

Position on Unfair Competition from Public Bodies

21th June 2017

Introduction

The European Business Services Alliance, EBSA, is representing business services in the EU. EBSA's members represent a diverse range of business services that are provided to both public and private clients. In their daily operations providers of business services experience unfair competition from public bodies. This competition takes several forms and creates distortions when private companies compete for public contracts and when public bodies decide to provide services, which could have been more efficiently provided by private businesses.

EBSA strongly believes that the expertise and innovation of private sector firms ensure the delivery of quality, on-time services to public clients. When public bodies outsource to professional service providers, the European taxpayers benefit from higher quality services at a lower price. In this paper we outline four main challenges, that EBSA's members experience: In-house public procurement rules, VAT distortions, exemptions from bankruptcy and insolvency laws, and unclear price determination. We furthermore give recommendations to how these challenges can be addressed. EBSA is convinced that addressing these challenges would have a positive impact on the effectiveness of the public sector, growth and job creation in the EU.

Challenges

1. In-house public procurement rules

The 2014 Public Procurement Directive (2014/24), contrary to its intention, entails the risk of closing an increasingly large number of markets to private firms, and is likely to lead to a greater use of public-public exemptions. Service providers experience that public in-house departments engage in commercial activities and bypass public procurement provisions through the use of public-public and in-house exemptions and exclusive rights. The use of these exemptions can be warranted in certain instances, but it is our view, that the wording of the Directive is too wide and, due to the lack of adequate interpretation, can be abused. It should be ensured that the essential part of the in-house entity's activities is confined to the tasks conferred by the controlling entity and it should be clear, that exemptions are to be applied restrictively. EBSA believes that excessive use of public-public (including in-house) exemptions in the Public Procurement Directive is damaging market openness and transparency as well as the competitiveness of the European industry.

2. VAT

One of the main and most prevalent challenges faced by EBSA's members is rooted in the VAT legislation. Under the current VAT legislation private service providers are at a disadvantage when they are offering services to public bodies, and when they are competing with public bodies on offering services to other entities.

The VAT problem is two sided. On the input-side the competition is distorted because the VAT regime applicable to public bodies and exemptions on services in the public interest create an incentive for public bodies to self-supply. This is a significant barrier to outsourcing. On the output-side

the competition is distorted because exempted public bodies often are in direct competition with private service providers, who remain subject to VAT, when it comes to offering services to other public entities.

Input-side distortions:

Private operators engaged in for instance the healthcare, social, and education sectors currently experience large difficulties as they need to include VAT in their final price, which public bodies subsequently are unable to deduct. The issue is further exacerbated by high VAT rates in several Member States, causing costs to increase substantially via the non-deductible VAT. This leads to a disincentive for public bodies to invest or to outsource even where services could be provided more efficiently by private providers.

The extent of the incentive to self-supply depends on different factors

- The VAT rate on the particular service and the materials used to supply it in the particular Member State
- Whether exemptions are applied based on the nature of the service or based on the nature of the provider (public vs. private)
- Whether the standard or a reduced rate is applied to private operators (the distortion being more significant where the standard rate applies).

The bias towards self-supply that follows from the current VAT rules can be found in numerous sectors and all Member States.

Output-side distortions:

Private service providers also continue to experience competition from VAT exempt public bodies who supply their service to other public bodies. This can for instance be an in-house cleaning service for a school, which starts providing its cleaning service to the local university as well, without this being a part of its original mandate.

This amounts to unfair competition, as the public service providers are exempt from VAT hence can offer a lower price than private service providers, and the access to the market gets restricted in particular for SMEs.

While some Member States have put in place measures to correct this, distortions of competition on both the input and output side persist in most EU countries. While each Member State can decide whether to involve private entities in these sectors, once private enterprises are given access to these markets, it should be on equal footing with public actors. This is currently not the case as the applicable VAT rules are conducive to distortions of competition as outlined above. As a result, society misses out on investments in new equipment, facilities and innovations and a more efficient use of tax-payers money.

3. Exemptions from bankruptcy and insolvency law

The output distortion explained above goes further than the VAT problem. Public sector departments do not fall under usual insolvency or bankruptcy procedures. This improves their financial position to reduce charges which would normally feature in their budgets, and gives them the ability

to provide services at prices below the market price. One example of this would be non-for-profit public waste collection services, which extend their mandate to general carriage of goods. These public services are in direct competition with private carriage companies, but do not have to follow the same budgetary rules.

4. Unclear price determination

In situations where public bodies for good reason engage in activities which are or could also be provided by private businesses, it is important that these services are provided at market prices. If this is not the case, it will in effect be state aid to the buyer of the service and amount to unfair competition towards the private competitors. EBSA's members experience that it is often unclear how prices on services provided by public bodies is calculated, and that the methods differ. This not only results in unfair competition between public and private actors but also in an unlevelled playing field in the EU, or even within one member state between different regions or municipalities.

Recommendation for action

1. Provide guidance on the new in-house public procurement rules

EBSA regrets the divergent implementation and interpretation of the in-house public procurement exemptions, and is of the opinion, that **the guidelines on these aspects should be updated to reflect the provisions in the new directive**. Some member states have issued useful guidance and these could be used as a source of inspiration. EBSA especially want it to be emphasized, that the implementation and use of public-public (including in-house) exemptions are optional and in no way obligatory. In addition, it should be underlined that the exemptions foreseen in the Directive, as well as the corresponding national transposition measures, should be interpreted strictly.

2. Revising the VAT Directive art.13 and exchange best practices

In our view, the most effective way to address both the input and the output VAT distortion would be to ensure a full taxation model, notably through the elimination of art. 13 and art. 132-34 of Directive 2006/112 on the common system of value added tax (VAT Directive). A study conducted by Copenhagen Economic for the European Commission also concludes, that this model would bring the highest economic gains.

Nevertheless, EBSA realises that this option will be politically very difficult to follow, and therefore suggests **that art.13 is included in the upcoming review of the VAT directive and that it is redrafted and clarified together with art. 132**. In particular, the scope of art.132 should be limited and **the loosely defined “closely related services” should be excluded from the scope of the exemption**. Furthermore **the exemptions should be drafted on the basis of the character of the supply rather than on the character of the supplier**.

EBSA furthermore want to point the attention to the fact, that some Member States have made successful use of refund systems, while in other Member States it has been less successful and increased the administrative burdens. **Exchange of best-practices on these systems could be beneficial, and in any event, it is important that the systems apply equally to all exempted entities weather public or private**. The latter have for instance been a problem in Denmark,

where both private and public hospitals are VAT exempted, but only public hospitals can take advantage of the refund system. Finally, this system would only remedy input-side distortions and would have to be combined with initiatives tackling the output-distortions.

The Commission's intention to present a modernised VAT rates policy in 2017 is an opportunity to address distortions of competition related to VAT exemptions by simultaneously providing Member States with an option to tax currently exempted activities and giving them the freedom to set a reduced or zero rate of VAT on these activities. A combination of these two measures could go a long way towards alleviating the challenges posed by the current regime but should be considered without prejudice to deeper reform of the VAT legislation on public bodies and exemptions in the public interest, in particular as with regards to the possible reform of Article 13 and/or Article 132 of the VAT Directive.

3. Investigate price determination techniques and their compatibility with state aid rules

In 2016 the Danish competition and consumer authority carried out a comprehensive study of the service provision of public bodies in private markets. The report used OECD guidance to look into price determination methodologies and concluded that major problems existed and several public bodies were in effect breaching state aid rules. **EBSA would recommend the Commission to carry out a similar investigation to clarify to what extent there is unfair competition from public bodies across the EU, and if action is needed.** If clear principles for determining prices on public services are developed, the problem of unfair competition due to exemptions from bankruptcy and insolvency rules would also be minimized as this could no longer be directly reflected in the price.

Conclusion

EBSA is fully convinced that the first two recommendations made in this paper can significantly contribute to reduce the most obvious unfair competition from public bodies. Nevertheless, we think that this is only the top of the iceberg and a more thorough investigation to determine the full extent of the problem is needed. This is why we include the final more comprehensive recommendation. EBSA strongly believes that such an investigation will reveal extensive room for improvements and opportunities for private companies to innovate and deliver services to European taxpayers more effectively than it is done today. EBSA understands that it is up to the Member States to decide which markets to open for private or public entities, however, once this decision is taken, the competition should take place on a level playing field between all entities on the basis of clear rules and principles.