LIBERAL VOICES 2015

Analysis and policy ideas by think tanks in Central and Eastern Europe in response to a range of European Union legislative proposals

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About the publication

This publication is result of cooperation between independent think tanks in Central and Easter Europe (CEE). The purpose of this cooperation is to increase awareness of upcoming legislative initiatives in CEE countries, and to increase the presence of liberal opinions from CEE countries in the EU decision making.

Provided are abridged responses to individual EU public consultations on selected issues analyzed by the think tanks involved.

1. Transatlantic Trade and Investment Partnership

A Joint Open Letter on the Transatlantic Trade and Investment Partnership to the European Parliament, the European Council, the European Commission and national parliaments of the EU member states

5 May 2015
To:
President of the European Parliament Martin Schulz
President of the European Council Donald Tusk
President of the European Commission Jean-Claude Juncker
National parliaments of the EU member states

cc. Commissioner for Trade Cecilia Malmström
cc. Permanent representations of the member states to the European Union

The European Union and the United States of America are currently negotiating the Transatlantic Trade and Investment Partnership - a comprehensive free trade and investment treaty commonly known as TTIP. The main focus of negotiation has centered on cutting tariffs and reducing regulatory barriers to trade. Other areas include investor-state dispute settlement (ISDS), and achieving greater participation by small businesses in EU-US trade. In the EU, the treaty will have to be presented to the European Council and the European Parliament, both of which must agree on the outcome. It will then have to be ratified by the national parliaments of all 28 EU member states.
More international trade between developed nations brings unambiguous, tangible economic benefits to all sides involved. While the magnitude and distribution of benefits among the trading partners can be discussed, freer trade clearly brings more well-being, not less.

We must remember that among democracies it is not countries or governments that trade with each other. It is people – consumers and companies – whose inventions and products span national borders. It is people – consumers and entrepreneurs – who are the primary actors and benefactors of free trade. Therefore, the role of governments is not to restrict human action, but to facilitate it. The question governments should raise is not "How much free trade should we allow?" but "What can we do to facilitate more trade?"

TTIP is not the first time Europe is opening its borders to trade and investment. The creation of the common market has seen its member states limit their power to use taxpayer money to prop up failing businesses, as well as dismantling the tools of arbitrary and capricious legislation - once used to protect failing industries with non-tariff barriers (e.g. regulations, technical standards, etc.). Renouncing these powers and tools did not mean that we began to live without rules or without consumer protection. The EU internal market shows that both more trade and benefits to consumers are clearly compatible.

Before the recent round of EU expansion some predicted a race to the bottom in terms of wages and standards, a dilution of the social contract, as well as many other pitfalls. None of them materialized. The same arguments were used in the United States when they negotiated the North American Free Trade Agreement (NAFTA), and they proved just as baseless.

Clear rules bring more democracy, not less. TTIP and Investor-to-State Dispute Settlement (ISDS) are not a threat to sovereignty or democratic governance. States' powers to regulate their respective economies would remain unaffected by ISDS. The current performance of arbitrators shows no bias towards investors. Its track record demonstrates the following outcomes of arbitration procedures: 50 percent of concluded arbitration cases against the EU member states were won by the member states concerned, and an additional 26 percent were settled.

The right of investors to seek an independent (non-national) arbiter should be seen in a positive light, remembering that such a possibility exists even without ISDS. After all, the right to a fair and impartial trial is a virtue espoused by democracies. It is not unheard of to predict that at least in some instances of a dispute between an investor and a national government, national courts can pass biased rulings, either from overt or covert pressure from the national government or even based on simple national feelings. Is this not the reason why international sporting events are refereed by non-national referees?

Finally, clear and *a priori* set rules are essential to the rule of law. The ISDS mechanism highlights possible legal costs of arbitrary actions by the state, thus adding to a better and more comprehensive impact assessment of government regulation. It is also a means to reduce regulatory risk and boost foreign investment. In the current conditions of ever-growing global competition, the EU should seize the opportunity to engage in a closer relationship with a country it shares its values with.

There are certain aspects regarding TTIP and ISDS that should be carefully addressed. Firstly, it is of utmost importance to secure the integrity of TTIP and ISDS, meaning that no policies or products should be excluded from them. Any compromise would open a Pandora's box of exemptions, special privileges, and favoritism that would be largely incompatible with free trade. Exemptions would lead to lobbying for more exemptions and thereby undermine the whole deal in principle.

Secondly, it is essential to prevent regulatory-creep. Most barriers to be removed are non-tariff barriers, so arguments will evolve around whose rules to adopt and to what extent. It should be kept in mind that "harmonization" of rules and regulations might lead not to simpler rules but to more rules. Adding EU regulations to US regulations and vice versa would just augment red tape. The point of regulatory coherence or harmonization (or mutual recognition) should be to streamline superfluous regulations and standards for the purpose of eliminating unnecessary costs and passing the benefits on to consumers in the form of lower prices and better choices.

Finally, two leading trading blocks acting by one set of rules would create more order, not less.

We, the fourteen undersigned think tanks in eight Central and Eastern European Member States, all members of the 4Liberty network, urge the European Commission, the European Council, the European Parliament and national parliaments of the EU member states to ground their decisions in rigorous research-based economic evidence and to embrace TTIP and its elements, including ISDS.

Undersigned by:

Academy of Liberalism, Estonia
CETA - Centre for Economic and Market Analyses, the Czech Republic
Centre for Liberal Studies, the Czech Republic
Civil Development Forum (FOR), Poland
F. A. Hayek Foundation, Slovakia
Fundacja Industrial (Liberté!), Poland
Hungarian Free Market Foundation, Hungary
Institute for Market Economics, Bulgaria
Institute of Economic and Social Studies, Slovakia
Lithuanian Free Market Institute, Lithuania
Projekt Polska Foundation, Poland
Republikon Institute, Hungary

Svetilnik - Association for Promotion of Freedom, Slovenia

Visio Institute, Slovenia

2. Digital Single Market Strategy

Purpose:
The Digital Single Market Strategy (henceforth – the Strategy) is a set of policies presented by the European Commission to create growth and jobs with the help of the development of innovations, digital technologies and cyberspace. Such a development of the Digital Single Market is expected to generate up to €250 billion worth of growth in the European economy in the course of the mandate of the current Commission through the creation of thousands of jobs and a vibrant and knowledge-based society.
Various regulatory measures are stipulated to achieve these goals. They include a revised telecom regulation, copyright and data protection legislation, management of radio waves, and changes in competition regulation.

Summary of the response:
While the strategy is generally a step forward in advancing the single market, there are concerns regarding potential restrictions of competition in some of the aforesaid areas. Analysis of the Lithuanian Free Market Institute (henceforth LFMI) shows that there are three main areas where competition might be distorted, preventing the attainment of the strategic goals.

The regulatory environment for platforms and intermediaries

Competition policy in the digital market raises some serious concerns. The Strategy pays close attention to the biggest entities in the digital market. It should be noted though that the market situation has developed organically and may change at any moment. No particular entities should be targeted for the following reasons:

- Market concentration does not necessarily indicate market power;
- The digital market can be quickly transformed by innovations that come from other sectors;
- Legal certainty is crucial for business.

Market concentration does not necessarily indicate market power

The fact that some entities hold a significant market share does not necessarily indicate that market power can be abused. Previous research in the digital sector carried out by DG COMP gives a very different image from what we are used to and it is perfectly illustrated by the Microsoft case.

The software developer has long been in the crosshairs of antitrust institutions. In 2004 the Commission was concerned with Microsoft's actions in bundling its products with the Windows operating system. However, competition is what drives changes in the market, and other software developers such as Apple and Google have pushed Microsoft's market share down to 20 per cent. Therefore, changes were caused by other market players rather than the Commission's policies.

Innovation can quickly change the market

Innovation is a key element of the digital market. Even though the Commission acknowledges this, it fails to fully appreciate the impact that innovation has on the market.

First of all, the goal to apply strict competition rules and focus on entities with higher market concentration disregards potential competition, especially that from other sectors. Since the digital market is open and the entrance costs are low, a new market player may enter the market at any time. What is more, innovations may emerge from another digital sector, therefore market players operate in a competitive environment regardless of the size of their market share.

New digital market players such as Amazon, Facebook and Twitter show just that. Even though they are new in the digital sector, they have aggressively moved into the market of online advertising. Their expansion has led to a decrease in Google's share of online advertising revenues.

The above-mentioned case of Microsoft is another example. The loss of such a tremendous part of Microsoft's market share was a result of innovations from other digital sectors. The development of smart phones and tablet computers led to a sizeable extension of the software market where Microsoft failed to react as fast as other companies did.

Situations like that happen in all sorts of digital sectors and VoIP is one of them. This innovation has become a significant competitor to telecom providers even though it is built on a completely different technology. The Strategy also addresses this issue briefly stating that telecom operators are competing with services that are chosen by end-users as substitutes but are not subject to the same regulatory regime. While the precise formulation on this is ambiguous, we should bear in mind that if the same economic regulations that are currently applicable to the telecom industry were imposed on VoIP industries, they could restrict competition in the VoIP sector and therefore stifle innovation. If the VoIP technology is working well enough to compete with the incumbent telecom industry even in its early stages of maturity, there is no point in regulating it, especially from the point of view of competition policy. The goal of the Strategy is to increase competition and innovation and to implement rules that foster them. Equal rules are usually regarded as instrumental in this respect, but this case shows otherwise and suggests that equal rules may bring equal restrictions that would stifle the performance of a particular sector.

These cases show that technological innovation and open market entry are the most effective safeguards. Regulation that stifles innovation or attempts to shape the market may do more harm than good.

Legal certainty and clarity is crucial for business

The Strategy states that the Commission has to evaluate the situation in order to create new legislation for different digital sectors. While the goal of ushering in new laws is not detrimental per se, the scope of this future legislation is of vital importance.

It is understandable that there is a need to create a regulatory environment suitable for all purposes, but regulation should not be targeted at particular entities. The Strategy states that the way in which some online platforms use their market power raises concerns and should be analyzed beyond the application of the law on competition. Such a fragmented application of the law, possibly aimed at particular market players, is far from certain and clear. Any differentiated regulation for specific market players must have a strong justification. To add, claims that the current regulation is not sufficient or does not exist cannot justify differentiated regulation. Such a precedent for applying harsher rules for specific legal entities in the European Union is against the principles of legal certainty and clarity. What is more, similar regulations would send a wrong message to other potential investors.

The one-size-fits-all regulation can only work on a very broad level, e.g. regulation of basic and most fundamental features of the market. Regulation can only remain fair and technology-neutral when it is concentrated on this level. By venturing into very specific regulation of particular sectors the Commission risks starting to pick winners and losers among technologies or companies or even fundamentally changing the market and depriving consumers of products that could be developed by market forces rather than regulatory regimes.

Public broadband networks

The Commission aims to improve infrastructural competition in fixed line and broadband networks and there is an additional plan to invest public funds into broadband networks. The following three aspects should be considered prior to carrying out such a plan:

- The “market failure” argument is not true;
- Public investments might not be economically justified and could stifle innovations and investment;
- Public investment must ensure competition.

Different levels of infrastructure development across countries or regions do not mean a market failure

The main argument for the necessity of public investment into network infrastructure is that supposedly a market failure can be observed in some territories in the European Union. The Commission claims that given the large investments needed to roll out and upgrade the current connections to the next generation of digital networks – often based on fiber technology – there is a serious risk that market failure will rapidly increase the so-called “digital divide” across Europe.

Such arguments are not correct. Private sector investment into internet connection technologies is very significant. The global proportion of people using the Internet has risen at a compound annual growth rate (CAGR) of 12% in the period from 2008 through 2012. Due to the introduction of the 4G technology in 2010, there was a significant increase in the Internet speed too. [1] And it was not public investment but the private sector that gave a boost for such a rapid growth. When it comes to internet coverage, growth rates in mobile broadband population penetration appear to be significantly higher than the already high corresponding historical growth in mobile cellular penetration. Mobile broadband penetration exceeds cellular penetration by 5 to 19 per cent. Given the increasing reach of mobile broadband networks and upgrades to newer technologies, fast uptake of mobile broadband access is very encouraging for increasing overall Internet penetration.

Therefore, the argument that the market has failed and the public sector must step in with public investment is not true. The Commission has formulated standards that may appear a bit unrealistic to reason its intervention into the market. The market has not failed but has performed precisely as it should. The regions with the most users and demand have seen the largest development of infrastructure. On the contrary, rural regions are not developing as fast as heavily urbanized ones and have less users and less demand. It would be strange and unnatural to expect the same or comparable level of IT infrastructure in cities and rural areas. However, the data suggest that the internet penetration is increasing. This situation can be defined as a market action rather than failure. Market mechanisms define where the infrastructure development is necessary. It is important to acknowledge that investing in unlimited access to high speed internet is irrational as it competes with alternatives uses of resources.

Government broadband networks - economically unjustified and costly

Active public investment into broadband networks might bring unexpected consequences. In 2011 President of the United States Barack Obama stated that one of the goals of his term was to ensure that 98% of Americans have access to the Internet. Governmental public networks sprung up throughout the country, but the results were not as positive as expected. These government-owned networks did not meet the objectives in terms of coverage. To add, the private sector could have reached the same coverage without government intervention. What is more, these networks imposed a heavy financial burden on taxpayers.

Government-owned networks used taxpayer funds to build networks in areas where high-speed Internet was already provided by the private sector. This network overbuild is counter-intuitive since it requires that taxpayers fund and subsidize a network that duplicates an existing one. This is one of the most important lessons from the United States' case. Even if a government decides to develop broadband infrastructure, it has to carefully assess where such projects are necessary in order to avoid duplication and maintain competition. Otherwise government-owned networks would unfairly compete with the existing providers. What is more, as a government entity, a government-owned network can practice various anticompetitive activities that may put private firms at a competitive disadvantage. Thus, municipalities that use taxpayers' money to build a broadband network actually act to forestall market entry and decrease competition. Government-owned networks deprive consumers of the benefits of competition and choice, governments lose tax revenue from private networks that might have otherwise entered that market, and taxpayers pay more in taxes as they subsidize the operation and maintenance of those networks.[2]

Government-owned networks tend to fail because they lack a sustainable business plan and long-term resources to invest in maintenance and necessary upgrades as technology evolves. When this happens, taxpayers have to fund the failures.

What is more, investment into infrastructure may slow down innovations. With public infrastructure in place, the private sector might lose incentives to innovate and devise cost-effective ways to reach far-away end-users.

Outcomes that have been registered in the United States should be examined carefully in order to avoid the same mistakes and related economic losses and other damages such as distortions of free competition and slower investments.

Public investment must ensure competition

Even if the Commission decides to proceed with a public investment plan, it has to follow two fundamental principles: it must cooperate with the private sector and ensure competitive procedures.

Cooperation with the private sector will not only provide private entities with an opportunity to participate in infrastructure development. It will also ensure that the best practices of the private sector are used in the process. Private companies could bring advanced business management techniques, innovations and private investment into infrastructure development projects. This will not be possible without ensuring competition, because the public sector will deliver the most by competing for the participation in infrastructure development.

There is a danger that the government would see a public investment plan as a carte-blanche to favor public companies in tenders, create government-owned IT entities and engage in business. If the Commission goes ahead with this plan, it must provide very stringent safeguards to prevent governments from engaging in such practices.

Telecom single market

One of the goals of the Strategy is to review the Telecom Single Market package. It is expected that revisions will help to provide harmonized rules for net neutrality and rules that would eliminate roaming surcharges (for data in particular). But the Net Neutrality policy and prohibitions on roaming charges are not as positive as they seem to be.

- Net neutrality slows down competition, helps bigger companies to consolidate their market position and increases barriers for upstart companies.
- Prohibition on roaming charges could lead to lower supply and higher consumer prices.

Net neutrality slows down competition

Current internet regulation allows companies to focus on the most profitable sectors. Basically, Internet Service Providers (ISPs) charge more those who are willing to pay more. Net Neutrality policy would force ISPs to charge the same for different types of data transferred. Also, this policy does not allow data transfer prioritization. Prioritization allows ISPs to charge people more if they want a faster or more stable connection. A tangible empirical analogy would be a furniture delivery company charging the same regardless of the amount of furniture delivered or a restaurant charging the same as a fast food outlet.

Such limitations on data transfer prioritization would diminish competition. Firstly, such limits may increase data transfer prices. Net Neutrality may result in higher prices for those users that need lower quality data transfer services. What is more, this does not simply mean an increase in prices, but a better competitive position for the established market players as opposed to their upstart competitors. In order to progress, large companies have to maintain existing consumers and protect them against emerging upstarts. To add, Net Neutrality could raise the costs of doing business. This means that the established market players will adapt to higher costs more easily than their new competitors. It may also slow down the development and decrease investments in fiber optics as there will be less incentives to strengthen your competitiveness. Therefore, less competition will result in higher prices and slower innovation will bring lower quality.

It should be noted that other sectors to which a parallel is being drawn (e.g. utilities or electricity grids) do not operate completely neutrally with regard to what is being transferred. Electricity grids have congestion charges, some types of energy (e.g. green energy) is sometimes given priority in congested situations, users have different contracts depending on how much reliability they need, etc. Regulation of the Internet just like other utilities is incorrect in both cases: in the direction intended as well as the analogy used.

Prohibition on roaming charges may lead to lower service supply and higher end-user prices

Instead of bringing benefits, the Commission's goal to completely ban roaming charges may actually harm consumers. Roaming charges exist because it is more expensive to provide cross-border calls, messaging or data transfer services. Prohibitions on roaming charges might lead to two outcomes. Firstly, such a policy might reduce supply. Economic logic says that price-ceiling policies tend to do that. This means that if telecom companies cannot cover their cross-border call costs, they will refrain from providing these services. Another option is that service providers will cross-subsidize roaming calls in order to cover the costs. This means that they will have to charge more for local services in order to cover the costs of cross-border services and this will in turn affect all users regardless of whether they need roaming services or not. Therefore, the abolition of roaming charges will not help solve problems. It would only lead to lower supply and higher prices.

Conclusion

In considering what regulation is necessary for the implementation of the Strategy, it should be remembered that market concentration does not necessarily indicate market power and market changes are frequently the result of innovation. Also, legal certainty is crucial for business. Therefore, the broadband network development has to be competitive and very limited, because such an investment could inflict a heavy financial burden and stifle innovation. The Telecom Single Market plan raises concerns since both the Net Neutrality policy and the prohibition on roaming charges might slow down competition.

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[1] http://www.internetsociety.org/sites/default/files/Global_Internet_Report_2014_0.pdf
[2]http://www.coalitionfortheneweconomy.org/wp-content/uploads/2012/01/1-6-12-Coalition-for-a-New-Economy-White-Paper.pdf

3. Capital Market Union

Purpose:

To mark the beginning of a three-month consultation period in the first half of 2015, the European Commission launched a green paper to simulate conversation about a proposed Capital Markets Union (henceforth CMU) that should take shape by 2019. The need for a CMU is clear; capital markets still remain shallow despite the European Union's founding commitment to the free-flow of capital in the Treaty of Rome. If the green paper's estimates are correct, 90 million additional euros would be available for business financing in the member-states if capital markets were as deep as the US.

Raising capital indeed seems difficult for businesses, especially compared to the US:

- The typical medium-sized business receives approximately five times more capital funding in the US than in the European Union (EU). [1]
- As a percentage of GDP, EU public equity markets are only half as large as the US public equity markets.
- In contrast to the US, domestic stock market capitalization in the EU remains very uneven. The authors of the consultation authors note that capitalization "exceeded 121% of GDP in the UK, compared to less than 10% in Latvia, Cyprus, and Lithuania."
- EU business financing remains dominated by banks, with firms relying on bank loans more heavily than their US counterparts. Bank loans comprise roughly 30% of total business financing in the UK, Denmark, Italy, Spain, and Sweden, compared to around 10% for the US.
- The financing landscape for small-and-medium sized enterprises (SMEs) in the EU is heavily dominated by banks. European SMEs often rely on financing from the same bank throughout their lifecycle, due to the difficulty of securing funds elsewhere. Although this long-term "relationship lending" could be optimal for high-risk, informationally opaque small firms, the European Commission is concerned that these businesses are over-leveraging with negative consequences in economic downturns. The authors argue that "bank lending makes the European economy, especially SMEs, more vulnerable when bank lending tightens, as happened in the financial crisis."

Information Asymmetries

The authors of the Green Paper speak of "important frictions that get in the way of providing finance 'especially for smaller or more medium sized companies, and for longer term projects such as infrastructure…'" One specific issue that the consultation identifies is the inability of banks and investors to appropriately monitor the risk profile of SMEs. Often, a bank or investor *would* invest in an enterprise if they had sufficient financial information to secure that their investment would not disappear immediately. But, as it stands, "13% of these applications are rejected…"

To facilitate the flow of information for SME financing and reduce general ambiguities that impede the flow of finance, the consultation suggests mandatory, standardized disclosure document. It also suggests implicitly[2] mandatory measures for the protection of minority shareholders.

Unfortunately, the argument that is put forward about information asymmetries lacks empirical evidence. In order for the market to fit the scenario described in the consultation, both healthy and unhealthy firms that seek financing must view the marginal cost of information disclosure to be greater than the marginal benefit. If financially healthy firms in the market for capital simply disclosed information, investors could simply assign a higher price to the firms' shares, and information would cease to be asymmetric. Empirical evidence shows, however, that SMEs that stand to benefit from information disclosures tend to do so voluntarily (Lardon and Deloof, 2014). In particular, firms registering on the "Free Market," or "Marche Libre" division of the EuroNext stock exchange (located in Paris and Brussels) voluntarily disclose information when it is beneficial in securing financing, despite the exceptionally-low listing requirements of the exchange.

Companies located outside of France and Belgium decline to list on the "Free Market" exchanges *not* because of some "market failure," but because of a home bias exhibited by investors. Simply, investors are more likely to pair with firms that originate from their own countries (Grinblatt and Keloharju, 2001; Hursti and Maula, 2007). Unfortunately, there is little that the European Commission could do to hasten the demise of home bias. A mandatory, standardized disclosure document, however, is a misguided solution that does not address the real problem.

Informational Asymmetries: Proposals

- The European Union should refrain from directives attempting to micromanage these policies and allow Europe's leading stock exchanges room to grow.

- If foreign firms were unburdened by cultural problems in investing in places like Brussels, Paris, or London, the problem of insufficient information disclosure could be solved by free-exchange. If faced with a "menu" of possible disclosure regimes, SMEs could choose the right amount of disclosure that leads to equity purchases by investors without overburdening the firm with a disclosure cost.

Solvency Directive

Given the significant assets held by pension and insurance companies, investments made by pension and insurance funds make up a large part of the capital market infrastructure in the EU. To this end, the consultation authors discuss a new directive relating to insurance fund regulation known as Solvency II. They argue that the new directive, scheduled to go into effect on January 1st, 2016, "will allow companies to invest more in long-term assets by removing national restrictions on the compositionon of their asset portfolio."

This abolition of national restrictions is a welcome step, but the Solvency II Directive goes far beyond this. The European Insurance and Occupational Pensions Authority (EIOPA), tasked with implementation of the directive, aims to make ensure that insurance companies always have adequate capital to match their operational risk profiles. Specifically, sufficient capital must be on hand to calibrate an insurance company's existing portfolio *plus* one year's expected new business at a VaR (value at risk) 99.5% over one year.

This means that, according to the models used, the capital on hand will mitigate unexpected shocks to the insurance company in 199 out of 200 cases. Sufficient capital is required on-hand to prevent the complete depletion of a firm's capital stock under virtually any modelled adverse scenario.

Predictably, the largest capital requirements pertain to the riskiest assets, making the directive more likely to decrease investment in cash-strapped SMEs desperate to sell off their equity. We can already see some of this effect by examining the risk-based-capital requirements of countries such as Canada, the U.S., and the Netherlands (Boon, Briere, and Rigot, 2014). Strangely, funds looking to invest in government bonds have to put aside *zero* capital in the process. This seems to imply that government debt should get a free pass regardless of the government's risk profile, a strange assumption in light of financial difficulties plaguing Greece and some other EU countries. Despite the European Systemic Risk Board repeatedly accentuating this problem, the concern remains unaddressed.

Due to the dire effect of capital markets and the probable shift toward the purchasing of government debt that will likely follow Solvency II, implementation should not be a part of the EU's capital markets program.

Solvency Directive: Proposals

- The EC should abandon capital requirements and allow the optimal asset allocation of insurers and pension funds to be determined on the market.

- To regulate the risk, the EC should encourage the development of rule-making boards that lack formal regulatory power, such as the U.S.'s National Association of Insurance Commissioners (NAIC). Allowing for non-governmental organizations without a monopoly of force to propose rules encourages more thoughtful deliberation and less "one-size-fits-all" solutions. The NAIC, for example, has recommended heterogeneous approaches to risk accounting in contrast to Solvency II's proposed uniform VaR standard.

Capital Taxation

The consultation authors note that, "differences in the tax treatment of different types of financing […] may create distortions." Specifically, "differences in the tax treatment of debt and equity financing might increase the reliance of companies on debt and bank funding." The consultation is vague on a solution to this issue but claims that the Commission will take action to end any discrimination in tax treatment.

The decision to pursue debt or equity financing is biased by the vast majority of national tax codes that allow for corporate debt financing (ie. interest payments) to be written off. The negative implications for credit markets, however, are not necessarily obvious. Obtaining financing through lenders and depositors, after all, is simply another vehicle by which firms can raise capital. But not all firms are created equally; some firm characteristics allow for a capital structure that is friendlier to debt accumulation than others. In particular, large firms are typically able to enjoy greater leveraging than small firms due to having greater access to collateralizable assets. SMEs must often sell large chunks of their equity in the absence of these assets. This behavior is found in both dynamic capital structure models (ie. Kurshev and Strebulaev 2007) and in panel data (ie. Zare et al 2013). Thus, the debt tax bias over equity hampers capital formation in a group of firms that the European Commission sees as being in the direst of straits.
With this in mind, the consultation's critical view toward inequitable debt-equity tax treatment is well grounded. We agree that action should be taken in the long-term, with leeway as to how countries go about removing the disparity in treatment. Belgium, for example, reformed their code

to allow companies to deduct equity from their tax bills at a notional rate of interest. Another option is the Comprehensive Business Income Tax (CBIT) which removes the tax deduction on debt.

Capital Taxation: Reform Agenda

- The European Commission should implement a directive requiring debt-equity tax treatment to be harmonized, without specifying the method. Our aforementioned methods (the Belgian equity model and the CBIT) are two ways that countries could use to achieve equality in their tax treatment.

- In order to ensure that reforms such as the CBIT do not quash capital markets by suddenly increasing taxation of corporate debt, the European Commission should require that removing any exemption must be accompanied by a lowering of the overall corporate tax rate for that nation.

- To allow countries maximum leeway in setting their taxation policies, the requirement that CBIT-like tax reform should be accompanied by corporate tax deduction should allow indirect corporate tax reduction. That is, corporations shoulder the burden of indirect taxes, such as energy and payroll taxes, as well as the direct levy on their bottom line. If countries see reducing indirect taxes as easier than reducing their corporate tax, they should be allowed the opportunity in the new directive.

Insolvency Regime

The consultation authors note the “divergent national conflict-of-law rules regarding the internal functioning of a company,” and recommend “harmonizing substantive insolvency legislation.” Specifically, they point to “the lack of or inadequacy of rules enabling early debt restructuring […] the absence of ‘second chance’ provisions, and the excessive length and cost of formal insolvency proceedings[…].”

Creating a national bankruptcy framework, however, invites the government to tilt the scales in favor of either creditors or debtors. In contrast to the US emphasis on firm reorganization (known in the US code as “Chapter 11”), many European member states have creditor-friendly provisions that make it difficult for a distressed firm to have a second chance. This trend has partially reversed in recent years, with countries like France, Germany, Spain, and Italy allowing insolvent companies to reorganize their assets and have a second-go at their operations (as opposed to liquidization). But while granting a generous reorganization option for debtors sounds reasonable, the impact on capital markets is not necessary positive. In debtor-friendly US states with high personal asset exemptions, for example, credit rationing is more pervasive. In this case, lending institutions came to the realization that debtors had broader leeway in repayment, and adjusted the price of credit upward to compensate for greater repayment risk in bankruptcy.
Bankruptcy law should thus be viewed as a volatile seesaw between debtor and creditor interests that could potential make financing options scarce for high-risk enterprises. Therefore, the European Union should tread lightly before attempting to implement a cross-national framework that is overtly debtor-friendly.

Insolvency Regime: Reform Agenda

- In line with Rasmussen (1992), the European Commission should allow for a bankruptcy “menu” offered by the government, where firms could choose their own bankruptcy laws upon being chartered. A SME, for example, could voluntarily waive its ability to choose reorganization in the event of bankruptcy. Thus, a bank contemplating lending to a young

firm with a moderate-to-high risk profile need not fear a scenario where the firm declares bankruptcy hoists an unfavorable debt-restructuring plan upon the creditor.

- If the decision was enshrined in the business charter and made difficult to alter, the banks and other institutions could incorporate this into the price of credit for SMEs. This choice, however, should be made very costly to change, and should be binding regardless of the specific jurisdiction that the firm decides to do business in. Furthermore, a firm taking up the EU's offer to choose from the bankruptcy menu can choose to waive all potential state aid in the reorganization process (i.e., market re-entry educational resources) in exchange for a lump-sum payment. The resources for this lump-sum payment will be diverted from existing EU programs that currently subsidize SMEs going through the bankruptcy process.

Conclusions

The capital markets of the European Union are fundamentally broken. If we think of companies as comprising the heart of the EU, then the capital market infrastructure is analogous to the many veins that supply blood to the heart. Yet, regulatory plaque and blockages keep capital from flowing efficiently, with dire consequences.

In the areas of reform we have analyzed, proposals made by the consultation will impede the development of deep capital markets.

In the area of information disclosure, creating a standardized product is a solution to a non-problem. Since firms *will* disclose information if they stand to gain from such a disclosure, making disclosures mandatory will only succeed in imposing onerous costs on small firms. We propose that the European Union continues to allow for unregulated basic and premium divisions of European stock exchanges, in order to facilitate flows of information necessary in capital market transactions. If the EC wishes to “nudge” exchanges toward adapting more divisions/listing categories, it should propose loosening information disclosure and financial product regulation on EuroNext and London Stock Exchange in exchange for more offerings from those financial companies. In the long-term, the EC should refrain from establishing a standardized disclosure product or a minority shareholder protection law.

We have also seen how the soon-to-be-implemented Solvency II directive will make it harder to raise capital by imposing “capital charges” on risky investments. It is therefore imperative that the risk-based capital regulations set forward in Solvency II Directive be relaxed as an interim measure. The oft-inappropriate value-at-risk (VaR) actuarial method for determining risk need not be imposed from the top and should be varied depending on the asset product being evaluated. In the long-term, government involvement in the risk-weighting of insurance and pension asset portfolios should be phased out, allowing freer investment in private equities according to market considerations.

Despite our critique of the consultation proposals put forward in the fields of information disclosure and risk-based capital regulation, we agree with the authors' assessment regarding discriminatory tax treatment. Prioritizing debt-based corporate financing over equity distorts capital markets by favoring large businesses that can more easily sell their debt. Furthermore, investors now have fewer possible equities to invest in as a result of the tax bias. The EU should issue a directive mandating the equality of debt-equity tax treatment across member- states, with deference to countries with regard to method. Should the member state choose to end the tax break on debt financing, however, the EU should ensure that either direct or indirect corporate taxes are lowered so as not to increase the overall tax burden over-night.

Finally, in the area of insolvency legislation, we advise caution on the European Commission's attempts to implement a cross national framework. If the scales are tipped too favorably toward debtors as opposed to creditors, the bias will likely be reflected in an increase in loan prices. Rather than imposing a one-size-fits-all solution, the EU should implement a directive allowing firms with a center of main interest (COMI) in the Union to choose from a menu of bankruptcy options, including the right to waive reorganization. This choice, however, should be made very costly to change, and should be binding regardless of the specific jurisdiction that the firm decides to do business in. Furthermore, a firm taking up the EU's offer to choose from the bankruptcy menu can choose to waive all potential state aid in the reorganization process (i.e., market re-entry educational resources) in exchange for a lump-sum payment. The resources for this lump-sum payment will be diverted from existing EU programs that currently subsidize SMEs going through the bankruptcy process.

Despite the regulatory plaque accumulating in the veins of Europe, the right treatment will make for a healthy Union and direct resources toward the most promising ventures and accompanying assets.

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[1] See http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=COM:2015:63:FIN&from=EN
[2] The proposals are fleshed out more explicitly in the 2011 consultation.

4. New Energy Market Design Consultation

Objective of the Consultation:
The EU is aiming to transform the European electricity system and redesign the electricity market to empower the reach of the 2030 climate and energy targets and the leading role of the Union in the field of renewable energy. The changes are claimed to be necessary in order to meet “consumers' expectations, deliver real benefits from new technology, facilitate investments, notably in renewables and low carbon generation; and recognise the interdependence of European Member States when it comes to energy security”. The Commission believes the transformation of electricity system and redesigned electricity market to have an added value to cross-border competition as well as to promote decentralized electricity generation (self-consumption and innovative energy service companies). The Commission’s questions of the consultation are classified into three groups: (i) a new electricity market for the EU; (ii) regional cooperation in an integrated electricity system; and (iii) the European dimension to security of supply.

Summary of the Response:

1. **A new electricity market for the EU:**
    - Introducing deregulation which allows real market price signal, including scarcity, shall become the core element of an integrated electricity market;
    - Only flexibility and autonomy of suppliers and consumers in managing price volatility by allowing diversified products and services based on dynamic pricing will ensure that the value reflects the actual scarcity. Facing with informative price signals increases incentives for innovation in entrepreneurial activities and technology, responsiveness to consumer demands, and management of consumption;
    - To prevent Member States from using capacity mechanisms, ,next to the prices reflecting scarcity, there is a need to remove the barriers to cross-border trade, including interconnections;
    - It should be noted that the development of interconnections and a full integration of renewable generators might cause overinvestment into infrastructure;
    - The EU shall not force any regulatory measures to the electricity market and its structure. Introducing mandatory regulatory requirements will threaten that regulation and regulators will prevent innovation and technology from evolving in the market.
    - Renewables shall not be seen as immature; therefore, additional public financial incentives are not needed to the market. Continuous subsidies are distorting the market, impeding competition, and will affect market signals, reliability of which will be of even greater importance in the integrated European Energy Market.

2. **Regional cooperation in an integrated electricity system:**
   - The European Commission should not take for granted that the Integral energy market necessarily implies centralised (at the EU level) decision making and justifies expanding roles of the EU agencies or harmonizing measures;
   - The European electricity system and electricity markets are under ongoing innovation and sufficient time should be left for the market as well as national authorities to adapt and offer solutions.
   - The Commission focuses too much on EU-level measures suggesting new and stronger functions to the EU agencies and bodies; there is a danger that EU institutional and regulatory frameworks will not evolve along with technology;
   - Voluntary regional and pan-European cooperation shall not be undermined.

3. **The European dimension to security of supply:**
   - According to Article 194(2) of the Treaty on the Functioning of the European Union (TFEU), Member States are entitled to choose the structure of energy supply and energy mix. Thus, it should be taken into consideration that Member States are responsible for security of supply;
   - The Commission's role in the European dimension to security of supply shall focus on the application of the EU Internal Market rules and the competition law, assessing whether national policy measures relevant to security of supply are justified, proportional and in line with the principles of free access to generation and networks, and undistorted competition. Moreover, questions of technical nature shall be discussed in cooperation between Member States and market players, including, but not limited to, national regulators and TSOs.

QUESTIONS

1. DELIVERING THE NEW ELECTRICITY MARKET FOR THE EUROPEAN UNION

1) Would prices which reflect actual scarcity (in terms of time and location) be an important ingredient to the future market design? Would this also include the need for prices to reflect scarcity of available transmission capacity?

It is welcoming that the Commission raises a question regarding real market prices, because market-based prices and actual scarcity of goods and services are the only informative signals that allow making decisions for market participants. The actual scarcity should not become just one more component of the price calculation formula/methodology, but imply a right of energy companies to offer diversified products and services based on customers' choice on what level of price volatility to accept. Dynamic pricing and the right to differentiate products are necessary to maximise the value of technological innovation.

2) Which challenges and opportunities could arise from prices which reflect actual scarcity? How can the challenges be addressed? Could these prices make capacity mechanisms redundant?

The actual scarcity requires flexibility and autonomy of the suppliers and consumers in managing price volatility. That would mainly include product differentiation, price differentiation, employment and use of smart technologies, implying (i) potentially more competition in the retail electricity market, (ii) entrepreneurial decisions and innovation in pricing, products/services and end-use technology, and (iii) de-centralized coordination of the electricity power industry. Therefore, the EU and its Member States shall make adjustments in existing regulation allowing these opportunities, and, in a way, take necessary measures to achieve full value of introducing prices reflecting the actual scarcity.

To prevent Member States from using capacity mechanisms next to the prices reflecting scarcity, there is a need to remove the barriers to cross-border trade, including interconnections.

3) Progress in aligning the fragmented balancing markets remains slow; should the EU try to accelerate the process, if need be through legal measures?

The question imposes a pure wish "to do something". However, the tendency to institutionalize and define administration/governance units which need adjustments to certain economic contexts and technological changes is negatively affecting those units. In the present case, the acceleration of market or policy decisions would have negative effects on the electricity market structure both at national and the EU levels. Necessary changes in balancing markets need innovative technology-based solutions which are offered in competitive processes, analyse best-practice examples, etc. Therefore, the EU shall not take any legal measures, but to support the existing mutual cooperation and trust between national, regional and Member States' market players in the field.

4) What can be done to provide for the smooth implementation of the agreed EU wide intraday platform?

The intraday trading has been introduced recently. Therefore, sufficient time should be left for markets to adapt and offer their own solutions to develop the system. Introducing mandatory regulatory requirements will threaten that regulation and regulators will remain behind the evolving innovation and technology.

ENTSO and ACER have provided a great platform for the developing frameworks for the intraday platform, coordinating the activities of national regulation authorities, TSOs and power exchanges for the practical implementation of the intraday markets. However, further development shall be left to market players, whereas the EU action shall be limited to ensuring transparency of governance in the intraday markets and the platform.

5) Are long-term contracts between generators and consumers required to provide investment certainty for new generation capacity? What barriers, if any, prevent such long-term hedging products from emerging? Is there any role for the public sector in enabling markets for long term contracts?

Long-term contracts per se have no negative sides as far as they are acceptable to private contractual parties in the electricity generation market. However, long-term contracts shall not become a tool for the public sector to favour certain (private or public) undertakings operating in the market or to put a price on the taxpayers.

Before making public intervention by means of large investments into infrastructure, the elimination of the barriers for interconnections and cross-border trade shall be the priority when solving the generation capacity issues.

6) To what extent do you think that the divergence of taxes and charges levied[1] on electricity in different Member States creates distortions in terms of directing investments efficiently or hamper the free flow of energy?

[1] These may be part of general taxation (VAT, excise duties) or specific levies to support targeted energy and/or climate policies.

Private investment decisions are based on multiple conditions and determinants, not only on taxes and charges, as the revenue of the investment for an entity does not come from taxes or charges. Only governments and public undertakings lean on taxes and charges levied as a source of revenue. Due to the nature of taxes and charges levied on electricity, e. g. VAT and excise duties, finally it is always a consumer who bears the sums imposed. In case of VAT, according to Article 38 and Article 39 of the VAT Directive 2006/112/EC applied to intra-community trade of electricity, electricity supplied by a power plant from one Member State to a company for distribution in the second Member State, it is taxed in the second state, while private customers pay VAT to the Member State which supplied the electricity. Thus, in terms of investments or energy flow, divergence of taxes and charges levied are irrelevant as it is not the electricity companies who undertake the cost of VAT; unless it is understood as giving the capacity for governments to intervene into the markets by public spending, which shall be limited.

Taxation and charges, especially supporting energy and climate policies, are imposing higher consumer prices and harming the poor, because they tend to use older and less energy efficient products due to the issue of affordability. While the biggest issue for businesses is complex, time consuming and financial resources requiring divergent compliance procedures and administrative declarations among the different Member states, as well as instability of taxes and other charges.

7) What needs to be done to allow investment in renewables to be increasingly driven by market signals?

Seeing investment in renewables as an ultimate goal poses a threat of overinvestment. Any investment shall be assessed in terms of efficiency. Market players' unwillingness to invest into renewable is another signal that investments are not regarded as economically sound. Thus, public authorities shall take it into consideration.

On the other hand, investment decisions require stable regulatory environment. The form, structure, policy and regulation, and subsidy schemes of the energy market went through extreme changes in the last decade. Those changes made investors to delay their long-term investment decisions as well as attracted 'opportunistic' investment based on "subsidy" signals rather than the market. Therefore, the EU and its Member States should put efforts to re-created energy market conditions with information-rich environment where the market price is clear rather than shaded by regulation and subsidies.

All EU Member States bear the burden of implementing 2020 Europe's targets on renewables. However, according to Article 194(2) TFEU, Member States have the right to decide on their energy mix. Therefore, in order to ensure the potential of long-term investments more attention should be paid to renewable energy sources which are more common in particular Member States rather than promoting and focusing RD&D on certain renewable types (like solar and wind energy) at the EU level.

8) Which obstacles, if any, would you see to fully integrating renewable energy generators into the market, including into the balancing and intraday markets, as well as regarding dispatch based on the merit order?

Fully integrated renewable energy generators may cause overinvestment into infrastructure. The majority of national grids are not suitable for massive generation from renewables. Instead of looking for other innovative technology solutions, Member States and market players might undertaking large investment-requiring projects, e.g. those that will increase public spending and taxpayers' burden.

Also, arrangements of transmission and balancing system are hardly suitable for massive generation from renewables. As generation from renewable sources is regularly interrupted due to natural causes and since TSOs have the duty to prioritize renewable energy units (Article 16 of Directive 2009/28/EC), generators must have incentives to manage their outputs so they would not become a burden on the grid at the cost of consumers. TSO contracts with generators from renewable sources play a significant role in the situation at stake.

Traditional balancing systems are based on steady forecasts and stict arrangements, in a way penelizing generators and suppliers/buyers which have not arranged their contracts precisly before the established despatch. The system is unsuitable in the case of renewables as generation from renewable sources is not fully predictable and forecasted. Therefore, there is a need for quick transactions, and flexible/adjusted balancing system.

9) Should there be a more coordinated approach across Member States for renewables support schemes? What are the main barriers to regional support schemes and how could these barriers be removed (e.g. through legislation)?
Integrated energy market requires informative market signals. Unregulated, market investment and market price-based signals are the only signals valuable to energy market participants when making their decisions on investment or management of energy generation and supply, as well as selling and buying.

Both the EU and its Member States had to learn their lesson of subsidies and their consequences on the energy sector. Renewable subsidies (i) distort competition and market functioning, (ii) create a lack of regulatory stability, (iii) a vast public spending on renewables has left neither enough time for energy market to adapt, nor allowed the market signals to inform about the decisions necessary. Besides, renewables are not an immature industry anymore (the Commission emphasizes that renewable markets are not new in the Communication C(2013) 7243, final 5 November 2013) and Member States should not intervene in the functioning market.

Consequently, the Commission shall not encourage any renewable support schemes, but strictly apply competition and State aid rules assessing national measures to ensure barriers of trade or access to markets/networks, and competition in the market. Support schemes shall be limited to research and enabling the employment of the results of research funded by public funds for the use among Member States.
10) Where do you see the main obstacles that should be tackled to kick-start demand- response (e.g. insufficient flexible prices, (regulatory) barriers for aggregators / customers, lack of access to smart home technologies, no obligation to offer the possibility for end customers to participate in the balancing market through a demand response scheme, etc.)?
Demand-response starts from market price signals. The existing regulatory burden, large and changing schemes of subsidies, non-dynamic pricing and limitation on possibility to offer differentiated goods and services do not allow facing informative price signals and demolish incentives for innovation in entrepreneurial activities and technology, as well as prevent consumers from demand-responsive and management of their consumption.

2. STEPPING UP REGIONAL COOPERATION IN AN INTEGRATED ELECTRICITY SYSTEM

11) While electricity markets are coupled within the EU and linked to its neighbours, system operation is still carried out by national Transmission System Operators (TSOs). Regional Security Coordination Initiatives ("RSCIs") such as CORESO or TSC have a purely advisory role today. Should the RSCIs be gradually strengthened also including decision making responsibilities when necessary? Is the current national responsibility for system security an obstacle to cross-border cooperation?

Would a regional responsibility for system security be better suited to the realities of the integrated market?

It should be noted that both CORESO and TSC have been established on voluntary basis for the cooperation between TSOs. The Regional Security Coordination Initiatives work as a scheme defined by TSOs, coordinating operational security data/analysis in a certain territory. Also, it is a great platform of discussions, research and modelling that provides valuable data, allows exchange of experience and uses the information for further decisions on the security of the system. RSCI is an example of market players' solution to the issues they faced in both, regulatory environment and new market developments.

Appointing new functions and responsibilities to existing public bodies must be considered carefully and justified not to impede the ongoing processes of innovation in system security and integrated electricity market in general. Attention should be paid to the fact that electricity markets are under rapid innovation. The regulatory and climate change targets and new technologies imply evolving structures of the market and other novelties relevant to the efficiency and security. Economic dynamism and technological change require non-static regulatory and legal concepts. Institutions which are designed for centralised control have no potential to evolve along with technology and innovation.

As the systems are in the ongoing innovation period, decisions made at decentralized level are the best solutions to accommodate the innovative solutions market has to offer in one or another region of the EU, or even in cooperation with the neighbouring countries. Voluntary cooperation and data/information exchange between national TSOs is so far the most efficient way to foster electricity markets as it allows market players to compete looking and offering more efficient and innovative solutions to ensure system security and other objectives of integrated electricity markets.

Besides, national TSOs already coordinate their activities through ENTSO which has EU legal mandate and functions in both, pan-European and regional level in the field of technical support to TSO, reporting and adequacy forecasting under Regulation (EU) 543/2013 – as a central information platform providing fundamental market data on generation, load, transmission, balancing, etc. Therefore, EU is doing enough to allow for national TSOs to manage system security efficiently.

12) Fragmented national regulatory oversight seems to be inefficient for harmonised parts of the electricity system (e.g. market coupling). Would you see benefits in strengthening ACER's role?
ACER should not be entitled to make directly applicable and binding decisions on the EU-level initiatives and cross-border issues, e.g. to become a new EU regulator. The EU primary and secondary law already provide measures to ensure correct and effective transmission, implementation and enforcement of the EU regulation into national laws, including, but not limited to (i) preventive initiatives such as Regulatory impact assessment (RIA), training member states' officials and judges in EU law, regular consultation between member state officials negotiating the implementation and enforcement of EU legislation, 'mutual recognition'; (ii) pre-infringement initiatives, like SOLVIT and EU-Pilot established by Art. 17(1) TFEU and Communication COM(2007)502 final; (ii) formal infringement procedures under Art. 258 TFEU for violations of treaty provisions, regulations and decisions, non-transpositions of directives, incorrect legal implementation of directives, improper application of directives or non-compliance with CJEU judgments. The Commission has not provided any evidence that those measures are not sufficient to ensure correct and effective implementation of the EU law. Moreover, if harmonized, regulation seems not efficient enough to achieve established EU electricity system goals and further regulatory decisions on electricity system should be left to Member States and national regulators and/or agreed by Member States at the EU level via legislative procedures, but not entitled to a new regulator to solve on its own discretion.

13) Would you see benefits in strengthening the role of the ENTSOs? How could this best be achieved? What regulatory oversight is needed?

ENTSO-E has a strong and clearly-defined role and its place in the regulatory framework. Its principles of conduct deriving from the Third Energy Package, Regulation (EC) 714/2009, Regulation (EU) 838/2010, Regulation (EU) 347/2013, Regulation (EU) 543/2013, provide practical tools for Member States and TSOs to implement EU internal electricity market and related goals. Coordination of TSOs' actions in the fields of transmission system operation, system development, market development and research, and actions to define processes of compliance with EU legislation, like network codes, infrastructure development plans, methodology making, data collection and analysis/reporting assist Member State and TSOs as a reliable source on decision making and regional and pan-European cooperation when implementing EU frameworks and policies. Thus, ENTSO's role should be preserved and not mixed with any other functions to ensure independent coordination of TSOs by means of research, and platform of data, reports and methodologies which serve for the implementation of the EU integral electricity market.

15) Shall there be a European approach to distribution tariffs? If yes, what aspects should be covered; for example tariff structure and/or, tariff components (fixed, capacity vs. energy, timely or locational differentiation) and treatment of self-generation?
The electricity market is under the ongoing innovation period due to technological change and economic dynamism. The innovation is relevant not only to the efficiency of networks, system security, smart grids and metering and intelligent appliance, but also the innovation in tariffs.

The Report of 28 January 2015 on Study on Tariff Design for Distribution Systems commissioned by DG Energy to the consortium of AF-Mercados, REF-E and Indra defines the distribution business providing that "technology and network planning methodologies are consolidated, implying limited uncertainty optimal investment decisions and ease of auditing by regulators" as well as that industry has a very diverse structure among Member States. Moreover, the Report emphasizes the impact of a variety of factors, other than regulation, to unit distribution costs, such as different quality of service required, loads served, proportions of distributed generation accommodated and operation in incomparable conditions (e.g. density of population, geographic constraints having impact on network design and operation.). Most importantly, the Report admits the ongoing "major changes" in distribution activity due to renewable generators, low-carbon energy, and the development of smart metering and smart automated appliances requiring to increase the capacity of distribution network, including more active and different-than-usual management of power flows, and implying the necessity for different investment approaches compared to the traditional ones. Consequently, the distribution industry will have to make decisions on innovation where "multiple options to achieve the same results are available" and innovative technologies will make investment, costs and performance less certain and requiring more flexibility in order to achieve the goals appointed to distributors in the energy market. Therefore, non-interventionist approach would allow potential innovation in terms of distribution and tariff types.

16) As power exchanges are an integral part of market coupling – should governance rules for power exchanges be considered?
It should be noted that Power Exchanges is still a very new part of the electricity market, thus, harmonized institutional arrangements would occur remarkably quickly without giving both markets and Member States time to adapt to changes and to test existing frameworks of Power Exchanges, as well as look for the best practices to improve them.

According to the EU regulation, Power Exchanges are of a twofold nature - market place and institution. As a market, it facilitates trading and determines bidding. As an institution, it participates in the market design, offers products and services, and competes with other Power Exchanges. The

EU already has existing mechanisms under Internal Market rules, competition law, Regulation No 714/2009, Regulation No 1227/2011, etc. that enable supervision at both, the EU and national levels of power exchange activities, including their agreements with TSOs. Instead of looking for administrative and institutional frameworks for power exchanges, EU should work to enforce existing EU framework in order to eliminate barriers between bidding zones and to ensure a customer-oriented market coupling based on an “open market infrastructure”, e.g. that capacity allocation and calculation mechanism (including regional cooperation agreements between TSOs) would be based on technical (laws of physics) and economic principles, rather than on political means and limiting access to generation from the neighbouring countries.

In this case, two options could be considered. Firstly, continuing the current voluntary approach (no additional EU action), or, secondly, creating a new European governance framework through a legally binding guideline of minimal level of harmonization of coupling arrangements maintaining the diversity of local/regional market arrangements and/or regulatory specifications.

3. THE EUROPEAN DIMENSION TO SECURITY OF SUPPLY

17) Is there a need for a harmonised methodology to assess power system adequacy?
The adequacy of the power system has two components: (i) the ability of the generation to cover the peak load taking into consideration generation availability and load level, and (ii) the ability of the transmission system to perform importing and exporting flows through interconnection. Thus, the adequacy of the power system is of pure technical nature. The task is fulfilled by national regulatory authorities, TSOs and governmental regulation. Whereas on the EU level, ENTSO annually collects and reports the statistical data and explanations that can be used to assess and forecast trends. In its Scenario Outlook & Adequacy Forecasts 2015, ENTSO indicates the focus on cross-border flows and the need for flexibility. Moreover, CEER also provides public data updates by benchmarking reports on the continuity of electricity supply.

CEER has undertaken an extensive research on adequacy assessment comparing existing generation adequacy assessments among Member States (Assessment of electricity generation adequacy in European countries, Ref: C13-ESS-32-03, 3 March 2014) and provided its recommendation (Recommendations for the assessment of electricity generation adequacy, Ref: C13-ESS-33-04, 08 October 2014). Even CEER promotes “coordinated approach in the design and implementation of policy instruments” in the field of system adequacy; however, the problems it firstly emphasizes are the lack of transparency in national reports, the lack of possibility to compare of national methodologies, and the reliability of data. These are the issues of reporting techniques, but not a lack of methodological assessment. Such issues can be solved using ACER and ENTSO in order to improve them. The issues of transparency in the national reports or data reliability/comparability in power system adequacy, that are of technical nature, shall not be solved by introducing new harmonised measures, but by encouraging innovation in technology and communication.

It should be noted that Article 194(2) TFEU provides that it is Member States’ right to choose the structure of energy supply and energy mix. Member States are responsible for the security of supply and together with TSOs have enough power and competence to supervise and enforce this part of the security of electricity supply.

18) What would be the appropriate geographic scope of a harmonised adequacy methodology and assessment (e.g. EU-wide, regional or national as well as neighbouring countries)?
Article 194(2) TFEU establishes the right to Member States to decide on the structure of energy supply and choose its energy mix. Therefore, Member States shall decide on adequate methodology

at national or regional levels, where regional level could also cover the neighbouring countries, if necessary.

19) Would an alignment of the currently different system adequacy standards across the EU be useful to build an efficient single market?

In order to foster an efficient single market, the EU should remain active in applying Internal Market rules and competition law to ensure that national policy measures relevant to security of supply are justified and in line with the principles of free access to generation and networks, as well as refrain from imposing priority to generation from the EU countries, excluding the neighbouring capacities.

20) Would there be a benefit in a common European framework for cross-border participation in capacity mechanisms? If yes, what should be the elements of such a framework? Would there be benefit in providing reference models for capacity mechanisms? If so, what should they look like?

Capacity mechanisms are a question of political and economic, rather than technical nature. As Member States are under pressure to implement challenging EU climate change and renewable targets, as well as investment needed to implement EU set of goals on the energy efficiency and interconnections, they tend to look for an interventionist approach towards the energy sector. The capacity mechanism is one of the tools under consideration. However, rewarding generation based on the value of capacity and not the output, e.g. paying for capacity and not the energy produced, potentially distorts competition and challenges the structure of the energy markets.

It is admitted that Member States vary in terms of problems and goals tackled by the capacity mechanisms, methodologies applied and their needs in general. Consequently, common European framework will not manage to cover all the issues and needs and will end up as additional regulatory burden on Member States. Also, market capacity does not lead to better security of supply. Furthermore, the EU should not allow impeding the long way energy market liberalization went through and give incentives to Member States to pursue further capacity mechanisms by establishing a common European framework.

On the other hand, the EU focus should remain on deregulation, removing market obstacles which blunt market price signals, as well as on the promotion of research and employment of smart technologies which empower market agents to be producers and consumers, buyers and sellers. Moreover, the focus shall remain on removing regulatory risks which discourage investors from making investments into the market. Also, the Commission should strictly apply competition law, State aid rules and Guidelines on State aid for environmental protection and energy 2014-2020, assessing the capacity mechanisms or Altmark criteria in case the capacity mechanism is modelled as a compensation for public service obligation of SEGI.

21) Should the decision to introduce capacity mechanisms be based on a harmonised methodology to assess power system adequacy?
Market capacity itself does not lead to securing continuous, efficient and affordable electricity supply, e.g. better security of supply. In general, capacity mechanisms as an interventionist approach to the energy market shall not be promoted.

5. Better Regulation for Better Results

Purpose:

The objective of this paper is to comment on the “Better regulation for better results - An EU agenda” from May 19, 2015 (hereinafter – EU BR Agenda) in a broader context.

The EU BR Agenda confirms the existing schemes and frameworks of EU Better Regulation policy, expresses a firm political commitment to continue efforts in this regard, and embraces evolutional – not revolutionary – novelties in two main areas: first, transparency and consultation and, second, in the domain of the quality of legislation.

Summary:

Businesses can perceive the EU BR Agenda positively, as the ultimate goal of the smart regulation tools (simplification or abolishment of legislation, evaluations, “fitness checks”, impact assessments of new regulatory initiatives, consultation fora, etc.) are first of all oriented towards reduction of the administrative burden on businesses, job creation and fostering economic growth in the EU.

EU NGO’s, inter alia those that are sometimes sceptical about the better regulation goals, e.g. dealing with the environmental issues and consumer rights, can also benefit from the Agenda’s enhanced consultation fora.

The society shall benefit from the lower administrative costs when the EU and member states deal with the simplified legislation and from the economic growth that the better regulation tools will ensure.

In addition to this positive evaluation, while the EU BR Agenda is perceived within the context of EU Better regulation policy developments, the Agenda may and shall be seen within the broader context of regulatory reforms – the ones that encompass the implementation, transposition and regulatory delivery phases. E.g. as those being launched in other international organizations, such as the World Bank, OECD, or in some reform-oriented countries, e.g. the United Kingdom, the Netherlands, Sweden, etc.

The focus shall be broadened by understanding that the better quality of legal rules and better transparency and consultation during the legislative process in not enough, if the transposition of EU law into domestic legislations is improper, also if the delivery of the regulation (implementation in practice, enforcement) is rough and burdensome.

Thus, two points can be made in this regard. First, the prevention of gold-plating shall be addressed with due regard. Smart and fit EU legal rules do not guarantee these rules are properly transposed into the legislative systems of EU member states. If EU rules are transposed in national legislation by adding regulatory requirements beyond what is required by an EU directive, or applying stricter sanctions or other enforcement mechanisms, or in other improper ways that are defined as gold-plating

instances, the results of smart regulation measures taken at the EU level will not have expected effects at the national level.

Secondly, the implementation, enforcement and delivery of legal rules shall be carried out with the proper attitude and knowledge. Businesses shall be assisted by enforcement executives (regulatory agencies, inspectorates, and inspectors) in order to comply with the legal rules. Enforcement shall be carried out in line with risk-based attitude, which means the biggest risks shall be monitored and controlled in the first place, not the minor breaches of legislation. Sanctions shall be as the *ultima ratio* and preventive measures shall prevail in the process of legislation delivery (implementation). The EU BR Agenda does not cover the regulation delivery stage directly, nor do other EU initiatives. So, "better delivery" might be the next question in row when updating the EU BR Agenda.

On the side of acknowledgements, the insights presented in this paper correlate with the observations from Better Regulation and Regulatory experts, to name but a few: Monika Beniulytė (Lithuania), Florentin Blanc (France), Oscar Fredriksson (Sweden), Charles-Henri Montin (France, Australia), Ana Maria Zárate Moreno (USA), and others. All comments, articles, materials were very valuable.

I. AN EU AGENDA "BETTER REGULATION FOR BETTER RESULTS" – AN OUTLINE AND MAJOR NOVELTIES

1.1. The context of EU Better Regulation initiatives

European Commission became active in the area of Better Regulation in 2001-2002 when first Commission report to the European Council on Better Lawmaking and White Paper on European Governance were announced in July 2001, and the Action Plan to Simplify and Improve the Regulatory Environment was adopted in June 2002. Earlier the questions on quality of regulatory environment were addressed within the reports from the Commission on subsidiarity and proportionality (pursuant to Article 9 of the Protocol to the EC Treaty on the application of the principles of subsidiarity and proportionality).

In December 2003 the European Parliament, the Council, and Commission have signed an Inter-Institutional Agreement on Better Lawmaking[2]. Different initiatives on Better Regulation followed since that.

In January 2007 The Action Programme for Reducing Administrative Burdens on business stemming from EU legislation by 25% by the 2012 was launched by the Commission and endorsed by the Council. 13 priority areas, where to reduce EU administrative burdens of legislation, were identified:

- Agriculture and Agricultural Subsidies; Annual Accounts / Company Law; Cohesion Policy; Environment; Financial Services; Fisheries; Food Safety; Pharmaceutical Legislation; Public Procurement; Statistics; Taxation and Customs; Transport; Working Environment / Employment Relations.

European Commission efforts to reduce regulatory burden, including administrative burden, got the title the Smart Regulation Agenda – under this title it was included into Europe 2020 Strategy[3]. Smart Regulation efforts address the whole policy cycle: from the *ex ante* up to the *ex post* assessments, from legislature to implementation, evaluation and revision. The goal of Smart Regulation – to

[2] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2003:321:0001:0005:EN:PDF

[3] Communication from the Commission. EUROPE 2020. A strategy for smart, sustainable and inclusive growth, Brussels, 3.3.2010 COM(2010) 2020.

provide the best possible quality of legislation, while complying with the subsidiarity and proportionality principles.

In 2010 "fitness checks" pilot exercises were launched in four policy areas: environment, transport, employment and social policy, and industrial policy. "Fitness checks" are comprehensive policy evaluations assessing whether the regulatory framework for a policy sector is fit for purpose. Their aim is to identify excessive regulatory burdens, overlaps, gaps, inconsistencies and/or obsolete measures which may have appeared over time, and to help to identify the cumulative impact of legislation. Their findings shall serve as a basis for drawing policy conclusions on the future of the relevant regulatory framework. Fitness checks do not replace "traditional" evaluations, such as impact assessments.

In its Communication on EU Regulatory Fitness of December 2012, the Commission committed to strengthening its various smart regulation tools (impact assessment, evaluation, stakeholder consultation) and launched the Regulatory Fitness and Performance Programme (REFIT). Through REFIT, the Commission services have mapped the entire EU legislative stock looking to identify burdens, gaps and inefficient or ineffective measures including possibilities for simplification or repeal. REFIT is a rolling programme. E.g., almost 200 actions decided in 2013-2014 are being implemented. These include simplification proposals for the benefit of business adopted by the Commission and awaiting decision by the legislator (e.g., a standard EU VAT declaration; The improvement of the European Small Claims Procedure); they also include various evaluations and fitness checks (e.g., in the areas of Safety and Health at Work, Protection of birds and habitats (Natura 2000), General Food Law, etc.).

1.2. The EU Better Regulation Agenda

On May 19, 2015, the European Commission has adopted and published a new communication for improving the Union’s rulemaking process – *“Better regulation for better results - An EU agenda. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions”*[4]. Commission has declared it is outlining further measures to deliver better rules for better results.

The EU BR Agenda shall ensure the EU legislative measures are evidence-based, well designed and deliver tangible and sustainable benefits for citizens, business and society as a whole. The goal is boosting jobs and growth in the EU. In order to achieve this the Commission through the “*Better Regulation Package*”[5] established a set of policy changes that seek to improve: first, the transparency and participation within the EU’s regulatory process, and second, the quality of new and existing legislation.

The Agenda confirms the existing schemes and frameworks of EU Better Regulation policy, at the same time it expresses the firm political commitment to continue efforts in his regard. Thus, the Agenda is an evolutionary, not revolutionary, step in line with previous policy initiatives on Better and/or Smart Regulation.

The Agenda embraces such main novelties[6]:

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[4] Strasbourg, 19.5.2015 COM(2015) 215 final,
http://ec.europa.eu/smart-regulation/better_regulation/documents/ com_2015_215_en.pdf

[5] **Better Regulation, Key Documents, 19 May 2015 - Better Regulation Package,**
http://ec.europa.eu/smart-regulation/better_regulation/key_docs_en.htm

[6] for novelties see the ANNEX.

- within the transparency and consultation domain:
  - the interactive tool for citizens to provide ideas to the Commission is going to be updated;
  - REFIT platform, based on Regulatory Fitness and Performance (REFIT) Programme[7], is to be used as a forum for review of existing legislation by high level experts from social partners;
  - public consultation mechanism will cover all Impact Assessments and Evaluations;
  - feedback on Roadmaps, Evaluations Roadmaps and Inception Impact Assessments from stakeholders is going to be considered;
  - stakeholders will be able to provide feedback on Commissions proposals and on draft Delegating and Implementing Acts prepared by the Commission.
- within the domain of quality of legislation:
  - REFIT check of existing stock of legislation shall be more targeted, quantitative, inclusive, embedded in political-decision making;
  - monitoring and evaluation of legislative process is going to be stronger;
  - Better Regulations Guidelines[8] and associated Better Regulation "Toolbox" shall be used throughout the legislative process; Guidelines should be applied in a proportionate manner using common sense bearing in mind that the aim is not to respect procedural requirements per se;
  - Regulatory Scrutiny Board that since 1st of July 2015 replaced the Impact Assessment Board shall provide a central quality control and support function for Commission impact assessment and evaluation work, "fitness checks" of existing legislation. Half of the Board Members shall be independent experts, not delegated by the Commission.
  - Impact Assessment on substantial amendments shall be subject to confirmation by Council and Parliament.

The higher level of independence while performing Impact Assessments, and the greater involvement of the Parliament and the Council in Better Regulation mechanisms may be indicated as the strongest sides of the Agenda.

Both businesses and NGOs can benefit from the updated and enhanced consultation mechanisms. Two groups are part of the REFIT platform, based on the REFIT Programme: a government group comprising 28 member state experts and a group of 20 stakeholders representing the private sector, social and civil society organizations, and the EU Economic and Social Committee and the EU Committee of the Regions. The stakeholder group is selected through an open call[9] and is expected to have its first meeting in November 2015. The platform will: 1) gather proposals for burden reduction, 2) assess those proposals, 3) send them to the Commission, and 4) respond to and publish a proposal each. The platform mandate runs through October 2019.

II. THE BROADER CONTEXT OF THE EU BR AGENDA

The EU BR Agenda shall be considered in a broader context of regulatory reforms, the ones that encompass the implementation, transposition and regulatory delivery phases. The EU reformers may benefit from the “know-how” and best practices being used in the World Bank, OECD, or in the

[7] For REFIT platform see – Strasbourg, 19.5.2015 C(2015) 3261 final, http://ec.europa.eu/smart-regulation/better_regulation/documents/c_2015_3261_en.pdf; for REFIT program – COM(2012)746 final, http://ec.europa.eu/smart-regulation/better_regulation/documents/com_2013_en.pdf

[8] Strasbourg, 19.5.2015 SWD(2015) 111 final, http://ec.europa.eu/smart-regulation/guidelines/docs/swd_br_guidelines_en.pdf

[9] Call for expressions of interest for the selection of experts for the stakeholder group of the "REFIT platform", http://ec.europa.eu/smart-regulation/better_regulation/documents/20150624_refit_platform.pdf

reform-oriented countries, including the United Kingdom, the Netherlands, Sweden and several others.

During the last two-three decades, few reforms of the public sector have received more attention, and stimulated more controversy, than the reforms made to regulation making (law making) and regulatory management. The rise of regulatory policies – explicit policies aimed at continuously improving the quality of the regulatory environment – shows how early notions of "deregulation" or "cutting red tape" quickly gave way to a central "good governance" notion[10]. This notion is based on an understanding of how regulatory practices can substantially improve market performance, public sector effectiveness and citizens' satisfaction, through a mix or deregulation, re-regulation and better quality regulation, backed up by new or improved institutions and new practices of regulatory enforcement (rules implementation in practice).

One of the main theses of this paper is that the "smart and balanced laws" are only one prerequisite necessary to create a proper legal environment. The good quality of EU legal rules and a smooth process of consultation during the EU legislative process in not enough, if, e.g. the transposition of EU law into 28 domestic legislations is improper, and if the delivery of the regulation (implementation in practice, enforcement) is rough and burdensome.

The following provides an overview of, and comments on, different initiatives launched in various international fora and/or in single countries in order to illustrate possible additional focuses of the EU BR Agenda.

2.1. The set of "Better Regulation" tools – the World Bank and single countries

The program on Better Regulation is being developed in line with other programmes (e.g. IFC / World Bank Group's Investment Climate Program) within the framework of World Bank initiatives and programmes since 2005. The Better Regulation for Growth (BRG) Program was launched in 2007 with the participation of the Dutch Ministry of Foreign Affairs, the UK Department for International Development (DFID) and FIAS, the investment climate advisory services of the World Bank Group. The objective of the BRG Program is to review and synthesize experiences with regulatory governance initiatives in developing countries, and to develop and disseminate practical tools and guidance that will help developing countries design and implement effective regulatory reform programs.

Better Regulation for Growth 2010 paper „Tools and Approaches to Review Existing Regulations"[11] outlines 12 tools and approaches to be explored when seeking better rules for better outcomes:

- Process Reengineering; Doing Business; Standard Cost Model (SCM); Guillotine; Bulldozer; Scrap and Build; Staged Repeal; Review and Sunset Clauses; Statute Law Revision; Codification; Recasting; Consolidation.

The listed tools mean different possibilities. E.g. Process Reengineering may mean reducing burdens through e-government solutions that replace traditional ones. Doing Business reports may be used to create objective benchmarks of business regulations at the sub-national level, point out bottlenecks, and provide concrete recommendations for reform. The "Guillotine" tool is a process of counting and then reviewing a large number of regulations against some criteria. It then eliminates those that are no longer needed, using extensive stakeholder input. The guillotine approach espouses the principle of the "reversal of burden of proof, i.e., the regulators need to justify why a license or regulation is needed, otherwise it will be removed. The Bulldozer approach involves establishing a grassroots and public awareness methodology in which local business communities are mobilized to identify unnecessary regulations and to advocate for its reform or removal. Scrap and build is a severe

[10] See the http://www.oecd-ilibrary.org/governance/regulatory-policies-in-oecd-countries_9789264177437-en
[11] https://www.wbginvestmentclimate.org/uploads/BRGTools.pdf

approach that challenges the entire regulatory regime. It consists of a complete review of the regulatory system, rethinking its principles, and the interactions between regulators. With the scrap and build approach the basic principles of an entire regulatory regime are comprehensively rethought and a new coherent and integrated regulatory policy package is built, thus the Scrap and build has not been used very often. Staged repeal or "automatic revocation" consists of a systematic and comprehensive review of existing regulations, in which regulations are grouped according to their age and progressively repealed after review. It is a progressive and staggered schedule of repeal based on the date of adoption. Regulations that are deemed meritorious are re-made. And so on[12].

The EU BR Agenda shall take a full advantage of the above mentioned techniques.

Different EU countries have various programmes in addition to EU Better Regulation policy. E.g. "SME-focus" (positive discrimination, a more favourite regime for SMEs) in the United Kingdom and Germany, "Simplegis" in Portugal[13], "Burden Hunter" in Denmark (the methods includes observation studies, process mapping, expert interviews, focus groups, co-production, nudging, service design and user-centered innovation. Burden hunters are civil servants who involve businesses in developing smart regulation that can remove "red tape"), "One In – One Out" and "One In – Two Out" in the United Kingdom (no new primary or secondary legislation which would create new expenses to businesses can be introduced without prior identification and removal of an existing regulation with an equivalent (or twice greater) financial burden that could be removed), "Regelradet" in Sweden, Common Commencement dates in the United Kingdom, The Red Tape Challenge in the United Kingdom, the "Kafka" project in Belgium[14], etc.

The examples of best national practices shall be studied and incorporated when updating the EU Better Regulation Agenda.

2.2. Preventing Gold-plating – the UK, Sweden and other countries

While one state will successfully apply a European law without a burden, another state may turn a European legal text into something very complex and burdensome for companies.

Here the phenomena of Gold plating may occur. Historically, the meaning of this term widened from this narrow definition to include various possible situations that may occur during the adoption of the European legislation at the country level.

The term and notion of Gold plating was first addressed by two countries of the European Union, namely Sweden and the United Kingdom. This phenomenon was defined to highlight and then tackle its negative effects which became apparent in both of these countries as the cumulative effects of the added legislation at the national level was causing local business hard times compared with their competitors coming from a neighbouring country. For the current moment the problem of Gold plating is understood and perceived in other EU countries, e.g. Slovakia and, Lithuania[15].

Gold plating is defined as covering these main instances: 1) adding regulatory requirements beyond what is required by an EU directive (inappropriate action); and 2) retaining national regulatory requirements that are more comprehensive than is required by an EU directive (inappropriate

[12] See further WB "Tools and Approaches to Review Existing Regulations", https://www.wbginvestmentclimate.org/uploads/BRGTools.pdf .

[13] http://ec.europa.eu/dgs/secretariat_general/admin_burden/docs/enterprise/administrative-burdens/high-level-group/files/hlg_pt_simplegis_201010_faq_en.pdf

[14] http://www.kafka.be/fr

[15] See, e.g., The Gold-Plating: Identification of Problems in Slovakia and Lithuania and Possible Solutions for EU Member States", Policy paper, May 7, 2015, http://4liberty.eu/the-gold-plating-identification-of-problems-in-slovakia-and-lithuania-and-possible-solutions-for-eu-member-states/

inaction). Also such manifestations of improper transposition[16]: 3) using implementation of a directive as a way to introduce national regulatory requirements that actually fall outside the aim of the directive; 4) implementing the requirements of a directive earlier than the date specified in the directive; 5) applying stricter sanctions or other enforcement mechanisms than are necessary to implement the legislation correctly; 6) extending the scope of a directive; and 7) not taking (full) advantage of any derogations.

In the area of EU law transposition Commission launches the process of infringement procedures or formal notices towards EU member states. Nevertheless, only some infringement procedures and formal notices from the European Commission concern the transposition breaches that could be indicated as "Gold-plating". Usually the correlation between the numbers of infringements and formal notices from the EC and the number of instances of Gold-plating is only indirect. For example, many infringement procedures is being started due to the fact that the EU legislation has not been transposed in a timely manner (late transpositions). On the contrary, from the viewpoint that requires preventing "Gold-plating", an earlier transposition of EU law (early transposition) is an undesired practice.

Drawing on the infringement procedures or formal notices that concern the content of EU and national legislation, one could also observe that the European Commission first of all focuses on the aspect of non-discrimination of service providers from other EU member-states. The focus is not so detailed as the problem of "Gold-plating" requires.

The measures to prevent Gold-plating shall be addressed with due regard within the EU BR Agenda, as smart and fit EU legal rules do not guarantee these rules are properly transposed into legislative systems of EU member states. The Commission shall consider taking special preventive (ex-ante) and evaluative (ex-post) measures to ensure proper transposition of EU law.

2.3. A Comprehensive Approach – OECD, United Kingdom, etc.

The burden on businesses might happen not only in the form of administrative burden (when businesses shall perform obligations to provide the information to the state or municipal authorities, to fill various forms, etc.) or in the form of regulatory burden (when businesses shall comply with different legal regulations and technical requirements), but also in the form of enforcement (when sanctions, bans on activities, penalties and other repressive measures are applied on businesses if they fail to comply with legal regulations, and cause damages or create risk to people, environment, property, etc.). In the ideal word sanctions shall only be the last resort, *ultima ratio*, and the prevention and consultation shall precede in the regulation enforcement (supervision of economic activities) process. Unfortunately, enforcement agencies (regulatory agencies, inspectorates and inspectors) do not always act in the right or business-friendly way. Thus businesses face an additional burden of rigorous enforcement.

The EU BR Agenda does not cover regulation delivery stage directly, neither other EU initiatives. This might be seen as a shortage of EU Better Regulation policy.

Oscar Fredriksson outlines the importance of the regulation delivery stage as follows[17]:

> **Box 1.** *"As a Better Regulation advisor I believe that we need to focus more attention to "Inspections Reform" rather than "Regulatory Reform". Both perspectives are of course important but sometimes Governments as well as business organizations tend to focus too much attention to simplification and de-regulation. The idea is to reduce burdens on business in order to create economic growth and generate more jobs. There*

[16] See, e.g., the report "Clarifying Gold-plating – Better Implementation of EU Legislation" The Swedish Better Regulation Council / Board of Swedish Industry and Commerce for Better Regulation.

[17] https://www.linkedin.com/pulse/changing-hearts-minds-more-important-than-regulatory-fredriksson

> *is clearly a need in most countries to simplify the legal framework in order to promote growth but this is not enough /.../ Any simplified legal framework can be burdensome in the hands of an overzealous local inspector. But the opposite is also true. Any complicated and burdensome legal framework can be made easy (or at least less burdensome) if your local inspector take the time to explain it and help you out.",* Oscar Fredriksson, 2015

Businesses shall be assisted by inspectors in order to comply with the legal rules. Enforcement shall be carried out in line with risk-based attitude, which means the biggest risks shall be monitored and controlled in the first place, rather than focusing on minor breaches of legislation. Other principles of "right enforcement" and "right enforcers" are listed below.

2.3.1. OECD

The Organization for Economic Co-operation and Development (OECD) has been at the forefront of developing "best practice" guidelines for regulatory reform since 2002[18]. One could consider the attitude towards improvement of regulatory policy and practices professed within the OECD as one of the most comprehensive approaches.

In November 2014 OECD published a study "International Regulatory Co-operation and International Organisations"[19], where 16 international organizations (IOs) playing in the field of regulatory activities were indicated as an open list of such IOs. The conclusion is - the better rules can be constructed through international co-operation as well as by single IOs themselves; nevertheless, the first opportunity remains largely untapped.

In 2014 OECD has published "Best Practice Principles for Regulatory Policy: Regulatory Enforcement and Inspections"[20] where 11 principles for better regulatory delivery (law implementation) were outlined:

- Evidence-based enforcement; Selectivity; Risk focus and proportionality; Responsive regulation; Long-term vision; Co-ordination and consolidation; Transparent governance; Information integration; Clear and fair process; Compliance promotion; Professionalism.

Subsequently "OECD the Best Practice Principles for Regulatory Policy: The Governance of Regulators" followed[21]. Here 7 principles for the proper governance of regulators were indicated:

- Role clarity; Preventing undue influence and maintaining trust; Decision making and governing body structure for independent regulators; Accountability and transparency; Engagement; Funding; Performance evaluation.

The "better delivery" might be the next question in row when updating EU BR Agenda. The OECD know-how shall be used in his regard.

[18] See, e.g., OECD. 2002. Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance. OECD: Paris; OECD. 2012. Recommendation of the Council on Regulatory Policy and Governance, Paris, http://www.oecd.org/gov/regulatory-policy/2012-recommendation.htm

[19] http://www.oecd.org/gov/international-regulatory-co-operation-and-international-organisations-9789264225756-en.htm

[20] http://www.oecd-ilibrary.org/governance/regulatory-enforcement-and-inspections_9789264208117-en

[21] http://www.oecd-ilibrary.org/governance/the-governance-of-regulators_9789264209015-en

2.3.2. UK

United Kingdom is one of the world leading countries in area of regulatory and regulatory delivery reforms[22].

Well known Hampton Review Report from 2005 "Reducing administrative burden: effective inspections and enforcement"[23] outlined such recommendations for inspection activities and enforcement:

- Regulators, and the regulatory system as a whole, should use comprehensive risk assessment to concentrate resources on the areas that need them most.
- No inspection should take place without a reason.
- Regulators should provide authoritative, accessible advice easily and cheaply.
- All regulations should be written so that they are easily understood, easily implemented, and easily enforced, and all interested parties should be consulted when they are being drafted.
- Businesses should not have to give unnecessary information, nor give the same piece of information twice.
- The few businesses that persistently break regulations should be identified quickly, and face proportionate and meaningful sanctions.
- Regulators should recognise that a key element of their activity will be to allow, or even encourage, economic progress and only to intervene when there is a clear case for protection.
- Regulators should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions they take.
- Regulators should be of the right size and scope, and no new regulator should be created where an existing one can do the work.
- When new policies are being developed, explicit consideration should be given to how they can be enforced using existing systems and data to minimise the administrative burden imposed.

These principles have inspired enforcement (inspection) reforms in other countries (e.g. Lithuania) as well.

Following on from the Hampton Report, Professor Macrory's report „Regulatory Justice: Making Sanctions Effective"[24] published in November 2006, made a number of recommendations in relation to regulatory non-compliance, including that regulators should have regard to certain principles for setting penalties and characteristics of a successful sanctioning regime, such as:

- A sanction should: Aim to change the behaviour of the offender; Aim to eliminate any financial gain or benefit from non-compliance; Be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction; Be proportionate to the nature of the offence and the harm caused; Aim to restore the harm caused by regulatory non-compliance, where appropriate; and Aim to deter future non-compliance.
- Regulators should: Publish an enforcement policy; Measure outcomes not just outputs; Justify their choice of enforcement actions year on year to stakeholders, Ministers and

[22] The Netherlands, Denmark, Australia, New Zeeland, Canada can be mentioned as well in this regard. Due to the limited space of the paper, the experience of these countries isn't discussed more broadly.
[23] Hampton P., Reducing administrative burden: effective inspections and enforcement – Report to HM Treasury, London, HMSO, 2005, http://www.publications.parliament.uk/pa/cm201213/cmselect/cmspeak/1069/106911.htm
[24] http://webarchive.nationalarchives.gov.uk/20121212135622/http://www.bis.gov.uk/files/file44593.pdf

Parliament; Follow-up enforcement actions where appropriate; Enforce in a transparent manner; Be transparent in the way in which they apply and determine administrative penalties; and Avoid perverse incentives that might influence the choice of sanctioning response.

The newest changes of UK legislation – the Deregulation Bill from March 2015[25] shall ensure the regulators, inspectorates, other persons exercising a regulatory function, in the exercise of the function, have regard to the desirability of promoting economic growth of those which are being regulated (so called "Growth Duty"). Regulatory action shall be taken only when it is needed, and any action taken shall be proportionate (Deregulation Bill, Para 83).

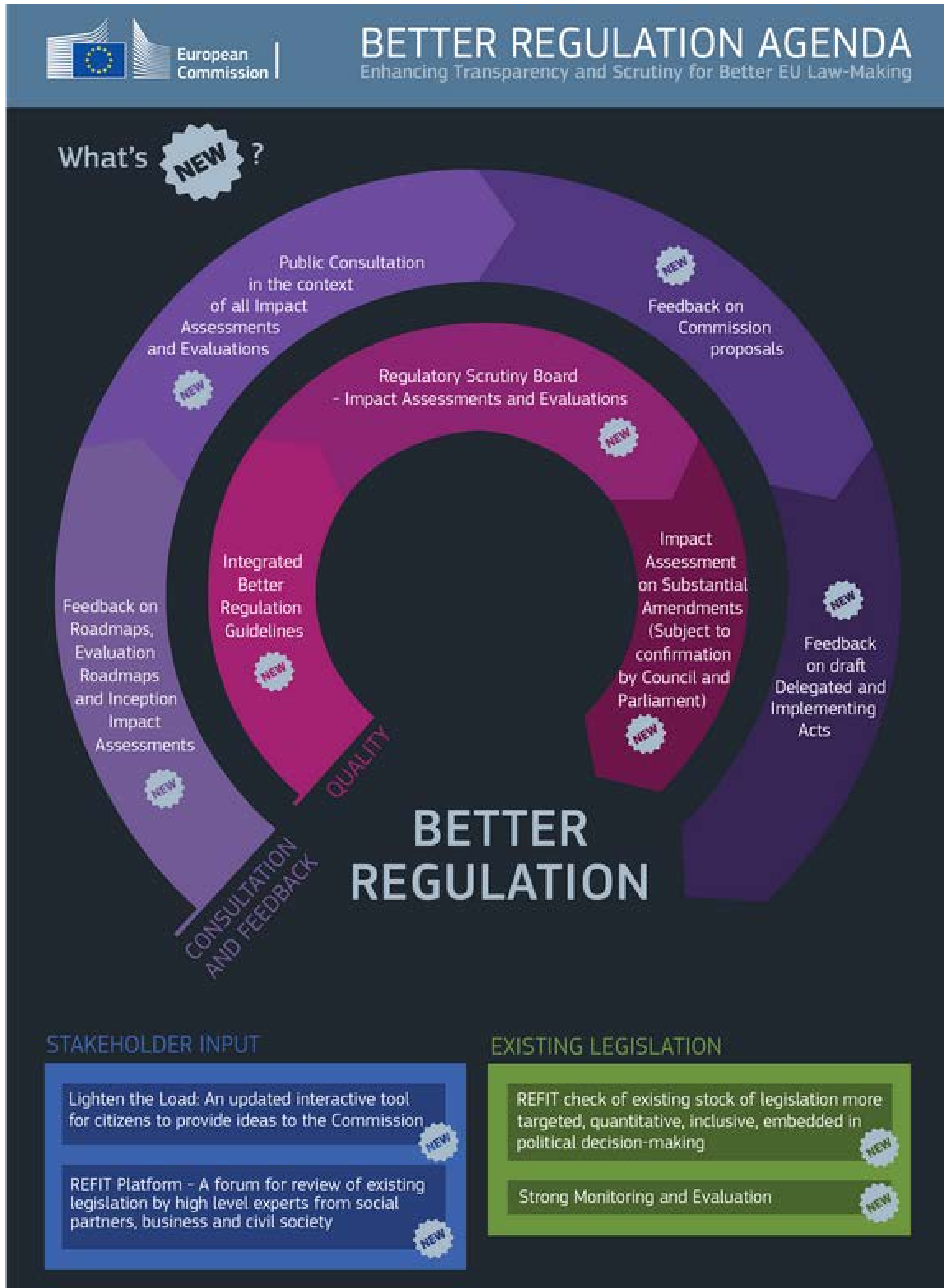
The Deregulation Bill provides for the removal or reduction of regulatory burdens on businesses, civil society, individuals, public sector bodies and the taxpayer. It includes measures relating to general and specific areas of business, companies and insolvency, the use of land, housing, transport, communications, the environment, education and training, entertainment, public authorities and the administration of justice.

The Bill also will repeal legislation that is no longer of any practical use.

This overview of UK regulatory initiatives shows: first, the importance of the delivery side, and second, the possibility to combine "better/smart regulation" with "better/smart delivery".

[25] http://www.parliament.uk/business/news/2014/july/lords-deregulation-bill/

ANNEX BETTER REGULATION AGENDA OF 19 MAY 2015 in graph[26]



[26] http://ec.europa.eu/smart-regulation/images/br_infographic.png

6. Regulatory Framework For Electronic Communications Networks and Services

<u>The objective of the Consultation:</u>

The review of the regulatory framework for electronic communications is one of the 16 actions of the Digital Single Market Strategy adopted by the Commission on 6 May 2015 and the key element for creating the right conditions for digital networks and services to flourish (the second pillar of the Strategy). In accordance with the Commission's Work Programme for 2015, the review will be preceded by the evaluation of a Regulatory Fitness and Performance Programme (REFIT) aimed at assessing whether or not the current regulatory framework is "fit for purpose."

The purpose of the questionnaire provided is therefore twofold. Firstly, it aims to gather input for this evaluation process in order to assess the telecoms regulatory framework against the evaluation criteria according to the following criteria of the Better Regulation Guidelines: effectiveness (have the objectives been met?), efficiency (were the costs involved reasonable?), coherence (does the policy complement other actions or are there contradictions?), relevance (is EU action still necessary?), and EU added value (can or could similar changes have been achieved at national/regional level, or did EU action provide a clear added value?)

Secondly, the questionnaire is designed to obtain views on the issues that may have to be reviewed with the aim of reforming the regulatory framework in the light of market and technological developments as well as achieving the ambitions laid out in the Digital Single Market Strategy. Further information on relevant developments and the emerging challenges for the existing sector rules can be found in the background document to the public consultation.

<u>Summary of the Respose:</u>

General questions on the current regulatory framework and the universal service regime

- Public investment is based on a wrong assumption that private sector faces a market failure and cannot provide sufficient quality and coverage of internet connection in some areas;
- Public investment into high speed internet connection infrastructure might not be economically justified and might lead to stifled innovations and investment in the private sector;
- If the Commission decides to invest into high speed internet connection infrastructure, it is of major importance to ensure possibilities of competition and cooperation with the private sector.

Spectrum Policy

- Spectrum allocation will benefit from a greater role for market forces. Relaxing usage requirements and trading limitations to allow for secondary markets to emerge would be a way to achieve this.

Sector-specific regulation for communications services

- Regulation of specific sectors should focus on the wellbeing of consumers rather than a regulatory-level playing field;
- New over-the-top interpersonal communication service providers should not be put under the same regulations that apply to traditional telecom service providers.

QUESTIONS

General questions on the current regulatory framework and the universal service regime
Description
The Consultation states that relatively little full "infrastructure competition" has emerged in the fixed-line networks, except in very densely populated areas where cable networks were already present or where local authorities have been active; and the extent of upgrades to the highest capacity networks varies markedly. Various questions (3.2 General questions on the current regulatory framework; 3.3 Network access regulation; 3.6 The universal service regime) cover different aspects of the same issue – the problem of providing end-users with a stable high speed internet connection and ensuring possibilities of competition in the process.
There are two main areas in this field: 1) a policy assumption that in some areas private sector is unable to ensure a sufficient network connection to end-users due to a market failure; and 2) a necessity of competition and innovation when ensuring network access to end-users.

1. **The assumption of a market failure**

One of the greatest risks to any possible future investment into any further fixed-line or wireless technologies providing full ubiquitous and accessible very high-speed connectivity across the EU is the aim to invest public funds into the development of broadband internet infrastructure. It is especially relevant to rural and other areas which may pose difficulties in terms of geographic coverage.

Such public investment is usually backed by the argument that the private sector is incapable of providing the necessary connection due to a market failure. The Commission claims that given the scale of investments needed to roll out and upgrade the current connections to the next generation of digital networks – often based on fibre technology – there is a serious risk that a market failure will rapidly increase the so-called "digital divide" across Europe.

LFMI's Position
The assumption of a market failure is not entirely true

The argument of market failure is not true. Private sector investment into internet connection technologies is very significant. The global proportion of people using the Internet has risen at a compound annual growth rate (CAGR) of 12% in the period from 2008 through 2012. Due to the introduction of the 4G technology in 2010, there was a significant increase in the Internet speed too.[27] Notably, it was not public investment but the private sector that gave a boost for such a rapid

[27] http://www.internetsociety.org/sites/default/files/Global_Internet_Report_2014_0.pdf

growth. When it comes to internet coverage, growth rates in mobile broadband penetration appear to be significantly higher than the already high corresponding historical growth in mobile cellular penetration. Mobile broadband penetration exceeds cellular penetration by 5 to 19 per cent. Given the increasing reach of mobile broadband networks and upgrades to newer technologies, fast uptake of mobile broadband access is very encouraging for increasing overall Internet penetration.

Therefore, the argument that the market has failed and the public sector must step in with public investment is not true. The Commission has formulated standards that may appear a bit unrealistic to reason its intervention into the market. The market has not failed, but performed precisely as it should. The regions with the most users and demand have seen the largest development of infrastructure. On the contrary, rural regions are not developing as fast as heavily urbanized ones for they have less users and lower demand. It would be strange and unnatural to expect the same or comparable level of IT infrastructure in cities and rural areas. However, the data suggest that internet penetration is increasing. This situation can be defined as a market in action rather than a failure. Market mechanisms define where the infrastructure development is necessary. It is important to acknowledge that investing into unlimited access to high speed internet is irrational as it competes with alternatives uses of resources. What is more, it should not be forgotten that such public investment may stifle innovation and competition as it is covered in this response further on.

2. Inclusion of access to internet within the scope of universal services

Any possible inclusion of access to a broadband network connection within the scope of universal services will require public investment into infrastructure development. As it is explained above, markets develop in the areas of high demand.

LFMI's position
Public broadband networks – economically unjustified and costly

Any active governmental participation in the development of broadband networks may lead to unexpected consequences. Let us take the United States as an example. In 2011 President of the United States Barack Obama stated that one of the goals of his term was to ensure that 98% of Americans have access to the Internet. The aim in itself is similar to that of the European Commission. As a result, public networks emerged throughout the United States, but the results were not as positive as expected. These government-owned networks did not meet the objectives in terms of coverage. Moreover, the private sector could have reached the same coverage without government intervention and additional financial burden on taxpayers.

Government-owned networks used taxpayer funds to build networks in areas where high-speed Internet was already provided by the private sector. This network overbuild is counter-intuitive since it requires taxpayers to fund and subsidize a public network that duplicates an already existing private one. Therefore, even if a government decides to develop broadband infrastructure, the assessment of the necessity of such infrastructure will be of vital importance in order to avoid duplication and maintain competition. Otherwise government-owned networks would unfairly compete with the existing providers. What is more, as a public entity, a government-owned network can practice various anticompetitive activities that may put private market participants at a competitive disadvantage. Thus, municipalities that use taxpayers' money to build a broadband network actually act to forestall market entry and decrease competition. Government-owned networks deprive consumers of the benefits of competition and choice, governments lose tax

revenue from private networks that might have otherwise entered that market, and taxpayers pay more in taxes as they subsidize the operation and maintenance of those networks[28].

Finally, government-owned networks tend to fail because they lack a sustainable business plan and long-term resources to invest in maintenance and upgrades as technology evolves. When this happens, taxpayers have to fund these failures.

It is important to carefully examine the outcomes that have been registered in the United States in order to avoid the same mistakes, economic losses related, and other damages such as distortions of free competition and slower investments.

Competition and innovation

The Communication states that with the opening of the telecommunications market to competition there was a need to provide safeguards for those circumstances where competitive market forces alone would not satisfactorily meet the needs of end-users, particularly in cases where they lived in areas which were difficult or costly to serve, or had low incomes or disabilities. However, a possible financial or infrastructural governmental intervention into the field of providing internet based on the argument of eliminating social exclusion of socially vulnerable groups should also follow the rules of competition. Thoughtless actions may lead to a stifled competition and slower innovations.

LFMI's Position

Any public investment must ensure competition. Even if the Commission decides to proceed with a public investment plan, it has to follow two fundamental principles: it must cooperate with the private sector and ensure competitive procedures.

Cooperation with the private sector will not only provide private entities with an opportunity to participate in infrastructure development, but ensure that the best practices of the private sector are used in the process. Private companies could bring advanced business management techniques, innovations and private investment into infrastructure development projects. This will not be possible without ensuring competition, because the public sector will deliver the most by engaging in competition for the participation in infrastructure development.

There is a danger that the government would see a public investment plan as a carte-blanche to favor public companies in tenders, create government-owned IT entities and engage in business. If the Commission goes ahead with this plan, it must provide very stringent safeguards to prevent governments from engaging in such practices.

If the Commission decides not to uphold these principles and invest into infrastructure, it may slow down innovations. With public infrastructure in place, the private sector might lose incentives to innovate and devise cost-effective ways of reaching far-away end-users.

Spectrum policy

Description

The Consultation states that while technical harmonization of the use of radio spectrum for EU-wide allocations has progressed significantly based on the 2002 Radio Spectrum Decision (RSD), the designation of (additional) spectrum to a (new) application or technology in the EU still requires several steps. It is vital to ensure proper competition in the field of allocating radio spectrum frequencies.

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[28]]http://www.coalitionforthneweconomy.org/wp-content/uploads/2012/01/1-6-12-Coalition-for-a-New-Economy-White-Paper.pdf

LFMI’s position

Spectrum regulation is a good example where good intentions of regulators to harmonize spectrum policy may ultimately harm competition. There is good reason to believe that a broader spectrum should be awarded to mobile operators, especially those considering the launch of 5G services in the near future. However, one should refrain from conflating technological and economic considerations. Although mobile may be a superior technology to broadcasting from a technical perspective, this does not necessarily imply that it is the task of national governments to determine the best way to pursue ultra-fast broadband connections and the Commission should not be the one to pick winners in spectrum allocation.

Regulation has many ways of affecting market developments, especially when regulators are in charge of resource allocation. However, the efficiency of the outcome depends on whether or not market players have the opportunity to decide upon the best use of the spectrum available. This may be addressed by relaxing the usage requirements and trading limitations that would allow the emergence of secondary spectrum markets. A market-driven mechanism should be the path for the Commission to follow.

Sector-specific regulation for communications services

Description

The Communication states that over-the-top (OTT) services are increasingly seen by end-users as substitutes for traditional ECS, such as voice telephony and SMS, used for interpersonal communication. Such OTT services, however, are not subject to the same regulatory regime. As a consequence, the issue of a level playing field has been raised, with some stakeholders calling for a re-evaluation of the existing provisions in order to ensure that wherever the activities of providers of competing services give rise to similar public policy concerns, they would have the same rights and obligations (i.e. end-users’ protection, interconnection, numbering, etc.) But the main goal in terms of regulating different types of service providers is not to create a regulatory-level playing field, but to ensure the wellbeing of consumers.

LFMI’s position

At the moment, telecom operators are competing with the OTT services that are chosen by end-users as substitutes but are not subject to the same regulatory regime. We should bear in mind that if the same economic regulations that are applicable to the telecom industry were imposed on their OTT competitors, they could restrict competition in the OTT sector and therefore stifle innovation. If new ways of providing interpersonal communication services are working well enough to compete with the incumbent telecom industry even in its early stages of development, there is no reason to regulate it, especially from the point of view of competition policy. The goal of the Communication and the Digital Single Market Strategy is to increase competition and innovation, and to implement rules that will foster them.

Even though equal rules are usually regarded as instrumental in this respect, the case of Voice over IP technology (VoIP), for example, shows otherwise and suggests that equal rules may bring equal restrictions that would stifle the performance of a particular sector.

7. Common Consolidated Corporate Tax Base Initiative

Purpose of the initiative:

The European Commission has re-launched the Common Consolidated Corporate Tax Base (CCCTB) initiative. CCCTB refers to a proposal by the European Commission for an EU-wide tax code aimed at companies operating in more than one member state. Under a CCCTB, businesses would compute their annual EU taxable income and apportion shares of it to the different member states where they operated, according to a pre-defined formula taking into account revenue, employee numbers and wages, as well as most assets. Under a CCCTB, each member state would tax the profits of the companies in its state at their own national tax rate. The renewed proposal for a CCCTB introduces a two-step approach: efforts will first concentrate on agreeing the rules for a Common Corporate Tax Base (CCTB), and consolidation will be left to be adopted at a later stage (CCCTB).

Proponents of corporate tax harmonisation claim that the proposal is designed to:

- create the common market and secure free trade by removing tax obstacles;
- simplify compliance with the EU tax system;
- alleviate the burden of tax administration (both for taxpayers and tax administrators);
- guarantee even competition conditions;
- safeguard national tax revenues;
- improve tax transparency; and
- reduce tax avoidance (profit shifting and double non-taxation) and aggressive tax planning.

Summary of the response:

There are reasons to claim that CCCTB is not the best tool to achieve these objectives:

- Tax harmonization would destroy tax competition between countries, and this will have negative consequences;
- CCCTB confuses value-added with inputs;
- CCCTB will deprive market agents of the opportunity to select better taxation options;
- If imposed on all companies, CCCTB would make tax compliance harder;
- CCCTB might not reduce companies' and tax administrators' costs and could even increase them;
- Requirements to disclose sensitive information would put EU businesses at a competitive disadvantage;

Tax harmonization would destroy tax competition between countries, and this will have negative consequences.

Unified tax rules can hardly contribute to trade liberalisation. The diversity of tax systems is not a roadblock for free trade. Quite the opposite, differences of tax systems might serve as a stimulus to trade. Taxes constitute a significant share of costs and a large share of the price of factors of production, labour in particular. It is tax diversity (which is usually determined by the necessity to accommodate to local conditions and traditions) that provides serious incentives to produce cheaper goods and services and to offer them on the international market. Non-existence of centralised tax harmonisation promotes beneficial trade rather than undermining it.

Countries have always competed using their exogenous factors (e.g. the amount of land, population, proximity to waterways, etc.) as well as endogenous one (e.g. the level of corruption, political stability, low bureaucracy, as well as the level of taxation). Competition by endogenous factors (e.g. taxation) should not be perceived as “unfair” or “unnatural.” Tax competition is no different than competing for investment by cutting red tape, speedy bureaucracy and other factors that depend on the national governments.

CCCTB confuses value-added with inputs.

The current proposal of CC(C)TB for a harmonized tax base and sharing of the profit tax is based on a calculation formula which takes into account revenue, employee numbers and wages, as well as most assets. By trying to reduce tax avoidance CCCTB might directly interfere with modern production and distribution practices. By attempting to determine the “true” location of economic activity (and the country that the tax is due to), CCCTB incorrectly equates value added to inputs (labor, wages or real estate). CCCTB does not account for modern practices where the value of a product is composed of branding, brand names and other subjective factors too.

CCCTB will deprive market agents of the opportunity to select better taxation options.

Companies will not be able to exploit the advantages of different tariffs in different member states. Tax harmonisation must not justify a deterioration of the tax environment because business activity requires favourable business conditions, not uniform taxes. This is confirmed by the fact that the introduction of a CCTB would have a considerable impact on the values of the tax base in the EU member states. Except for Cyprus and Ireland, the values of the tax base would increase in all countries. On average, the effective tax burden would increase by 5.15% [1] and the common tax base would be extended by 7.9%.[2] In particular, the business environment would deteriorate dramatically in Estonia which charges the corporate income tax only on dividends.

If imposed on all companies, CCCTB would make tax compliance harder.

If unified tax rules were imposed on EU companies operating only in the domestic (national) market, corporate tax harmonisation would bring no tangible effects that are expected from the common market and free trade. At the same time businesses (especially SMEs) would also incur costs of conforming to the new rules. For example, a Lithuanian company selling goods only in Lithuania would have to bear compliance costs if CCCTB were to replace the current corporate tax base applicable in Lithuania.

CCCTB might not reduce companies' and tax administrators' costs and could even increase them.

Although CCCTB may be advantageous for businesses in terms of saving their time that is needed to scrutinise different rules of computing the corporate tax base, there is a high probability that a reduction of the administrative burden will be offset by an increase in other burdens and costs. Also, differences between tax bases in various member states may still remain as they are usually given some leeway even in the case of the strictest harmonisation.

According to a study performed by PricewaterhouseCoopers based on a survey of business companies, an introduction of CCTB in Lithuania would increase internal costs of a company by 14%, external costs, by 6 %, while one-off costs associated with the introduction of CCTB would be approximately 19.000 EUR. The projected growth of costs has generally been associated with more complex tax rules than the current regulations, as anticipated by the surveyed companies.
An introduction of CCCTB would increase internal costs by 5% and reduce external costs by 22 %, while one-off costs associated with introduction of CCCTB would be the same as in CCTB scenario (approximately 19.000 EUR).
The introduction of both CCTB and CCCTB is likely to increase the administrative burden for the State Tax Inspectorate (STI). If CCTB were compulsory, the administrative burden would increase by 23% or 1.4 mln. EUR *per annum* (assessing a 5-year period). If the CCTB were optional, the administrative burden would increase by 45% or 2.7 mln. EUR *per annum* (assessing a 5-year period). In case of a compulsory CCCTB, the administrative burden would increase by 25% or 1.5 mln. EUR *per annum* (assessing a 5-year period). If CCCTB were optional, the administrative burden would increase by 47% or 2.9 mln. EUR *per annum* (assessing a 5-year period). This increase is associated with the complexity of the CC(C)TB tax administration process, taking into account existing expertise of STI and the need to administer two systems (national and CC(C)TB).[3]
In three scenarios (optional CC(C)TB and compulsory CCCTB) an increase in the administrative burden of STI would outweigh the expected corporate tax revenues.

Requirements to disclose sensitive information would put EU businesses at a competitive disadvantage.

Requirements to disclose more information about a company's tax affairs and the nature of other corporate activities which are necessary for the operation of CCCTB would also increase the likelihood of disclosure of trade secrets and confidential business information (like information about tax management, revenues, revenue split between related and unrelated parties, profit or loss before tax, income tax paid and accrued, stated capital, accumulated earnings, tangible assets, public subsidies received, etc.). This policy would be harmful for EU companies as businesses established in the EU would be placed at a competitive disadvantage vis-à-vis non-EU multinational companies operating in the EU.

<u>Conclusions</u>

Harmonisation of the corporate tax base would not only fail to attain the targeted goals but would also entail a number of negative consequences such as:

- Corporate tax harmonisation will spawn considerable compliance costs in the transition period, especially for SMEs operating within the market of only one member state.
- Fiscal centralisation would undermine competitiveness of the entire region. The region's competitiveness would decline as the centralised tax system erected inside the region would force companies to take opportunity of the competitive advantage outside the region's territory.

- In certain cases harmonisation of the corporate tax base may be advantageous to individual tax payers or tax payers in certain countries (due to the removal of double taxation, reduction of administrative costs of MNEs in a long term, etc.). However, this would not occur as a systematic reduction of the tax burden but rather as a side effect of tax harmonisation on individual tax payers.

Recommendations

- The Commission should work to preserve the highest degree of tax competition between member states. CC(C)TB poses a danger of fundamentally hindering this vital feature of the internal market and should therefore be reconsidered.
- If CC(C)TB is retained, the Commission should also ensure that CC(C)TB remains optional and pre-empts future moves to damaging harmonisation.
- High-tax EU member states that are advocating tax harmonisation should undertake practical steps towards harmonisation by bringing their tax systems closer to more competitive tax regimes that stimulate economic growth.

8. Excise Duties

Purpose and Summary:
Minimum excise rates are set by the European Union cover alcohol and tobacco products, certain energy products (e.g. electricity and natural gas), and transportation fuels. A specific feature of this excise taxation is that the EU sets the minimum level of excise duties for these products, therefore member-states cannot apply lower excise duties. There are many arguments for and against the excise tax per se, but there is a very specific case against minimum excise duty rates set by the EU.

1. There is a strong and imperative case for implementing one of the following measures:

    a) Allowing full or partial reduction of the EU-set minimum excise duties by the member-states bordering non-EU countries that charge considerably lower excise duties.

    b) Scrapping the EU-set minimum excise duties.

2. In addition, new initiatives to increase the EU-prescribed minimum excise duties need to carefully evaluate the effects on the demand of alternatives, mainly products like transportation fuel, tobacco or alcohol supplied by the grey (shadow) economy, especially given the differences in the purchasing power of citizens in different member-states. The same careful evaluation should apply to measures with similar effects, e.g. introduction of minimal prices for certain goods. We recommend instituting a rigorous mandatory evaluation for the aforementioned proposals.

The arguments for allowing full of partial reduction of the minimum excise duties for certain member-states are the following:

3. EU minimum excise duties ignore different purchasing power parities of member states. The same excise duty (in nominal terms) is less affordable if purchasing power is lower. This results in disproportionate levels of excise duty in poorer member-states, which bolsters demand for goods to be obtained in the shadow economy.

4. This disparity between purchasing power and minimum excise duty is especially prevalent in new member-states, thus creating a robust demand for illicit goods. However, most of new member-states border non-EU countries, which in turn are a source of illicit goods (e.g. fuel, tobacco or alcohol). This is amplified by the fact that these non-EU countries have significantly lower excise duties than those applied by the EU. These circumstances are one of the driving forces of the shadow economy in new member-states. Research indicates that the shadow economy comprises around 20% of GDP in the EU. More specifically, in certain member states the shadow economy is 30% for tobacco, 33% for spirits, and around 20% for transportation fuel. Other countries have similar estimates.

5. A disproportionately high excise duty has side-effects of its own. It leads people to consume alcohol products (e.g. surrogates) derived from industrial alcohol, home-made alcohol, rubbing alcohol etc. The consequences involve not only a loss in tax revenues, but also dire side-effects on consumer health.

6. Alternatively people also turn to other sources of transportation fuel. These range from repurposing natural gas usually designated for cooking to be used as transportation fuel to stolen oil from transformer stations (which in turn generate more losses due to technical failures).
7. *The proposed measures are in line with the principles of the common market or free movement of goods in the EU.*

8. The EU minimum excise rate exemption for wine (minimum excise duty for wine is 0) serves as an important piece of evidence. First, it does not violate the principle of the single market. Second, most countries apply excise duty on wine regardless. Fears that the abolition of EU-prescribed minimum excise rates would lead to zero excise duties in member states are baseless.

9. An excise duty is paid in the country where the final product is sold (the consignee pays the tax). This means that before being sold to the final consumer the products cross national borders of member states effectively without any excise duty. As long as the excise duty is applied in the country of sale, the actual excise duty has no relevance for a single market (assuming that the excise duty is not discriminating according to the principle of the country of origin).

10. Minimum excise duties are not needed for a single market. The single market would be hampered if governments set excise rates on products based on the country of origin. But such taxation *per se* is contrary to the principles of the single market. To protect a single market, a simple set of rules on how excise duties are to be determined would be sufficient. Charging a specific excise rate is not needed for the operation of a single market.

11. Different rates of excise duties do result in different final prices for the same good. But this is no argument to have minimum excise duties.

    (a) First, limited cross border trade in border regions of member-states is exactly the manifestation of a single market and movement of goods; there is no basis to counter it.

    (b) Second, if more equal prices for the same products (i.e. price convergence) *are* the basis for minimum excise duties, then setting *maximum* excise duties, not *minimum* ones, should be a logical measure. Especially given the propensity of national governments to levy excise tax on fuel, tobacco and alcohol (and other good with low price elasticity of demand) for revenue purposes. It is very high excise duties (in nominal terms) as applied in some countries, not very low ones, that are an obstacle to price convergence.

12. Regardless of the existence of minimum excise duties, the actual rates applied are very different across countries. There is no basis in arguing that current excise duties set by member states are more equal than they would be if minimum excise duties were not set by the EU. Therefore, scrapping or allowing partial reductions for excise duties would not result in divergence of prices.

13. Argicultural Land Purchase

Summary:

THE LAW ON LAND "SAFEGUARDS" MAY BE CONTRARY TO EU LAW, AND THE CONSTITUTION OF THE REPUBLIC OF LITHUANIA, AND IS DETRIMENTAL TO THE INTERESTS OF THE COUNTRY.

May 1, 2014 – A new recast of the Law on the Acquisition of Agricultural Land in the Republic of Lithuania[29] (hereinafter referred to as "LAAL"), also known as the land "safeguards" law, has taken effect. The law stipulates provisions that limit the right to freely operate in the agricultural market by restricting agricultural land purchase and sale transactions.

The said provisions are detrimental to the interests of the country, may be contrary to the Constitution of the Republic of Lithuania (hereinafter referred to as "The Constitution"), the EU principle of the free movement of capital, and Lithuania's bilateral agreements on foreign investment.

Certain restrictions exist in other EU countries, but they are most stringent in the EU's new Member States:, Latvia, Slovakia, Poland, Hungary, and Lithuania. Other countries have less stringent restrictions. In Finland, for instance, restrictions on agricultural land sale transactions are imposed in certain regions only (Aland). Research shows that even before enforcing the "safeguards" law, concerning restrictions agricultural land purchase in the EU, Lithuania was already among countries with the most stringent restrictions.[30]

1. Regarding LAAL application when purchasing over 10 ha of agricultural land or(and) a legal entity or(and) over 25 per cent of shares in a legal entity owning the said amount of agricultural land

1.1. The law may not be in line with the EU principle of the free movement of capital

The successful functioning of the European Union's (hereinafter EU) common market is ensured by a consistent implementation of the four fundamental freedoms: the free movement of goods, persons, services, and capital. Article 26 of the Treaty on the Functioning of the European Union (hereinafter TFEU) stipulates that *"the internal market shall comprise an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured."* Furthermore, Article (63)(3) TFEU states that *"within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."*

[29] Law No XII-854 on the Acquisition of Agricultural Land in the Republic of Lithuania.

[30] Swinnen, J., Herck, K. and L.Vranken. 2014. Land Market Regulations in Europe. *Discussion Paper 354/2014.* Available at http://feb.kuleuven.be/drc/licos/publications/dp/dp354, accessed 23 January, 2015.

Although the TFEU notion of the free movement of capital is not defined, Directive 88/361/EEC[31] provides an indicative list of the transactions regarded as capital movements. The freedom of capital movement implies several freedoms that should ensure the maximum efficiency of the utilisation of the factors of production in the common market: the freedom of individuals to purchase real-estate, shares, and perform other investment procedures in other Member States, as well as the freedom of businesses to purchase, invest, or participate in the management of companies of other Member States.

Under Article 4(3) of the Treaty on European Union, *"the Member States shall facilitate the achievement of the Union's tasks and refrain from any measure which could jeopardise the attainment of the Union's objectives."*

It should be noted that although Lithuania's legal framework for agricultural land sales has been tightened recently, the experience of other countries show that the European Commission opposes strict agricultural market regulation. For example, Hungary has introduced extremely strict restrictions under which agricultural land could only be purchased by farmers who are Hungarian citizens while both Hungarian and foreign companies were not allowed to purchase agricultural land. Exemptions were made for the State, credit institutions, religious institutions, agricultural cooperatives and municipalities. The European Commission identified such flawed regulation at the end of last year and initiated legal proceedings against Hungary. The Commission noted that Hungary had infringed on the EU principle of free movement of capital and the freedom of estalishment guaranteed for Member States.[32] This reaction of the Commission towards the Hungarian land market regulation is an indication that the provisions of LAAL may not be in line with the principle of free movement of capital as well.

Given that some countries have tightened agricultural land market regulation recently, the number of infringements on the principle of free movement of capital identified is relatively small. However, the European Commission's approach towards similar regulation is clear - stringent restrictions on EU citizens purchasing agricultural land are intolerable.

1.2. The law may not be in line with Lithuania's agreements on foreign investment protection

The restrictions on agricultural land purchases may not be in line with Lithuania's bilateral agreements on investment promotion and protection. Lithuania has such agreements with fifty countries.

The principles on foreign investment protection enshrined in these agreements protect investors from expropriation of property, restrictions and obligations that would significantly reduce the value of their investment (unjustified refusal to renew permits and licences, for example), as well as discriminatory prohibitions and other legal restrictions.

Lithuania's agreements on foreign investment promotion and protection usually include a clause on unjustified restrictions, discrimination in investment management, disposal, etc. E.g.: *"Either Contracting Party in the territory of the other contracting party shall not discriminate the citizens or enterprises of the other country in any way and shall not create any arbitrary obstructions to the*

[31] Annex I of the Council Directive of 24 June, 1988 for the Implementation of Article 67 of the Treaty (88/361/EEC).

[32] *Free movement of capital: Commission opens infringement procedure against Hungary on rights of cross-border investors to use agricultural land*. 2014. Brussels: European Commission Press Release Database. Available at http://europa.eu/rapid/press-release_IP-14-1152_en.htm, accessed 23 January, 2015.

utilisation, management and disposal of investments".[33] The conditions set out in the treaty between Lithuania and the USA are as follows:

> *"3. (a) Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less favourable than required by international law. (b) Neither party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For purpose of dispute resolution under Articles VI and VII, a measure may be arbitrary or discriminatory notwithstanding the fact that a Party has had or has exercised the opportunity to review such measure in the courts or administrative tribunals of a Party."*[34]

Investment agreements not only impose an obligation to ensure equality, and prohibit discrimination of foreign investment in respect of local, or vice versa, but also prohibit arbitrary measures that impair the management, enjoyment, disposal and other use of investments.

Unilateral restrictions enshrined in LAAL restrict the abilities of both local and foreign investors to freely manage, enjoy, and dispose of investments in the Republic of Lithuania, thereby violating the principles laid down in the agreements on foreign investment protection.

Also, the law limits the number of potential purchasers. So then a foreign investor would sell the shares of n agricultural land owning company at a lower price than without such restrictions. What is more, a foreign investor could incur additional costs related to the sale of shares when, for example, there is a need to reorganise a holding company into separate enterprises in order to sell its shares to different purchasers. Therefore, the requirements laid down in LAAL may violate Lithuania's commitments set out in the agreements on foreign investment promotion and protection, as well as result in investor-to-state disputes against the Republic of Lithuania.

1.3. Discriminatory requirements apply to new farmers only, thereby possibly violating the principle of equality

The requirements laid down in LAAL apply to future farmers only (those who will purchase agricultural land after the law is enforced on May 1, 2015) thus those who have purchased land before adopting the restrictions will be able to continue their market operations. It distorts the market and may infringe on the principle of equality. For example, individuals who were able to purchase agricultural land without restrictions prior to enforcement of the law will have much more favorable conditions due to the lack of competition caused by LAAL. For instance, an agricultural company which acquired 1,500 ha of land a few years ago will continue to produce the same amounts of production whereas those who would like to acquire the same amount of land now and compete with bigger companies will be limited to acquiring 500 ha.

Therefore, it seems that the law will not attain its objectives to protect the agricultural land market from the influence of large landowners and the restrictions will not have any influence on the current situation, because after closing the market, large landowners will continue to dispose their market power without competition.

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[33] Article 2(2) of the Agreement of 28 February, 1992 between the Republic of Lithuania and the Federal Republic of Germany on the Promotion and Reciprocal Protection of Investment.

[34] Article 3(3) of the Treaty of January 14, 1998 between the Government of the United States of America and the Government of the Republic of Lithuania for the Encouragement and Reciprocal Protection of Investment

1.4. The law may not be in line with the freedom of individual economic activity and initiative

The provisions laid down in LAAL stipulate restrictions on entering (purchasing) and leaving (selling) the agricultural land market. These rules restrict the right of individuals to acquire agricultural land and may not be in line with Articles 46 and 23 of the Constitution. The Constitutional Court of the Republic of Lithuania (hereinafter referred to as "The Constitutional Court") ruled that:

> *"<...> the freedom of individual economic activity and initiative is a set of legal possibilities which presupposes individual autonomy in making decisions on economic activities, implies the freedom of contract and fair competition, as well as opportunities to restructure economic entities, change the nature of their activities and freely establish or liquidate an economic entity as a response to market developments; it is an integral part of the possibility of an individual who wants to engage in or cease economic activities, to enter and leave the market without artificial barriers."*[35]

The requirements laid down in LAAL create artificial barriers for agricultural land purchasers and the existing land owners to enter and leave the market by purchasing and selling agricultural land respectively.

2. The land acquisition requirements may not be in line with the constitutional principle that Lithuania's economy shall be based on private ownership rights and freedom of individual economic activity and initiative

The requirements laid down in LAAL for natural persons purchasing agricultural land may not be in line with the fundamental rights and freedoms that are private ownership rights, freedom of economic activity and initiative.

The explanatory note of the law[36] indicates that restrictions are provided to prevent speculation and concentration of land ownership in the hands of a number of citizens, foreigners, or their legal persons and to ensure that the land shall only be purchased by a person who is *"actually prepared and is able to farm."* Such an opinion is formulated unambiguously: a land owner is prohibited from selling it (allegedly "speculating"). In other words, the land owner is deprived of his right to dispose of assets at his discretion.

2.1. Occupational skill and competence requirements for natural persons

The requirement for a person to have a diploma in agriculture in order to purchase agricultural land may not help to attain its objective of rationalizing land use. Firstly, it should be noted that there are cases when the purchaser may not carry on the activities himself. For example, a purchaser of a plot of land for building a house is not subject to occupational skill and construction competence requirements. Such requirements would be considered unreasonable, unnecessary, and unjustified, because in order to build a house on his property, a purchaser does not need construction skills and, in the majority of cases, does not perform the construction himself. Construction permits and the competences necessary are subject to special rules and there is no reason to additionally associate particular competences with the construction area. However, it is believed that a purchaser of agricultural land must be specifically trained in order to acquire it.

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[35] Ruling of 8 October, 2009 of the Constitutional Court of the Republic of Lithuania. 2009. *Valstybės žinios,* No 121-5237.

[36] Explanatory note of the Law No XIIP-1498(2) on Amending the Provisional Law No IX-1314 on the Acquisition of Agricultural Land in the Republic of Lithuania.

Occupational skill and competence requirements for agricultural land purchasers are unjustified and the obligation to carry on agricultural activities in the purchased land infringes on the right of self-determination. It seems that the requirement to be prepared and able to farm the purchased land means that whoever bought the land must farm it himself. Such a requirement is flawed, restrictive and may be against the Constitution. The Constitutional Court concluded that the requirement for agricultural land owners to farm the land themselves is constitutionally unjustified. What is more, the Court ruled on what requirements are regarded as unconstitutional: *"<...> unjustified, disproportionate or unjust in any other respect so that such regulation restrict the rights or freedoms of an individual more than it is necessary for the constitutionally based protection of public interests <...>".*[37]

2.1.1. An obligation for natural and legal persons to carry on agricultural activities for at least 3 years and to have utilized agricultural area and crops declared

Firstly, there is no evidence for the selection of a three year criteria. It should be regarded as subjective and unjustified and thereby violating the fundamental principles of law-making. Also, the obligation to have utilized agricultural area and crops declared deprives the opportunity to purchase land of those who meet other requirements, but have no crops declared on their own behalf, but, for example, on the behalf of a business partner. To add, this regulation is retrospective, because the legislature sets out rights and obligations that must have been fulfiled in the past. In this case, the obligation to have agricultural activities performed and crops declared prior enforcing the law violates legitimate expectations of persons.

2.1.2. An obligation for natural persons to register a farm or to have a diploma in agriculture

The obligation laid down in LAAL on the purchasers of agricultural land to have occupational skills and agricultural competences may violate the fundamental rights and freedoms and may not be in line with the constitutional right to private ownership which covers the possibilities to acquire, manage, use and dispose of private property at the owner's discretion. The Constitutional Court ruled that:

> *"The Constitution, guaranteeing the protection of private property, also enshrines the constitutional right of acquiring private property <...> the constitutional right of private ownership is an essential (obligatory) condition of the implementation of the freedom of individual economic activity", also "under the Constitution, a person's right to private ownership shall not be restricted depending on the person's education".*[38]

The Constitutional Court acknowledged that the provisions of the Law on Pharmaceutical Activities that stipulated restrictions on persons without a relevant university degree in pharmaceutics on acquiring the ownership rights of pharmacies, infringed on Articles 23(1), 23(2), 46(1) and 48(1) of the Constitution. The Constitutional Court stated the following:

> *"The requirements to have necessary qualification and education in pharmaceutics shall be imposed on persons engaged in pharmaceutical activities in pharmacies. Education requirements shall not be imposed on persons seeking the ownership rights of pharmacies."*

[37] Ruling of 30 March, 2006 of the Constitutional Court of the Republic of Lithuania. 2006. *Valstybės žinios,* No 37-1319.

[38] Ruling of 14 March, 2002 of the Constitutional Court of the Republic of Lithuania. 2002. *Valstybės žinios,* No 28-1003.

The requirements laid down in LAAL to have occupational skills and competences in order to acquire agricultural land are the same as those set out in the provisions of the Law on Pharmaceutical Activities which were declared unconstitutional. Therefore, the present requirement may also be against the Constitution.

There are around 132,000 farmers in Lithuania. Data regarding their education is not stored separately and only one third of the farmers are estimated to have a formal agricultural education. Therefore, the law restricts farming opportunities of the remaining part of the farmers who have acquired their competences in practice and the possibilities to start farming of those who did not have any farming experience before.

2.1.3. An obligation for legal persons to obtain more than 50 per cent of income from agricultural activities

The following example illustrates a lack of justification for the obligation to obtain more than 50 per cent of income from agricultural activities: a concern which is engaged in a large-scale production of agricultural machinery (which is very close to agriculture) and obtains 2/3 of its profit from it, will not be regarded as engaged in agricultural activities and therefore, will not be able to purchase agricultural land. Although the production of agricultural machinery is not considered as an agricultural activity, it is difficult to argue that such company does not have enough competence to understand the management peculiarities of agricultural land and there are no arguments to support the prohibition on such a company to purchase agricultural land, an agricultural company owning it or, at least, a part of it.

2.1.4. An obligation for legal persons to meet financial viability requirements

The law imposes an obligation on legal persons to prove their financial viability according to the procedure set out by the Ministry of Agriculture. In this way, public authorities have powers to prevent economic operators from engaging in agricultural activities.

Article 46 of the Constitution stipulates that *"Lithuania's economy shall be based on the right of private ownership, freedom of individual economic activity and initiative."* In such an economy, as opposed to a planned economy, it is the market and not the government which decides on business development, production and its quantities. Formalistic economic non-viability of enterprises is subject to the Law on Enterprise Bankruptcy.

In the ruling of 8 October 2009, the Constitutional Court clarified that *"situations when government or municipal authorities or their officials make decisions that hinder the expression and the development of individual initiative that is not harmful to the society shall not be possible."*[39] There is no indication that the opportunity to freely dispose of agricultural land may be harmful to the society. This view may be justified in some individual cases, but it cannot become a presumption. On the contrary, Article 46 of the Constitution states that *"Lithuania's economy shall be based on the right of private ownership, freedom of individual economic activity and initiative."* The Constitutional Court ruled that:

> *"The Constitution, guaranteeing the protection of private property, also enshrines the constitutional right of acquiring private property*[40] *<...> the constitutional right of*

[39] Ruling of 8 October, 2009 of the Constitutional Court of the Republic of Lithuania. 2009. *Valstybės žinios,* No 121-5237.
[40] Ruling of 14 March, 2002 of the Constitutional Court of the Republic of Lithuania. 2002. *Valstybės Žinios,* No 28-1003.

private ownership is an essential (obligatory) condition of the implementation of the freedom of individual economic activity. Restrictions on the right of private ownership also restrict the freedom of individual economic activity."

The obligation to meet financial viability requirements laid down in LAAL imposes unjustified restrictions on the freedom of individual economic activity enshrined in Article 46 of the Constitution and the right of freely choosing business enshrined in Article 48 of the Constitution.

2.2. An obligation for natural and legal persons to obtain authorization

The law stipulates that agricultural land shall only be purchased after obtaining authorization from the National Land Service under the Ministry of Agriculture (hereinafter referred to as "NLS") and sold after obtaining a corresponding certificate.

A person who intends to sell land is required to provide a statement to a notary public (when the land is common partial property) or a territorial NLS which performs the procedure of informing those having priority rights to purchase the land and issues a certificate and permits the sale. This service costs 26.07 EUR (90 LTL). In case a person intends to buy land, he has to obtain a one-year temporary permit. It issued by the NLS within 15 working days and costs 8.69 EUR (30 LTL).[41] Upon the expiration of the one-year period, a person shall obtain a new permit; therefore, to meet the same criteria and pay the stamp duty again. This procedure is a significant administrative burden which delays the transaction not only due to the documentation processing time in public bodies, but because of the time needed to collect the documents prior applying for a permit. Furthermore, it is not free of charge.

2.2.1. The law is contrary to the case-law of the CJEU and may infringe on the principle of the free movement of capital

It must be realized that by joining the European Union, Lithuania did not only obtain the right to enjoy new privileges, but assumed certain obligations including the obligation to ensure free movement of capital. Meanwhile, the issue of such permits is contrary to the case-law of the CJEU and may be regarded as an infringement of the principle.

The CJEU heard a case[42] in which the European Commission accused Portugal of holding the golden shares of *Portugal Telecom* and having the right of veto when over 10 per cent of the company's capital is purchased by shareholders engaged in competitive activities. For that purpose, prior administrative authorization is provided by the legislation of Portugal.[43]

In his opinion, Advocate-General Paolo Mengozzi[44] concluded that public security requirements that deviate from the principle of the free movement of capital shall be interpreted narrowly and therefore, may be only relied upon in the event of a genuine and sufficiently serious threat to the overriding public interest. In accordance with a well-established case-law, the free movement of

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[41] Public and administrative services of the National Land Service under the Ministry of Agriculture of the Republic of Lithuania. Available at http://www.nzt.lt/go.php/lit/Vieosios-ir-administracines-paslaugos, accessed 1 January, 2014.

[42] Decision in case No C-367/98 2002 of 4 June, 2002 *Commission of the European Communities v. Portugese Republic.*

[43] *"By virtue of those shares, indeed, a large number of management decisions concerning the undertaking's structure and significant aspects of its activities must previously be authorised by the Portuguese State. The Portuguese rules thus establish a system of prior administrative authorisation for the adoption of certain management decisions and for the acquisition of shareholdings in Portugal Telecom, as the Commission correctly describes"* (Opinion of Advocate-General Paolo Mengozzi of 2 December, 2009 in case No 367/98 *Commission of the European Communities v. Portugese Republic*).

[44] Opinion of Advocate-General Paolo Mengozzi of 2 December, 2009 in case No 367/98 *Commission of the European Communities v. Portugese Republic.*

capital may be restricted by national measures which are justifiable under Article 58 of the Treaty Establishing the European Community (hereinafter referred to as "TEC") or, in case of an absence of Community measures to ensure the implementation of the measures necessary to protect these interests, overriding reasons in the public interest.

The CJEU concluded that under Article 56 TEC, national legislation that allows Portugal to make decisions on issuing a permit to an individual who seeks to acquire over 10 per cent of *Portugal Telecom* shares, stipulate restrictions on the freedom of capital movement.

By contrast, LAAL imposes an obligation to obtain authorization from the NLS prior acquiring agricultural land. According to the CJEU, the introduction of the administrative procedure into the legislation of Portugal restricts the freedom of capital movement and LAAL also sets out a separate procedure of obtaining authorization. Therefore, the obligation to obtain authorization laid down in LAAL may infringe on the EU principle of the free movement of capital.

2.2.2. The law may not be in line with the case-law of the Constitutional Court

The Constitutional Court ruled that *"<…> the freedom of individual economic activity and initiative <…> is an integral part of the possibility of an individual who wants to engage in or cease economic activities, to enter and leave the market without artificial barriers."*[45] Therefore, artificial barriers for individuals to freely dispose of assets shall not be created.

LAAL stipulates that both spouses shall obtain authorization before purchasing agricultural land. Such an obligation may infringe on the freedom of individual economic activity by imposing unjustified obligations, on a farmer's wife, for example, who has to obtain authorization. In cases when crops are declared on behalf of a husband, a family cannot purchase agricultural land; because the farmer's wife does not have any crops declared and does not meet the requirements. Therefore, the husband is allowed to acquire personal ownership rights to land only.

3. A restriction on related persons to acquire more than 300 ha of land from the State and more than 500 ha from private individuals

Related persons – spouses, parents (including adoptive parents) and their minor children (including adopted), related companies – those holding 25 per cent or more shares of a company and having the right to vote at a meeting of the company which they intend to purchase.

Such a restriction may infringe on the right of private ownership and the principle of equality. It is fundamentally flawed and unjustified to determine how much land may be legally acquired in the civil market.

The market is also distorted, because the restriction applies to agricultural activities only and excludes animal farming. The restriction on related persons to acquire more than 500 ha of agricultural land laid down in LAAL does not apply to animal farming if the amount of the land purchased does not exceed the relative number of livestock units (1 ha of agricultural land for each unit). To add, abuses of the dominant position and the possession of excessive market power are subject to the Law on Competition thus the restriction on acquiring more than 500 ha is not necessary.

[45] Ruling of 8 October, 2009 of the Constitutional Court of the Republic of Lithuania, 2009. *Valstybės žinios,* No 121-5237.

This restriction is not imposed in neighbouring Estonia or Latvia[46], as well as Denmark or Germany, whereas Poland only limits the amount of land purchased from the State.

Since the restriction does not apply to those who already own over 500 ha, they will continue to operate on the market, whereas others who would like to enter the market (those who own 400 ha and intend to acquire 150 ha more, for example) and become big farmers, will not have such possibilities.

The number of particularly large farms (over 500 ha) have merely changed between 2009 and 2013[47] thus the fears that small farms will be pushed out of the market by the sweeping powers of large farm owners are unjustified.

To add, very few people in Lithuania (15) own over 500 ha of agricultural land while there are 172 individuals who own between 400 and 500 ha; therefore, the restriction will freeze these numbers.

3.1. On the disproportion of the sanctions provided

Under a claim of a prosecutor defending public interests and a court decision, in case of exceeding the limit of acquiring 500 ha of private or 300 ha of state-owned agricultural land, *“<...> the area of land is taken over and transferred into state ownership <...>”.*[48] Therefore, the law provides a disproportionate punishment for exceeding the purchasing limits which is land seizure and transfer into state ownership.

> *“<…> with regard to the circumstances of each individual case, it must be evaluated whether the corresponding changes did not deny the substance of the rights acquired. The principle of proportionality means that measures provided by law shall constitute legal and socially important objectives, shall be vital to the attainment of those objectives and shall be no more restrictive of the individual rights and freedoms than it is necessary to attain those objectives <…>”.*[49]

Land sales contracts are transactions concluded and annulled under the Civil Code. Since legal consequences of the annulment of land sales contracts are also defined by law, it would be reasonable to apply it. For example, after declaring a contract invalid, it could be annulled and restitution could be made. However, under LAAL, legal consequences of declaring a contract invalid constitute taking over the agricultural land acquired. Under the Constitution, land may be taken over only for the needs of society and shall be justly compensated for. However, taking over the excess land applies as a fine and does not constitute a public interest in this case.

More than two parties should express an interest in order to recognize a parcel of land as a public interest; *“<…> public interest is when there is a violation of the fundamental values protected by the Constitution <…>”*[50], or when the infringement is very serious and resulting in adverse legal consequences, etc. It is difficult to prove the existence of these criteria. *“The public interest shall only protect <…> constitutionally important and significant, for example, human rights and freedoms*

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[46] http://www.triniti.ee/newsletterV3/mail.php?n=135&t=862&l=eng

[47] Lithuanian institute of agrarian economics. 2014. *Lietuvos žemės ir maisto ūkis, 2013*. Vilnius: Lithuanian institute of agrarian economics, p. 31.

[48] Article 3(7) of the Law No XII-854 on the Acquisition of Agricultural Land in the Republic of Lithuania. 2014. *Register of Legal Acts,* No 2014-04860.

[49] Ruling of 29 June, 2012 of the Constitutional Court of the Republic of Lithuania. 2012. *Valstybės žinios,* No 78-4063.

[50] Order in the administrative case No A146-335/2008 of 25 July, 2008 of the extended Chamber of the Supreme Administrative Court of Lithuania.

(freedoms of assembly and expression), the stability of the financial system <…>"[51]. It is also important to identify *"<…> why the applicant appealed to an administrative court – to defend the public interest, subjective rights or the interest protected by law."*[52] It should be evaluated whether agricultural land acquisition, even when breaching the administrative procedures provided, may be regarded as an infringement on the public interests. There is no doubt that offenders shall be punished, but it is inadequate to nationalize assets.

4. An obligation to ensure agricultural activities for five years

The provisions of LAAL that stipulate that the purchased agricultural land shall be used for agricultural activities for at least five years according to the minimum annual production rate per hectare determined by the Ministry of Agriculture may be contrary to the freedom of individual economic activity and initiative. Such a requirement is rather a prescriptive obligation than a rule. The Constitutional Court ruled that *"<…> the freedom of individual economic activity and initiative is a set of legal possibilities which presupposes individual autonomy in making decisions on economic activities <…>".*[53]

An obligation on the land owner to ensure cultivation of his private land even if it is economically unviable for a certain period of time (due to market changes), restricts the constitutional right of private ownership and the freedom of individual economic activity. Therefore, the requirements laid down in LAAL may not be in line with the principle of the freedom of economic activity and the right to freely choose businesses enshrined in Articles 46 and 48 of the Constitution.

It should be also noted that the Code of Administrative Offences provides disproportionate fines for infringements of these rules. For example, the fine imposed in the event of failure to prepare land so that it would be suitable to farm varies from 72 to 144 EUR whereas the fine for a very similar infringement, a failure to ensure agricultural activities, varies from 724 to 1448 EUR.

In general, the requirement to ensure the intended use of agricultural land according to the production rate determined by the Ministry of Agriculture is too detailed, unjustifiably strict and poses a significant burden on land owners. Furthermore, it is unlikely that the actions of an individual who fails to reach the output of 50 EUR from a hectare of land are harmful to the society. It is not the society that suffers from a reduction in the agricultural output; it is farmers who are unable to achieve maximum profit, as well as the agricultural market which is several tones poorer. There is no violation of the legal order.

4.1. On the disproportion of the sanctions provided

It is important to note that there are cases (for example, when the productivity score of a parcel is lower than 32 or parcels belong to the priority areas for afforestation) when agricultural land may be used for afforestation. Such land is frequently purchased to be afforested rather than cultivated. Similarly, agricultural land may be purchased for other lawful activities such as construction and operation of wind and solar power plants. Therefore, sanctions may have a negative impact on those who have no connection to agriculture, but intend to purchase and use agricultural land for forestry, electricity production, rural tourism and other activities.

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[51] Klimas, E. 2014. Identification of the public interest – objective criteria. *Jurisprudencija,* 21(1): 131.

[52] Ruling in the administrative case No A822-1542/2013 of 19 November, 2013 of the Supreme Administrative Court of Lithuania.

[53] Ruling of 14 March, 2002 of the Constitutional Court of the Republic of Lithuania. 2002. *Valstybės žinios,* No 28-1003.

5. A right of first refusal vested in a tenant or a neighbour

The law stipulates the right of first refusal vested in joint owners (Article 4.79 of the Civil Code) or users (if used for at least one year for agricultural activities and if meets the requirements) or to those who have their parcel bordering with the parcel for sale and meet the requirements.

A person who intends to sell land is required to provide a statement to a notary public (when the land is common partial property) or a territorial NLS which, within 5 working days, informs a land user regarding the sale. The user, within 15 working days from the date of notice, informs about his decision. If the user does not agree to purchase the land, within 5 working days, the NLS informs those who have their parcel bordering with the parcel for sale. They are given 15 days to respond. Then, within 5 working days, the NLS issues a permit to sell the land. Thus, 44 working days (over two months) is the maximum period. Therefore, such a long period just to find out if anyone wants to enjoy the right of first refusal may deprive the owner of the opportunity of making the most effective transaction quickly.

Firstly, it is a direct restriction on individuals' freedom to choose how to manage their property. The Constitutional Court's opinion regarding such restrictions has already been discussed in the previous sections. Therefore, the prohibition to sell your parcel to a close relative who lives elsewhere may not be in line with the constitutional freedom of individual economic activity. However, these requirements unjustifiably restrict the freedom to sell a parcel to a close friend or relative.

References to European Commission Consultations

- **Digital Single Market**
  http://ec.europa.eu/news/2015/05/20150506_en.htm

- **Building a Capital Markets Union**
  http://ec.europa.eu/finance/consultations/2015/capital-markets-union/index_en.htm

- **Capital Markets Union**
  http://ec.europa.eu/finance/capital-markets-union/index_en.htm

- **New Energy Market Design**
  https://ec.europa.eu/energy/en/consultations/public-consultation-new-energy-market-design

- **Better Regulation**
  http://ec.europa.eu/smart-regulation/better_regulation/key_docs_en.htm
  http://ec.europa.eu/smart-regulation/better_regulation/documents/com_2015_215_en.pdf

- **Common Consolidated Corporate Tax Base (CCCTB)**
  http://ec.europa.eu/taxation_customs/common/consultations/tax/relaunch_ccctb_en.htm

- **Regulatory Framework For Electronic Communications Networks And Services**
  https://ec.europa.eu/digital-agenda/en/news/public-consultation-evaluation-and-review-regulatory-framework-electronic-communications

- **Excise Duty On Alcohol And Alcoholic Beverages**
  http://ec.europa.eu/taxation_customs/common/consultations/tax/2015_alcohol_en.htm

- **Retail Financial Services**
  http://ec.europa.eu/finance/finservices-retail/index_en.htm