justified as such, environmental protection may also be considered a source of competitive advantage for Europe.

[67] See eg. Historical overview of the EU Single Market at European Commissions web page > Internal Market > General Policy Framework > Historical Overview. Available at: http://ec.europa.eu/internal_market/top_layer/index_2_en.htm. Last visited in 25.10.2010.

[68] Article 3 TFEU.

[69] COM(2005) 107 final.

[70] *Buelens–Garnier–Johnson–Meiklejohn* 2007, p. 2.

[71] State Aid Action Plan, COM(2005) 107 final.

The Treaty debars the application of state aid rules in the following sectors: agriculture (Article 42 TFEU), transport (Article 93 TFEU), disequilibrium in the balance of payments (Article 143 TFEU), world trade (Articles 206 and 207 TFEU) and protection of the security (Article 346 TFEU). Yet, in recent years, there has been a clear trend to invoke the EU `s rules on state aid in certain sectors in which the role of the state has traditionally been dominant.[72] In the agriculture sector for example, the single common market organization regulation, which applies to most agricultural products, provides for the application of the state aid rules of Articles 107, 108 and 109[73] TFEU. Likewise the rural development regulation expressly provides that Articles 107 – 109 TFEU are applicable to aid granted by Member States to support rural development[74].[75] Hence, practically all the regulations establishing the common organizations of the market provide for the application of the state aid rules of Articles 107, 108 and 109 of the Treaty to the products concerned[76]. Also services of general economic interest (SGEI)[77] are subject to the internal market and competition rules of the TEU. As an interesting curiosity, the environment is also an area where these services might be established[78].

The TEU affords the Commission the task to monitor proposed and existing state aid measures by Member States. This way the Commission can ensure that Member States do not distort intra-community competition and trade contrary to the common interest.[79]

[72] *Plender* 2004, p. 5.

[73] See (EC) No 1234/2007 of 22 October 2007 establishing a common organisation of agricultural markets and on specific provisions for certain agricultural products (Single CMO Regulation), article 18.

[74] (EC) No 1698/2005 Council Regulation on support for rural development by the European Agricultural Fund for Rural Development (EAFRD), Article 88.

[75] *Heidenhain* 2010, p. 288-289.

[76] Community Guidelines for State Aid in the Agriculture and Forestry Sector, point 10.

[77] SGEIs are activities economic in nature, such as postal services, telecommunications, transport services and also the supply of electricity and gas. They have a clear Europe-wide dimension and are therefore regulated by a specific Union legislative framework

[78] Communication of the Commission of 12.5.2004 COM(2004)374 final, section 3.4.

[79] COM(2005)107 final, p. 3-4.

3.3 The Definition of State Aid

Article 107 TFEU regulates generally the prohibition of state aid and possible exceptions. The first part (107(1)) says:

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

The most important legal consequence of a measure being a grant of aid within the meaning of Article 107(1) TFEU is that it has to be notified to the Commission according to Article 108(1). State aid may however receive approval without notification on the basis that it fits within an already notified and approved general aid scheme or so called "block exemption" Regulation[80]. The state aid rules also treat previously "existing aid"[81] differently from aid granted after a member state signs up. The difference is that existing aid is presumed lawful unless the Commission challenges it, whereas "new aid" is illegal until the European Commission approves it. Consequently the aid is illegal, if it is granted without the Commission being informed or without its approval. Neither may a Member State put the proposed measure into effect before the Commission has taken a final favourable decision. This so-called "stand still clause" has direct effect[82].[83]

Before considering the question under what circumstances the Commission may consider state aid compatible with the common market, it has to be decided whether the measure in question is to be regarded as state aid according to the TFEU. First of all, it is necessary to understand the precise boundaries of state aid. It seems clear from the case law of the Court that the term "aid" must be interpreted broadly[84]. However, there is no exhaustive definition for state aid in EU law. That is why the definition must eventually be made on a case-by-case-basis.

According to settled case-law, four cumulative conditions must exist for a state measure to be classified as state aid[85]. The aid must; 1) be granted by a Member State or through state resources, 2) favour certain undertakingS or the production of certain goods, 3) distort or threaten to distort competition and 4) affect trade between Member States.

[80] (EC) No 800/2008 (6.8.2008).

[81] Aid existing before Member State joined the Union.

[82] Case 47/69 *Steinike & Weinlig* [1977] ECR 595.

[83] *Jans–Vedder* 2008, p. 288 - 289.

[84] *Jans–Vedder* 2008, p. 289.

[85] Case C-280/00, *Altmark Trans GmbH* [2003] ECR I-07747.

3.3.1 Aid Granted Through State Resources

Economic advantage granted by public authority is a fundamental feature of state aid[86]. From case law[87] it seems clear that the concept of "state" embraces regional and local authorities as well as other public bodies set up by government[88]. In Finland the concept includes for example municipalities. Thus, any financial advantage which directly or indirectly comes from the resources of state is regarded as a grant through state resources. Even if a benefit entails no actual transfer of resources, it may still be regarded as "granted through state resources", even in form of revenue foregone as a result of exemptions from taxation and other compulsory levies[89].

According to case law, if no burden on state resources is caused, state aid rules will not apply. At least some kind of indirect connection to public economy is required, and the advantages that result from administrative regulation of economic life should not alone constitute state aid[90]. For example, in *Openbaar Ministerie v Van Tiggele*, the Court held that "Article 92 (now 107) of the Treaty must be interpreted to mean that a fixing of minimum retail prices for a product at the exclusive expense of consumers by a public authority does not constitute an aid granted by a state within a meaning of that Article"[91]. Similarily, in *PreussenElektra*[92] the Court of Justice concluded that "the obligation imposed on private electricity supply undertakings to purchase electricity produced from renewable energy sources at fixed minimum prices does not involve any direct or indirect transfer of state resources to undertakings which produce that type of electricity. Therefore, the allocation of the financial burden arising from that obligation

[86] *Siikavirta* 2007, p 99.

[87] Case C-5/89 *BUG-Alutechnik* [1990] ECR I-3437; Case 177/78 *Pigs and Bacon Commission v McCarren* [1979] ECR 2161.

[88] *Ahlborn–Berg* 2004 p. 55.

[89] *Bellamy–Child* 2001, European Community Law of Competition, Fifth Edition, 19-015.

[90] *Siikavirta* 2007, p 107. Originally from *Nicolaides–Kekelekis–Buyskes*: State Aid Policy in the European Community. A Guide to practitioners. Kluwer law international. 2005. On pages 11 - 13 there is a refer to Case C-379/98 *PreussenElektra AG v Schhleswag* [2001] ECR I-2099, para 58:"In that connection, the case-law of the Court of Justice shows that only advantages granted directly or indirectly through State resources are to be considered aid within the meaning of Article 92(1). The distinction made in that provision between 'aid granted by a Member State' and aid granted 'through State resources' does not signify that all advantages granted by a State, whether financed through State resources or not, constitute aid but is intended merely to bring within that definition both advantages which are granted directly by the State and those granted by a public or private body designated or established by the State—"

[91] Case 83/77, para 24.

[92] Case C-379/98, para 59-60.

for those private electricity supply undertakings as between them and other private undertakings cannot constitute a direct or indirect transfer of state resources either"[93].

Still, Article 107 might be taken to imply that aid is granted through state resources, even if it is not granted from the actual resources of state, but is instead granted by another body. According to Plender[94], crucial in considering whether the aid should be regarded as "granted through state resources", is whether the body granting the aid is subject to control by the state. Aid pursuant to Article 107(1) may, for example, be financed by taxes or payments collected from users. These payments may then be dispatched into a fund wherefrom payments are deferred to certain enterprises.[95] Such financing has been regarded as granted from state resources, when 1) it is based on legislation, 2) payments are compulsory, 3) the administration and execution of the payment are based on law and 4) the fund is founded by the state.[96]

3.3.2 Favouring Certain Undertakings

For Article 107(1) to apply there must be an advantage that must benefit certain undertakings. Any digression from conventional application of a general scheme can be considered aid. Sectoral, geographical or company-based selectivity, are all basically discriminatory. Besides direct grants, the provision of infrastructure by public authorities, serving specifically the interest of a certain undertaking or type of product may constitute state aid[97]. Also more generally, channelling of public funds to private undertakings can be interpreted as state aid on relatively many, and sometimes rather slight signals of discrimination.

The European Courts have defined the concept of aid as "a direct or indirect economic advantage on the beneficiary, which it would not have obtained in the ordinary course of business"[98], in other words "gratuitous benefit".[99] Such benefit might typically be the

[93] PreussenElektra claimed that the mechanism established by German law amounted to state aid. The basis of their claim was on two arguments: First, that financing through state resources should not be constituting element of state aid and the measure being a result of action by a Member state regardless of whether the aid was privately or publicly funded should suffice. Second, they alternatively argued that the German legislation had the effect of converting private resources into public resources. They likened the system established by the German legislation to a parafiscal charge: Where private funds are under the direct control of the state, they should be caught by the state aid rules.

[94] *Plender* 2004, p. 19-20.

[95] *Siikavirta* 2007, p. 108.

[96] See Joined Cases C-78/90, C-79/90, C-80/90, C-81/90, C-82/90 and C-83/90. *Compagnie Commerciale de l'Ouest and others v Receveur Principal des Douanes de La Pallice Port. - References for a preliminary ruling: Cour d'appel de Poitiers - France. - Parafiscal charges on petroleum products*. [1992], ECR I-01847.

[97] *Plender* 2004, p. 13.

[98] Case 61/79 Amministrazione delle finanze dello Stato v Denkavit italiana Srl [1980] ECR 1205.

[99] *Ahlborn–Berg* 2004, p 60.

contribution via sale, lease or purchase of land by public bodies to or from private parties at non-market prices, but it might even occur in the national administration of EU structural funds.[100] Selective labour experiment[101] and discounts on employer contributions[102] may also be regarded as aid. The so-called "market investor test" is applicable in cases where the state intervenes by means comparable to private investors. According to the test, state aid is allocation of resources in situations where a private investor seeking profit, and not because social, political or philanthropic aims, after examining the situation, would not give such aid. [103] The grant of loans at reduced rates as well as the provisions of loans at market rates, where it is apparent that a private investor would not act as the public authority does, amount to aid.[104]

According to Ahlborn and Berg, the expansive interpretation of selectivity has turned state aid control into a broad rule against unjustified discrimination through state measures. For instance, in its widest interpretation the application of selectivity leaves barely any scope for general public measures. Neither is there clear guidance as to the criteria which determine whether any discrimination is justified. The policy of the Commission seems random and distinction between cases is sometimes hard to justify.[105] For instance, there seem to exsist a "contradiction" between *Commission v Italy*[106] and Commission Decision *Belgique*[107]. In *Commission v Italy*, a reduction in contributions to the health insurance scheme for female employees, was held to be selective for it favored certain Italian industries employing large numbers of female employees. Whereas, in the *Belgique* case, a reduction of employer`s social security contributions for firms that introduced shorter working hours, was regarded as general measure, as it applied to all firms in Belgium.

It is probable that the measure is regarded as aid, if the public authority exercises discretion in granting it. In *French Republic v Commission* the litigation arose from the financial participation of the Fonds National de l`Emploi (FNE) in the implementation of a social plan by the company Kimberly Clark Sopalin[108]. The Court concluded that the FNE enjoys a degree of latitude, which allows it to adjust its financial assistance having regard to a number of

[100] State Aid and Public Procurement: A Practical Guide. Available at: http://www.cobbetts.com/OurServices/ECCompetition/StateAidandPublicProcurementAPracticalGuide.

[101] *Plender* 2004, p. 15.

[102] *Hancher–Ottervanger–Slot* 1999, p. 32.

[103] For example, in deciding whether services are supplied by an entity subject to the control of the state to recipients who are alleged to have paid less than they are worth or whether an undertaking which has provided services to the state is alleged to have received a reward exceeding their value. See joined cases C-278/92, C-279/92 and C-280/92 Kingdom of Spain v Commission of the European Communities, [1994] ECR I-4103.

[104] *Plender* 2004, p. 8 - 10.

[105] *Ahlborn–Berg* 2004, p. 53.

[106] Case C-203/82, *Commission v Italy* [1983] ECR I-2525.

[107] Commission Decision N232/2991 *Belgique*, 3.7.2001.

[108] Case C-241/94 *French Republic v Commission of the European Communities* [1996] ECR I-04551.

considerations, in particular, the choice of beneficiaries, the amount of the financial assistance and the conditions under which it is provided. Thus, the Court held that by virtue of its aim and general scheme, the system under which the FNE contributed to measures accompanying social plans was liable to place certain undertakings in a more favorable position than others.[109]

The criterium of discretionary power on the part of public authorities is not however an absolute demand. In *Adria-Wien Pipeline GmbH*[110], which concerned an Austrian legislative measure providing tax exemptions from energy taxes on natural gas and electricity, the Court regarded measures selective and as constituting state aid within the meaning of the Article 107(1) of the EC Treaty. The Court reached its conclusion, although the measure was established in the context of an overall package of measures to consolidate the budget, and exemptions were based on objective automatic criteria without the administrative authorities having any discretionary power in selecting the beneficiaries, and the measure gave benefits for a very large number of undertakings. One of the main reasons for this conclusion was that the tax exemption was applied only to undertakings whose activity was mainly in the manufacturing sector. The Court held that the ecological considerations underlying the national legislation did not justify treating the consumption of natural gas or electricity by undertakings supplying services differently than the consumption of such energy by undertakings manufacturing goods, because the damage to the environment was the same. The Court stated that undertakings in the services sector may, just like undertakings in the manufacturing sector, be major consumers of energy and incur a high level of energy taxes. Therefore, they were in a disadvantaged position.

The application of state aid rules on taxation is complicated, since schemes of taxation are usually generally expressed, but may still unequally affect taxpayers, based on their circumstances. The main criterion in applying state aid to a tax measure is that the measure provides an exception to the application of the tax system in favor of certain undertakings in the Member State. The common system applicable should thus first be determined. It must then be examined whether the exception to the system or differentiations within that system are justified by the nature or general scheme of the tax system. If this is not the case, then state aid is present. [111] The fact that some firms or some sectors benefit more than others from some of these tax measures does not necessarily mean that they are caught by the competition rules

[109] Case C-241/94 *French Republic v Commission of the European Communities* [1996] ECR I-04551, para 23 - 24.

[110] Case C-143/99 *GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v Finanzlandesdirek Adria-Wien Pipeline tion für Kärnten* [2001] ECR I-08365.

[111] Commission notice on the application of the State aid rules to measures relating to direct business taxation. OJ 1998 C384/3, para 16.

governing state aid[112]. Tax measures of a purely technical nature as well as measures pursuing general economic policy objectives through a reduction of the tax burden related to certain production costs, do not constitute state aid.[113]

Most environmental support measures constitute an advantage for the undertaking, but in some cases the Commission has found that there is no advantage. For example, in *Waste disposal system for car wrecks*[114], the Commission found that there was no economic advantage for the companies in question, and therefore no state aid. The aim of the waste management system was to ensure that the companies that produce and sell cars also take the responsibility for a high degree of recycling of car wrecks, which corresponds to the polluter pays principle. The Dutch government had declared that all car producers and importers had to pay charge for each car registered in the Netherlands. The collected resources were paid to car dismantling companies. As the charge for car producers and importers and premiums to the dismantling companies were corresponding to the cost of recycling, the Commission found that there was no advantage and state aid for car producers, nor for car dismantling companies.

A state measure that must be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations *(a benefit for public services)* is generally regarded as compensation instead of aid, when it grants no notable economic advantage to the undertaking[115]. In *ADBHU* [116]the Court followed the compensation approach. It involved the granting of indemnities that did not exceed the actual yearly costs to waste oil disposal undertakings as compensation for the obligations imposed on them to collect and dispose of waste oil. As the indemnities were held as appropriate compensation for waste disposal services, they did not constitute state aid. In *Altmark Trans,* the Court specified its interpretation and stated: "~for such compensation to escape classification as state aid in a particular case, a number of conditions must be satisfied~ First, the recipient undertaking must actually have *public service obligations* to discharge, and the obligations must be clearly defined.~ Second, the parameters on the basis of which the compensation is calculated must be *established in advance* in an objective and transparent manner~ Third, the *compensation cannot exceed what is necessary* to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit~ Fourth, where the undertaking which is to discharge public service obligations, in a specific case, is not chosen

[112] Measures designed to reduce the taxation of labour for all firms have a relatively greater effect on labour intensive industries than on capital intensive industries, without necessarily constituting State aid. Similarly, tax incentives for environmental, R&D or training investment favour only the firms which undertake such investment, but again do not necessarily constitute State aid. OJ 1998 C384/3, para 14.

[113] *Quigley* 2004, p. 208.

[114] C-11/2001 (ex N 629/00). Invitation to submit comments pursuant to Article 88(2) of the EC Treaty concerning the waste disposal system for car wrecks in the Netherlands.

[115] Case C-280/00 *Altmark Trans GmbH* [2003] ECR I-07747, para 87.

[116] Case 240/83 *Procureur de la République v ADBHU* [1985] ECR 531.

pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, *the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided would have incurred* in discharging those obligations".[117]

3.3.3 Distortion or Threat to Competition & Adverse Effect on Trade between Member States

Generally avoiding discrimination and selectivity is recommended in state support measures, so that they can be considered general measures and not state aid measures. The baseline is that all state aid has an adverse effect on trade and competition[118]. It is crucial to separate injurious aid from the beneficial. Even though no explicit regulation for this exists, it is quite clear according to Article 107(2) and (3) that aid may be used as a remedy in achieving acceptable goals.[119]

The EU Courts have stated in several cases that Article 107(1) defines aid in relation to its effects instead of drawing distinction according to the causes or aims[120].[121] The development of "distortion of competition" as an independent analytical concept is the starting point of an effects-based state aid analysis. It is to say, that an improvement of the beneficiary`s relative market position (the effect) is a necessary condition for the "distortion of competition" interpretation. However, not every measure which affects the relative position of competitors should be viewed as distortion of competition. The ultimate aim of competition policy is the protection of competition, not competitors. This means that state aid control should be primarily concerned with the harm to those competitors that are at least as efficient. Therefore, competition is distorted when state aid allows inefficient undertakings to survive artificially in a

[117] Case C-280/00 *Altmark Trans GmbH* [2003] ECR I-07747, para 88 - 93. The general provisions are now listed in the Community framework for State aid in the form of public service compensation (2005/C 297/04), para 6.

[118] See for example the traditional case 730/79 *Philip Morris Holland BV v Commission of the European Communities*. [1980] ECR I-02671. According to Advocate General, Mr Capotorti "~it is permissible—to start from the presumption that any public aid granted to an undertaking distorts competition—or threatens to do so where the aid is only proposed and not yet granted~".

[119] *Siikavirta* 2007, p. 112.

[120] Yet, the aim is naturally taken into account by the Commission when it determines whether an aid is compatible with the common market.

[121] For example: Case 173/73, *Commission v Italy*, [1974] ECR 709: "The social character of such State measures is not sufficient to exclude them outright from classification as aid for the purposes of Article 92 of the Treaty. Article 92(1) of the Treaty does not distinguish between measures of State intervention by reference to their causes or their aims but defines them in relation to their effects"; Case C-126/01 Ministère de l'Économie, des Finances et de l'Industrie v GEMO SA. [2003] ECR I-13769. Opinion of Mr Advocate General Jacobs delivered on 30 April 2002: "Article 87(1) EC (now 107(1)) does not distinguish between measures of State intervention by reference to their causes or aims but defines them in relation to their effects. The causes or aims of a measure are not to be taken into account for its classification as aid but only for the assessment of its compatibility under Article 87(2) and (3) EC (107(2) and (3))".

competitive market to the detriment of more efficient competitors.[122] In practice, the criteria of distortion of competition and effect on trade between Member States are met when an undertaking trades cross-border or when the branch extends from one Member State to another[123].[124] Small amounts of aid are not regarded competition-distorting or as affecting trade between Member States.[125] The above discussion of the conditions for evaluating the legality of state aid can be depicted as follows:

[122] *Ahlborn–Berg* 2004, p. 49 - 50.

[123] See Commissions decision No 543/2001 – *Ireland Capital Allowances for Hospitals* (C (2002)608fin) where the Ireland government proposed to introduce a system of capital allowances for investors in hospitals which meet specified service criteria and which undertake to reserve a minimum number of beds for National Health patients. The Commission held that the direct beneficiaries of this measure can only be private individuals with their economic interest based in Ireland. Therefore it cannot be considered as effecting trade between Member States. It was also pointed out that the hospitals which receive an advantage from this measure operate on a market where the provision of facilities is liberalised and consequently there could be a potential effect on cross-border trade. However, in this specific case there are a number of factors which should be taken into account and which moderate this view. Thus, although the three other cumulative conditions of state aid fulfilled, Commission concluded that "The features of this specific case indicate that there is no effect on cross-border trade. Consequently, even though there is an advantage to hospitals, the measure can be considered as not constituting state aid under Article 87(1) [107(1)]".

[124] *Siikavirta* 2007, p. 113.

[125] More about the *de minimis* aid on page 38.

Identifying state aid

ECONOMIC ADVANTAGE: This can be in the form of sale of land at less than open market value, capital injection, loan guarantees, tax reliefs, privileged infrastructure access or simply direct grants.

YES

GRANTED BY PUBLIC AUTHORITY: Does the aid involve a transfer of state resources (including central or local government, other public sector bodies, or private bodies acting under public direction and funding).

YES

SELECTIVITY: Is the aid only available to a limited number of enterprises? (cf. General measures).

YES

EFFECT ON TRADE AND COMPETITION: Does the undertaking trade cross-border or does the branch extends from one Member State to another?

YES

IS THE AID LESS THAN EUR 200 000 (EUR 100 000 IN THE ROAD AND TRANSPORT SECTOR & EUR 7 500 IN THE AGRICULTURE SECTOR) OVER A THREE FISCAL YEAR PERIOD ("DE MINIMIS" RULE)?

NO

IS THE AID COVERED BY A BLOCK EXEMPTION REGULATION: The Commission exempts some categories of state aid from the obligation of notification provided that the terms of the block exemption are respected.

NO

HAS THE AID ALREADY BEEN APPROVED BY THE COMMISSION AS PART OF AN EXISTING AID SCHEME?

NO

THE AID NEEDS TO BE INDIVIDUALLY NOTIFIED AND APPROVED BY THE COMMISSION.

3.4 Conclusions: Does the Measure Constitute State Aid?

It should be fair to assume that all the following incentive instruments, if not purely market-based, non-economic or solely granted to undertakings functioning in the markets where there is no cross-border transaction, distort or threaten to distort competition and affect trade between Member States. Consequently, the main focus here is on the conditions of selectivity and whether the aid must be granted by state or through state resources.

Having said this, it seems clear that *tax reliefs*[126] as well as *subsidies*[127] based on public financing constitute a grant through state resources. In addition, if the measures are selective, they most probably constitute state aid. Schemes executed in the form of administrative contracts, for instance, within the Forest Biodiversity Programme for Southern Finland (METSO)[128] seem to be somewhere in the grey zone between state aid and compensation for public services. When a public authority and landowner make an agreement on reimbursement for certain commitments it supports the interpretation that the measure is normal public procurement of services. Yet, the measure in question allows the national authority to seek politically found targets that alternatively could be realized through binding national regulation, which is a genuine ground for state aid. It is anyhow quite challenging to evaluate the measure in the light of the general provisions of public service, set out in *Altmark Trans GmbH* [129], for no corresponding private service-markets yet exist.[130] However, it should be born in mind that the METSO program is executed only in non-industrial private forests and the policy is based on economic incentives and voluntarism on the part of forest owners. Biodiversity conservation through binding regulation is thus not in practice an alternative to it. In a recent Commission

[126] **Tax reliefs** for biodiversity conservation would be arrangements and provisions in general tax schemes, with the explicit aim of providing positive financial incentives steering the taxpayers' behaviour in a more biodiversity-friendly direction. This definition excludes the use of tax revenues to finance or subsidize biodiversity conservation. It also excludes specific environmental taxes (for example, pollution charges and taxes on the conversion of nature into urban areas). Examples of tax-reliefs include reduced rates or exemptions for forest and nature areas, tax relief on income from forest exploitation and deduction of expenses for nature management and losses on nature protection. Tax reliefs can also be made on income from investments in nature and nature-friendly enterprises or in the form of reduced rates or exemptions for forest and nature areas, exemptions if the forest is managed sustainably or reduced tax-rates for eco-labelled (certified) products (POLICYMIX Task 2.2. Literature Review on tax Reliefs for Biodiversity conservation).

[127] **Environmental subsidies** are used to stimulate changes in consumer behavior and create new markets for environmental goods. In this study the focus is especially in national **payments for environmental services (PES) schemes**. Although the line between traditional subsidies and PES is blurred, the main difference is that, at least in theory, PES are more conditional on performance and can be suspended if the landowner defaults. Environmental subsidies consist of financial assistance (often from governmental bodies) to businesses, citizens, or institutions to encourage a desired activity by reducing costs for beneficial activities, or by increasing the revenues of such entity for the purpose of achieving an objective. There are technical assistance grants or targeted grants for capacity building and knowledge sharing. PES schemes redistribute national wealth by making direct payments or compensations to those who produce the conservation benefit. (The payments considered in this study are made to landowners The Use of Market Incentives to Preserve Biodiversity 2006, p 14). An example of a national PES scheme is a pilot nature values trading scheme in Finland where voluntary conservation of sites was contracted against a fee that consisted of a payment for ecological values and a compensation for lost income. Most PES schemes aiming at biodiversity conservation focus their attention on forest protection. When assigning an economic value to biodiversity, it must be recognized that biodiversity has both intrinsic and instrumental values. The latter includes revenues and potential revenues from ecotourism, bioprospecting and services that already have a market value. Intrinsic value on the other hand is based on existence value in time and space. Valuation of both the services is limited by the poor knowledge and understanding of their biophysical parameters and the non-existence of markets for those services (*Chacón-Cascante – Porras – Robalino* 2010).

[128] Mmmp 144/2000.

[129] Case C-280/00, *Altmark Trans GmbH* [2003] ECR I-07747, para 88-93.

[130] *Siikavirta* 2007, p. 90.

Decision on state aid, environmental conservation tasks have now, for the very first time, been defined as services of general economic interest (SGEI) by a Member State[131]. According to the Commission, the criteria that differed the SGEI from a classical environmental aid measure, is that in the latter case the activities can only be carried out by undertakings on a voluntary basis, whereas SGEI falls within the remit of the state acting as public authority. Additionally, subsidies for conservation tasks[132] implemented in the form of administrative contracts within the METSO program have already been regarded as state aid by the European Commission[133].

There is no legal difference whether the aid is granted by state or by county, federal authority, municipality or any other organ using public authority. As such, transfer of assets between public authorities is not generally regarded as aid. *Ecological fiscal transfer*[134] is state aid, if it ends up giving advantage to certain undertakings. In conclusion, if a municipality addresses the assets that it has received as central government transfers forward to certain undertakings, the measure is state aid and the municipality is the "aid-official". If however, the assets received as central government transfers are not forwarded to undertakings (e.g. the measure does not provide tax reliefs or any other subsidies) but are rather just used to level the loss of municipals tax incomes[135] caused by land use restrictions, the measure is presumably not regarded as state aid (in practice this might enable maintaining a lower municipal tax level in the future).[136]

Tradable permits[137], and possibly also *habitat banking*[138], may constitute state aid if the trading instruments set by the officials are seemingly artificial, discriminatory or create economic

[131] C(2009) 5080 final. This case will be dealt more carefully later in this study.

[132] Maintaining and restoring ecological, protective and recreational functions of forest, biodiversity and healthy forest ecosystems.

[133] The European Commission has regarded certain subsidies granted on grounds of Law on finance for sustainable forestry (Laki kestävän metsätalouden rahoituksesta 1094/1996) as state aid. See Commissions decision N 130a/2007, para 27-29.

[134] Investments and maintenance of socio-economic public sector functions of urban agglomerations (such as schools, hospitals, and theatres) have long been a justification for targeted fiscal transfer schemes. Targeted fiscal transfers are a suitable instrument for internalizing positive externalities. In the case of ecological fiscal transfers, this means greening the public expenditure. Protected areas, for example, involve land-use restrictions that may force municipalities to forego development opportunities that would generate communal income. If transfers are made to compensate for these protected areas, their acceptance could be increased both at the municipal decision-making level, and by citizens in the area. Brazil and Portugal have implemented ecological fiscal transfers, compensating municipalities for land-use restrictions imposed by protected areas (*Ring* 2008, p. 143-150).

[135] See 1704/2009, chapter 7.

[136] The interpretation is partly based on communication with *Kristian Siikavirta*, October 2010.

[137] **Tradable permits** are a way to provide market incentives to trade rights to pollute, use natural resources or develop areas that have previously been forest or pristine environments. They are designed to achieve fixed reduction targets in a cost efficient way (much reiterated but in a way also an unproven claim). In the cap-and-trade approach, allowances for future emissions or development of land are sold or granted free (grandfathering) to existing polluters or developers (The Use of Market Incentives to Preserve Biodiversity 2006, p. 14).

[138] See footnote on page 7.

advantages. For example, the Commission considers emission trading instruments (and possible habitat banking instruments) such as quotas, allowances, certificates and credits to be intangible assets for recipients if they are tradable in the market. When the state on its own initiative allocates such assets free of charge, the allocation can constitute state aid[139].

As such, *certificates*[140] do not generally constitute state aid if the measure is not taken from the state budget.[141] In its decision on the green oil certificate system in Sweden (N789/2002), the Commission held that an advantage given to the producers of green oil by granting them free oil certificates, which they can sell to the suppliers on the (future) green certificate market, does not constitute state aid.[142] Because the grant of free green certificates does not cause revenue forgone to the state, it does not constitute state aid. Neither does the obligation by the state for licensed electricity suppliers to purchase a certain amount of green certificates (comparable to the obligation to purchase electricity produced from renewable energy sources at fixed minimum prices[143]), constitute state aid. However, if the certificate scheme, for example, includes sanctions for omission to buy the necessary amount of certificates, and suppliers who have not bought a sufficient amount have to pay a fine to a fund wherefrom the payments are

[139] See National allocation plans for Emissions trading: http://www.europa.eu.int/comm/environment/climat/emission_plans.htm. Last visited on 22.10.2010.

[140] **Certificates** are proofs of qualification. In the biodiversity context they imply that activities are carried out in an environmentally friendly way, for instance forest certification can advance biodiversity conservation in commercial forests through setting certain standards for sustainability of forest management and use. It can set even very strict standards for ecological sustainability and conservation of certain characteristics, e.g. retention trees, and setting aside certain habitat patches. Certification is not a forest protection instrument, as it does not aim at protecting new areas nor can it influence the management of strictly protected forests, since forestry is forbidden in these by law. Consequently forests in protected areas are not certified. Forest certification can however ensure that conservation values in strictly protected forests are not endangered by forest work in adjacent commercial forests. Increasing consumer demand for certification creates a powerful incentive for retailers and manufacturers to seek out suppliers that follow sustainability standards. This in turn prompts forest managers to adopt certified practices aimed at maintaining natural forest characteristics, and to move away from destructive practices (Natural Resources Defence counsil).

[141] In order to decide that the notified measure on green certificates constitutes state aid, the Commission has to determine whether state resources are at stake. See eg. Commissions decision N 504/2000, p 11.

[142] "De svenska myndigheternas avsikt är att ge producenter av grön elektricitet extrainkomster genom försäljning av elcertifikat på marknaden. Systemet utgör därför en förmån för dem. Orsaken till att förmånen ges till dessa producenter är att det av miljöskäl är önskvärt att höja den gröna elektricitetens konkurrenskraft på den avreglerade elmarknaden. En åtgärd utgör emellertid inte statligt stöd om det inte är fråga om statliga medel. Kommissionen har redan slagit fast att utdelning av gratis elcertifikat till producenter inte innebär någon förlust av statliga medel, eftersom certifikaten endast är ett bevis på att grön el har producerats. Inte heller i föreliggande fall tas medlen från statsbudgeten, utan dessa betalas av alla elförbrukare – myndigheter, företag och enskilda – som omfattas av skyldigheten att köpa elcertifikat. Elleverantörerna hanterar endast inköpsskyldigheten för slutkonsumenterna och får en hanteringsavgift för dessa tjänster". Statligt stöd N 789/2002 – Sverige Elcertifikatsystemet (C(2003)382fin).

[143] See case *PreussenElektra* above.

forwarded to producers, in order to secure a "guarantee price", such a fund-based procedure may constitute state aid.[144]

Especially habitat banking and certificate schemes may coexist with some kind of *fund-based financing*, which for that reason is target for closer scrutiny. Also, depending on the amount of state`s control, fund-based financing may be regarded as given through state resources. However, interpretations vary. As enshrined in *van Tiggele*, the Court also confirmed in *Sloman Neptun*[145] that "advantages granted from resources other than those of the state do not fall within the scope of the provisions in question". In some cases the Commission has regarded fund-based measures as aid, yet compatible with the common market in the light of environmental protection. In a Dutch case the Commission authorised two measures called MEP (*Milieukwaliteit van de ElektriciteitsProductie* — Environmental quality of electricity production), aimed at stimulating renewable energy[146] and combined heat and power (CHP) production[147]. The purpose of this subsidy scheme was to increase supply. The scheme was financed through a compulsory contribution by electricity consumers in the form of an increased connection fee that was fed into a fund. The fund would favour Dutch producers of renewable electricity and of CHP electricity who feed their electricity into the high-voltage grid. The Commission noted that the fund was set up by the state, was managed by a state company and would support only Dutch producers of renewable electricity and of CHP electricity. The Commission therefore concluded that the scheme constituted state aid within the meaning of Article 107(1) of the Treaty and thus assessed the measures in the light of the Community guidelines on state aid for environmental protection.[148]

Environmental taxes, fees and charges[149] are naturally left outside the definition of state aid for no grant from state`s resources occurs. The conclusion is that tax reliefs, subsidies, fiscal transfers, fund-based financing, tradable permits and liability compensation schemes may include state aid in the meaning of the Article 107(1) TFEU. Once a measure is considered to include state aid it must then be decided whether it still could be - and on what conditions - compatible with the common market in the light of environmental protection.

[144] See Commissions decisions N 789/2002 and N 504/2000.

[145] Joined Cases C-72/91 and C-73/91 *Firma Sloman Neptun Schiffahrts AG v Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts AG*. [1993] ECR I-00887, para 19.

[146] N 707/2002.

[147] N 708/2002.

[148] European Commission, XXXIIIrd Report on Competition Policy 2003, p. 102.

[149] Environmental taxes are compulsory, unrequited payments to general government levied on tax-bases deemed to be of particular environmental relevance. Taxes are unrequited because benefits provided by government to society are not normally in proportion to their payments. Environmental fees and charges are requited compulsory payments to the government, levied in proportion to services provided (The Use of Market Incentives to Preserve Biodiversity 2006, p. 14).

In conclusion, we can assess whether typical environmental measures would constitute state aid, based on the chart below.

Does the instrument constitute state aid?

Taxes, fees and charges (disincentives)	Are naturally left outside the definition of state aid for no state resources are at stake.
Subsidies	Subsidies for conservation tasks, also the ones implemented in the form of administrative contracts, have been regarded as state aid by the European Commission.
Tax reliefs	Are regarded as state aid if they provide in favor of certain undertakings in the Member State an exception to the application of the tax system: First the common system applicable should be determined, and then examined whether the exception to the system or differentiations within that system are justified by the nature or general scheme of the tax system. If not, state aid might be present.
Fund-based financing	May be regarded as "given through state resources" depending on the amount of state`s control. In order to assess the involvement of state resources three cumulative criteria have to be fulfilled: the fund must be established by the state, the fund must be fed by contributions imposed by the state, and the fund must be used to favour specific enterprises.
Tradable permits	May constitute state aid if the trading instruments set by the officials are seemingly artificial, discriminatory or create economic advantages.
Habitat baking and offsets	May constitute state aid if the trading instruments set by the officials are seemingly artificial, discriminatory or create economic advantages. Where payments for credits are dispatched into a fund, from where they are deferred to the creators of beneficial biodiversity outcomes, there is a possibility that this fund-based finance will be regarded as “granted trough state resources”.
Certificates	As such, do not generally constitute state aid if the measure is not taken from states budget, which is usually not the case. If eg., the certificate scheme includes sanctions for omission to buy necessary amount of certificates and suppliers who do not have sufficient amount have to pay a fine to a fund from where those payments are granted forward to the producers to provide them a "guarantee price", such fund-based measure may constitute state aid.
Fiscal transfers	As such, transfer of assets between public authorities is not generally regarded as aid. Such transfer is state aid if it ends up giving advantage for certain undertakings: If a municipality addresses the assets that it has received as central government transfers forward to certain undertakings, the measure is state aid and the municipality is the “aid-official”. If however, the assets received as central government transfers are not delivered forward to undertakings but are rather just used to level the loss of municipals tax incomes, caused by land use restrictions, the measure is presumably not regarded as state aid.

4 When is the Measure which Constitutes State Aid Compatible with Common Market?

4.1 Preface – The Antithesis of Environmental Policy and Competition Policy

According to Article 4 TFEU, the EU shares competence with the Member States in the principal area of environment. Article 193 TFEU provides for the so-called environmental guarantee of the Member States. Pursuant to that, the Member States are allowed to introduce more stringent national policies as long as the measures are compatible with the Treaties and have been notified to the Commission.

According to Articles 34-35 TFEU quantitative restrictions on imports and exports and all measures having equivalent effect are prohibited between Member States. Article 107 TFEU provides the principal prohibition on the use of state aid. The formation of the internal market through realization of the Single European Act (1986) had a crucial influence, since the completion of the internal market and the approaching economic and monetary union required an increasingly effective control of state aid, and such aid could be used to resurrect barriers to trade that had already been dismantled in the integration process.[150]

On the other hand, the environmental exceptions in the Treaty have been invoked to justify these policy measures. Pursuant to Article 36 TFEU "the provisions of Articles 34 and 35 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; *the protection of health and life of humans, animals or plants*; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property". In the case-law of the European Court of Justice, environmental protection has become accepted as a legitimate objective capable of hindering the free movement of goods. The *Danish Bottles* case"[151] was the first case where the Court recognized that *the protection of the environment is a mandatory requirement*, which may limit the application of Article 28 (now 34).[152] In *Bluhme*[153] the Danish Kriminalret decided to refer to the Court the question as to whether Danish legislation complied with Community law. In order to protect an indigenous population of bees in specific areas, a Danish legislative decree provided that only nectar-gathering bees of the

[150] Fifth survey on state aid in the European Union in the manufacturing and certain other sectors. Report from the Commission. COM (97) 170 final, 16 April 1997.

[151] Case 302/86. Judgment of the Court of 20 September 1988. *Commission of the European Communities v Kingdom of Denmark. - Free movement of goods - Containers for beer and soft drinks.* ECR 1988, p. 4607.

[152] In order to protect the environment, Denmark introduced and applied an order which meant that all containers for beer and soft drinks must be returnable, and that the containers must be approved by a National Agency. According to the Court, the mandatory collection system for containers of beer and soft drinks applied in Denmark was justified by a mandatory requirement related to the protection of the environment. Case 302/86, point 7.

[153] Case C-67/97 Criminal proceedings against Ditlev Bluhme [1998] ECR I-08033.

subspecies *Apis mellifera mellifera* (Læsø brown bee) may be kept on the island of Læsø and certain neighbouring islands. Mr Bluhme argued that the Danish legislation hinders the free movement of goods. The Court held that a national legislative measure prohibiting the keeping on an island such as Læsø of any species of bee other than the subspecies Apis mellifera mellifera (Læsø brown bee) must be regarded as justified, under Article 36 of the Treaty, on the ground of the protection of the health and life of animals.[154]

Regardless of the principal prohibition of state aid, the Treaty includes many exemptions in Articles 107(2) and 107(3). Accordingly, certain beneficial aids that foster the function of the common market should be permitted. Hereby the demarcation must be made between artificial aids granted with protectionist aims on the one hand and genuinely justifiable aids, on the other[155]. For instance, aid may be justified by it giving private firms an incentive to invest more in environmental protection or through relieving some firms from a relatively high financial burden in order to enforce a stricter environmental policy overall.

The growth of the importance of environmental protection, as well as the position of environmental arguments as a ground for restriction of trade liberalisation, has followed the general development of EU environmental policy. Especially this has happened after the Treaty of Amsterdam.[156] Additionally, the Charter of *fundamental rights* in the European Union (Article 37) pronounces that "a high level of environmental protection and the improvement of the quality of the environment must be integrated into the policies of the EU and ensured in accordance with the principle of sustainable development". Since according to Article 6 TEU the EU recognises the rights, freedoms and principles set out in the charter has the same legal value as the Treaties, the environmental protection can be seen more as a fundamental right than as a restriction principle for trade liberalisation[157]. It so seems that trade liberalisation no longer takes precedence over the environmental protection in the interpretation of EU law, but they are given more or less equal importance. The question is thus about consolidating these two goals in accordance with the relevant regulation, which will be presented in the following.

[154] Case C-67/97, para 38.

[155] For example, the Commission is aware that almost all new investments in technological developments have an indirect positive effect on the environment and there is a temptation to present normal productive investments as being determined by environmental factors in order to attract state aid (see eg. Commissions decision C34/2000). *Facenna* 2004, p. 253.

[156] *Paunio* 2007, p. 63.

[157] About environmental protection as a fundamental right, see eg. *Paunio* 2007, p. 117-120.

4.2 The Justification Grounds for State Aid

4.2.1 Preface

Though state aid is basically prohibited under Article 107(1), paragraphs 2 and 3 define the exemptions under which aid measures can be authorised. Member States cannot themselves assess the eligibility of aid, but a prior notification procedure is applied. Over the past decades, a lot of secondary legislation and guidelines have emerged in order to give practical guidance as to the application of these exemptions. The rules must evolve to keep pace with economic and technological change, with the emergence of new political priorities, such as the increased emphasis placed on the protection of the environment during the last decade.[158]

Articles 107(2) and (3) enable aid that fosters the growth of the economy, competition and the functioning of the common market, if such effects can be formulated. Regulation also allows aid as an instrument for society politics. The idea is that beneficial aids should be permitted.[159] The European Commission and ultimately the Court of Justice decide whether the aid is compatible with the common market according to the Treaties. The Commission has wide discretion, the exercise of which involves economic and social assessments which must be made in EU context. The Court may primarily only interfere with clear errors concerning the discretion.[160]

4.2.2 Aid compatible as such

According to Article 107(2) the following shall be compatible with the internal market:

(a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;

(b) aid to make good the damage caused by natural disasters or exceptional occurrences;

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division. Five years after the entry into force of the Treaty of Lisbon, the Council, acting on a proposal from the Commission, may adopt a decision repealing this point

Article 107(2) does not seem to have much relevance from an environmental point of view, but at least point (b) may well be relevant for the regulation of the environment. Exemplary is the case of the floods caused by the River Maas in the south-east of the Netherlands, which gave rise

[158] *Buelens–Garnier–Johnson–Meiklejohn* 2007, p. 2.

[159] *Siikavirta* 2007, p. 114.

[160] *Siikavirta* 2007, p. 115.

to aid approved under the natural disaster or exceptional occurrence provision.[161] Also State aid– *Finland Draft Decree of the Council of Ministers on compensation to fishermen for losses caused by seals* (N: o N 102/01), was justified on the ground of the Article 107(2)(b). The purpose of the Draft Decree was to grant aid to fishermen for the catch losses caused in 2000 and 2001 by seals and it embraced partial compensation for proven catch losses, less an amount to be borne by the fisherman[162].

4.2.3 Aid that may be considered compatible

Article 107(3) stipulates that the following may be considered compatible with the internal market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation;

(b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;

(d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Union to an extent that is contrary to the common interest;

(e) such other categories of aid as may be specified by decision of the Council on a proposal from the Commission.

It must be examined to what extend the normal grounds for exemption can be used to make aid compatible. In the light of the integration principle such exemptions should be interpreted

[161] XXIVth Competition Report, point 354.

[162] Pursuant to point 2.9.3. (Aid to make good damage caused by natural disaster or exceptional occurrences) of the guidelines for the examination of state aid to fisheries and aquaculture (OJ C N:o 19, 20.1.2001, p 7): "According to article [107(2)(b) of TFEU], aid to make good damage caused by natural or exceptional occurrences is deemed to be compatible with the common market". Pursuant to Council Directive 92/43/EEC ringed seal and gray seal are protected species. The aid was thus justified on the exception grounds (article 16) of that directive. Accordingly, "provided that there is no satisfactory alternative and the derogation is not detrimental to the maintenance of the populations of the species concerned at a favourable conservation status in their natural range, Member States may derogate from the provisions~ to prevent serious damage, in particular to crops, livestock, forests, fisheries and water and other types of property~". From that aspect, and foremost taking into account the exceptional increase of the seal population, the hunting prohibition of the seals and the size of the damage caused, there was a reason to assume that the aid was meant to compensate the damage caused by natural disaster.

in an environmentally friendly way[163] for the requirements of environmental protection need to be integrated into the definition and implementation of competition policy, particularly in order to promote sustainable development. Two grounds for exemptions are essentially relevant for environmental state aid: Article 107(3)(b)[164] and topmost Article 107(3)(c).[165] It is for Member States to show that the aid benefits the environment.

Even though protection of the environment may seem one of the more legitimate objectives of state aid, there is an immediate potential contradiction with a fundamental principle of environmental policy, i.e. the polluter pays principle (PPP).[166] Accordingly, the PPP is the main rule for achieving a higher level of environmental protection. State aid is in fact the second-best option and may not be an appropriate instrument in the context of PPP for it would relieve the polluter from paying the cost of its pollution[167]. Whilst the polluter pays principle means that polluters should not be relieved of the obligation to pay for their own waste, the Commission has allowed environmental aid in several cases.[168] According to European Council Recommendation exceptions to the PPP may be justified in limited cases where the immediate application of very stringent standards or the imposition of substantial charges is likely to lead to serious economic disturbances and where, in the context of other policies investment affecting environmental protection benefit from aid intended to solve certain industrial, agricultural or regional structural problems.[169] A large number of the environmental measures approved serve the support of renewable energy production, using different aid instruments for

[163] *Jans–Vedder* 2008, p. 295.

[164] The Court held, in the Case 62/87 *Exécutif régional wallon and SA Glaverbel v Commission of the European Communities.* [1988] ECR 1573, para 20 - 22, that "a project may not be described as being of common European interest for the purpose of that Article [107(3)(b)] unless it forms part of transnational European programme supported jointly by a number of governments of the Member States, or arises from concerted action by a number of Member States to combat a common threat such as environmental pollution".

[165] It should be noted that, in assessing aid by Member States in fields other than that of the environment, the environmental effects of aid should be taken into account. Equally, aid for projects which entail disproportionate effects for the environment should be avoided. See Jans–Vedder 2008, p. 295.

[166] *Jacobs* 2004, p. x.

[167] The decision of the Commission (OJ 1993 L 273/51) shows that state aid cannot be given if it conflicts with the polluter pays principle. The Commission concluded that the proposed aid to *Cartiere del Garda* does not meet the "polluter pays principle" contained in the Treaty. The Commission doubted whether the aid was necessary to achieve the desired objective. "The derogations may be applied only if the Commission finds that, if the aid were not granted, market forces alone would not be sufficient to induce the recipients to act in such a way as to achieve one of the objectives pursued".

[168] SEC (2007) 860, para 28. Report on competition policy 2006.

[169] Council Recommendation 75/436 of 3 March 1975, regarding cost allocation and action by public authorities on environmental matters. (OJ L 194, 25.7.1975, p. 1 - 4).

that purpose, mostly investment aid and operating aid in the form of tax reductions or feed-in tariffs[170].

The PPP is based on the assumption that market failure[171] may be avoided if individuals are required to incur the full costs of their actions, including any negative externalities their actions may impose on the community through environmental damage and biodiversity loss.[172] Under PPP, impacters are required to contribute to the costs of activities that improve biodiversity or prevent biodiversity damage in proportion to their impacts on biodiversity. Environmental aid to assist undertakings just to comply with valid EU standards cannot thus be authorised, for such aid would not lead to a higher level of environmental protection[173]. Neither is state aid granted to farmers for simply respecting - or not meeting - an obligation to keep all agricultural land in good agricultural and environmental condition.[174]

However, there are limits on the application of the PPP and some environmental costs are not fully reflected in the prices, because adequate standards do not exist. This regulatory failure should not prevent Member States from reducing negative externalities to the greatest extent possible and from imposing requirements for environmental protection that go beyond EU requirements. By lowering the burden on undertakings, state aid may be an appropriate instrument in helping Member States to adopt national environmental regulation that goes beyond EU standards. When environmental protection is unsatisfactory, state aid may also provide positive incentives for undertakings to carry out non-mandatory activities.[175]

4.3 Exemption from the Obligation of Notification

In addition to aid approved without notification on the basis that it fits within an already notified general aid scheme, the Commission may exempt some categories of state aid from the obligation of notification. These *General block exemptions (GBER)*[176] simplify the EU regulations. In order to be exempted from the obligation to notify, the categories of aid concerned must

[170] See for example: NN162/A/2003 and N317/A/2006, *Austria, support of electricity production from renewable sources under the Green Electricity Act (feed-in tariffs)* (OJ C 221, 14.9.2006, p 9), NN162/B/2003 and NN317/B/2006, *Austria, support of CHP production under the Green Electricity Act (support tariff)* (OJ C 221, 14.9.2006, p 9).

[171] When individuals do not bear the full cost of their decisions, resources are misallocated and market failure occurs.

[172] *Arentino et al.* 2001, p 15.

[173] Community Guidelines on State Aid for Environmental Protection (OJ 2008 C 82/1).

[174] (EC) No 1782/2003.

[175] Community Guidelines on State Aid for Environmental Protection, OJ C 82, 1.4.2008, p. 4 - 7.

[176] Commission Regulation (EC) No 800/2008 (6.8.2008) declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation). (OJ L 214).

conform to all the conditions (specifically they must have an incentive effect and conform to transparency criteria) and the relevant provisions (intensity of the aid, eligible costs, maximum amount of aid) listed in detail in this particular regulation (EC) No 800/2008. The GBER authorizes the following aid types: aid in favor of small and medium-sized undertakings (SMEs), aid for research and innovation, regional development aid, training aid, employment aid, aid in the form of risk capital, environmental aid[177], and aid promoting entrepreneurship.[178]

Another exemption from obligation of notification is the so-called *de minimis* rule.[179] The *de minimis* rule was introduced in order to exempt small aid amounts[180]. It sets a ceiling below which aid is deemed not to fall within the scope of Article 107(1) and is therefore exempt from the notification requirement. According to the *de minimis* rule, an aid of no more than EUR 200 000 (EUR 100 000 in the road and transport sector) granted over a period of three fiscal years is not regarded as state aid within the meaning of Article 107(1)[181]. In order to avoid circumvention of maximum aid intensities provided in different Community instruments, *de minimis* aid should not be cumulated with state aid in respect of the same eligible costs if such accumulation would result in an aid intensity exceeding that fixed in the specific circumstances of each case by a Block Exemption Regulation or Decision adopted by the Commission. This Regulation should apply only to transparent aid, for which it is possible to calculate precisely the gross grant equivalent *ex ante* without a need to undertake risk assessment. Such precise calculation can, for instance, be realised as regards grants, interest rate subsidies and capped tax exemptions.[182]

In view of the special rules, which apply in the agriculture sector and of the risks that even low levels of aid could fulfill the criteria of Article 107(1) of the Treaty in that sector, the primary

[177] Accordingly, in some cases, investment aid enabling undertakings to go beyond Community standards for environmental protection or increase the level of environmental protection in the absence of Community standards; aid for acquisition of new transport vehicles which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards; aid for early adaptation to future Community standards for SMEs; investment aid for energy saving measures; investment aid or high-efficiency cogeneration; investment aid for the promotion of energy from renewable energy sources; aid for environmental studies; and aid in the form of reductions in environmental taxes do not need to be notified. However, any such aid needs to be notified if it exceeds the individual notification thresholds of EUR 7.5 million per undertaking per investment project. Similarly, if the conditions of the GBER are not fulfilled, aid also needs to be notified and will be assessed on the basis of the Guidelines.

[178] See closer about the eligible cost etc in (EC) No 800/2008.

[179] (EC) No 1998/2006 (15.12.2006) on the application of Articles 87 and 88 of the Treaty to de minimis aid. (OJ L 379).

[180] The idea of state aid regulation is that injurious aids must be banned. Small aids are not regarded to have an adverse effect on the competition and trade.

[181] When an overall aid amount provided under an aid measure exceeds this ceiling, that aid amount cannot benefit from this Regulation even for a fraction not exceeding that ceiling.

[182] (EC) No 1998/2006 (15.12.2006), points 11-13.

production of agricultural products are excluded from the general *de minimis* regulation.[183] Pursuant to Regulation (EC) No 1535/2007[184] the maximum non-aid amount in the agriculture sector is EUR 7500 per beneficiary over a period of three fiscal years and the ceiling of annual output is 0,75%.

The forestry sector has its "own" guidelines[185] according to which the forest sector can benefit from aid granted under the *de minimis* regulation applicable to industrial activities. However, pursuant to aforementioned regulation (EC) No 1535/2007 undertakings active in the primary production of trees and other plants would seem to be excluded from the general *de minimis* regulation[186] and environmental conservation tasks executed under primary production of forests would seem to be left under the scope of (EC) No 1535/2007 and the maximum non-aid ceiling of EUR 7500. Yet, the Court[187] has held that "the aid to the forestry holdings is aimed at a sector, forestry sector, which is not included in the list of agricultural products in Annex II[188] to the Treaty and therefore does not relate to an agricultural product within the meaning of Article 38[189] of the Treaty".[190] Thus, the crucial question seems to be whether environmental conservation tasks in forests are forestry or not. For the Commission has held that the land use of a farmer is too interconnected to create a separation into different functions, such as environmental services and forestry[191], it seems that environmental conservation in forests is to be held forestry, and the general *de minimis* rule applies.

[183] Also aid for fisheries and aquaculture, export-related activities, the coal sector, the acquisition of road freight transport vehicles or firms in difficulty, or to aid tied to the use of domestic over imported goods are excluded from Regulation (EC) No 1998/2006.

[184] (EC) No 1535/2007 on the application of Articles 87 and 88 of the EC Treaty to de minimis aid in the sector of agricultural production.

[185] Chapter VII of the Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013 (OJ C 319, 27.12.2006).

[186] According to article 2 of (EC) No 1535/2007. "undertakings in the sector of agricultural production" means undertakings active in the primary production of agricultural products and "agricultural products" means the products listed in Annex I to the Treaty, which includes live trees and other plants (in Chapter 6).

[187] Joined Cases C-346/03 and C-529/03 [2006] State aid - Decision 97/612/EC - Preferential loans in favour of agricultural undertakings - Article 92(2)(b) and (3)(a) and (c) of the EC Treaty (now, after amendment, Article 87(2)(b) and (3)(a) and (c) EC) - Admissibility - Legal basis - Legitimate expectations. ECR I-1928.

[188] Now Annex I, which includes eg. live trees and other plants.

[189] Article 38, according to which the Union shall define and implement a common agriculture and fisheries policy. The internal market shall extend to agriculture, fisheries and trade in agricultural products. 'Agricultural products' means the products of the soil, of stockfarming and of fisheries and products of first-stage processing directly related to these products. References to the common agricultural policy or to agriculture, and the use of the term 'agricultural', shall be understood as also referring to fisheries, having regard to the specific characteristics of this sector.

[190] Joined Cases C-346/03 and C-529/03, para 43.

[191] See closer Chapter 5.2. of this study: *Case of Netherlands*.

4.4 Guidelines

According to State Aid Action Plan the compatibility of state aid is fundamentally about balancing the negative effects of aid on competition with its positive effects in terms of advancing a common interest[192]. In balancing the positive impact of the aid measure against the potentially negative side effects, the Commission has to consider whether the *aid measure is aimed at a well-defined objective of common interest* (here: the protection of biodiversity) and whether the proposed *aid address the market failure or other objective*. This includes deliberating whether the state *aid is an appropriate policy instrument*, whether *it has an incentive effect* in changing the behaviour of undertakings, and whether *the aid measure is proportional* -or could the change in behaviour be obtained with less aid. Finally, the Commission has to estimate whether the distortions of competition and effect on trade is so limited that the *overall balance is positive*.[193] The duration of aid schemes should be subject to reasonable time limits. However, Member States have a possibility to re-notify a measure after the time limit has passed. Member States may also support notifications of aid measures by rigorous evaluations of similar past aid measures demonstrating the incentive effect of the aid.[194]

While the principles put forward in the Action Plan apply to all sectors, the Commission has issued several regulations, guidelines and notifications which more specifically define the grounds for acceptabitility of the exceptions laid down in Article 107(3) TFEU. Besides the already mentioned general block exceptions and *de minimis* regulation, the most important rules in the view of biodiversity conservation are the Community Guidelines on State Aid for Environmental Protection (hereinafter environmental aid guidelines)[195] and Community Guidelines for State Aid in the Agriculture and Forestry Sector (hereinafter agriculture and forestry aid guidelines)[196].[197] Since conservation tasks may sometimes be seen as public services, also the Community framework[198] considering public service compensation may apply.

The environmental aid guidelines function on the basis of Article 107(3)(c) and the exemption provided for in Article 107(3)(b). In these guidelines the Commission has identified a series of measures in respect of which it considers *a priori* that state aid will address a market failure

[192] If state aid on the basis of *balancing test* leads to increased environmental protection activities without adversely affecting trading conditions contrary to the common interest, it is compatible with the common market within the meaning of Article 107(3)(c).

[193] State Aid Action Plan—Less and better targeted state aid: a roadmap for state aid reform 2005-2009. COM(2005) 107 final, point 10-12.

[194] Community Guidelines on State Aid for Environmental Protection, point 71.

[195] Community Guidelines on State Aid for Environmental Protection (OJ 2008 C 82/1).

[196] Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013 (OJ C 319, 27.12.2006).

[197] See also Guidelines for the examination of State aid to fisheries and aquaculture OJ C 84/06 2008.

[198] Community Framework for state aid in the form of public service compensation (OJ C 297 29.11.2005).

hampering environmental protection or improve on the level of environmental protection. Measures that are targeted at environmental protection, but are not covered by environmental aid guidelines or a general block exemption regulation, as well as certain remarkable aid amounts, will be subject to a detailed assessment according to chapter five of the environmental aid guidelines. These measures will be declared compatible if the balancing test results in an overall positive evaluation.[199] As a result of this detailed assessment, the Commission may approve the aid, declare it incompatible with the common market or take a compatibility decision subject to conditions.[200] The environmental aid guidelines apply to state aid for environmental protection in all sectors governed by the EU Treaty. They also apply, unless otherwise disposed, to those sectors which are subject to specific EU rules on state aid. Hence, the environmental aid guidelines, also apply to the agriculture sector[201] and to the forestry sector. In the forestry sector though, the use should be limited to authorizing additional state support for forestry, promoting the ecological, protective and recreational functions of forests.[202]

The agriculture and forestry aid guidelines apply to all state aid granted in connection with activities related to the production, processing and marketing of agricultural products[203]. The guidelines describe the main types of aid, which the Commission can accept and the conditions attaching to the granting of the aid. Chapter VII of the agriculture and forestry aid guidelines contains rules for aids for the forestry sector, including aids for the afforestation of agricultural land. Pursuant to that chapter it is an established Commission practice to authorize state aid for conservation, improvement, development and maintenance of forests on account of the ecological, protective and recreational functions of forest. Traditionally the Commission has accepted state aid up to 100 % of eligible costs for measures promoting the maintenance of the forest environment.[204]

[199] Additional scrutiny is necessary, because of higher risks of distortion of competition and trade. The additional scrutiny will generally consist in further and more detailed factual analysis of the measure in accordance with chapter 5. Community Guidelines on State Aid for Environmental Protection, para 40.

[200] Guidelines are given for two types of assessments: a standard assessment for measures involving aid under a certain threshold or aid granted to installations with a production capacity below a certain threshold (Chapter 3) and a detailed assessment for measures involving aid above that threshold or aid granted to installations with a production capacity above that threshold as well as for aid granted to new plants producing renewable energy where the aid amount is based on a calculation of the external costs avoided (Chapter 5), para 13.

[201] Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013, points 49, 61-63.

[202] Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013, point 174a.

[203] See the Annex I of the Treaty.

[204] Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013, point 173.

5 Commission's Decisions

5.1 Introduction

The Commission is bound by the guidelines and notices that it issues in the area of supervision of state aid where they do not depart from the rules in the Treaty and are accepted by the Member States. [205] Yet the Commission has a wide discretion, the exercise of which involves economic and social assessments. As mentioned before, Article 107(1) defines aid in relation to its effects. Consequently, the used measure is not pivotal and the state aid rules seem to be quite neutral regarding the form in which the aid is awarded. However, different instruments are conventionally used for different kind of nature and biodiversity conservation activities. Next, examples on a few of the more important biodiversity conservation measures will be presented. By reviewing Commission practice, the aim is to form an overall perception on what kind of state aid challenges these conservation measures may need to deal with.

5.2 Conservation Areas

5.2.1 Purchase of Land

Nature conservation areas are the most conventional way to preserve biodiversity values. In addition to expropriation, states may procure land for conservation purposes on a voluntary basis. If a landowner wishes to establish a private conservation area in his forest, he will be paid for the economic loss based on the intrinsic value of the timber in the area. When a landowner sells the land to the state, the price will be set based on the intrinsic value of the timber and the sub grade. The pricing methods are the same as those used in the forestry land and in the sales of properties. The costs of timber production are taken into account in pricing. Luxuriant sub grades, such as groves, are valued higher than unproductive sub grades.[206]

The sales of land between private and public authority may include an element of state aid in favor of the private party. With regard to the problem of state aid through sales of land and buildings by public authorities, the Commission has drawn up general guidance to Member States in order to make its general approach transparent and to reduce the number of cases it has to examine.[207] Even though the guidance concerns only the sales of land and buildings by public authorities, the principle of forbidden state aid is equally applied on over-pricing of the

[205] Case C-351/98 *Kingdom of Spain v Commission of the European Communities* [2002] ECR I-8031, para 76.

[206] METSO Uutiskirje 1/2011. Available at: http://www.metsonpolku.fi/metso/uutiskirje/2011/1/fi/rahajuttu.php. Last visited in 30.3.2011.

[207] Commission Communication on State aid elements in sales of land and buildings by public authorities (OJ) C 209, 10.7.1997, p. 3-5. The Guidance describes a simple procedure that allows Member States to handle sales of land and buildings in a way that automatically precludes the existence of State aid and specifies clearly cases of sales of land and buildings that should be notified to the Commission to allow for assessment of whether or not a certain transaction contains aid and, if so, whether or not the aid is compatible with the common market.

purchase of land by public authorities[208]. According to Commission`s decision N 657/1999 "the acquisition and development of land and buildings are addressed in part by the EC public procurement directives[209], which, if satisfied, generally eliminate state aid from the transactions."[210] According to the public procurement regulation the awarded contract should be either the most financially advantageous tender or the lowest price. If the contract is awarded on the basis of the most financially advantageous tender, tenders are compared against the predescribed criteria.

To escape the classification as state aid the purchase of the land has to be in conformity with *the market economy investor principle* (*MEIP)*. Accordingly, when a public authority invests on terms and in conditions which would be acceptable to a private investor operating under normal market economy conditions, the investment is not a state aid. The MEIP is a construction, a test of what the Treaty means by "favour" in Article 107(1).[211] Pursuant to that, the purchase of the properties has to be done under market conditions.[212]

Also, when the state arranges an open auction where it invites landowners to make offers of biodiversically rich land areas and then selects the overall economically most advantageous offer, the purchase seems to be done under market conditions. In this case the state is able to take into account the biodiversity richness as one selection criteria in weighing the option that best suits its needs, since any market investor in principle has the same right. Fixing up an open auction would seem to be quite strong proof that the public authority is seeking to avoid the possibility of state aid. Hence, in so far as land is bought at the highest price, which a private investor acting under normal competitive conditions is ready to pay in the same situation, the purchase complies with the market economy investor principle and therefore does not constitute state aid.[213]

If the public authority however pays "extra" on top of the market value, the purchase most likely constitutes state aid. According to the detailed assessment of environmental aid guidelines, in order to be compatible with the common market, the state aid has to: induce undertakings to pursue environmental protection which they would not otherwise have pursued, be targeted at a market failure by having a substantial impact on environmental protection, be an appropriate

[208] See State Aid C 37/2004 Finland – Alleged Aid to Componenta.

[209] See closer at: http://ec.europa.eu/internal_market/publicprocurement/legislation_en.htm.

[210] State aid No N 657/1999 – UNITED KINGDOM Business Infrastructure Development, p. 4.

[211] The Market Economy Investor Principle has been a cornerstone of state aid control ever since the Commission published its communication on Government Capital Injections (Bulletin EC 9-1984). *Ben Slocock, Directorate-General Competition*: The Market Economy Investor Principle. Competition Policy Newsletter. Number 2—June 2002, p. 23-26.

[212] See eg. State Aid C 12/2009 (ex N 19/2009) – Potential aid measures in favour of Järvi-Suomen Portti Osuuskunta, paras 28-29.

[213] The interpretation is partly based on communcation with *Julius Parikka*, November 2010.

instrument to obtain the objective of environmental protection, result in the recipient changing its behaviour to increase the level of environmental protection, be necessary, be kept to the minimum amount and go through a proportional selection process. In addition, the Commission will assess the likelihood that the beneficiary will be able to increase or maintain sales as a result of the aid.[214]

Even if the state aid improves environmental protection, it is yet quite challenging for any "over-valuation" to pass the balance test in the assessment of the Commission, since its established practice is to only compensate for the revenue losses and additional costs.[215] It would thus seem illogical to accept "trade of nature values". It might also be hard to provide evidence of necessity of the aid, since at least in principle, the possibility for expropriation exists, too. Nevertheless, the state aid rules do introduce uncertainty, with it only being possible to obtain certainty through state aid notification to the Commission[216].

The aid may also be granted as tax relief (as an exception to the tax system). For example, in Finland, according to the Income Tax Act,[217] profit gained from assignment of one`s real estate is not taxable income when taxpayer assigns it to the state, or commercial enterprise of the state, to be used as a natural conservation area consistent to the definition in Natural Conservation Act (Luonnonsuojelulaki 1096/1996).[218] The main criterion in applying state aid to a tax measure is that the measure provides an advantage in favor of certain undertakings in the Member State. If so, it must then be examined whether the exception to the system or differentiations within the system, is justified by the nature or general scheme of the tax system. If this is not the case, then the tax relief might be considered state aid. [219] The application of state aid rules to taxation presents particular difficulties, as distinguishing between them and general measures of economic policy may be rather obscure[220]. According to Advocate General Darmon, "The only fundamental precondition for the application of Article [107(1)] is that the measure should constitute a derogation by virtue of its actual nature, from the scheme of the general system in which it is set"[221]. This particular tax exception could well involve aid as it constitutes a derogation from the ordinary rules relating to income taxes, in favor of

[214] Community Guidelines on State Aid for Environmental Protection, points 165-185.

[215] See eg. "Payments for environmental services" below (in chapter 5.2.).

[216] If the compensation for natural values was included in the agri-environmental state aid payments it could also be more justifiable to accept similar aid measures for land procurement.

[217] Tuloverolaki 30.12.1992/1535, 48.4 §.

[218] According to the same point, profit gained from land exchange, when the assingned land is used as a natural conservation area, is neither taxable income of the taxpayer.

[219] Commission notice on the application of the State aid rules to measures relating to direct business taxation. OJ 1998 C384/3, para 16.

[220] *Quicley*, C: The Notion on State Aid in the EEC, 13 ELRev (1988) 243 at 245.

[221] Opinion of Advocate General Darmon, [1993] ECR I-887, para 50.

landowners whose activity on this land is mainly in the primary production of forest.[222] Yet, there is no discretion on the part of the tax authority. This would speak in favor of a general measure, as it applies to all taxpayers who assign their real-estate to the state, or commercial enterprise of the state, to be used as a natural conservation area.

Assuming the advantage is given through exemption from income taxation, it constitutes state aid if it distorts competition and affects trade between Member States. As practically all aid distorts competition it is up to the criterion of affecting trade between the Member States whether the measure in question is state aid within the meaning of Article 107(1). As stated above, this criterion is met when an undertaking trades cross-border or when the sector extends from one Member State to another, which is usually the case with forestry sector.

It is most probable that the aforementioned tax relief is to be held as a general scheme, and even if it was state aid within the meaning of Article 107(1), it could still be viewed as so-called "existing aid", which the state aid rules treat differently from aid granted after a Member State signs up. Also, the original basis for the tax relief, The Income Tax Act (Tuloverolaki), was in force already before Finland joined the European Union in 1995. The difference is that existing aid is presumed lawful unless the Commission challenges it.[223]

5.2.1 Services of General Economic Interest (SGEI)

Making the demarcation between compensation of public service and market investment is sometimes difficult. The interpretative guidance ability of the market investor principle is so imperfect that it does not seem to apply to cases where no private market actor exists, for in such cases there is no natural parallel to evaluate the market terms of the measure against.[224] It is also worth noting that nature conservation is never based purely on commercial consideration, but there is also a constitutional dimension in all environmental issues. In situations where a public undertaking takes care of the services of general economic interest "normal market terms" are inevitably hypothetical.

The state aid programme *NN 8/2009 – Germany Nature Conservation Areas* consisted of the gratituitous transfer of federally-owned natural heritage sites and the funding of large-scale nature conservation projects. Pursuant to the description of the scheme, valuable natural

[222] Comparably to the case *Adria-Wien Pipeline GmbH*, where the Court of Justice found that the measure is selective for the tax exemption was applied only for undertakings whose activity is mainly in the manufacturing sector. See closer in chapter 3.2.2.

[223] The following might also be considered analogically applicable to the sales of forestry land: Pursuant to point 175(g) of the guidelines for state aid in agriculture and forestry sector, "the Commission will declare state aid up to 100 % compatible with article 107(3)(c) of the Treaty for the costs of purchase of forestry land used or to be used as nature protection areas".

[224] *Raitio* 2008, p 861.

heritage sites existed on federally-owned land in Germany. However, due to budgetary constraints the German authorities found it increasingly difficult to finance the long-term upkeep and development of these areas wherefore they needed to be transferred to ensure their proper upkeep. Experience gathered had shown that, where such areas were sold to private individuals, their naturalistic value was significantly degraded over the years. Besides, nature conservation organizations did not have the financial means to purchase the federally-owned land and to pay for follow-on costs.

Germany therefore decided not to sell the areas concerned, but to transfer responsibility for the conservation of these areas of outstanding naturalistic value to the Länder and the Deutsche Bundesstiftung Umwelt (DBU, German Environment Foundation). The Länder were entitled to further transfer these areas gratuitously to nature conservation organizations. While ownership of the land was transferred to the recipients free of charge, all other costs related to the transfer (for example surveying costs and taxes) as well as maintenance costs and inherited pollution risks were borne by the recipients of the areas. The federal programme for the establishment and protection of valuable natural areas and landscapes of national importance, aimed to finance projects on conservation of landscapes and natural heritage sites. The main aim of the measures was the maintenance of biodiversity.[225]

In its assessment the Commission held that the nature conservation entities were undertakings[226] and that the measures constituted state aid[227]. The Commission considered that a necessary precondition for qualifying a measure as a service of general economic interest (SGEI) is that it genuinely serves the interest of citizens. The conservation tasks entrusted by Germany to the nature conservation entities pursued objectives, which were in the interest of society as a whole, namely the preservation of intact habitats of outstanding naturalistic value for future generations. These tasks, which can be construed as services rendered to all citizens, clearly fall within the remit of the state acting as public authority, which however may find it appropriate to entrust them to other entities, for example for budgetary reasons. "In that sense, the scheme differs from a classical environmental aid measure: in the latter case the activities which are beneficial for the environment cannot be carried out by the state, but can only be carried out by undertakings on a voluntary basis". Therefore, the Commission accepted that the conservation tasks at issue constituted services of general interest. The Commission assessed

[225] NN 8/2009, points 8-17.

[226] "According to settled case-law, any activity consisting in supplying goods or services on a given market is an economic activity. The Commission considers that, in the case at hand, activities like sales of wood, leases of land and tourism must be classified as economic in nature. The German nature conservation entities concerned by the notified measures should therefore be considered as undertakings within the meaning of Article 107(1) of the EC Treaty insofar as they exercise these activities", point 41.

[227] NN 8/2009, points 43-52.

the compatibility of the aid on the basis of the post-Altmark package[228] and concluded that the measure was compatible with the common market.

The separation between the tasks of the scheme and a classical environmental aid measure seems rather artificial, since the ownership of the land was transferred to the recipients. However, as will become evident, the agrarian function of a farmer's land cannot be disconnected from its recreational or natural functions. Hence, the agri-environmental aid measures have to be assessed under the agriculture and forestry aid guidelines (not on the basis of the post-Altmark package).

5.3 Payments for Environmental Services

5.3.1 The Case of Finland

As strictly protected areas have been fiercely resisted by landowners, and as they do not provide for spatial continuity, nor alone capable of ensuring conservation of biodiversity, it is necessary to combine biodiversity protection with other resource use, such as forestry.[229]

The Southern Finland Forest Biodiversity Programme (METSO), launched in 2002, introduced two new economic conservation instruments: nature values trading and bidding competition. They were based on voluntarism in offering sites and negotiations on payments for conservation. The METSO nature values trading produced mainly ten year contracts where compensation was paid for loss in forest income, and to some degree, based on the biodiversity values of the sites.[230] The bidding competition was used to attract landowners whose lands hosted certain biodiversity values. They led through negotiations, mostly to permanent conservation or land purchase. The compensation or payment for these conservation contracts were tied either only to the potential forest revenue, or to that potential and to the conservation value (i.e. decayed wood, large aspen trees and such environmentally valuable elements have “a price tag”).[231]

These measures were in line with Article 107(3)(c) TFEU under the previous guidelines on state aid for agriculture sector, pursuant to which "the Commission takes a favorable view of aid schemes which are intended to provide technical support in the agricultural sector. Such soft aids improve the efficiency and professionalism of agriculture in the Community, and thus

[228] Public service compensation which cannot be qualified as non-aid on the basis of the Altmark criteria may, however, be found compatible if it complies with the conditions laid down in the Community Framework for state aid in the form of public service compensation. Community Framework for state aid in the form of public service compensation (OJ C 297 29.11.2005).

[229] *Wolf – Primmer* 2006, p 845.

[230] *Paloniemi–Varho* 2009.

[231] *Horne* 2006, p. 171.

contribute to its long-term viability while producing only very limited effects on competition. Aid may therefore be granted at a rate of up to 100 % of costs to cover activities such as-- activities for the dissemination of knowledge relating to new techniques, such as reasonable small scale pilot projects or demonstration projects".[232]

Since new guidelines on state aid for agriculture and forestry became effective in 2007, this also caused changes on the aid measures within METSO program[233]. The following Commission decision assesses the compatibility of biodiversity conservation measures in a current state aid practice. *State aid No N 130a/2007 – Finland - Aid for forestry* involved maintaining and restoring ecological, protective and recreational functions of forests, biodiversity and healthy forest ecosystems. The Finnish authorities affirmed that grants are discretionary and granted only for schemes that are significant for biodiversity preservation, aid can never exceed 100% of the actual costs of the conservation and the authorities monitor that aid amounts too high will not be paid. The aid will only be granted for tasks that commence after Commission approval.[234]

The Commission considered that the aid had an incentive effect and examined it against the background of Chapter VII of the Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013[235]. The aid scheme included plenty of measures, many of which were not related to biodiversity conservation, but other forest functions.

*Environmental aid*according to § 16 of *Law on financing sustainable forestry* [236], which is the legal national basis of the aid scheme, may be granted for commitments to improve biodiversity in forests. These commitments last for 10 years and beneficiaries have to go beyond the mandatory regulation. Such aid was regarded as being in accordance with point 176 of the guidelines. Pursuant to that point, actions are compatible with Article 107(3)(c) of the Treaty if the aid meets conditions laid down in Article 47 of Regulation (EC) No 1698/2005. Accordingly,

[232] Community Guidelines for State Aid in the Agriculture Sector (OJ C 28 1.2.2000), point 14.1. Pursuant to the new guidelines Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013 (OJ C 319, 27.12.2006) "aid granted for private landowners for pilot and demonstration projects connected to sustainable use of forests will now be authorised if the aid fulfils the conditions set out in point 107 of the guidelines. Accordingly, the Commission will examine such activities on a case by case basis and the Member State shall provide a clear description of the project including an explanation of the novel character of the project and of the public interest in granting support for it (for example because it has not been tested before) and demonstrate that the number of participating companies and the duration of the pilot scheme shall be limited to what is necessary for proper testing, the combined amount of aid for such projects granted to a company shall not exceed EUR 100 000 over three fiscal years, the results of the pilot scheme shall be made publicly available and that any other condition the Commission may deem necessary to avoid the scheme having a distorting effect on the market or amounting to operating aid".

[233] A new METSO programme 2009-2016 institutionalizes voluntary site allocation and a possibility to make fixed term conservation contracts.

[234] N 130a/2007, paras 9-12.

[235] N 130a/2007, paras 29-31.

[236] Law and decree on finance for sustainable forestry (Laki ja asetus kestävän metsätalouden rahoituksesta).

"payments shall be granted to beneficiaries who make forest-environmental commitments on a voluntary basis. These payments shall cover only those commitments going beyond the relevant mandatory requirements and shall be undertaken for a period between five and seven years. Where necessary and justified, a longer period shall be determined in for particular types of commitments. The payments shall cover additional costs and income foregone resulting from the commitment made. Support shall be fixed between 40 and 200 Euros per hectare"[237].[238]

Conservation value -based payments are no longer granted. Instead, the Commission will only authorise state aid for additional costs and income foregone. Whereas in the pilot phase the compensation or payment for conservation contract was tied either only to the potential of forest revenue, or to that potential and to the conservation value, the compensation is now based only on the market value of the timber in the area to be protected[239]. Aid exceeding the amounts fixed in the Annex to Regulation (EC) No 1698/2005 can in principle only be declared compatible with Article 107(3)(c) of the Treaty, if granted for demonstrated additional costs and/or income foregone, in exceptional cases taking into account specific circumstances to be duly justified, in favour of commitments which lead to a demonstrable and significant positive effect on the environment.[240]

The Finnish authorities grant payments per contracted hectare of forest to beneficiaries who make forest-environmental commitments that go beyond the relevant mandatory requirements on a voluntary basis. However, the duration of these commitments is 10 years and the payment exceeds the maximum amount of 200 Euros in some cases. Since Finland`s forests are located in a subarctic area where the nature renews slowly, the populations of flora and fauna need enough time to recover. The Commission therefore assessed that only longer-lasting measures have a positive effect on biodiversity and approved the exceptional contract period of ten years. The payments may cover additional costs and income foregone resulting from the commitments made. On ground of a calculation made by the Finnish authorities, some areas in Southern Finland have such high income value that the aid amount exceeds 200 Euros per year. The Commission considered that the limit of 200 Euros is exceeded only in some areas which are proved to be exceptionally valuable in biodiversity and the compensation is based on actual income forgone. It is also required that such commitments would not be made on normal payment level. Hence, in such special situations caused by exceptional circumstances aid amounts exceeding 200 Euros per hectare may exceptionally be accepted.[241]

Pursuant to point 175(d) of the Guidelines state aid for restoration and maintenance of natural pathways, landscape elements and features and the natural habitat for animals, including

[237] (EC) No 1698/2005, article 47 & ANNEX.

[238] N 130a/2007, paras 48-49.

[239] N 130a/2007, para 20

[240] Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013, point 177.

[241] N 130a/2007, paras 50-52.

planning costs, is compatible with Article 107(3)(c) TFEU. Aid can be accepted up to 100% of eligible costs. Thus, aid meant for biodiversity preservation in committed areas is compatible up to 100% of eligible costs and may be granted by the Finnish authorities.[242]

5.3.2 The Case of Netherlands

The Netherlands case-study uncovers both resources and barriers for establishing new agri-environmental schemes. Accordingly, two local nongovernmental nature and landscape organizations and a local agricultural nature association took the initiative to involve farmers in the management of the countryside to sustain the mixed landscape of cultural and natural grounds. Financial means were considered necessary to pay for their activities. Instead of working with a fixed set of measures, as in the traditional agri-environmental schemes, the initiative was intended to draw up "custom-made contracts" based on market-based prices. The introduction of the concept of green services (GS) reframed the maintenance of landscape and nature, from a bad external circumstance into a desirable social demand. Instead of compensating these activities as additional labor costs, they should be rewarded with a market-related price. [243]

The initiative was included in a pilot project by the Ministry of Agriculture, Nature and Food (MANF), which supported and facilitated bottom-up initiatives that sustained the quality of the rural landscape. However, the European Commission stated that market-based payments to farmers granted by governments would be considered market distortion and therefore would not be allowed. Instead, payments could be based only on the loss of revenues and additional labor costs. These requirements could not be changed because of international agreements[244]. [245]

Hence, to make certain that the pilot projects would meet the EU state aid requirements for farmers, the MANF required that the GS projects would be notified to and approved by the Commission. Farmers could be paid only on the basis of a loss of revenues and additional labor costs and those contracts could be drawn up for a maximum period of six years. As contracts can be drawn up only for activities that "go beyond what is legally obliged" and the definition of what is legally obliged changes as rules are updated, contract periods could not exceed this period.[246]

[242] N 130a/2007, paras 50-54.

[243] *Zwaan–Goverde* 2010, p. 771-772.

[244] WTO trade agreements.

[245] *Zwaan–Goverde* 2010, p. 772-773.

[246] *Zwaan–Goverde* 2010, p, 774.

These requirements were not readily accepted by all local or regional actors involved in the pilot programme, because they wanted to work on the basis of market-based prices and to increase the duration of the contracts up to ten years. Therefore, the actors contracted a private consultancy office which advised that they should qualify the GSs as "services of general interest" (SGEI) that would meet the so-called "Altmark" criteria. The consultancy office suggested that the agrarian function of a farmer's land would be disconnected from its recreational or natural functions. By separating these functions it would become possible to bypass the EU state aid requirements for farmers as farmers would not carry out any agrarian activities on this recreational or natural land, and would formally only be a landowner of the recreational or natural land. By using this construction, GSs could be qualified as services of general interest, to which the state aid requirement for farmers would not apply. In addition, the suggestion was made to establish a "landscape fund" that would be entrusted in the care of independent actors who could draw up the contracts with farmers for these GSs. The landscape fund would be "filled" with both public and private money from local businesses or profits from building projects. Governmental contributions were considered to be important especially at the start of the fund to cover overhead costs.[247]

The European Commission however, stressed that payments had to be based on a "loss of revenues and additional labor costs" and argued that the land use of a farmer is too interconnected to create a separation into different functions. It would be impossible, for example, for the Commission to check whether a farmer leaves a piece of land fallow for bird breeding, or whether this allows him to access his arable land more easily.[248] In its decision on *state aid programme NN 8/2009 – Germany Nature conservation areas* the Commission also stated, that if Member States define services of general economic interest for sectors of the economy which have been the object of harmonisation measures at EU level, then these services must be reviewed with special care in order to avoid inconsistencies. Since the forest sector is harmonised and state aid for forestry is subject to the "Community guidelines for state aid in the agriculture and forestry sector 2007 to 2013", the Commission first examines whether the agriculture and forestry guidelines are applicable to the case at hand. The agriculture and forestry aid guidelines apply to all state aid granted in connection with activities related to the production, processing and marketing of agricultural products[249] and under them state aid is permitted to support the ecological, protective and recreational functions of forests.[250] That being the case, the agri-environmental aid measures in question were assessed under the Agriculture and Forestry Guidelines.

[247] *Zwaan–Goverde* 2010, p, 774.

[248] *Zwaan–Goverde* 2010, p. 776.

[249] See the Annex I of the Treaty.

[250] NN 8/2009 – *Germany Nature conservation areas*, point 59.

If the landowner gave up all the forestry in his land (i.e. gave up the production, processing and marketing of agricultural products) and thus became only a landowner of recreational or natural land, was it logical that he could then, by fostering naturalistic values for future generations, start producing services of general economic interest (SGEI)? Also, if certain areas in landowners land were already protected by law, would the silvicultural tasks in these areas serve objectives that are in the interests of society as a whole? For example, the tasks in favour of Habitat Types, which are of great value for future generations, increase the *public goods*[251] which fall within the remit of the state acting as public authority. When Member States enjoy a wide margin of discretion when deciding whether and in what way to finance the provision of services of general economic interest[252] they should really take maximumadvantage of that. At least the possibility to produce SGEI also in private natural (forestry-free) lands should be thoroughly investigated.

5.3.3 Summary

As the agriculture and forestry aid guidelines apply to all state aid granted in connection with activities related to the production, processing and marketing of agricultural products,[253] the payments granted to beneficiaries who make forest-environmental commitments on a voluntary basis may cover only additional costs and income foregone resulting from the commitment made.[254] Forests produce a multitude of environmental services alongside consumable goods like timber and berries. Some of these goods and especially the services are public goods. The conservation of native species or biodiversity has typical public goods character, the benefit of

[251] Public goods are goods which are beneficial for society but which are not normally provided by the market given that it is difficult or impossible to exclude anyone from using the goods (and hence making them pay for the goods).

[252] State Aid Action Plan, p. 9-10.

[253] Community Guidelines for State Aid in the Agriculture and Forestry Sector 2007 to 2013, point 175.

[254] Pursuant to point 176 of the guidelines. actions are compatible with article 107(3)(c) of the Treaty if the aid meets the conditions laid down in article 47 of Regulation (EC) No 1698/2005. and be fixed between certain minimum and maximum amounts. In addition, they shall be undertaken for a period between five and seven years "The Commission considered that the limit of 200 Euros exceeds only in some areas which are proved to be exceptionally valuable in biodiversity and the compensation is based on actual income forgone. It is also required that such commitments would not be made on normal payment level. Hence, in such special situations caused by exceptional circumstances aid amounts exceeding 200 Euros per hectare may exceptionally be accepted."

which cannot be exclusively experienced by the private forest owner. [255] When there is no market for biodiversity conservation, or market value for biodiversity, those who experience and value forest nature and biodiversity benefit from positive externalities but the forest owners cannot charge for these benefits. As the state aid compensation is based on additional costs and income foregone, and as biodiversity values bring no revenue to the landowner, the aid is based only on the market value of the timber in the area to be protected. This seems to be problematic, since in many cases, the sites that are most valuable for biodiversity conservation are not necessarily the most productive forestry areas (lots of tree species not used commercially, lots of decayed wood, long hauling distance, etc.).[256]

It follows that the landowners who possess the most valuable sites for biodiversity conservation may not find it compelling to make forest-environmental commitments when they would only get paid for the revenue losses based on the market value of the timber in the area. Actually, sites with poorer diversity are offered protection because payments for such sites may well be higher than payments for ecologically more valuable, yet not so productive sites. This is not effective environmental protection, and does not provide any incentive for the landowners to identify and offer ecologically valuable sites for conservation. On a temporary contract, the landowner actually risks the economic value of the forest shrinking during the contract period, if the trees are very old and decaying[257].

Positively the Commission has recognized that exceptional, longer conversation contracts may be approved when only longer-lasting measures have a positive effect on biodiversity, and that the limit of 200 Euros may exceptionally be exceeded in biodiversically valuable areas possessing so high income value that the commitments on biodiversity conservation would not be made on normal payment level. Yet this does not eliminate the problem that compensation for additional costs and income foregone is based only on the market value of the timber in the protected area, since no market value for biodiversity values exists.

5.4 Proposed amendments and introduction of new measures

The Commission will continue to develop criteria to fulfil its assessment of aid compatibility, in particular through analyses of specific sectors. It is for Member States to provide the necessary

[255] According to Coasean logic the compensation obligation depends on the property rights. The definition of the *ownership* of different forest goods and services varies between countries, as it is specific to national jurisdiction. Depending on the definition of the ownership, environmental public goods can be viewed as either positive or negative externalities. If the property rights were complete and *exclusive* covering all the aspects of forestland, any conservation values provided in the forest would be positive externalities and the owner should be compensated for all the lost private values when the resource is used to produce public services. *Innes–Polasky–Tschirhart* (1998): Takings, compensation and endangered species protection on private lands. Journal of Economic Perspectives 12(3): 35–52.

[256] Horne 2006, p. 171.

[257] Communication with *Eeva Primmer,* February 2011.

evidence in this respect, prior to any implementation of the envisaged measure.[258] Therefore, , the Member States should provide evidence that because the agrarian function of a farmer's land cannot be disconnected from its recreational or natural functions, the nature values of the sites should also be included in the state aid compensation, in order to be efficient and also in order to attract those biodiversically rich forests that are not necessarily the most productive forestry areas.

Since also possible new incentives, such as habitat banking and offsets[259] require a relevant involvement of the national and regional levels of governance, state aid may be involved. Comparable to what was shown in *PreussenElektra*[260], the obligation to purchase a specific amount of credits did not include any transfer of state resources. Hence, the obligation as such did not constitute state aid within the meaning of Article 107(1) TFEU. Where however, these payments are dispatched into a fund(bank), from where payments are deferred to the creators of beneficial biodiversity outcomes, there is a possibility that this fund-based finance will be regarded as "granted trough state resources"[261]. The Court jurisprudence has established three cumulative criteria in order to assess the involvement of state resources where money is transferred by a fund[262]: 1) the fund must be established by the state, 2) the fund must be fed by contributions imposed by the state, and 3) the fund must be used to favour specific enterprises. Thus, if the Commission concludes that state`s resources are involved and also all other criteria of state aid in the meaning of Article 107(1) are fulfilled, the measure constitutes state aid. Hence, it would be better to organise the fund/bank in a way that escapes the criteria of the involvement of state resources.

The following assessment is hypothetical based in relevant part on *No N 416/2001 - UK Emission trading scheme*, and discusses possible incentives for introducing a habitat banking and offset scheme. This scheme was introduced before the European Union Greenhouse Gas Emission Trading System (EU ETS) commenced operation. Since the decision at hand is given before implementation of the EU ETS, it is interesting to see how a new measure that promotes the execution an important project of common interest, has been assessed by the Commissionprior to its launch. The UK ideawas to introduce a voluntary trading scheme to reduce greenhouse gas emissions. The scheme granted an incentive for a period of five years,

[258] State Aid Action Plan, p. 6-8.

[259] See definition on chapter 2.3. and assessment on chapter 3.3. of this study.

[260] Case C-379/98 "An obligation imposed on private electricity supply undertakings to purchase electricity produced from renewable energy sources at fixed minimum prices does not involve any direct or indirect transfer of state resources".

[261] For example within Biobanking, New South Wales Astralia (Threatened Species Conservation Amendment Act 2006), developers buy credits from landowners generating them. Part of these incomes will be deposited in the BioBanking Trust Fund and paid to the owner of the biobank site in annual payments for carrying out the agreed management activities in perpetuity. Fromond – Similä – Suvantola, 2009, p. 23.

[262] C-173/73 *Italy vs Commission* and C-78/79 *Steinike vs Germany*.

spread across all entities entering the scheme in return for participating and taking on absolute emission reductions. Companies bid for the incentive in an auction.[263]

Comparably, a Member State could introduce a habitat bank and offset scheme to reduce the biodiversity loss through obliging developers to purchase credits from a habitat bank. Since implementing the scheme would increase the costs borne by the undertakings, the Member State could grant an incentive for a restricted period of time for all undertakings adapting to national standards.

The UK government considered the emission trading scheme to constitute state aid insofar as the incentive was concerned. The UK government held that the aid was compatible under Article 107(3)(b) as it promoted the execution of an important project of common European interest, and even if Article 107(3)(b) would not have applied, the scheme was compatible under Article 107(3)(c) as it complied with the environmental aid guidelines.

According to Article 107(3)(b), state aid may be considered compatible with the common market if it promotes the execution of an important project of common European interest. Point 73 [now point 147] of the environmental aid guidelines says that "aid to promote the execution of important projects of common European interest which are an environmental priority and will often have beneficial effects beyond the frontiers of the Member State(s) concerned can be authorised under the exemption provided for in Article 107(3)(b). However, the aid must be necessary for the project to proceed, and the project must be specific, well defined and qualitatively important and must make an exemplary and clearly identifiable contribution to the common European interest."

The Commission acknowledged that tackling climate change was a priority of environmental policy of the EU. The scheme was regarded an important element in achieving the targets that the Member States undertook to fulfil, and it is evident that emission trading would deliver most effects if it was done on an EU-wide basis. In the absence of a binding EU emission trading scheme, the UK government made specific choices on the main elements of its scheme in order to best adapt the scheme to national needs. Even though these choices were not necessarily the choices that will be made for a trading scheme at European level[264] the Commission appreciated the UK initiative to already go ahead with an emission trading scheme while there were no rules at European level. The UK scheme thus contributed valuable learning experience to the establishing of other emission trading schemes in other Member States. Therefore the Commission assessed the UK emission trading scheme under Article 107(3)(c). It considered that the scheme was compatible with Chapter F, "Policies, Measures and

[263] N 416/2001, p. 3.

[264] The Commission in its proposal for a directive on an EU emission trading scheme developed potential criteria, which aim to reflect the wider European interest.

Instruments for reducing Greenhouse Gases", of the Community guidelines on state aid for environmental protection.[265]

Similar assessment could be used within a possible habitat banking and offset scheme. Since biodiversity protection is regarded as a pre-requisite for sustainable development[266] and the new target aims to "halt the loss of biodiversity and the degradation of ecosystem services in the EU by 2020[267]", it seems evident that biodiversity preservation is a crucial element in EU`s environmental policy, and the habitat banking scheme would be an important element in achieving that target. The scheme might be considered compatible under Article 107(3)(b), or most likely, under 107(3)(c) and Article 18 of the general block exemption regulation[268] as an "investment aid enabling undertakings to go beyond Community standards for environmental protection or increase the level of environmental protection in the absence of Community standards". Such aid could be compatible with the common market within the meaning of Article 107(3) of the Treaty and exempt from the notification requirement of Article 108(3) of the Treaty, provided that certain conditions are met.[269]

Within the habitat banking and offset scheme, the condition of enabling the beneficiary to increase the level of environmental protection resulting from its activities in the absence of

[265] The Kyoto Protocol, signed by the Member States and by the Community, provides that the parties undertake to limit or reduce greenhouse gas emissions during the period 2008-2012. For the Community as a whole, the target is to reduce greenhouse gas emissions by 8 % of their 1990 level. In the absence of any Community provisions it is for each Member State to formulate the policies, measures and instruments it wishes to adopt in order to comply with the targets set under the Kyoto Protocol. (The previous guidlines, OJ C 37 of 3.2.2000). In the current guidelines (OJ C 82 of 1.4.2008) the basis for Commission`s assessment concerning aid involved in tradable permit schemes is set out in point 55.

[266] See the communication on "Halting Biodiversity Loss by 2010 – and Beyond: Sustaining ecosystem services for human well-being".

[267] –restore them (ecosystem services) in so far as feasible, while stepping up the EU contribution to averting global biodiversity loss.

[268] Commission Regulation (EC) No 800/2008 (6.8.2008) declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation). (OJ L 214).

[269] The eligible costs shall be the extra investment costs necessary to achieve a level of environmental protection higher than the level required by the Community standards concerned, without taking account of operating benefits and operating costs. The eligible investment shall take the form of investment in tangible assets and/or in intangible assets. In the case of investments aiming at obtaining a level of environmental protection higher than Community standards, the counterfactual shall be chosen as follows: (a) where the undertaking is adapting to national standards adopted in the absence of Community standards, the eligible costs shall consist of the additional investment costs necessary to achieve the level of environmental protection required by the national standards; (b) where the undertaking adapts to or goes beyond national standards which are more stringent than the relevant Community standards or goes beyond Community standards, the eligible costs shall consist of the additional investment costs necessary to achieve a level of environmental protection higher than the level required by the Community standards. The cost of investments needed to reach the level of protection required by the Community standards shall not be eligible; (c) where no standards exist, the eligible costs shall consist of the investment costs necessary to achieve a higher level of environmental protection than that which the undertaking or undertakings in question would achieve in the absence of any environmental aid.

Community standards[270] would seem to be fulfilled. On the contrary, a subsidy granted by a public authority for measures taken in order to compensate for damage to a Natura 2000 site could not be accepted in the light of environmental protection[271].

Viable use of state aid within measures to preserve biodiversity in the forests

Purchase of land by the state	• To escape the classification as state aid the purchase of the land has to be in conformity with the market economy investor principle (the purchase of the properties has to be done under market conditions, such as an evaluation of the properties by an independent expert). The purchase based on an open auction (where state invites landowners to make offers of land and then selects the overall economically most advantageous offer) would seem to be done under market conditions. • The purchase most likely constitutes state aid if public authority pays "extra" ie. more than the highest price which a private investor acting under normal competitive conditions was ready to pay in the same situation - this "over-valuation" (based on nature value-trading) would probably not pass the balance test in detailed assessment (hard to provide evidence of necessity of the aid since there is also possibility for expropriation). Since Commission`s practice is to only compensate for the revenue losses and additional costs it would seem illogical to accept trade of nature values here either. *Hence, it would be important to include compensation for nature values in state aid payments.*
Services of general economic interest (SGEI)	• Public service compensation which cannot be qualified as non-aid on the basis of the Altmark criteria may be found compatible if it complies with the conditions laid down in the Community Framework for state aid in the form of public service compensation. • The objectives have to be in the interest of society as a whole. • Whereas in a classical environmental aid measure the activities which are beneficial for the environment cannot be carried out by the state, but can only be carried out by undertakings on a voluntary basis, the tasks, which can be construed as SGEI clearly fall within the remit of the state acting as public authority (which however may find it appropriate to entrust them to other entities). • *Tasks that foster biodiversity values increase the public goods even if they were carried out in a private recreational or natural land – For that reason, the possibility for SGEI should be similar.*
Voluntary protection in private forests within forestry	• In order to contribute to the maintenance and improvement of forests and to promote their ecological, protective and recreational function the Commission will declare state aid up to 100 % compatible with Article 107(3)(c) of the Treaty • Payments may be given to beneficiaries who make forest-environmental commitments on a voluntary basis. • Payments can cover only those commitments going beyond the relevant mandatory requirements.

[270] Article 18(2)(b) of (EC) No 800/2008 (6.8.2008).

[271] According to Article 38 of (EC) No 1698/2005 support provided for Natura 2000 payments shall be granted annually and per hectare of UAA to farmers in order to compensate for **costs incurred and income foregone resulting from disadvantages** in the areas concerned related to the implementation of Directives 79/409/EEC, 92/43/EEC and 2000/60/EC **–not in order to compensate for damage to a Natura 2000 site.** However, in the case of an undertaking acting as a contractor for a public authority to build an infrastructure, the subsidy would not be considered as a state aid as long as it is granted in exchange of works carried out. (compensation for public services will be assessed according to "Altmark" criteria).

	• Commitments shall be undertaken for a period between five and seven years. Where necessary and justified, a longer period shall be determined in for particular types of commitments. • Payments may cover additional costs and income foregone resulting from the commitment made. • Support shall be fixed between 40 and 200 Euros per hectare albeit these amounts may be increased in exceptional cases taking account of specific circumstances to be justified in the rural development programmes. • *For the aid to be efficient, also the compensation for nature values should be included in the agri-environmental state aid payments.*
Market based measures (eg. Habitat banking and offsets)	• *A possible incentive for introducing habitat banking and offset scheme? (On the basis of 107(3)(b) as "aid to promote the execution of important projects of common European interest which are an environmental priority and will often have beneficial effects beyond the frontiers of the Member State(s) concerned" or on the basis of 107(3)(c) as "investment aid for undertakings which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards").*

6 Contemplation and Improvement Suggestions

6.1 Should States Compensate for the Nature Values?

As a general rule under the PPP governments should not subsidise individuals to conserve biodiversity, which means that the government's cost share is generally zero, unless the government is also an impacter and therefore required to pay.[272] It is however claimed, that even though the PPP has been confirmed as an environmental principle, the expansion of it onto biodiversity conservation needs still further clarification.[273] Inversely the PPP signifies that no compensation is paid for disallowance of a licence to actions that are harmful to the environment.[274] Still, under the Nature Conservation Act in Finland, compensation is paid for disallowance of a licence to deviate from a Habitat-Type Conservation.[275] This kind of principle is called the "society pays" or the "beneficiary pays" principle. Because different parties bear the costs and benefits of biodiversity conservation, some activities that are desirable from a national perspective may not occur for they do not generate net benefits to those implementing them and are not privately profitable. As a result, insufficient conservation may occur from a social perspective. This raises the question of whether it may be in the interests of society for the wider community to meet some costs related to on ground activities to ensure they proceed. This would involve the government meeting some costs of conservation on behalf of the general community.[276] In contrast to the PPP, which obliges resource users to pay for conservation, the

[272] *Arentino et al.* 2001, p. 15-16.

[273] *Kokko* 2003, p. 109.

[274] *Naskali–Hiedanpää–Suvantola* 2004, p. 118.

[275] *Kuusiniemi* 2001.

[276] *Arentino et al.* 2001, p. 5.

"beneficiary pays" principle can only be used to encourage *voluntary* conservation. This is because compulsory conservation is equivalent to an obligation under existing property rights.[277]

It seems that the Commission has already approved the "beneficiary pays" principle for it allows states to grant payments to beneficiaries who make forest-environmental commitments on a voluntary basis. The government is consequently meeting some costs of conservation on behalf of the general community. With that in mind, there should not be a big difference in whether the nature values were included in these costs too.

McNeely argues that since nowadays the perception of one`s own advantage is determined by economic actors, the conduct that affects preservation of biodiversity can best be modified by offering such approach to conservation that alters that perception.[278] Within forestry, this could be realised by including compensation for natural values in agri-environmental state aid payments. If nature values were included in the agri-environmental payments, the landowners who possess the biodiversically most valuable sites would be more willing to commit themselves to conservation. This would also be effective, not only from an environmental point of a view, but also economically. As set out in the Lisbon strategy, environmental protection is essential in itself, and can also be a source of competitive advantage for Europe.

According to the Commission, the *effective* use of state aid stipulates that state aid measures are used to correct market failures.[279] The legal meaning of the requirement of efficiency is however not yet completely solved for the requirement itself is still relatively new.[280] In addition to the principle that state aids are legitimate responses to market failure, economic analysis of EU state aid policy stipulates that the state aids should not lead to undue market distortions. In other words, the realization of state aid should not be incompatible either with competition in the market or with competition for the market. Accordingly, intervention is warranted only if its expected benefit, in terms of improving market outcomes, outweighs the expected cost of intervention. As a consequence, state aid should only be used as a remedy for market failures if it is the best feasible remedy. While this is uncontroversial as a matter of general principle, its application in concrete cases may not be straightforward.[281]

[277] *Arentino et al.* 2001, p. 15-16.

[278] *McNeely, Jeffrey A.* 1988. Economics and Biological Diversity: Developing and Using Economic Incentives to Conserve Biological Resources. IUCN, Gland, Switzerland.

[279] State Aid Action Plan—Less and better targeted state aid: a roadmap for state aid reform 2005-2009. COM(2005) 107 final, para 23. The principal economic justifications for State aid can be subsumed under the general heading of market failures. Since state aid measures can correct market failures and thereby improve the functioning of markets and enchance European competitiveness, they may sometimes be effective tools for achieving these objectives.

[280] *Siikavirta–Parikka* 2010, p. 16.

[281] *Clemenz–Dewatripont–Motta–Neven–Seabright–Zemplinerova* 2006, p. 1.

The State Aid Action Plan requires that state aid only be used when it is an appropriate instrument for meeting a well-defined objective, when it creates the right incentives, is proportionate and when it distorts competition to the least possible extent. For that reason, appreciating the compatibility of state aid is fundamentally about balancing the positive impact of the aid measure (reaching an objective of common interest) against its potentially negative side effects (distortions of trade and competition).

The efficiency requirement shows much similarity to the *proportionality principle*, which, according to the practice of the Court of Justice, would seem to embrace these elements The first criterion of proportionality, the measure`s appropriateness, is also referred to as "suitability", "usefulness" or "effectiveness" criterion. The second criterion is often "necessity" and "least trade-restrictiveness". The third and most controversial element of determining proportionality includes cost-benefit analysis.[282] The growth of the importance of environmental values has affected the way the Court has assessed whether the acts of the Member States are accordant with the proportionality principle.[283] In the *Danish Bottles* case[284] the Court assessed the allowance of the national measure (order that all containers for beer and soft drinks must be returnable) in relation to the restrictions it caused on the internal market. At the time the Court was only ready to accept measures that were proportionate in relation to the restrictions on the internal market. In later cases, the Court has emphasized environmental aspects more. For example, in *Bluhme*[285] the Court assessed the proportionality of the national measure mostly on the basis of environmental protection. It stated that the establishment of a protection area constituted an appropriate measure in relation to the aim pursued by the Convention on Biological Diversity[286].[287]

The traditional, wide interpretation of the proportionality of a measure is based on the idea that environmental measures are permitted only when their importance is higher than the free movement of goods.[288] According to *Cruz* and *Castillo de la Torre*[289] the Court has, in its environmental cases, to some degree already given up the traditional wide interpretation of the proportionality principle. In other words, the Court has moved from balancing the positive effects of a measure against its negative effects on the internal market, to the assessment of the

[282] *Wiers* 2002, p. 72-73.

[283] *Sorto* 2002, p. 251.

[284] Case 302/86, p. 4607.

[285] Case C-67/97.

[286] Case C-67/97, para 37.

[287] *Hanhijärvi* 2003a, p. 76.

[288] *Krämer* 2000, p. 78.

[289] *Cruz, Julio Baquero–Castillo de la Torre, Fernando*: A note on PreussenElektra. European Law Review 26/20001, p. 499.

necessity of the measure.[290] This is reasonable, since, although proportionality is a fundamental EU principle, environmental protection cannot be held categorically inferior to it.[291] On the contrary, according to the Article 11 TFEU the environmental protection requirement must be integrated into the definition and implementation of the EU `s policies and activities, in particular with a view to promoting sustainable development. This allows placing a duty on EU institutions to reconsider all policies for sustainability, as an overall Treaty objective.[292]

Pursuant to Article 193 TFEU, the Member States are allowed to introduce more stringent national policies as long as the measures are compatible with the Treaties. State aid may be declared compatible with the Treaty provided it fulfils clearly defined objectives of common interest. Since state aid can correct market failures, it may be an effective tool for achieving these objectives. To be an effective tool, state aid should be appropriate, incentivizing, proportionate and distort the competition to the least possible extent. In compliance with environmental protection within the Treaties and pursuant to recent practice of the Court of Justice, the efficiency test as an assessment of suitability and necessity is better suited with environmental standards than cost-benefit analysis[293]. That is because the benefits of biodiversity conservation typically occur in the uncertain future and may thus be challenging to show. Yet, the integration of environmental considerations must be strengthened by the need to seriously address the existing pressures on biodiversity, now and in the future, for failure to act now means greater, and possibly irreversible, damage or higher remedial costs in the long term[294].

Hence, the Member States should provide evidence that because the market fails to reflect the value of biodiversity it is in the interest of the EU as a whole to correct the following market failure by including compensation for natural values in agri-environmental state aid payments. For the protection to be effective and well-suited to its purpose, the compensation for nature values would constitute an appropriate measure in relation to the aim of protecting biodiversity, which is the responsibility of EU and the Member States, pursuant to the Convention on Biological Diversity.[295]

Principally, it would also be possible to avoid all the challenges described above, by regulating environmental aid to be paid as the *de minimis* aid. Then it would not be state aid within the meaning of the Treaty and would thus be left outside of the restrictions therein. Since the general *de minimis* rule applies to the forestry sector, an aid of EUR 200 000 over a period of

[290] *Hanhijärvi* 2003a, p. 77.

[291] *Hanhijärvi* 2003a, p. 78.

[292] *Bär–Kraemer* 1998, p. 318.

[293] See e.g. *Hanhijärvi* 2003a, p. 79.

[294] See Facing the challenge: The Lisbon strategy for growth and employment. Report from the High Level Group chaired by Wim Kok 2004. Why is the environment a source of competitive advantage for Europe?, p. 36.

[295] See Case C-67/97, para 37.

three fiscal years could be freely granted to all undertakings that commit themselves to the conservation. However, the *de minimis* option is problematic in the light of constitutional equality rule[296] and thus also politically difficult to accept. The *de minimis* regulation is hassle free for those landowners who do not practice other activities for which the *de minimis* aid could be granted. However, farmers (who practice agriculture) also often practice forestry. Among these farmers, there are those who have got paid agricultural or general *de minimis* aid. Farm counselling and flood compensation are examples of agricultural *de minimis aid*; start up aid, investment aid and development aid examples of general *de minimis* aid. The *de minimis* regulation may also become problematic within large jointly owned forests. For jointly owned forests, the aid for forestry is paid to the management associations which, according to relevant law[297], manage the jointly owned forests. For that reason, pursuant to financing legislation, the management associations are the aid recipients instead of discrete joint owners. On part of the largest jointly owned forests, the *de minimis* ceiling would thus be reached and the environmental aid could not be paid completely.[298]

It should also be born in mind, that as long as there is an effective aid scheme, the *de minimis* aid should not be cumulated with state aid in respect of the same eligible costs, if such accumulation would result in an aid intensity exceeding that fixed in the Decision adopted by the Commission.

6.2 SGEI as a Possibility in Environmental Conservation

Also the improvement needs in protected areas bring new challenges for nature conservation. For example, in Finland many Habitat Types which suffer from eutrophication (e.g. esker forests) need silvicultural measures such as clearing of excessive vegetation, but the landowner cannot be obliged to commit these tasks. Therefore, to make biodiversity preservation more efficient also in protected private forestry-free lands, the possibility to use the concept of services of general economic interest (SGEI) in imposing an obligation on the landowner to produce "green services" could be thoroughly investigated.

Services of General Economic Interest (SGEI) as laid down in Article 14 and Article 106 of TFEU, are defined in EU competition law as economic activities that public authorities identify as being of particular importance to citizens and that would not be supplied (or would be supplied under different conditions) if there were no public intervention. The rules that should

[296] 11.6.1999/731, 6 §.

[297] Law on jointly owned forests (Yhteismetsälaki) 14.2.2003/109.

[298] Based on communcation with *Kirsi Taipale*, MMM, February 2011.

constrain the way in which national, regional and local Governments deal with their SGEI constitute a special case of "state aid policy".[299]

In economic terms, the concept of SGEI as defined above is closely related to that of "Universal Service Obligations" (USO), that is, obligations imposed on one or more firms of a given industry to supply given products or services to all citizens. SGEI are by definition services which are provided at a loss by firms, otherwise there would be no need to impose the SGEI. Therefore firms often need be compensated for the provision of such services. Since the private benefit is lower than the social benefit, there may be scope for subsidising into the network citizens who would not otherwise have subscribed the service.[300]

Since social and political priorities vary greatly across member states, it is impossible to determine at a supra-national level which sectors should have which SGEI. The EU should typically not constrain the desire of national, regional or local Governments to define what are to count as instances of SGEI. This allows each Member State to have a wide margin of discretion in setting SGEI. The role of the European Commission should be only to check that there exist no manifest errors and no abuses in exercising such discretion. To this end, each member state is rightly required to clearly and explicitly indicate services that are classified as SGEI.[301] In line with the EU's policy on sustainable development, due consideration has to be taken of the role of SGEI for the *protection of the environment and of the specific characteristics of services of general interest directly related to the environmental field.*[302]

In the Preamble of the Convention on Biological Diversity, the Contracting Parties reaffirm that states have but sovereign rights over their own biological resources also responsibilities for conserving their biological diversity and for using their biological resources in a sustainable manner. The Parties also determine to conserve and sustainably use biological diversity for the benefit of present and future generations. As mentioned above, states are additionally bound by the Charter of the United Nations and the principles of international law. Reaching the obligations therein[303], it is a requisite to care for the environment properly.[304] Additionally, the basic right related to the environment is included in plenty of national constitutions. According to the Finnish Constitution 20 § 2 "public authorities must endeavour to guarantee for

[299] *Clemenz–Dewatripont–Motta–Neven–Seabright–Zemplinerova* 2006, p. 1.

[300] *Clemenz–Dewatripont–Motta–Neven–Seabright–Zemplinerova* 2006, p. 2.

[301] *Clemenz–Dewatripont–Motta–Neven–Seabright–Zemplinerova* 2006, p. 3.

[302] Communication of the Commission of 12.5.2004 COM(2004)374 final, section 3.4.

[303] Pursuant to the preamble of the Charter of the UN, states promote social progress and better standards of life in larger freedom and reaffirm faith in fundamental human rights.

[304] Also the European Union Strategy for Sustainable Development (COM(2001) 264 final) provides an EU-wide policy framework to meet the needs of the present without compromising the ability of future generations to meet their own needs.

everyone the right to a healthy environment and for everyone the possibility to influence decisions that concern their living environment".[305]

The formulation "public authorities must endeavour to guarantee" differs from other safeguarding obligations, which obligate the public authority to improve the right referred to regulation in question. The obligation is thus proportioned, but the choice of the formulation is not considered to make any difference in regards to its binding nature. The question is about the safeguarding obligation directed at the public authority. It is within the core of a right to a healthy environment that the habitat is viable in a way that it does not cause people any direct or indirect health risk. In the 20 § 2 of Finnish Constitution, the obligation to ensure the right to a healthy environment is understood in a wider sense: including also the environmental satisfaction. Even though the statement remains somewhat open, it can be seen to refer also to aesthetic and landscape values.[306]

The English jurist and philosopher *Jeremy Bentham*, who is best known for his advocacy of utilitarianism, thought that according to the nature of things, the law cannot grant a benefit to any, without, at the same time, imposing a burden on someone else. In other words, a right cannot be created in favour of anyone, without imposing a corresponding obligation on another. So that the basic right related to the environment would not be just a declaration but a real right, the public authority has to have a responsibility in ensuring it.

In the Commission's view a measure can only be classified as a service of general interest if it actually serves the interests of citizens. The nature conservation tasks that can constitute a service of general economic interest differ from classic environmental protection measures in that under the classic measures only the undertakings can voluntarily implement actions for the benefit of the environment, and not the state itself.[307] Silvicultural measures in forestry-free private lands i.e. "green services" could be considered to bring public benefit/be of general interest and consequently fall within the remit of the state. Hence, a public service obligation might be imposed on them. The difference to activities related to the agriculture and forestry guidelines is that the latter are connected to the production, processing and marketing of agricultural products whereas the "green services" are connected to responsibility of a state to conserve biodiversity and obligation to guarantee for everyone the right to a healthy environment. Instead of producing these services themselves, the public authorities impose the *public service obligation to be fulfilled* by a public or private company -in this case, the landowner.

Where the services are of general economic interest, the Member States are required to apply Community law, such as competition rules (including those on State aid) and rules on public

[305] Perustuslaki (Finnish Constitution) 20 § 2.

[306] *Kumpula, Anne*: Perustuslain 20 § ja sen merkitys kaivoslainsäädännön valmistelussa. Available at: http://ktm.elinar.fi/ktm_jur/ktmjur.nsf/all/41FAFD5BBEC7CD57C22571C4003B68C0/$file/Anne%20Kumpula_kaivoslausunto.pdf. Last visited in 28.3.2011, p. 9-10.

[307] State Aid No. NN 8/2009 – Germany, point 58.

procurement. Although economic efficiency considerations might exist on principle, in practice justifications for SGEI are in the vast majority of cases related to non-efficiency objectives.

The Altmark judgement`s key provisions have been incorporated into the Community Framework for State Aid in the Form of Public Service Compensation[308]. It establishes that compensation for a SGEI should not be considered as state aid within the meaning of the Treaty if the following conditions are satisfied: 1) the Universal Service Obligation is clearly defined, 2) the parameters for the compensation are objective, transparent, and are established in advance, 3) the compensation do not exceed costs plus a reasonable profit, 4) the compensation is determined either through public procurement (that is, a public tender has taken place and it is the winning firm which is chosen to provide the SGEI) or, if no public tender has taken place, the firm is compensated on the basis of the costs of a typical well-run company. The Community framework also lays down the conditions under which SGEI which constitute state aids (because the conditions above are not fulfilled) may still be compatible with the Treaty. Importantly, the framework indicates that as long as the first three above mentioned conditions are fulfilled and the firm is not overcompensated, the SGEI will be compatible. This implies that firms which are inefficient but not overcompensated would not be sanctioned.[309]

7 Final Words

The upcoming challenges of EU`s environmental policy deal with the expansion of the EU. This is considered to indicate that differentiation, as well as the subsidiarity principle, are going to be emphasized. Increase of different regional and local experiments is also predictable.[310] As a guideline for the future, it is foreseeable that EU will encourage Member States in adopting singular environmental taxes and solutions that are consistent with the ecological tax reform. The reversal of environmentally injurious aid and tax systems will also be actively carried out.[311]

Biodiversity cannot be protected solely by regulations, but the conservation necessitates actions and measures in many sectors of society. More attention should be paid to biodiversity in development of existing aid schemes. Within forestry, this could be realised by including compensation for nature values in agri-environmental state aid payments. To make biodiversity preservation more efficient also in protected private forestry-free lands, the possibility to take advantage of producing "green services" as services of general economic interest (SGEI) should

[308] OJ 29/11/05, see http://europa.eu.int/eurlex/lex/LexUriServ/site/en/oj/2005/c_297/c_29720051129en00040007.pdf.

[309] *Clemenz–Dewatripont–Motta–Neven–Seabright–Zemplinerova* 2006.

[310] *Naskali–Hiedanpää–Suvantola* 2004, p. 24.

[311] *Naskali–Hiedanpää–Suvantola* 2004, p. 25.

be untwined, especially since the environment has already been accepted by the Commission as an area where these services might be established[312].

Some new aid measures have already been approved at the EU level. Under the rules on state aid the European Commission has authorised, for instance, a revised version of a Dutch tax incentive measure, "Regeling Groenprojecten" (Green Funds Scheme), to stimulate investments in projects that have a positive effect on nature and the environment in the Netherlands.[313] The "Regeling Groenprojecten" offers a fiscal incentive to invest in green projects, including projects in the areas of nature, forestry and organic agriculture. In order to be eligible, projects need a "green certificate", issued by the Ministry of Environment. Presently, all major banks have dedicated "Green Funds", investing in eligible green projects. Money invested or saved in such "Green Funds" is exempt from income tax, which allows the bank to pay a lower dividend on such investments and thus to charge a lower interest rate on the money lent to the project initiator, or to accept a lower level of profitability. This has resulted in significantly higher numbers of certain species found on organic farmland than on conventional farmland.[314]

Among existing aid schemes, new, genuinely market-based measures like habitat banking and offset schemes could be more utilized. There are various options available to try to ensure long-term management of the offsets, including regulatory instruments, contracts, conservation easements, and funding -and combinations thereof. An interesting example of a mix of these instruments can be found in the Bio banking Trust Fund established in New South Wales. Owners of the lands in bank receive an annual payment out of this fund if they adequately carry out the management actions that have been set in an agreement concluded between the Minister of the Environment and the owner. If not, they do not receive the payment or have to repay the money paid.[315]

Habitat banking is not part of the EU policy for tackling biodiversity loss, but it can make a significant contribution to several EU policies. This instrument can complement the use of public funds from the Common Agricultural Policy enhancing the provision of public goods by agriculture, and it can potentially be incorporated into several directives, including the Habitats Directive, the Environmental Impact Assessment and the Environmental Liability Directive.[316] Incentives for introducing habitat banking and offset scheme on the basis of 107(3)(b) as an

[312] See State Aid No. NN 8/2009.

[313] The Commission found the various parts of the scheme to be in line respectively with its guidelines on state aid to agriculture, to fisheries, to the environment and with Treaty rules on state aid for the development of certain economic activities (Article 107(3)(c)).

[314] See State aid N 249/2008 - *Netherlands – Green Funds*.

[315] Department of Environment and Climate Change NSW, November 2007: Pilot Report of the May 2007 draft BioBanking Assessment Methodology. Available at: http://www.environment.nsw.gov.au/resources/biobanking/biobankingpilot07535.pdf. Last visited in 31.3.2011.

[316] *Eftec, IEEP et al.* 2010.

"aid to promote the execution of important projects of common European interest which are an environmental priority and will often have beneficial effects beyond the frontiers of the Member State(s)" or on the basis of 107(3)(c) as an "investment aid for undertakings which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards" -could possibly be used to facilitate the implementation of these measures.

In accordance with its Treaties, the EU has established an internal market which works for sustainable development based on balanced economic growth and a high level of protection and improvement of the quality of the environment. So that the market economy is able to improve the living conditions to the benefit of EU citizens in a sustainable manner, the legal frames must be built to guarantee that biodiversically rich environment, which not only is a prerequisite for healthy and wealthy living, but also enables innovation and new markets, is protected. That is why it is vital to integrate environmental protection requirements into the definition and implementation of all EU's policies and activities.

Environmental protection is no longer inferior to trade liberalisation requirements under EU law, but both interests are given more or less equal importance. Additionally, environmental protection, economic growth, and social development should be viewed as mutually compatible, rather than conflicting objectives. Forestry has traditionally defined the use of natural resources in forests in a major way. Lately however, it has been realised that biodiversically rich forests are irreversible for many ecosystem services to stay in balance as well. This balance has a remarkable effect on the economy. Hence, it is not only accordant with European environmental principles, especially the high level of protection-, the precautionary- and the prevention principle, but also with the objective of achieving an efficient economy, that biodiversity conservation is taken solemnly.

If a market operates on the basis of outdated values, it works neither sustainably nor efficiently. The sustainable values to strive for can be shown effectively with the help of economic incentives. The Commission should, in cooperation with Member States, keep under constant review all systems of aid existing in those states[317] and it should also continue to develop criteria to fulfil its assessment of aid compatibility, in particular through analyses of specific sectors[318]. Each Member State has the best knowledge of their own legislative, political and economical functions. Hence, it is for Member States to provide the necessary evidence in respect of developing the criteria of aid compatibility.

So that the conservation would also be a real alternative to forestry the compensation for conservation would have to be competitive. By aiding actions that conserve biodiversity, also by giving compensation in money for nature values, states can not only carry their share for the

[317] Article 108(1) TFEU.

[318] State Aid Action Plan, p. 6-8.

public goods, also act as forerunners for the future markets for ecosystem services. It should yet beborn in mind that these "markets" only work in addition to, not as a substitute for regulation. Since the minimum level of protection should remain based on regulation the fears of nature values turning into merchandise seem somewhat overstated.

By defending their desired measures, the Member States can help to educe the EU and its policies towards the most appropriate, sustainable and effective ways of action. "In the end, we will conserve only what we love, we will love only what we understand and we will understand only what we are taught[319]." We must now learn the multiple values of nature and that the threats to biodiversity are also threats to economic goals, human health and eventually, human life. Consequently, we will understand that investing in nature values today makes it possible to benefit from them also tomorrow.

[319] *Baba Dioum*, Senegalese conservationist.

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List of Abbreviations

BPP	Beneficiary pays principle
CBD	The Convention on Biological Diversity
EC	The European Community
EU	The Europen Union
EU ETS	The European Union Greenhouse Gas Emission Trading System
GBER	General block exemption Regulation
GS	Green services
MA	The Millennium Ecosystem Assessment
MEIP	The market economy investor principle
METSO	The Southern Finland Forest Biodiversity Programme
PES	Payments for environmental services
PPP	Polluter pays principle
SGEI	Services of general economic interest
SME	Small and medium-sized undertakings
TEU	The Treaty on the European Union
TFEU	The Treaty on the Functioning of the European Union