

**EC Competition Policy and Regional  
Aid: An Agenda for the Year 2000?**

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## **ABSTRACT**

This paper reviews the development of EC competition policy with respect to regional aids. The paper begins by outlining the legal basis for European Commission control of the regional policies of the Member States. It goes on to trace the history of regional aid discipline since the late 1960s and then reviews recent policy developments. A final section highlights a number of issues which seems likely to dominate the policy agendas of national and Community policymakers as the Commission seeks greater aid discipline whilst coping with the potential impact of enlargement.

*Keywords: regional policy; regional aids; state aids; competition policy.*

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## **EC COMPETITION POLICY AND REGIONAL AID: AN AGENDA FOR THE YEAR 2000?**

### **1. INTRODUCTION**

Recent developments in the European Community have placed considerable emphasis on the objective of economic and social cohesion. The Single European Act provided for the Community to “develop and pursue its actions leading to the strengthening of economic and social cohesion”; the Treaty of European Union went further and made the promotion of economic and social cohesion one of the “tasks” of the Community.

This concern with economic and social cohesion was provoked by two main factors. First, the enlargement of the Community to include Portugal and Spain significantly widened existing regional disparities in the EC. Second, several Commission-sponsored reports warned of the dangers of failing to distribute the benefits of the Single European Market. In particular, it was suggested that there were serious risks of aggravated regional imbalance in the course of market liberalisation and that there was a need for adequate accompanying measures to speed adjustment in the structurally weaker countries and regions.

The most high profile response to the need to promote economic and social cohesion was the 1988 reform of the Structural Funds. This involved a complete overhaul of policy administration and implementation, as well as a very significant increase in the budget allocation.

A second strand to Commission action on regional disparities involves the control of the regional policies of the Member States under the competition policy provision of the Treaty. Indeed, it is interesting to note that, for most of the history of the Community, the Competition Policy Directorate of the Commission (DGIV) has had more impact on regional policy in the Member States than has the Regional Policy Directorate, DGXVI. Moreover, the notion of competition policy as an instrument of economic and social cohesion appears to have become a standard part of the Commission defence of (often controversial) decisions on State aid.

The past year or so has been an active period in the development of competition policy controls on State aids generally. The Commission has issued guidelines in a number of new policy areas and has proposed institutional changes for State aid notification and monitoring that would have major consequences for the Member States. Regional aids have not escaped Commission attention in this period. Proposals for a new regional aid framework have been under discussion since early 1996 and these, together with longstanding plans to make all large awards to projects of significant size subject to scrutiny, seem likely to be put to the Commission in late 1997.

In considering these development and the evolution of policy which underlies them, this paper is in four main parts. Following this introduction, Section 2 sets out the basis for the current policy practices of the Commission and their impact on national regional policies. Section 3 reviews how Commission policy has altered over time.

Section 4 focuses on recent policy developments. A final section highlights a number of issues which seems likely to dominate the policy agendas of national and Community policymakers as the Commission seeks greater aid discipline whilst coping with the potential impact of enlargement.

## **2. CURRENT POLICY PRACTICE**

### **2.1 Introduction**

The basic provisions for controlling subsidies in the European Economic Community were incorporated into the Treaty of Rome; it was recognised from the start that mechanisms to control subsidies to firms were an essential component in the rules underpinning the establishment of a common market. As barriers to trade such as tariffs and quotas were being outlawed, the temptation for governments to resort to other instruments of protectionism was considered likely to increase.

More recently, this view has been reinforced; in the context of the completion of the internal market a number of influential reports<sup>1</sup> stressed the need for strict control of subsidies. The further dismantling of barriers to trade that was to take place as part of the Single European Market programme (including more open public procurement procedures and the ending of discriminatory national product standards) would leave subsidies as one of few measures of protectionism at the disposal of EC governments. This meant not only that governments were perceived to be more likely to use subsidies, but also that the *effects* of subsidies would be felt more keenly by competitors in other countries. In response to this, the control of State aids moved higher up the Community policy agenda in the late 1980s. This was reflected in a systematic attempt to catalogue the aids on offer in the EC and the use of this to identify major areas of government expenditure on State aids and priorities for Commission scrutiny.

### **2.2 The Legal Basis for the Control of State Aids**

In spite of the resurgence of interest in the issue of government subsidies in the run up to 1992, the legal basis of policy and action on State aids in the European Union has remained substantially unchanged since the Treaty of Rome<sup>2</sup>; the key provisions are Articles 92 to 94.

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<sup>1</sup> Most notably, Padoa-Schioppa, T. *et al* (1987) *Efficiency, Stability and Equity: A Strategy for the Evolution of the Economic System of the European Community*, Economica, Paris; and Cecchini, P. (1988) *The European Challenge 1992: The Benefits of a Single European Market*, Wildwood House, Aldershot, England.

<sup>2</sup> The Treaty on European Union added a new Article 92(3)(d) - relating to aids for culture and heritage conservation - and amended Article 94 to involve consultation of the European Parliament in the event of the Council making regulations on the application of Articles 92 and 93.

The first paragraph of Article 92 provides that:

“Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Member States, be incompatible with the common market.”

The second paragraph (Article 92(2)), indicates those aids that are *de jure* exempted from this general ban. Three categories of aid are identified. In broad terms, these are: aids of a “social” nature<sup>3</sup>; aids related to the damage caused by natural disasters<sup>4</sup>; and aids to parts of the Federal Republic of Germany affected by the division of Germany<sup>5</sup>.

The third paragraph (Article 92(3)) outlines those types of aid that *may* be considered to be compatible with the common market. These are:

- a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- c) aid to facilitate the development of certain economic activities or of certain economic areas where such aid does not adversely affect trading to an extent contrary to the common interest;
- d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community to an extent that is contrary to the common interest;
- e) such other categories of aid as may be specified by decision of the Council acting by qualified majority on a proposal from the Commission.

In short, Article 92 provides for a general prohibition of State aids insofar as they affect trade between the Member States, but then goes on to identify those aids which *are* compatible with the Treaty and those aids which *may* be compatible with the Treaty. The core of Commission policy on the admissibility of regional aids is its interpretation of Articles 92(3)(a) and 92(3)(c) of the Treaty, which both enable regional aids to be exempted from the general ban on State aids. There are, however,

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<sup>3</sup> Basically, aid paid to individuals, rather than firms.

<sup>4</sup> Such as floods, droughts, earthquakes and volcanic eruptions.

<sup>5</sup> For most of the post-war period the German Federal government operated special measures for the so-called Zonal Border Area (the *Zonenrandgebiet*) and West Berlin under these provisions. However, the Commission increasingly questioned the appropriateness of continuing special treatment. Even although the Treaty on European Union was signed after German reunification, this provision was retained in the revised Treaty; indeed, the German authorities have sought to rely on it to justify assistance to Volkswagen in the *Land* of Saxony. See Pery, B. (1997) *State Aids to the Former East Germany: A Note on the VW / Saxony Case*, *European Law Review*, 22.

important differences between the two provisions and these impact directly on the areas in which the Commission will authorise aid, the type of aid that it will authorise and the “intensity” (or rate of award) of that aid.

Article 92(3)(a) is clearly targeted at areas that are particularly disadvantaged. More specifically, the European Court of Justice has emphasised that:

“the use of the words ‘abnormally’ and ‘serious’ in the exemption contained in Article 92(3)(a) shows that it concerns only areas where the economic situation is extremely unfavourable *in relation to the Community as a whole*”<sup>6</sup> [emphasis added]

Article 92(3)(c) is potentially wider:

“inasmuch as it permits the development of certain areas without being restricted by the economic conditions laid down in Article 92(3)(a), provided such aid ‘does not affect trading conditions to an extent contrary to the common interest’. That provision gives the Commission power to authorize aid intended to further the economic development of areas of a Member State which are disadvantaged in relation to the national average.”<sup>7</sup>

Notwithstanding the importance of the differences between Articles 92(3)(a) and (c), the early policy of the Commission did not make reference to these provisions.

### 2.3 The Frameworks on Systems of Regional Aid

From the outset, the stated rationale for action on regional aids was the perceived risk of competitive outbidding between regions for internationally-mobile investment. This emphasis has continued through the history of EC policy on the control of regional aids and has been instrumental in shaping the approach. This has highlighted the perceived need for the regulation of competition between *Member States and regions*; there has been less explicit emphasis on competition between *undertakings*.

State aid control policy was slow to develop. It was some 10 years after the signature of the Treaty of Rome that explicit policy positions in respect of regional policy were formulated - and regional aids were the first policy area addressed. The Commission proposed a system for co-ordinating regional aids in 1968; this culminated in the adoption in 1971 of the first set of principles for co-ordinating regional assistance<sup>8</sup>. These principles were added to in 1975 and 1979<sup>9</sup> so that, together, the documents addressed a number of issues relating to the control of regional aids, which are still applied today, notably:

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<sup>6</sup> Case 248/84 *Federal Republic of Germany v Commission of the European Communities* [1987] ECR 4013 at 4042.

<sup>7</sup> *Ibid.*

<sup>8</sup> Council Resolution of 20 October 1971 on General Systems of Regional Aid, OJEC No C 111; 4 November 1971.

<sup>9</sup> Communication on Regional Aid Systems, OJEC No C 31; 3 February 1979.

- the need to establish maximum rates of award in the problem regions which reflect the severity of the regional problem;
- the need to establish a common method of assessing the value of aid across countries;
- the need for transparency of aid;
- and the need for regional specificity.

In 1988, these existing documents were supplemented by a further Communication<sup>10</sup>. The 1988 Communication was an important development. Whereas previously the various guidelines had referred to “central” and “peripheral” regions, without reference to Articles 92(3)(a) and (c), the distinction between the provisions was now made explicit, as was the Commission’s intended approach to their interpretation. Indeed, the 1988 Communication was principally concerned with issues of area designation.

These various documents together form the basis for the assessment by the Commission of the regional aid policies of the Member States. There are three principal aspects to this: first, the control of the spatial coverage of policy; second, the requirement that the aids offered must be in a form that is capable of being assessed under a common methodology; and, third, the stipulation of maximum rates of award that vary with the perceived severity of the regional problem.

## **2.4 Commission Control of the Spatial Coverage of Regional Aids**

The Commission methodology for approving the designated areas for regional policy is outlined in the 1988 Communication mentioned above. Following on from the Court of Justice interpretation, although without making reference to it, the methodology makes use of the exceptions from the prohibition of aid provided for in Articles 92(3)(a) and (c).

### *Article 92(3)(a)*

Article 92(3)(a) provides that “aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment” may be considered to be compatible with the common market.

The 1988 methodology interprets this as regions where *per capita* gross domestic product is equal to or less than 75 percent of the Community average, based on the average for the three most recent years for which data is available. For the purposes of the methodology, regions are considered to be the so-called NUTS II level units<sup>11</sup>. The GDP figures are expressed in terms of purchasing power standards (to allow for

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<sup>10</sup> Communication on the Method for the Application of Articles 92(3)(a) and (c) to Regional Aid, OJEC No C 212; 12 August 1988.

<sup>11</sup> NUTS refers to the Nomenclature of Territorial Units for Statistics established by the Statistical Office of the European Communities. Examples of NUTS II regions are the Spanish Autonomous Communities and the Italian regions.

differences in the cost of living between countries) and are averaged over the last three years for which data are available.

The result of applying this methodology is that the whole of the territories of Greece, Ireland and Portugal, much of Spain and the south of Italy are approved as assisted areas under Article 92(3)(a). In addition, Northern Ireland and Teruel (Spain) are added, even although they do not meet the criteria.

There are two interesting points to note about the initial Article 92(3)(a) designation. First, per capita GDP/PPS is essentially used as a proxy for “abnormally low” standards of living or “serious underemployment”. The Communication claims that this indicator provides a “method of measuring living standards which allows for differences in the cost of living between Member States”. In practice, however, the link between *per capita* GDP and living standards is indirect, at best; the former measures the output of a region in relation to its population, whereas the latter implies some measure of personal prosperity.

The second point of interest is that Northern Ireland and Teruel are included not because they meet the criteria, but because of their “exceptional situations”. It could be argued that Article 92(3)(a) does not provide for the exercise of such Commission discretion to extend the basis of the exemption beyond that stated.

#### *Article 92(3)(c)*

Article 92(3)(c) provides, among other things, that “aid to facilitate the development of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest” may be compatible with the common market.

The interpretation of this provision is more complicated than that for assisted areas under Article 92(3)(a). Moreover, it differs in two important respects. First, the analysis is based on the NUTS level III region<sup>12</sup>; and second, the methodology takes account of the situation of a region not only in relation to the Community average, but also in relation to the national average.

Designation is approved on the basis of a two-stage analysis: the first, essentially quantitative; the second, more qualitative. The first stage involves an assessment on the basis of either a) *per capita* gross domestic product and unemployment or b) population density.

Under the GDP / unemployment test, a region must normally display the following minimum disparity in order to qualify under Article 92(3)(c):

- *per capita* GDP/GVA at least 15 percent below the national average; and/or
- unemployment at least 10 percent above the national average.

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<sup>12</sup> Examples of NUTS III regions are the German *Kreise* and the Belgian *arrondissements*.

In order to take the EC context into account, national averages are themselves adjusted on the basis of European indices of GDP per head and unemployment. Using these indices, a formula is applied that determines the threshold that a region must reach in order to qualify for approval under Article 92(3)(c). The net result of applying the formula is that the better the situation of a Member State in relation to the EC average, the greater must be the disparity of a region within the national context for the availability of regional aid to be justified. Thus regions in Denmark and Germany (among the more prosperous nations of the EC) must diverge from the national average to a greater extent than those in Italy and the United Kingdom in order to qualify. This is reflected in Figure 1 which sets out the relevant thresholds for GDP per head and unemployment for each Member State.

**Figure 1: Thresholds for the Application of Article 92(3)(c) to National Regional Aid**

Member State	GDP / GVA per capita		Structural Unemployment	
	29 May 1996	4 June 1997	29 May 1996	4 June 1997
<b>Austria</b>	79	79	(1)	145
<b>Belgium</b>	82	81	123	118
<b>Denmark</b>	74	73	115	126
<b>Finland</b>	81	83	110	110
<b>France</b>	80	80	110	110
<b>Germany<sup>(2)</sup></b>	77	77	130	128
<b>Greece</b>	85	85	121	122
<b>Ireland</b>	85	85	110	110
<b>Italy</b>	85	85	110	110
<b>Luxembourg</b>	69	68	145	145
<b>Netherlands</b>	83	82	141	144
<b>Portugal</b>	85	85	145	145
<b>Spain</b>	85	85	110	110
<b>Sweden</b>	75	76	134	121
<b>UK</b>	85	85	111	116

**Notes:** (1) The unemployment threshold for Austria was to be published as soon as national unemployment statistics became available. (2) The former German Democratic Republic is included from 1991.

**Sources:** OJEC No C186, 26 June 1996; OJEC No C 198, 28.6.97.

An alternative to the GDP per capita and/or unemployment thresholds was introduced as a result of the accession negotiations with the Nordic countries<sup>13</sup>. The population density test concerns NUTS III regions where the population is less than 12.5 per km<sup>2</sup>. It is not clear how this threshold was arrived at, although the population density of the current assisted areas of the Nordic countries seems to have played a major role in determining the threshold. Moreover, the maps themselves were approved informally, *before* agreement was reached on the definition of NUTS III areas in the Nordic

<sup>13</sup> Commission notice, addressed to the Member States and other interested parties, concerning an amendment to part II of the communication on the method for the application of Article 92(3)(a) and (c) to regional aid, OJEC No. C 364, 20 December 1994.

applicant countries, which raises some questions about just how the Commission managed to apply the amended methodology.

The second, qualitative, stage of analysis under Article 92(3)(c) takes other factors into account. These may include the trend and structure of unemployment, demographic pressures, structure of economic activity, etc. These data are used in a discretionary manner; there is no set formula for analysis.

An important point to note about the methodology as a whole is that neither stage of the analysis is conclusive. Meeting the relevant threshold under the first stage does not necessarily mean that a region will be approved by the Commission; equally, regions excluded on the basis of the first stage may qualify on the basis of the second.

As a consequence of Commission intervention, and as Figure 2 shows, almost all the northern wealthier EC Member States were forced to cutback and/or amend the spatial coverage of their regional aid policies in the course of the 1980s. In contrast, the impact of DGIV intervention on the poorer southern or peripheral Member States has been generally to increase the spatial coverage of regional aids. As a consequence, Commission control of national regional aid maps has become a highly controversial topic and the methodology has been exposed to much criticism from national policymakers.

**Figure 2: Trends in Assisted Area Coverage 1980-1995 (% of national population)**

	1980	1985	1990	1995
<b>Belgium</b>	39.5	33.1	33.1	35
<b>Denmark</b>	27	24	20.7	19.9
<b>France</b>	38.2	39	41.9	40.9
<b>Germany</b>	36	28.4	42.5*	38.5*
<b>Ireland</b>	100	100	100	100
<b>Italy</b>	34.2	35.6	35.6	48.8
<b>Luxembourg</b>	100	100	100	79.9
<b>Netherlands</b>	27.4	25+	19.9	15.6
<b>UK</b>	45.4	37.8	37.8	36.8
<b>Greece</b>	65	100	100	100
<b>Portugal</b>	100	100	100	100
<b>Spain</b>	52	41	58.6	58.6

**Note:** \* By this time, Germany was reunified; in 1991 coverage in the west amounted to 27 percent of the west German population, falling to 22 percent in 1995.

**Sources:** Yuill *et al* (various editions) European Regional Incentives, Bowker-Saur, London.

## 2.5 Application of the Common Method of Assessment

Provisions for a common method of assessing the value of different types of aid date back to the early 1970s. Underlying the development of the method is the desire to make aid “measurable” or transparent. The aim of the methodology is to enable

different forms of aid to be measured as a percentage of the investment after tax - the so-called “net grant-equivalent” (nge). To this end, the methodology makes a number of assumptions about the nature and composition of assisted investments, the expenditure eligible for assistance and the profitability of the recipient firm. In practice, however, it is clear that the net grant-equivalent value of a given aid can only be measured *ex post* and on a case-by-case basis. This arguably raises serious questions about the genuine contribution of the method to improving transparency with regard to the value of aid.

Commission opposition to so-called “operating aid” - ie. aid not conditional on initial investment or job creation - is clearly expressed in the 1979 principles. The Commission view is that such aids merely reduce the running costs of recipient firms, enabling them to survive in the market without making necessary “structural” adjustments; in addition, the Commission stance perhaps also reflects the difficulties inherent in subjecting operating aids to the common method of assessment. In the 1979 principles the Commission stated that, within a three-year period, it would specify the circumstances, if any, in which operating aids could be considered to be compatible with the common market. In practice, however, the Commission did not do so until the 1988 Communication in which it stated that operating aids could be made available in Article 92(3)(a) regions in specific circumstances. Interestingly, the Communication notes that “island regions in peripheral locations can suffer permanent cost disadvantage with respect to trade because of the burden of additional transportation expenses”. However, it goes on to say that the Commission will only authorise operating aid which “is limited in time and designed to overcome the structural handicaps of enterprises located in Article 92(3)(a) regions”; this seems rather inconsistent with the recognition that the cost disadvantages are permanent.

Somewhat different provisions are made for sparsely populated areas. In those areas that qualify on the basis of the population density test, the Commission is to give “sympathetic consideration” to aid intended to compensate for the additional cost of transport. This is subject to a number of conditions, in particular:

- aid must be restricted to areas that qualify on the basis of very low population density;
- it must serve only to compensate for the additional cost of transport inside national borders;
- it must be objectively quantifiable in advance, on the basis of aid-per-kilometre or aid-per-kilometre and aid-per-weight ratios;
- it must not be made available in respect of products for which there is no alternative location (eg. extractive industries, hydroelectric power);
- aid to “sensitive” sectors (motor vehicles, synthetic fibres etc.) is subject to individual notification and prior approval.

The Commission notice also provides that, two years after accession, the existing schemes of assistance to transport will be examined on the basis of these criteria. Also, any new schemes are to be limited in time and less favourable than current measures. It is a measure of the difficulty of the accession negotiations that the

Commission should have made such concessions. The Commission has always been opposed to operating aids and had hitherto prohibited their use in Article 92(3)(c) areas. As discussed, it has taken a more flexible attitude towards operating aids in the least-favoured (ie. Article 92(3)(a)) regions but, even in these areas, the methodology stipulates that such aids must be limited in time; no such restriction seems to have been imposed on *existing* transport aids in the eligible Nordic regions.

At a more general level, many aspects of the Commission methodology for measuring aid are arcane and complicated. Nonetheless, Commission insistence on transparency has been influential in shaping the regional incentive policies of the Member States over the past two decades, contributing to a situation in which virtually all (the one exception is Greece) offer a grant as the mainstay of their regional aid packages.

### ***2.5.1 Commission Control of Regional Aid Values***

The third strand of Commission policy on the control of regional aids is to stipulate the maximum levels of assistance that may be offered. These are set on the basis of the common method of assessment. In broad terms, the distinction between Articles 92(3)(a) and (c) is retained for the purposes of maximum rates of award. In Article 92(3)(a) areas the Commission can authorise investment aid of up to 75 percent net grant-equivalent. In contrast, in Article 92(3)(c) areas the Commission rarely authorises award rates exceeding 30 percent net grant-equivalent. In practice, however, the actual award ceilings approved by the Commission vary very widely. Moreover, the Commission is by no means consistent in setting ceilings in net grant-equivalent terms; it frequently sets maxima as a gross grant-equivalent<sup>14</sup> - as illustrated in Figure 3.

In general, this aspect of Commission discipline of regional aids is much less controversial among national regional policymakers than is Commission control over the geographical coverage of policy. The main reason for this is that the Commission aid ceilings tend not to constrain regional policy administrators in making award offers. On the contrary, the average awards under the main regional incentive grants are typically between a quarter and a half of the maxima permitted. As a result, the award ceilings authorised by the Commission are of limited impact in terms of disciplining regional aids. This is principally because these ceilings were determined by the level of assistance available in certain regions at the time the limits were first introduced rather than by any analysis of the severity of the problem in the various regions. Moreover, since the early 1980s, regional policy expenditure has tended to decline as most countries have experienced budgetary pressures; a consequence of this is that policymakers have increasingly sought “value-for-money” in making grant offers with the result that the advertised maxima are rarely attained in practice.

Given its highly-evolved, if controversial, approach to approving assisted area coverage, it is perhaps surprising that the Commission should apparently have paid so

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<sup>14</sup> Wishlade, F. and Yuill, D. (1997) Regional Incentive Policies in the European Union: Rates of Award and Award Values, *Regional and Industrial Research Paper Series 23*, European Policies Research Centre, University of Strathclyde, Glasgow.

little attention to the modulation of maximum rates of award. Indeed, the general practice of adopting Member States' advertised maxima as ceilings has resulted in a large number of different authorised ceilings, with little rigour applied to establishing a relationship between the maximum award level and the severity of the regional problem.

Figure 3: Commission Award Ceilings

	Gross Award Ceiling (%)	Pop Coverage (%)
<b>Finland</b>	35	12.7
	27	12.8
	20	16.1
<b>Germany</b>	<b>35</b>	20.8
	18	11.1
	15	1.8
	12	3.9
<b>Luxembourg</b>	25	34.6
	17.5	8.1
<b>Netherlands</b>	25	1.5
	20	9.1
	15	6.7
<b>Portugal</b>	<b>75</b>	100.0
<b>Sweden</b>	35	5.9
	25	12.6
	NGE Award Ceiling (%)	Pop Coverage (%)
<b>Austria</b>	<b>40</b>	1.8
	<b>30</b>	1.7
	25	2.3
	20	26.4
	15	3.0
<b>Belgium</b>	25	12.6
	20	9.7
	15	12.6
<b>Denmark</b>	25	4.9
	16.9	15.0
<b>France</b>	<b>65</b>	2.5
	30	0.4
	25	1.5
	22	11.8
	15	26.2
<b>Greece</b>	<b>75</b>	3.5
	<b>67.9</b>	3.5
	<b>64</b>	3.0
	<b>58.2</b>	35.0
	<b>54.2</b>	15.0
	<b>47.4</b>	40.0
<b>Ireland</b>	<b>75</b>	2.4
	<b>71.4</b>	31.5
	<b>57.3</b>	66.1
<b>Italy</b>	<b>50</b>	9.4
	<b>40</b>	24.8
	10	14.7
<b>Spain</b>	<b>60</b>	31.6
	<b>50</b>	16.8
	<b>40</b>	4.5
	<b>30</b>	6.8
	25	5.8
	20	9.7
	15	0.8
<b>United Kingdom</b>	<b>47.4</b>	2.9
	30	16.9
	20	18.3

Source: Unpublished data kindly supplied by DGIV, European Commission.

This approach has led to a 75 percent net grant-equivalent ceiling in many areas approved under Article 92(3)(a) simply because that was the prevailing rate in the Italian *Mezzogiorno* at the time that the basic principles on aid intensity were first enunciated. When Greece, Portugal and Spain joined the Community, the impact of the competition rules on their regional policies was to *increase* permissible rates of award over the levels of support that had been available previously. This reflected the fact that these new Member States were less prosperous than the EC average and the higher ceilings were intended to maintain the competitive advantage of the problem regions of these countries in attracting mobile investment. In practice, however, these countries lack the budgetary resources to finance regional aids at these levels so that the higher ceilings authorised by the Commission are, in reality, largely theoretical. A more general point is that the Commission appears never to take account of the budget assigned to regional aid policies when considering their impact on competition.

### ***2.5.2 The Impact of Competition Policy on the Regional Policies of the Member States***

Not all Member States have been affected by the ebbs and flows of competition policy influence over regional policy in the same way. The differences in the impact of competition policy over regional aid largely reflect the degree of prosperity of the Member State concerned as well as the scale of internal regional disparities.

Over the last three years, the Commission has reviewed the assisted area maps of all the Member States. In general, its approval of the maps extends to the end of 1999, to coincide with the expiry of the current Structural Fund planning period. However, in the case of the three new Member States, Austria, Finland and Sweden, whose maps were authorised by the EFTA Surveillance Authority, approval extends only until the end of 1998. For some countries, for example Greece, there is no formal expiry date for the map; however, under Article 93, the Commission is required to keep aid systems under “constant review” and can propose “appropriate measures” to the Member State at any time, so the absence of an expiry date is less significant than it might appear.

This section briefly reviews recent developments in selected countries within four broad country groupings:

- Member States wholly covered by Article 92(3)(a) - Greece, Ireland and Portugal
- Member States with significant Article 92(3)(a) and (3)(c) areas - Germany, Italy and Spain
- Member States largely governed by Article 92(3)(c) - Austria, Benelux, Denmark, France, United Kingdom
- and the Nordic Member States where the special nature of the regional problem is characterised by areas of low population density.

*Article 92(3)(a) Member States*

In the countries where Article 92(3)(a) areas cover the whole territory (Greece, Ireland and Portugal) regional policy relations with DGIV have, for the most part, been uncontentious. This reflects the fact that even the prosperous regions of all three countries are relatively poor in an EC context. In consequence, the entire territories of these countries have, to date, been admitted as eligible for regional aid by the Commission and the assisted area maps of these countries have tended not to be subjected to the regular review process undertaken for other Member States. A feature common to all three countries is that membership of the EC resulted in an upgrading of the value of regional aids in relation to the situation prior to accession; higher award maxima were authorised to reflect the severity of the regional problem in a European context. However, as noted earlier, these maxima are largely theoretical; in none of the three countries is the aid maximum authorised by DGIV reached on a regular basis or even at all.

Although to date, regional aid discussions between these countries and DGIV may have been easy, for Ireland and Portugal changes in prosperity may complicate future relations. The situation is potentially most uncertain for the Republic of Ireland where GDP at the national level is set to rise well above the 75 percent qualifying threshold by the time of the next review. In the Irish context, the situation is made more difficult by the fact that there is no NUTS II breakdown, the basis for Article 92(3)(a) designation. In other words, the current methodology would result in none of the country qualifying for Article 92(3)(a), even although it is certain that the increased prosperity is largely attributable to Dublin. This would mean that the whole country would need to be assessed at the NUTS III level on the basis of Article 92(3)(c). Whilst this is the logical outcome of the current methodology, it is unclear whether in practice the method would be applied so strictly; on the other hand, it does reinforce the point that the choice and size of the territorial units used for area designation fundamentally affect assisted area coverage.

*Article 92(3)(a) and (3)(c) Member States*

The situation is more mixed in Germany, Italy and Spain where many of the designated areas are approved under Article 92(3)(a) and appear uncontentious, but where some of the proposed assisted areas under Article 92(3)(c) are hotly contested. This dichotomy parallels the different methodologies adopted for the least-favoured regions (under Article 92(3)(a)), on the one hand, and the development areas (under Article 92(3)(c)), on the other.

In *Germany*, for example, the 1993 Commission decision to authorise the GA status of all the new *Länder* until 31 December 1996 was straightforward in view of the very low *per capita* GDP figures in the east (around 35 percent of the Community average). In contrast, area designation in the west was considerably more difficult. As it had done in 1991, the Commission adopted an approach based on an agreed population ceiling and proposed that GA coverage in the west should not exceed 18 percent of the west German population; this was considerably less than the 23.5 percent sought by the German authorities. Eventually a compromise figure of 22 percent of the population (including west Berlin) was reached. This represented a substantial reduction in the population coverage of the problem regions of west

Germany - down from 30.3 percent in the period until 31 December 1993; on the other hand, overall coverage in Germany remained significant - at 37.6 percent of the population under the map approved until 31 December 1996. Within the ceiling set for west Germany, it is of note that there was relative freedom to designate areas as the German authorities saw fit; though the selection had to be made on the basis of transparent and verifiable criteria that complied with the second stage of analysis under the 1988 methodology. In addition, the German authorities were given scope to include areas that did not fully comply with the criteria but where acute regional problems were clearly identifiable.

Subsequently, the German authorities devised a new map for the period 1 January 1997 to 31 December 1999. This maintained the coverage of the west German *Länder* at just over 14 million inhabitants ie. 22 percent of the west German population as calculated in 1993. However, in the interim, West Berlin had been included with the new *Länder* for the purposes of GA Area designation. This map was submitted to the Commission for approval, but DGIV was of the opinion that the population coverage for 1997-99 should be the same as that for 1994-96, but *excluding* West Berlin. In consequence, the Commission argued that the population coverage for the western *Länder* should be around 13.25 million. Eventually a compromise was reached where the German authorities were given flexibility in area designation, provided that coverage was reduced by the required 800,000 inhabitants<sup>15</sup>.

As discussed elsewhere in this volume, a key feature of regional policy in *Italy* is the extent to which national regional policy has become intertwined with the operation of the Structural Funds. The basic regional policy legislation in Italy provides for the national assisted areas to coincide with those designated as Objective 1, 2 and 5b. Nevertheless, the approval of DGIV was still required before regional incentive policy could be operationalised in these areas. A key area of controversy concerned the regions of Abruzzi and Molise. These were both Objective 1 areas (Abruzzi only until end 1996), but DGIV considered that neither should qualify as least-favoured areas under Article 92(3)(a).

In consequence, the Commission considered that the population concerned (some 2.2 percent of the Italian population) should be included as part of a national “quota” of Article 92(3)(c) areas, set at 12.5 percent of the population. This was highly controversial because Abruzzi is traditionally considered a part of the *Mezzogiorno* and it would have been politically difficult to substitute Abruzzi for designated areas in the Centre-North at a time when the separatist movements were gathering strength. In the event, a compromise was reached in spring 1995: Abruzzi was accepted within Article 92(3)(c) *in addition* to areas in the Centre-North, but only until the end of 1996. As for Molise, rates of award for the region were set to decline over the period until 1999.

The temporary arrangement for Abruzzi meant that the status of the region was once more up for review in 1996. Initially, it seemed certain that the Commission would take a firm line on the population quota approach, insisting on a reduction in

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<sup>15</sup> Commission approves the redefinition of regional aid areas in Germany for the period 1997-99; IP/96/1202.

population coverage from 14.7 percent to 12.5 percent. In practice, however, early in 1997, it emerged that the Italian authorities had succeeded in negotiating the continued designation of Abruzzi without a corresponding reduction in coverage elsewhere; there is, however, no published information on the agreement.

Overall, there is a very high degree of coincidence between the national and the Structural Fund maps in Italy; however, despite the stress placed on common map boundaries there are some Objective 2 and 5b areas which are not approved under Article 92(3)(c) and, conversely, there are some areas approved under Article 92(3)(c) that are not covered by the Structural Funds map - most notably Abruzzi, whose Objective 1 status expired at the end of 1996. A feature of the initial Commission decision authorising the new Italian map is that it refers to areas designated as Objective 1, 2 and 5b *and* areas approved under Article 92(3)(c). This is the first time that area designation approval by DGIV has been couched in these terms, suggesting a recognition of the extent to which national and European policies have become inseparable in the Italian context. On the other hand, from a strictly legal perspective, this approach is curious since Objective 1, 2 or 5b status *per se* is not a valid justification for an exception from the Article 92(1) general ban on State aids. In national regional policy terms, the direct relationship between domestic and European regional policies has resulted in a substantial increase in assisted area coverage in Italy; this now extends to almost 49 percent of the Italian population compared with around 37 percent previously.

In *Spain* too, not only is there a mix of Article 92(3)(a) and (c) areas, but area designation under the Structural Funds has also been an important factor in determining the spatial coverage of domestic regional incentive policy. DGIV initiated a review of the Spanish assisted areas at the end of 1993. Negotiations between DGIV and the Spanish authorities culminated in a revised list of approved assisted areas being published by the Commission<sup>16</sup> at the start of 1996. This involved more extensive spatial coverage than the then current map but, for most eligible areas, lower award maxima. However, the map actually used by the Spanish authorities was then, and is now, narrower in coverage than that agreed with the Commission. Indeed, ever since the Spanish assisted areas have become subject to Commission scrutiny, following membership of the European Community, the spatial coverage actually implemented by the Regional Incentives Directorate in Spain has been less extensive than that authorised by DGIV. Decisions on where to offer the Regional Investment Grant have been based on both the relative severity of the regional problem and the relative prosperity of the Autonomous Communities (the Spanish regions). Consequently, it was concluded that Madrid and Cataluña, for example, were themselves in a position to fund regional policies within their territories and, as a result, the national scheme was not made available in these areas. In part, this reflects the significant economic development role played by the Autonomous Communities within what amounts to a quasi-federal institutional structure; it also reflects the desire to concentrate national government resources on priority areas.

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<sup>16</sup> OJEC No C 25; 31.1.96.

Revisions to the national assisted area map were not initiated or sought by the Spanish authorities but rather by the Commission. Greater coherence with Objective 1 and 2 Structural Fund areas was an important factor in the changes made. This meant, among other things, that Cantabria and Valencia (Objective 1 for the period 1994-99) were included in Article 92(3)(a). Also, the whole of the Basque Country (which is designated, in its entirety, as either Objective 2 or 5b) was included on the approved list for Article 92(3)(c). The Commission based its approval of the Article 92(3)(c) areas on the population quota approach which is described in more detail below. This gave rise to some tensions in the negotiating process since the acceptable quota of Article 92(3)(c) areas was never actually disclosed to the Spanish authorities. Instead, the assisted areas were decided in an iterative manner, based on proposals from the national authorities and the Autonomous Communities.

The overall population coverage of the Spanish assisted areas approved by the Commission has risen from 62.5 percent to 75.7 percent of the national population. Of this, some 59.4 percent is designated under Article 92(3)(a). The implementation of changes to the Regional Investment Grant map required a Royal Decree of Delimitation for each of the Autonomous Communities affected; these were passed in late 1996 and early 1997.

With regard to rates of award, the Commission decision involved lowering the authorised aid ceiling in most assisted areas. Previously, the Commission had authorised aid ceilings of 75 percent of eligible expenditure in much of the country. In practice, however, the Spanish authorities only applied this maximum in very closely-defined areas and tended to set a ceiling of 50 percent in areas where 75 percent was authorised. Moreover, even this 50 percent ceiling could be reached only in priority areas; actual rates of award offered were typically very substantially lower. In consequence, the Commission decision to lower the maximum aid level from 75 percent to 60 percent or 50 percent (depending on location) is likely to have little impact in practice.

#### *Article 92(3)(c) Member States*

In most of the northern Member States where Article 92(3)(c) regions predominate (Austria, Benelux, Denmark, France, UK), DGIV is keen to exert downward pressure on assisted area coverage. As a result, relations between the Commission and the Member States are frequently strained by proposals to change the assisted areas, whether these be made by the Commission or at the initiative of the Member State.

For **Austria**, formal assisted area designation and the need for the areas selected to be approved by an external body was a new experience; prior to membership of the European Economic Area (EEA) and the EC no such process was necessary in the domestic arena. It is interesting that all the discussions over area designation in the Austrian context took place before the EEA came into force and that agreement over Austrian regional policy coverage was reached with the Commission, not with the EFTA Surveillance Authority (ESA) which was presented with a *fait accompli* on area designation once the EEA was effective. Aid intensities were agreed later, and with ESA.

As a first step in the designation exercise, the Federal authorities in Austria worked with the 1988 Commission methodology to establish which areas would qualify on this basis. An initial proposal was then passed to ÖROK (Austrian Conference of Regional Planning) for revision before being submitted to the Commission. The ÖROK conference proposals therefore provided the starting point for the negotiations. The Austrian analysis showed that Burgenland qualified under Article 92(3)(a) as an underdeveloped region. The Commission reaction to this was that a prosperous country such as Austria should not claim this designation even if, in theory, the criteria were met. Understandably, however, the Austrian authorities were reluctant to renounce the designation of a region which met the criteria. From the Burgenland perspective the main motivation for designation under Article 92(3)(a) was the prospect of Objective 1 status.

The Commission undertook its own analysis and established a population ceiling of some 39 percent for the Austrian assisted areas (including Burgenland). It also devised proposals for a somewhat different assisted areas map. The major area of contention was that the Austrian proposals had not provided for the designation of Graz. This created a problem for the Commission since it had been on the basis of Austrian claims that Graz would be an assisted area under the EC rules that Community proposals to impose duties on products from an assisted car plant in Graz had been withdrawn. The Commission proposal was that an exchange with other areas should be made to include Graz within the assisted area map. However, the Austrian authorities resisted this for internal reasons; the Commission response was to reduce the population quota it had proposed by some four percentage points, an action that was regarded as quite arbitrary by the Austrian authorities.

A certain amount of trading of potential assisted areas took place as part of the process of negotiation, with the result that there are some areas designated at below NUTS III. A more general problem for Austria was the fact that there was opposition within the country to the fixed delimitation of assisted areas. The Austrian position is that such an approach ignores the scope for the “trickle down effect” that flows from being able to attract projects to relatively prosperous areas that are adjacent to less-developed areas. From an Austrian perspective, wider spatial coverage is viewed as more important than high rates of award. Indeed, the Austrians offered to exchange wider coverage for lower rates but the Commission would not agree. A further consideration for Austria was the wish to have an explicit link between Structural Fund area designation and the national map. In proposing designated areas to the Commission, coincidence of the two maps was sought as a priority.

In *France*, for most of the 1980s and the early 1990s there were unresolved issues in the relationship between regional policy and EC competition policy and the long-running dispute between the French authorities and the European Commission over the assisted areas map for the PAT scheme. This dates back to 1990 when the Commission had proposed that assisted area coverage in some 20 *départements* should be cut back. These were mainly in the west and south-west of France and involved a reduction in assisted area coverage from 42 percent to 36 percent of the national population. Negotiations over the map were effectively suspended by the disagreement between DGIV and DGXVI over the lack of coincidence between the national and the Structural Funds maps (see 3.4). As in other countries, discussions on

the national map were only reopened once the 1989-93 Community Support Frameworks had expired. By this time, DGIV had begun to adopt a somewhat different approach to the approval of assisted areas involving the negotiation of population ceilings with Member States. As a consequence, it abandoned its attempt to impose its own designation proposals. The ceiling ultimately agreed was 40.9 percent of the population, just over one percentage point less than the previous map and five percentage points more than the original Commission proposal.

Reflecting this slight reduction in population coverage, the new French map is, unsurprisingly, not radically different from its predecessor. The most visible changes are in the west and south-west where quite extensive areas are now excluded from the PAT scheme (the population density of these areas is low, hence the limited impact on the overall population coverage of the map). In the area designation exercise, consistency with Objectives 2 and 5b was sought fairly systematically so that 82 percent of Objective 2 areas and 72 percent of Objective 5b areas are covered by the new PAT map.

Relations between the *United Kingdom* and the Commission over regional aid policy have probably been among the least strained in northern Europe. In large measure, this reflects general UK government antipathy towards interventionism under the Conservatives and explicit support for DGIV action over State aids. The UK was unusual in submitting proposals for changes to the assisted areas map for Great Britain during the course of 1993, well before the expiry of the 1989-93 Community Support Frameworks; this was in line with the UK position that there is no direct connection between the assisted areas map and eligibility for the Structural Funds. The map was approved relatively swiftly by DGIV, in spite of the fact that some fairly significant changes were involved. The most notable of these was the designation of areas in London and the south-east, the most prosperous region in the UK. Approval was doubtless aided by the fact that the Commission was increasingly using population coverage as a measure of discipline - it is almost certain that a slight reduction in coverage facilitated negotiations; given the population ceilings approved for France and west Germany, it seems highly probable that the Commission would have been willing to approve coverage exceeding 34 percent of the population of Great Britain.

#### *The Nordic Member States*

Like Austria, the need for regional incentive policy to be sanctioned by an external supranational authority was a new experience for *Finland* and *Sweden*. This resulted from membership of the European Economic Area and, subsequently, accession to the European Union.

The treatment of regional aids was an important issue in the accession negotiations and this for several reasons. First, the relative prosperity of the two countries limited the extent to which their territories were likely to qualify as assisted areas on the basis of the Commission's 1988 methodology. Second, the major focus of regional policy in Sweden and Finland is on the northern territories which are not only at a considerable distance from the main population centres, but which are also characterised by difficult geography and harsh climate; the 1988 methodology makes a passing reference to population density and topography in the second stage of analysis, but it

is primarily concerned with measuring disparities in relation to GDP per head and unemployment. Last, the Nordic countries have traditionally provided transport subsidies in respect of goods from the northern regions as well as ongoing tax and social security concessions. Such support, which amounts to an “operating aid” in Commission terminology, has always been vigorously opposed by DGIV.

In considering these issues, it is notable that, as for the existing Members of the EC, the main areas of contention concerned the types of assistance offered and the spatial coverage of policy; in neither Finland nor Sweden do award values appear to have been a source of friction.

The main difficulties for all three Nordic countries (Norway was also reviewed in detail by the Commission because membership of the EC was anticipated) arose from the provision of operating aids. The provision of such support is clearly a reflection of the fact that the areas concerned are affected by permanent structural handicaps, notably distance from markets and harsh weather conditions. These involve permanent cost disadvantages to firms located in these areas. The Commission’s preference is for one-off subsidies related to capital investment or job creation, and not incentives that provide ongoing support and reduce operating costs on a permanent basis. In part, this reflects the Commission’s wish to be able to subject all assistance to the common method of assessing aid described earlier and thereby have a uniform approach across the EC. Related is the conceptual problem of measuring peripherality; in an EC context this would be highly problematic.

As discussed earlier, a partial solution to the problem of operating aids was reached in the context of transport subsidies in sparsely populated areas. Following on from the Commission’s decision to amend the Article 92(3)(c) methodology in 1994, the first transport aid scheme under this provision was approved for Finland in 1996<sup>17</sup>. The scheme enables between 7 percent (for distances between 266 km and 300 km) and 29 percent (for distances over 1001 km) of transport costs to be reimbursed. Subsequently, the Commission also approved a transport subsidy for northern Sweden<sup>18</sup>. In spite of agreements on these schemes, some outstanding issues on the use of regionally-differentiated social security concessions, which the Commission also views as operating aids, remain to be resolved.

Spatial coverage was also a sensitive issue for the applicants. The main issue was the fact that the nature of the regional problem is very different from that in the EC of twelve. In terms of the negotiations, the relationship between the existing designated areas in the Nordic countries and the EC framework for approving assisted areas seems to have been an interactive one. On the one hand, the application of the existing rules would have resulted in substantially-reduced coverage in the Nordic Member States; on the other hand, whilst the need for some accommodation was accepted by the Commission, it was also desirable that any compromise should not affect area designation in the existing EC membership. The process was also an *iterative* one - with area designation, changes to the Commission rules and approval of the assisted

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<sup>17</sup> State aid Finland: Commission approves aid scheme for transport in northern and eastern regions; IP/96/1131.

<sup>18</sup> Commission approves aid scheme for transport in northern regions of Sweden; IP/97/91.

area maps being different stages in an interactive process. For example, the Norwegian government completed its four-year review of the assisted areas and submitted the map to the European Commission in January 1994; in June 1994, the Commission decided on an amendment to the existing rules on regional aid to make special provision for areas of low population density; and in November 1994 the map received approval from the Commission. From this sequence of events, it seems evident that the Commission amendment was very much built around the assisted area map proposals of the Norwegian and other Nordic governments.

### **3. POLICY TRENDS**

#### **3.1 Introduction**

Since the early years of the European Community, the approach of the Commission to controlling State aids and the substance of policy itself has changed considerably. Three distinct phases in the tone of the relationship between competition policy and the regional aid policies of the Member States can be identified.

In a first phase up to 1988, DGIV's approach was widely viewed as opaque; the only published policy documents on the principles underlying area designation approval dated back to the 1970s and these principles were expressed in very general terms.

A second phase began in 1988 when the Commission published its methodology for approving assisted areas; it appears that the Commission had been applying this methodology since 1983. However, its publication exposed the Commission to much criticism since it provided the Member States with the ammunition to identify the weaknesses and anomalies of the approach, whereas previous complaints had been concerned mainly with Commission secrecy and obstinacy.

In the early 1990s the nature of the relationship between competition policy and regional aids changed further. The effects of the negative reactions of many Member States to the 1988 methodology were compounded by the impact of the reformed Structural Funds. In all of the Member States (except Greece, Ireland and Portugal) there were significant differences between the maps approved for Structural Fund purposes and the maps used for national regional aid policies. A number of complicated practical, political and policy issues arose from these discrepancies in spatial coverage. Ultimately, this led not only to national authorities playing a much greater role in the designation of assisted areas under the 1993 Structural Fund Regulations, but also to the undermining of the 1988 methodology. In parallel, a Commission review of the German assisted areas map (which coincided with the reunification of Germany) culminated in a much more flexible approach to applying the Commission methodology and one which substantially reduced the importance of the quantitative assessment, the so-called first stage of analysis referred to in Section 2.4 above. The following sections consider these three policy phases in more detail.

### 3.2 The Early Years: Commission Policy as a “Black Box”

EC competition policy interest in the regional aid policies of the Member States dates back to the late 1960s. At that time, the rationale for controlling regional aids was expressed in terms of concern at the risks of competitive outbidding which required “that a first system of coordinating measures intended to limit those risks be evolved without delay”<sup>19</sup>. The priority was for co-ordination to be implemented first in the most industrialised regions of the Community, the so-called “central regions”. These were defined with reference to existing area designation systems and included all of the Community except for the German Zonal Border Area and west Berlin; the *Mezzogiorno*; and the areas eligible for the industrial development grant in France. Moreover, co-ordination was to be constituted by four principal aspects: a single ceiling for aid intensity; transparency; regional specificity; and the sectoral repercussions of regional aid. With respect to regional specificity, five principles were identified:

- that regional aids should not cover the whole national territory
- that regional aids should define, either geographically or by quantitative criteria, the boundaries of the areas benefiting from aid
- that regional aids must not be granted in a pinpoint manner
- that where problems of varying degrees occur, this must be reflected in different aid intensities
- and that the graduation and variation in rates must be clearly shown.

As noted earlier, the principles relating to area designation were not publicly enlarged upon until 1988, some 17 years later. Nevertheless, this apparently quiescent period saw the beginnings of major disputes between the Commission and the Member States. In the first half of this period, competition policy did not have a significant impact on assisted area coverage in the Member States. Indeed, the existing assisted areas of the Member States were taken as given and spatial coverage appears to have been uncontroversial. This changed significantly in the early 1980s. In Belgium, for example, the national authorities were subjected to a bruising encounter, the outcome of which was that the Commission virtually imposed its own map on the country. This came into effect in 1982 but substantial parts of it were subsequently subjected to review on a three-year basis. In the same period, the Danish government also experienced considerable difficulties in getting its map approved, even although it involved a significant cutback in coverage; again, the Commission made use of transitional provisions to approve the map only until a specified date.

During the course of the 1980s the role of DGIV in area designation became increasingly controversial and influential. Of particular note, the Commission made extensive use of transitional periods after which assisted areas would be dedesignated; as well as Belgium and Denmark, this approach was also used in the United Kingdom and Germany in the early 1980s. Similarly, in France, the Commission accepted, in

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<sup>19</sup> Council Resolution of 20 October 1971 on General Systems of Regional Aid, OJEC C 111; 4 November 1971.

1984, the map proposed some two years previously, but subject to some regions ceasing to qualify by 1985. The increasingly interventionist approach of the European Commission was widely resented by the Member States, not least because there was no published basis for its policies. Some countries appeared to be involved in endless disputes over assisted area maps. The problems were particularly acute in Germany where the map is subject to regular internal reviews; the Commission took advantage of the opportunity to reconsider the map at every notification. In France, too, there were protracted disagreements arising from changes to the map which took a number of years to resolve.

The extensive powers of the Commission and the arcane manner in which they were exercised contributed to an atmosphere of considerable suspicion and hostility. To some extent this was counter-productive; national policymakers were disinclined to discuss policy proposals in advance with DGIV and some simply took the decision to offer aid in particular areas without Commission approval rather than engage in long-running negotiations. At that time, the sanctions against unnotified aid were weaker; indeed, it could be argued that such aid was treated no more harshly by the Commission than schemes that were formally notified. Subsequent case law and Commission policy have changed this situation; in particular the Commission has indicated that it will consider issuing provisional decisions requiring repayment of aid, with interest, where procedural requirements are breached<sup>20</sup>. However, by the late 1980s, the Commission had anyway recognised that it required greater policy transparency and the active cooperation of the Member States if the system of monitoring and approving aids was to operate effectively. This was arguably the prime motivation behind the publication of the 1988 methodology.

### **3.3 The 1988 Communication: Moves to Policy Transparency**

With the publication of the 1988 methodology, the influence of the Commission over problem area designation entered a new phase. The more transparent approach diffused some of the resentment felt by Member States, but arguments shifted to the *substance* of the Commission's approach and policymakers were vocal in their criticisms. The concerns of the Member States centred on DGIV's handling of area designation and three issues in particular: first, the indicators utilised by DGIV and the way in which they were used; second, the territorial units adopted for area designation purposes; and last, the role of other, more qualitative factors (ie. the second stage of analysis - see Section 2.4) in the area designation process.

As far as the issue of indicators was concerned, there was widespread disquiet among the Member States that the Commission relied too heavily on quantitative indicators in area designation and was insufficiently willing to take account of geographical factors or specific circumstances. A long-running dispute between DGIV and the French authorities in the early 1990s provides a good illustration of the arguments espoused by many Member States. The issues arose from the Commission examination of the PAT assisted areas map undertaken as part of its regular review process. This resulted in the Commission proposing that substantial parts of the

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<sup>20</sup> Commission communication to the Member States, OJEC C 156; 22 June 1995.

French assisted areas map (notably large parts of western and south-western France) be dedesignated. This met with considerable opposition from the French authorities, mainly because the changes proposed were considered not take account of the nature of the French regional problem. One of the principal aims of French regional policy is to counter the domination of Paris and to support areas with a declining population. Such areas predominate in south-western France which the Commission proposed to dedesignate. However, the problems faced by such regions failed to show up in the measurements of unemployment and GDP per head used by the Commission.

The use of unemployment data for gauging regional problems in rural areas is frequently regarded as inappropriate since many such areas are characterised by strong out-migration trends. This often results in levels of unemployment that are below the national average but which reflect lack of local job opportunities rather than a buoyant local economy. Moreover, these migration patterns tend to contribute to higher rates of unemployment in urban areas, potentially exacerbating regional problems elsewhere. In the French context, the case for maintaining the designation of the rural areas concerned was not supported by recourse to GDP data either. Indeed, excluding the Paris region, disparities in GDP per head at NUTS III in France are not particularly wide. Overall, a strict application of DGIV's methodology would have led not only to the dedesignation of areas whose development the French authorities perceived to be an integral part of regional policy, but also the designation of areas which they did not seek and which would have been out of line with national regional policy priorities.

The second principal criticism of DGIV policy voiced by the Member States concerned the territorial units to which the indicators relate. There were a number of issues raised in this context. One problem stemmed from the widely-held view that the NUTS III region is too large an entity for the designation of industrial closure areas, mainly because the severity of problems in particular localities is camouflaged by the relative prosperity of surrounding areas. In Spain, for example, for a number of years the authorities sought the designation of the industrial belt to the south of Madrid as part of the solution to very severe, but localised, problems of unemployment. DGIV's refusal to consider evidence other than unemployment at NUTS III (and its rejection of proposals to designate the area) was the source of considerable frustration to the Spanish authorities.

Similar problems arise in relation to GDP per head at the regional level. GDP per head figures are frequently more of a reflection of the way in which regional accounts are constructed rather than of the genuine prosperity of an area. This is well-illustrated by the artificially high per capita GDP figures registered for Grampian (UK) and Groningen (Netherlands) as a consequence of the fact that income from offshore oil and gas extraction is attributed to those regions.

A further concern about the use of NUTS regions is their general unsuitability for area designation purposes and the lack of comparability across (and within) Member States. Many consider that NUTS regions are inappropriate for area designation purposes because they are administrative rather than economic units; as a result, they are not meaningful from a policy perspective (unlike, for example, labour market areas). A further problem with the NUTS categorisation is that there are massive differences in physical size, population and population density between regions

classed at the same NUTS level across the EC: NUTS III areas range from 10 km<sup>2</sup> (Spain) to 98,900 km<sup>2</sup> (Finland) with an EC15 average of 5,400 km<sup>2</sup>; NUTS III populations range from 17,000 (Germany) to 6.9 million (UK) with an EC15 average of 410,000. These figures undermine any notion that the Commission approach can involve genuine comparability across Member States<sup>21</sup>.

The third main criticism of the Commission's approach to area designation concerned DGIV's use of both qualitative and quantitative criteria and the scope for discretion on the part of the Commission. Neither the first nor the second stage of analysis set out above are necessarily conclusive as to whether an area merits designation; in addition, the 1988 Communication provides no guidance on how the factors mentioned for the second stage of analysis should be taken into account. This led many to consider that DGIV used the quantitative stage merely to construct an essentially spurious justification for decisions that were largely subjective and frequently the net result of extensive negotiations with Member States. This perception was heightened by the nature of discussions between national authorities and the Commission, which frequently involved considerable bargaining over the timing of decisions in relation to sensitive domestic or European events (notably elections and referenda) and the trading of concessions by both sides over particular issues. In many respects this criticism was perhaps the least sustainable of the three outlined here since the Member States clearly benefited from the fact that the Commission did not always stick rigidly to the methodology and many policymakers would have been yet more vocal in their complaints had the Commission done so.

The exposure of the methodology in the form of the 1988 Communication led to a shift in the balance of power between national policymakers, on the one hand, and DGIV on the other. National policymakers were now in a stronger position to justify their area designation proposals, frequently citing the arguments above in support of particular claims. The first stage of analysis, the quantitative element, provided a starting point for the Commission, but the second stage, the more qualitative element, enabled national policymakers to justify certain special cases, albeit with varying degrees of success; the Commission did not accept the designation of the southern industrial belt of Madrid, for example, but it did accept the inclusion of parts of London in the assisted areas map.

### **3.4 The 1990s: The Methodology Undermined?**

Commission awareness of Member State concerns coincided with two further developments in the early 1990s which, in turn, led to a further evolution in the relationship between competition policy and regional aid. The first resulted from the designation of areas for the purposes of the EC's own regional policy under the Structural Funds; the second involved a more flexible approach to the application of the 1988 methodology, based on the population coverage of assisted areas rather than a rigid application of the GDP per head and unemployment criteria.

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<sup>21</sup> For a fuller discussion see Wishlade F. and Yuill, D. (1997) *Measuring Disparities for Area Designation Purposes: Issues for the European Union*, Regional and Industrial Research Paper Series, 24, European Policies Research Centre, University of Strathclyde, Glasgow.

A key feature of the reform of the Structural Funds in 1988 was the designation of areas for the purposes of European Regional Development Fund intervention, independently of the national assisted area maps. As discussed in the previous chapter, a new typology of regions was devised and policy was targeted at designated Objective 1, 2 and 5b regions. For most Member States, this resulted in two different assisted areas maps: one for national regional policy and one for the Structural Funds. Overall some 37 percent of the EC population qualified for both national and EC regional policies, but almost 14 percent qualified for one or the other, but not both. The lack of coincidence between the maps became of practical relevance because of the emphasis placed on support for productive investment under the reformed Structural Funds; for this, financial incentives were a key instrument. Accordingly, it was agreed that the Structural Funds could be used to part-finance aid schemes implemented by the Member States under the Community Support Frameworks. However, the Structural Fund “Coordination” Regulation<sup>22</sup> required measures to “be in keeping with the provisions of the treaties, with the instruments adopted pursuant thereto and with Community policies, including those concerning the rules on competition”. Moreover, each of the Community Support Frameworks contained a standard clause to the effect that only aid notified and approved in accordance with Articles 92 and 93 could be considered for co-financing. These provisions brought EC competition policy and EC regional policy into direct conflict.

Initially discussions focused on the conceptual issue of whether in fact the two sets of maps should coincide completely. Subsequently, the priority was to find a compromise for the period until the expiry of the Community Support Frameworks (ie. until 1993) and to secure a solution for the next round of regional plans (ie. for the period 1994-99)<sup>23</sup>. From a competition policy perspective the impact of the dispute was two-fold: first, DGIV’s otherwise regular reviews of the assisted area maps of the Member States were, for the most part, suspended until the start of 1994; second, the Member States played a much greater role in area designation for the Structural Funds under the 1993 Regulation and, indirectly, gained more influence in their negotiations with DGIV over the national assisted area maps. This arose from the fact that it was largely up to Member States individually to decide whether, within their jurisdictions, the two sets of areas should coincide; DGIV had accepted, in principle, that Objective 1 and 2 areas would be approved for national regional policy purposes, where the Member State so desired.

The general controversy surrounding the Commission’s area designation methodology, coupled with the conflict over the coherence of the national and EC assisted areas maps, reawakened the debate on area designation systems within DGIV.

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<sup>22</sup> Council Regulation (EEC) No 2052/88 of June 1988 on the tasks of the Structural Funds and their effectiveness and on the coordination of their activities between themselves and with the operations of the European Investment Bank and the other existing financial instruments, OJEC No L 185; 15 July 1988.

<sup>23</sup> A detailed account of the debate and of solutions agreed is given in Yuill, D *et al* (1995) *European Regional Incentives 1995-96*, 15<sup>th</sup> Edition, Bowker Saur, London.

This is reflected in the Commission's 1993 mid-year review of competition policy<sup>24</sup> which stated that:

“In order to correct imbalances in the current method, the Commission asked the Services to propose a simplified method in order to provide the Member States with greater room for manoeuvre in designating the assisted areas within a global percentage of the population concerned and at the same time respecting the rules of transparency.”

Given these growing criticisms of the 1988 Communication, a mechanism to give the Member States more flexibility, while still restraining overall population coverage, had some attractions. Moreover, there was a precedent for this approach in the 1991 negotiations between the German authorities and the Commission. The timing of these negotiations meant that Commission pressure for a reassessment of the special status of the Zonal Border Area coincided with German reunification, as well as an internal review of area designation. Given the range of issues, it might have been expected that the discussions would have been even more difficult than usual; in practice, however, they were considerably less contentious than anticipated. In large measure, this is attributed to a more than usually flexible attitude on the part of the Commission, which stipulated a population coverage ceiling for west Germany (27 percent) and allowed the German authorities considerable freedom in designating areas within this limit; indeed, all the areas proposed were accepted by DGIV. DGIV was certainly well aware that Germany had already gone through a complex domestic designation process involving different levels of government and considerable political implications; recognition of this was a primary motivating factor in taking a different line.

Based on this experience, DGIV developed an internal (unpublished) methodology for setting population ceilings during the course of 1993-4. There were two stages to the methodology. First, DGIV decided on an “acceptable” level of coverage for Article 92(3)(c) areas as a proportion of the EC population; and, second, this quota was divided between countries on the basis of the national situation in relation to unemployment and GDP per head as compared to the Community average for areas not covered by Article 92(3)(a). In other words, the approach involved removing Article 92(3)(a) areas from the equation at the outset, both in relation to total population coverage and average levels of GDP per head and unemployment.

The population ceilings resulting from these calculations have generally been communicated individually to Member States as and when reviews of national assisted area maps have been undertaken; however, the “global” Article 92(3)(c) ceiling has not been made public, nor has the list of country ceilings that DGIV has arrived at. Moreover, it is clear that the ceilings initially proposed by DGIV are themselves the subject of negotiations with the Member States and are often revised as a result before the final map is agreed. As will be seen, the experience with the “population coverage” method laid the foundations for the new guidelines on regional aid which are currently under discussion.

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<sup>24</sup> CEC (1993) Competition Policy - Six Months of Commission Activities, Spokesman's Service of the European Communities; MEMO/93/20.

The accession negotiations with the Nordic countries further contributed to the erosion of the 1988 methodology. The three countries (including Norway) were able to exert a considerable influence over the European Commission's State aid rules. As noted earlier, the main issue was the fact that the types of regional problem faced by the Nordic countries are not ones common to the rest of the EC membership. Moreover, the Commission methodology for assessing area designation is based on quantitative criteria which fail to identify the presence of the type of problems the Nordic countries seek to address.

The difficulty for the Commission is that of operating in a Europe-wide environment that is extremely diverse and, consequently, of finding a system that can be applied across countries. Moreover, the Commission was doubtless keen not to set precedents that could result in higher assisted area coverage elsewhere in the EC or different types of incentive, notably operating aids, being sought by the existing Member States. The Commission's solution was to add a new designation criterion for which few, if any, regions outside the Nordic countries would qualify and to authorise operating aid, in the form of transport aid, only in these areas<sup>25</sup>.

This third phase in the relationship between competition policy and regional aid would appear to herald a significant weakening of Commission control over national assisted areas. In theory, the 1988 methodology remains in place; in practice, however, recent events have undermined it. The application of a population ceiling to development areas was intended to be a *supplement* to the existing approach, but instead appears to have *supplanted* it. On the other hand, the range of policy proposals currently being promoted by DGIV signals a determination on the part of the Commission to reassert its authority over the regional aid policies of the Member States.

## 4. RECENT DEVELOPMENTS

### 4.1 Introduction

The last eighteen months or so have been a highly active period in EC competition policymaking in relation to State aids. Moreover, a number of the developments impact very directly on the operation of the regional aid policies of the Member States. In particular, DGIV has progressed proposals to limit levels of assistance to large projects under regional aid programmes. In addition, new rules on regional aid which both consolidate and revise the approach to area designation are currently under discussion with the Member States. Perhaps most radically of all, the Commission has published proposals for a Council Regulation under Article 94, which would fundamentally alter the nature of the State aid authorisation process and the respective roles of the Commission and the national authorities in the field of State aid control. These developments are increasingly being referred to as the three "pillars" of the

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<sup>25</sup> For an overview of the impact of the rules on the new Member States and their impact on the rules see Wishlade, F. G. (1996) *European Regional Policy News: Competition Policy, Regional Aid and the New EU Member States Regions: The Newsletter of the Regional Studies Association*, No. 202, April 1996.

reform of State aid policy. The sections which follow consider these three aspects in turn. A subsequent section reviews some further developments which have implications for regional aids.

## 4.2 Monitoring and Controlling State Aid for Large Investment Projects

The authorisation of a regional aid scheme by the Commission provides, in effect, a block exemption from any claim that awards made under the notified scheme breach competition policy rules, on condition that such awards fall within the parameters approved and that proposed awards to so-called sensitive sectors<sup>26</sup> receive authorisation in advance of implementation. This has the advantage for the Commission of obviating the need for case-by-case scrutiny of aid proposals, as would otherwise be required by the Treaty. However, this “blanket” approach provides the Commission with no further scope to control subsidies offered under approved schemes.

For the Commission, the absence of any further scrutiny is potentially a matter of concern because the scale of assistance to firms can be extremely high and, although rates of award are limited by the percentage ceilings authorised by the Commission, the *volume* of assistance can be significant. This is particularly so for capital-intensive sectors which have the added perceived drawback of creating few jobs in relation to investment and aid. Related to this, although higher percentage ceilings are authorised in Article 92(3)(a) areas, these are typically located in, or cover the entire territory of, countries that are least able to afford to pay the maximum. In consequence, there tends to be a convergence in the *actual* rates of award offered in richer and poorer regions, in spite of wide differences in the authorised ceilings. Moreover, the Commission is also concerned that the less prosperous countries may expend considerable sums in competing against the wealthier Member States to attract mobile investment.

A second set of issues relates to sectoral concerns. As noted above, the approval of regional investment aids is subject to the proviso that special rules apply to awards to firms in specific sectors. The common themes of these frameworks are that the sectors concerned are considered to be in “overcapacity” and that all or specified awards must be notified individually for consideration by the European Commission. Beyond this, however, the frameworks diverge considerably. The Motor Vehicle Framework<sup>27</sup>, for example, requires only aid to investments exceeding ECU 17 million to be notified. In contrast, the Synthetic Fibres Code<sup>28</sup> makes no reference to size of project or level of award.

The sectoral rules also diverge considerably in substance and in the discretion afforded to the Commission. The Motor Vehicle Framework provides the basis for the Commission to evaluate the regional development benefits of aid against its possible adverse effects on the sector as a whole. The approach taken by the Commission

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<sup>26</sup> Steel, shipbuilding, synthetic fibres, motor vehicles.

<sup>27</sup> *Community Framework on State Aid to the Motor Vehicle Industry*, Official Journal of the European Communities No. C 123, 18.5.1989, as amended.

<sup>28</sup> *Code on Aid to the Synthetic Fibres Industry*, Official Journal of the European Communities No. C 94, 30.3.96.

involves undertaking a cost-benefit analysis with a view to identifying, and compensating for, the cost disadvantages of a problem region location<sup>29</sup>. In contrast, the Synthetic Fibres Code states that the “fundamental consideration is the effect of that aid on the markets for the relevant products”; in short, there is no explicit provision for balancing potential regional benefits against possible sectoral consequences.

In addition to the widely divergent nature of the frameworks themselves, there is also the issue of the sectors covered by the frameworks. There are two aspects to this question: on the one hand, is a sectoral approach appropriate at all? If so, are the sectors affected by frameworks appropriate? In other words, should more or fewer sectors be covered by specific guidelines? These issues have become of increasing importance as various sectors lobby for codes to be introduced to discipline subsidies for particular industries. They are also of significance in the context of assessments where there is no relevant sectoral framework but where an individual case needs to be appraised because it involves *ad hoc* or unnotified aid. As well as a desire to avoid a proliferation of sectoral codes, such issues have tended to reinforce moves towards a sectorally-neutral approach covering all large investment projects.

A further question is the extent to which notified cases should be assessed on an individual basis, as opposed to some “formula-based” method. The case-by-case approach presents two main problems for the Commission. First, it is extremely resource intensive and time-consuming in terms of DGIV staff and costly in the use of external consultants with sectoral expertise; and second, because of the discretionary nature of the decision, the case-by-case approach is more easily open to challenge by the potential beneficiary or by competitor firms, involving yet more Commission resources and reducing the legal certainty and transparency of outcomes. These drawbacks have made the development of an “objectively justifiable” approach an attractive option, if indeed such a solution can be found. It is against this background that DGIV and the Member States have been discussing proposals to limit aid to large investment projects.

Initial proposals on the part of the Commission focused on the issue of *aid to capital intensive projects*. Following the acceptance of a Commission Communication<sup>30</sup> on industrial policy, work began on devising rules to regulate incentives to projects involving high levels of investment in relation to job creation. Commission concern centred on two factors. First, it considered that the higher the capital investment in relation to job creation, to increased production capacity, or to value-added, then the greater the distortion of competition. Second, it took the view that incentives to highly capital-intensive projects did not contribute significantly to the objectives of the policies under which they were offered. Associated with this, it argued that assistance to capital-intensive projects resulted in a lower level of job creation overall than could be obtained with a more balanced distribution of government incentives.

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<sup>29</sup> Of course, problem region locations are not necessarily more costly.

<sup>30</sup> CEC (1990) *Industrial Policy in an Open and Competitive Environment: Guidelines for a Community Approach*, COM(90)556, 16 November 1990, Brussels.

According to the Communication “it is not so much the *quantity* of aid granted as the importance of the *differential* between existing aid schemes which acts as the spur for footloose industrial location” [emphases added]. It further argued that the poorer countries could make substantial budgetary savings if the appropriate differentials were maintained at a lower level.

Reflecting these issues, consideration was given to finding a method which would reduce the *value* of incentives without affecting maximum *rates* of award. The proposals made (details of which were not been made public) involved setting cost-per-job limits to investment eligible for incentives. This proved highly controversial and left Member States and different Directorates of the Commission deeply divided.

Certainly, there are a number of obvious problems with the approach. In particular, the Commission’s view that it is the rate differential and not the quantity of aid which is central to locational choice is questionable. In addition, such an approach would tend to discriminate between sectors; this could restrict aid where little or no distortion was involved in one sector, whilst leaving a less capital-intensive sector unaffected. Also, highly-capital intensive projects are sought after precisely because capital-intensity is often associated with high-value new technologies that can bring benefits to the problem regions; cost-per-job limits could reduce the value of the aid on offer to such projects in the problem regions, making such areas attractive only for labour-intensive, lower-technology activities. Further, a straight calculation based on jobs associated in the investing firm takes no account of indirect job creation or local linkages. There are also practical problems; incentive applicants consistently overestimate the number of jobs likely to be created. This approach would encourage that tendency, raising complicated issues for subsequent monitoring and possible repayment of incentive awards. Last, taking a wider view, there is the issue of whether such limits would make a European location less attractive in a global context.

As noted above, these proposals met with a mixed reaction. At the national level, for example, Spain and Germany were opposed to such regulation. In contrast, the United Kingdom government regarded “effective constraints on ‘subsidy auctions’ for internationally mobile investment projects” as a priority and claimed to be “pressing the Commission to adopt its proposal to limit aid for capital intensive projects”<sup>31</sup>. It is, incidentally, not surprising that the UK government should have taken this view, and this for several reasons. First, the main UK incentive offered to mobile projects is operated with internal cost-per-job limits; second, over the past decade, UK regional aid budgets have come under intense pressure; and third, the UK government of the day had a more free-market oriented stance than any other EC government, with the result that, unusually for the UK, it was frequently allied with the Commission on competition policy issues.

Having met with significant objections, the proposals to restrict support for capital-intensive projects have now been partially superseded by a series of drafts on aids for *large investment projects*, of which the most recent are referred to as the *multisectoral framework*. This title is indicative of the Commission’s original

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<sup>31</sup> HMSO (1994) *Competitiveness: Helping Business to Win*, Cm 2563, London.

intention that a new “horizontal” approach should eventually supersede some or all of the existing codes<sup>32</sup>.

The proposed multisectoral framework has not been made public and indeed, at the time of writing, is still under negotiation. Moreover, although the proposals grew out of initial plans for limiting aid to capital-intensive projects (and still contain an element of this in the approach) the framework has been through many iterations, reflecting the scale of the disagreement among Member States and the Commission, together with the different policy repercussions of the rules on different Member States. These factors prohibit a detailed discussion of the Commission’s current plans at this stage. However, in spite of the lack of published information, it is known that a combination of project size and aid value related thresholds will be used to determine whether an aid proposal should be subject to individual analysis. At the time of writing, the criteria triggering the requirement to notify were thought to be as follows:

1. Any aid to projects involving investments exceeding ECU 150 million

or

2. Aid to projects exceeding ECU 30 MECU where the level of aid is:

- either more than 50 percent of the regional aid ceiling for the area
- or more than ECU 50,000 per job

The subsequent analysis is intended to be “automatic”, that is, it would rely on published criteria related to factors such as regional impact, capital-labour ratios, project type and sectoral issues. Nevertheless, it has to be said that the quantification of factors such as market domination would, of necessity involve a degree of discretion on the part of the Commission. A methodology involving a combination and weighting of these factors would then be used to set an “appropriate” rate of award for the project in question. As with the thresholds that trigger notification, however, the proposed composition and combinations of these factors has been through many iterations.

The development of policy in this area has been a lengthy and controversial process and by summer 1997 negotiations between the Commission and the Member States were not complete. However, a recent press statement signals confidence on the part of Commissioner van Miert that DGIV will be ready in autumn 1997 formally to present to the Commission proposals for a multisectoral framework<sup>33</sup>.

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<sup>32</sup> The current Synthetic Fibres Code states that: “In principle, they [the aid rules for the synthetic fibres industry] will be abolished no later than six months after the date on which the planned horizontal framework on State aid in support of major investments comes into force.” However, the Commission now appears to be backtracking on this principle, following pressure from industry associations. Instead, the sectoral rules are likely to remain in place until the horizontal rules prove workable – see Schaub, A. (1997) European Competition Policy - In Particular Developments in Policy on State Aid Control, paper to CIRFS General Assembly, 14 May 1997, Brussels.

<sup>33</sup> “Mieux contrôler les aides d’Etat en les rendant plus transparentes pour les citoyens: la Commission propose une première étape dans la réforme” IP/97/661; 15 July 1997.

### 4.3 New Regional Aid Guidelines

As well as seeking to discipline aid to particularly large projects, the Commission has also been developing proposals to tighten the rules on regional investment aid generally. Like the multisectoral framework, the proposals are not yet in the public domain, nevertheless, the main lines of Commission policy are now emerging.

In terms of the overall approach to producing new policy guidelines, the preparation of the guidelines is strongly reminiscent of the development phase of the 1988 Communication on regional aids. At that time, it was disclosed that the Commission had, in fact, been applying the methodology described in the Communication since 1983. The current proposals for regional aid guidelines in part involve a consolidation and formalisation of the “population ceiling” approach to disciplining assisted area coverage under Article 92(3)(c) and first used in the 1991 negotiations of the German map; in other words, in some respects, the proposed guidelines are lagging considerably behind what has become established practice.

The initial proposal was made to the Member States early in 1996; this was revised during the course of the year and amended proposals submitted to the Member States for discussions at the multilateral meetings on State aids in the spring and summer of 1997. Although not yet published or agreed, it is known that the draft guidelines contain a number of important principles regarding assisted area coverage; area designation; eligible expenditure; and rates of award.

#### *Assisted Area Coverage*

With respect to assisted area coverage, the emphasis is, not surprisingly, on limiting the extent of coverage expressed as a proportion of the EC population. Current coverage approved under Articles 92(3)(a) and (c) amounts to some 47 percent of the population, with around 23 percent accounted for by Article 92(3)(a) areas.

Reflecting existing practice, the Commission does not propose any changes to the method for designating areas under Article 92(3)(a). The criteria would continue to be NUTS II regions where GDP/PPS per head is less than 75 percent of the EC average for the three most recent years for which data are available.

For Article 92(3)(c), a number principles are enunciated, some of which essentially formalise Commission practice of recent years. An EC-wide population ceiling for assisted areas would be set with the objective of limiting overall coverage. After the designation of Article 92(3)(a) areas, the Commission would divide the available Article 92(3)(c) “quota” between the Member States. The precise details of the mechanism to establish national population ceilings are still under discussion, but the essence of the methodology proposed is that the principles of the first stage of analysis under the 1988 methodology should be used to determine national quotas. In other words, whereas previously the method was used to select *eligible areas* themselves; under the revised method, it is used to set national assisted area population *coverage*.

In its Spring 1997 paper DGIV outlined proposals for dividing a notional Article 92(3)(c) coverage between the Member States. This was done on the basis of the coverage of regions which had the *potential* to be Article 92(3)(c) areas; these were

defined as areas which were not eligible for Article 92(3)(a) and where the unemployment rate was higher than the national level and GDP per head lower than the national level. The Spring 1997 proposals to establish assisted area ceilings would have resulted in radical changes for some Member States, as shown in Figure 4.

**Figure 4: Changes to Spatial Coverage under the First Population Ceiling Proposal**

	Current coverage			Spring 1997 method result		
	92.3.c	92.3.a	a + c	92.3.c	92.3.a	a + c
<b>Austria</b>	31.7	3.4	35.1	14.0	3.4	17.4
<b>Belgium</b>	35	0.0	35.0	27.8	0.0	27.8
<b>Germany</b>	20.4	17.7	38.1	16.3	17.7	34.0
<b>Denmark</b>	20.0	0.0	20.0	22.6	0.0	22.6
<b>Spain</b>	16.3	59.4	75.5	27.9	44.2	72.1
<b>France</b>	39.9	2.1	42.0	30.3	2.1	32.4
<b>Finland</b>	41.6	0.0	41.6	50.0	0.0	50.0
<b>Greece</b>	0.0	100.0	100.0	0.0	100.0	100.0
<b>Italy</b>	14.7	33.5	48.2	17.2	23.5	40.7
<b>Ireland</b>	0.0	100.0	100.0	50.0	0.0	50.0
<b>Luxembourg</b>	42.7	0.0	42.7	10.0	0.0	10.0
<b>Netherlands</b>	17.3	0.0	17.3	18.9	0.0	18.9
<b>Portugal</b>	0.0	100.0	100.0	9.4	66.6	76.0
<b>Sweden</b>	18.5	0.0	18.5	23.7	0.0	23.7
<b>UK</b>	35.2	5.3	40.5	27.3	2.5	29.3
<b>EC15</b>	23.9	23.0	46.9	23.0	17.6	40.6

Of particular note, coverage in Ireland and Austria would have been halved; the Luxembourg assisted areas would have fallen to less than a quarter of their current levels; and the Portuguese assisted areas would have declined by around a quarter. At the other end of the spectrum, under the method used, coverage in Denmark, Finland, the Netherlands and Sweden would have increased.

This outcome was clearly unsatisfactory to a number of Member States and bilateral representations were made during the course of June 1997 by a number of countries. This culminated in a revised version of the methodology involving an approach based on the first stage of the 1988 area designation methodology. A number of further principles were added in order to reduce the immediate impact of the new methodology, whilst retaining overall discipline. In particular:

- the coverage for each country is adjusted so that total EC coverage does not exceed 40 percent (Articles 92(3)(a) and (c) together)
- each country has an Article 92(3)(c) assisted area “floor” of 10 percent of the non-Article 92(3)(a) areas and a ceiling of 40 percent
- any increase in coverage over the current period suggested by the method is prohibited

- any reduction in the previous coverage is limited to 25 percent of the previous coverage
- any areas that cease to qualify for Article 92(3)(a) qualify for Article 92(3)(c).

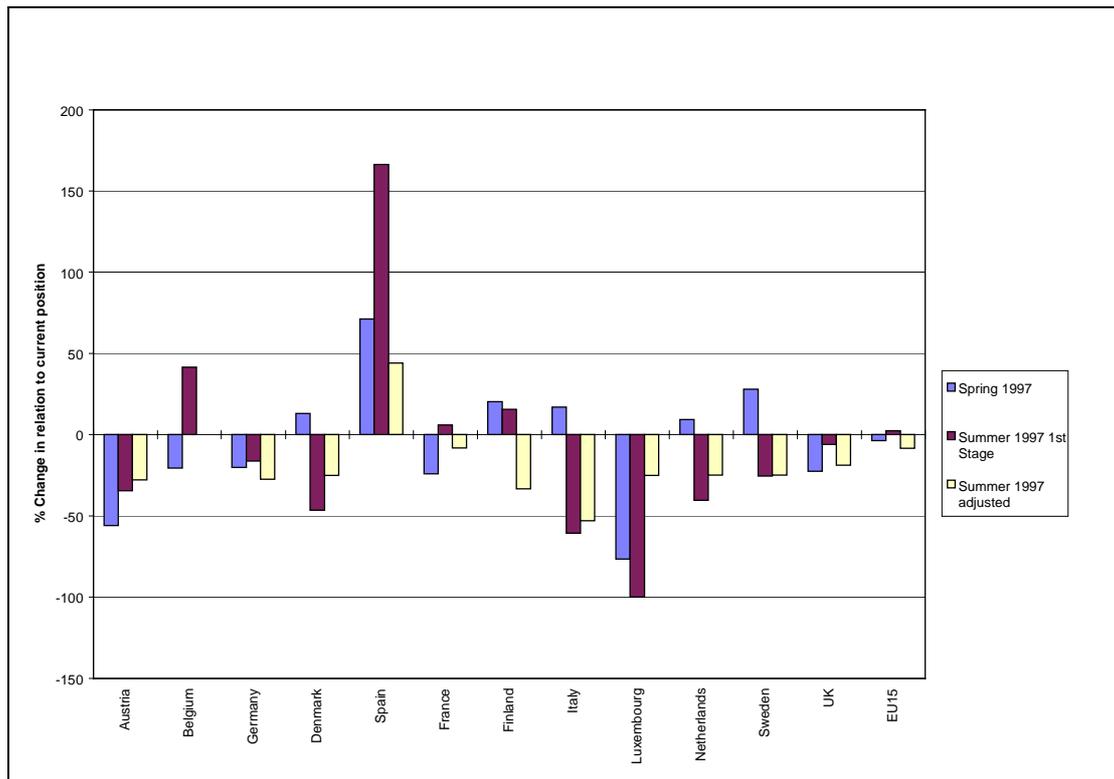
The coverage proposed using the revised methodology supplemented by these principles is included in Figure 5. Figure 5 shows this coverage alongside the current position, the Spring 1997 outcome and the outcome that results from a “straight” application of the methodology - that is, before the various adjustments outlined above are made.

**Figure 5: The Evolution of Spatial Coverage Proposals under Article 92(3)(c)**

	<b>Current coverage</b>	<b>Spring 1997</b>	<b>Summer 1997 1<sup>st</sup> Stage</b>	<b>Summer 1997 Adjusted</b>
<b>Austria</b>	31.7	14.0	20.8	22.9
<b>Belgium</b>	35.0	27.8	49.5	35.0
<b>Germany</b>	20.4	16.3	17.1	14.8
<b>Denmark</b>	20.0	22.6	10.7	15.0
<b>Spain</b>	16.3	27.9	43.4	23.5
<b>France</b>	39.9	30.3	42.3	36.6
<b>Finland</b>	41.6	50.0	48.1	27.7
<b>Greece</b>	0.0	0.0	0.0	0.0
<b>Italy</b>	14.7	17.2	5.8	6.9
<b>Ireland</b>	0.0	50.0	0.0	100.0
<b>Luxembourg</b>	42.7	10.0	0.0	32.0
<b>Netherlands</b>	17.3	18.9	10.3	13.0
<b>Portugal</b>	0.0	9.4	0.0	33.4
<b>Sweden</b>	18.5	23.7	13.8	13.9
<b>UK</b>	35.2	27.3	33.1	28.6
<b>EC15</b>	23.9	23.0	24.5	21.9

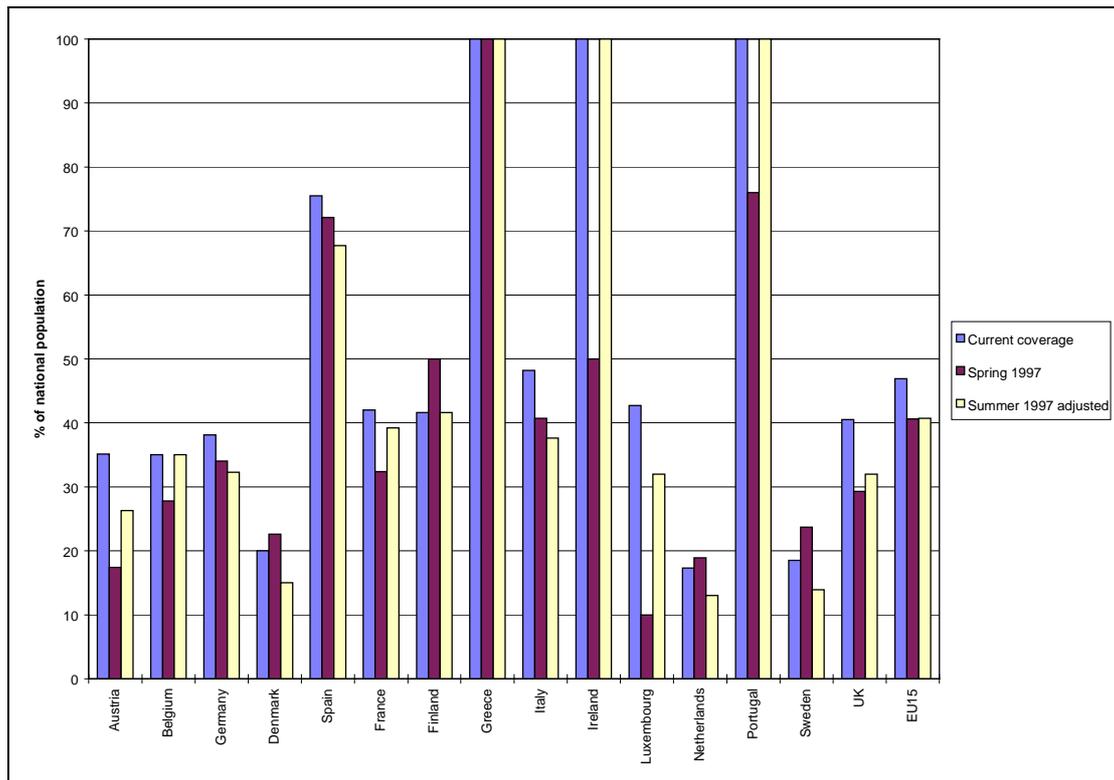
The differences in outcomes between Member States, and between methodologies, is dramatic. Although overall the Commission’s desired aim of reducing Article 92(3)(c) coverage is achieved, there are wild variations in the extent to which that reduction is borne by different Member States under the different methodologies.

Moreover, it could be argued that the differences in the results are so wide as to discredit *all* of the methodologies! The absence of any identifiable trend in the impact that the different methodologies have on coverage is reflected in Chart 1. This shows the percentage change in Article 92(3)(c) coverage in relation to the current position, according to the method used.

**Chart 1: Changes in Article 92(3)(c) Population Coverage by Methodology**

Not only is there no identifiable trend, but in a number of cases, the different methodologies produce quite contrary results, even although they purport to be assessing the same thing. In Belgium, for example, the Spring 1997 methodology produces a reduction in Article 92(3)(c) coverage of over 20 percent of the present coverage but the summer 1997 method (1<sup>st</sup> stage) would imply an *increase* in coverage of over 40 percent; judiciously, the subsequent adjustments (which, it will be recalled, do not permit an increase in coverage even if the methodology suggests it) result in no change in coverage for Belgium. Similarly, Italy would gain 17 percent in Article 92(3)(c) coverage if the Spring 1997 method were used, but lose 53 percent of its coverage under the adjusted Summer 1997 method.

Although no changes to the Article 92(3)(a) methodology are proposed, under a strict application of the methodology there would be a number of amendments to the coverage of areas eligible for support as a consequence of changes in regional disparities. In particular, all of the Republic of Ireland, the Lisbon region, and a number of Spanish and Italian regions would lose Article 92(3)(a) status. Under the most recent methodology, these regions would qualify under Article 92(3)(c), at least for a transitional period, irrespective of whether they reached the relevant threshold.

**Chart 2: Changes in Total Assisted Area Coverage by Methodology**

The current and proposed coverage of Article 92(3)(a) and (c) areas is illustrated in Chart 2. Over the summer of 1997, Member States had the opportunity to comment on the revised method; it is not clear what further changes DGIV might have made as a consequence of these representations. However, at the time of writing, it is thought that a proposal from Commissioner van Miert to the college of Commissioners is imminent.

### *Area Designation*

A key change in the proposal currently under preparation is that the 1988 methodology has a role in determining the population coverage of the assisted areas for Article 92(3)(c) (as described above) but not in the actual selection of those areas.

Under the proposal the formalisation of the population ceiling approach would be complemented by more flexibility for the Member States in area designation within the population ceiling set. However, this apparent flexibility would be limited by a number of important factors:

- although units other than NUTS III can be used in justified circumstances, the same unit must be used for *all* the indicators employed in the area designation process
- designated area units must contain at least 100,000 inhabitants; in general, any unit containing fewer than 100,000 population would be deemed to contain this number for the purposes of calculating the population coverage

- regions must be selected on the basis of “scientific” methodologies presented in a clear and detailed manner suitable for Commission verification
- the analysis must involve a ranking of areas on the basis of a maximum of five indicators (including combinations of indicators) using reliable statistical sources for which at least five-year time series are available; the ranking can be supplemented by qualitative inputs
- assisted areas must display “significant” disparities (at least 15 percent) in relation to the national average for the indicator chosen
- subject to the population ceiling, areas meeting Structural Fund criteria may also be included in the national assisted areas map with a view to improving coherence.

Although greater flexibility for the Member States is proposed, the above conditions involve significant constraints on the area designation process. Insistence on the use of the same territorial unit for all indicators is likely to be problematic. In many countries labour market areas are used for measuring employment-related trends; other indicators are not always available at this level. The imputation of 100,000 inhabitants to areas containing less than this figure, together with the general emphasis on the use of NUTS III regions limits what Member States can do. The emphasis on quantitative systems of area designation is at odds with traditions in many Member States. Last, and of crucial importance for the Structural Funds, DGIV’s proposals tie Structural Fund areas to the NUTS III and 100,000 population rule if Member States wish Structural Fund assisted areas to qualify for national policy.

#### *Eligible Expenditure*

With respect to eligible expenditure, the main change proposed concerns the extension of the definition of eligible expenditure to include a proportion of intangible assets. There is some precedent for this in the Framework on Aids to SMEs<sup>34</sup>. The obvious concern in the context of larger firms, with plants within and outside assisted areas, is that intangible assets (such as licences, patents etc.) purchased with the support of regional aid could readily be used outwith plants located in designated regions; this is clearly less problematic in the case of fixed assets. Nevertheless, it could be argued this provision is of limited importance since the fixed asset base is used for determining the ceiling on aid and Member States can already, in effect, assist intangible assets, provided that overall levels of aid do not exceed the given percentage of fixed asset expenditure. In this context, it is interesting that a number of countries now exclude land from eligible expenditure. More fundamental, perhaps, are proposals to shift the balance between capital and labour costs by enabling assistance to take the form of a wage subsidy over a period of two years. These proposed changes suggest attempts to bring the control of regional aids into line with wider policy objectives expressed in terms of competitiveness and employment:

“There should... be a review of the criteria governing the admissibility of aid to industry, which, under most existing schemes, encourages firms to increase

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<sup>34</sup> OJEC C 213; 23 July 1996.

the capital intensity of production and to boost their physical as opposed to their non-physical investment in order to improve productive efficiency. The aim should be to take fuller account of the creation of value-added and the non-physical content of growth”<sup>35</sup>.

### *Rates of Award*

As far as rates of award are concerned, the new guidelines propose to follow recent trends in reducing aid intensity ceilings. The proposals are summarised in Figure 6.

**Figure 6: Proposed Rates of Award under the New Regional Aid Guidelines**

<b>Assisted Area Type</b>	<b>Maximum Rate of Award</b>
Article 92(3)(a): very peripheral areas	65 percent
Article 92(3)(a): standard	50 percent
Article 92(3)(a): GDP > 60% of EC average	40 percent
Article 92(3)(c): low population density areas	30 percent
Article 92(3)(c): standard	20 percent
Article 92(3)(c): GDP > than EC average and unemployment < than EC average	10 percent

In general, award maxima in Article 92(3)(a) areas would be reduced to a net grant-equivalent of 50 percent; this would be raised to 65 percent for very peripheral areas, but lowered to 40 percent where GDP per head exceeded 60 percent of the EC average. Until recently, a ceiling of 75 percent net grant-equivalent has been widespread, although not universal, in Article 92(3)(a) areas.

The standard ceiling in Article 92(3)(c) areas would be 20 percent net grant-equivalent; a higher ceiling of 30 percent would apply to areas designated on the basis of low population density. Significantly, a lower ceiling of 10 percent would apply to Article 92(3)(c) areas where the unemployment rate is lower and the level of GDP per head higher than the EC average. Until now the standard Article 92(3)(c) ceiling has been 30 percent net grant-equivalent, although as the earlier discussion showed, there have been wide variations in the actual ceilings set.

These are important proposals. It was noted earlier that Commission limits on aid intensity tended not to constrain policymakers in making award offers. If the limits outlined above are agreed, this seems likely to change in the future. In particular, these proposals need to be read in conjunction with Commission plans to reduce levels of award to large projects under the Multisectoral Framework. As already discussed, this would involve reducing rates of award to significant projects, based on an analysis of competition, sectoral and other factors. If the maximum award available were 10 percent of eligible expenditure, then any proposed award exceeding 5 percent of eligible expenditure would need to be notified individually for projects exceeding the investment threshold. One might anyway question the attractiveness of a maximum 10

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<sup>35</sup> CEC (1993) Growth, Competitiveness and Employment, White Paper, OOEPEC, Brussels.

percent award rate as an incentive to locate in a problem region; the prospect of further controls and reductions could erode the value of regional aids completely.

#### 4.4 Article 94 Regulation

In general terms, the most significant new development concerns Commission proposals for a Regulation based on Article 94. Article 94 provides that:

“The Council, acting by a qualified majority on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 92 and 93 and may in particular determine the conditions in which Article 93(3) shall apply and the categories of aid exempted from this procedure.”

The essence of this is that the Council can limit the scope of Articles 92 and 93 and establish procedural rules with respect to State aid monitoring. For example it could decide that certain categories of measure are not caught by Article 92 or that they need not be subject to the notification requirements outlined in Article 93.

In practice, apart from in the transport sector, no regulations have been made on the basis of Article 94. Early proposals to do so in the 1960s and 1970s floundered; instead, the Commission proceeded by way of issuing guidelines, frameworks and communications in areas such as support for SMEs, R&D aid and support for environmental protection. These are essentially intended to clarify Commission policy and provide guidance for national authorities on how aids of a particular type will be assessed when notified. However, conformity of a proposed aid measure with the relevant guideline does not obviate the need for notification. A largely inevitable consequence of the publication of guidelines is that national policymakers have become increasingly mindful of Commission policy in designing new aid policies. This, in turn, has meant that a very high proportion of aids notified (which run to between 500 and 800 cases annually) can essentially be approved through a “rubber stamping” exercise, since they conform with advertised Commission policy. Indeed, many national policymakers would be loath to notify schemes that were out of line with the relevant guidelines. Nevertheless, the administrative demands of handling the bureaucratic requirements are considerable, drawing Commission resources away from what it perceives to be the most important cases.

Reflecting concerns at this, and at the administrative burden on the Member States, the conclusions of the 1996 Irish Presidency of the European Council charged the Commission with drafting a Regulation on the basis of Article 94; the proposal was published in summer 1997<sup>36</sup>.

The Commission proposal raises a very wide range of legal, policy and practical issues. In particular, the Commission proposes to give *itself* the competence to make Regulations in the field of State aid, under the terms of the Council Regulation. In

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<sup>36</sup> Proposal for Council Regulation (EC) on the Application of Article 92 and 93 of the EC Treaty to Certain Categories of Horizontal State Aid, COM(97)396 final, 15 July 1997, Brussels.

addition, the legal force of what are currently guidelines would be changed radically, as would the roles of national authorities and courts. However, these issues lie outside the scope of this paper.

From a policy perspective, the essence of the proposal is that measures that conform with specified Regulations would effectively qualify for a “group exemption” and would not be subject to notification to, and prior approval by, the Commission. The proposal cites various categories of aid which the Commission can declare compatible with the common market. These include “aid respecting the map approved by the Commission for each Member State to implement regional aid”.

At present the full implications of the proposed Regulation are unclear. Nevertheless, there is a precedent for national authorities taking a role in assessing the compliance of State aids with the EC rules. Under the Europe Agreements the Association countries of central and eastern Europe effectively adopt the *acquis communautaire* in the sphere of competition policy and State aids. However, whilst there are provisions for co-operation and consultation on the rules, it is the appointed *national* monitoring authorities which have the jurisdiction to assess whether a given measure complies with Article 92 criteria.

#### 4.5 Other Recent Developments

The three proposals described in the preceding sections will, if agreed, bring about major changes to the substance and procedure of EC State aid policy. In addition, however, recent months have seen the introduction of a number of developments of particular relevance to regional aid policies and other spatially-targeted schemes.

First, the Commission has issued guidelines on aid to firms in *urban areas*<sup>37</sup>. The development of policy in this area had been announced in the context of Commission approval of a package of French urban policy measures<sup>38</sup> and against a background of growing concern at issues of “social exclusion” in many European cities.

The guidelines on urban aid explicitly recognise that there were no appropriate rules on public aid for urban problems. In particular, the use of NUTS III units for area designation does not allow for fine delineation of areas and poor urban districts are typically part of conurbations where levels of GDP per head exceed the Article 92(3)(c) qualifying threshold. In short, the regional aid guidelines fail to capture the nature of the urban problem. The SME aid guidelines provide scope for small firms to receive assistance throughout the EC; however, lack of Article 92(3)(c) status means that poor urban areas are treated in the same way as non-assisted areas, whilst SME aid in assisted areas can reach higher aid levels.

In the light of this, the Commission proposes that support which meets specified criteria in relation to assisted areas and beneficiaries will either not be liable to affect

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<sup>37</sup> Guidelines on State aid for undertakings in deprived urban areas, OJEC C 146; 15 May 1997.

<sup>38</sup> State Aid France: Commission gives go-ahead for “city pact” aimed at assisting 300,000 persons living in some 35 “high risk” neighbourhoods, IP/96/267; 27 March 1996.

trade, and therefore not constitute aid, or where it does contain an aid element, it may be considered compatible with the common market.

In order to be eligible, areas must be geographically identifiable and homogenous. They must have a population of 10,000 to 30,000 and belong to cities of at least 100,000 inhabitants. In addition, socio-economic statistics for the area must be significantly worse than the national average and the agglomeration to which the area belongs. The guidelines provide an illustrative list of indicators, which include levels of youth unemployment, *per capita* wealth, etc. As an alternative, areas qualifying for the URBAN Community Initiative would also be eligible. At a national level, assisted area coverage is restricted to one percent of the population.

With respect to beneficiaries, aid to small firms<sup>39</sup> engaged in activities which essentially supply the local market (these are listed in an annex) is considered to fall outside the scope of Article 92(1). Other activities are considered to be caught by Article 92. Within the context of the framework, an undertaking (which must meet the small firm definition) must carry on its principal activity in the assisted area (ie. not merely register an office address there) and must reserve at least 20 percent of the new jobs created for people resident in the assisted area. The maximum rate of award is set at 26 percent net grant-equivalent or 10,000 ECU per job created.

Overall, the introduction of these urban aid guidelines does not involve a major shift in policy – under the SME guidelines, small firms could anyway receive 15 percent (gross) of eligible investment. It is difficult to imagine that the increase proposed under these guidelines, with the stringent conditions attached, will radically alter the economic development potential of Europe's deprived urban areas; in any event, it seems unlikely that the State aid rules have been a very real constraint on urban development policy. On the other hand, the guidelines are interesting in that they reveal how difficult it is to devise rules to cover a range of spatial development eventualities in a equitable manner. By way of example, it is interesting that France operates an incentive to encourage relocation outside the Paris region, at the same time as the new urban policy mentioned above; in contrast, the UK operates its main regional incentive, Regional Selective Assistance in parts of the London area, while also operating a distinct urban policy, which in budget terms rivals UK regional policy. The increasing range and variety of spatial problems evident in western Europe will not facilitate the application of the Commission's proposed new regional aid guidelines.

The second development of note is that the Commission has published a Communication on the *sale of land by public authorities*<sup>40</sup>. This seeks to set out the circumstances in which the Commission will consider that aid is not involved in such transactions and requires Member States to notify the following two types of transaction (without prejudice to the *de minimis* rule)<sup>41</sup>: first, any sale not concluded

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<sup>39</sup> As defined in the SME framework.

<sup>40</sup> Commission Communication on state Aid Element in Sales of Land and Buildings by Public Authorities, OJEC C 209; 10 July 1997.

<sup>41</sup> OJEC No. 68; 6 March 1996. This notice effectively sets a threshold below which Article 92(1) can be said not to apply.

on the basis of an open and unconditional bidding procedure honouring the best or only bid; and second, any sale that, in the absence of such procedures, was at less than the market value as established by independent valuers. The decision to issue these guidelines reflects the fact that the Commission has, on a number of occasions, investigated sales of publicly-owned land; the stated aim of the guidelines is to increase the transparency of the Commission's approach to such transactions and thereby reduce the number of cases to be examined. At this juncture, it is unclear what the impact of the guidelines will be; however, it seems probable that they will impact most on subnational authorities which are often involved in assembling "packages" of support for incoming investors.

Finally, the Commission is proposing to amend the *Motor Vehicle Framework*<sup>42</sup> with effect from the start of next year. There are several interesting features about the modifications proposed. First, the project size threshold beyond which aided investments must be notified is raised from ECU 17 million to ECU 50 million; on the other hand, there is an alternative notification threshold of aid over ECU 5 million. Second, the scope of the Framework is broadened considerably; it is now set to include first-tier component suppliers producing modules or subsystems where these are produced in the car manufacturer's plant or on one or more industrial sites in the vicinity. Last, the context for the cost-benefit analysis which lies at the heart of the examination of individual cases under the Framework is to be changed. At present, the method involves comparing costs in a proposed problem region location with those in a non-assisted area. Under the new proposals, the comparator location could be in the European Economic Area, in the central or eastern European countries, in Slovenia or the Baltic countries or, in some cases, on another continent.

## 5. ISSUES FOR THE POLICY AGENDA

This paper has reviewed the main policy trends in the competition policy control of regional aid and its influence on the policies of the Member States. Policy has shifted significantly over time and has impacted differently on different countries. In some respects, DGIV has been highly influential; in virtually all the Member States, the mainstay of the regional incentive package is a grant related to initial investment and job creation. Other aspects of competition policy scarcely bite; few countries regularly reach the award ceilings set by the Commission, making these limits, and the differentials established between different assisted areas, of only theoretical interest. It is in the area of spatial coverage that most activity has taken place and most controversy has arisen. Over time, however, the Commission appears to have found it increasingly difficult to maintain discipline over spatial coverage. There are a number of reasons for this. The 1988 methodology has been progressively eroded by the impact of the dispute over differences with the Structural Funds map and by the application of the population coverage approach (but without sufficient controls). These two factors conspired to undermine the discipline on spatial coverage that DGIV had sought to impose. In addition, enlargement of the Community has further increased the heterogeneity of its membership. In this environment, DGIV has found it

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<sup>42</sup> Community Framework for State Aid to the Motor Vehicle Industry, OJEC No. C 279; 15 September 1997.

increasingly difficult to design and implement systems for the discipline of assisted area coverage that take account of all the legitimate regional development concerns of the Member States. This is amply illustrated by the negotiations with the Nordic countries over membership and their impact on the 1988 methodology.

The new proposals under discussion signal a toughening of competition policymaker attitudes to regional aids. If put into effect, they would arguably reverse recent trends. There would be more flexibility in area designation, in some respects, but the basis for designation would require adequate justification on the part of the Member State. In addition, whereas, until now, award maxima have tended not to constrain policymakers, the levels currently being proposed are likely to prove a consideration, especially where assistance from several sources may be available in combination. Moreover, the new regional aid framework needs to be seen in conjunction with the proposed multisectoral framework. The combination of lower award ceilings to begin with, followed by a systematic reduction in the rate of award for certain large projects will almost certainly reduce award maxima to a level where they do bite.

These developments and the changing environment within which competition policy must operate raise important issues for the Commission and the Member States alike. Against the background of the new controls, Member States must consider what kind of regional aid policies they can implement and whether their policy objectives can more readily be achieved by other means. At the same time, the emphasis on the coherence of national and EC policy maps seems set to put the relationship between national and EC policies back on the agenda. Last, the positive opinions on the enlargement negotiations with five countries raises the prospect of expansion to include countries that are significantly poorer than all of the current membership. This final section considers some of these issues.

**The proposed new regional aid guidelines purport to give the Member States greater flexibility in designating assisted areas, within the limit of a population ceiling agreed with the Commission. Can “sensible” maps be produced within the constraints of the new framework?**

The new regional aid guidelines appear to give the Member States considerably more freedom in designating assisted areas within an agreed population ceiling. In practice, however, there are considerable constraints imposed in terms of *how* areas should be selected. In particular, unless otherwise justified, NUTS III units must be used as the basis of analysis. It is worth recalling here that, far from being a comparable unit across the Community, NUTS III units vary enormously in area and population. Whilst the average population is 410,000 inhabitants, actual populations range from just 17,000 to almost 7 million. Moreover, it is unclear from the guidelines how the requirement to designate on the basis of NUTS III squares with the further requirement to designate minimum population “blocks” of 100,000 inhabitants. In all of the EC countries except Ireland and Luxembourg, the smallest NUTS III regions contain considerably fewer than 100,000 inhabitants. Conversely the largest NUTS III regions in each country typically contain over 1 million inhabitants.

An additional constraint flows from the fact that the same territorial unit of analysis must be used throughout the designation process. This is likely to prove difficult for some Member States; moreover, many would argue that the same unit of analysis is

inappropriate for different types of indicator. The new regional aid guidelines also propose to dictate the *style* of the area designation process, which must be scientific and capable of verification by the Commission. As earlier research for the Sponsors showed, there is a wide variety of approaches to area designation at the national level so the imposition of what amounts to a relatively tight model with few options for policymakers will be a new experience for some countries.

Unlike the 1988 Communication, the new guidelines do not dictate the indicators as such; however, they do specify that they must be reliable, quantifiable, relevant to the analysis of regional socio-economic problems and available for a minimum five-year time series. By implication, they must also be available at NUTS III. More than this, a maximum of five indicators may be used and, in order to be designated, regions must display a minimum 15 percent disparity on one or other indicator in order to qualify.

It is unclear what kind of role the Commission will allow to qualitative analyses in the designation process. However, it seems likely that a strict application of the quantitative criteria will produce solutions that are close to a rigid interpretation of the 1988 methodology, if only because of data availability. This may prove to be an astute solution on the part of DGIV; it will simultaneously shift responsibility for area designation onto the Member States and cease to be the scapegoat for domestic resentment at changes whilst imposing strict limits on Member States' room for manoeuvre.

**The new regional aid framework significantly reduces maximum rates of award. Coupled with the proposed multisectoral framework, could these controls completely erode the attractiveness of regional aids to firms?**

This paper has suggested that Commission controls on rate of award ceilings have not mattered too much in the past. Certainly, many Member States regional aid policies do not systematically, if ever attain the authorised ceilings (although local level assistance may "top-up" national regional aid). The current proposals on regional aids would change this. The impact of the proposed changes will be most felt in the northern, more prosperous Member States where typical award maxima would be reduced to a net grant-equivalent of 20 or even 10 percent of eligible expenditure. The impact of this reduction would be compounded by the effects of the multisectoral framework. This would require all aid proposals to very large projects and all significant aid proposals to large projects to be notified and approved individually. However, the Commission's review process will not necessarily leave the proposed level of award untouched; a series of factors related to competition and sectoral issues will be used and may result in the aid proposal being down-graded.

There are two possible effects of this process of downgrading award values and subjecting large projects to individual analysis. First, it may reduce the value of regional aids to the extent that they lose their attractiveness to investors; in other words, the value of the aid may not be considered adequate to offset the perceived disadvantages of a problem region location. Second, and related, it may lead to higher "windfall gains" for large projects in the problem regions. This is because firms would be aware of the fact that the level of award proposed might subsequently be reduced by the Commission and, unless they were genuinely willing to reconsider their location decision in the event of a reduction, they would discount the value of the aid

early on. A wider issue is the extent to which such stringent controls might affect the attractiveness of Europe as a whole as a destination for mobile projects; no other trade block or jurisdiction is subject to the same degree of subsidy discipline as the European Community and individual States and cities in north America are quick to assemble attractive incentive packages to compete with European locations.

More generally, one might argue that the degree of downward pressure on assisted areas and rates of award may be counter-productive. Many national policymakers have expressed their exasperation at the detailed nature of Commission intervention in regional aid policies whilst pointing to the range of fiscal and other factors that fall outside Article 92, but which still distort competition between the Member States. This complaint comes at a time when a number of countries have expressed increasing concern about tax competition and fiscal degradation. These issues fall within the remit of different Directorates-General, but the Commission will need to co-ordinate its activities carefully if pressure on one type of policy is not simply to result in distortions in another.

**In recent years, DGIV has tended to come off “third best” in its triangle of area designation disputes with the Member States and DGXVI over the coherence of national and Structural fund maps. Does the new framework suggest that DGIV may be regaining the upper hand?**

The dispute between DGIV and DGXVI over the coverage and coincidence of the national and EC maps was been documented in past reports to Sponsors. On balance, DGIV came off worst in what was essentially a triangular dispute. The hasty compromise early in the 1989-93 Community Support Frameworks effectively suspended DGIV reviews of national assisted area maps until the end of 1993. By this time, the new Structural Fund maps had been devised with a significant role accorded to *national* priorities, policies and indicators. Moreover, the political commitment to achieving coherence made it difficult for DGIV to question the eligibility of areas under national regional policy if they had already been designated for the Structural Funds.

The proposed new regional aid framework signals DGIV’s determination not to allow a repeat of the dilution of its approach. It indicates that areas eligible for the Structural Fund may be included in the Article 92(3)(c) areas proposed by the Member States. However, such areas would be included within the national population quotas and would be subject to the rules with respect to area delimitation; in other words, the basic unit would be NUTS III and the requirement to designate blocks of 100,000 population would remain.

A further consideration for many Member States is how eligibility for national regional policy might impact on eligibility for the Structural Funds. The criteria for Objective 1 and Article 92(3)(a) are essentially the same, but neither has ever been applied strictly. However, Agenda 2000 makes a clear commitment to complete congruence of Objective 1 and Article 92(3)(a) areas whilst also saying that the criteria for Objective 1 *will* be applied strictly.

In any event, achieving coherence of the maps is likely to prove difficult. Agenda 2000 proposes Structural Fund coverage of 35 to 40 percent for EC15 from the year

2000 and notes that “this figure will be smaller than the population covered by Article 92(3)(a) and (c), which should also be reduced from 1 January 2000”. The implication of the new regional aid framework is that total national aid coverage from the start of the year 2000 would be 40.7 percent of the EC 15 population. However, not all Member States share the view that the maps need to coincide. Moreover, in past Structural Fund negotiations, area designation has been a very contentious process which has consistently led to higher levels of assisted area coverage than originally proposed. If the present aim is to reduce national assisted area coverage to 40.7 percent, there is little room for manoeuvre if the Structural Fund areas overshoot their present targets.

**EC enlargement to embrace six further Member States will add significantly to the EC population, but not to its prosperity. For the existing Member States the ratchet effect of the use of EC averages and population ceilings would exclude significant areas from eligibility.**

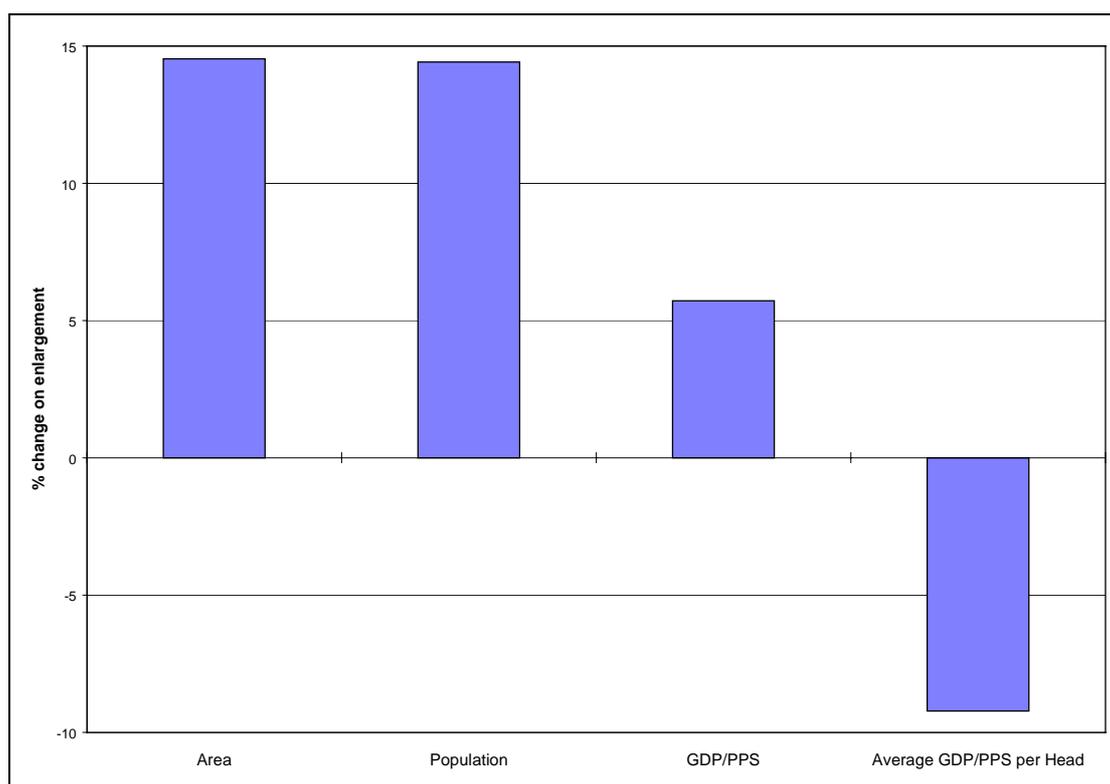
Aside from the implications of the current review of the regional aid rules, competition policy still faces formidable challenges in the future. The recent positive Commission opinions on starting EC accession negotiations with Poland, Hungary, the Czech Republic, Estonia and Slovenia raise the prospect of enlargement to include countries that are very significantly poorer than all of the existing membership. The repercussions of this are significant for the regional aid policies of the existing Member States since much of the Commission methodology defines assisted areas with reference to EC averages. Indeed, the Commission itself recognises that:

“some assisted areas in the present Member States could be crowded-out as a result of the overall increase in eligible areas, and as a consequence of the mechanical effect of enlargement on average EC per capita GDP”<sup>43</sup>.

It is worth recalling here some basic data about enlargement. The proposed five new central and eastern European Members would add some 63 million to the EC population, making this enlargement the single biggest expansion of the Community in absolute terms. Importantly, however, the increase in GDP is very small indeed, resulting in a decrease in GDP per head following enlargement.

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<sup>43</sup> CEC (1997) Agenda 2000: For a stronger and wider Europe, COM(97)2000, 15 July 1997, Brussels.

**Chart 3: The Impact of Enlargement on Basic EC Indicators**

**Note:** Figures refer to the change in EC data assuming expansion to include Hungary, Poland, Estonia, the Czech Republic and Slovenia. The analysis is essentially static in the sense that 1995 data are used to relate indicators for the applicant countries to those of the current membership for the same year; it takes no account of possible future trends.

**Source:** Calculated from Agenda 2000.

In terms of the impact on national assisted area authorisation, it has long been established that Article 92(3)(a) is intended to be reserved for areas that are disadvantaged in relation to the EC average. Regional level data in the applicant countries remains poor. Nevertheless, it is not unreasonable to assume that most of Poland, Hungary, Estonia and the Czech Republic would have levels of GDP per head equal to less than 75 percent of the EC average well into the next century<sup>44</sup>. As Chart 3 shows, enlargement would impact significantly on average GDP per head, lowering the absolute value of the current 75 percent threshold and theoretically, at least, excluding a number of the current Article 92(3)(a) areas from eligibility. Moreover the scale of the population involved is significant: current Article 92(3)(a) areas contain some 85 million inhabitants; it remains to be seen what proportion of this might be supplanted by the 63 million inhabitants of the applicant countries.

<sup>44</sup> The Commission has just made a proposal for a Council Decision to extend the equivalent of Article 92(3)(a) status under the Europe Agreement for the whole of Hungary for a further five year period (ie. up to 31 December 2001). The proposal notes that even the capital region of Budapest, which has the highest GDP per head in the country, only reaches 66 percent of the EU average measured in purchasing power parities. COM(97) final, 3 September 1997.

Needless to say, Agenda 2000 proposes no immediate answer to this question and the new regional aid guidelines do not address it<sup>45</sup>. This seems likely to lead to difficult policy choices and may mean that the current regional aid guidelines are effectively short-lived. It will be difficult enough for DGIV to limit coverage in the current membership to 40 percent of the population, the stated objective in the proposed guidelines. In an enlarged Community it seems highly improbable that DGIV could maintain the discipline it desires. An increase in the EC population is certain to be translated into an increase in assisted area coverage. In response, a further adaptation of DGIV's controls can be expected as competition policy evolves to deal with further pressures and challenges in an increasingly heterogeneous Community.

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<sup>45</sup> Nevertheless, the attempt to reduce coverage to 40 percent of the EU population among the present membership appears designed to forestall the full impact of enlargement on total coverage.