All's well that ends well?

Recent developments in EU competition policy and regional aid control

EoRPA Paper 07/4

Fiona Wishlade

This paper has been prepared for the 28th meeting of the EoRPA Regional Policy Research Consortium at Ross Priory, Loch Lomondside on 7-9 October 2007. It should not be quoted without permission.

European Policies Research Centre
University of Strathclyde
40 George Street
Glasgow G1 1QE
Tel: +44-141-548-3061
Fax: +44-141-548-4898
e-mail: fiona.wishlade@strath.ac.uk

EPRC

EUROPEAN POLICIES
RESEARCH CENTRE

Preface

This paper aims to provide a review and assessment of EU competition policy control of regional State aid. The paper has been prepared by the European Policies Research Centre (EPRC) under the aegis of EoRPA (European Regional Policy Research Consortium), which is a grouping of national government authorities from countries across Europe. The Consortium provides sponsorship for the EPRC to undertake regular monitoring and comparative analysis of the regional policies of European countries and the inter-relationships with EU Cohesion and Competition policies. EoRPA members currently comprise the following partners:

Austria
- Bundeskanzleramt (Federal Chancellery), Vienna

Finland
- Sisäasiainministeriö (Ministry of the Interior), Helsinki

France
- Délégation interministérielle à l'aménagement et à la compétitivité des territoires (DIACT), Paris

Germany
- Bundesministerium für Wirtschaft und Arbeit (Federal Ministry for Economics and Labour), Berlin
- Ministerium für Wirtschaft, Technologie und Arbeit, Freistaat Thüringen, Erfurt

Italy
- Ministero dello Sviluppo Economico (Ministry of Economic Development), Dipartimento per le Politiche di Sviluppo e Coesione (Department for Cohesion and Development Policies), Rome

Netherlands
- Ministerie van Economische Zaken (Ministry of Economic Affairs), The Hague

Norway
- Kommunal-Og Regionaldepartementet (Ministry of Local Government and Regional Development), Oslo

Poland
- Ministerstwo Rozwojce Regionalnego (Ministry of Regional Development), Warsaw

Sweden
- Näringsdepartementet (Ministry of Enterprise, Energy and Communications), Stockholm

United Kingdom
- Department of Business, Enterprise and Regulatory Reform, London
- Scottish Government

Many thanks are due to everyone who participated in the research. The European Policies Research Centre also gratefully acknowledges the financial support provided by the members of the EoRPA Consortium.

Disclaimer

It should be noted that the content and conclusions of this paper do not necessarily represent the views of individual members of the EoRPA Consortium.

Contents

All's well that ends well?

Recent Developments in EU Competition Policy and Regional Aid Control

1. INTRODUCTION

Regional aid control has entered a new phase. At the end of 2005, the European Commission adopted new Regional Aid Guidelines for the period 2007-13 (RAG 2006),[1] requiring the redrawing of regional policy maps for most Member States and the withdrawal or revision of all existing regional aid schemes. Almost everywhere this has involved a fall in assisted area coverage and/or a reduction in aid values. In parallel, the new Regional Aid Block Exemption Regulation (Regional BER)[2] has the potential to eliminate some of the bureaucracy surrounding the authorisation of schemes, since those that meet the transparency and other requirements of the Regulation can now be implemented without prior Commission approval. Against this backdrop, many Member States spent much of 2006 redrawing their assisted areas within the parameters set out in RAG 2006 and negotiating their proposals with the Commission; by end 2006 almost all the new maps had been approved and by mid 2007 a number of countries had implemented regional aid schemes under the Regional BER. This process has been comparatively uncontentious. The key areas of dispute between Member States and the Commission were resolved in the drafting of RAG 2006 so that its implementation has been relatively trouble-free. Notwithstanding the general absence of controversy over the application of the Guidelines, some concerns have been expressed at whether the EU State aid regime is globally competitive. RAG 2006 not only cuts back the geographical coverage of investment aid for large firms but, especially in the case of very large projects, significantly reduces the value of aid. Crucially, EU State aid discipline not only applies to every tier of government and its agents, but is also legally enforceable. This is in sharp contrast to other jurisdictions where there is scant, if any, restriction on the use of investment subsidies, beyond those applicable under the WTO rules.

Against this background, this paper has two main objectives. First, to provide an overview of the implementation of regional aid maps and incentives under RAG 2006 and the Regional BER; and second, to consider the new EU regulatory environment for State aid in the context of *international* incentive competition for mobile investment. Reflecting this, Section 2 reviews the approaches of the Member States to area designation under the new Guidelines, assesses the implications of the Regional BER and takes stock of the aid schemes implemented to date. Section 3 considers the impact of RAG 2006 on aid values, the effect of the rules on aid to large projects and the use of State aid in global competition for direct investment. Last, Section 4 identifies some discussion issues.

[1] Guidelines on National Regional Aid for 2007-13, OJEU No C 54 of 4 March 2006.

[2] Commission Regulation (EC) No 1628/2006 of 24 October 2006 on the application of Articles 87 and 88 of the Treaty to national regional investment aid, OJEU No L 302 of 1 November 2006.

2. NEGOTIATION OF THE 2007-13 MAPS

2.1 Coverage and area designation parameters

The underlying principle governing spatial coverage in the 2006 Regional Aid Guidelines is the "exceptional nature of regional aid" so that the Commission considers that the total population of the assisted regions should be "substantially" less than that of the non-assisted regions.[3] On this basis, RAG 2006 sets the initial ceiling at 42 percent of the EU25 population, this being "similar" to the limit set for the EU15 under RAG 1998 (42.7 percent).[4] However, the application of the safety net, which ensures that no Member State would lose more than 50 percent of its current coverage, raises the overall ceiling to 43.1 percent of the EU25 population or 46.6 percent of the EU27 population, with the accession of Bulgaria and Romania which have 'a' area status in their entirety.[5]

RAG 2006 follows the basic architecture of RAG 1998:[6] an overall ceiling on EU assisted area population is set; 'a' area coverage is defined with reference to EU averages in GDP(PPS) per head; areas losing 'a' status may qualify as 'c' areas; 'c' area coverage is determined according to the same basic methodology; and safety net provisions limit overall losses in coverage. However, the shift in national and regional economic disparities brought about by enlargement (and growth) means that, for some countries, the outcomes are significantly different.

Leaving aside the (modest) transitional arrangements for 'c' areas, six Member States (Denmark, France, Ireland, Cyprus, Luxembourg and Netherlands) have seen current coverage fall by half. The case of Cyprus is interesting because the new Structural Funds Regulation treats the *whole* of Cyprus as a 'Phasing in' region, ie. nominally equivalent to an economic development region under the Regional Aid Guidelines, whereas only 50 percent of the population is eligible for *national* regional aid.

A further eight Member States (all EU15) have had coverage reduced by between 15 and 25 percent, while the cutback in the Czech and Slovak Republics is around 11 percent. Sweden stands alone with a reduction of just 3.8 percent, reflecting the role of population density, an absolute criterion unaffected by enlargement, in determining Swedish coverage. The remaining countries see no change in coverage; all except Greece are new Member States and all have 100 percent coverage in the 2007-13 period.

Overall, it is clear that the Commission has succeeded in retaining considerable discipline over the extent of the assisted areas. Total coverage across the EU27 has fallen by almost

[3] Paragraph 12.

[4] The ceiling was set at 42.7 percent, see: National ceilings for regional aid coverage under the derogations provided for in Article 92(3)(a) and (c) [now Article 87] of the Treaty for the period 2000 to 2006, OJEC No C 16 of 21 January 1999. However, it was exceeded by the inclusion of Northern Ireland in addition to the UK quota, instead of within it. The resulting total was around 43 percent, see: Figure 34, pp205, Wishlade, F. (2003) *Regional State Aid and Competition Policy in the European Union*, Kluwer Law international, The Hague.

[5] Paragraph 13.

[6] Regional Aid Guidelines, OJEC No C 74 of 10 March 1998.

one-sixth. However, the brunt of the cuts is borne by the EU15 – a reduction of around a quarter – with coverage in the 12 new Member States reduced by less than one percent.

Figure 1: EU and EEA total coverage 2000/4-6 and 2007-13

	2000-6	2007-13				2007-8	% Change
	TOTAL	'a' areas	Stat effect	'c' areas	TOTAL	Trans. 'c' areas	(exc. Trans.)
EU27	**55.3**	32.2	3.4	11.0	**46.6**	3.6	-15.7
EU15	**43.1**	15.0	4.3	13.2	**32.6**	4.2	-24.5
NMS12	**98.3**	94.9		3.1	**98.0**	1.3	-0.4
EEA3	**26.1**			29.4	**29.4**		12.8
Belgium	**30.9**		12.4	13.5	**25.9**		-16.2
Bulgaria	**100.0**	100.0			**100.0**		0.0
Czech Rep	**88.6**	88.6			**88.6**	7.7	0.0
Denmark	**17.1**			8.6	**8.6**	2.7	-49.7
Germany	**34.9**	12.5	6.1	11.0	**29.6**		-15.2
Estonia	**100.0**	100.0			**100.0**		0.0
Greece	**100.0**	36.6	55.5	7.9	**100.0**		0.0
Spain	**79.2**	36.2	5.8	17.7	**59.7**	12.4	-24.6
France	**36.7**	2.9		15.5	**18.4**	6.9	-49.9
Ireland	**100.0**			50.0	**50.0**	25.0	-50.0
Italy	**43.6**	29.2	1.0	3.9	**34.1**	5.6	-21.8
Cyprus	**100.0**			50.0	**50.0**	16.0	-50.0
Latvia	**100.0**	100.0			**100.0**		0.0
Lithuania	**100.0**	100.0			**100.0**		0.0
Lux	**32.0**			16.0	**16.0**	5.1	-50.0
Hungary	**100.0**	72.2		27.8	**100.0**		0.0
Malta	**100.0**	100.0			**100.0**		0.0
Neths	**15.0**			7.5	**7.5**	2.4	-50.0
Austria	**27.6**		3.4	19.1	**22.5**		-18.5
Poland	**100.0**	100.0			**100.0**		0.0
Portugal	**100.0**	70.1	3.8	2.8	**76.7**	19.2	-23.3
Romania	**100.0**	100.0			**100.0**		0.0
Slovenia	**100.0**	100.0			**100.0**		0.0
Slovakia	**88.9**	88.9			**88.9**	7.5	0.0
Finland	**42.3**			33.0	**33.0**		-22.0
Sweden	**15.9**			15.3	**15.3**		-3.8
UK	**30.7**	4.0	0.6	19.3	**23.9**		-22.1
Iceland	**33.2**			37.5	**37.5**[a]		13.0
Lichtenstn	**0.0**				**0.0**		0.0
Norway	**25.8**			29.1	**29.1**		12.8

Note: a) This figure applies from 1 January 2008 to 31 December 2013; from 1 January to 31 December 2007 coverage is 31.4 percent of the national population.
Source: Own calculations from Guidelines on National Regional Aid for 2007-13, Wishlade F., *Regional State Aid and Competition Law in the European Union,* Kluwer Law International, The Hague (2003), Figure 34 at p 205, *The EFTA Surveillance Authority adopts new Regional Aid Guidelines for 2007-13,* ESA Press Release PR(06)18, ESA Decision 378/06/COL and Eurostat data;.

In the EEA3, total coverage actually increases – by almost 13 percent in total. In both Norway and Iceland coverage is determined by population density. In Iceland, the population ceiling was set to fall to 31.6 percent. This ceiling was calculated by ESA and based on NUTS IV, rather than NUTS III, as provided for in the Guidelines. The rationale for

ESA's decision to take this approach was that Iceland constitutes a single NUTS II and III area, so that a strict application of the rules would have led the whole country to be designated on the basis of sparse population.[7] However, the Icelandic authorities were in the midst of negotiating a new NUTS breakdown with EUROSTAT; this divides Iceland into two NUTS III regions and applies from 1 January 2008. Applying the population density threshold at NUTS III results in 37.5 percent of the population being eligible. As a result, ESA approved two maps for Iceland, the first for 2007 only and the second, more extensive map, from 2008 onwards.

2.1.1 Coverage of 'a' areas

Article 87(3)(a) of the Treaty 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 compatible with the common market. The European Court of Justice has held that this provision applies only to areas which are disadvantaged in relation to the Community as whole.[8] For its part, the Commission takes the view that GDP per head in purchasing power standards (PPS) "is capable of reflecting synthetically both phenomena mentioned."[9] This seems a debatable interpretation both of the Treaty provisions and the statistical indicators: Article 87(3)(a) does not require low standards of living AND underemployment to be present, but rather views them as alternatives; moreover, GDP(PPS) per head measures neither phenomenon. Nevertheless, it is clear that the Commission's view is now well entrenched in State aid policy and practice and is further embedded by the use of the same indicators for Objective 1 / Convergence regions under EU Cohesion policy. Accordingly, the 'a' areas for 2007-13 are defined as NUTS II regions where GDP(PPS) per head is less than 75 percent of the EU25 average for the period 2000-2002.

In addition, the seven Outermost regions (OMR)[10] have 'a' area status, irrespective of whether they meet the GDP per head threshold. Five of the seven are below the threshold, but Canarias and Madeira both have per capita GDP of around 88 percent of the EU25 average. In spite of the emphasis on 'coherence' between the two policy areas, Canarias and Madeira have 'Phasing-in' status under the Competitiveness and Employment strand of Cohesion policy, rather than Convergence status, although special additional Structural Funds allocations are made to all OMRs for 2007-13.

Last, transitional arrangements are made for so-called 'statistical effect' regions. These are regions with GDP per head above the *EU25* qualifying threshold, but which would have qualified as 'a' areas had it not been for enlargement (equivalent to Phasing-out regions under EU Cohesion policy); the qualifying threshold is 82.2 percent of EU25 GDP(PPS) per head. Significantly, not all of the eligible regions had 'a' area status in 2000-6 – namely:

[7] EFTA Surveillance Authority Decision of 6 December 2006 on the maps of assisted areas and levels of aid (Iceland) Decision No 378/06/COL.

[8] Case 248/84 Germany v Commission [1987] ECR 4013 at 4042.

[9] Paragraph 16, footnote 19.

[10] Açores, Madeira, Canarias, Guadeloupe, Martinique, Réunion and Guyane.

Hainaut (Belgium); Lüneburg (Germany); and Highlands and Islands (UK). Statistical effect regions will have ‘a’ area status at least until 31 December 2010. During 2010 the Commission will review the position of the regions concerned on the basis of the most recent GDP data then available. Regions where GDP per head has fallen to below 75 percent of the EU25 average will retain ‘a’ area status; the remainder will become ‘c’ areas from 1 January 2011.

The impact of enlargement on average EU GDP(PPS) per head squeezed some 4.3 percent of the EU15 population out of ‘a’ area eligibility – this is around 20 percent of previous ‘a’ area coverage. The principal ‘losers’ were Greece, Germany and Spain. In Greece over half the population has statistical effect status, leaving just over one-third with ‘classic’ ‘a’ status; this compares with the 2000-6 situation in which the entire country had ‘a’ status. In Germany, around a third of the 2000-6 ‘a’ areas have statistical effect status from 2007. In Spain, less than 10 percent of 2000-6 ‘a’ areas moved to statistical effect status; however, this reflects the higher growth trends of some Spanish regions, which qualified as economic development regions from 2007.

2.1.2 Coverage of ‘c’ areas

Article 87(3)(c) provides that “aid to facilitate the development of certain economic activities or 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 European Court has confirmed that this provision is wider than Article 87(3)(a) and that it gives the Commission the authority to allow Member States to offer regional aid in areas that are disadvantaged in relation to the *national* average.

The Guidelines stress that, because the ‘c’ areas are less disadvantaged than the ‘a’ areas, their geographical scope and the aid intensity must be strictly limited and only a small part of the national territory may normally qualify for aid.[11] The determination of the coverage of ‘c’ areas was a two-stage process: first, the Commission set a population coverage ceiling for each Member State; second, eligible areas were selected by the Member States, subject to approval by the Commission. In addition, there are transitional provisions for some ‘c’ areas.

Overall ‘c’ coverage for each Member State comprises the following elements:

- *Economic development areas:* each Member State automatically received a quota equivalent to the population of areas that had ‘out-grown’ ‘a’ area status and were beyond even the threshold for statistical effect regions – in other words, regions that would have ceased to qualify as ‘a’ regions, even without the impact of enlargement on EU average GDP per head. Northern Ireland was added to this group. Although it was not an ‘a’ area in 2000-6, it benefited from comparable aid intensities in that period.[12]

[11] Paragraph 22.

[12] Paragraph 25.

- *Low population density areas*: in broad terms, these are defined as NUTS II areas with fewer than 8 inhabitants per km^2 or NUTS III areas with fewer than 12.5 inhabitants per km^2. This differs from RAG 1998, which only specified the NUTS III definition.

- *A population quota based on internal disparities in GDP per head and unemployment*: the remaining population (ie. 42 percent, less the 'a' areas, the economic development areas and the low population density areas) was distributed between the Member States. The formula for doing so was set out in the Guidelines[13] and allocated population according to the extent of national disparities in GDP per head and unemployment, adjusted to take account of the EU context.

- *Safety net*: special provision was made to ensure that no Member State lost more than 50 percent of its total population coverage under the 1998 Guidelines. The application of the safety net raised the initial 42 percent ceiling to around 43.1 percent.

New provisions for the phasing out of 'c' areas were introduced into the final version of the Guidelines. These enabled a proportion of the existing 'c' areas to remain eligible until 1 January 2009. Coverage of the transitional 'c' areas together with the 'c' areas based on the quota and safety net provisions (see Figure 1) cannot exceed 66 percent of 'c' coverage as at 31 December 2006 (excluding areas which qualified as statistical effect, economic development and low population density areas from 1 January 2007).[14]

The combined effects of enlargement and the effective retention of the existing EU population ceiling squeezed 'c' area coverage, reducing the eligible population by over a third. All EU15 Member States lost 'c' area coverage (except Finland, but this reflected the 'downgrading' of Itä-Suomi from 'a' to 'c', rather than an overall increase). Moreover, these decreases are significant – in many cases (eg. Denmark, France, the Netherlands) around half of previous 'c' area coverage will be lost after the transitional period ends. Moreover, in some cases (eg. Spain and Ireland), the loss is far more significant than it appears because most of the quota is made up of former 'a' areas (see also Figure 1 for the full impact of coverage changes).

In the European Economic Area (EEA) countries, to which a parallel text adopted by the EFTA Surveillance Authority (ESA) applies, overall 'c' area coverage is around 13 percent higher for 2007-13 than for 2000-6. This reflects the fact that the population quotas for Iceland and Norway are wholly based on the population density criterion, which is unaffected by changes in prosperity at the EU level; in the case of Iceland, as mentioned, the increase largely resulted from a reconfiguration of NUTS III.

[13] Annex IV. It is described in detail in Wishlade, F. (2005) 'Plus ça change, plus c'est la même chose? Recent Developments in EU competition policy control of regional aid' European Policy Research Paper 58, European Policies Research Centre, University of Strathclyde, Glasgow.

[14] Paragraph 95.

2.1.3 Designation of ‘c’ areas

The designation of ‘a’ areas (‘classic’, statistical effect and outermost regions) is essentially a given, based only on EU criteria. However, Member States are not obliged to include within their assisted area maps areas that meet the EU criteria and as a result the take-up of eligible statistical effect areas has not been universal; in Germany, the authorities opted not to designate Lüneburg in its entirety, in spite of it being a statistical effect area.

For the ‘c’ areas, RAG 2006 distinguishes two types of assisted area that may be designated within the population quotas: those where large firms may be assisted, comprising comparatively large geographical areas principally meeting EU-level criteria;[15] and those where assistance is more tightly focused on localised disparities and is restricted to SMEs.[16] In principle, the list of regions notified applies throughout the period 2007-13, but there is provision for a mid-term review in 2010.[17] However, changes should not involve more than 50 percent of ‘c’ area coverage.

Areas which can be designated for aid to *large* firms are specified in the Guidelines under Paragraph 30(a)-(h) as follows:

a. Economic development areas (see definition above).

b. Low population density (LPD) areas (see definition above).

c. Contiguous zones with a minimum population of 100,000. These must be within NUTS II or III regions where either GDP per head is less than the EU25 average or unemployment is more than 115 percent of the *national* average.

d. NUTS III areas with a population of less than 100,000 where either GDP per head is less than the EU25 average or unemployment is more than 115 percent of the *national* average.

e. Islands and “other regions categorised by similar geographical isolation” where either GDP per head is less than the EU25 average or unemployment is more than 115 percent of the *national* average.

f. Islands with fewer than 5,000 inhabitants and other communities with fewer than 5,000 inhabitants characterised by similar geographical isolation.

g. Border areas. These concern all or parts of NUTS III regions that are adjacent to ‘a’ areas and those which share a land border or a sea border of less than 30km with a country that is not a member of the EEA or EFTA.

---

[15] Paragraph 30 (a) to (h).

[16] Paragraph 31.

[17] Paragraph 104.

h. Areas undergoing restructuring. These must be "contiguous zones" with a minimum population of 50,000 which are undergoing major structural change or are in serious relative decline "compared with other comparable regions".

In paragraph 31 of the Guidelines, there is scope to target very localised regional disparities. However, aid is restricted to small and medium-sized enterprises (SMEs) and the areas targeted must involve a minimum population of 20,000. Obviously these areas also count towards the 'c' area population quotas.

Transitional arrangements for areas losing 'c' status were a late addition to the proposals for the guidelines and were apparently made largely in response to French pressures for a phasing-out mechanism. In practice these arrangements are not generous. First, coverage is for a period of two years only – ie. until 1 January 2009; and second, aid intensity is limited to a maximum of 10 percent of eligible investment. As far as the actual selection of areas is concerned, the only stipulation appears to be that the area had 'c' status for 2000-6. In other words, there are apparently no minimum population or contiguity requirements.

2.2 Strategies and outcomes: assisted area designation 2007-13

On 13 September 2006 the Commission approved a first batch of assisted area maps under RAG 2006. These decisions concerned seven Member States: Estonia, Greece, Latvia, Hungary, Poland, Slovenia and Slovakia. Of these, six are covered by 'a' or 'c' areas in their entirety. Slovakia is mainly covered by 'a' status, but has a small transitional area quota. It is clear from Figure 2 that many of these assisted area maps were submitted later than others which concerned 'c' areas only (for example Finland and France) – a clear indication that the Commission sought to make the least contentious decisions first and, at the risk of setting unwanted precedents, left potentially more controversial decisions until later. Nevertheless, by the end of 2006, almost all the maps had been approved; by June 2007 all maps had been notified, with only the Italian map still to be approved.

Figure 2: Map submission and approval status

	Submission date	**Status at end August 2007**
Belgium	16, 17 November 2006	COM approval 21 February 2007
Bulgaria	12 June 2006	COM approval 24 January 2007
Czech Rep	27 July 2006	COM approval 24 October 2006
Denmark	13 October 2006	COM approval 21 February 2007
Germany	11 July 2006; 19 July 2006	COM approval 8 November 2006
Estonia	14 July 2006	COM approval 13 September 2006
Greece	23 June 2006	COM approval 13 September 2006
Spain	19 September 2006	COM approval 20 December 2006
France	1 June 2006; 8, 9 February 2007	COM approval 7 March 2007
Ireland	14 June 2006	COM approval 24 October 2006
Italy	12 June 2007	*Not yet approved*
Cyprus	4 December 2006	COM approval 24 January 2007
Latvia	5 July 2006	COM approval 13 September 2006
Lithuania	19 September 2006	COM approval 24 October 2006
Luxembourg	3 August 2006	COM approval 12 October 2006
Hungary	18 July 2006	COM approval 13 September 2006
Malta	20 September 2006	COM approval 12 October 2006
Neths	2 May 2007	COM approval 27 June 2007
Austria	20 July 2006; 25 October 2006	COM approval 20 December 2006
Poland	8 August 2006	COM approval 13 September 2006
Portugal	9 November 2006	COM approval 7 February 2007
Romania	10 November 2006	COM approval 24 January 2007
Slovenia	4 July 2006	COM approval 13 September 2006
Slovakia	13 July 2006	COM approval 13 September 2006
Finland	28 March 2006; 9 June 2006?	COM approval 20 December 2006
Sweden	30 June 2006	COM approval 20 December 2006
UK	11 October 2006	COM approval 20 December 2006
Iceland	11 July 2006	ESA approval 6 December 2006
Norway	12 June 2006	ESA approval 19 July 2006

Source: European Commission, DG Competition at: http://ec.europa.eu/comm/competition/state_aid/regional_aid/regional_aid.html and EFTA Surveillance Authority at: http://www.eftasurv.int/fieldsofwork/fieldstateaid/stateaidregistry/

The remainder of this section focuses on the information available about those Member States with the flexibility to select 'c' areas under RAG 2006. These are primarily among the EU15. As Figure 1 shows, most of the new Member States are designated in their entirety as 'a' areas. The Czech and Slovak Republics are mainly designated as 'a' areas, but each also has a quota of transitional 'c' areas amounting to around eight percent of the population. Among the new Member States, only Cyprus is concerned with the designation of 'c' areas.

2.2.1 Member State objectives and area designation strategies[18]

Member States adopted diverse *area designation strategies* to reconcile Commission constraints with domestic considerations. These considerations often comprised a mix of policy options such as indigenous or inward investment, areas of need or opportunity – and

[18] This section is based on documentation kindly provided by national policymakers and on EPRC fieldwork by the following team: Austria (Tobias Gross); Belgium (Frederike Gross); Finland (Heidi Vironen); France (Frederike Gross); Germany (Sara Davies); Ireland (Irene McMaster and Douglas Yuill); Italy (Laura Polverari); Netherlands (Douglas Yuill); Spain (Carlos Méndez); Sweden (Heidi Vironen); and UK (Martin Ferry and Rona Michie).

political issues, such as the perceived equitable distribution of assisted areas between regions and the sensitivity of de-designating some areas, while according assisted area status to others for the first time. More prosaically, an important factor was often the ease with which the map could be approved, sometimes leading to rather pragmatic, as opposed to strictly policy-oriented, approaches to area designation.

For *Austria,* the initial *political* issue was the fact that Vienna was in principle eligible in its entirety for 'c' status on the grounds of high unemployment (Paragraph 30c of the Guidelines); however, designation of the capital on this basis was not only viewed as inappropriate, but would have used up a large part of the Austrian population quota. A consensus was reached which involved granting additional Structural Funds monies to the capital (whereas the other *Länder* will see a reduction of one-third), but its exclusion from 'c' eligibility. More generally, the objective was to balance the reduction in assisted area coverage against the specific needs of disadvantaged regions. There was also an emphasis on *continuity* with the previous map. At the same time, the map aimed to support both structural change and regional development potential, while minimising the differences in aid intensities at the borders with new Member States. On the other hand, there was no *overarching* national strategy – each *Land* was autonomously responsible for preparing its own map based on individually defined indicators and within the respective population ceiling.

For *Belgium* the starting point for area designation involved decisions about how to divide the population quota between the three regions (Brussels, Flanders and Wallonia) since regional development is not a national responsibility. This decision was complicated by the fact that Hainaut (Wallonia), which contains 12.3 percent of the Belgian population, was 'entitled' to be designated as a statistical effect area with 'a' status at least to end 2010; this accounted for a large proportion of the total Belgian population quota (25.9 percent). Ultimately a political decision was reached on the split, with 71 percent of the total allocated to Wallonia (including Hainaut); 23 percent to Flanders; and 6 percent to Brussels; these shares compare with 65 percent, 31 percent and 4 percent, respectively, in the 2000-6 period. In terms of area designation *per se,* each region pursued its own strategy. In fact, the Flemish authorities were initially opposed to the idea of an assisted areas map, preferring instead to use horizontal measures, but political pressures proved difficult to resist. The resulting Flemish map is quite different from its predecessor, although the eligible areas are within the same provinces, the designated municipalities are different. By contrast, in Wallonia, there was an emphasis on continuity: no new zones were designated – it was essentially a question of how to cut back to meet the population ceiling.

In *France* the task of drawing up the assisted areas map was largely delegated to the *Préfets de region,* partly reflecting the increased emphasis in decentralisation of economic development in France, but also, pragmatically, as a way of exploiting to the full the much reduced population quota by taking advantage of local knowledge. In the first instance

Corsica was proposed for designation in its entirety.[19] For the remainder of the country a population quota for each region was determined on the basis of five criteria: unemployment, employment trends, manufacturing and service employment, qualifications, disposable income; a safety net was applied to ensure that no region lost more than two-thirds of previous coverage and that no region had a population quota of less than 150,000. Interestingly a 'reserve' of 250,000 inhabitants was retained by the government to deal with major economic development issues that might arise in the future.[20] This reserve was deducted from the initial quota for the Île de France (Paris) region. Instructions to the *Préfets* highlighted the fact that the assisted areas map had two objectives: to contribute to the attraction of inward investment and to enable the development of SMEs. The transitional population quota was divided *pro rata* among the regions in line with losses in assisted area coverage.

In *Germany* the approach to area designation largely followed the model used in the past; the key difference was that the same model was used for evaluating all German regions – previously, separate systems were used for the old and new *Länder*. Large scale regional aid is perceived to be one of the most effective instruments of regional policy and it is considered important in the attraction of investment, especially to the new *Länder.* The stated aims underpinning the map are: to reduce socio-economic disadvantages; to create sustained employment; to create prospects for development in rural areas; to foster cohesion; and to support a social policy which encourages social stability and avoids right/left political extremism. In more specific terms, the map aims to ensure that domestic regional policy expenditure focuses on those areas with clear structural economic weaknesses, as shown by objective indicators, and that regions with similar problems are treated equally.

In *Italy* (where the map has not yet been approved), there was no overarching national strategy, largely because constitutional reforms have devolved economic development responsibilities to the regional level. As a result, the emphasis was on reaching agreement between the regions. This was extremely difficult, largely owing to the very small 'c' area population quota accorded to Italy – just 3.9 percent of the national population. Moreover, of this quota, most (2.9 percent) was accounted for by Sardegna which, as an economic development area, had an *a priori* claim on 'c' status. In the first instance, the objective was to reach agreement on the division of the population quota. Most regions objected to Sardegna being designated in its entirety, given the very limited overall quota. However, agreement was difficult to reach and negotiations immediately took a political rather than a technical turn. Moreover, discussions about the Structural Funds and regional aid were sometimes merged as some regions, especially those bordering 'a' areas like Molise, and Friuli-Venezia-Giulia noted that they would exchange a higher quota of 'c' area for lower Structural Funds resources; other regions with no 'pre-eligible' areas,[21] such as Veneto,

[19] Under Paragraph 30e of the Guidelines, which refers to islands meeting the GDP or unemployment rate criteria.

[20] In the initial submission, the reserve was 430,000, but the map was subject to detailed negotiations with the Commission and part of the reserve was used to resolve a number of contentious issues.

[21] Those meeting the GDP and unemployment criteria.

Piemonte, Liguria, and Emilia-Romagna followed suit seeking minimum allocations of 50,000 population in return for lower Structural Funds shares. Ultimately Sardegna was persuaded to concede some 700,000 of its total population quota (1.6 million) to other regions. However, in August 2006 negotiations over both the Structural Funds allocations and the 'c' area quotas collapsed, following two months of negotiations. Initial agreement on the quotas was reached in October 2006, but this did not meet with Commission approval and final internal agreement was not reached for a further four months. On this basis the regions defined their own assisted areas, which were then assembled into a national map with, in effect, an *ex post* justification for the choices made. The map was 'pre-notified' on 30 March 2007 and following a meeting with the Commission was formally notified on 12 June 2007.

In the *Netherlands* the goal of regional development policy is "to stimulate economic growth in all regions by exploiting region-specific opportunities of national significance".[22] However, at the national level, little weight is attached to regional *aid* under this philosophy. On the other hand, the *decentralised* element of the regional investment premium (IPR) operated in the north is well used and there was pressure from both the Cabinet (concerned at losing out in cross-border competition for investment) and the Parliament for the retention of a regional aid map. As a result, in dealing with the (very low) population quota, the emphasis was threefold. First, on those areas which met the 'pre-eligibility' criteria; second, on border areas; and third, on areas eligible for regional aid in the past and which reflect new regional strategies.

In *Finland* and *Sweden* the bulk of the 'c' area quota is generated by sparsely-populated areas, and, in the case of Finland, by economic development areas. In practice, however, in both countries the assisted areas were selected on the basis of an internal assessment of disparities rather than on the basis of the EU population density criterion.

For *Spain* the overall objective at the *national* level was to minimise the impact of the reduction in coverage. The regionalised nature of economic development policy in Spain meant that each Autonomous Community had its own priorities. For example, in Cataluña the aim was to maximise the coverage of areas affected by textile restructuring, whilst in Madrid the main objective was to cover as much territory as possible (rather than population) with a view to preventing relocation of firms to neighbouring Castilla-La Mancha. These policy choices were respected by the Regional Incentives Unit of the Ministry of Economy and Finance, which had an overall coordinating role. As in Italy, part of the economic development area quota (in principle accorded to Valencia) was conceded for use in other regions; the exclusion of two densely-populated municipalities in the Valencia released 1.8 percent of the population for use elsewhere, raising the 'non-earmarked' quota to 2.8 percent of the Spanish population.

In the *United Kingdom* the government "considered where the flexibility provided by Assisted Area coverage is justified by both need and opportunity" and used the existing map as the baseline for developing new proposals. As far as the philosophy underlying the map is

[22] Ministry of Economic Affairs (2004) Peaks in the Delta: Regional Economic Perspective, The Hague.

concerned, in its response to the first consultation it expressed the view that the primary purpose of assisted area coverage was to provide flexibility to support larger firms; it therefore, opted not to propose areas under Paragraph 31 – ie. SME only aid areas. This is rather a surprising outcome in the UK context since Paragraph 31 appears to respond to a suggestion put forward by the UK authorities in the course of the consultation on the Guidelines.[23]

Administrative arrangements for area designation have varied widely between the Member States. This reflects a number of factors, including administrative traditions, institutional structures and responsibilities and the perceived sensitivity of the process. In addition, however, perhaps most notably in France and Italy, but also Austria, Belgium and Ireland, the fact that a single national area designation system is not required under the 2007-13 Guidelines has allowed for greater delegation of responsibility to the subnational level.

Austria, *Italy*, *Spain* and *France* (to some extent) adopted a similar approach. In these countries the 'c' area population quota was divided between the regions and the task of selecting the eligible areas delegated to that level. However, in *France* the process was essentially *deconcentrated* rather than *devolved.* The main responsibility for the task lay with the *Préfets*, the government representative in the region, which were charged with consulting with Regional Councils and local partners as they saw fit. By contrast, in *Austria* the process was led by *Land* level governments which produced draft maps based on their own choice of indicators, and which were later subject to negotiation at a political level, the whole process being coordinated by ÖROK.[24] The population quota was divided between the *Länder* in proportion to their shares of current coverage. In *Italy,* the whole process, including negotiations over population quotas, was undertaken at the regional level, reflecting recent constitutional change. This proved highly controversial given the very small population quota assigned to Italy. In *Spain,* the process was led by the Ministry of Economy and Finance in consultation with the 'c' regions, but the actual selection of areas was primarily undertaken by the Autonomous Communities, reflecting their own priorities.

The process was even further devolved in *Belgium* where each of the three regions (Brussels, Flanders and Wallonia) drew up a separate map, although ultimately a single map was submitted to the Commission. Initially, a major obstacle had been the lack of agreement on how to divide the 'c' area population quota between the three regions, notably in the light of the Hainaut region (Wallonia) having 'a' status as a statistical effect region. Once this was resolved, the three regions worked independently on their proposals.

In *Ireland* too the process was partly devolved. The Border-Midlands-Western (BMW) region has economic development status and it was taken as a given that the whole region should have 'c' status; the decision about which parts of the Southern and Eastern region should

[23] Letter from UKRep dated 1 March 2005.

[24] The Austrian Conference of Regional Planning comprising, among others, civil servants at the Federal, Land and municipal levels.

be eligible was devolved to the regional authority which put forward proposals on the basis of a study which it commissioned.

In *Germany* the process was led by the Federal Ministry of Economics and Technology which coordinated the proposals and secured domestic agreement. The main domestic forum where the proposals were discussed was the GA ('joint task') planning committee comprising Federal and Land representatives.

In the *United Kingdom*, as in the past, there was an extensive public consultation process. This was led by the Department of Trade and Industry (DTI)[25] in liaison with the devolved administrations for Scotland and Wales. The first stage of the consultation outlined the requirements of the new Guidelines and raised a number of specific questions concerning appropriate approaches and designation criteria.[26] In the second stage the government published its response and a draft assisted areas map for further consultation.[27] Following the second round of consultation, the government adjusted the map and notified it to the European Commission.

In contrast with countries where the process has either been delegated to the subnational level, involved partnership or extensive consultation, in *Finland*, the *Netherlands*; and *Sweden* the process was conducted internally within the lead ministries.

The choice of *building blocks* for area designation was a highly contentious issue in the negotiation of the 2000-6 maps. In particular, the Commission sought the use of a single unit across all indicators within a given country and disallowed the splitting of the chosen unit (except to achieve coherence with Objective 2 areas, but even then not in all Member States). In RAG 2006 the requirements in respect of building blocks are much less stringent. In informal discussions early on in the process the Commission accepted the use of LAU1 and LAU2[28] as building blocks, but emphasised that any breakdown below NUTS III must be 'traditional' and not simply involve units generated on an *ad hoc* basis for the purposes of the area designation exercise.

---

[25] Now the Department for Business, Enterprise and Regulatory Reform (BERR).

[26] Department of Trade and Industry (2006) Review of the Assisted Areas: Stage 1 – Identifying Criteria, 15 February, URN 06/816.

[27] Department of Trade and Industry (2006) Review of the Assisted Areas: Stage 2 – The Government's Response and Draft Assisted Areas Map, 10 July, URN 06/1588.

[28] In Eurostat's geographical classification system NUTS IV and V have been redesignated as Local Administrative Units and renamed LAU1 and LAU2 respectively.

Figure 3: Building blocks proposed by the Member States

Belgium	*Gemeenten / Communes*(LAU2) (Flanders and Wallonia); parts of communes (Brussels)
Denmark	Municipalities
Germany	Labour market regions (*Arbeitsmarktregionen*); Transport areas (*Verkehrszelle*) in Berlin
Spain	Municipios (LAU2); Census districts
France	*Commune* (LAU2); *Cantons urbains* in cities
Ireland	Counties (LAU1); District Electoral Divisions (LAU2)
Italy	Commune (LAU2) and Census areas (map not yet approved)
Cyprus	Communes
Luxembourg	*Commune* (LAU2)
Netherlands	Gemeenten (LAU2) and part Gemeenten
Austria	*Gemeinden* (LAU2)
Portugal	*Freguesias* (LAU2)
Finland	*Maakunnat /Landskap* (NUTS III); *Seutukunnat* (LAU1)
Sweden	Municipalities (LAU2)
UK	Wards (LAU2)

A review of the approved maps suggests that, where Member States have changed the unit of analysis since the designation for the 2000-6 period – for example in Austria, Denmark, France, Spain and the UK - they have opted for smaller units. This reflects the constraints of the population ceilings set by the Commission, which create an imperative to optimise the designation of assisted areas and less stringent requirements under the guidelines, coupled with apparently greater flexibility on the part of the Commission. Of particular note, RAG 2006 neither requires the use of a single geographical building block nor the ranking of those building blocks by a limited number of indicators.

In *Austria* the *Gemeinden* were used to build up designated areas within eligible NUTS III areas. Previously the Austria map had been based on NUTS III, with adjustments made for the coverage of Objective 2 areas under the Structural Funds.

In *Denmark* the assisted areas were designated on the basis of municipalities, the boundaries of which were redrawn with effect from 1 January 2007, reducing their number from 271 to 98. Previously the map had been based on a ranking of the 59 *Kommunergrupper*, labour market areas built up from LAU2 units.

In *France* the *commune*, the smallest tier in the administrative structure was used as the building block. This enabled a detailed level of analysis to be undertaken locally, not least since there are 36,678 communes in France. In some built-up areas an even smaller unit, the *canton* was used. This approach differs from the last area designation exercise where labour market areas (*zones d'emploi*), of which there were 348, were the building blocks.

In *Spain,* municipalities (LAU2) were used in most Autonomous Communities, although a smaller unit - census districts – was used in Madrid. The 2000-6 map had been based NUTS IV units.

The *United Kingdom* also chose the smallest possible unit of analysis, the ward (LAU2), of which there are around 10,660; the ward level was used to 'build up' zones with a minimum population of 100,000.

By contrast, in *Germany* the authorities opted to *retain* the *Arbeitsmarktregionen* (labour market areas) as the unit of analysis; these number 270 and are largely unchanged from the previous area designation exercise, but there have been some adjustments so that each labour market area contains one or more NUTS III regions. Particular difficulties arose in relation to Berlin which, in principle, qualifies in its entirety under Paragraph 30(c) of RAG 2006. Berlin has clear socio-economic problems, but is also a large and diverse labour market area; moreover, its population accounts for more than a third of the national population quota for 'c' areas. The consensus was that a significant proportion of the Berlin population should be designated, but not the entire city. In administrative terms the difficulty was that Berlin corresponds to NUTS I, II, III and LAU2 so that an *ad hoc* solution had to be found to subdividing the area. The proposal adopted was to use *Verkehrszelle* (transport areas) which have been used since 1973 for planning purposes, and to include just over 70 percent of the city's population in the 'c' area map in areas earmarked for business activity.

2.2.2 Negotiations and outcomes[29]

As outlined earlier, RAG 2006 set out a series of parameters within which Member States could propose assisted areas. Economic development areas[30] (ie. areas that have outgrown 'a' status) and sparsely-populated regions[31] would be accepted automatically by the Commission as 'c' areas; however, Member States have also been able to use the population quotas generated by these areas to designate other areas – provided that these meet the other criteria in Paragraphs 30 or 31. It is interesting to note, however, that the transfer of quotas has not been allowed where a Member State opted not to designate an 'a' area in its entirety.

The broadest category for 'c' eligibility concerns areas with GDP(PPS) per head of less than the EU average or unemployment more than 15 percent above the *national* average – hereafter referred to as pre-eligibility criteria.[32] These must be either: 'contiguous zones' with a population of at least 100,000; NUTS III areas with a population of less than 100,000; or islands or other geographically isolated areas. In practice, in most countries the areas meeting the pre-eligibility criteria are more extensive than the national population ceilings, requiring further selection criteria at the national level.

Alternatively, there are further specific criteria under which areas could be proposed[33] (small islands and border areas) or criteria under which the onus is on the Member State to

[29] Information in this section is primarily drawn from the texts of the final Commission Decisions, available at: http://ec.europa.eu/comm/competition/state_aid/register/

[30] Paragraph 30(a).

[31] Paragraph 30(b).

[32] Paragraphs 30(c) to (e).

[33] Paragraphs 30(f) and (g).

demonstrate that regional aid is justified[34] (areas undergoing structural change and small aid areas for SMEs).

For the Member States there were several considerations to address, including: how the Commission parameters intersect with national priorities and indicators; whether to designate solely within the pre-eligibility criteria; whether to use the quotas from economic development and sparsely-populated areas to designate other 'c' areas; and whether to designate areas justified on the basis of national arguments. Member States have addressed these questions in a variety of ways reflecting national traditions in area designation, the flexibility allowed by the pre-eligibility criteria and the need for expedient and pragmatic solutions to complex and politically sensitive tasks.

Figure 4 summarises the criteria under which the Commission has approved the map proposals of the Member States to date. As far as the selection of 'c' areas is concerned, two main points emerge from this summary. First, the EU criteria aside (low population density and economic development areas), the single most important basis for coverage is paragraph 30c – areas with a minimum population of 100,000 with either GDP(PPS) below the EU average or unemployment 15 percent above the *national* average. In Austria, Denmark, France and the UK, these areas account for more than 50 percent of the assisted areas. Second, and related, Member States have largely shunned the scope to designate assisted areas outside the Commission's framework criteria and select on the basis of nationally-justified criteria. There are two main options for designating areas which do not meet the pre-eligibility criteria: paragraph 30h enables areas with a minimum population of 50,000 "undergoing major structural change" to be designated as 'c' areas; paragraph 31 enables smaller areas (minimum population 20,000) to be targeted for SME support only. In both cases the onus is on the Member State to demonstrate the need for intervention.

Six countries have used the structural change option (paragraph 30h) – Belgium, Germany, France, Spain, Finland, Sweden – but coverage is arguably significant only in France and Sweden where it accounts for around one-fifth or more of total coverage. Across the EU as a whole, coverage of paragraph 30h areas is likely to amount to less than one percent of the EU population.[35]

Six countries also opted for the micro-targeting of SME aid under paragraph 31: Belgium, Denmark, Germany, France, Ireland and Finland. In Denmark and Ireland these areas account for about a quarter of the assisted area total, but elsewhere coverage is not significant. Total coverage of paragraph 31 areas is likely to amount to well under 0.5 percent of the EU population.

[34] Paragraphs 30(h) and 31.

[35] Probably much less once the Italian maps have been agreed.

Figure 4: Assisted areas by type under the 2007-13 Guidelines (% of national population)

	'a' areas	Stat effect	Econ dev	LPD	Cyprus/ Lux	Pop 100000	NUTS 3	Islands / isolated	Islands <5000	Border	Struct chg.	SMEs	TOTAL	Res.	Trans.
Guidelines para	**15**	**18**	**30a**	**30b**	**Note 32**	**30c**	**30d**	**30e**	**30f**	**30g**	**30h**	**31**	**ex Res /Trans**		**95**
Belgium		12.3				9.8				0.97	1.2	1.5	**25.7**		
Bulgaria	100.0												**100.0**		
Czech Rep	88.5												**88.5**		7.6
Denmark						4.5	0.8	0.8	0.189			2.2	**8.4**		2.6
Germany	12.5	4.9				8.4	0.2		0.002	1.71	0.5	0.1	**28.4**		
Estonia	100.0												**100.0**		
Greece	36.6	55.5	7.8										**100.0**		
Spain	36.2	5.8	14.3	0.3		1.8				0.70	0.6		**59.6**		12.4
France	2.8					10.5		0.5		0.02	3.5	0.6	**17.9**	0.4	6.9
Ireland			26.5			10.8			0.014			12.7	**50.0**		23.5
Italy															
Cyprus						44.9		5.1					**50.0**		
Latvia	100.0												**100.0**		
Lithuania	100.0												**100.0**		
Lux					15.8								**15.8**	0.2	4.6
Hungary	72.2		27.8										**100.0**		
Malta	100.0												**100.0**		
Neths						7.5							**7.5**		2.4
Austria		3.4				15.1	0.3			3.74			**22.5**		
Poland	100.0												**100.0**		
Portugal	70.2	3.8								2.72			**76.7**		17.6
Romania	100.0												**100.0**		
Slovenia	100.0												**100.0**		
Finland			12.6	12.0		2.9			0.736	2.20	1.0	1.4	**32.9**		
Slovakia	88.9												**88.9**		7.2
Sweden				7.8		3.4					4.0		**15.3**		
UK	4.0	0.6	6.4			12.6				0.30			**23.9**		
Iceland				32.0									**32.0**		
Lichtenstn													**0.0**		
Norway				27.5									**27.5**		

Source: Own calculations from information in Commission decisions and Eurostat data.

In *Austria* well over two-thirds of the population is designated on the basis of *Paragraphs 30 c* and *30d,* areas with at least 100,000 population or entire NUTS III areas meeting the pre-eligibility criteria. These areas comprise eight contiguous zones (with a total population of 1.24 million) and a single NUTS III region (Lungau, with a population of 21,261). In addition, the Austrian map includes parts of three NUTS III regions (Klagenfurth-Villach, Oststeiermark and West-und Südsteiermark) which border Slovenia and are designated on the basis of being adjacent to 'a' areas (*Paragraph 30g*).

In *Belgium,* Hainaut aside, the bulk of the eligible Belgian population was proposed under *Paragraph 30c* in the form of four 'clusters' of communes. In addition, four communes were designated on the basis of *Paragraph 30g* (areas bordering 'a' regions) as they adjoined Hainaut; however, the Commission noted that, in the event that Hainaut lost 'a' status in the 2010 review, one of these (Tubize) would have to be reassessed since GDP per head currently exceeds the EU25 average and unemployment is below the national average. Two areas (one in Flanders and one in Wallonia) were designated on the basis of *Paragraph 30h* (structural change). In the Turnhout NUTS III region, the Flemish authorities argued for the designation of three communes with a population of 61,800; the justification provided was the planned closure of a nuclear power plant, which would potentially affect over 5000 jobs in the communes concerned. The Walloon authorities sought to designate two urban communes with a total population of 67,840 within the Liège NUTS II area, mainly on the basis of a synthetic indicator ranking all communes in Wallonia, and also on the basis of unemployment data. These proposals were accepted by the Commission. In the Brussels capital region all the eligible population (154,960) was designated on the basis of *Paragraph 31* (micro-targeting of SME aid). The Brussels authorities justified this on the basis of exceptionally high unemployment rates compared to the national average and low income levels.

Cyprus (along with Luxembourg) benefited from special provisions for the designation of 'c' areas which required minimum population blocks of 10,000, rather than 100,000 under *Paragraph 30c.* In practice, the Cypriot authorities appear not to have opted to use this provision, designating instead a single contiguous zone in the west of the island, with a population of 340,005. As Cyprus is itself a NUTS III region with GDP(PPS) per head lower than the EU25 average, the conditions of Paragraph 30c were easily met. In addition, the Cypriot authorities opted to designate a small area in the eastern part of the island under *Paragraph 30e*, which enables islands and other isolated areas to be designated. The so-called 'Eastern Zone' is separated from the rest of the island by the UK Eastern Sovereign Base Area and the Commission considered that the area, which contains a population of 38,915, could be deemed to be isolated on this basis. On the other hand, this area could presumably, with the special provision of 10,000 population blocks, also have been included under Paragraph 30c.

In *Denmark* the assisted areas were designated on the basis of municipalities, the boundaries of which were redrawn with effect from 1 January 2007, reducing their number from 271 to 98. Municipalities were assessed on the basis of earned income and population trends. Some 16 municipalities were identified as disadvantaged, this being defined as having earned income of less than 90 percent of the national average (for 2001-3) *and* a fall in population or population growth of less than half the national average (for 2000-5). All

the areas proposed by the Danish authorities were among these 16. Some 75 percent of the Danish eligible areas were approved on the basis of *Paragraph 30c, d* or *f* (100,000 population zones, NUTS III areas with less than 100,000 population, islands with population of less than 5000) as areas meeting the GDP or unemployment criteria. In addition, as noted earlier, Denmark opted to designate around a quarter of the assisted area population for SME aid only; this was justified on the basis of a range of indicators to demonstrate that the areas targeted were the most disadvantaged among the remaining municipalities.

In *Finland* the bulk of the ‘c’ area quota is generated under the low population density criterion and from the status of Itä-Suomi as an economic growth region. In practice, however, the selection of eligible areas was not based on these EU criteria, but rather on an internal system, broadly similar to that used for 2000-6. This was based on the Seutukunnat (LAU1), using the following indicators:

- GDP
- Unemployment (comprising the unemployment rate and the share of youth and long-term unemployed in the total)
- Net migration
- An income and education index.

Regions were ranked according to these criteria and classed into five groups; Groups 4 and 5 were proposed for designation in the map submitted to the Commission. Reflecting the designation system outlined above, no areas were *proposed* simply on the basis of low population density. However, in the Commission analysis, low population density accounts for a third of the eligible areas (with Itä-Suomi, an economic development area, accounting for a further 38 percent). In central Finland (Keski-Suomi) a single zone containing 152,897 inhabitants was designated on the basis of *Paragraph 30c*. The next most significant category is *Paragraph 30g* which concerns regions bordering non-EU or EEA states; two sub-regions of Etelä-Karjala which border Russia and have a population of 115,848 were designated on this basis. In addition, a number of small islands with a total population of over 38,658 were designated under *Paragraph 30f.* A single area (Pohjois-Satakunta and the neighbouring Suupohja) with a population of 54,319 were designated under *Paragraph 30h*, this being justified on the basis of a range of national indicators, which were accepted by the Commission. Three areas were proposed for SME aid under *Paragraph 31.* These are: Ylä-Pirkanmaa in central Finland (population 40,818), which the Finnish authorities argued was the 8th most disadvantaged area (out of 48) outside northern and eastern Finland; the city of Kuusankoski (population 20,247) in southern Finland, which is set to be affected by the imminent closure of several paper manufacture related activities; and Ålands Landsbygd (population 12,829) which has a significantly lower level of value-added per head than the capital town Mariehamn and which has a sparse population, low skills base and is relatively inaccessible.

In *France*, as described, the task of devising the assisted maps was undertaken at the regional level, led by the regional *Préfets* and involving local partners. It was decided at

the outset that Corsica would be designated as a 'c' area in its entirety; the remaining 21 regions were each assigned a population quota. A circular from DIACT[36] to the *Préfets* outlined the parameters set by the Commission in the Guidelines. In addition, DIACT provided a database of 19 statistical indicators to assist in the exercise. The maps proposed by the regional level were then brought together into a single national map for notification. This approach meant that there was no single system applicable to all French regions; the *Préfets* were free to choose their own combinations of indicators and criteria.

The initial notified map was subject to extensive discussion with the Commission, leading to a revised notification some eight months later. The French map was amongst the first to be notified and amongst the last to be approved, reflecting the Commission's well-used strategy of saving potentially precedent-creating decisions until the last moment.

The negotiations between the French authorities and the European Commission were by far the most controversial.[37] As mentioned earlier, the drafting of area designation proposals was delegated to the *préfets de region.* Each *préfet* was provided with detailed instructions which the Commission had apparently endorsed, or at least had had the opportunity to correct. However, the resulting map was essentially the sum of the regional parts, rather than the outcome of any overarching strategy. Moreover, while the map proposals may largely have followed the *letter* of the guidelines – some omissions of information and minor errors of calculation notwithstanding – it seems probable that the Commission was surprised at the cosmetics of the proposal and took the view that it was contrary to the *spirit* of the guidelines. Indeed, the proposal exploited to the full the omission from RAG 2006 that 'c' areas should form "compact" as well as "contiguous" zones. Under RAG 1998, the 'compactness' provision had enabled the Commission to reject proposals which displayed too many 'white spots', especially where zoning targeted industrial areas to the exclusion of associated residential neighbourhoods.

Exchanges between the French authorities and the Commission in the summer and autumn of 2006 culminated in a letter from the Commission seeking various revisions to the map proposal. The most fundamental of these was that the areas designated under Paragraph 30c should be contiguous zones displaying real economic interdependence and set within a well-defined regional development strategy, reflecting the Commission's opposition to what it characterised as ribbons of diverse areas snaking over distances of a hundred kilometres of more. The Commission also sought further justification of the areas proposed under Paragraph 30h.

The French authorities produced a robust defence of their position, noting that there was no requirement in the Guidelines for zones to be compact or homogenous, as had been required previously, and that the decision to decentralise area designation was consistent with legislation that had made economic development a regional responsibility. Nevertheless, as well as providing further justification for the original proposal, the

[36] The national regional development agency, Délégation interministériel à l'aménagement et à la compétitivité des territoires, formerly DATAR.

[37] The Italian map has not yet been agreed.

response also proposed some adjustments to the original map. These mainly took the form of adding communes to the map where the points of contact were not perceived to be broad enough to amount to contiguity. In addition, in several areas, zones comprising 50,000 inhabitants were linked to reach the 100,000 threshold and bring the area concerned within the ambit of Paragraph 30c, obviating the need for a more specific justification under Paragraph 30h. In their initial proposal, the French authorities had proposed to keep back a population reserve to be used in the event of new issues arising (eg. major plant closures) during the 2007-13 period; part of this reserve was used to 'improve' contiguity. For its part, the Commission allegedly consulted its legal services about challenging the 'shape' of the map, but this was deemed to be ill-advised. At a political level, however, the situation was eased by the intervention of the then minister for territorial development, Christian Estrosi, and, after further bilateral meetings the Commission approved the revised map proposal. Although the list of changes submitted by the French authorities was quite extensive, these were changes of detail and did not alter the overall character of the map. Moreover, it was felt that while the Commission remained opposed to the map, the combination of its compliance with a strict reading of the guidelines and the endorsement by the Commission of the instructions to the *préfets* gave it little choice but to approve it.

Turning to the map as actually approved, most of the French assisted areas were proposed under *Paragraph 30c.* A total of 38 areas were designated under this provision, together accounting for almost 60 percent of the French assisted areas (and 10.5 percent of the French population).

Two areas were designated under *Paragraph 30e,* which allows islands or other isolated areas meeting the pre-eligibility criteria to be designated. Corsica (a NUTS II region) and parts of the NUTS III Jura region were included on this basis. In the case of Haut-Jura, the Commission noted that the area proposed fell within a NUTS III areas with GDP per head below the EU25 average and considered that the mountainous area (close to the Swiss border) was sufficiently cut-off to meet the 'isolation' criterion. These areas account for just 0.5 percent of the French population.

A single commune – Jeumont, in the Nord-Pas de Calais region (population 10,775) – was designated on the basis of *Paragraph 30g,* which allows for the designation of areas adjacent to 'a' regions. Jeumont shares a border with Hainaut in Belgium, which is classed as a statistical effect area and an 'a' region at least until end 2010. Thereafter, the status of Hainaut would be subject to a reassessment on the basis of GDP per head, but at the least entitled to 'c' status until end 2013. The French authorities have requested that, in the event of Hainaut losing 'a' status, Jeumont should be considered eligible on the basis of Paragraph 30c, the pre-eligibility criteria for the Nord NUTS III area being met and its contiguity with Hainaut enabling the minimum population requirement to be reached.

France made extensive use of *Paragraph 30h*, which enables smaller zones (less than 50,000 population) to be designated on the basis of structural change or significant relative decline. Some 26 zones were designated on the basis of Paragraph 30h and all were already

the subject of a *contrat de site* or a *contrat territorial*, a fact which contributed to the Commission's acceptance of their inclusion in the map.[38] For the most part, the justification for designation was supplied at the level of *zones d'emploi* and mainly relied on unemployment rates and income levels compared to the national average, but factors such as outmigration, dominance by particular activities or share of unskilled labour were also mentioned. The areas affected are predominantly industrial and the principal rational for their inclusion concerned the restructuring of activities that dominate the locality, for example: the motor industry (Gironde, Sarthe); aeronautics/ defence (Gironde, Chatellerault); textiles (Somme, Ales-Le Vigan, Ariège, Tarn); shipbuilding (Nord Contentin, Saint-Nazaire); chemicals or petrochemicals (Rouen, Marignane); or the closure or reduction of the workforce of specific firms, eg. Kodak (Chalon-sur-Saône), Sony (Pays Basque), Moulinex (Orne), Michelin (Poitiers), Nestlé (Marseille). In addition, however, some predominantly rural areas (parts of Pyrenées Atlantiques and Bretagne) and some urban areas (parts of Marseille and Seine-St Denis near Paris) were also included. The total population designated on the basis of Paragraph 30h is over 2 million – some 3.5 percent of the French population. These areas account for around two-thirds of the EU27 total designated on this basis so far.[39]

A small proportion of the national population (about 0.6 percent) was designated for SME support only under *Paragraph 31.* A total of 14 zones were designated on this basis, justified with respect to the decline in specific sectors which dominate the locality or unemployment trends. In practice, the rationale for this approach had less to do with an explicit policy to target SMEs and was more concerned with the difficulty of achieving the minimum 100,000 population threshold for targeting assistance at large firms.

In *Germany*, the method adopted largely followed past practice, although, as noted, for the first time the same system was applied to the old and new *Länder*. However, a specific issue that arose was the classification of Lüneberg as a statistical effect 'a' area. The federal authorities and several of the *Länder* argued that 'a' status did not reflect the economic development situation of the entire region. This is perceived to be varied: some parts of the region do have economic weaknesses comparable to those of the new *Länder,* but others have low GDP per head purely because they are within the Hamburg commuter belt. Internally agreement was reached that each region's labour market areas should be treated separately based on the results of the national area designation model, rather than the whole region simply being designated an 'a' area on the basis of EU criteria. As a result, two of the labour market areas were designated as 'a' areas, a further three as 'c' areas and the remainder left as non-assisted; resulting coverage amounts to 42 percent of the Lüneberg population. As a consequence of this decision, assisted area coverage in Germany is slightly less than the ceiling; the German authorities argued, albeit not very aggressively,

---

[38] These *contrats* were established as policy instruments in 2003 and aim to support structural change brought about by major industrial closures. The delimitation of the areas is more extensive in the case of *contrats de site*, where the problems are more severe than in the areas designated under the *contrats territoriaux*.

[39] Excluding Italy.

for the transfer of the surplus to the 'c' area population quota (as accepted by the Commission in applying the 1998 Guidelines), but the Commission refused.

The German area designation model for 2007-13 uses the same indicators as in the past, namely:

- Average unemployment rate 2002-5 (50 percent)
- Annual gross wage per employee paying social insurance in 2003 (40 percent)
- Employment forecast 2004-11 (5 percent)
- Infrastructure (5 percent)

The weightings given to each indicator are slightly different from the 2000-6 exercise: more weight was given to unemployment and less to infrastructure and the employment forecast in the 2007-13 exercise. Labour market regions were ranked on the basis of these indicators and a 'cut-off' applied to respect the population quota. The *Länder* were then invited to identify areas with problems not properly reflected in the model and to swap eligible areas, within the eligible population for the *Land*.

As mentioned earlier, a major issue concerned the treatment of Berlin. The German authorities were concerned that if the whole of Berlin continued to be eligible, this would consume too large a proportion (over a third) of the population ceiling for the 'c' areas, leading to a disproportionate reduction elsewhere. Accordingly, there was internal agreement to apply the reduction in coverage to meet the new population new ceiling to Berlin and the west German *Länder* equally, so that around 70 percent of the Berlin population would continue to be in 'c' areas.

Almost 80 percent of the German 'c' areas are approved under *Paragraphs 30 c* and *d* of the guidelines - that is, they consist of 100,000 population blocks or NUTS III areas which meet the pre-eligibility criteria. This amounts to some 18 zones and two NUTS III regions. Under *Paragraph 30f*, the island of Helgoland in Schleswig-Holstein was designated.

Areas in four *Länder* (Bayern, Hessen, Niedersachsen, Schleswig-Holstein) were designated on the basis of *Paragraph 30g,* sharing a boundary with an 'a' area; these are partly in the new *Länder* and partly in the Czech Republic. The areas approved amount to less than 2 percent of the German population.

A small proportion of the population (just 0.5 percent) was designated on the basis of *Paragraph 30h* as structural change areas. Four areas were approved. In the Pirmasens labour market area the German authorities argued that, although parts of the zone did not meet the pre-eligibility criteria for Paragraph 30 c or d, the area as a whole had been seriously affected by the dismantling of military facilities and the withdrawal of US and German armed forces based in Zweibrücken, leading to job losses and the abandonment of large tracts of land. The area holds a population of 157,743. The labour market area of Kaiserlautern (comprising two whole and parts of a further NUTS III region) was also designated partly owing to the impact of military redeployment (of US airbases) and partly

because of decline in the automotive and mechanical engineering sector. The area has a population of 113,069. The designation of Stadverband Saarbrücken (population 50,462) was essentially justified by the decline in the coalmining industry leading to major job losses. Last, the Commission approved the designation of parts of Landkreis Steinburg (population 966,685), an area with a weak industrial structure which had fallen 35 places in the regional ranking used as the basis for area designation.

Last, the German authorities designated some 0.15 percent of the population for SME aid under *Paragraph 31.* Two areas were approved: parts of Bremen, which is affected by closures in manufacturing, automotive and shipbuilding; and Weiden, in Bavaria, which is affected by the proximity of the Czech Republic and its impact on wage differentials.

In *Ireland* the Border-Midland-Western (BMW) NUTS II region is eligible as an economic development area and was retained as such in its entirety by the Irish authorities under *Paragraph 30a.* In addition, the entire NUTS III region of South East Ireland, with a population of 423,616 was proposed under *Paragraph 30c*, accounting for about one-fifth of the national population. Some small islands (containing just 539 inhabitants) were approved by the Commission under *Paragraph 30f.* Of wider significance, the single largest element of the map outside the BMW region is the designation of areas at LAU1 and below for SME aid on the basis of *Paragraph 31.* These are counties Clare, Limerick (City and County), North Tipperary and Kerry, together with the Cork Urban Regeneration Area, involving a total population of 495,977. According to the Commission decision, a range of indicators support this selection, including income per head and unemployment rates. The Cork Urban Regeneration Area was designated on the basis of specific problems of urban blight caused by deindustrialisation. Ireland also had the most extensive transitional areas in the EU (amounting to almost a quarter of the national population). The areas covered are the same as those under Paragraph 31, except that the whole of the City and County of Cork is covered, not just the Urban Regeneration Area.

In *Luxembourg* a special provision enabled the minimum population block used under *Paragraph 30c* to be reduced to 10,000, rather 100,000. This was extensively used by the Luxembourg authorities which designated four zones on this basis, with populations ranging from 31,213 to 10,348, each with unemployment rates well above the national average.

For *Portugal*, the ‘c’ area population quota of 2.8 percent represented just over 290,000 inhabitants, with around three-quarters of the country having ‘a’ status. Reflecting the very modest ‘c’ quota, this was allocated entirely on the basis of *Paragraph 30g* (areas bordering ‘a’ areas), which does not have a minimum population requirement. Four of the areas selected are in the NUTS III area of Peninsula de Setúbal and comprise a total of 24 LAU2 areas with populations ranging from 13,010 to 113,934; a fifth area is in the Grande Lisboa NUTS III area and has a population of 61,991. Paragraph 30g requires no further justification other than being adjacent to an ‘a’ area.

In *Spain* the ‘c’ population quota was also very limited once the economic development and low population density areas were taken into account. Although the ‘c’ area total is 17.7 percent of the national population, only 1.1 percent of the population did not qualify on the basis of either Paragraph 30a or b – ie. was not *a priori* ‘entitled’ to ‘c’ status. In

practice, the Spanish authorities curbed the coverage of areas under *Paragraph 30a,* excluding a densely-populated part of the Valencia region thereby reducing Paragraph 30a coverage to 14.3 percent, from a potential 16.1 percent of the national population and 'releasing' some of the quota to be used elsewhere. The NUTS III area of Teruel was designated in its entirety on the basis of low population density (*Paragraph 30b*), the first non-Nordic region to be so designated in recent times. Two whole NUTS III regions (Cantabria and Huesca, with a population of 733,895) were designated on the basis of *Paragraph 30c.* In Madrid and Aragón the Spanish authorities proposed areas which border 'a' regions, in line with *Paragraph 30g*. The Madrid zone contains almost 77,000 inhabitants, while the Aragón area (in Zaragoza) is larger with over 206,000. Last, three zones were designated on the basis of *Paragraph 30h,* areas affected by structural change. In País Vasco an area containing 70,236 inhabitants, mainly affected by closures in the shipbuilding and die-casting industries and with unemployment 75 percent higher than the national average was approved by the Commission. A slightly larger zone (102,209 inhabitants) was designated in the Barcelona region, mainly justified by the impact of decline in the textile and mining sectors. Finally, in Navarra, some 139 municipalities (containing just 55,429 inhabitants) were approved for designation by the Commission on the basis of the demographic situation (ageing population, population decline) and the large share of employment in agriculture compared to the national average.

In *Sweden* around half the assisted areas were approved on the basis of low population density – *Paragraph 30b.* In practice, a much larger proportion of the national population qualifies according to this criterion (1.156 million, as opposed to the 710,060 actually designated). This reflects the decision of the Swedish authorities to exclude the main population centres Luleå, Umeå and Sundsvall from eligibility, enabling this population to be used elsewhere. Under *Paragraph 30c*, a single contiguous zone cutting across three NUTS III areas and holding a population of 306,930 (about 3.4 percent of the Swedish population) was approved. Under Paragraph 30h (structural change) two further areas were designated, comprising just over four percent of the Swedish population. Parts of the Kalmar NUTS III region containing 72,640 inhabitants were designated as was the 'Värmland-Örebo-Västra Götaland' zone which cuts across three NUTS III regions, taking in a population of 293,603. This was justified partly on the basis that the GDP and employment figures for Västra Götaland as a whole were not enjoyed by municipalities at the periphery of the region, and partly because of major industrial closures, high unemployment and a sharp fall in the population.

In the *United Kingdom* the development of the assisted areas maps was the subject of extensive consultation. At Stage 1, the consultation paper asked whether the economic development areas (Merseyside and South Yorkshire) should be designated as 'c' areas in their entirety (most respondents were opposed to this, so these areas were subject to the same analysis as all other potential 'c' areas); more generally the paper sought feedback on what indicators should be used. The responses to these questions, together with the decision to include Northern Ireland in its entirety, formed the basis for the map proposals which were the subject of a further consultation.

The starting point for the first government proposal was the existing map in conjunction with what it terms the Commission's "filter" (ie. the pre-eligibility criteria) to eliminate a

number of areas from the map.[40] In other words, there was, in effect, a requirement that areas meet the pre-eligibility criteria AND fall within the 2000-6 assisted areas map; moreover, there was an explicit decision *not* to use the scope to designate small areas for SME aid only (*Paragraph 31*). The government rejected the suggestion that *Paragraph 30h* be used, judging that the areas concerned did not display the scale or severity of decline that the Commission would find sufficient to justify special treatment.

Regarding indicators, a wide range of criteria were apparently put forward in the consultation. As a result of the process the government used the following:

- Employment rate
- Adult skills
- Incapacity benefit claimants
- Manufacturing share of employment

As noted earlier, ward level data were used to build up zones with a minimum population of 100,000. For a zone to be eligible for coverage it was proposed that it must be:

- *Either,* one standard deviation worse than the Great Britain average on any one of the four indicators
- *Or,* half a standard deviation worse than the Great Britain average on at least two of these indicators.

The resulting map was the subject of further consultation prior to submission to the European Commission. This process resulted in "a significant number of small scale ward 'swaps'", but did not alter the basic premises on which the initial map had been designed.

As a result of the approach taken by the UK authorities – the 'filter' approach - the bulk of the 'c' areas are eligible on the basis of *Paragraph 30c*. This accounts for about 12.6 percent of the UK population (and about two-thirds of all 'c' areas). Economic development areas (*Paragraph 30a*) cover some 6.4 percent of the population and are less extensive than the 7.3 percent which the Commission would have allowed (but this quota is used up elsewhere). In addition, there are four areas in Wales, which border West Wales & the Valleys, that are eligible on the basis of *Paragraph 30g* (areas adjacent to 'a' areas); these contain just 0.3 percent of the population.

2.2.3 Continuity and change

Figure 5 aims to summarize the extent to which the new guidelines have induced continuity or change in area designation systems and outcomes. RAG 1998 was highly prescriptive regarding the choice of geographical unit (building blocks), the insistence on a ranking of

[40] Namely: Halton and Ellesmere Port; South Manchester; North Warwickshire; Lowestoft; Brighton and Hove; and Edinburgh and West Lothian.

regions and the number of indicators and their perceived relevance. The constraints of that system made the negotiation of the maps for 2000-6 highly contentious. All of these constraints were relaxed under RAG 2006, although almost all Member States are subject to much lower 'c' area coverage.

Figure 5: Impact of the new guidelines on area designation systems and outcomes

	Admin process	Building blocks	Designation method	Indicators	Outcome
Belgium	Different	Same	Different	Different	*Flanders*: Different *Wallonia*: Subset
Denmark	Same	Different	Similar	Different	Similar
Germany	Same	Same	Similar	Same	Similar
Spain	Same	Different	Different	Different	Similar
France	Different	Different	Different	Different	Different
Italy	Different	Different	Different	Different	
Lux	Same	Same	Different	Different	Similar
Neths	Same	Different	Different	Differ	Subset
Austria	Same	Different	Different	Different	Similar
Finland	Same	Same	Similar	Similar	Similar
Sweden	Same	Different	Different	Different	Similar
UK	Same	Different	Different	Different	Subset

In terms of the *administrative process*, in Belgium, France and Italy the approach to designating 'c' areas been significantly different to that under RAG 1998. In *Belgium*, the change reflects the fact that regional development is not a national responsibility and the requirement for a single system covering the entire country was wholly artificial in the Belgian context; it is scarcely surprising that, once agreement had been reached on the division of the population quota, the task of area designation should revert to the regional level. In *France*, the decision was taken to delegate the area designation process to the *préfets de region*. In reality, this is not such a radical step as might first appear, and this for several reasons: first and foremost, the *préfet* is the government representative in the region, and not, therefore, an independent regional actor; second, key decisions about the map, such as statistical data and population coverage, were made centrally; and third, the final decision, and responsibility for it, lay at the central level. In essence, the decision to 'decentralise' the decision is about exploiting local knowledge and understanding of economic conditions rather than devolving responsibility to the subnational level. In *Italy* the change reflected constitutional changes which devolved economic development responsibilities to the regional level.

In *Austria, Germany* and *Spain* the administrative arrangements for area designation remained essentially the same as in 1998/9, reflecting the importance of partnership between the national and *Land* levels. In the smaller Member States (*Denmark, Finland, Luxembourg, Sweden, the Netherlands*) area designation remained a national responsibility, as before, and, in the *United Kingdom,* again as previously, area designation was the subject of an extensive public consultation process.

In terms of *building blocks,* many countries took advantage of the more relaxed rules to use smaller geographical units than under RAG 1998. RAG 1998 was highly constraining in this respect: it prescribed the use of NUTS III as the building block, unless otherwise justified in which case an alternative 'homogenous unit' could be used; and only one type of unit could be used for the selection of all 'c' areas. The principal 'escape clause' from this constraint was the provision for consistency with the Structural Funds; this was used to designate partial building blocks in some countries, albeit mainly as means of resolving difficult negotiating issues between the Commission and Member States. The choice of unit and its use by the Member States were the most contentious issues in the 1999 negotiations. In RAG 2006, there is no prescription regarding the choice of unit *per se*, the main limits relating to minimum population blocks (100,000, 50,000 and 20,000 under Paragraphs 30c, 30h and 31, respectively). Moreover, the references to 'homogeneity' and 'compact' zones having been dropped, Member States had considerably more freedom than before. In Germany, Finland and Luxembourg, however, the same building blocks were retained. In *Germany* this reflects a long-standing tradition in regional policy where a labour-market area based approach has been at the core of the area designation system for several decades. In *Finland*, the decision was taken to retain broadly the same system as under the previously guidelines. In *Luxembourg,* the smallest administrative unit (NUTS V, now named LAU2) had already been allowed by the Commission in 1999, reflecting the small size of the Luxembourg population. Elsewhere, most notably in *Spain, France, Austria, Sweden,* the *Netherlands* and the *UK***,** the strategy was to use the smallest unit possible to build up blocks of population meeting the relevant thresholds. This is clearly a major shift and one which considerably eases the task of area designation, partially mitigating the impact of much lower population ceilings.

RAG 2006 is also much less prescriptive in terms of *area designation systems.* RAG 1998 required the proposed list of eligible regions to "be arranged on the basis of the indicators" chosen and to show significant disparities (at least half the standard deviation) compared to other areas in the Member States concerned. In short, RAG 1998 apparently required a ranking of eligible areas, with the implication that areas be designated in the order in which they appeared in the ranking, subject to the population ceiling.[41] No country has retained the system dictated by RAG 1998, although Germany, Denmark and Finland have opted for similar approaches, albeit dispensing with some of the rigidities. RAG 1998 was ostensibly modelled on the German system, although important differences of detail – most notably the capacity to exchange areas where the statistics were not felt appropriately to reflect the real situation - made the application of RAG 1998 to the German context highly controversial. RAG 2006 eased those difficulties for *Germany*, enabling it to apply the long-standing domestic system unfettered by the Commission. Similarly, *Denmark* and *Finland* opted for systems that were similar to the previous approach to the extent that they involved a single ranking of regions according to the selected criteria, although areas were not necessarily designated in order of ranking. In *Spain* the aim was to optimise the use of population coverage and take account of the priorities of the Autonomous Communities. In practice, this was the same objective as for the 2000-6 period, but was *technically* easier

[41] In practice, this was not universally enforced.

to achieve within the parameters of RAG 2006, although the map was more constrained by the population ceiling than before. In the *Netherlands,* given the limited population quota, area designation focused on three aspects: 'pre-eligible' areas; border areas; and existing designated areas which reflected new regional strategies. Using these criteria, support is focused on the north, but with cutbacks to concentrate support on areas with growth potential, and south Limburg. In the *UK*, the starting point was the existing map, together with the pre-eligibility criteria; four indicators were then chosen to prioritise areas within this set. In *Belgium, France* and *Austria* there was, in effect no national area designation system, the selection of areas being delegated to the subnational level; this approach would have been completely untenable under RAG 1998.

More generally, it could be said that, in many countries, the new rules led to a more *qualitative* approach to area designation where the emphasis was often on building up zones of the required population size within the pre-eligible NUTS II or III areas and, for priority areas that were not pre-eligible, or where the population threshold could not be reached, finding sufficiently compelling arguments to designate them. In other words, because the area designation system *per se* was not subject to scrutiny as it had been under RAG 1998, Member States simply had to shoehorn their own preferences, however arrived at, into the overarching criteria of RAG 2006.

Partly reflecting this, with the exception of Germany and Finland, Member States tended to use different sets of *indicators* for area designation under RAG 2006 than in the last round. In *Germany***,** the same indicators were used, although the weighting was altered and, for the first time, the system was applied uniformly to the old and new *Länder*. Elsewhere changes were more significant. In *Denmark,* for example, the indicators used were income and population trends; previously the criteria contained several employment-related indicators. In *the Netherlands* a more pragmatic and less indicator-based approach was used. In the **UK**, the indicators for residence and workplace based unemployment rates were dropped in favour of measures of adult skills and number of incapacity benefit claimants. As noted, in *Belgium, Spain, France, Italy* and *Austria* areas were in effect chosen on the basis of different criteria in different regions, the process having been largely or entirely decentralised.

Turning to *outcomes,* Figure 5 characterises the resulting maps as similar, different or subset. As all EU15 countries not wholly covered by 'a' or 'c' status in 2000-6 suffered reductions in coverage for the 2007-13 period, no maps could be characterised as being the same. In this context "subset" refers to an approach where the starting point for the 2007-13 map was the existing map, avoiding the need for 'unnecessary' dedesignation; this was the line taken in *Wallonia* (Belgium) and the **UK**. "Similar" refers to maps that are cosmetically comparable to their predecessors but contain some new assisted areas, in spite of the overall reduction in coverage. *Germany, Spain, Luxembourg, Austria, Finland* and *Sweden,* all fall into this category. Last, "different" refers to maps that are cosmetically quite distinct from their predecessors notably in *France,* which had to deal with the largest cutbacks in coverage, doubtless creating an impetus for the judicious use of the coverage remaining.

2.3 The block exemption regulation, exempted and notified measures

2.3.1 Background

The Regional Aid Block Exemption Regulation (BER)[42] introduced at the end of 2006 is an important change in the administrative arrangements for regional aid. It brings the approval of regional aid schemes into line with that of other aid areas considered to be straightforward, namely SME aid, training and employment aid. The essence of the approach is to exempt from prior Commission approval measures that meet certain criteria; these measures can then be implemented by the Member State, subject to reporting and various transparency requirements. The objective is to lighten the administrative burden on the Commission by eliminating from the scrutiny process those measures that evidently comply with the RAG 2006 and for which approval amounts to little more than a bureaucratic rubber-stamping exercise. This section begins by outlining the key provisions of the Regional BER and proposals for change which are currently under discussion. It goes on to provide an overview of the measures introduced to date by Member States, whether on the basis of the Regional BER or following prior notification and Commission approval.

2.3.2 Regional aid block exemption

(i) Current provisions: Regulation 1628/2000

The Regional BER applies to schemes put into effect after 31 December 2006. The Regulation enables schemes meeting certain criteria and whose legal basis cites the BER to be exempted from prior notification and Commission approval.

In order to fall within the scope of the BER, aid schemes must be 'transparent',[43] must comply with the geographical coverage[44] and aid ceilings[45] of the approved regional aid map and aid must be 'necessary'.[46] In addition, eligible expenditure must meet certain criteria, notably that investment be retained in the recipient region for at least five years (three for SMEs).[47]

In the context of the Regulation, *transparency* means regional investment aid schemes under which it is possible to calculate *ex ante* the gross grant equivalent (GGE) as a percentage of eligible expenditure. Such schemes include grants, interest rate subsidies and capped fiscal measures. Schemes which use public loans are considered transparent if they are backed by normal security and do not involve abnormal risk (and are not therefore

---

[42] Commission Regulation (EC) No 1628/2006 of 24 October 2006 on the application of Article 87 and 88 of the Treaty to national regional investment aid, OJEU No L 302 of 1 November 2006.

[43] Article 2(i).

[44] Article 4(1)(a).

[45] Article 4(1)(b).

[46] Article 5(1).

[47] Article 4(2).

considered to contain a state guarantee element).[48] Public participation and aid in risk capital measures are not considered transparent.

Regarding the *necessity* for aid, the BER only exempts schemes from notification if, prior to work on the project starting, the beneficiary has submitted an application and received from the awarding authority written confirmation that the project meets the eligibility criteria for the scheme (subject to a final detailed verification). An express reference to these two requirements must be included in the scheme; if work begins before these requirements are fulfilled, the whole project becomes ineligible for aid.

Ad hoc aid which is used to supplement aid granted on the basis of transparent regional aid schemes, and which does not exceed 50 percent of the total aid, is also exempt from notification provided that the *ad hoc* aid fulfils all the criteria of the Regulation.[49] This provision would enable, for example, a local authority to complement national level incentives (subject to the prevailing regional aid ceiling); however, it does not allow for the use of *ad hoc* aid independently, which must always be notified, unless it is *de minimis.*

The following categories are explicitly *not* exempted from notification and must be approved by the Commission on a case-by-case basis prior to implementation:[50]

- Non-transparent regional aid schemes.
- Regional aid schemes targeted at specific sectors of economic activity within manufacturing or services (schemes targeting tourism are not considered specific).
- Regional aid schemes which involve operating aid.
- Regional aid schemes which provide for aid other than investment or consultancy aid to newly created small enterprises.
- Regional aid for large projects on the basis of existing schemes where the amount of aid exceeds the notification threshold – ie. the amount that a €100 million investment could receive.
- *Ad hoc* aid, other than that which supplements exempted aid (as mentioned above).
- Aid to firms which are subject to a recovery order following the award of illegal and incompatible aid.

Member States must provide summary information on schemes they deem to be exempted from notification within 20 days of implementation. Records of aid awarded under exempted schemes must be maintained; these must be sufficiently detailed for the

[48] Schemes which do comprise a guarantee element may be considered transparent if the Commission has, since the adoption of the Regulation, accepted the methodology used to calculate the intensity of the guarantee.

[49] Article 1(1).

[50] Article 7.

Commission to establish that the conditions of the Regulation have been complied with. The full text of the aid scheme must be published and the internet address of the publication provided.

(ii) Proposals for change: the General Block Exemption Regulation

As part of the rationalisation and simplification of the State aid rules, the Commission is in the process of finalising a so-called General Block Exemption Regulation (GBER). This brings together existing block exemption Regulations,[51] amends those regulations in certain areas and extends the scope of policy areas included under the block exemption approach.[52] It is anticipated that the GBER will be adopted in Spring 2008 and replace the existing block exemption regulations at that time.[53] Schemes implemented on the basis of the Regional BER will not be affected by the new requirements; only those adopted after the entry into force of the GBER will have to comply with it.

The draft GBER is in two parts. The first contains 'common provisions' affecting all aid types (scope, definitions, aid intensity and eligible costs, transparency, individual notification thresholds, cumulation, incentive effect, transparency and monitoring and conditions for investment aid). The second part contains rules relating to individual aid areas (SME aid, environmental protection aid, regional aid etc.).

As far as the Regional BER is concerned, a number of changes are envisaged in the draft; these would flow from the 'common provisions' of the GBER.[54] For the most part, these are essentially a 'sharpening' up of the definitions relating to, for example, eligible assets, monitoring requirements and the scope of transparent aid, rather than involving significant substantive changes. However, the draft GBER introduces additional requirements in respect of the 'necessity' of aid.

In the Regional BER, as noted above, under the heading 'Necessity for the aid', potential beneficiaries must apply for aid and must receive written confirmation of eligibility prior to work on the project starting. In the draft GBER, the conditions are much more stringent. In particular, the provisions[55] specify that the GBER only exempts aid which has an incentive effect. For SMEs it is sufficient for the beneficiary to have submitted an application prior to project start. However, for large firms aid must enable "the beneficiary to carry out activities or projects which it would not have carried out in the absence of such aid." As far as regional aid is concerned, it shall be considered to have an incentive effect if "in the absence of aid, the investment project would not have been carried out in the assisted area concerned". This must be substantiated by the Member State which must verify that the

[51] Those for SMEs, training aid, employment aid and regional aid.

[52] To include environmental aid, risk capital and R&D aid to large firms.

[53] DG Competition (2007) Memorandum on the draft block exemption regulation, 11 June 2007, available at: http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm

[54] European Commission (2007) Draft General Block Exemption Regulation, available at: http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm

[55] Article 8 draft GBER.

documentation provided by the beneficiary establishes the incentive effect of aid on the basis of one or more of the following criteria:[56]

- Increased size of the project/activity due to the aid
- Increased scope of the project/activity due to the aid
- Increased total amount spent by the beneficiary on the project/activity due to the aid.

Where the requirements on the incentive effect of aid are not met, the entire aid measure will not be exempted under the GBER. The Commission views the demonstration of an 'incentive effect' to be "one of the cornerstones of the refined economic analysis to be implemented in the State aid area".[57] For some Member States, this requirement is unlikely to be viewed as onerous, already being a standard component of the application process.[58] However, others[59] have expressed concern that these requirements will give rise to legal uncertainty, placing firms in a situation in which it is unclear whether the documentation provided is sufficient. No indications of the level of detail or counterfactual analysis required are provided in the draft. More generally, it might be observed that it is difficult to *prove* that certain activities would not have been undertaken without aid; on the other hand, given the informational advantage that an undertaking has concerning its own operations, the value of such documentation purporting to provide such proof might anyway be in doubt.

2.3.3 Approved measures

To date a number of measures have been notified under the Regional BER or notified to the Commission (or ESA). However, progress has arguably been relatively slow, with a number of countries still having no regional aid schemes in place. Moreover, there is a time lag between the reporting of a measure and its publication in the Official Journal and an even longer delay where notification and Commission approval is required.

Figure 6 shows the number of schemes implemented in each country. In practice, this is a crude measure of progress in implementation. This is largely because the numbers are distorted in countries where responsibility for regional economic development lies mainly at the subnational level or where there is a tradition of regional differentiation. There are already signs, in line with the Commission's intention, that Member States will opt to design schemes that fit within the BER and avoid schemes which will require case-by-case scrutiny. This is reflected in the small number of schemes individually notified.

---

[56] These requirements do not apply to fiscal measures where there is a legal right to aid in accordance with objective criteria and without further exercise of discretion by the Member States.

[57] DG Competition (2007) Memorandum on the draft block exemption regulation, point 35.

[58] See Draft General Block Exemption Regulation: Response from the UK Government at: http://www.berr.gov.uk/files/file40738.pdf

[59] See, for example, Confederation of European Business Comments on Draft Block Exemption Regulation, 5 June 2007 at: http://www.businesseurope.eu/content/Default.asp?PageID=424

Figure 6: Block exempted and notifiable schemes (Status at August 2007)

	Block-exempted schemes (published in OJ)	Approved individually-notifiable schemes
Belgium	3	
Bulgaria		
Czech Rep	2	
Denmark		
Germany	3	
Estonia		
Greece	1	
Spain	17	3
France		
Ireland	2	
Italy		
Cyprus		
Latvia		
Lithuania	2	
Luxembourg		
Hungary	3	1
Malta		
Neths		
Austria		
Poland	5	
Portugal		1
Romania	6	
Slovenia		
Slovakia		
Finland		1
Sweden	1	
UK	10	
Iceland		
Norway	1	3

Source: Official Journal, various editions; and European Commission State Aid Register at: http://ec.europa.eu/comm/competition/state_aid/register/

(i) Block-exempted schemes

Summaries of some 55 schemes have been published on the basis of the Regional BER; about half these are in Spain and the UK (see Figure 7). To date, 16 Member States have not reported schemes under the BER. However, it would appear that almost 100 further schemes, covering almost every Member State, are in the pipeline.[60] There is no published information on the substance of these measures.

[60] See: http://ec.europa.eu/comm/competition/state_aid/register/i/

Figure 7: Aid Schemes Notified under the Regional Block Exemption Regulation (OJEU as at 21 August 2007)

Country	Region	Scheme Title	Annual budget (€m)
Belgium	Wallonia	Incitants en faveur des petites ou moyennes entreprises	103.17
Belgium	Wallonia	Incitants en faveur des grandes entreprises	50.25
Belgium	Brussels	Aides regionales pour les investissements generaux en faveur des micro et PME	5.00
Czech Republic	‘a’ and ‘c’	Investment Incentives	74.23
Czech Republic	‘a’ and ‘c’	Ramcovy program pro podporu technologickych center strategickych sluzeb	34.30
Germany	New Lander; Berlin 'c' areas	Investitionszulagengesetz 2007	580.00
Germany	Nordrhein-Westfalen	RWP NRW Richtlinie fur die Gewahrung von Finanzierungshilfen zur Forderung der gewerblichen Wirtschaft einschliesslich des Tourismusgeweres vom 15.12.2006	24.00
Germany	‘a’ and ‘c’	Gemeinschaftsaufgabe "verbesserung der regionalen Wirtschaftsstruktur" (GA)	60.00
Greece	‘a’ and ‘c’	Kinitra idiotikon ependyseon gia tin oikonomiki anaptyxi kai tin perifereiaki sygklisi	2,080.00
Hungary	‘a’ and ‘c’	Fejlesztesi adokedvezmeny (Development tax benefit)	69.58
Hungary	‘a’ and ‘c’	A Kornamy egyedi dontesevel megitelheto tamogatas (Investment subsidies granted by individual Government decision)	146.88
Hungary	‘a’ and ‘c’	Beruhazasi celu turisztikai allami tamogatasi program (tourism promotion)	19.33
Ireland	BMW, SEAT (ex Dublin & Mid-east)	Regional aid scheme 2007-13	80.00
Ireland	BMW and southern & eastern	Mid-Shannon Corridor Tourism Infrastructure Scheme	5.00
Lithuania	Kaunas	Nacionalines regionines pagalbos teikimo Kauno laisvojoje ekonomineje zonoje schema	4.93
Lithuania	Klaipedos	Nacionalines regionines pagalbos teikimo Klaipedos laisvojoje ekonomineje zonoje schema	5.79
Poland	‘a’	Program pomocowy w zakresie regionalnej pomocy na niektore inwestycje w ochronie srodowiska	41.75
Poland	Wroclaw	Uchwala nr III/13/06 Rady Miejskiej Wroclawa z dnia 28 grudnia 2006	0.65
Poland	Wroclaw	Uchwala nr III/14/06 Rady Miejskiej Wroclawa z dnia 28 grudnia 2006	0.65
Poland	Wroclaw	Uchwala nr III/16/06 Rady Miejskiej Wroclawa z dnia 28 grudnia 2006	0.52
Poland	Wroclaw	Uchwala nr III/15/06 Rady Miejskiej Wroclawa z dnia 28 grudnia 2007	0.52
Romania	‘a’	Schema de ajutor de stat regional privind prevenirea, reducerea si controlul integrat al poluarii	6.14
Romania	‘a’	Schema de ajutor de stat regional privind epurarea apelor uzate urbane si industriale	4.91
Romania	‘a’	Schema de ajutor de stat regional privind reciclarea anvelopelor uzate	0.92
Romania	‘a’	Schema de ajutor de stat regional privind procesarea deseurilor de sticla in vederea reciclarii	0.98
Romania	‘a’	Schema de ajutor de stat regional privind reciclarea deseurilor de ambalaje din mase plastice	1.84

Romania	‘a’	Schema de ajutor de stat regional privind gestionarea deseurilor lemnoase si a rumegusului provenite de la exploatarile forestiere si pomicole si din industria de prelucrare a lemnului	1.76
Spain	Comunitat Valenciana	Concesion de ayudas por la Agencia Valenciana del Turismo	1.00
Spain	Cantabria	Subvenciones a la inversion industrial	8.00
Spain	Extremadura	Financiacion prioritaria	10.00
Spain	Extremadura	Incentivos Industriales Extremenos	11.00
Spain	Murcia	Programa de Instalacion en Parques Tecnologicos de Empresas de base Tecnologica	0.60
Spain	Murcia	Programa de ayuda a la subcontratacion industrial	1.50
Spain	Murcia	Programa de implantacion de la innovacion	0.40
Spain	Murcia	Programa de promocion de infrastructuras y equipamientos economicos	0.45
Spain	La Rioja	Bases Reguladores de la concesion de subvenciones en regimen de concurrencia competititiva a la inversion de finalidad regional	6.48
Spain	Castilla y Leon	Ayudas regionales a la inversion	192.00
Spain	Extremadura	Programa para la innovacion empresarial	2.00
Spain	Galicia	Subvenciones a los proyectos dinamizadores de las areas rurales de Galicia	5.00
Spain	Murcia	Programa de Ayudas a la financiacion de empresas en Murcia mediante el apoyo a operaciones financiadas on fondos procedentes del Instituto de Credito Oficial	1.80
Spain	Galicia	Subvenciones a empresas turisticas para el fomento del turismo en el medio rural	2.40
Spain	Galicia	Subvenciones a empresas privadas para la creacion y mejora de establecimientos turisticos	1.80
Spain	Navarra	Ayudas regionales a la inversion en industrias agroalimentarias	6.00
Spain	Navarra	Ayudas regionales a la inversion industrial	15.00
Sweden	‘c’	Forordning om regionalt investeringsstod	14.84
UK	‘a’ and ‘c’ Scotland	Scottish Property Support Scheme	23.56
UK	Northern Ireland	Urban Development Grant Scheme	13.25
UK	‘a’ and ‘c’ Scotland	Regional Selective Assistance - Scotland	125.18
UK	Northern Ireland	Tourism Development Scheme	2.21
UK	England, Wales	Regional Investment Aid for Speculative and Bespoke Developments	103.09
UK	‘a’ and ‘c’ England	Selective Finance for Investment in England (SFIE)	132.54
UK	West Wales & the Valleys	Welsh Property Development Grant	14.73
UK	Wales	Section 4 Tourism Grant Scheme	14.73
UK	‘a’ and ‘c’	Business premises renovation allowances	66.27
UK	Wales	Assembly investment grant	10.31
Norway	‘c’	Regional investment grant	27.65

Source: Official Journal, various editions.

A detailed analysis of the measures reported is outside the scope of this paper and anyway premature given the uneven national coverage. Nevertheless, even on the basis of the summary information published, the very wide variation in the scale of the measures introduced is evident (see Figure 8). Annual budgets for BER schemes reported to date range from just € 400,000 for an innovation-related scheme in Murcia to in excess of € 2 billion for the main regional aid package in Greece. Indeed, at the national level (Greece has reported a single package of measures comprising several different schemes), Greece alone accounts for half the annual budget of schemes reported under the BER to date.

Figure 8: Annual budgets of reported schemes under the Regional BER

Country	Total (€ m)
Belgium	158.42
Czech Republic	108.53
Germany	664.00
Greece	2080.00
Hungary	235.79
Ireland	85.00
Lithuania	10.72
Poland	44.10
Romania	16.56
Spain	265.43
Sweden	14.84
UK	505.88
Norway	27.65

Source: Figure 7.

(ii) Notifiable measures

As far as notifiable measures are concerned, there has been relatively little activity. Feedback from the Member States concerning the Regional BER is positive and early indications are that Member States will, as far as possible, opt to design measures which fall within its scope. However, some categories of measure still require notification, notably operating aid, transport aid, aid for SMEs other than investment and consultancy aid (such as aid for entrepreneurship provided for under RAG 2006) as well as any other measures which do not meet all the requirements of the BER. Reflecting this, even in the longer term, regional aid notifications are likely to be concentrated in a few countries / jurisdictions.

To date, nine measures (of which three are in Norway and therefore come under the jurisdiction of the EFTA Surveillance Authority) have been approved (see Figure 9). So far, only Murcia (Spain) has taken advantage of the RAG 2006 provisions for aid for entrepreneurship. Elsewhere the schemes are in the form of transport aid (Norway and Finland); operating aid in outermost regions (Canarias and Madeira) and sparsely-populated regions (Norway); or lack the transparency required by the BER (Norwegian regional risk loan scheme). In Hungary, aid takes the form of a tax credit for investment projects; it is not clear from the published information why the entire scheme does not fall within the scope of the BER, but it is also possible that the scheme was notified for reasons of legal certainty.

Figure 9: Approved notified aid (as at August 2007)

Country	Region	Scheme Title	Annual budget (€m)
Spain	Murcia	Aid for newly-created enterprise	~
Finland	Subset of 'c' areas	Regional transport subsidy	4.7
Hungary	'a' and 'c' areas	Development tax benefit	540.0
Spain	Canarias	Regimen economico y fiscal de Canarias	981.9
Spain	Canarias	Zona Especial Canaria	16.4
Portugal	Madeira	Zona Franca Madeira	~
Norway	Subset of 'c' areas	Regionally-differentiated social security concession	1060.0
Norway	Regional aid map	Regional risk loan scheme	13.0
Norway	Subset of 'c' areas	Regional transport aid scheme	9.0

Note: Budgets given are typically estimates: in the case of tax and transport subsidies the number of beneficiaries is not known in advance and such schemes tend not to be budget-limited. Decisions on the Murcia and Madeira aid schemes have not yet been published so no budget information is available at present.
Source: European Commission, DG Competition website at: http://ec.europa.eu/comm/competition/state_aid/register/ii/

Overall, the notified schemes involve relatively high levels of expenditure. The Hungarian tax scheme, the Canaries tax regime and the Norwegian social security concession all involve revenue foregone estimated at well over € 0.5 billion annually. It is worth noting in passing that, although annual budgets for aid schemes must be reported to the Commission, the Commission does not place limits on what can be spent.

3. REGIONAL AID VALUES AND GLOBAL COMPETITION FOR INVESTMENT

As described in some detail, RAG 2006 required a recasting of the assisted areas maps for all countries, with significant implications for many EU15 Member States where coverage was reduced by as much as half. However, RAG 2006 also has significant implications for award values. Historically, Commission limits on rates of award have tended not to constrain regional policymakers who, for domestic budgetary reasons, have preferred to remain well inside Commission ceilings. However, RAG 1998 reduced maximum award rates to levels that did begin to impact on regional aid decisions, especially for very large projects where the 2002 Multisectoral Framework (MSF 2002) reduced rates even more. RAG 2006 reduces award maxima further, and to a level at which some policymakers have raised concerns at the international competitiveness of EU incentives in the attraction of mobile investment. This section sets out the aid values applicable under RAG 2006 and outlines the special provisions for large investment projects, before going on to discuss the issue of international competitiveness.

3.1 Aid values

RAG 2006 reduces maximum rates of award significantly in relation to those applicable under RAG 1998. This is partly a consequence of the imposition of lower *absolute* values,

and partly a result of the use of gross (GGE) rather than net grant-equivalents (NGE);[61] this means that since the start of 2007, regional aid values are assessed without regard to national tax arrangements, ie. they will be valued on a pre-tax basis. The maximum award rates set out in RAG 2006 are summarised in Figure 10.

Figure 10: Rates of award by firm size post 2006 (gross grant equivalents)

	Large	Medium	Small
'a' areas < 45% EU25 GDP; OMR < 75% EU25 GDP	50	60	70
'a' areas < 60% EU25 GDP	40	50	60
'a' areas < 75% EU25 GDP; OMR > 75% EU25 GDP	30	40	50
Statistical effect	30[a] → 20	40[a] → 30	50[a] → 40
Low population density 'c' areas	15[b]	25[b]	35[b]
Economic development 'c' areas	15[b]/10[c]	25[b]/20	35[b]/30
Other 'c' areas	15[b]/10[c]	25[b]/20	35[b]/30
Non-assisted	0	10	20

Notes: a) Until 1 January 2011 when the rate falls as indicated for those areas that move from 'a' to 'c' status. **b)** This may be raised in the case of areas adjacent to 'a' regions to ensure that the rate differential does not exceed 20 percentage points. **c)** The lower rate applies to eligible areas where GDP(PPS) per head is higher than the EU average and unemployment below the EU average measured at NUTS III. Some further transitional arrangements apply to 'a' regions and economic development areas where the fall in award rates would otherwise be especially sharp.
Source: Assembled from information RAG 2006, paragraphs 44-48.

The combined effects of enlargement on GDP thresholds, changes in levels of economic development and the shift from net to gross grant-equivalents complicates comparisons between the position under the 1998 and 2006 Guidelines. However, some indication of the impact may be gleaned from Figure 11. This shows that in a 'standard' 'a' area the maximum would fall from 50 percent NGE to 30 percent GGE; in the low population density regions the rate would be *halved* in nominal terms (and would be even lower in real terms owing to the shift from net to gross); and in other 'c' areas maximum rates would typically fall from 20 percent net to 15 percent gross.

Figure 11: Maximum rates of award for large firms under the 1998 and 2006 Guidelines

	2007-13 (% GGE)	2000/4-6 (% NGE)
'a' area OMR < 75% EU25 GDP	50	65
'a' areas < 60% EU25 GDP	40	50
'a' areas < 75% EU25 GDP	30	40[a]/50
Statistical effect	30 → 20	40[a]
Low population density 'c' areas	15	30
Economic development 'c' areas	15/10[b]	20
Other 'c' areas	15/10[b]	20/10[b]
Non-assisted	0	0

Notes: a) This rate applied in 2000-6 to 'a' areas with GDP per head exceeding 60 percent of the EU15 average. **b)** The lower rate applies to eligible areas where GDP(PPS) per head is higher than the EU average and unemployment below the EU average measured at NUTS III.
Source: Assembled from information in RAG 1998 and 2006.

It is difficult to generalise about the impact of the change from net to gross values, but in broad terms it is likely to involve a reduction of around a quarter (ie. 20 percent GGE is roughly equivalent to 25 percent NGE). This means that the new award maxima are, for the

[61] Paragraph 41.

most part, very significantly lower. However, transitional arrangements may be applied where the reduction is more than 15 percentage points net to gross;[62] in these circumstances, an initial reduction of at least 10 percentage points is applied on 1 January 2007 and the remainder on 1 January 2011.

In addition, it is worth noting the changes recently introduced concerning *de minimis* support. The *de minimis* rule sets a threshold below which Article 87(1) can be said not to apply. This was initially set at € 100,000, but has recently been raised to € 200,000.[63] The 2001 *de minimis* Regulation[64] stated that: "[T]he *de minimis* rule is without prejudice to the possibility that enterprises receive, also for the same project, State aid authorised by the Commission or covered by a group exemption Regulation." In other words, *de minimis* support could be paid in addition to the maximum under other types of aid. The Regional BER (and the 2006 *de minimis* Regulation), exclude this possibility: regional investment aid exempted by the Regulation may not be cumulated with *de minimis* support in respect of the same expenditure if this would result in the aid intensity exceeding that fixed by the Regulation.[65]

It can be argued that this ends a somewhat anomalous position in which aid ceilings could, in effect, be circumvented by simply adding *de minimis* support on top of existing regional or other aid. On the other hand, it is perhaps equally anomalous that *de minimis* support is effectively treated as aid if a project receives support from another source, but otherwise falls outside the scope of Article 87(1). Aside from the lack of consistency in an approach that sums aid with support not deemed to be aid, there is also the question of aid differentials. From a regional aid perspective, this differential is eroded since *de minimis* support is available everywhere, but, where added to regional aid, is subject to the regional aid ceilings.

3.2 Large investment projects

For large projects, RAG 2006 set even lower maxima than those given in Figure 10. This owes to the impact of the 2002 Multisectoral Framework (MSF),[66] which is now an integral part of the Guidelines.[67] Under MSF 1998 and MSF 2002 the Commission introduced mechanisms which reduced award levels to particularly large projects. For reasons of transparency, MSF 2002 has effectively been incorporated into RAG 2006. In so doing, some changes have been introduced, but these are limited and discussed in passing in the section that follows.

---

[62] Paragraph 92.

[63] Commission Regulation No. 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to de minimis aid, OJEU No. 28 December 2006.

[64] Commission Regulation No. 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the Treaty to de minimis aid, OJEC No L 10 of 13 January 2001.

[65] Article 6(3) of the Regional BER.

[66] Multisectoral Framework on regional aid to large investment projects – Rescue and restructuring aid and closure aid for the steel sector, OJEC No C 70 of 19 March 2002.

[67] Paragraphs 60 to 70.

3.2.1 Key provisions on aid to large firms

The essence of the provisions on large investment projects is to reduce rates of award under existing regional aid schemes to projects with eligible investment of more than €50 million. This is achieved through a reduction scale (the larger the project, the lower the rate of award) incorporated into the regional aid schemes operated by the Member States, as set out in Figure 12. The award reduction formula and notification thresholds in RAG 2006 are nominally unchanged from MSF 2002, but because rates are expressed in gross rather than net terms (and nominal rates have also declined), the rates applicable to large projects and the level at which individual notification is required are typically very considerably lower than previously.

Figure 12: Rate reduction matrix for large investments

Eligible expenditure	Aid ceiling
Up to € 50 million	100 % of regional aid ceiling
For the part between € 50 and € 100 million	50 % of regional aid ceiling
For the part exceeding € 100 million	34 % of regional aid ceiling

As Figure 12 shows, projects involving investments of less than € 50 million are unaffected by the matrix. However, for larger projects the standard award rate is progressively reduced. This is illustrated in RAG 2006 as follows:

Maximum rate of award = **R * (50 + 0.5B + 0.34C)**

Where **R** is the unadjusted regional aid ceiling; **B** is the eligible expenditure between € 50 million and € 100 million; and **C** is any expenditure above € 100 million

The impact of this formula on the standard award maxima under the RAG 2006 is shown in Figure 13.[68] As would be expected, the higher the amount of eligible investment, the lower the rate of award applicable since an increasing proportion of the investment qualifies for aid at only 34 per cent of the prevailing regional aid rate. Thus, for an investment of € 500 million, the maximum rate of award in a 10 percent rate 'c' area would be 4.22 percent of eligible investment – a maximum of € 21.1 million.

[68] In MSF 2002 there was a significant exception to this principle: the reduction matrix did not apply to the motor vehicle industry where, instead, the aid ceiling was set at 30 percent of the prevailing rate for all projects with investment exceeding € 50 million or an aid amount exceeding € 5 million. This provision is important in the later discussion of individual aid cases.

Figure 13: Impact of the large investment project provisions on award rates

	Standard ceilings (% GGE)					
	10	15	20	30	40	50
Eligible expenditure	**Adjusted ceilings (% GGE)**					
€ 50 m	10.00	15.00	20.00	30.00	40.00	50.00
€ 100 m	7.50	11.25	15.00	22.50	30.00	37.50
€ 150 m	6.13	9.20	12.27	18.40	24.53	30.67
€ 200 m	5.45	8.18	10.90	16.35	21.80	27.25
€ 300 m	4.77	7.15	9.53	14.30	19.07	23.83
€ 500 m	4.22	6.33	8.44	12.66	16.88	21.10

Importantly, however, *individual* notification is required where the aid proposed is higher than that which a project involving eligible investment of € 100 million could have obtained on the basis of the application of the formula. As Figure 14 shows, for very large projects the notification thresholds bite at very low levels of aid when expressed as a percentage of investment. In a 10 percent rate area, the notification threshold in proposed aid would be € 7.5 million, just 1.5 percent of a € 500 million investment.

Figure 14: Individual notification ceilings for large investment projects

	Standard ceilings (% GGE)					
	10	15	20	30	40	50
	Aid notification threshold (€ million)					
	7.5	11.25	15.0	22.5	30.0	37.5
Eligible expenditure	**Notification threshold (% of eligible expenditure)**					
€ 50 m	~	~	~	~	~	~
€ 100 m	~	~	~	~	~	~
€ 150 m	5.0	7.5	10.0	15.0	20.0	25.0
€ 200 m	3.75	5.63	7.5	11.25	15.0	18.75
€ 300 m	2.5	3.75	5.0	7.5	10.0	12.5
€ 500 m	1.5	2.25	3.0	4.5	6.0	7.5

For individually notifiable projects where either:

i. the aid beneficiary accounts for more than 25 percent of the sales of the products concerned on the markets concerned (either before or after the investment); or

j. the capacity created by the project is more than 5 per cent of the size of the market measured in apparent consumption, except in rapidly growing markets,

The Commission will only approve regional aid after opening the Article 88(2) investigative procedure and a "detailed verification… that the aid is necessary to provide an incentive effect for the investment and that the benefits of the aid outweigh the resulting distortion of competition and effect on trade".

To this extent, RAG 2006 involves some discretion in the treatment of individually-notifiable projects that raise market share or capacity concerns. Under the new Guidelines, aid *can* be authorised; in contrast, under MSF 2002 such individually-notifiable projects were *not* eligible for aid. On the other hand, although the Commission was to draw up

further guidance on how it would carry out the assessment of the incentive effect against the distortion of trade and competition, no such guidance has been published to date.[69]

The onus is on the *Member States* to demonstrate that a given project does not reinforce a high market share or increase capacity in a stagnant sector. Where no such competition concerns apply, the matrix given in Figure 13 is used to determine the maximum rate, as for projects under the € 100 million investment threshold.

3.2.2 Reporting of aid to large investment projects

An important element of recent State aid reforms is the emphasis on transparency. Since MSF 2002, two new sources of information on large projects have emerged.[70] First, the Commission has required *ex-post* reporting of aid to projects exceeding €50 million. Second, as described above, Member States must notify to the Commission cases where the aid proposed is higher than that which a project involving eligible investment of € 100 million could have obtained on the basis of the application of the formula; aid above this limit must have the prior approval of the Commission. The sections which follow consider the output from the general reporting requirement and the notification requirement in turn.

(i) Aids reported under the transparency mechanism of the Multisectoral Framework

Under the transparency mechanism of MSF 2002 (and now under RAG 2006), Member States' reporting of aid to large projects is published online.[71] The data concern regional investment of any amount awarded to projects involving investments of more than € 50 million. By July 2007 some 102 projects had been reported under this mechanism. In purely numerical terms, these were heavily concentrated in three countries, namely Germany, Spain and Hungary, which together account for just over half of all such projects (see Figure 15).

[69] Paragraph 68, footnote 63 of the Guidelines.

[70] MSF 1998 also required notification and priori approval of measures above certain aid and investment levels and this experience informed the changes introduced under MSF 2002. However, there was no general reporting requirement for assistance to large projects and no published information.

[71] See: <http://ec.europa.eu/comm/competition/state_aid/register/msf_2007.pdf>

Figure 15: Reported aid to investments exceeding € 50 million since end 2003

Member State	Number of projects	Aid total (€ million)
Austria	1	14.080
Belgium	5	49.489
Czech Republic	8	238.672
Germany	17	398.732
Spain	13	280.646
France	5	46.497
Hungary	22	481.183
Ireland	9	73.478
Italy	6	167.643
Netherlands	1	8.762
Poland	4	33.093
Portugal	2	90.287
Sweden	1	4.910
UK	8	73.944
Total	102	1961.416

Note: The figures for Spain (and therefore the total) are under-reported since aid amounts for two projects are missing from the dataset.
Source: Own calculations from European Commission data provided in <http://ec.europa.eu/comm/competition/state_aid/register/msf_2007.pdf> as at 24 July 2007.

As far the total *amounts* of aid are concerned, these too are concentrated in a few countries – Czech Republic, Germany, Spain and Hungary. These four countries together account for well over 70 percent of reported aid to large projects, which itself totals around € 2 billion.[72] The *sectoral* distribution of aid to large projects is dominated by the motor vehicle and associated industries (including parts, components, tyres etc.). Aid to this sector amounts to over one-third of the aid paid to large projects over the period (see Figure 16).

[72] More with the Spanish projects from which data is missing.

Figure 16: Reported aid to investments exceeding € 50 million by sector since end 2003

Sector / Activity	Aid amount (€ m)	Share of total aid (%)	Number of projects
Aerospace	46.1	2.3	3
Chemicals	123.1	6.3	7
Construction materials	48.2	2.4	4
Electronic equipment & components	297.1	15.1	13
Energy production	102.1	5.2	5
Food & drink	113.5	5.8	6
Medical & surgical equipment	50.0	2.5	4
Metal products & processing	17.4	0.9	2
Motor vehicles & parts	713.4	36.2	28
Other manufacturing	42.7	2.2	2
Pharmaceuticals	82.9	4.2	8
Plastics	114.2	5.8	5
Pulp, paper & printing	82.4	4.2	5
Tourism	22.6	1.1	2
Transport, communications & logistics	42.6	2.2	3
Wood & wood products	70.7	3.6	3
Total	1969.1	100.0	100

Note: As noted earlier, the figure for the motor vehicle sector is an underestimate owing to missing data for two projects; these are excluded from the final column.
Source: Own calculations from European Commission data provided in <http://ec.europa.eu/comm/competition/state_aid/register/msf_2007.pdf> as at 24 July 2007.

This is in turn reflected in the 'top ten' projects, as measured in terms of the aid amount (see Figure 17). Seven of these are in the motor vehicle and related sectors. Not surprisingly, the 'top ten' projects are concentrated in the 'a' regions, where the prevailing award rate is relatively high; the progressive nature of the formula for calculating aid means that the maximum bites at lower levels in countries with lower award ceilings.

Figure 17: 'Top ten' investment aids (by € million) 2003-7

MS	Beneficiary	Sector	Aid type	Aid (€ m)	Aid (%)
PT	AUTOEUROPA Portugal	Motor vehicles & parts	Tax relief	69.4	8.1 NGE
ES	Peugeot Citroën Automoviles España SA	Motor vehicles & parts	Grant	58.3	8.2 NGE
IT	FIAT AUTO - Pomigliano d'Arco	Motor vehicles & parts	Grant	47.2	10.5 NGE
ES	Renault España Valladolid	Motor vehicles & parts	Grant	45.1	9.8 NGE
IT	Sevel SpA	Motor vehicles & parts	Grant	40.5	5.8 NGE
HU	Kárpát Energo Ltd.	Energy production	Tax credit	37.5	35.9 NGE
HU	Holcim Hungaria Cementipari	Construction materials	Tax credit	37.5	22.5 NGE
HU	Samsung Electronics Magyarorszag	Electronic equipment & components	Grant, tax credit	37.5	36.8 GGE
ES	Ford España	Motor vehicles & parts	Grant	36.6	8.2 NGE
HU	Bridgestone Manufacturing Ltd	Motor vehicles & parts	Grant, tax relief	36.5	24.2 NGE

Source: Own calculations from European Commission data provided in <http://ec.europa.eu/comm/competition/state_aid/register/msf_2007.pdf> as at 24 July 2007.

The large amounts of aid to the motor vehicle sector are partly a consequence of the very large scale of the projects typical of the sector. Information on the size of investments is not disclosed, but, from the data available, it may be surmised that nine of the ten largest

investments involved major motor vehicle manufacturers (the other project being undertaken by Intel in the computer components sector). These projects each involved eligible investment in the range €400 million to €1200 million.

Importantly, however, the high levels of aid to the motor vehicle sector may also result from the application of transitional provisions for the motor vehicle sector[73] under MSF 2002 until end 2006. Under these provisions, the standard award reduction matrix did *not* apply to this sector; instead, there was a flat rate reduction in award ceilings to 30 percent of the prevailing rate (a much sharper reduction) for any project involving investment exceeding € 50 million or aid exceeding € 5 million. Of *key* importance, however, the notification and prior approval requirement for projects where the aid exceeds that which a €100 million project could receive, did *not* apply to the motor vehicle sector either. This meant that there was no mechanism for the Commission to scrutinise exceptionally large awards to the sector. By way of example, the single largest aid amount was €69.4 million to AUTOEUROPA Portugal for investment in Setubal, where the prevailing regional aid rate in 2003 was 26.9 percent NGE. Under the standard rules, such an award would have been subject to notification and prior Commission approval if the award proposed was in excess of that which a €100 million project could have obtained, this being €20.2 million. Instead, the Portuguese authorities were able to award over three times this sum, without further scrutiny.

This situation has been changed under RAG 2006 with the same maxima now applicable to *all* eligible sectors. This is likely to mean either that far more motor vehicle sector projects will be subject to individual scrutiny by the Commission (and that, as such, the onus will be on Member States to show that the market power and capacity criteria are not met) or that Member States will opt to cap aid to motor vehicle projects in order to avoid notification.

(ii) Notified aids

Where a Member State proposes to offer an aid amount higher than that which a €100 million investment could receive, the award must have the prior approval of the Commission. Under MSF 2002, the Commission could not approve the award if the beneficiary accounted for more than 25 percent of the sales of the product or if the capacity created was more than 5 percent of the market.[74] This has been relaxed slightly under RAG 2006, which enables the Commission to approve aid even in these cases, provided that the aid is necessary and its benefits outweigh the distortion of competition.[75]

In practice, since the introduction of MSF 2002 relatively few projects have been notified to the Commission. This is perhaps not surprising for two reasons. First, the motor vehicle industry accounts for a substantial proportion of large aided projects and, as discussed, the transitional provisions meant that a separate award matrix applied and there was no prior

[73] Note that some activities, such as tyre production, have been included in 'motor vehicles and parts' in the tables in this section but are not classified as belonging to the motor vehicle sector under MSF 2002 Annex D.

[74] See MSF 2002 at point 24 for more details.

[75] See MSF 2006 at point 68 for more details.

approval requirement for awards of any size aided under an approved scheme. Second, it seems reasonable to assume that the very existence of a ceiling beyond which notification is required would act as a cap on aid values. This is because, in such cases, it is for the Member States to demonstrate that the project does not raise market power and capacity concerns; in cases of doubt, the Commission must open the investigative procedure, a lengthy process with an uncertain outcome. It is difficult fully to substantiate the impact of the notification threshold on award values from the evidence available – partly because there is no data on project size and partly because there is a lack of consistency in the use of gross and net grant-equivalents to express award values. However, an analysis of the information available suggests a significant clustering of award values at or just below the level beyond which notification is required.

Since MSF 2002 a total of 14 aid proposals have been notified, one of which under RAG 2006 (see Figure 18). Of these, in only one instance has the Commission opened the investigative procedure. This concerns proposed aid to IBIDEN in Hungary, a manufacturer of ceramic substrates for diesel particulate filters used in car exhaust systems.[76] The Commission has doubts about the definition of the relevant product market and the consequent share of the beneficiary in that market. In another instance the aid notification was withdrawn. This concerned aid to Intel in Ireland, where the proposal was withdrawn when it became apparent that the Commission would open the investigative procedure.

[76] Rapid Press Release (2007) State Aid: Commission opens in-depth investigation into €39 million aid to IBIDEN Hungary, IP/07/1071 of 11 July 2007.

Figure 18: Notified aid proposals under MSF 2002 and RAG 2006 (as at end July 2007)

MS	Beneficiary	Sector	Aid €	Aid %	Inv. € m	Outcome
IE	Intel	Computer components				Notification withdrawn
IE	Centocor	Pharmaceuticals	48.25	7.39 NGE	618.0	No objections
SK	Getrag Ford Transmissions	Automotive transmissions	53.50	18.14 NGE	265.0	No objections
DE	Avancis	Optical & photographic equipment				No objections
DE	Q-Cells	Electrical and optical equipment				No objections
DE	HighSi GmbH	Solar modules	76.63	14.73 GGE	520.3	No objections
HU	Malvai Eromu Zrt	Electricity generation	47.00		669.0	No objections
HU	Hankook Tire Hungary Ltd	Tyre manufacture	92.61	20.55 NGE	424.9	No objections
IT	Atlantica Invest AG	Fair and amusement park				No objections
PT	CELBI	Pulp and paper	59.32		319.0	No objections
PT	Artensa	PTA for polyester	99.29		360.0	No objections
PT	Repsol Polimeros	Polypropylene & polyethylene	150.00		750.0	No objections
PT	Soporcel	Pulp and paper	46.50		200.0	No objections
PT	About the Future	Pulp and paper	37.95		542.0	No objections
HU	IBIDEN Hungary Gyarto Kft	Diesel particulate filters & diesel oxidation catalysts	39.00			Investigative procedure

Source: European Commission press releases and DG Competition State aid register at: http://ec.europa.eu/comm/competition/state_aid/register/

In the remaining 12 cases, the Commission has raised no objections to the aid proposals. The paucity of the information available precludes any meaningful analysis of the cases notified. In only a few instances is the amount of the investment or aid known. This reflects the substantial delay in publishing Commission decisions, the texts of which are censored by the awarding authority and the beneficiary to prevent the disclosure of commercially sensitive details.

3.3 International competition for mobile projects

It is plausible to conclude from the discussion on aid to large investment projects that the Commission has succeeded in lowering aid values for large investments since MSF 2002 – although it is also true that, in many countries, there is already considerable emphasis on offering the minimum necessary to attract a given project. The changes introduced by RAG 2006 seem likely to increase the impact of the competition rules in the future. In particular, the lowering of award values generally and the use of gross rather than net values will feed through into the reduction matrix which applies to projects over € 50 million. In addition, projects in the motor vehicle sector, which account for a substantial proportion of large investment projects, will be brought into the scope of the rules on the same basis as other sectors. For many countries the lowering of award values comes on top

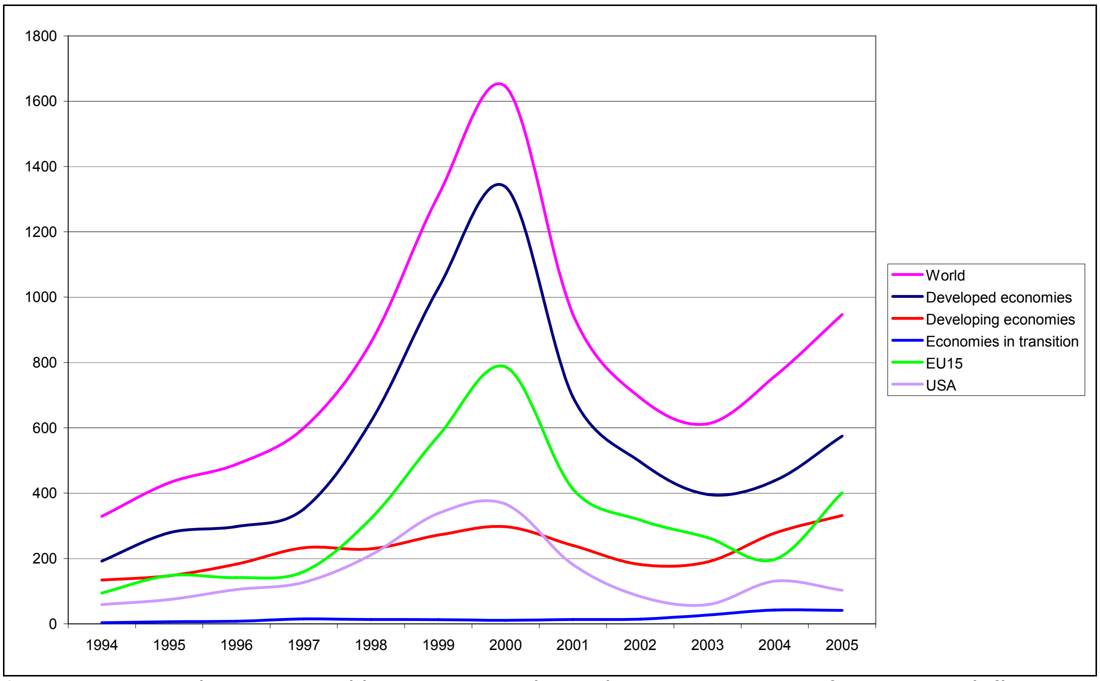
of major cutbacks (up to 50 percent) in the coverage of assisted areas, dramatically reducing not only the value of assistance to large projects but also the geographical scope of the areas in which aid can be offered.

Against this background, policymakers in some EU Member States have expressed concern at the capacity of EU Member States, especially among the EU15, to attract and retain mobile investment in the face of global incentive competition. This section begins by highlighting recent trends in foreign direct investment and goes on to outline what is known about incentives operated in selected non-EU countries. Last, it sets out some of the current thinking about how the EU might respond to global incentive competition.

3.3.1 Global investment trends and incentive competition

The latest UNCTAD estimates put global FDI flows at US $ 1,230 billion in 2006,[77] their second highest level ever. This continues a trend of rising FDI since a global bottoming out in 2003, following the all-time peak in 2000. Figure 19 illustrates the trends in FDI flows globally, in the three major groupings of countries used by UNCTAD (developed, developing and economies in transition), as well in the EU15 and the US (which are obviously also counted in the developed economies data). These data suggest that, while the EU15 accounts for the single biggest share of FDI flows, its trends are also volatile. By contrast, the developed and developing economies have seen relatively steady growth in FDI over the decade from 1994, with, in some years, FDI in developing countries overtaking that in the EU15.

Figure 19: FDI flows US $ billion (2006 prices)

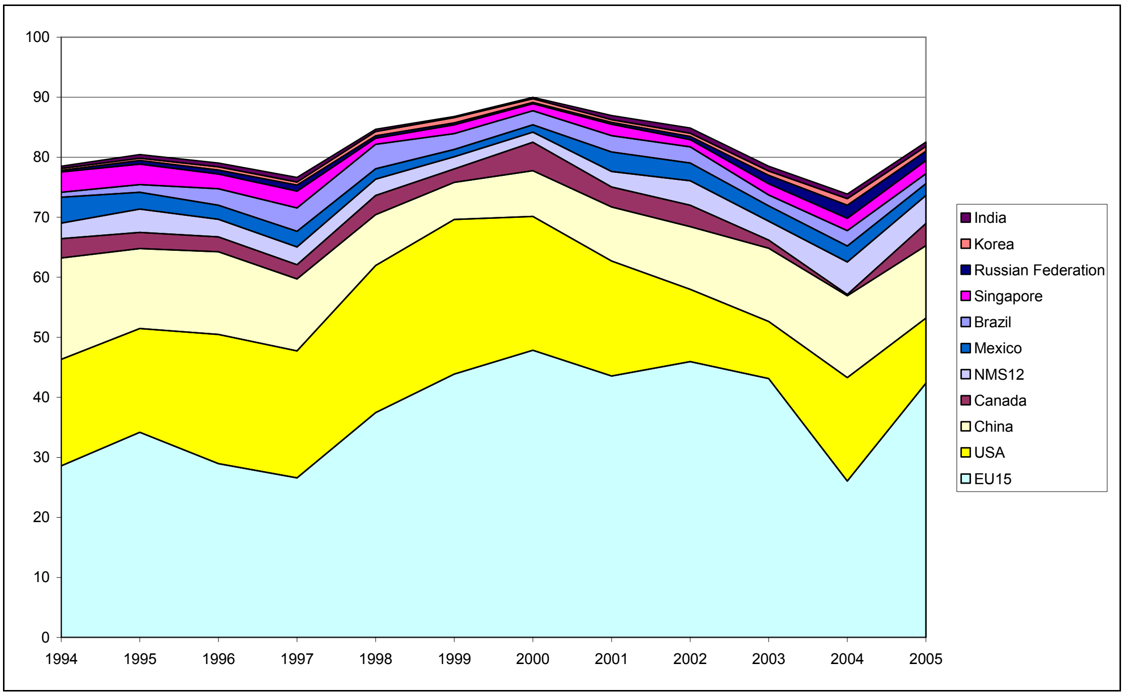


Source: UNCTAD data converted into constant prices using US Department of Commerce deflators.

[77] UNCTAD Investment Brief No 1, 2007.

It is clear from Figure 19 that developed economies, and mainly the EU15 and the US, account for most FDI inflows. This is also reflected in Figure 20. However, Figure 20 also shows that from 2000 to 2004, the overall share of the EU15 fell from 48 percent of the world total to around 26 percent, before increasing in 2005; provisional figures for 2006 suggest this may rise to 42 percent, but in any event it is clear that EU15 shares of FDI were severely dented in the first half of the decade and have yet fully to recover.

Figure 20: Trends in shares of FDI inflows (%)



Source: UNCTAD

Concern within the EU15 at the relative decline in FDI has focused on trends in emerging economies, especially in Asia, as well as in the new Member States (NMS12). In reality, the share of FDI flows to these economies is relatively modest. However, it is noteworthy that, in some cases, the value of flows has seen high levels of growth, albeit from a low starting point; in India, Korea, Brazil and the new EU Member States, for example, FDI inflows increased more than five-fold in the decade to 2005, and more than in either the EU15 or the US (see Figure 21).

Figure 21: Change in FDI flows 1994-2005, constant prices (1994=100)

World	288.0
Developed economies	299.7
Developing economies	247.4
Economies in transition	1268.8
Russian Federation	1691.9
Korea	723.3
Brazil	560.0
India	541.3
NMS12	519.8
EU15	426.5
Canada	329.4
China	205.9
Singapore	187.7
USA	176.2
Mexico	131.5

Source: Own calculations from UNCTAD data converted into constant prices using US Department of Commerce deflators.

In practice, such data are difficult to interpret in the context of incentive competition for mobile investment. In particular, the data include cross-border mergers and acquisitions as well as transactions by collective investment funds (eg private equity and hedge funds) but exclude the retention of potentially-mobile projects by the country of origin; this can be important – one estimate suggests that New York City spent US $ 2 billion on incentives over a ten-year period, mostly to prevent the relocation of existing firms.[78] Nevertheless, it is clear that recent FDI trends have contributed to concerns at EU15 competitiveness, not least since there is evidence of emerging economies gaining an increasing share both of high-end manufacturing and of value-added services.[79]

Also important, at least on a political level, are public perceptions of shifts in investment flows, particularly in the context of job losses. Eurobarometer reports[80] 'delocalisation' to countries with lower wage costs as the single most commonly cited consequence of trade globalisation, with fear of delocalisation being particularly strong in France, Austria and Germany. However, others have claimed that reported anxieties contrast with the limited magnitude of the phenomenon in practice – according to UNICE, relocation only represents about eight percent of restructuring operations and seven percent of job losses in European firms and "relocation is a marginal form of direct investment across national boundaries"[81] Moreover, it has been estimated that market-seeking FDI initiatives (as opposed to efficiency-seeking or cost-cutting FDI) accounts for over 80 percent of FDI flows.[82] On the other hand, it has also been suggested that the importance of market size as a determinant

[78] Cited in A. Charlton (2003) Incentive Bidding for Mobile Investment: Economic consequences and Potential Responses, Working Paper No. 203, OECD Development Centre.

[79] UNCTAD World Investment Report 2006.

[80] Special EUROBAROMETER "Lisbon" No. 215, February 2005.

[81] UNICE (2005) Relocation: challenge and opportunity, Brussels.

[82] E. M. Plasschaert (2005) Relocating Productive Capacity to China? Or Elsewhere? European Institute for Asian Studies, BP 05/02.

of investment location may be in decline. Regional integration agreements have reduced barriers to international trade, and innovations in IT and telecommunications have facilitated the coordination of international production networks. As a result, it is argued, even small countries can compete for FDI provided that investment conditions are sufficiently attractive.[83]

A discussion of location factors in international investment decisions is outside the scope of this paper. However, two broad conclusions may be drawn from the literature.[84] First, that incentives are relatively unimportant when set against other factors such as distance, size of host market, agglomeration effects, factor costs and business climate, with the actual weight attached to different factors varying widely according to project type and sector. Second, that evidence on the effectiveness of incentives in attracting investment is mixed: some argue that there are substantial windfall gains for projects that would have gone ahead in that location anyway, but others suggest that firms are becoming more responsive to incentives as they become more footloose.[85] There is some consensus that, while incentives may not be crucial in themselves, they can tip the balance in favour of one location where other factors are equal.

Notwithstanding doubts about the effectiveness (or indeed the efficiency) of incentives, incentive competition is on the increase.[86] This appears to be the case both at national and subnational levels, and is proliferating among developing countries with federal systems of governance such as Brazil and India, and in China.[87] Markusen and Nesse argue that, as well as geographic and economic factors such as falling transportation and communication costs, vertical disintegration of firms and increasing spatial division of labour within firms, three further factors have contributed to increased incentive competition: the rise of site location consultants involved in brokering deals between firms and governments; increased devolution and the delegation of economic development responsibilities to the subnational level; and the "significance of politics and political calculus on the part of participating governments".

3.3.2 Investment incentives outside the EU[88]

In practice, information on incentives available outside the EU is difficult to obtain. Within the EU, the regulatory framework on State aids has contributed a degree of transparency

---

[83] A. Kokko, (2002) Globalization and FDI Incentives, paper to ABCDE-Europe Conference, Oslo, 24 June.

[84] E. G. Lim (2001) Determinants of, and the Relation Between, Foreign Direct Investment and Growth: A Summary of the Recent Literature, IMF Working Paper WP/01/175.

[85] T. J. Bartik (2005) Solving the Problems of Economic Development Incentives, Growth and Change Vol 36(2) pp139-66.

[86] A. Markusen and K. Nesse (2007) 'Institutional and Political Determinants of Incentive Competition' in A. Markusen (ed.) Reigning in the Competition for Capital, W. E. Upjohn Institute for Employment Research, Kalamazoo, Michigan.

[87] A. Charlton (2003) Incentive Bidding for Mobile Investment: Economic consequences and Potential Responses, Working Paper No. 203, OECD Development Centre.

[88] I am grateful to Amanda Lim for research assistance for this section.

both in terms of the types of measures offered and, through the State aid surveys, the levels of expenditure involved. Moreover, Commission intervention has, over the years, brought about considerable homogeneity in the measures available. By contrast, in many non-EU countries, incentives are offered at the subnational level and are highly discretionary. Moreover, the widespread use of tax incentives makes the calculation of aid values more complex. There is limited detail on specific schemes, often because of their discretionary nature, and that information which is available filters through from reports in the financial press, corporate location publications or, in the US especially, research by the so-called anti corporate welfare lobby.[89]

According to the OECD,[90] fiscal incentives are the most commonly used for foreign direct investment, this is especially so in non-OECD countries which have limited funds for financial incentives, but also in jurisdictions with high levels of discretion in corporate tax administration (including some federal states within the OECD). The discussion which follows aims to sketch out what is known about the use of incentives in some of the main non-EU FDI destinations.

(i) United States

Competition for mobile investment in the US is almost unheard of at the federal level. However, “virtually every state offers both financial assistance and tax incentives to attract new firms”.[91] Moreover, there is a “political bias in favour of the most pernicious type of competition: the use of targeted tax incentives” used on a discretionary basis to attract or retain individual companies. These provide preferential tax treatment to firms in return for some specified business activity and often include tax concessions, job and investment credits and accelerated depreciation allowances.[92] The use of financial incentives appears to vary widely within the US, with some states effectively leaving economic development to the county level while others are highly active in this area. This makes it difficult to generalise about what is offered, but a number of key types of incentive have been identified.[93]

Property tax abatements, exemptions and reductions which reduce or eliminate the taxes payable on land, buildings and other fixed assets. For capital-intensive companies, property tax abatements can be one of the most lucrative subsidies. It is not uncommon for a tax abatement deal to last up to 30 years.

Tax increment financing (TIF) subsidises firms by refunding or diverting a portion of their taxes to part-finance development in an area or on a project site. Usually, TIF helps to fund infrastructure improvements but in some states TIF can also be used for acquiring land,

[89] See, for example: http://www.goodjobsfirst.org/

[90] OECD (2003) Checklist for Foreign Direct Investment Incentive Policies.

[91] Charlton, op cit.

[92] D. Brunori et al (2005) State and Local Fiscal Trends and Future Threats, George Washington Institute of Public Policy.

[93] This is drawn from: http://www.goodjobsfirst.org/

planning expenses (legal fees, studies, engineering, etc.), demolishing and refurbishing buildings, cleaning up contaminated areas or funding job training schemes. Some states allow TIF to directly subsidise private development expenses. TIF is authorised at the state level (47 states currently allow it) and administered by local governments. The local government designates an area it wants to target for redevelopment as a "TIF district".

Enterprise zones offer a package of incentives. State law sets out the criteria an area must meet to be designated an enterprise zone. Each state's EZ scheme is slightly different. In order to qualify as an enterprise zone, an area typically has to meet that state's definition of disadvantage, usually defined as having a relatively high rate of unemployment and/or job loss. Other common criteria include low income or education levels, population decline, high vacancy rate of buildings, or high proportion of old housing stock. Legislatures frequently specify the maximum number of zones for the state and may limit the number that can be created each year. Many states have designated whole counties or cities as zones. Three states - Arkansas, Kansas and South Carolina - have even extended zone benefits to businesses throughout the state, in effect making the entire state into an enterprise zone. Common subsidies for which an EZ company may qualify include: property tax abatements; investment tax credits (against corporate income tax); job creation tax credits (against corporate income tax); inventory tax exemption; sales, franchise, and use tax exemptions or reductions; lower utility rates; financial assistance through low interest loans and/or bond financing; and training grants.

Tax credits may be available for general investment or specific types of projects (such as R&D). While tax credits cannot be negotiated on a case-by-case basis with companies since they must be incorporated into the state tax code, many firms successfully lobby for the creation of tax credits tailored to their profiles. According to *Good Jobs First,* in several recent high-profile development deals, state legislatures have created new tax credits to subsidise specific companies considering locating in the area.

Industrial revenue bonds can provide low-cost financing since bonds issued through public entities are tax-exempt. Because of this advantage, tax-exempt bonds typically carry a lower rate of interest. The difference between the interest rate on tax-exempt bonds and the interest rate on commercial corporate bonds constitutes the subsidy to the firm.

Because of the lack of structured information on the incentives available and the absence of any systematic reporting requirement, the scale of incentive spending in the US is difficult to assess, but observers suggest that state (ie. *excluding* federal, city and county) expenditure is probably of the order of $50 billion (€36 billion) annually.[94] This is difficult to compare with EU spending given definitional differences (note, in particular, that the US figure is for economic development and appears to exclude subsidies for R&D at either state or federal levels), but is broadly comparable with EU25 expenditure on horizontal aid of €38 billion in 2005.[95] However, it dwarfs EU expenditure on regional aid, the principal

[94] K. P. Thomas (2000) *Competing for Capital*, Georgetown University Press and A. Peter and P. Fisher (2004) The Failures of Economic Development Incentives, *Journal of the American Planning Association*, Vol 70(1).

[95] See: http://ec.europa.eu/comm/competition/state_aid/studies_reports/studies_reports.cfm

source of investment aid for large projects, which accounted for just €8.4 billion in the same year.

There is no systematic reporting of aid to large projects in the US, but there is some anecdotal evidence since the scale of some individual incentive awards often makes headlines in the financial press. Figure 22 shows the largest aid awards for which information is available in the 1998-2004 period. Direct comparisons with awards in the EU are difficult to make, not least because in neither case are data on project size available (see Figure 17 for the ten largest awards in the EU). Moreover, in terms of both the time periods covered and the exchange rates applicable the comparisons are rather crude. Nevertheless, the data suggest that the top 19 US aid awards in the period were larger than any aid award in the EU. It is noteworthy that, in both cases, a significant proportion of the projects are accounted by the motor vehicle industry. Of course, it should be stressed that this data is not indicative of incentive competition between the US and the EU – no information is available on whether the projects concerned were considered for a non-US location - although there is considerable evidence of 'bidding – up' within and between the US states.

Figure 22: Largest US subsidies 1998-2004

Company	Industry	City	State	Year	Aid amount €m
UPS	Package delivery	Louisville	KY	1998	25.2
Cisco Systems	Electronics	San Jose	CA	1998	14.4
Gap	Retailing	Fishkill	NY	1998	14.4
Eli Lilly	Pharmaceuticals	Indianapolis	IN	1999	154.2
Dell	Computers	Nashville	TN	1999	119.6
Honda	Motor vehicles	Lincoln	AL	1999	113.9
Volvo	Motor vehicles	Dublin	VA	1999	43.2
IBM	Electronics	East Fishkill	NY	2000	363.0
Nissan	Motor vehicles	Canton	MS	2000	212.6
General Motors	Motor vehicles	Lansing	MI	2000	140.4
Vanguard Group	Financial services	Malvern	PA	2000	40.0
Capital One	Financial services	Richmond	VA	2000	25.2
USAA Insurance	Financial services	Phoenix	AZ	2000	7.6
Pfizer	Pharmaceuticals	Ann Arbor	MI	2001	60.7
Toyota	Motor vehicles	Huntsville	AL	2001	21.5
Citicorp Credit Services	Financial services	Florence	KY	2001	19.2
Ford Motor	Motor vehicles	Norfolk	VA	2001	8.6
Hyundai	Motor vehicles	Montgomery	AL	2002	181.6
International Sematech	Electronics	Albany	NY	2002	151.3
AAI (Ford & Mazda)	Motor vehicles	Flat Rock	MI	2002	95.8
Honda (expansion)	Motor vehicles	Lincoln	AL	2002	64.6
BMW	Motor vehicles	Greer	SC	2002	57.7
Nissan (expansion)	Motor vehicles	Canton	MS	2002	49.0
Boeing	Aerospace	Everett	WA	2003	2306.0
Toyota	Motor vehicles	San Antonio	TX	2003	288.3
Scripps Research Institute	Biotechnology	Palm Beach	FL	2003	223.4
Texas Instruments	Electronics	Richardson	TX	2003	97.3
Ford Motor	Motor vehicles	Wayne	MI	2003	77.0
Pfizer	Pharmaceuticals	New York	NY	2003	33.7
Wells Fargo	Financial services	Des Moines	IA	2003	32.4
Philip Morris USA	Tobacco	Richmond	VA	2003	20.2
Dell	Computers	Winston-Salem	NC	2004	174.4
Alenia/Vought	Aerospace	Charleston	SC	2004	115.3
7 semiconductor firms	Electronics	Fishkill & Albany	NY	2004	108.1
Countrywide Financial	Financial services	Richardson	TX	2004	15.1

Source: http://www.goodjobsfirst.org/corporate_subsidy/reference_material.cfm converted using current € / US $ exchange rates.

(ii) China

China is now firmly established as one of the foremost destinations for FDI[96] and has been characterised as having a possibly unbeatable combination of low wages and other costs *and* a large domestic market.[97] A key feature of the Chinese tax system with respect to FDI has been the distinction drawn between foreign and domestic firms; in principle foreign investments in China are subject to 30 percent corporation tax and 3 percent local corporation tax, an effective rate of 33 percent; "in practice, foreign invested companies rarely have to pay the full corporate tax rate".[98] Importantly, however, the distinction between foreign and domestic firms is set to disappear from 2008 following a major reorientation of tax policy under new corporate income tax legislation. As a result "[T]he overall strategic direction of the new tax law and policy appears to be shifting away from a philosophy of granting special tax preferences to foreign investors in order to induce FDI and is focusing more on a unified system with tax incentives that will apply universally to both foreign-invested and domestic taxpayers".[99] Hitherto, the main elements of the incentive package for foreign investors have been as follows:[100]

Special Economic Zones (SEZ) and Economic and Technical Development Zones (ETDZ). The main purpose of establishing these zones was to attract foreign capital and modernise the country through foreign technology. Manufacturing firms are generally granted an exemption from corporation tax in the first two years, a reduction of 50 percent in the subsequent three years and a reduced tax rate of 15 percent thereafter.

Corporate tax exemptions/concessions: Foreign firms due to operate in China for at least 10 years and involved in specific sectors are entitled to an exemption from income tax for the first two years in which profits are made and a 50 percent reduction for the next three years. Eligible sectors are broadly defined and include manufacturing, construction, agriculture and forestry, communications and scientific and technical development. Additional benefits can be granted (or negotiated) in various circumstances, including firms locating in certain regions, export-oriented firms or technologically advanced firms. For example, in some remote and underdeveloped parts of China, firms may benefit from tax concessions for up to 15 years after the initial exemption; special concessions are available to firms with an export ratio of more than 70 percent or to firms in the software industry; and high technology firms may request a three-year extension to the standard five-year concession period. In addition, a tax refund of 40 percent may be claimed on reinvested profits; this rises to 100 percent if profits are invested in an export-oriented or technologically-advanced enterprise.

---

[96] OECD (2006) International Investment Perspectives, Paris.

[97] E. M. Plasschaert (2005) Relocating Productive Capacity to China? Or Elsewhere? European Institute for Asian Studies, BP 05/02.

[98] Ernst & Young (2006) Special Economic Zones and tax exemption in China

[99] Ernst & Young (2007) Unified PRC Corporate Income Tax Law Becomes Effective January 1, 2008, Press Release, 16 March, Beijing.

[100] This is based on UNCTAD (2000) Tax Incentives and Foreign Direct Investment: A Global Survey; and Ernst & Young (2006) Special Economic Zones and tax exemption in China.

As mentioned earlier, new tax legislation appears to involve a significant shift in Chinese fiscal policy and "there is strong evidence that China is increasingly moving away from using tax policy as an instrument to attract foreign investment and moving more towards a focus on tax revenue collection with respect to those tax payers who have a taxable presence in China".[101] The new law will repeal the concessions outlined above, although transitional provisions will apply to existing foreign firms. The main thrust of the law is to introduce a 25 percent tax rate for all firms; this will reduce the tax burden on domestic firms, but tax costs for foreign firms currently under a preferential regime will rise. In addition to the ending of discrimination between domestic and foreign-owned firms, the geographic orientation of policy under the SEZ and ETDZ is abandoned in favour of a horizontal approach that focuses on particular sectors and activities, including infrastructure, agriculture, forestry, fisheries, new technologies, recycling and environmental protection and venture capital.

It remains to be seen what the impact of these changes will be on China's attractiveness as a foreign investment location. It has been observed that, in the past, China's policy towards investment incentives has shifted back and forth. In 1996 the government dramatically reduced tax benefits for foreign investment, partly because high levels of growth in the preceding five years had led the authorities to believe that they were no longer necessary and partly because of China's desire to join the WTO. However, within a few months the level of new FDI had dropped in comparison to some neighbouring countries, a fall which was attributed to the absence of incentives. Moreover, the Chinese authorities were less able to exert control over the nature and location of inward investment so that, by the end of 1997, most of the old incentives had been reintroduced under new initiatives.[102]

(iii) India

Foreign investment in India is often associated with outsourcing especially in the information technology sector, but FDI is also significant in the automotive and mining sectors.[103] Although FDI into India remains modest compared to China (even allowing for so-called 'round-tripping'),[104] FDI into India has grown much more rapidly in the last decade.

Responsibility for economic development in India lies primarily at the level of the 28 States, although the framework for some incentive provision is at the national level. For large

[101] Ernst & Young (2007) Unified PRC Corporate Income Tax Law Becomes Effective January 1, 2008, Press Release, 16 March, Beijing.

[102] Charlton, A. (2003) Incentive Bidding for Mobile Investment: Economic Consequences and Potential Responses, Working Paper No. 203, OECD Development Centre.

[103] OECD (2006) International Investment Perspectives, Paris.

[104] The existence of separate rules for FDI can result in capital leaving a country simply to return in the form of 'foreign' investment in order to meet foreign ownership requirements. Round-tripping between China and Hong Kong is though to have been significant. See A. Easson and E. M. Zolt (2002) Tax Incentives, World Bank Institute.

firms, the main incentives are in the form of tax concessions. Three main types of incentive can be identified:[105] regional incentives; sectoral incentives; and Special Economic Zones.

Projects locating in designated underdeveloped *regions* qualify for a full exemption from tax on profits for the first three to five years of operation, followed by a 30 percent reduction for the subsequent five years. The terms and conditions of the concessions vary by state and by sector.

Projects in specific *sectors* qualify for reductions in profit tax ranging from 30 to 100 percent, for between five and ten years. Eligible sectors include parts of the food-processing industry, oil production and refining and scientific research. More generous terms are available for projects involved in infrastructure development.

Special economic zones provide a package of measures enabling the export-related profits to be exempt from income tax for ten years, as well as exemption from a number of taxes and other duties.

In addition, State governments frequently offer a package of measures, decided on a case-by-case basis for so-called 'mega projects'. These may include special tax incentives, rebates on land purchase, stamp duty reduction, power tariff concessions and employment subsidies. However, it is difficult to generalise about the value of such packages, partly because they are administered at the State level and partly because of the degree of discretion involved.

(iv) Korea

Korea has also seen very high levels of FDI growth in the last decade. This follows liberalisation of the economy after the 1997 Asian financial crisis, ending the dominance of the family-controlled *chaebol.* The emphasis of policy is to provide incentives for research and development centres, headquarters of transnational corporations or component parts industries which create quality jobs and have forward and backward linkages with domestic industry.[106]

Korea operates a number of measures aimed at foreign investors.[107] Foreign firms that invest in designated high technology sectors can benefit from a five-year exemption from corporation tax followed by a 50 percent reduction for two years. There is also a package of measures aimed both at foreign investors and encouraging cluster formation, particularly in high technology sectors. Firms locating in these designated areas may benefit from measures such as free land lease for up to 50 years, 5 year exemption from corporation tax followed by 50 percent reduction, 15 year exemption from local taxes and tax exemptions on imported capital goods.

---

[105] This is based on: www.india,gov.in; UNCTAD (2000) Tax Incentives and Foreign Direct Investment: A Global Survey; Price Waterhouse Coopers (2007) Worldwide Tax Summaries: India; Ernst & Young (2006) Doing Business in India.

[106] FDI Magazine (2006) On the march, October 2006.

[107] See http://www.investkorea.org/.

Korea also operates a grant for foreign investment (minimum 30 percent foreign-owned) and for investments in high technology projects. The minimum investment is US $ 10 million (US $ 5 million for high technology projects). Grants exceeding 5 percent of investment are negotiated on a case-by-case basis, with the maximum being determined by an "internal calculation formula." The grant may also be related to jobs created and employee training.

3.3.3 Issues for the EU

In April 2006 the Irish authorities initiated a short study on globalisation and the factors which affect the EU ranking in competition of internationally-mobile investment, with special reference to the effects of the EU State aid regime.[108] The study,[109] proposed at a meeting of the Enterprise Policy Group[110] considered a number of questions, notably:

- whether EU guidelines on investment aid restrict intra-EU FDI and the ability of EU countries to attract FDI from non-EU countries;
- whether the EU is losing FDI projects to emerging economies and the role of incentives in this;
- the need for greater flexibility in offsetting the competitive advantage of third countries in relation to investment aid; and
- the desirability of offering investment aid in non-assisted areas in exceptional circumstances.

In response, there was a general view that investment decisions were not determined by the level of financial assistance available, but incentives might help tilt the balance in some cases. In particular, financial assistance could be the final factor in a finance plan and was often regarded as a symbol of the commitment of public authorities to an investment project, particularly for foreign investors. The lack of constraints on the use of incentives outside the EU, coupled with low rates of award for large projects and, for very large projects, the involvement of the Commission in deciding awards, was perceived to be a disadvantage in relation to non-EU locations.

There was general consensus that the EU *is* losing FDI projects to emerging economies, but less agreement on the role incentives played in this. Some attributed this, at least in part to EU restrictions on State aid, but others argued that high potential growth rates, low

[108] A number of countries participated in the study, namely Germany, Spain, France, Cyprus, the Netherlands, Portugal, Italy, Czech Republic and Malta; the UK subsequently expressed interest in participating.

[109] The study has not been published but a summary of its findings has kindly been made available by the Irish authorities.

[110] In 2000 the European Commission established an Enterprise Policy Group (EPG), the aim of which is to advise the Commission on enterprise policy issues. The Group is composed of two different sections, one for representatives from the Member States (Directors-General of Industry and senior administrators) and the other - the Professional Chamber - for high-level experts from the enterprise community. This issue was considered by the Directors-General section.

wages and improving skills were more important, with the EU unable to compete either on growth or wages.

The Irish authorities had floated the notion of greater flexibility in aid ceilings where a *single* EU location is in competition with a non-EU location offering higher aid intensities. Following the approach in the 1996 R&D aid Guidelines,[111] it was suggested that, if the Commission had evidence that aid proposed by a third (ie. non-EU) country was higher than that permitted under the regional aid guidelines, it could assess the need to authorise a higher rate to offset that competitive advantage. In practice, the clause in the 1996 R&D guidelines was never used, apparently owing to the high burden of proof required on the part of the Member State concerned; the new R&D guidelines,[112] in force since January 2007, relax the information requirements in this regard under the 'Matching clause'.[113] Most national authorities responded positively, but guardedly, to this suggestion emphasising the need for rapid action on the part of the Commission, without a disproportionate administrative burden, and expressing concerns at the uncertainty and complexity that might be involved for investors and responsible authorities.

A variant on the above proposal put forward by the Irish authorities was that, in limited circumstances, modest levels of investment aid could be permitted in non-assisted areas. This would only be allowed where aid was necessary to attract the project to the EU and the project would ensure the creation or maintenance of jobs; it would be explicitly prohibited in the case of projects relocating within the EU or where two or more Member States were competing for the project. This proposal received a mixed response from the participating Member States. On the one hand there were objections to the notion of extending the availability of State aid and concerns at the practical difficulties and uncertainty involved; on the other hand it was argued that targeted aid in non-assisted areas was the only way for the EU to compete with incentive packages offered by third countries to large projects and suggestions that such aid should be available where more than 250 jobs were created or there was research or innovative potential.

The Commission's view was summarised in a progress report on the study.[114] It argued that there was no justification to extend the scope to offer aid and suggested a number of reasons why a relaxation of the rules would entail significant risks, specifically: that, as aid is hardly a determining factor in firms' location decisions, it is likely to result in a windfall profit at taxpayers' expense, which could further distort competition and discourage innovation; that even if aid were necessary to 'tip the balance' in favour of an EU location, it could result in 'subsidy races' between Member States; that offering aid in non-assisted areas would erode the effect of regional aid and could undermine EU cohesion policy; and

[111] Community framework for state aid for research and development, OJEC No. C 45 of 17 February 1996.

[112] Community framework for state aid for research and development, OJEC No. C 323 of 30 December 2006.

[113] Paragraph 5.7.1.

[114] The progress report has not been made public but has kindly been made available to EPRC by the Irish authorities.

that extending the scope to offer aid would expose the EU to increased risk of criticism and litigation under the WTO rules and contribute to global subsidy races, involving costs to taxpayers and no benefits to consumers.

Notwithstanding apparent Commission opposition to amending the rules on investment aid, under the German Presidency the topic was the subject of discussion between the Informal Competitiveness Council and the Commissioner for Competition Policy, Neelie Kroes. The delegations called on the Commission to review present State aid policy with regard to the possibility of offering State aid in special cases of international competition. Some delegations also stressed the need to consider extending the R&D aid matching clause to other policy areas. Last, ministers asked the Commission to examine whether the review procedure could be expedited where there is international competition for an investment.[115]

To date, the Commission (DG Competition) has not pursued the matter. However, the French authorities have recently commissioned a study on the 'External Dimension of the Competitiveness of the European Union' and the issue seems likely to be back on the agenda during the French Presidency in 2008.

4. DISCUSSION ISSUES

This paper has examined two main themes: the implementation of RAG 2006, most notably the redrawing of the regional aid maps; and the impact of RAG 2006 on aid vales, especially in the context of international incentive competition. A number of issues emerge from these themes.

(i) Are regional aid map disputes a thing of the past?

The negotiation of the regional aid maps for 2007-13 has entailed a significant shift in the tone and content of discussions between the Member States and the European Commission. For the first time since Commission involvement in regional aid control began – some four decades ago – the Commission has tried, and largely succeeded, in withdrawing from a detailed appraisal of proposed assisted area maps, improving the climate of regional policy relations with the Member States. There are several reasons why this has happened.

It was widely viewed as undesirable to repeat the RAG 1998 experience. Under RAG 1998 there were highly prescriptive requirements for building blocks, indicators and area designation systems. It is plausible to surmise that many national policymakers thought that these criteria would ultimately be negotiable; they were mistaken – the Commission proved to be intransigent, if somewhat inconsistent, in its application of the rules. Only two out of 15 maps were approved without changes to the original proposal and in six cases the Article 88 investigative procedure was opened. The Commission Decision on the German map was challenged before the European Court, drawing criticism of the RAG 1998 methodology

[115] Informal Competitiveness Council in Würzburg on 27/28 April 2007.

from the Advocate General. The detailed intervention undertaken by the Commission consumed scarce resources and the bruising encounters which resulted were widely resented by national policymakers; there was no appetite for a re-run of RAG 1998.

Two main issues drove the initial Commission proposals for the 2006 Guidelines: first, the focus on the poorest regions (mainly in the new Member States); and second, the desire not to become embroiled in detailed analyses of area designation systems and individual assisted area maps. As is well-documented, these initial proposals essentially restricted regional aid to the 'a' regions and some limited areas, also selected on the basis of the EU criteria. This was fiercely resisted by many Member States, which sought to retain some scope to pursue regional aid policy in areas selected according to domestic criteria. Over the course of four texts, and against the backdrop of dozens of position papers and meetings, the Commission reversed its initial position. How far the Commission was really pushed and how far its initial proposal was simply a negotiating stance is open to debate; even though RAG 2006 is much less stringent than the initial proposals, it is still more restrictive on coverage than RAG 1998. Nevertheless, policymakers in those countries which had fought to retain nationally designated 'c' areas could claim victory and, for the most part, were confident that national preferences could be shoehorned into the new requirements.

Under RAG 2006 detailed Commission involvement in the maps and area designation systems *per se* was replaced by an approach which set the broad parameters for area designation while substantially reducing spatial coverage and award values. From a Member State perspective, reductions in coverage were less constraining than they might have been, given the greater flexibility in the use of building blocks. This enabled policymakers to maximise the use of their population quotas, with assisted areas able to weave around taking in areas of opportunity, without the 'wastage' of designating residential communities.

The general absence of controversy over the maps (France notwithstanding) is not attributable only to the change in approach under RAG 2006. The importance of regional aid is in decline almost everywhere: policy priorities have shifted away from designated problem regions in favour of an approach that emphasises the competitiveness of *all* regions and therefore a more horizontal approach; at the same time, investment aids are used more sparingly and, in some countries, viewed with increasing scepticism. As a result, a number of countries were content with the Commission's initial plan to drop nationally-designated 'c' areas. In short, to some extent the Commission was pushing against an open door.

It remains to be seen whether the question is settled for the long term. Since coverage for 2007-13 was calculated, further enlargement to include Bulgaria and Romania has taken place so that coverage will be assessed on an EU27, rather than EU25 basis. This, together with growth rates in some regions, will reduce coverage of 'a' areas overall, but create pressures for transitional status for those losing 'a' areas eligibility. For 'c' coverage, perhaps the Commission will renew its earlier ambition to outlaw nationally-designated areas or perhaps it will simply seek to cut 'c' areas back enough to remain within an overall ceiling of around 43 percent of the EU27 population. How will Member States react? Have

regional aid coverage and rates been cut back so far that the effectiveness and impact of regional aid has been eroded and policy will simply wither away? Can horizontal approaches fill the gap or will there be a renaissance of problem-region targeted intervention?

(ii) Will regional aid policy end up much the same everywhere?

A by-product of competition policy control of regional incentives has been the progressive harmonisation of the instruments on offer. Since the 1970s, the Commission has intervened in the spatial coverage of regional aid, award values and forms of aid. This intervention has become more systematic both in timing and content: all maps have been approved for a seven-year cycle; more comprehensive EU-wide systems have been developed for determining assisted area coverage and award rates; and the emphasis on transparency has narrowed the range and form of policy instruments that can be offered.

RAG 2006 reinforces and expands on this trend. Most EU assisted areas are defined on the basis of EU criteria;[116] an EU-wide matrix sets award values, primarily according to levels of EU GDP per head; the requirements for calculating aid values constrain the types of aid that can be offered, with grants predominating and operating aids only permissible in closely proscribed conditions. In addition, RAG 2006 ventures into the realm of incentive administration in the name of 'necessity for the aid', requiring specific steps to be undertaken in the application process prior to work starting on a given project. Moreover, the Draft General Block Exemption Regulation proposes to reinforce this criterion, stipulating that applicants provide documentation to the effect that the project could not proceed without the aid in question. More generally, the very existence of the Regional BER creates an incentive for policymakers to design measures that conform to the exemption requirements.

The only element of regional aid policy which now remains beyond direct Commission control is the budget assigned to it; historically the Commission has doubted its competence under the Treaty to dictate how much Member States spend on particular policy instruments. However, spending is influenced by the award criteria, and it might be expected that lower coverage and lower award rates would reduce spending across the board.

National policymakers may, of course, attach little or no importance to the growing homogeneity of regional aid policy, especially given the appeal of introducing measures that do not require prior notification. However, it can be argued that this trend is both an unwarranted intrusion into policy administration and may stifle policy innovation longer term.

[116] Either GDP(PPS) per head of less than 75 percent of the EU average ('a' areas); former 'a' areas; or the pre-eligibility criteria ('c' areas).

(iii) Will RAG 2006 improve the effectiveness of regional aid?

Under the State Aid Action Plan (SAAP)[117] the Commission has developed and is implementing a comprehensive reform package. Key elements of the reform are "less and better targeted state aid" and "more use of a refined economic approach", of which the incentive effect of aid is "one of the cornerstones". These objectives are reflected in RAG 2006 which: reduces levels of aid, especially for large projects; emphasises the *necessity* for aid; requires the individual notification and appraisal of cases where aid exceeds given thresholds; and provides for a verification that "the aid is necessary to provide an incentive effective effect for the investment and that the benefits of the aid measure outweigh the resulting distortion of competition and effect of trade between Member States" where the recipient has a large market share.[118]

In terms of 'less aid', the control of aid values has long been an element of regional aid discipline, although it was arguably not until RAG 1998 that the ceilings imposed by the Commission began to bite. Until then, for internal budgetary reasons, Member States had tended to offer substantially less than the authorised ceilings. MSF 2002, and subsequently RAG 2006 have had a significant impact on the rates that can be offered to large firms without prior notification.

As far as 'better targeted' aid is concerned, the emphasis on the need for aid and its incentive effect are new.[119] To some extent the RAG 2006 provisions on the necessity for aid echo the requirements that many Member States already operate, but the draft General BER goes further than many, and would oblige Member States to demand from potential beneficiaries documentation that would demonstrate the incentive effect of the aid. It can be argued that the value of such documentation would anyway be questionable: due simply to information asymmetry, firms will always be better placed to provide such justification than aid administrators will be to challenge it.[120]

The lowering of rates of award, together with more stringent procedural requirements are intended to make aid 'less but better targeted'. It is not clear that they can achieve this aim. Little is really known about what levels of incentive 'tip the balance' in favour of a given location. Meicklejohn[121] has observed that, in several cases of aid to the motor industry,[122] it was evident that firms were willing to choose a problem area location even

---

[117] European Commission (2005) State Aid Action Plan, COM(2005) 107 final, 7 June 2005.

[118] The Guidelines state (paragraph 68) that the Commission will draw up further guidance on the criteria it will take into account in this assessment, but no such guidance has been published to date.

[119] Although under the motor vehicle industry rules in the 1990s, prospective beneficiaries had to show that there was a viable alternative non-assisted area location in order for regional aid to be considered.

[120] Anecdotal evidence suggests that motor manufacturers had little difficulty in substantiating the existence of viable non-assisted area alternatives.

[121] Meicklejohn, R. Comments on 'The sources and processes of tax and subsidy competition' by Kenneth P. Thomas (undated conference paper).

[122] In the 1990s special rules on aid to the motor industry operated on the basis of a cost-benefit analysis

where the aid offered did *not* offset the additional costs when set against a comparator location, a conclusion that even sector specialists employed by the Commission were unable to account for. On the other hand, for very large projects, the levels of aid available without notification may be too low to have any incentive effect. Moreover, the delays and uncertainty associated with notification if higher levels of aid are sought may, in themselves, create a disincentive to apply for assistance in those cases where aid *would* tip the balance; in short, the 'hassle factor' might be too great to make regional aid worthwhile. It is not easy to square concerns at the effectiveness of policy with concerns at the distortion of competition: measures which are so small that they do not affect competition may also be too small to alter investment decisions; in terms of regional policy goals, the most effective measures may also be the most distortive ones. Perversely, then, these new requirements may actually *increase* the risk of windfall gains and reduce the effectiveness of policy.

A more general issue is how far the effectiveness of aid is really a concern of the Commission. National policymakers are unlikely to indulge in wilful wastage of the regional aid budget, but realistically there will inevitably be deadweight losses; how much and to which projects they relate is an unknown, but there is an argument for governments to be accountable to their electorates for inefficient or ineffective policies, not to the Commission, whose primary concern should be with the distortion of competition.

(iv) Do EU aid rules damage the EU's global competitiveness for mobile investment?

An emerging concern for a number of Member States is whether the reductions in aid coverage and rates and changes in procedural requirements for regional aid might affect the EU's global competitiveness for mobile investment.

In considering the use of incentives outside the EU, two main points emerge. First, the EU has the most highly-regulated and systematic approach to subsidy discipline in the world. Clearly WTO constraints also apply, but these rely on the self-discipline of Members coupled with challenges or the imposition of countervailing duties to offset domestic effects, rather than an *ex ante* approach. The second main characteristic of non EU subsidies is that, insofar as information is available, most measures appear to take a form that would not comply with EU State aid rules. In particular, tax incentives where a grant-equivalent cannot be calculated tend to predominate and measures are frequently export-oriented; moreover, levels of discretion are often high (even in the case of tax measures) and the absence of published ceilings mean that measures are difficult to value.

Some are sceptical about the capacity of incentives to offset locational disadvantages and point to the importance of other factors. Moreover, the evidence on the effectiveness of incentives in attracting investment is mixed: some argue that FDI incentives involve substantial windfall gains for investors, but others suggest that firms are becoming more responsive to incentives as they become more footloose. There is some consensus that, while incentives may not be crucial in themselves, they can tip the balance in favour of one location where other factors are equal. Within, the EU several countries have confirmed

losses of FDI projects to emerging economies, but there is less certainty about the role of incentives as a factor locational competition.

Commission control of State aid has historically been a source of controversy in regional aid relations with the Member States. However, it has played an important role in subduing incentive competition within the EU and preventing the use of retention and relocation subsidies of the type which are rife in the US. Overall, the Commission has achieved a degree of discipline which is frequently envied by other jurisdictions. To this extent is it scarcely surprising that it should be unenthusiastic about proposals that widen the scope for aid and that increase the probability of global subsidy competition. Greater global subsidy discipline is a long-term and uncertain option. In the short-term, given the ambiguity of the evidence, it would be wise at least to monitor the effects of RAG 2006 on incentive competition with a view to establishing whether EU aid control is appropriately calibrated.