State-Owned Enterprises in the European Union: ensuring level playing field

REPORT

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1. INTRODUCTION

The European Union (EU) internal market is facing certain challenges provoked by the current economic crisis. Actions at the EU level, close cooperation with the Member States are crucial in order to foster growth of the European economy. The EU institutions proposed structural reforms with aim to achieve the strategy’s Europe 2020 objectives, namely sustainable, smart and inclusive growth.\(^1\) Better allocation of resources in governmental institutions, increased efficiency of the Member States’ public administration, more competitive public procurement procedures, increased competitiveness of the enterprises as well as sustainability are often found in the current EU initiatives as well as policy proposals.

In the context of fostering growth and jobs, there is a particular focus on the issue of enterprises’ competitiveness as it covers more efficient economic activities, effective management techniques or increased focus on innovation. The concept of competitiveness is interlinked with the principle of fair competition in the EU internal market. Ensuring that undertakings are treated equally and Member States do not implement competition–distortive policies is one of the preconditions for economic growth in the EU and the EU’s increased worldwide competitiveness.

In this context, large enterprises coming from telecommunications, transport, energy or postal network industries remain continuously under a focus due to their legal nature and specific economic activity. Their legal ownership and governance practise often fall under category of state–owned enterprises (SOEs): undertakings entirely or partially owned by the government. State remains a shareholder of certain enterprises in order to fulfil the following objectives: address market failure and ensure that the key strategic services for the citizens maintain the high quality. In addition, in the current situation of economic decay, the state partial or full ownership of enterprises helps to ensure that sectors in difficulty gain sufficient support.

SOEs are entitled for public services provision, which can be broadly observed in utility sectors such as transport, telecommunications or energy. Although this provision of

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services is not directly included into EU Services Directive\(^2\) (it does not apply to communication networks, transport, healthcare and social services), the EU over the recent years has developed a comprehensive set of oversight to ensure the effective and non-distortive operation of SOEs.

With increasing integration of EU Internal Market, SOEs are becoming highly concentrated on the issue of effective economic performance and fulfilment of public service obligations. On their behalf, Member States are encouraged to find the right balance between maintaining competition and ensuring the quality of key public services for their citizens, often by raising a broader question on the extent of openness to the competition while ensuring their higher standards of service quality. Taking this into account, an importance of EU–level discussion on SOEs is increasing.

The role of SOEs and potential for their competitiveness in the EU is a rather complex issue. The role of the EU internal market is increasing: cross-border economic activities gain ever more importance, for instance, capital of large enterprises from network industries is often divided in several Member States. From a regulatory angle, there are EU–level regulations (mostly concerning competition in the internal market, transparency requirements or public procurement procedures). The EU oversight of SOEs can be also observed under the European Semester\(^3\). However, it is important to note that Member States share a wide scope of discretion and different practices exist in level of supervision and governing of their owned entities. Thus, while addressing the role of SOEs in the internal market of their cross-border activities, there is a need of a more focused discussion of what could be done at the EU level to ensure effective performance of SOEs in the current economic context.

With regard to SOEs regulation and the Community’s acquis, despite wide Member States’ discretion, certain aspects related to SOEs such as state aid, public procurement or provisions of Services of General Economic Interest (SGEI) are regulated by Community law. It should also be noted that Organisation for Economic Co-operation and Development

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(OECD) has developed a targeted approach towards SOEs by providing guidelines on better governance and instruments to ensure competitive neutrality – the conditions when “no entity operating in an economic market is subject to undue competitive advantages or disadvantages”\(^4\). This could be a good starting base for the next steps in the EU-wide discussion on how to boost a level playing field for SOEs.

Therefore, the main objective of the study is to assess the role of SOEs in the current EU context and indicate policies and instruments to foster their competitiveness in the internal market. The study will address the following tasks:

- Analyse the EU *acquis* concerning aspects relevant for SOEs: state aid, public procurement procedures, provision SGEI.
- Overview the employment of open method of coordination: analyse and assess current European semester and Member States’ progress towards smart, inclusive and sustainable growth of the EU.
- Identify the role of SOEs in a broader context of structural reforms with a special focus of country-specific recommendations and EU flagship initiatives for growth.
- Indicate existing policy instruments to foster competitiveness of the SOEs and explore their potential for achieving growth objectives and recovery from the economic crisis.
- Provide analytical insights on the new EU initiatives concerning SOEs governance, exchange of best practise and monitoring tools.

The study will look into the relevant EU legislation, case law of the European Court of Justice to assess legal and economic conditions where the European SOEs operate. Comparative analysis of regulatory frameworks and economic performance evaluation in the EU internal market will help identify their achievements and challenges. Finally, case studies of SOEs governance and competitiveness practice in different Member States will be employed to indicate best practise and bring it up to the EU level. In the study, particular focus will be based on the concept of maintaining the EU level playing field competitive

neutrality, while the EU *acquis* and SOEs governance in this area will be analysed together with the OECD recommendations. A framework for analysing Community *acquis* relevant for SOEs includes certain aspects from OECD guidelines and instruments. This comparison results in a more complex and in-depth approach towards the issue.

The second chapter of the study is dedicated for Community *acquis* analysis in order to assess the regulatory framework relevant for SOEs functioning. The third chapter presents open coordination method–based supervision of Member States’ activities with regard to European Semester, growth initiatives and their relevance to SOEs. The forth chapter will look at European SOEs’ corporate governance and indicate best practice examples. The fifth chapter will present results and recommendations of the study, which will serve as analytical source for the Council meeting during Lithuanian EU presidency in the second half of 2013.
2. SOES AND THE EU LAW

In the Community law, there is a clear effect on state owned enterprises through state aid, Services of general economic interest (SGEI), public services compensation, transparency requirements, public procurement procedures, corporate governance and to some extent the scope of the Services Directive 2006/123/EC as well as through current EU initiatives under the SEA second package. The EU acquis mainly focuses on a broader objective to maintain and ensure competition within EU internal market. Regulatory frameworks provide requirements and obligations for Member States to ensure that their policies and financial operations as regarding SOEs do not distort competition unless they serve a purpose of public interest. By the same token, public authorities are strongly encouraged to revise their public expenditure, guarantee transparency and employ more efficient resource allocation.

2.1 Public service obligations and services of general economic interest

SOEs are to a large extent subjects to state aid measures. As entities providing public services, SOEs often receive subsidies or other forms of compensation in order to guarantee the fulfilment of public obligations. This represents SOEs as public service providers as well as enterprises acting in the market and being subject to the competition requirements.

In the Community law, the public service provision falls under the title of Services of General economic interest (SGEI). SGEI are “economic activities that public authorities identify as being of particular importance to citizens and that would not be supplied under different conditions if there were no public intervention”\(^6\). Public intervention refers to any financial support measures or other actions including tax privileges or exemptions. The following services fall into this scope: transport, postal and social services. In order to meet the needs of the citizens and insure quality of public services, the state imposes certain public obligations on the provider. This situation may constitute additional costs for the

\(^6\) http://ec.europa.eu/competition/state_aid/overview/public_services_en.html
provider to insure effective fulfilment of obligations. In this case, the undertakings providing SGEI may receive public service compensation in order to ensure high quality performance. A wide range of SOEs in Member States represent the transport or postal sectors and are often recipients of governmental subsidies. The provision of public service compensation for SOEs and other undertakings is restricted and need to meet certain conditions.

There is a wide scope of discretion for Member States to decide on the precise definition of SGEI under the principle of subsidiarity. Nevertheless, the European Commission checks the intentions and procedures of public services compensation in order to make sure the compensation does not have distortive effect on the competition in the EU internal market. With regard to this, Member States are obliged to notify to the European Commission on any state measures that may constitute state aid. State aid, as provided in the Article 107 of Treaty of Functioning of the European Union (TFEU)\(^7\), is any resources granted by the state and distorting or threatening to distort competition in the EU internal market. In general, state aid covers subsidies, direct grants, tax privileges (exemptions) or guarantees that certain undertakings gain from the state. For state measures to constitute state aid, there has to be an element of selective advantage\(^8\): certain undertakings should gain privileges over their counterparts in the market. This situation may potentially affect trade between Member States therefore measures are taken to prevent this situation.

As already noted before, there are some provisions in the Treaties on state aid and key public services. The SOEs as undertakings providing SGEI are subjects to the competition rules insofar the application of such rules does not hinder the quality of their performance\(^9\). This aspect was further addressed in the rulings of ECJ (see below).

In the case of controlling state aid, the Article 108 of the TFEU gives a wide range of decision power to the European Commission: to employ control mechanisms, carry out assessment procedures and decide whether the aid does not entail distortive effect on the

\(^7\) Consolidated versions of the Treaty on European Union and the Treaty on the functioning of the European Union; Official Journal C 83 of 30.3.2010, Article 107
\(^8\) Guidance Paper on state aid-compliant financing, restructuring and privatization of State-owned enterprises, Brussels, 10.02.2012 swd(2012) 14 final
\(^9\) Consolidated versions of the Treaty on European Union and the Treaty on the functioning of the European Union; Official Journal C 83 of 30.3.2010, Article 108
internal market competition.\textsuperscript{10} As the Treaties did not provide specific clarifications of the concepts and difficulties occurred while discussing the measures’ compatibility with the competition principles, the European Commission provided more clarifications on definitions.

In order to prevent distortion of competition, the notification procedure applies:

\begin{table}[h!]
\centering
\begin{tabular}{ |l| }
\hline
\textbf{Notification to the Commission on intentions to provide state aid measures} \\
\hline
- Notification regarding aid submitted by a Member State \\
- Commission has to take a decision within 2 months \\
- Commission decides: the measure is no aid; it is with the internal market compatible aid; it is doubtful whether the aid is compatible and therefore an investigation procedure is needed. \\
- In case of an investigation procedure, there has to be a detailed assessment (no time-limit but Commission shall endeavour to decide within 18 months from the opening of investigation) \\
- Commission takes the final decision whether the measure was state aid. If so, whether it can be safely implemented or it is incompatible with the EU internal market and therefore must not be implemented. \\
\hline
\end{tabular}
\end{table}

As regards the specific character of SGEI, the following exemptions from notification to the Commission apply:

- Services “meeting social needs as regards health and long term care, childcare, access to and reintegration into the labour market, social housing and the care and social inclusion of vulnerable groups”\textsuperscript{11}
- other SGEI that gain aid below 15 million Euros a year
- contracts under \textit{de minimis} regulation (less than 500 000 Euros of compensation over 3 years)\textsuperscript{12}

\textsuperscript{10} Consolidated versions of the Treaty on European Union and the Treaty on the functioning of the European Union; \textit{Official Journal C} 83 of 30.3.2010, Article 108

\textsuperscript{11} N. Pesaresi, A. Sinnaeve, V. Guigue–Koeppen, J. Wiemann, M. Radulescu. The New State Aid Rules for Services of General Economic Interest (SGEI), p. 4-5
Any other state measures that do not aim to support SGEI may cause a distortion of competition in the internal market.

In order to provide more clarification and legal certainty, the European Commission initiated two packages of state aid rules. The first package of 2005 introduced the following acts: Commission Decision 2005/842/EC on the Application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest and a Community Framework for State aid in the form of public service compensation. With regard to the current economic situation and difficulties occurring in the Member States, the European Commission drew up a new package of State aid rules for SGEI on 20 December 2011.

The new state aid rules address the circumstances of economic crisis and are focused on ensuring the competition in the EU internal market. The rules address undertakings, Member States’ authorities and the role of the EU institutions themselves. The European Commission, while introducing revised rules, aims to promote greater social cohesion, growth and productivity in the EU internal market. By the same token, new requirements and guidelines should help to ensure transparency, more effective management of legal state aid procedures and better resources’ allocation in the Member States. The second SGEI package comprises of two communications, revised Decision and a Regulation:

**The Second SGEI package (2012)**

- Revised Commission Decision of 20 December 2011 on the application of Article 106(2) on the Functioning of the European Union State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest

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13 Ibid

In the new State aid package 2012, some of the concepts relevant for SOEs, such as the nature of economic activities and state resources, gained more certainty and were clarified in more detail.

Clarification of the concepts in the new State aid package 2012

Referring to relevant case law of ECJ, the European Commission identifies the practises that do not fall under the scope of economic activities: army or police; air navigation safety and control; maritime traffic control and safety; anti-pollution surveillance; the organization, financing and enforcement of prison sentences. Furthermore, with respect to the case-law, the Commission draws attention to the specificity of social security schemes and distinguishes between solidarity–based and economic activities. Activities under economic schemes encompass the following components:

- optional membership,
- principle of capitalisation
- profit–making nature
- provision of entitlements which are supplementary to those under a basic schemes

State resources

Despite direct grants, tax credits and benefits in kind, there might be other forms of measures that constitute state aid:

- financing provision of public services from the resources provided by a public undertaking
- the absence of tendering while granting certain licences to use the public domain or other exclusive rights
financing SGEI from the sources gained from other undertakings or users or similar compensatory payments financed by para-fiscal charges.

The SGEI package should provide not only more clarifications but also indirectly foster more effective management of public expenditure in the Member States. This aspect falls under a wider scope of structural reforms and will be further assessed in chapter 3.

2.2 Public service obligations: the compensation

There is a significant part on the compensation for profit losses occurring for undertakings during SGEI delivery. Under the subsidiarity principle, Member States can decide on the method of compensation calculation. Nevertheless, several general requirements apply: the compensation has to be compatible with the principles of the EU internal market and not produce any distortive effects. On its behalf, the European Commission provides guidelines on counting the compensation for SOEs with regard to Altmark criteria stemming from ECJ ruling:\(^{15}\):

\textbf{“Altmark criteria”}

The European Court of Justice clarified the concept of state aid and laid down four conditions for public service compensation to be excluded from state aid regulation. As the Court pointed out in its ruling, a state measure does not constitute state aid when all the following four conditions are met:\(^{16}\):

- the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined
- the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner

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With regard to *Altmark* criteria, it is important to look at the case itself as the ECJ ruling of case C-280/00 *Altmark Trans GmbH and Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, judgement of 24 July 2003 gave stimulus on further EU-wide measures. With regard to state aid in relation with public services provision, there were also other relevant cases, for instance, *Chronopost, La Poste and France vs European Commission of 3 July 2003*. However, the *Altmark* judgment itself addressed the concept of SGEI and provided more legal certainty on the concept of public services obligations.

As lawyers from Ysendyck, Latham&Watkins stress, the ruling of ECJ provided clear limits on public service compensation and several new insights on conditions for services to be considered as of general economic interest. In addition to requirements of clear definition and imposition by public authorities, public services compensation must meet the two following conditions. Firstly, the parameters for compensation have to meet criteria of objectivity and transparency: all the costs have to be identified and budgeted before deciding of undertaking’s public obligation. Secondly, analysis of cost is introduced: when there is no public procurement, the compensation for an undertaking entitled for provision of public services cannot exceed the costs an average, well-managed company would have incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations.\(^{17}\)

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\(^{17}\) Ibid

incurred.\textsuperscript{19} However, as a Brussels–based lawyer Wolf Sauter points out, the fourth \textit{Altmark} criteria, namely economic efficiency, is rather problematic due to a lack of clarity of what “efficient” means.\textsuperscript{20} Thus, the ruling left some unclear details in definitions and application procedures. Nevertheless, the European Commission issued several acts with regard to concepts of SGEI, public services compensation measurement and small scale state aid.

\section*{2.3 Entitlement of public services provider}

Depending on existing legal practise in a Member State, several forms of entrustment to deliver SGEI are possible: legislative instrument, regulative instrument or a contract. Although the regulatory framework does not provide strict requirements on the form, the European Commission strongly encourages include the following information in the act of entrustment\textsuperscript{21}:

\begin{itemize}
  \item content and duration of public service obligation
  \item undertaking and, where applicable, the territory
  \item nature of any exclusive or special rights assigned to the undertaking by the authority
  \item parameters for calculating, controlling and reviewing the compensation
  \item arrangements in the case of avoiding and recovering any compensation.
\end{itemize}

One of the successful examples of how to determine compensation and avoid overcompensation is the case of Polish transport sector. This case can also be found in OECD studies on competitive neutrality\textsuperscript{22}. In the Polish case, the amount of compensation is composed by revenues lost by operator with regard to the use of concessionary fares (imposed by statutory act or by the decision of authority responsible for the organisation of public transport) and costs deriving from the provision of the service. The contracts of

\textsuperscript{19} Marc Hansen, Susanne Zuehlke and Anne van Ysendyck, Latham & Watkins, London and Brussels: \textit{Altmark Trans: European Court of Justice outlines conditions for public services compensation}


public services include the method of compensation and the operator has to prove (with submission of certain documents) that losses of profit incurred due to delivering of public transport services. In addition, the public authority has to verify the documents provided by the public services provider. The undertakings that engage in various economic activities outside the scope of public services provision shall hold different separate accounts for SGEI and other activities.\(^\text{23}\)

With regard to compensation, the EU aims to prevent any potential to distort competition in the EU internal market. However, this potential mostly occurs when large enterprises and large amounts of aid are at stake. In order to avoid administrative burden for small amounts of compensation for small–scale local-based services providers, the European Commission adopted \textit{de minimis} Regulation.\(^\text{24}\) The basic principle (\textit{de minimis rule}) is the following: state measures up to 500 000€ in three years to a given undertaking delivering SGEI do not constitute state aid. It does not distort competition or trade between Member States.

The threshold applied for SGEI is higher than a regular state aid threshold of 200 000€\(^\text{25}\). An underlying rationale for introduction of 500 000€ threshold refers to possible economic loss undertakings undergo due to their entrustment of public obligations. Additionally, the new threshold contributes to increased legal certainty of the conditions constituting state aid. Finally, it is aimed to reduce administrative burden for Member States entitling small SGEI for undertakings. The European SOEs are directly concerned by this regulation: taken into account that they are providers of services at the local level and recipients of small amounts of aid, the current framework should ensure a more effective administrative procedure.

\(^{23}\) Ibid: p. 71  
\(^{25}\) Consolidated versions of the Treaty on European Union and the Treaty on the functioning of the European Union; \textit{Official Journal C 83 of 30.3.2010}
2.4 Competitive public procurement

The fourth *Altmark* criterion encourages Member States’ public authorities to introduce public procurement procedure when the SGEI provider is selected. In general, the aim of the EU-level public procurement regulation is to ensure maintenance of market competition and transparent procedures of provider entitlement. Currently, regarding public procurement and public services provision, the key requirements derive from the two following Directives:

- Directive 2004/18/EC\(^{26}\) on the coordination of procedures for the award of public work contracts, public supply contracts and public services contracts;
- Directive 2004/17/EC\(^{27}\) on coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sector (Utilities directive)

In principle, the Directive 2004/18/EC covers “classic” public procurements when the private undertakings are competing. The first requirement is related to respecting the thresholds calculated by the European Commission. However, certain services, including public telecommunications and services on the basis by an exclusive right are exempted from the threshold requirements\(^{28}\). The second aspect is contract award criteria: the winner has to be chosen either by lowest price basis or by assessment of the most economic advantageous tender with respect to the contracting authorities’ criteria. The third aspect concerns publication by the contracting authority: apart from optional guidelines, notification of contract or design contest as well as contract award notice is compulsory. Finally, certain requirements apply to the form of public procurement procedure: open, restricted, negotiated procedures or competitive dialogue. The Utilities Directive (2004/17/EC) is closely linked to SOEs as it covers services where the monopoly rights are often met: water, energy, transport and postal services. Referring

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\(^{26}\) Directive 2004/18/EC on the coordination of procedures for the award of public work contracts, public supply contracts and public service contracts, Official Journal of the European Union L134/114

\(^{27}\) Directive 2004/17/EC on coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors, Official Journal of the European Union L134/1

\(^{28}\) Directive 2004/18/EC on the coordination of procedures for the award of public work contracts, public supply contracts and public service contracts, Official Journal of the European Union L134/114
directly to SOEs, Utilities Directive (2004/17/EC) is less complex and detailed. It emphasizes the need of a transparent and open selection procedure: the legal ownership of an undertaking has no effect (can be private or state-owned) as long as its activities fall under the scope of water, energy, transport and postal services provision. All in all, there is a wide scope of discretion for Member States left as regards the organisation of procedures when SOEs are involved.

With regard to general requirements on competitive public procurement, Member States apply different types of procedural instruments and the case below could be an example of good practice.

**Competitive public procurement procedures in the UK**

There are six principles to be followed in order to ensure competition in the public procurement processes. The following keystones concern both public authorities and providers:

**Process:** public authorities are obliged to establish different departments for procedures (separation based on regulatory, commissions, procurement and bidding functions) in order to avoid conflicts of interests; bidders should provide all the requested documents on-time.

**Costing:** provide a certain formula for all public sector bids in order to address all indirect costs.

**Grant funding:** a requirement for all bidders to disclose grant funding and ensure the grant funding will not be directed to subsidise their bid.

**Pensions:** public authorities are encouraged to provide special guidance on pensions transfer or treatment of public service pensions as well as more general guidance for treatment of staff transferred from public sector.

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29 Competitive Neutrality. Maintaining a level playing field between public and private business, OECD 2011, p. 103
Competitive public procurement procedures in the UK (continued):

**Risk:** obligation for bidders to provide risks assessment, indicate their value, present commercial insurance coverage.

**Tax:** bidders should provide expected liabilities for both VAT and corporate taxes.

The European Commission employs certain control measures and implementation assessment instruments on Member States’ activities in this field. Started in 2012, the Annual Public Procurement Implementation Review monitors the annual state of Community *acquis* implementation as well as overviews the national public procurement procedures and structures. Additionally to implementation assessment, there is often a focus on public procurement procedures and cross–border aspect in the Internal Market Scoreboard – report on the functioning of the internal market and EU–law transposition as well as implementation. In addition to best practise examples of effective EU–law transposition, there is data on infringement procedures opened for Member States (mostly the cases of fair competition distortions). As currently available data of November 2012 demonstrate, infringements in the fields of public procurement or services provision are common: 23 cases in the former and 32 in the latter. Member States are obliged to respond and take relevant actions to avoid distortions.

### 2.5 Ensuring transparency of public finances

Transparency of public financing is one of the key concerns related to both governance of and efficient allocation of public finances of SOEs. There is a close resemblance between the OECD practise and guidelines on the one side and the requirements for public undertakings regulated in the Community law on the other. The transparency directive

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30 Annual Public Procurement Implementation Review, SWD (2012)342 final, Brussels 2012 10 09
32 Internal Market Scoreboard 2013 No. 26, p. 22
http://ec.europa.eu/internal_market/score/docs/score26_en.pdf
2006/111/EC\(^{33}\) (with its amendments) provide legal framework on financial relations between public authorities and public as well as private undertakings within the context of state aid.

Although Member States have a wide scope of discretion in regulating their owned enterprises under the subsidiarity principle, the state aid regulations apply to prevent the distortion of competition. Nevertheless, provisions account for SGEI and allow Member States’ authorities to provide compensations for SOEs delivering strategic public services: entitled undertakings, while delivering SGEI, encounter certain costs that need to be compensated. However, in order to maintain transparency of the financial relations between governmental institutions and undertakings, the Transparency Directive imposes certain requirements:

- Obligation for enterprises to keep separate accounts for regular financial operations and transactions from public authorities;
- Ensure the subsidies for public undertakings do not exceed the costs of their economic activities;
- Prevent any forms of cross-subsidising;
- Guarantee that the European Commission has all the information on compensations at its disposal;
- Requirements for all the large undertakings in manufacturing (with an annual turnover higher than €250 million) to provide reports on accounts and any other relevant financial information

The requirements for transparency in the EU Directive 2006/111/EC go along the OECD principles of corporate governance. In the case of OECD practise, the concept of transparency covers more than transparency of SOEs’ financial relations and fall under a broader context of corporate governance of SOEs\(^{34}\). For instance, a disclosed information on board members’ remuneration, identification of potential material risks or annual audit

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procedures are prerequisites for efficient governance of public undertakings in OECD countries. This issue will be further addressed in the chapter 4 of this study.

2.6 EU Company Law

Large SOEs are concerned by the EU regulation on the European Company Law aimed to foster competitiveness, ensure transparency, implement shareholder rights and prevent the market from competition distortion. At the moment, the following Directives are key legal acts in the EU Company Law:

- Forth Council Directive of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies 78/660/EEC


These directives are important to SOEs in so far they protect the rights of shareholders. The EU imposes obligations for Member States to ensure the right for shareholders to have an input on the agenda of general meetings and the right to present draft resolutions for the information to be included in the agenda of general meetings. Transparency requirements apply for the information on accounts. However, certain issues such as remuneration could be further taken on board, especially in the context of recent EU legislative developments in the area of financial markets.

The SOEs are important players in the EU internal market due to their employment capacities, added value to the EU GDP and key services provision. However, a wide range of their services are not covered by the Services Directive 2006/123/EC, in sectors of internal networks of transport or communications. In order to foster effective and competitive EU internal market, improve conditions for business, the EU issued two Single Market Acts. The Second Single Market Act\(^\text{39}\) of October 2012 covers the following policy proposals related to network industries which would be also relevant to SOEs:

- Opening of domestic railway passenger services to operators from another Member State to improve the quality and efficiency of those particular services
- Establish the EU Single Market for maritime transport (in order to reduce administrative burden and custom formalities)
- Foster implementation of the Single European Sky to improve safety, capacity and efficiency of the European aviation
- Action plan to improve implementation and enforcement of the third energy package

The EU in applying these instruments aims to broaden the scope of Services Directive in the fields where large SOEs operate: for instance, national airlines such as Air France, national seaport companies, such as Klaipėda State Seaport, or domestic railway passenger services such as Polish State Railway. The SOEs will play a prominent role in the EU internal market and its regulation as the Member States will open their markets for foreign suppliers in the fields previously dominated by national providers.

The keeping of right balance between quality of SGEI and ensuring equal market conditions will be an important task, which has to be fulfilled by the Member States’ public authorities. Furthermore, as joint actions will be taken to foster competitiveness in network

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industries, the creation of a common framework for large industrial SOEs will become more salient.

### 2.8 Other regulatory initiatives relevant to SOEs

The European Commission points out in its communication on state aid modernisation, that state aid which does not target market failures and has no incentive effect is not only a waste of public resources but it acts as a brake to growth by worsening competitive conditions in the internal market\(^\text{40}\). In this respect a focus must be kept on:

- state aid to address market failure: identification and definition of common principles in order to tackle market failures, incentive effect and negative effects of public interventions, and
- aligned guidelines, including guidelines for Regional Aid, Research & Development & Innovation, Environmental aid, Risk Capital and Broadband by the end of 2013.

The Member States, on their behalf, will be encouraged to fulfil the requirements of notification and, within a broader perspective, foster their national reforms towards:

- ensuring *ex ante* compliance with the State aid rules of *de minimis* measures and block-exempted schemes and cases,
- ensuring increased quality and better timing in submission of information for notifications,
- better equipped national systems to ensure that state aid exempted from *ex ante* notification comply with the Community law.\(^\text{41}\)

The outcomes of state aid modernisation will be relevant for SOEs in different ways. Firstly, the successful implementation of proposals should reduce administrative burden – the procedures will be simplified for small amounts of state subsidies and there will be a clear distinction and set of rules for regional, R&D oriented state aid. In general, there will be a more focused approach towards state aid to address market failure.


\(^{41}\) Ibid
Regarding modernisation of public procurement, there is a general tendency in the initiatives of the European Commission to indirectly encourage a wider application of public procurement procedures. In the context of SGEI and state aid, the European Commission put an emphasis on the requirement to increase competitiveness of the entitlement of public services provider. With regard to services in the water, energy, telecommunications and post, the Commission proposes two directives that will replace the current Directive 2004/17. The revision will focus on simplifications of rules and initiatives such as:

- Cuts in administrative burden, such as decreased number of documents to be provided by the economic operator
- Wider application of electronic communication means
- Better conditions for negotiations in order to achieve a purchasing of goods and services in accordance to the governmental needs.

Taking into account the prospective steps at the EU level and their relevance for SOEs, there is a potential for improved conditions for competitive neutrality. The Member States will be obliged (especially in the context of state aid modernisation) to more effective notification procedures and better allocated aid. With regard to SGEI, increased transparency of entrusting the public services provider will be achieved. However, there is a need of monitoring instrument to tackle difficulties SOEs face in compliance with the aforementioned requirements.

As regards the issue of corporate governance of the companies, there are several EU-level initiatives which fall under the scope of Company law. The Communication “Action plan: European Company Law and Corporate Governance” addresses the need and conditions of an EU-wide framework. There is also a link to SOEs as they are also concerned by the issue of better governance. The OECD in this regard has developed a set of

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recommendations for corporate governance of SOEs as well as guidelines on accountability and transparency\(^{45}\), which serve as a useful tool to improve their management and performance\(^{46}\). The SOEs governance issues will be further elaborated in the chapter 4.

\(^{46}\) Corporate Governance of State–Owned Enterprises. A Survey of OECD Countries, OECD 2005
3. SOES AND THE EU INTERNAL MARKET

As it goes from the analysis of Community _acquis_, the relationship between SOEs and public authorities increases with new initiatives, be it through regulatory framework of state aid, SGEI or new requirements on public procurement and transparency. However, the role of the SOEs remains prominent within the EU internal market and needs to be addressed separately.

3.1 The EU internal market: strategy on SOEs

The EU over the recent years has adopted a set of strategies and presented different proposals suggesting structural changes in the economies of the Member States to fulfil the objectives of smart, sustainable and inclusive growth. Modernised frameworks, better monitoring instruments and recommendations aim all together to contribute to effective functioning of the EU internal market. Rationale for a new state aid framework, revision of public procurement application or encouragement for public administration reform lies behind several flagship initiatives of _Europe 2020_ strategy. The SOEs as well could have several links with the following flagship initiatives:

- “Innovation Union” – promoting cooperation of research, business and education in order to strengthen the EU’s innovative capacities
- “Resource efficient Europe” – sustainable usage of resources, promoting more effective and sustainable technologies
- ”An industrial policy for a globalisation era” – balanced and focused industrial development.

3.1.1 SOEs and resource efficient Europe

While developing an effective and sustainable infrastructure one can observe a set of financial and market measures employed in form of subsidies, taxation or procurement procedures. With the adoption of EU initiative on Resource efficient Europe, the state aid framework has become a subject to a revision. The European Commission is revising the

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framework to employ state aid in promoting a usage of sustainable resources, where state aid is regarded as a tool to promote business and services provision focused on low-carbon, green technologies or reduction of waste. This initiative has been focusing on energy and network industries, mostly on transport and energy sectors known as biggest polluters.

Since the initiative took place, the Member States have been invited to contribute and develop “smart, upgraded and fully interconnected transport and energy infrastructures”. The aim to employ state aid was to promote “greener” and more sustainable industrial activities, which is also of relevance to the operation of SOEs. Modernised state aid instruments may promote more sustainable usage of natural resources and “greener” economic activities.

SOEs could also fall under a scope of postal, energy or public transport sectors. However, the extent of certain public services delivered by SOEs, via competitive tendering remains under discretion of the Member States. For instance, in some Scandinavian countries the SOEs are not participants in the public procurement procedures. Concerning their legal status they are regarded as contractors, and not as potential entities to participate in the tendering.

Several practises of how to encourage SOEs to use more resource–efficient and sustainable business could be observed among Scandinavian countries.

**Sustainability reports – a practice by Scandinavian countries**

In several countries, particularly Scandinavian, public authorities imposed certain reporting obligations for their SOEs in order to raise awareness of sustainability issues and possibly to improve companies’ performance in terms of environmental protection and social responsibility. One of the initiatives to foster more sustainable business was the imposed obligations of sustainability reports.

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49 except certain requirements outlined in Directives 2004/18/EC and 2004/17/EC
50 The Swedish Public Procurement Act: an Introduction, Swedish Competition Authority, May 2012
In 2007, Sweden has adopted guidelines for reporting on their SOEs sustainability. The state owned undertakings are supposed to monitor their own economic performance and assess social and environmental impact of their business practise. The Global Reporting Initiatives’ guidelines serve as guidance for companies to assess their environmental and social performance. In order to measure whether reporting obligation leads to more sustainable activities of SOEs, several assessments were conducted. In the case of Sweden, in the period of 2007–2009, the SOEs’ concern about environmental and social issues increased together with higher level of sustainability issues’ awareness among companies’ staff members. However, the actual performance in terms of environment and social responsibility is rather diverse: some companies had a positive change in their day-to-day activities whereas the others remained the same. In a global context, observers agree on actual increase of sustainability of world companies’ activities after they are obliged to apply Global Reporting Initiatives’ guidelines on social and environmental performance.

As the case illustrates, Member States’ initiatives to impose sustainability reporting obligations have a positive effect on enterprises’ performance. Taking this into account, a wider application of reporting initiatives will contribute to more efficient and sustainable usage of resources. In parallel, the reports on SOEs’ sustainability performance could be also incorporated in the European Semester, which would contribute to a general objective of a more sustainable economic performance of the EU.

### 3.1.2 SOEs and industrial policy

During a financial and economic crisis, state aid was considered as a tool for restructuring sectors in difficulty. The Commission introduced a distinction between crisis state aid and non-crisis state to prevent an overuse of state subsidies and other forms of aid to once the recovery goals are reached. As it is stated in Europe 2020, short-term crises–related measures, usually based on subsidies or tax exemption, should be disciplined again once

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51 Swedish Government Office official website: http://www.government.se/sh/d/8194/a/93506
53 Ioannis Ioannou, George Sarafieim. The consequences of mandatory corporate social responsibility reporting, October 26,2012. Harward Business School, p. 27 -28
the recovery is reached.\textsuperscript{54} However, in this context there is some legal uncertainty: allowance and instruments of control are not clearly identified. However the new state aid package of 2011 provides more certainties of legal state measures, mostly in public service compensation matters.

### 3.1.3 SOEs and innovation Union

The flagship initiative “Innovation Union” introduced a wider focus on revision of state aid framework. The SOEs to enhance their effectiveness could use such measures as partnership initiatives between research, universities and business for launching innovative and sustainable technologies. SOEs can be encouraged to more close cooperation with universities and other research institutions. Furthermore, as undertakings representing energy, transport or postal sectors, they are important targets for application of innovative and efficient technologies in order to increase their economic performance.

### 3.1.4 SOEs and smart budgetary consolidation

The Europe 2020 strategy provides important insights for structural public administration reform. More focused public spending, usage of state aid measures only in the case of recovery, assuring competition environment are clearly identified in the strategy. For instance, it is stated that efficiently redirected state resources will contribute to higher integration in energy and transport sectors. The Member States are being gradually encouraged to revise and more effectively allocate their public spending\textsuperscript{55}, including in the operation of SOEs. Furthermore, due to gradually increasing fiscal supervision through European Semester instruments, the Member States will be obliged to improve their SOEs performance and aim for a discipline in budgetary expenditure and national debt.

The Member States should focus on more efficient allocation of resources for public expenditure, employ more effective resources’ management techniques and ensure competitive tendering. Some Member States already introduced several measures to


improve efficiency of public sector and especially in the case of public procurement arrangements.

**Public administration and public expenditure in Sweden**

With regard to public administration reform, Sweden introduced a new body to cover some administrative tasks of governmental bodies and in turn reduce public administration costs. This step stemmed from the 2009 Government Bill Public Administration for democracy, participation and growth. The National government service centre opened in 2012 will offer administrative assistance services for Swedish governmental agencies. Moreover, it is aimed to contribute to more effective governmental agencies’ management techniques and reduce costs as well as ensure more competitive access to tendering procedures. What is more, National government centre will help to identify what services in the governmental agencies can be contracted out to private sector undertakings. Thus it will ensure more competitive appointment of services providers.

### 3.2 European Semester and SOEs: checking the progress

The European Semester as a framework for annual EU policy coordination was adopted in June 2010 in the European Council with the agreement of ECOFIN Council. It aims to foster economic recovery and help Member States to identify problems as well as propose effective policy options.

The European Semester process is helping to secure a stability of public finances in the Member States via a set of policy recommendations. The European Commission analyses economic performance by the Member States and addresses the challenges to fiscal stability through necessary structural reforms. The Council in this respect issues country-specific recommendations and proposes necessary policy actions.

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57 Official website of Government Offices of Sweden: http://www.government.se/sh/d/15474

The Annual Growth Survey, one of the key parts of the European Semester, helps to review a current economic situation in the EU, identifies areas where more change has to be achieved at both European and national levels and presents guidelines to improve overall economic performance. The Annual Growth Survey of 2013 mentioned the following areas being of a particular concern for EU institutions and Member States: services, energy, transport, digital market and financial services. Several aspects of service provision could be linked to the effective operation of SOEs, namely:

- Progress in services market integration
- State of public procurement procedures

In the context of European Semester Member States are encouraged to work on their reforms and adopt policies focused on growth. The Council has emphasised the importance of reform commitments under National Reform Programmes in line with country–specific recommendations. In the latest Council conclusions on annual growth survey the role of public administration was also emphasised. The Council highlighted the role of effective public administrations supporting national and EU–level growth strategies and indicated that more should be done to modernising and making full use of public procurement; ensuring interoperable, user–friendliness provision and use of services, including e-Government tools; and improving the quality, independence and efficiency of the judicial system.\textsuperscript{59}

The country–specific recommendations prepared by the Commission and adopted by the Council encompass overview of countries’ achievements in terms of growth objectives,\textsuperscript{60} the state of National reforms implementation, identification of current difficulties and proposals of policies to be further implemented. These recommendations serve as guidelines for Member States to tackle economic difficulties, assess efficiency of implemented policies and foster effective public administration and business competitiveness related policies.

The table below presents the main elements of the European Semester being a main instrument of European economic governance.

\textsuperscript{59} Council conclusions on the Annual Growth Survey 2013, 3220\textsuperscript{th} Economic and Financial Affairs Council Meeting, Brussels, 12 February 2013, p. 7
Two countries, Lithuania\textsuperscript{62} and Slovenia\textsuperscript{63}, have received country specific recommendations with regard to the operation of SOEs. The recommendations given for both Lithuania and Slovenia do not contain detailed policy suggestions and rather leave a wider discretion to the implementation by the Member States. This show that the EU monitoring tools for the supervision of SOEs can be further developed in a more concise manner.

\textsuperscript{61} The European Commission, DG ECFIN
\textsuperscript{63} Recommendation for a Council recommendation on Lithuania’s 2012 national reform programme and delivering a Council opinion on Lithuania’s convergence programme for 2012-2015, Brussels, COM(2012) 319 final
3.3 Unlocking the potential: significance to SOEs and to internal market

For the time being the EU is not in a possession of a cross-sector data on the share of European SOEs in the EU service industry. There is some data on number of foreign undertakings in the Member States, which provides some insights on integration level in the market of services. The graph below demonstrates the share of foreign undertakings from other Member States in value added to the service sector during 2003–2009, however it does not distinguish the services, which are provided by SOEs.
The share of foreign undertakings from the other Member States providing services rarely exceeds 25% and the European Commission draws a particular attention on this trend\(^{64}\). It could be further argued that the opening of SOEs to the competition and ensuring their effective operation through best practices of corporate governance would boost the internal market of services and vice-versa as these processes are closely interrelated.

### 3.3.1 Unlocking internal market of services

A more integrated services market would lead to two important outcomes: higher level of competitiveness of SOEs and a better quality of services to the European consumer. According to the Commission’s calculation, the removal of obstacles for providers established in other Member States and improved mutual recognition would lead to 2.6% of GDP growth of the EU\(^{65}\).

The effect of more integrated internal market of services will have a positive effect on the competitiveness of the European SOEs. Facing the market competitors from home and other Member States, the SOEs will have to focus their investments on efficient, innovative technologies and adopt innovative business strategies in a more competitive environment. The public authorities, on their behalf, will be encouraged to ensure competitive neutrality

\(^{64}\)Ibid: p. 5-7

\(^{65}\)Ibid: p. 9
conditions linked to the effective operation of SOEs. The introduction of good corporate governance practices in this regard would be an effective supplement to regulatory neutrality policies, which usually require relatively higher political and administrative costs.

One of the sector–based examples of integration potential could be found in the EU transport market, which is one of the key concerns in the European Semester and Annual Growth Survey of 2013. This also concerns the operation of SOEs, which have varying market shares in the public transport.

The progress of integration in transport markets is considered as rather low in comparison to other services or trade in goods. Lower degree of market openness, still prominent barriers for market entry for foreign operators, delays in transposing EU legislation were identified by the European Commission as requiring urgent solutions.

On the other hand positive achievements could be seen in the inland waterways and international road transport; however domestic rail transport remains closed to competition. Several restrictions for market entry in the cross–border railway sector are still persisting, particularly in large transit Member States (Germany, France or Italy) and periphery markets, especially linked to the former structures of defunct Soviet Union. Port services do share a similar situation where entry for private operators remains restricted and monopoly practises are could be seen as common in some Member States.

The European Commission recently suggested the opening to competition of domestic rail passenger services, which should advance further together with next state of negotiations on the Services Directive. As the data of 2012 demonstrate, the number of enterprises in EU-27 railway sector is the lowest (800) in comparison with road passenger transport (331722) or air transport operators (40000). The situation in rail sector requires urgent solutions, especially from the point of view of SOEs operation, not to mention old abandoned practices of former soviet satellite countries.

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66 Ibid: p. 17
3.3.2 Unlocking public procurement

European businesses to large extent provide a true value to the SGEI if procured under the contracts by SOEs or other public institutions. In this particular case, the public procurement value accounted for approximately 340 - 447 billion euros in 2010, therefore transparent, balanced and efficiency-oriented public procurement procedures would be crucial on effective management of costs associated with the operation of SOEs. In this regard the European Commission intends to put forward a competitive selection procedure before entrusting a public service obligation (non-binding).

Wider application of competitive public procurement procedures could contribute to promotion of sustainable growth. In the same direction, this requirement promotes procedural transparency and competitiveness. On the other hand, it could have higher costs, therefore a cost and benefit analysis could be applied to ensure the selection of a most efficient provider. The SOEs in this case would be encouraged to participate in the competitive procurement as it will help to achieve two important outcomes: maintain conditions of competitive neutrality and improve economic performance of SOEs.

The SOEs by tendering and contracting will gain the direct access to effective resource management, implementation of innovative technologies and business strategies, which would be a positive outcome of the process. This particularly accounts for large companies in transport or energy sectors. This should apply equally in the cross-border provision of SGEI by ensuring that participants from other Member States have an equal access to public procurement. This is one of the key prerequisites to preserve competition in the internal market, which is in hands of public authorities as the main contractors.

3.3.3 SOEs potential to the EU competitiveness

A broader picture on effective public expenditure and business regulatory environment can be found in worldwide surveys, for instance, in 2012 World Competitiveness Scoreboard69. The competitiveness scoreboard is an annually issued report presenting the countries according to their business regulatory environment, competition regulation, public sector

policies, etc. Among all, it provides important insights for assessing governmental performance in terms of legal framework for public expenditure and competition as well as public sector openness for foreign contractors.

The competitiveness index is composed of the following factors: economic performance, government efficiency, business efficiency and infrastructure. The measurement of Government efficiency factor, among others, includes some criteria that are highly relevant for the context of SOEs:

- Competition and regulations: governmental subsidies (%), state ownership of enterprises, competition legislation
- Openness: degree of protectionism, public sector contracts (openness for foreign contractors)

Thus the values of 2012 competitiveness index are helpful to have a taste of country’s business climate, its openness for foreign undertakings and efficiency of public expenditure framework.

**Table 1. Leading EU countries in the 2012 World Competitiveness Scoreboard**

<table>
<thead>
<tr>
<th>No.</th>
<th>The EU country</th>
<th>Competitiveness index (from 1 to 100)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Sweden</td>
<td>91,393</td>
</tr>
<tr>
<td>2.</td>
<td>Germany</td>
<td>89,257</td>
</tr>
<tr>
<td>3.</td>
<td>Netherlands</td>
<td>87,158</td>
</tr>
<tr>
<td>4.</td>
<td>Luxembourg</td>
<td>86,052</td>
</tr>
<tr>
<td>5.</td>
<td>Denmark</td>
<td>84,876</td>
</tr>
<tr>
<td>6.</td>
<td>Finland</td>
<td>82,467</td>
</tr>
<tr>
<td>7.</td>
<td>United Kingdom</td>
<td>80,142</td>
</tr>
<tr>
<td>8.</td>
<td>Ireland</td>
<td>78,465</td>
</tr>
<tr>
<td>9.</td>
<td>Austria</td>
<td>77,673</td>
</tr>
<tr>
<td>10.</td>
<td>Belgium</td>
<td>73,484</td>
</tr>
</tbody>
</table>

As we see from the table, among all EU Member States in 2012, Sweden presented the highest competitiveness index. In recent decades, it has undergone several reforms. One of the achievements was the SOEs reform implemented in 1997 and it could be claimed that
the outcome of SOEs–governance related policies has a direct effect to a friendly business regulatory environment, effective public expenditure and overall economic performance.

**Sweden: reform of SOEs**

Sweden was the first EU country to implement the SOE reform in 1997 with a particular focus on governance and effective management of its SOE industry. The reform helped to increase SOE efficiency though clearly identified objectives, ring-fencing of state ownership and, most importantly, through transparency requirements. Today Sweden manages 55 companies (owning 42 and partly owning 13), that are large employers and contribute around 58 billion SEK of value to GDP\(^70\).

\(^{70}\) Government Office of Sweden http://www.government.se/sb/d/2106/a/19792
4. REFORMING SOES: IMPROVING GOVERNANCE

The SOEs are affected by the regulatory framework linked to public procurement, transparency of financial relations between public authorities and enterprises, state aid and SGEI. Through the measures of European Semester, they would be subject to structural reforms in the Member States. However, despite the more aggregate level regulations, company–level issues, especially the governance should not be forgotten. This particular aspect is directly related to competitiveness across the sectors. Through effective governance the SOEs will increase economic performance and accountability that should result in higher quality of public services.

In order to achieve effective functioning of SOEs, guidelines on corporate governance at the company and Member States levels gain more importance. Board composition, reporting on annual performance, disclosure requirements, relations between shareholders, involvement of stakeholders are among the targets in determining SOEs performance. This process could be observed internationally, regionally and at the level of particular countries. For example, the OECD has developed the guidelines on corporate governance of SOEs\textsuperscript{71}. The Baltic Institute of Corporate Governance issued Baltic Guidance on the Governance of Government–Owned Enterprises. Some EU Member States have issued separate guidelines, for instance, Sweden has adopted guidelines for external reporting by state–owned companies” or Ireland the Code of Practise for the Governance of State Bodies.

The key aspects that cover main governance principles are transparency, accountability and, due to specific nature of SOEs, a clear separation of state ownership and regulatory functions.

4.1 Separation of state ownership and regulatory functions

In order to ensure that state as an owner does not have an overloading influence on the SOEs and market conditions are kept, there should be a clear separation between state ownership and regulatory functions. For example, in Nordic countries or United Kingdom there are no

\textsuperscript{71} Corporate Governance of State–Owned Enterprises. A Survey of OECD Countries, OECD Publishing 2005
state officials in the boards, state intervention possibilities remain highly limited and a
general SOEs’ performance resemblances private market players’ performance\(^\text{72}\). However,
a clear separation of the state ownership and other powers requires various legal measures
and is difficult to achieve. The most prominent difficulty is the state’s obligation to provide
high quality public services and in this case the state has at its disposal the means of
subsidies or tax exemptions. In order to maintain high quality of services and ensure
competitiveness, tendering procedures could be applied. In this case it was suggested to
focus on “contestability within the market” and to introduce tendering procedures, which
would open the competition in a subsidised segment in the market\(^\text{73}\). A wider application of
competitive tendering procedures within the EU framework for growth would be a right step
in this direction. Below are presented some examples of how Member States coordinate their
SOEs ownership in various forms.

In Ireland, SOEs gained the name of Government–sponsored Bodies. In terms of
accountability, they are under control of different ministries with the Ministry of Finance in
charge of a more general framework. In 2009 Ireland’s Ministry of Finance issued “Code of
Practise for the Governance of State Bodies” that gives guidelines on governance issues for
SOEs.

France in 2004 established the Government Shareholding Agency (Agence des
Participations de l’Etat). This body falls under the supervision of Ministry of Economy and
fulfils the function of Government shareholder: APE manages state’s ownership portfolio of
about 70 companies and coordinates governmental assets.

The UK has established the Shareholder Executive – body in charge of managing
Government’s shareholder function (about 20 SOEs) and providing expertise on SOEs
governance, governmental assets or corporate finance. The Shareholder Executive operates
as part of Government Department for Business Innovations & Skills.

http://dx.doi.org/10.1787/5kg9xfg6n4wj-en

\(^{73}\) The Role of State-owned Enterprises: Providing Infrastructure and Supporting Economic Recovery, Forfas
4.2 Transparency and accountability of SOEs

The effective operation of SOEs is linked to the transparency culture, parts of which can be found in the EU Transparency Directive\(^{74}\), which requires accounts to be kept separately for commercial and non-commercial activities, where the state has a financial input in the means of subsidies. These practices have to be reported and many EU Member States have different reporting obligations for SOEs by ensuring that adequate information is accessible to the public by which SOEs remain accountable.

In line with transparency requirements, the SOEs disclose information on their economic activities, identify risks and describe the governing practises. The reporting is necessary for a public control in achieving greater accountability and setting a framework of recommendations on better management of SOEs.

The OECD and various institutes on corporate governance issue guidelines and recommendations on transparency and accountability. For example, the Baltic Institute of Corporate Governance adequately represents a Nordic experience, where internal governing practices, relations with stakeholders, performance targets are among the key factors to effectiveness of SOEs. A national reporting system helps the implementation of these objectives and can be summarised in three types\(^{75}\):

- **Ex ante** reporting on SOE objectives with identification of economic risks
- **Ex post** reporting on financial activities, board management and sustainability
- **Aggregate-level** reporting covering the two forms indicated above and addressed to the public in general, usually through the legislative control mechanism of the Parliament.

The complexity of reporting systems usually is a result of increasing standards to accountability aiming at stricter limits on misbehaviour. For example, the disclosure of SOE information on the board member entitlements, remuneration policy or shareholders’ rights,

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\(^{74}\) Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, Official Journal of the European Union L318, 17.11.2006, p. 17-25

SOEs in the European Union: ensuring level playing field

creates a necessary discipline inside the SOEs for better performance. The identification of SOEs objectives helps to develop a clear economic strategy and reporting on external relations with the stakeholders to insure the communication with the public by addressing the quality issue of public services.

Stakeholder relations also cover the participation practices by the employees in the decision-making of the company and, according to the OECD, could have the following forms of employees’ representatives’ participation in the boards, formation of work councils, adoption of internal ethics code or media reporting.

Furthermore, Member States’ public authorities should report on their public expenditure towards SOEs in the means of subsidies or guarantees. Additionally, other state measures such as tax exemptions for SOEs should be disclosed in order to maintain the degree of transparency.

The scheme below summarises main aspects of reporting at the levels of the SOEs and of the Member States. At the level of SOE’s it includes governance reporting together financial statements on issues of governance and economic performance, while the Member States could be responsible on adequate regulatory framework in provision of SGEI, public procurement rules and discipline of public expenditure.
The effective functioning of SOEs as enforced by transparency and accountability requirements will contribute to improvement of competitiveness at a company and an aggregate sector level of the economy concerned and could be summarised below in line with the governance practices as observed in this study.

Figure 3. Effective governance of SOEs
5. RECOMMENDATIONS

The recommendations will derive from the analysis of EU *acquis*, as linked to internal market creation, and of international as well as Member State practices of increasing the effectiveness of SOEs and will focus on aggregate-level monitoring tools to foster the implementation of corporate governance principles in the SOEs as well as on forthcoming EU legislative initiatives.

5.1 Reporting on SOEs at the aggregate level

Different aspects of SOEs as linked to a provision of services of general economic interest, state aid regulation, internal market creation for network industries, public procurement rules, account transparency requirements, fair trade, tax and debt neutrality in particular and regulatory neutrality in general, are covered by the EU *acquis* and their performance to a different extent is targeted in the implementation of country specific recommendations within the European Semester. In a general sense the effectiveness of these actions is directly linked to the operational standards of SOEs as they can be set within an appropriated legal environment. It could be measured by indicators pertaining to the corporate governance of SOEs to create “a system by which businesses are directed and controlled”\(^{76}\).

Thus, in order to employ SOEs to fulfil the objectives of smart, inclusive and sustainable growth and to ensure a competitive neutrality of their operations, the creation of the SOE Observatory with the ownership at the EU level would be a preferred option. This instrument would be targeting national actions against a set of EU benchmarks or indicators encompassing the principles of corporate governance in accordance with international practices. The set of indicators will look at EU level playing field where SOEs and private sector enterprises would be set to compete under equal conditions and transparent rules. The SOEs will have to operate under commonly accepted principles and best practices of corporate governance among the EU Member States.

\(^{76}\) Cadbury Report, A Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States, by Weil, Gotshal & Manges on behalf of the European Commission, Internal Market Directorate General, 2002
The observatory would require a SOEs framework of indicators at the EU level, which could be initiated and architected by the European Commission and agreed by the Council. The observatory would include the elements mentioned in this study, such as national frameworks for SOEs, state ownership policy, rights of shareholders, transparency reporting, role of SOEs boards as well as national SOEs targets, national public procurement practices of SOEs and other measures aiming at competitive regulatory neutrality. These elements will be consistent with the EU *acquis* and its implementation actions as well as with other internationally recognised practices of good governance.

The EU Member States will be responsible for national reporting and the Commission on this basis could initiate the EU SOE Survey on annual basis with defined scope and structure. It should be noted, that in numerous Member States the SOEs reporting practises already exist to different extent to ensure a transparent and effective functioning of SOEs. Therefore, the designing of a common process in a form of a synthesis report at the EU level would contribute to:

- exchange of best practise in terms of SOEs regulation and corporate governance framework
- ensure better conditions for creation of internal market, prevention of competition distortive national policies and to boost SOE competitiveness at the EU level
- *ex–ante* guidance on SOEs reform for Member States and *ex-post* evaluation of best practices
- discipline of public expenditure, equal and transparent provision of SGEI and public procurement procedures at the national level

5.1.1 Reporting process

The process will address policy formulation, guidance and monitoring. The Member States will be asked to provide data on public expenditure, changes in SOEs regulatory environment and report on state aid as well as other regulatory measures applied to SOEs. The Member states will be asked about provision by SOEs of financial statements and reports on market activities aiming at greater transparency and as well as invited to assess the value added of SOE’s to economy at national level, including an aggregate or global
SOEs portfolio composition as well a share of cross-border provision of services. This would help to identify the economic significance of SOEs to economy in the process of unlocking their potential through set of measures at the EU level, among others to include EU growth and flagship initiatives.

The Member States will be asked to report about SOE governance procedures in line with agreed methodology which will follow best international practices. This will help to identify and exchange best national practices to increase competitiveness through corporate governance. Within the EU internal market the aggregate-level monitoring of SOEs activities will contribute to prevention of market–distortive activities as the member states will be asked to indicate their actions within two distinctive features of SOEs:

- Increasing economic efficiency and profitability (focusing on corporate governance)
- Ensuring high quality of services to meet citizens’ expectations (focusing on transparency policies).

The European Commission could be invited to produce a synthesis report for major European SOEs, which will have a defined structure linking together economic performance, governance issues and policies as well as national and EU regulatory frameworks. Inclusion of SOE reporting into the European Semester could be discussed among the options, however in that case it will have to be supplemented by a set of corporate governance indicators. Otherwise, the SOE Observatory could be launched as a separate process alongside the EU policy cycle as indicated below:

![EU-level SOEs observatory policy cycle](image.png)

**Figure 4. EU-level SOEs observatory policy cycle**
The depth of synthesis report could be further discussed as in general terms it could have an overview function. However, in some agreed areas, especially those linked to the implementation of EU *acquis*, it could also include a set of recommendations addressed to the Member States. In this case the European Commission could assess Member States’ practices on SOEs performance and governance by taking into account best practise examples and difficulties the SOEs are facing.

The next steps in designing the EU *acquis* in areas linked to operation of SOEs would further contribute to better governance and competitiveness at the EU level as well as the creation of the EU internal market, especially in the area of network industries as now proposed by the second package of SEA. As the share of cross–border services by large SOEs within the internal market looks more significant, the need for an aggregate monitoring framework becomes even more acute.

### 5.1.2 Scope of the EU level SOEs

The selective representation of EU level large SOEs could be done through the combination of the criteria on SOEs service network and value added to the economies of the Member States. This could include service responsiveness to the consumer needs combined with the need of the participation by all Member States in the EU SOE survey. The value added criterion could focus on SOEs capital levels as compared to the country’s GDP. This study has mentioned several indicators on the EU Transparency directive where certain large undertakings in manufacturing with annual turnover higher than 250 million euros should provide their reports on the use of accounts in delivering SGEI. A similar approach can be used also in the case of large SOE undertakings.

Under this category could fall large national SOEs, which operate mostly in network industries of telecommunications, energy or transport sectors and contribute a higher value to GDP, as well as provide a relatively larger share of cross-border services, for instance in airline or railway network industries. The Member States together with the European Commission would be invited to decide on a common definition of large industrial SOEs to
be included into SOE Observatory. Several possible selection criteria could be mentioned in this regard:

- SOEs creating largest value to the total EU GDP, however it should be balanced with the inclusion of all EU Member States and also have a representative coverage of EU consumers.
- SOEs creating largest value in the Member State alone. For example, the Member States could indicate three largest SOEs based on their input to annual GDP, revenues to the national budget, or three largest listed SOEs, etc.

5.1.3 Benchmarks for the EU Survey on SOEs

Following the EU acquis and best practises in the OECD countries\textsuperscript{77}, for example Nordic corporate governance guidelines\textsuperscript{78} or Baltic Guidelines on Corporate Governance of State and Municipality Enterprises\textsuperscript{79}, the Member States could be asked to provide their SOEs governance reports. These reports could include the following benchmarks:

5.1.3.1 National legal framework and EU acquis

The Member States will be asked to indicate whether there is a body ensuring a separation state ownership and regulatory functions. A special agency or institute (“the ownership entity”) is established in many Member States to manage and exercise state’s ownership. However, there is a variation of entity status and the degree of its members’ independence. The Member States could identify how this particular entity fulfils its shareholder function, how it does provide the information, or make an analysis or advising on management of SOEs.

Next to the implementation for the EU acquis, the Member States could be asked to present their legislative and administrative actions in relation to the operation of SOE’s in areas of SGEI provision and its entitlement, public expenditure, allocation of resources or

\textsuperscript{77} OECD Guidelines on Corporate Governance of State–Owned Enterprises, OECD publishing 2005
\textsuperscript{78} Corporate Governance in the Nordic Countries, April 2009, \url{http://www.nues.no/filestore/Rapportomnordiskcorporategovernance.pdf}
\textsuperscript{79} Baltic Guidelines on Corporate Governance of State and Municipality Enterprises, Baltic Institute of Corporate Governance 2010; \url{http://corporategovernance.lt/uploads/docs/BICG%20Guidance.pdf}
organisation of public procurement procedures. These aspects could fall under the scope of the structural reforms to improve public administration effectiveness and could include:

- An intensity of public procurement procedures by SOE as contractor to select the provider of SGEI as well as intensity of SOE’s as service provider of SGEI
- Number of listed and unlisted SOEs as well their relative share in GDP or in the market concerned within the Member State
- The information which is included into the act of entrustment by the Member State for the provision of SGEI (e.g. content, duration, undertaking, definition of special rights necessary for SGEI, service compensation parameters, etc.)

The information on the public procurement could correspond with the reporting to the Commission in the context of annual public procurement implementation reviews. The Member States in their national SOEs regulatory environment could address such changes as new legislation concerning governance, ownership or transparency requirements. A corresponding benchmark on the tendering procedures by SOEs for services concerning commercial and non-commercial activities could be also introduced in the reporting.

5.1.3.2 Composition and role of boards

The Member States could be asked to provide information on the transparency of the entitlements by SOEs board members. The reported information could be based on the following guidelines or practices of the Member States as linked to:

- The practices of state in exercising its ownership rights in board nomination, board performance assessment and accountability, including clear definition of its mandate and responsibilities
- The extent employees are represented in the boards within the national practices of employee participation
- The transparency practices for the remuneration: disclosed information on board members’ salaries.
- The presence of independent expert networks or central databases, which could be used in SOE board selection process.
5.1.3.3 Rights and participation of shareholders

In the case of large industrial SOEs, the Member States could be asked to report on their practices to ensure equitable treatment of all shareholders of the SOEs by indicating:

- The method of communication with shareholders and levels of access to corporate information, including through a presence of coordinating entity to this end.
- The methods of shareholder minority participation in taking key corporate decisions.

5.1.3.4 Relations with stakeholders

The Member States should ensure that the needs of citizens are met in provision of public services by SOEs and to this end aim that relations with the stakeholders be a part of a social dialogue as initiated by the enterprise either inside its structures or with a wider community. Several aspects of relations with the stakeholders could be included in the SOEs Survey:

- Presence of active stakeholder policies as ensured by coordinating entity to SOEs or by other relevant arrangements in the Member States (SOE or national level).
- Presence of reporting practices on stakeholder relations and presence of internal standards for communication with businesses, political parties, interest groups, NGO and wider public in general.

5.1.3.5 Sustainability of SOE economic performance

Some Member States already request their SOEs’ to report on sustainability of their economic performance. Taking into account the EU objectives to smart, sustainable and inclusive growth, the increasing sustainability of the largest SOEs may have a positive effect on environment and social conditions within as well as outside the enterprise. The Member States may be requested to report on the availability of targets in the following areas:

- Planned corporate profit of the SOE for the next business cycle and planned revenues to the national budget.
- Environmental effects of the SOE, especially with regard to waste management, air and water pollution, usage of renewable resources.
- Performance indicators in area of corporate social responsibility, a good reference of which could be found in ten principles of UN Global Compact\(^\text{80}\).
- Performance indicators in area of innovations such as SOEs’ partnership initiatives with research institutes, universities and business; targeting (e.g. in SOEs budget share) innovative and efficient technologies in sectors of energy, transport or postal services.

5.1.3.6 National transparency policies

The Member States could provide the information of presence of aggregate national *ex-ante* and *ex-post* reporting practices on SOE objectives and results, which could include assessment of SOE risks and planned actions in areas of financial activities, employee participation, social dialogue, board management and entitlements, remuneration policies, shareholders rights, SOE sustainability targets and/or their results. The Member States could present in more detail the national process of reporting, including disclosure practices and legislative control mechanisms (e.g. reporting to Parliamentary committees).

As the Member States have different practices on financial reporting about the performance of national SOEs, they could be asked to align national reporting and disclosure practices on a set of proposed key parameters linked to annual turnout and number of assets, structure of shareholders, economic, social and budgetary impact of SOE’s at aggregate levels, use of separate accounts for commercial and non-commercial activities or identification of potential social-economic risks.

5.2 The next steps in the development of the EU acquis

As it was shown in this study, several EU regulative initiatives having an impact on SOEs are under review. The EU is discussing different parts of SGEI reform package within the context of state aid, modernisation of public procurement policy and implementation of Action Plan on European Company Law and Corporate Governance.

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\(^{80}\) [http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html](http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/index.html)
The future of EU Company Law regulatory framework could be further extended to cover large industrial SOEs due to their share in the EU GDP added value, employment capacities and cross-border aspects. With the Action Plan on European Company Law and Corporate Governance, the EU is aiming at more legal certainty for large companies holding capital and operating in several Member States. It has an underlying rationale to foster the competitiveness in the EU internal market, ensure transparency and accountability of the commercial activities.

With increasing global competition the next EU policy initiatives should advance towards inclusion of common EU corporate governance principles for SOEs, especially for listed SOEs, which could be a general recommendation for larger SOEs. The EU Company Law legislation should advance further, in particular by aiming at enhancing transparency, shareholders rights, and in supporting growth and competitiveness through legal certainty and simple cross-border operations for European businesses.

The EU internal market creation must proceed further with implementation of a second Single European Act in areas of network industries (e.g. energy and rail transport), which on its behalf will boost the competitiveness of SOEs in particular and of EU economy in general. The passing economic and financial crisis shall aim at restoring “business as usual” policies with regard to SGEI provision and state aid. The future revision of Services Directive should proceed in parallel with regard to inclusion of network industries under the scope of free provision of services.

The efforts should continue on the modernisation of the Community public procurement regulatory framework which directly affects the operation of SOEs in areas of contracting public services which is also recommended by this study.

The proposed architecture of EU SOE observatory process would contribute to the development of EU acquis through inclusion of new areas into EU playing field for SOEs as

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81 See also Action Plan: European company law and corporate governance - a modern legal framework for more engaged shareholders and sustainable companies, European Commission, 2012
well as it will help the implementation through a systemic surveillance of common and national policies linked to the effective operation of European SOE’s.
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