Is fiddling sufficient when regional economies are flagging?

The reform of the Regional Aid Guidelines post 2021

EPRC blog

The European Commission has just finished consulting on its proposals for the Regional Aid Guidelines (RAGS).[1] This followed an extensive review from which the Commission concluded that only a few minor amendments were needed. ***This blog asks whether the Commission is right to consider that the current rules work well*** or whether more needs to be done to address the impact of COVID-19, Brexit and to meet the ambitions of the Green Deal and Digital Strategy.

What's new?

In most respects little change is proposed:

- the regulatory architecture and relationship between the General Block Exemption and the RAGS is the same
- there are 'housekeeping' changes to align the RAGS with other rules
- overall coverage of assisted areas remains at 47 percent of the EU population
- Just Transition Areas are added to the area designation criteria that Member States can use, but the other criteria are unchanged
- aid intensities are increased for most eligible areas
- aid to process innovation by large firms in 'c' areas[2] is excluded.

Spatial coverage – the devil is in the detail

The Commission proposes that coverage of assisted across the EU should stay at 47 percent as in 2014-20, but there is a ***Brexit effect from maintaining the same population ceiling***. This arises because the United Kingdom is relatively populous (about 66 million) but had relatively limited designated regional aid areas (about 28 percent). As a result, ***coverage in the EU27 is reduced by 5.59 percent or nearly 12.5 million inhabitants.*** Moreover, the outcomes of applying the spatial coverage methodology vary very widely between Member States (see table below).

Current regional aid areas (% of population) and Commission proposals

	2014-21	**2022-27**	**Change % point**
Malta	100.00	50	**-50.00**
Slovenia	100.00	62.42	**-37.58**
Ireland	51.98	25.64	**-25.64**
Greece	100.00	81.21	**-18.79**
Portugal	85.02	70.09	**-14.93**
Romania	100.00	89.26	**-10.74**
Germany	25.85	16.73	**-9.12**
Poland	100.00	92.84	**-7.16**
Belgium	29.95	24.30	**-5.65**
Austria	25.87	20.94	**-4.93**
Spain	68.66	64.12	**-4.54**
Cyprus	50.00	46.20	**-3.80**
Slovakia	88.48	87.97	**-0.51**
Luxembourg	8.0	7.50	**-0.50**
Denmark	7.97	7.50	**-0.47**
Czech Republic	88.1	87.75	**-0.35**
Bulgaria	100.00	100.00	**0.00**
Estonia	100.00	100.00	**0.00**
Croatia	100.00	100.00	**0.00**
Lithuania	100.00	100.00	**0.00**
Latvia	100.00	100.00	**0.00**
Finland	26.03	26.63	**0.60**
Netherlands	7.50	8.39	**0.89**
Hungary	76.71	82.09	**5.38**
Italy	35.52	41.33	**5.81**
France	24.17	30.07	**5.90**
Sweden	12.26	20.94	**8.68**

Source: RAGS 2014-20[3] and Commission proposals for RAGS

Is it justifiable to use 2016-18 data to determine assisted areas post-COVID-19?

As well as the 'Brexit effect' of maintaining the same percentage coverage but of a smaller population, the methodology for assisted area coverage uses regional GDP data, which inevitably have a significant time lag. This means that, ***until at least end 2024, regional aid maps would be determined by 'pre-COVID-19' data.*** Even by 2024, when a review is proposed, the Commission will only have regional GDP data up to 2022.

What are the alternatives?

- One option is to decide that spatial coverage should remain unchanged for all countries until new data are available and the economic impact of COVID-19 is clearer.
- Another would be to raise coverage to around 49 percent of the EU27 population, to remove the impact of Brexit on the data.
- A further possibility would be to identify countries particularly affected by Brexit and/or COVID-19 and determine that their coverage should not change – there is a precedent for this in the 2014-20 RAGS which specified that countries which were subject to the various financial crisis support mechanisms[4] should not have a reduction coverage imposed.

Why raise maximum aid intensities when many awarding bodies cannot afford to reach current permitted levels?

The proposals on aid intensities are a break from past practice - the Commission has always sought to reduce rates of award: the ***draft guidelines propose an increase in aid rates***, essentially back to the levels of RAGS 2007-13. So, for example, in a region with GDP per head of 50 percent of the EU average, a large firm could in future be offered a grant of up to 50 percent of eligible investment, compared to 35 percent at the moment. This proposal seems to be based on the evaluation[5] finding that, in some regions (the 'c' areas'), there is a correlation between a fall in maximum aid intensities and levels of investment by large firms. However, it is difficult to disentangle this finding from the fact that, under RAGS 2014-20, aid to large firms in 'c' areas was essentially restricted to greenfield investment and diversification. Thus, for simple expansion projects, the permissible aid intensity was effectively reduced to zero. As such, it may be that changes in project eligibility account for the 'lower aid, lower investment' correlation, rather than aid rates *per se*. Moreover, the study also found that up to 35 percent of awarding bodies ***could not afford to fund the current maximum rates in their region.***

Missed opportunities?

Spatial coverage in some countries aside, the changes proposed are modest. In the light of the Green Deal and Digital Strategy, and indeed the outcomes of the RAGS review, it is pertinent to ask whether the proposals should have gone further.

RAGS 2014-20 introduced a significant change to the eligibility criteria for large firms in 'c' areas; specifically, aid could only be offered to 'new economic activities' – essentially greenfield investments or the diversification of existing establishments into new products. The aim of the change was to exclude simple expansion projects from eligibility. Aid to so-called 'new process innovations' could be notified to the Commission on a case-by-case basis, but this has happened rarely and only one such case was approved.

When RAGS 2014-20 were under discussion, this change was highly controversial. Moreover, responses to the Commission's 2019 consultations[6] and the evaluation mentioned above highlight some specific issues from the experience of the last few years:

- considerable difficulties with the interpretation of 'new economic activities'
- discrimination between adjacent 'a' regions and 'c' areas where conditions 'on the ground' do not differ markedly
- inability to secure expansion investment which is then undertaken in other Member States or non-EU countries
- the need to widen the definition of SMEs to include mid-caps e.g. in the range 250-500 employees, if the restriction on support to large firms were to be retained.

Not only do the Commission's proposals fail to address any of these considerations, they actually tighten the rules by completely excluding support for 'new process innovation' by large firms in the 'c' areas. This seems distinctly at odds with the Green Deal 'industrial strategy for a green and circular economy'[7] for which the promotion of such innovation seems likely to be central.

There is also a missed opportunity to re-define the approach to diversification[8] so that it does not disadvantage investment in new technologies by large firms in 'c' areas. Post COVID-19 diversification may well be more commonplace than greenfield investment, but the very definition of diversification' could thwart support for investment related to the Digital strategy and other areas of innovation simply because they do not break out of the NACE class.[9] As the extracts below show starkly, the classification for ITC is a blunt instrument for defining diversification, compared to the fine-grained approach to areas of 'traditional' manufacturing.

Extract from Section J – Information and Communication

		60.20	Television programming and broadcasting activities	6020
61			Telecommunications	
	61.1		Wired telecommunications activities	
		61.10	Wired telecommunications activities	6110
	61.2		Wireless telecommunications activities	
		61.20	Wireless telecommunications activities	6120
	61.3		Satellite telecommunications activities	
		61.30	Satellite telecommunications activities	6130
	61.9		Other telecommunications activities	
		61.90	Other telecommunications activities	6190
62			Computer programming, consultancy and related activities	
	62.0		Computer programming, consultancy and related activities	
		62.01	Computer programming activities	6201
		62.02	Computer consultancy activities	6202*
		62.03	Computer facilities management activities	6202*
		62.09	Other information technology and computer service activities	6209
63			Information service activities	
	63.1		Data processing, hosting and related activities; web portals	
		63.11	Data processing, hosting and related activities	6311
		63.12	Web portals	6312
	63.9		Other information service activities	
		63.91	News agency activities	6391
		63.99	Other information service activities n.e.c.	6399

Extract from Section J – Information and Communication

	25.7		Manufacture of cutlery, tools and general hardware	
		25.71	Manufacture of cutlery	2593*
		25.72	Manufacture of locks and hinges	2593*
		25.73	Manufacture of tools	2593*
	25.9		Manufacture of other fabricated metal products	
		25.91	Manufacture of steel drums and similar containers	2599*
		25.92	Manufacture of light metal packaging	2599*
		25.93	Manufacture of wire products, chain and springs	2599*
		25.94	Manufacture of fasteners and screw machine products	2599*
		25.99	Manufacture of other fabricated metal products n.e.c.	2599*

Many of these points have been raised before,[10] but COVID-19, the Green Deal and Digital Strategies provide a new context for reframing how Member States can support firms in problem regions to contribute to a new agenda. Arguably, there is both a need and an opportunity for the Commission to be more radical and adapt the RAGS to the magnitude of the crisis.

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Notes

[1] See: https://ec.europa.eu/competition/consultations/2020_rag/index_en.html; the deadline for responses was 30 September 2020.

[2] Broadly, the RAGS distinguish between 'a' regions where GDP per head is less than 75 percent of the EU average, and 'c' areas – where the regional problem is deemed less severe - which are designated by Member State subject to a maximum population quota, criteria set out in the guidelines and Commission approval.

[3] As amended by Communication from the Commission amending Annex I to the Guidelines on regional aid for 2014-20, OJEU C231/ 1 of 25 June 2016.

[4] These were the European Financial Stability Facility, the European Stability Mechanism and the European Financial Stabilisation Mechanism.

[5] European Commission (2019) Retrospective evaluation of the regional aid framework: https://op.europa.eu/en/publication-detail/-/publication/4c143fec-6281-11ea-b735-01aa75ed71a1

[6] Wishlade, F (2020) Regional State Aid Control: Does it need Rebooting or Rerouting? European Policy Research Paper no. 114: https://www.eprc-strath.eu/public/dam/jcr:a149eda0-0dba-41d3-b277-4d6e8aacf32a/EPRP%20114.pdf

[7] Com(2019)640 final: https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1596443911913&uri=CELEX:52019DC0640#document2

[8] The key issue is concept of 'investment in favour of new economic activity' – this essentially means (i) 'setting up a new establishment' or (ii) 'diversification of the activity of a new establishment under the condition that the new activity is not the same or a similar activity to the activity previously performed in the establishment'.

[9] 'Same or similar' activity means an activity under the same four-digit NACE code. See NACE rev.2 Statistical Classification of Economic Activities: https://ec.europa.eu/eurostat/documents/3859598/5902521/KS-RA-07-015-EN.PDF

[10] See, for example, Wishlade, F (2015) Another Generation in Competition policy control of Regional Development Policy, European Policy Research Paper no 89: https://www.eprc-strath.eu/uploads/eprc/documents/PDF_files/EPRP_89.pdf