Competition policy and regional aid:
a highly-charged agenda

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Fiona Wishlade

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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

CONTENTS

1. INTRODUCTION 1

2. RECENT DEVELOPMENTS IN REGIONAL AID CONTROL 2

2.1 MATTERS ARISING 2
2.2 REGIONAL, SME AND REGENERATION AID 3
2.3 GERMANY CHALLENGES REGIONAL AID DECISION BEFORE EUROPEAN COURT OF JUSTICE 5

3. THE FUTURE OF THE REGIONAL AID GUIDELINES 7

3.1 WORKING HYPOTHESES 7
3.2 ARTICLE 87(3)(A) COVERAGE 8
3.3 ARTICLE 87(3)(C) COVERAGE 11
3.3.1 Article 87(3)(c) 'qualifying regions' 12
3.3.2 Article 87(3)(c) coverage adjustments 16
3.4 OUTCOMES 18
3.4.1 Assisted area coverage 18
3.4.2 Award values 19

4. REGIONAL AID AND LARGE INVESTMENT PROJECTS 21

4.1 THE 1998 MULTISECTORAL FRAMEWORK: KEY PRINCIPLES 21
4.1.1 Evaluation criteria 22
4.1.2 Administrative arrangements 23
4.2 THE 1998 MULTISECTORAL FRAMEWORK IN PRACTICE 24
4.2.1 Use of the investigative procedure 24
4.2.2 Unchallenged aid proposals 27
4.2.3 Assessment of the 1998 Multisectoral Framework 30
4.3 THE 2002 MULTISECTORAL FRAMEWORK 31
4.3.1 Aid levels 32
4.3.2 Notification of large awards 33
4.3.3 Aid for the motor vehicle, synthetic fibre and steel industries 34
4.3.4 Other sensitive sectors 36
4.4 IMPLICATIONS OF THE 2002 MULTISECTORAL FRAMEWORK 37

5. OTHER RECENT DEVELOPMENTS 40

5.1 PROPOSED NUTS REGULATION 40
5.2 STATE AID, REGIONAL DEVELOPMENT AND SERVICES OF GENERAL ECONOMIC INTEREST 43
5.2.1 Treaty provisions 44
5.2.2 Cohesion and competition in the provision of services of general economic interest 45
5.2.3 State aid and financial compensation for the provision of services of general interest 47
5.3 STATE AID EXPENDITURE – LESS BUT BETTER? 49

6. CONCLUSIONS 53

1. INTRODUCTION

The control of State aids by the European Commission is increasingly characterised by attempts to formalise its approach, both procedurally and substantively, and to address lacunae in policy coverage. The procedural Regulation[1] has increased legal certainty and clarity with respect to notification and review of aid measures. The adoption of 'block exemption' Regulations on aid to SMEs,[2] training[3] and *de minimis* aid[4] will considerably reduce the administrative burden on the Commission by obviating the need for notification of schemes that meet the relevant criteria. The stated purpose of these Regulations is to enable the Commission to focus resources on cases where the risk of distorting competition is considered higher. In parallel, the substance of State aid control policy has increased in scope: in the last two years the Commission has more proactively addressed areas that are either technically difficult, such as venture capital, or politically sensitive, such as fiscal aid and State guarantees, and is seeking to provide greater clarity on the question of State aid and the provision of services of general economic interest. These developments are testament to the continued tightening of State aid discipline wherein proposed State aid measures can increasingly be set against a matrix of rules which will determine spatial coverage, eligible costs, aid types, aid values and sectoral availability.

At the same time, the Stockholm Council made a political commitment to reducing overall levels of State aid as a proportion of GDP in the European Union and focusing aid on priority areas. The Commission was enjoined by the Council to improve the transparency of aid by producing regular so-called 'Scoreboards' on the State aid activities of the Member States. This apparent unanimity on the need for State aid discipline conceals a number of tensions. These are evident within the Commission itself: the 2002 Competitiveness Report pointed to modest State aid expenditure in the EU compared with global competitors and the potentially positive role of State aids in addressing market failures.[5] Tensions also arise from the growing tendency to interlink policy areas. While superficially neat, this produces frustrating anomalies in practice with, for example, urban and SME policies tied to regional policy assisted areas. More generally, the political consensus for State aid discipline expressed in European Councils is not always reflected in negotiations between national policymakers and DG Competition when it comes to specific instances of national interest.

By comparison with wider developments, the control of national regional aid policies by the European Commission is entering a period of stability. In the course of 1999 and 2000, the assisted area maps and the main regional aid schemes of all the Member States were subject to Commission scrutiny under the 1998 Regional Aid Guidelines.

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[1] Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJEC No L 83 of 27 March 1999.

[2] Commission Regulation (EC) No 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises, OJEC No L 10 of 13 January 2001.

[3] Commission Regulation (EC) No 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid, OJEC No L 10 of 13 January 2001.

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

[5] European Commission, *2002 Competitiveness Report*, COM (2002) 262 final of 21 May 2002.

For the most part these were approved until the end of 2006; although changes to assisted areas are possible before this end date, few policymakers appear to have any appetite for reopening debates on what were often delicate and difficult negotiations both internally and at the European level.[6] This quiescent period is likely to be short-lived: the expiry of the Guidelines at the end of 2006 means that new rules must be decided by 2005.

The aim of this paper is to set current and future regional aid control in the context of wider developments. The paper is structured as follows: Section 2 reviews recent developments associated with the Regional Aid Guidelines. Section 3 considers the future application of the Guidelines in an enlarged Europe. Section 4 examines the operation and impact of the 1998 Multisectoral Framework and the recently-adopted 2002 Multisectoral Framework. Section 5 reviews a number of recent developments in Commission State aid policy with implications for regional policy. The final section considers the key issues and challenges that arise from these developments.

2. RECENT DEVELOPMENTS IN REGIONAL AID CONTROL

2.1 Matters Arising

Following the approval of the assisted areas maps and the main regional aid schemes in 1999-2001, there has been comparatively little activity in the scrutiny of regional aid over the past year or so. This is in part because, in general, maps and schemes have been approved for the period 2000-6, so that the ‘rolling’ process of reviews undertaken by the Commission in the past has been replaced by approvals for the same fixed timespan for all Member States. In addition, the introduction of a block exemption Regulation for aid to SMEs means that schemes can readily be designed in a form that need not require prior approval by the Commission. On the other hand, experience at the subnational level in a number of countries suggests that there have been significant delays and difficulties in gaining approval for State aid measures included within Structural Funds Community Support Frameworks (CSF) and Single Programming Documents (SPD). This seems to be partly attributable to the nature of the cofunding made available at the national level – and in particular whether the matched funding is provided for under a notified aid measure. In addition, there are special problems associated with gaining approval for regeneration funding where the areas concerned are covered by Objective 2, but not Article 87(3)(c). Last, there is both confusion and frustration over the acceptability of complex funding arrangements like those involving collaboration between several partners, such as SMEs, large firms and public sector organisations.

In short, while the approval of the assisted area maps and related award maxima under the 1998 Regional Aid Guidelines appears to provide a relatively transparent framework for the authorisation of subsequent measures, such as those for SMEs, in practice, it falls short of providing guidance for all but the most straightforward (ie. essentially grant or soft loan based) measures. Moreover, from a subnational

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[6] The German map was approved to end 2003, reflecting domestic schedules for review of the assisted areas. A revised area designation system is in preparation in Germany.

perspective, the position is made more complex by the fact that the availability and intensity of State aids in Objective 2 regions is driven by the eligibility of the region for the Article 87(3)(c) derogation.

In this context, it is questionable whether the Commission's aim of greater 'coherence' in the coverage of the national and Structural Funds maps was achieved in the 1999 redesignations: in 1994-9, 6.6 percent of the Community population was in areas eligible for the Structural Funds, but not for national regional regions aid; in 2000-6 this has fallen to 5.8 percent. However, because coverage of the Structural Funds assisted areas overall has fallen, the proportion of the Structural Funds population *not* eligible for national regional aid has actually risen from 13 percent to 14 percent of the Community population.[7]

2.2 Regional, SME and Regeneration Aid

More generally, the formalisation of the regional aid rules, coupled with the extensive cutbacks in the spatial coverage of regional policy enforced in many countries, have thrown into sharp relief some important issues of policy coordination. These are most evident in the fields of SME policy and urban regeneration. The scope and flexibility of policymakers in these areas has been progressively constrained by two parallel trends in State aid control. First, since the early 1970s, the Commission has increasingly sought to target aid schemes at regional or horizontal objectives; this emphasis was reinforced in the mid 1980s when the Commission outlawed a number of 'general' aid schemes, making their application subject to individual notification and progressively narrowing the circumstances in which such aid could be approved. As a result, the Commission will not authorise general investment aid to large firms other than in Article 87(3)(a) and (c) areas.[8] Second, successive 'horizontal' aid frameworks which enable aid to be authorised in *all* regions – such as the rules on aid for SMEs, for R&D or for environmental protection - have provided for higher aid intensities to be authorised in areas qualifying for the Article 87(3)(a) or (c) derogation in favour of regional development.

The net effect of these trends is a tendency among national regional policymakers to give prime consideration to those areas that can accommodate investments by large firms rather than 'wasting' reduced assisted area coverage on regions that would be unlikely to attract such projects. Related, the scope to assist projects in areas outside the regional aid map is considerably reduced. From an economic development perspective this may be of critical importance. For example, rural areas that may have been omitted from the regional aid map for reasons of remoteness – and therefore unsuitability for large manufacturing investment – may depend on small and medium-sized enterprises for employment and income. Under the SME rules, maximum rates of award in such areas will be just 7.5 and 15 percent gross for small and medium-sized firms respectively; by contrast, within the regional aid map, rates may be up to 30 percent net grant-equivalent. Similar issues arise in inner urban areas and in the context of regeneration projects. Again, the availability and intensity of State aid is

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[7] This can be calculated from figures in European Commission, *Second Report on Economic and Social Cohesion* (OOPEC, Luxembourg, 2002), p 125.
[8] Aid to important projects of common European interest can be authorised, but instances of this are rare.

determined by the coverage of the regional aid map. The room for manoeuvre within the sometimes unexpected interaction of the various Guidelines is limited, as the following examples from France and the UK illustrate.

In France, there are considerable concerns at the impact of the changes to the PAT assisted areas map, which in many ways is felt to be ill-adapted to regional economic development needs because of the exclusion of many fragile rural areas from the map. The difficulty which arises in the context of such areas is not so much the loss of eligibility for the PAT scheme, but rather the fact that the assisted areas for the PAT determine award maxima for aids to small and medium-sized firms. In the context of rural disadvantaged areas where most economic activity is likely to be undertaken by SMEs, but where the local economy is relatively weak, the rationale for SMEs in parts of major agglomerations qualifying for twice the level of aid or more is difficult to rationalise. In response, special provision has been made for the use of *de minimis* aid to 'top up' assistance under notified schemes, subject the standard aid ceiling for manufacturing projects in PAT assisted areas.

In the UK, the design and operation of urban regeneration policies has been severely hampered by the State aid rules. Problems have arisen in two main instances: the English Partnerships initiatives and the recent proposal to offer stamp duty relief in designated urban areas.

In the English Partnerships (EP) case the finding that 'gap' funding to property developers in designated urban areas constituted State aid led to a major reorientation of the initiative. In 1995, the Commission had concluded that the Partnership Investment Programme (PIP) fell outside the scope of Article 87(1), but it reviewed its position in 1999 following concerns that the measure had been used by investors who were also motor vehicle manufacturers.[9] The UK authorities maintained that PIP did not constitute State aid because: the grant given was the minimum necessary to bridge the gap between development costs and market value of the regeneration site; it did not confer an unfair competitive advantage on the developer because any undertaking could apply for assistance under PIP, and all costs and values were assessed at open market rates; and there was negligible (if any) intra-Community trade in the development of derelict land and buildings. However, the Commission ruled that PIP involved the use of State aid because gap funding provides a quantifiable financial incentive to a developer to invest in an area or location in which little or no private investment would otherwise have happened; the aid favoured certain undertakings; and PIP had the potential to distort trade between Member States. An important factor, in the Commission's view, was that the recipients of EP's funding were undertakings active in trade between Member States. This led to a ruling that PIP could only be considered compatible with the common market if it were brought into line with the terms of a range of existing State aid codes or frameworks.[10] In practical terms, this meant that where the property developer was not an SME, gap funding could only be provided if the project were located in an

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[9] Invitation to submit comments pursuant to Article 88(2) of the EC Treaty, concerning aid C 39/99 (ex E 2/97) – English Partnerships (EP) under the Partnership Investment Programme (PIP), OJEC No C 245 of 28 August 1999.

[10] Commission Decision of 22 December 1999 on aid scheme C 39/99 (ex E 2/97) United Kingdom, English Partnerships (EP) under the Partnership Investment Programme (PIP), OJEC No L 145 of 20 June 2000.

assisted area, and subject to the regional aid ceilings approved in the context of the assisted areas map.

Recent proposals to provide relief from stamp duty in disadvantaged areas have also met with initial opposition from the European Commission.[11] The proposed exemption from stamp duty concerns non-residential property in deprived areas selected on the basis of indices for each of the four nations of the UK; these areas do not coincide with the areas designated for UK regional policy. Moreover, the logic of the scheme, for understandable reasons, bears no relation to that of UK regional policy. The outcome of the investigative procedure is not yet known. However, given recent trends, it would be surprising if the Commission did not require the measure to be restricted to small and medium-sized enterprises and made available to large firms only in the assisted areas, or somehow brought within the terms of the framework on environmental aid.

More generally within the UK, where urban policy expenditure has long since exceeded regional aid budgets and the loss of PIP has been described a "disaster", the perverse effects of EU competition rules have led to calls for the Commission to adopt a framework on regeneration aid.[12]

2.3 Germany Challenges Regional Aid Decision before European Court of Justice

Of potentially fundamental importance for the status of the Regional Aid Guidelines was the German Government's challenge to the Commission Decision on the regional aid map for 2000-3.

The core of the German case concerned the ceilings imposed on Article 87(3)(c) coverage and, specifically, the 'adjustments' made to the initial Article 87(3)(c) quota.[13] This initial quota was generated from an analysis of internal disparities in GDP per head and unemployment rates outside the areas classified as Article 87(3)(a) and represented each Member State's 'share' of EU-wide Article 87(3)(c) coverage. The adjustments applied to the initial quota involved the following:

- ensuring that all Member States had a minimum of 15 percent and a maximum of 50 percent of the national population covered by Article 87(3)(c);

- increasing the initial quotas as required so that all areas losing Article 87(3)(a) status could be accommodated in Article 87(3)(c) together with areas meeting the low population density criterion;

[11] State aid – United Kingdom Aid C 13/02 (ex N 27/02) – Stamp duty exemption for non-residential property in disadvantaged areas. Invitation to submit comments pursuant to Article 88(2) of the EC Treaty, OJEC C 102 of 27 April 2002.
[12] House of Commons, Transport Local Government and the Regions Committee, *The Need for a European Regeneration Framework*, Twelfth Report of Session 2001-2, HC 483-I of 31 July 2002 (The Stationery Office, London, 2002).
[13] This process is described in Annex II of the Regional Aid Guidelines (OJ No C 74 of 10 March 1998.) and is discussed further below in the context of the future of the Guidelines.

- and guaranteeing that no Member State incurred a reduction in Article 87(3)(c) coverage of more than 25 percent of existing coverage.

As these adjustments involved *increasing* the Article 87(3)(c) population quotas of some Member States, this had to be 'paid for' by others in order to remain within the overall population target of 42.7 percent of the Community population. For Germany, the adjustments applied to the Article 87(3)(c) population meant that the initial quota of 23.4 per cent of the population was reduced to 17.6 percent. Reflecting German opposition to the method of calculating the final Article 87(3)(c) population quotas, the initial German map proposed to include 23.4 per cent of the population; not surprisingly this was rejected by the Commission which opened the Article 88(2) procedure against the German proposal.[14] The German authorities recognised that, unless they agreed to the Commission's Article 87(3)(c) coverage limit, regional aid for *all* the proposed assisted areas – not just the areas lying between the 17.6 percent and the 23.4 percent thresholds – would be suspended until the Commission reached its final Decision; moreover, this Decision was likely to be negative. The Commission did, however, agree to a marginal increase in Article 87(3)(c) coverage owing to outmigration from the new *Länder*; this meant that Article 87(3)(a) coverage was 17.16 per cent of the German population, rather than 17.3 percent. The Commission accepted German arguments that the resulting surplus should be reallocated to the German Article 87(3)(c) quota. Article 87(3)(c) coverage ultimately agreed by the Commission was therefore raised from 17.6 percent to 17.73 percent of the German population. Because of concerns at the suspension of regional aid in *all* Article 87(3)(c) areas, the German authorities submitted a listing of regions which met the Commission's quota (ie. 17.73 per cent) and sought the approval of this without delay, whilst maintaining their opposition to the reduction of the quota from 23.4 per cent. This new listing was approved by the Commission.[15]

The German authorities remained opposed to the population quota methodology, although, pragmatically, the decision to notify a shorter list enabled regional aid to go ahead in most of the areas which German authorities wanted. Nevertheless, with a view to obtaining a definitive clarification of the Commission's competence in regional aid discipline, the German government challenged the Decision approving the limited list of Article 87(3)(c) areas before the European Court of Justice.[16] Following the hearing in January 2002, the Advocate General took the view that the German challenge should not be deemed admissible since it was, in reality, a challenge to a *positive* decision concerning the regions covering 17.73 per cent of the population rather than a *negative* decision on the remaining areas. However, on *substance*, were the Court to decide that the case *was* admissible, AG Mischo considered that the process of adjustments whereby one Member State lost assisted area coverage in order to maintain coverage in another whilst remaining within the Community ceiling breached the principle of equal treatment and could not be objectively justified. The Court concurred with the Advocate General's opinion regarding the admissibility of the German challenge, and made no comment on the

[14] OJEC No C 340 of 27 November 1999.
[15] Commission Decision of 14 March 2000 on the redefinition of assisted areas under the joint Federal / *Länder* scheme for improving regional economic structures in Germany for the period 1 January 2000 to 31 December 2003 - West Germany and Berlin, OJEC No L 97 of 6 April 2001.
[16] C 242/00 *Germany v Commission.*

substantive issues, save to observe that it was open to the German authorities to notify to the Commission proposals to designate further areas.[17]

From a policy perspective, this outcome is unsatisfactory. The Advocate General was clearly not content that the Commission's approach to Article 87(3)(c) population coverage in the Regional Aid Guidelines is justified, but the absence of a Court ruling on this leaves open the question of the legitimacy of the methodology. At the very least, however, it is a signal that the Commission must tread carefully in considering reforms to the Guidelines.

3. THE FUTURE OF THE REGIONAL AID GUIDELINES

At the time of writing it seems that only limited consideration has been given by the Commission to the control of regional aids after the expiry of the current Guidelines in 2006. Nevertheless, it does appear that the emphasis is more likely to be on adjusting the existing system, rather than another radical overhaul. The focus of this section is on the future of the Regional Aid Guidelines, particularly in the light of enlargement. The section begins by outlining the basis for the calculations and analysis that follows and goes on to assess the impact of enlargement on Article 87(3)(a) and (c) coverage in turn. Last, it considers some of the wider implications of applying the Guidelines in an enlarged Europe.

3.1 Working Hypotheses

For the most part, the discussion that follows assumes minimal change in the application of the Guidelines after 2006, with a view to assessing the impact of simply 'rolling forward' the existing rules. However, a number of working assumptions are necessary in order to make some predictions about the outturn of re-applying the Guidelines. The main hypotheses are as follows:

- The calculations assume EU enlargement to 27 Member States in the period covered by the next version of the Guidelines. This is in line with the current prognosis that 10 candidate countries will be ready to join in 2004, and two further countries (Bulgaria and Romania) in 2006 or thereafter, but at least within the timeframe for which the next Guidelines operate.

- The overall objective remains to contain population coverage at less than 50 percent of the EU population – in this case, the population of the enlarged Community.

- The mechanisms for determining Article 87(3)(a) and (c) coverage remain broadly unchanged, save that the calculations use EU27 indices and averages.[18]

- Countries are treated equally; for example, regions of candidate countries (CC12) that do not meet the criteria for Article 87(3)(a) are excluded from

[17] The Advocate General's Opinion and the Court's judgement are not yet reported but provisional texts are available on the European Court of Justice website at <www.curia.eu.int>.
[18] These indices were calculated using REGIO data.

Article 87(3)(a) status, but benefit from the transitional provisions built into the Article 87(3)(c) population calculations under the 1998 Guidelines methodology.

- For the most part, GDP and unemployment rate data are complete for EU27; the latest figures are 1999 for GDP, and 2000 for unemployment rates.[19] Eurostat sources other than REGIO have been used to complete national unemployment rate data for Bulgaria, Cyprus and Malta.[20] Figures for these countries were, however, still incomplete and some minor estimations were therefore used. These are unlikely to have any impact on the overall outcomes. Also missing from REGIO are NUTS III unemployment rate data for Sachsen (Germany), Ceuta and Melilla (Spain), all of Greece and Portugal. These gaps have some implications for the calculations relating to Article 87(3)(c) eligibility and award values.

- NUTS breakdowns have not been agreed for Cyprus and Malta.

3.2 Article 87(3)(a) Coverage

The first stage of the methodology under the 1998 Regional Aid Guidelines involves an assessment of GDP per head in purchasing power standards (PPS) at the NUTS II level and concerns the last three years for which data are available. For these purposes, GDP data covers the period 1997-99.

NUTS II regions qualifying for the Article 87(3)(a) derogation are those where GDP(PPS) per head averaged over the last three years is less than 75 percent of the EU average – in this case the EU27 average. The ranking of regions on this basis is illustrated in Annex I. A number of points arise from this table.

Most obviously, the use of EU27 averages excludes the majority of EU15 regions with Article 87(3)(a) status at present from eligibility for the derogation in the future. This is reflected in the fact EU15 coverage under Article 87(3)(a) would fall from 21.9 percent of the population to just 7 percent.

Overall coverage of Article 87(3)(a) areas would rise as a proportion of the EU population from 21.9 percent (of EU15) to 25.9 percent (of EU27). However, the increase is entirely accounted for by the candidate countries: 93 percent of the CC12 population would be covered by the Article 87(3)(a) derogation. This has direct implications for Article 87(3)(c) coverage, and therefore for the current Member States, assuming that the overall ceiling of 50 percent is retained.

The impact of the strict application of the Article 87(3)(a) criteria varies between countries (see Figure 1), as do the reasons for change.

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[19] Eurostat REGIO database, 30 April 2002 release.

[20] Eurostat, *EU Enlargement: Key data on candidate countries,* Memo 10/99 of 7 December 1999*;* and Eurostat, *EU Enlargement: Key data on candidate countries,* Memo 129/2001 of 13 December 2001.

Figure 1: Article 87(3)(a) Coverage (% of population)

	2000	Post 2006?
EU27	38.9	25.9
Austria	3.5	0.0
Belgium	0.0	0.0
Denmark	0.0	0.0
Finland	13.4	0.0
France	2.8	2.7
Germany	17.2	0.7
Greece	100.0	33.0
Ireland	26.6	0.0
Italy	33.6	3.6
Luxembourg	0.0	0.0
Netherlands	0.0	0.0
Portugal	66.6	60.4
Spain	58.4	32.3
Sweden	0.0	0.0
United Kingdom	8.6	0.0
Bulgaria	100.0	100.0
Cyprus	0.0	0.0
Czech Republic	100.0	88.4
Estonia	100.0	100.0
Hungary	100.0	71.7
Lithuania	100.0	100.0
Latvia	100.0	100.0
Malta	100.0	100.0
Poland	100.0	100.0
Romania	100.0	100.0
Slovenia	100.0	0.0
Slovak Republic	100.0	88.6

Notes: It has not proved possible to determine the status of Cyprus under Article 87(3) but the island does not currently meet the Article 87(3)(a) criteria.
Source: Current coverage: own calculations from REGIO, Association Council Decisions and various national and Community sources. Future coverage: own calculations from REGIO.

In *Austria*, *Finland*, and the *UK* all regions currently eligible for Article 87(3)(a) would lose that status in the scenario presented here. Burgenland (Austria), Itä-Suomi (Finland), Cornwall & the Scilly Isles, Merseyside and West Wales & the Valleys (UK) would lose Article 87(3)(a) status because of change in the threshold from EU15 to EU27 averages (see Annex I). However, it is worth noting that Itä-Suomi is just 0.1 percentage point below the EU15 threshold on the basis of the latest figures, so that its status might anyway be affected by updated data. South Yorkshire (UK) is over the EU15 threshold, but by just over one percentage point – again a level that might easily be affected by small changes in relative levels of per capita GDP over the next three years or so.

In *Germany* and *Italy,* where Article 87(3)(a) coverage has hitherto accounted for a significant proportion of the population, coverage would be dramatically reduced were the Guidelines reapplied in the context of enlargement. Only one region in each country would qualify on this basis: Dessau (Germany) and Calabria (Italy) accounting for 0.7 and 3.6 percent of the national populations respectively. For the most part, the current German and Italian regions would be excluded from Article 87(3)(a) because of the change in threshold linked to enlargement; only Leipzig and Sardegna appear over the EU15 75 percent GDP(PPS) threshold and would, on the basis of current data, be excluded from Article 87(3)(a) status anyway.

Among the formerly so-called 'cohesion countries', the picture is more mixed. *Greece* would face the largest cutback of all the Member States in absolute terms. The entire country is currently wholly covered by Article 87(3)(a); under the scenario presented here, coverage would fall to just 33 percent of the national population, with most of this purely as a consequence of the use of the EU27 index. However, Annex I suggests that around 9 percent of the Greek population would anyway have lost Article 87(3)(a) status owing to changes in GDP(PPS) per head relative to the EU15 average; moreover, the capital region of Attiki (containing about a third of the Greek population) lies at the margins of eligibility on the basis of EU15 figures and could easily slip from eligibility on the basis of updated data even without taking account of enlargement.

Following the division of *Ireland* into two NUTS II regions in 1998, only part of Ireland, the Border, Midlands and West region, qualifies as Article 87(3)(a) for the period 2000-6; on the basis of current data, this region too would lose Article 87(3)(a) eligibility in the future. GDP(PPS) per head in the region now exceeds even the EU15 GDP(PPS) 75 percent threshold by a wide margin.

In *Portugal,* Article 87(3)(a) coverage was reduced by around a third in 2000 with the exclusion of the Lisboa e Vale do Tejo region. The impact of enlargement on Article 87(3)(a) Portuguese coverage would be relatively limited; a reduction of around 9 percent of current coverage is implied by Figure 1: the Algarve region and Madeira would be excluded on the basis of the EU27 GDP(PPS) threshold, although both regions would still qualify on the basis of the EU15 index.

In *Spain,* Article 87(3)(a) coverage would be reduced by almost half. Two regions appear over the EU15 GDP(PPS) threshold (Valencia and Canarias - accounting for just over 14 percent of the Spanish population) and four further regions fall between the EU27 and EU15 percent thresholds. However, perhaps the most significant feature of the Spanish situation is that two of the regions that do qualify on the basis of the EU27 threshold (Galicia and Castilla-La Mancha) are right at the margins of eligibility. It is highly probable that only Andalucia (about 18 percent of the Spanish population) would be covered by Article 87(3)(a) in an enlarged Europe.

In the remainder of the current membership the position would be unchanged. The French *départements d'outre mer* (DOM) would continue to be eligible for Article 87(3)(a). In Belgium, Denmark, Luxembourg, the Netherlands and Sweden, there are currently no Article 87(3)(a) areas, and this would, self-evidently, continue to be the case. Nevertheless, it is interesting to note that the Belgian region Hainaut falls between the EU27 and EU15 GDP(PPS) thresholds. Hainaut is the only non-Article 87(3)(a) region in the EU15 that would *gain* Article 87(3)(a) status were the

GDP(PPS) per head threshold to remain at 75 percent of the EU15 average. This is largely attributable to the impact of the move from the ESA79 to ESA95 definition of gross domestic product under the European System of Accounts, which has produced a significant apparent widening of regional disparities in GDP per head in Belgium.

Turning to the candidate countries, the entirety of most countries would be covered by Article 87(3)(a) on the basis of a strict application of the criteria using EU27 indices. However, there are some important exceptions: Cyprus would have no Article 87(3)(a) areas; and the Czech Republic, Hungary and Slovakia would only partly be covered. As Annex I shows, Cyprus, Bratislava and Prague all have per capita GDP(PPS) well above the EU27 Article 87(3)(a) threshold (97, 113 and 140 percent of the EU27 average respectively). The current status of Cyprus is unclear from a State aid perspective; unlike the CEE and Baltic applicants, no provision appears to have been made for the country to qualify for Article 87(3)(a) status. Regarding Slovakia and the Czech Republic, Decisions of the relevant Association Councils had extended the provisions of the Association Agreements concerning Article 87(3)(a) coverage;[21] however, these extensions, which meant that the entirety of both countries was covered by Article 87(3)(a) have both expired.[22] No information is available on the scope for further renewal, but the situation of Bratislava and Prague in relation to the EU average suggests that the Commission might be reluctant to agree a further extension covering the whole country.

More generally, a significant number of regions fall between the threshold equal to 75 percent of the EU27 average GDP(PPS) per head and that equivalent to 75 percent of the EU15 average. The vast majority of these regions are regions of the current Member States that are eligible for Article 87(3)(a). The exceptions are Slovenia and the capital region of Hungary. The whole of Slovenia is currently regarded as eligible for Article 87(3)(a)[23] and this has apparently been proposed for Hungary.[24] Both of these regions (Slovenia is regarded as a NUTS II region) would be excluded from Article 87(3)(a) status on the basis of the EU27 GDP(PPS) threshold.

3.3 Article 87(3)(c) Coverage

The method for determining Article 87(3)(c) population is set out in Annex III to the Regional Aid Guidelines. In the first instance, the Commission sets a ceiling for regional aid coverage (Article 87(3)(a) and (c)) for the EU. As already mentioned, for the purposes of the calculations presented here, this has been assumed to be 50 percent of the EU27 population. As described, Article 87(3)(a) coverage is determined by a 'top down' process based on levels of GDP(PPS) per head; on the basis of current data, Article 87(3)(a) coverage would extend to 25.9 percent of the EU27 population, effectively limiting Article 87(3)(c) coverage to 24.1 percent. Article

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[21] Decision No 3/2001 of the EU – Slovakia Council of 18 May 2001, OJEC No L 217 of 11 August 2001; and Decision No 3/2001 of the EU – Czech Republic Association Council of 8 March 2001, OJEC No L 100 of 11 April 2001.

[22] 28 February 2002 in the case of Slovakia and 31 December 2001 in the case of the Czech Republic.

[23] Decision 4/2001 of the EU - Slovenia Association Council of 25 July 2001, OJEC No L 37 of 7 February 2002. This extends to 31 December 2004 the eligibility of Slovenia for the Article 87(3)(a) derogation.

[24] See European Commission, *XXXth Report on competition policy 2000* (OOPEC, Luxembourg, 2001); however, no Decision of the EU - Hungary Association Council appears to have been made.

87(3)(c) coverage for each country is calculated according to a ‘bottom up’ process that takes account of regional disparities in GDP(PPS) per head and unemployment rates in a national and Community context; this outcome is then subject to a number of adjustments regarding minimum and maximum levels of coverage. The principles and stages of this process are as follows:

- the basic principle is that only NUTS III regions which have either GDP per head 15 percent below the national average or unemployment 15 percent above the national average are taken into account in determining the national share of the Article 87(3)(c) population quota (referred to as ‘qualifying regions’ below). The basic threshold (ie. the 15 percent disparity in GDP per head or unemployment) against which NUTS III regions are measured is adjusted to take account of the national situation in relation to the Community average; in consequence, the higher the per capita GDP of a Member State in relation to the EU average, the lower must be the GDP per head of a *region* in relation to the *national* average in order for the region to count towards the quota

- the outcome of this exercise determines the basic share of the Article 87(3)(c) quota by Member State; this basic share is subject to a series of ‘adjustments’ to ensure the following:

    - that each Member State has at least 15 percent of the population not covered by Article 87(3)(a) assisted under the Article 87(3)(c) derogation

    - that no Member State Article 87(3)(c) areas exceed 50 percent of the population not covered by Article 87(3)(a)

    - that there is sufficient population coverage to include all the regions which have just lost Article 87(3)(a) status and areas with a low population density

    - that no Member State loses more than 25 percent of its assisted area population.

Should these adjustments result in the overall (ie. EC-wide) ceiling for Article 87(3)(c) being exceeded, then those Member States *not* affected by the adjustments share the burden of a reduction in their assisted areas in order to bring the total EC-wide assisted area population coverage down to the ceiling set by the Commission – assumed here to be 50 percent of the EU27 population. The process by which the Article 87(3)(c) qualifying regions are identified and the subsequent adjustments to coverage are made are set out below.

3.3.1 Article 87(3)(c) ‘qualifying regions’

The first stage in determining Article 87(3)(c) coverage involves assessing internal disparities in GDP(PPS) per head and unemployment rates for the last years for which data is available.[25] As outlined above, the situation of NUTS III regions *not* qualifying under the Article 87(3)(a) derogation is assessed against so-called ‘adjusted

[25] 1997-1999 for GDP and 1998-2000 for unemployment rates.

thresholds'. The adjusted thresholds take account of the position of a Member State in relation to the EU averages. In consequence, the higher the *per capita* GDP of a Member State in relation to the EU average, the lower must be the GDP per head of a given NUTS III region in order for it to count towards the national Article 87(3)(c) population quota. Similarly, the lower the unemployment rate of a Member State, the higher must be the regional rate of unemployment for that area to count towards the quota; however, the unemployment rate threshold is subject to a ceiling of 150 of the EU average in order that the criterion not be too "rigorous".[26] GDP(PPS) and unemployment rate averages for calculating the thresholds, alongside the thresholds themselves are shown in Figure 2.

As would be expected, levels of GDP(PPS) in the candidate countries as a group are significantly lower than in the EU15 – 44.6 percent of the EU27 average as opposed to 115.6 percent. However, this aggregate conceals marked disparities within the two groups of countries: it is noteworthy that per capita GDP in Cyprus is higher than that in Spain, Portugal or Greece; and levels of GDP per head are comparable in Greece and Slovenia. Differences in unemployment rates between the two groups of countries are less significant than those in GDP per head: 97.1 percent of the EU27 average in the current membership and 110.2 percent in the candidate countries. Again, however, there are significant differences between countries within those groups with the Czech Republic, Hungary, Malta, Romania and Slovenia among the candidate countries having relatively low levels of unemployment and high rates in a number of EU15 countries, notably Finland, France, Greece, Italy and Spain.

At one level, the Article 87(3)(c) thresholds are of limited relevance where most of the candidate countries are concerned. As described earlier, all of the candidate countries would be covered by Article 87(3)(a) in their entirety except for Cyprus and Slovenia and one region each in the Czech and Slovak Republics and Hungary. However, it is important to note that, even though only small areas of the candidate countries themselves will be affected by the Article 87(3)(c) derogation, levels of GDP(PPS) per head and unemployment rates in these countries impact significantly on the thresholds – which take account of EU27 rather than EU15 averages – and therefore on the distribution of qualifying regions elsewhere.

[26] Regional Aid Guidelines, Annex III, paragraph 5.

Figure 2: Adjusted GDP per head and Unemployment Rate Thresholds

	GDP(PPS) per head EU27=100 (1997-1999)	Unemp rate EU27=100 (1998-2000)	GDP(PPS) per head threshold (1997-1999)	Unemp threshold (1998-2000)
EU27	100.0	100.0		
EU15	115.6	97.1		
CC12	44.6	110.2		
Austria	127.7	44.0	75.8	150.0
Belgium	126.7	84.8	76.0	125.3
Denmark	137.7	53.5	73.4	150.0
Finland	116.2	119.6	79.1	115.0
France	114.7	110.7	79.6	115.0
Germany	123.3	92.0	77.0	120.0
Greece	77.4	114.5	85.0	115.0
Ireland	123.6	61.7	76.9	150.0
Italy	118.9	117.9	78.2	115.0
Luxembourg	207.7	25.9	63.0	150.0
Netherlands	131.8	34.4	74.8	150.0
Portugal	85.5	48.0	85.0	150.0
Spain	93.0	169.4	85.0	115.0
Sweden	117.5	77.4	78.7	131.8
United Kingdom	118.0	61.0	78.5	150.0
Bulgaria	31.0	176.9	85.0	115.0
Cyprus	96.8	41.9	85.0	150.0
Czech Republic	69.7	79.1	85.0	130.2
Estonia	42.8	117.6	85.0	115.0
Hungary	56.1	76.3	85.0	132.8
Lithuania	39.2	130.5	85.0	115.0
Latvia	32.6	144.1	85.0	115.0
Malta	63.3	59.3	85.0	150.0
Poland	44.2	131.2	85.0	115.0
Romania	28.7	64.1	85.0	147.3
Slovenia	77.2	73.6	85.0	135.6
Slovak Republic	55.6	168.3	85.0	115.0

Source: Own calculations from REGIO data using method described in Annex III to the Regional Aid Guidelines.

The proportion of the population meeting the GDP(PPS) per head or unemployment rate criteria for Article 87(3)(c) is shown in Figure 3. A number of observations are worth making about this table. First, several countries have no population qualifying on the basis of the Article 87(3)(c) criteria, namely: Denmark, Ireland, Luxembourg, the Netherlands, Sweden, Cyprus and the Czech Republic. Second, and especially within the current membership, those regions that meet the Article 87(3)(c) criteria do so mainly on the basis of the unemployment criteria. This largely reflects the fact that the analysis on the basis of EU27 rather than EU15 GDP(PPS) per head averages has made this criterion less 'attainable' by NUTS III regions in the EU15 countries and has skewed eligibility towards those countries with high rates of unemployment generally (such as Finland, France and Spain) or with concentrations of unemployment in particular areas (such as Belgium and Greece). Last, it is noteworthy that most of the regions meeting the Article 87(3)(c) criteria fall into one of two categories. One the one hand, and not surprisingly, are regions formerly eligible for the Article 87(3)(a) derogation, thus most of the east German regions, most of Greece, most of the Italian *Mezzogiorno* and most of the Spanish regions

losing Article 87(3)(a) status meet the Article 87(3)(c) criteria. On the other hand, and somewhat perversely, much of the Article 87(3)(c) population is attributable to the most prosperous or capital regions of various countries on account of high levels of unemployment. Thus Brussels (9 percent of the Belgian population), Athens (33 percent of the Greek population), Madrid and Barcelona (24 percent of the Spanish population) and Rome (7 percent of the Italian population) all meet the Article 87(3)(c) unemployment criterion.

Figure 3: Population meeting the Article 87(3)(c) Adjusted thresholds (%)

	Article 87(3)(a) population	NUTS III population below GDP(PPS) per head threshold	NUTS III population above unemployment threshold
EU27	25.9	8.3	18.1
EU15	7.0	9.9	23.2
CC12	93.1	2.4	0.0
Austria	0.0	7.5	0.0
Belgium	0.0	8.0	27.5
Denmark	0.0	0.0	0.0
Finland	0.0	0.0	57.2
France	2.7	0.7	33.1
Germany	0.7	13.2	15.5
Greece	33.0	18.6	32.8
Ireland	0.0	0.0	0.0
Italy	3.6	17.5	41.2
Luxembourg	0.0	0.0	0.0
Netherlands	0.0	0.0	0.0
Portugal	60.4	18.8	0.0
Spain	32.3	12.0	54.3
Sweden	0.0	0.0	0.0
United Kingdom	0.0	10.2	0.8
Bulgaria	100.0	n/a	n/a
Cyprus	0.0	0.0	0.0
Czech Republic	88.4	0.0	0.0
Estonia	100.0	n/a	n/a
Hungary	71.7	10.2	0.0
Lithuania	100.0	n/a	n/a
Latvia	100.0	n/a	n/a
Malta	100.0	n/a	n/a
Poland	100.0	n/a	n/a
Romania	100.0	n/a	n/a
Slovenia	0.0	75.5	0.0
Slovak Republic	88.6	0.0	0.0

Note: (i) The population percentages under the two criteria for Article 87(3)(c) should not be added to generate the total Article 87(3)(c) qualifying population as some areas qualify on the basis of both criteria. **(ii)** Only regions not eligible for Article 87(3)(a) are considered for the purposes of the Article 87(3)(c) quota.
Source: Own calculations from REGIO.

It is important to stress that this part of the process is not about selecting *which regions* should be eligible for regional aid, but rather determines the *initial national shares* of Article 87(3)(c) areas. On the other hand, it is not unreasonable to expect

that there might be some degree of correlation between the regions generating the population quotas and those that might ultimately be eligible for assistance. In fact, even the link between the coverage of the areas meeting the criteria and the initial coverage of Article 87(3)(c) areas for each country is quite tenuous. This figure is simply used as a 'distribution key' to determine the share each country has of the overall Article 87(3)(c) population. The overall Article 87(3)(c) population is assumed to be 50 percent of the EU27 population, less the areas eligible for Article 87(3)(a). The latter cover 25.9 percent of the EU27 population (see Figure 1), so that Article 87(3)(c) coverage is assumed to be 24.1 percent of the EU27 population, about 116.5 million persons. The distribution of this population among countries according to their share of areas displaying the relevant level GDP and unemployment rate disparities. sets the initial coverage of Article 87(3)(c) areas for each country.

3.3.2 Article 87(3)(c) coverage adjustments

Reflecting the process for determining the share of Article 87(3)(c) areas, the initial Article 87(3)(c) coverage for each country varies widely. As Annex II shows, in some Member States – for example, Finland, France, Spain – the initial coverage is higher than at present; in others – Austria and the UK – coverage is substantially lower than the 2000-6 figure; last, in five countries – Denmark, Ireland, Luxembourg, the Netherlands and Sweden – no coverage results from the process of assessing internal regional disparities described above.

Among the candidate countries, most are entirely or mainly covered by Article 87(3)(a). As mentioned earlier, the current formal status of Cyprus is unclear, and, because there is no NUTS III breakdown, none of the country is covered by Article 87(3)(c) in the initial stage. The Czech Republic and Slovakia are mainly covered by Article 87(3)(a), but there is no initial Article 87(3)(c) coverage for the remainder of these countries. On the other hand, parts of Hungary not covered by Article 87(3)(a) do qualify under the initial stage of the Article 87(3)(c) process as does most of Slovenia (which is not concerned by Article 87(3)(a) at all on the basis of current data).

This initial coverage is subject to a series of adjustments, the outcomes of which are illustrated in Annex II.

(i) Article 87(3)(c) minimum coverage

The first adjustment is made to ensure that all countries have minimum Article 87(3)(c) coverage of 15 percent of the population not covered by the Article 87(3)(a) derogation. This condition results in an upward adjustment for the five Member States which have no initial Article 87(3)(c) coverage, as well as for Austria and the UK. Similarly, among the candidate countries, Article 87(3)(c) coverage in Cyprus is raised to 15 percent of its population and small Article 87(3)(c) area allocations are made in the Czech and Slovak Republic. As will be seen, however, in all three cases, this is superseded by later adjustments.

(ii) Article 87(3)(c) maximum coverage

The second adjustment involves setting a ceiling on Article 87(3)(c) coverage equivalent to 50 percent of the population not covered by Article 87(3)(a). This results in significant reductions in Article 87(3)(c) coverage in Finland, Greece, Spain and Slovenia. There is also a marginal adjustment in Portugal. In the case of Greece and Slovenia, however, this is more than reversed by the third adjustment.

(iii) Former Article 87(3)(a) and low population density areas

The third adjustment guarantees that each country has a sufficient Article 87(3)(c) quota to include all areas losing Article 87(3)(a) status and all areas meeting the population density criterion within the assisted areas map. Annex II shows the proportion of the population concerned in each case.

Within the EU15, the former Article 87(3)(a) adjustment must accommodate almost 15 percent of the population. In practice, however, only Greece and Ireland require this correction.

Within the candidate countries the adjustment for former Article 87(3)(a) areas concerns the Czech Republic, Hungary, Slovenia and the Slovak Republic. In all four cases, the adjustment restores coverage to 100 percent of the national population.

The adjustment in respect of low population density areas concerns NUTS III regions with fewer than 12.5 persons per km^2. These are mainly in Finland and Sweden, but also cover Teruel (Spain) and three of the six NUTS III areas making up the UK Highlands and Islands NUTS II region. In the case of Finland, low population density areas cover 19.2 percent of the population, but some of these areas fall within the former Article 87(3)(a) area of Itä-Suomi. In practice, no adjustment is required in order to accommodate low population density areas since all the Member States concerned have sufficient coverage to include these areas within the existing Article 87(3)(c) allocation. There are no low population density areas in the candidate countries.

(iv) Maximum reduction in overall coverage

The 1998 Regional Aid Guidelines provide for a safety net such that no country loses more than 25 percent of existing coverage as a consequence of the methodology. This adjustment is of particular importance in the case of Ireland, where coverage under this correction is increased by over 48 percentage points. There are also significant increases in Austria, Luxembourg and the UK to ensure a limit on the cutback, and marginal change in Germany.

Among the candidate countries, in the calculations shown, Cyprus would benefit from an increase equal to 60 percentage points, but as noted earlier this is based on assumptions about current coverage which it has not proved possible to substantiate.

(v) Ceiling on EU-wide coverage

Three of the four adjustments involve an increase in Article 87(3)(c) coverage, leading to the overall ceiling being breached by 2.2 percentage points. The final adjustment concerns all countries *not* affected by the previous adjustments. Coverage in these countries is reduced proportionately in order to remain within the ceiling of 24.1 percent of Article 87(3)(c) coverage which, in turn, means that EU27 coverage is equal to 50 percent of the population, this being the upper limit for Article 87(3)(a) and (c) areas combined. The countries concerned are Belgium, France and Italy, which are each subject to a significant percentage point reduction.

3.4 Outcomes

3.4.1 Assisted area coverage

Overall, the reapplication of the 1998 methodology to an enlarged EU has significant implications for the existing membership. At an aggregate level, on the basis of the calculations discussed here, enlargement to EU27 would result in a reduction in assisted area coverage from the current 43 percent to 36 percent of the EU15 population. This is significant: the reduction sought by the Commission in 1998 was from 46.9 percent to 42.7 percent of the population,[27] substantially less both in relative and absolute terms. On a country-by-country basis there are significant variations in the impact on coverage.

Finland is alone insofar a reapplication of the rules would result in an *increase* in current coverage from the current 42.2 percent to 50 percent of the population; there are no provisions in the 1998 Guidelines which prohibit such an increase although the absence of such a requirement might not be considered to be in keeping with the spirit of increased restraint. Even if an increase were prohibited, the Finnish population is too small to have a significant impact on population coverage elsewhere.

In Greece and the Netherlands coverage would be unchanged. Greece is currently entirely covered by Article 87(3)(a); in an enlarged EU, those areas not covered by Article 87(3)(a) would be covered by Article 87(3)(c) under transitional provisions. In the Netherlands, coverage is already at the minimum 15 percent; it has no further to fall.

All other countries would experience a reduction in coverage. In five countries (Austria, Germany, Ireland, Luxembourg and the UK) this amounts to 25 percent of existing coverage. It is worth recalling that three of these countries – Austria, Luxembourg and the UK) already experienced cutbacks in excess of 20 percent of coverage in 1999-2000, making the longer-term impact on coverage even more significant. Three of the former cohesion countries experience the largest absolute cutbacks in coverage: 25 percent, 19.8 percent and 13.1 percent in the case of Ireland, Portugal and Spain respectively. A further two countries (Denmark and Sweden, in

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[27] The effective extension of coverage in the UK to include Northern Ireland in addition to the national quota rather than within it meant that final coverage rose from the initial target to 42.7 percent to 43 percent.

addition to the Netherlands) rely on the 15 percent minimum Article 87(3)(c) coverage in order to retain any assisted area coverage.

3.4.2 Award values

Although the focus of this section has been on the impact of a reapplication of the Guidelines on the future spatial coverage, there are also implications for award values.

Paragraphs 4.7 to 4.9 of the Guidelines set out the provisions relating to award values. Maximum award values for different types of area are set out in the text, but no matrix is provided, a factor which led to some confusion over the relationship between the Regional Aid Guidelines and the rules on aid to SMEs. Figure 4 sets out the rates of award as they appear from the text of the Guidelines.

Figure 4: Maximum Award Values

Assisted area type	**General maximum rate**	**SME supplement**
Article 87(3)(a) (outermost regions)	65% nge	15% gross
Article 87(3)(a) (standard ceiling)	**50% nge**	**15% gross**
Article 87(3)(a) (outermost with GDP > 60% EC average)	50% nge	15% gross
Article 87(3)(a) (GDP > 60% EC average)	40% nge	15% gross
Article 87(3)(c) (Northern Ireland)	40% nge	10% gross
Article 87(3)(c) (low population density)	30% nge	10% gross
Article 87(3)(c) (standard ceiling)	**20% nge**	**10% gross**
Article 87(3)(c) (GDP > EC av. & unemployment < EC av., outermost or low population or adjacent to Article 87(3)(a))	20% nge	10% gross
Article 87(3)(c) (GDP > EC av. & unemployment < EC av.)	10% nge	10% gross

Note: (i) This matrix represents an interpretation of the Guidelines – it does not appear in the Guidelines themselves; the SME supplement rates are taken from the SME Guidelines. **(ii)** The ceiling of 30 percent nge applies to firms of all sizes in low population density areas. In other words, the SME supplement can apply only to the extent that the general ceiling is less than 30 percent nge.

In addition, the Guidelines make clear that the ceilings mentioned constitute upper limits and that:

> "beneath these ceilings, the Commission will ensure that the regional aid intensity is adjusted to reflect the seriousness and intensity of the regional problems when addressed in a Community context."

In considering the reapplication of the Guidelines in an enlarged EU, there are several points to note regarding aid values. First, the provisions rely very heavily on relative levels of GDP per head. As a result, within the existing Member States, the 65 percent maximum would apply to the French DOMs, Guiana and Reunion; the 50 percent rate only to Dytiki Ellada (Greece) and the Azores; the remaining Article 87(3)(a) regions would qualify for the maximum rate of 40 percent.

Second, and related, the use of relative levels of GDP per head, coupled with relative levels of unemployment means that the 10 percent maximum rate would apply to a larger number areas within the existing Member States, but that its incidence would be uneven, mainly reflecting differences in national levels of unemployment. Comprehensive analysis of this for some countries is hampered by the absence of all the relevant NUTS III data, however, it is clear that significant parts of the current Member States would be subject to the 10 percent ceiling. As Figure 5 shows, this lower rate would apply to the majority of the population of the current Member States except in Finland, France and Spain where high levels of unemployment mean that the EU27 average rate is exceeded less often than elsewhere.

Figure 5: Population to which 10 percent nge ceiling would apply

	% of national population
Austria	72.6
Belgium	66.0
Denmark	90.8
Finland	30.4
France	23.8
Germany	50.3
Ireland	73.6
Italy	52.2
Luxembourg	100.0
Netherlands	92.9
Spain	7.3
Sweden	83.5
UK	52.3

Note: The absence of NUTS III unemployment data on REGIO for Greece and Portugal means that the calculation cannot be made for these countries; some gaps in the German data probably mean that the German figure is an underestimate.

In practice, it can be argued that areas with high levels of GDP per head and low unemployment rates are less likely to be included in the national assisted areas map, but the use of alternative 'building blocks', such as labour market areas, means that areas selected may well cut across NUTS III areas where the 10 percent rate applies.[28] Moreover, in some countries, the application of the 10 percent ceiling to some assisted areas is inevitable – notably in Denmark, Ireland, Luxembourg, and the Netherlands.

In some cases, the lower rate will apply to areas which have just lost Article 87(3)(a) status, and this with immediate effect. This is the case for Potsdam and Eisenach in the new *Länder;* it may also apply to small parts of Greece losing Article 87(3)(a) status and to Prague.[29] Within the candidate countries, this lower rate would apply to the capital regions of the Czech Republic, Hungary, Slovenia and the Slovak Republic. All of these areas currently fall within NUTS II areas with Article 87(3)(a)

[28] This is the currently the case, for example, with parts of Alsace and Doubs in France.
[29] The Commission Decision in respect of the Lisboa e Vale do Tejo region stated that transitional rates of award for former Article 87(3)(a) regions do not apply where GDP per head is above the Community average and unemployment below the Community average; instead the 10 percent rate applies with immediate effect. See *Commission Decision of 28 June 2000 on the part of the Portuguese regional aid map for the period 2000 to 2006 which relates to the regions eligible for exemptions under Article 87(3)(c) of the Treaty*, OJEC No L 297 of 24 November 2000.

status; as discussed earlier this ceases to be the case on the basis of EU27 data, but, on a strict reapplication of the 1998 Guidelines would immediately be subject to the 10 percent rate. It is a measure of the perverse impact of the statistical breakdowns that the Warsaw NUTS III area[30] in Poland would also be subjected to the 10 percent rate, were it not for the fact that the area is part of a NUTS II region which is eligible for Article 87(3)(a) derogation. Instead, the standard maximum applicable to the NUTS II region would, on the basis of the wording of the Guidelines, be up to 40 percent net grant-equivalent.

Given the extent to which the 10 percent rate is likely to apply, at least to the current membership, it is interesting that two of the award rate provisions rely essentially on absolute factors. Northern Ireland qualifies for a special rate of 40 percent net grant-equivalent and the low population density areas qualify for up to 30 percent or 20 percent (where the GDP per head and unemployment averages are exceeded). In practice, only one of the low population density NUTS III areas exceeds these thresholds (Västerbottens län in Sweden) so the upper limit of 30 percent net grant-equivalent would generally apply. In the context of lower aid maxima being widely applicable in the existing Member States, it is perhaps questionable whether special treatment at these levels is sustainable.

4. REGIONAL AID AND LARGE INVESTMENT PROJECTS

An important recent development in the control of regional aids is the revision of the *Multisectoral Framework on regional aid for large investment projects*.[31] The Multisectoral Framework was introduced in 1998 and was to apply for an initial trial period of three years. Before the end of the trial period, the Commission was to review the Framework and consider whether it should be renewed, revised or abolished. Following delays in the review process, the Framework was extended. A new Framework was approved in February 2002. This will apply generally from 1 January 2004, but from 24 July 2002 regarding investment aid in the steel sector and from 1 January 2003 for investment aid in the motor vehicle and synthetic fibres industries, replacing the existing rules for these sectors, which had been extended pending the review.[32]

This section begins by outlining briefly the main provisions of the 1998 Framework. It goes on to review its application in practice and to consider the implications of the 2002 Framework.

4.1 The 1998 Multisectoral Framework: Key Principles

The essence of the 1998 Multisectoral Framework is that projects/aid awards that meet specified size and sectoral criteria must be notified individually to the Commission, even where the proposed award is under a notified aid scheme. The 1998 Framework does not apply to sectors which are subject to special rules, whether

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[30] Warsaw has GDP(PPS) per head of 124.4 percent and unemployment of 38.8 percent of the EU27 averages.
[31] OJEC No C 7 of April 1998.
[32] Community Framework for State aid to the motor vehicle industry, OJEC No 279 of 15 September 1997; and Code on aid to the synthetic fibres industry, OJEC No C 94 of 30 March 1996.

these be provided for under the Treaty (such as transport, agriculture, coal and steel) or where the Commission has developed special rules (notably motor vehicles and synthetic fibres). Other than in these specified sectors, the Framework provides that any proposal to offer aid under an approved regional aid scheme (or in the form of an *ad hoc* award) must be notified to the Commission if it meets one of the following criteria:

- either: total project costs exceed € 50 million and the aid level[33] proposed is more than 50 per cent of the authorised ceiling for large firms in the region and more than € 40,000 per job;[34]

- or: total aid is more than € 50 million.

4.1.1 Evaluation criteria

The assessment undertaken by the Commission of those cases notified takes account of three factors:

1. competition (T)
2. capital-labour (I)
3. regional impact (M)

The *competition* factor is concerned with so-called 'structural overcapacity' in the sector or subsector concerned, whether the project takes place in a declining market and whether it will result in an increase in capacity. In addition, where a company has a high market share for the products concerned (set at 40 per cent for the purposes of the framework), there is presumed to be a high risk that aid at the maximum rate will unduly distort competition. The competition factor is calculated as set out in Figure 6.

Figure 6: Calculation of the competition factor (T)

Impact on competition	Factor
Project which results in capacity expansion in a sector facing serious structural overcapacity and/or an absolute decline in demand	0.25
Project which results in a capacity expansion in a sector facing structural overcapacity and/or a declining market *and* which is likely to reinforce high market share	0.50
Project which results in a capacity expansion in a sector facing structural overcapacity and/or a declining market	0.75
No likely negative effects in relation to the above	1.00

The *capital-labour* factor seeks to limit the value of assistance to highly capital intensive projects. It is predicated on the assumption that there is "a natural tendency for capital-intensive projects to locate in assisted areas", but that they do not necessarily create many jobs or reduce unemployment. This criterion also claims to take account of the possible distorting effects of the aid on the final price of the

[33] Including any Structural Funds contribution.
[34] In the case of the textiles and clothing industries, the investment and cost-per-job limits are ECU 15 million and ECU 30,000, respectively.

product. Jobs safeguarded are only taken into account when it can be shown that “they are directly linked to the investment project in question”. The capital-labour factor is calculated as set out in Figure 7.

Figure 7: Calculation of the capital-labour factor (I)

Investment per job created (€ 000s)	**Factor**
< 200	1.0
200 to ECU 400	0.9
401 to ECU 700	0.8
701 to ECU 1,000	0.7
> 1,000	0.6

The *regional impact* factor is intended to take account of the benefits of the project for the assisted area. In this context, the “Commission considers that job creation can be used as an indicator of a project’s contribution to the development of a region”. In part this criterion appears to try to counter the impact of the capital-labour factor, which makes no allowance for indirect jobs. Within the context of this factor, the regional impact is defined as “jobs created directly by the project together with jobs created by first-tier suppliers and customers in response to the aided investment”. In applying this factor, the Commission distinguishes between areas approved under Article 87(3)(a) and 3(c). The regional impact factor is calculated as set out in Figure 8:

Figure 8: Calculation of the regional impact factor (M)

Indirect job creation	**Article 87(3)(a)**	**Article 87(3)(c)**
High (>100% of direct jobs)	1.5	1.2
Medium (>50%, <100% of direct jobs)	1.25	1.1
Low (< 50% of direct jobs)	1.0	1.0

The maximum rate of award which the Commission will authorise is calculated as:

R x T x M x I, where **R** is the maximum rate applicable in the region concerned.

Although the application of the above formula could result in a higher award rate than that prevailing in the region (eg. if the competition and capital intensity factors are 1.0 and there is a ‘medium’ or ‘high’ level of indirect job creation), this is expressly ruled out by the framework. As a result of applying the formula, the aid level that can be authorised will be between 15 percent and 100 percent of the aid ceiling in the region concerned.

4.1.2 Administrative arrangements

Under the terms of the Framework, the Commission will either authorise the aid or else will open the procedure provided for in Article 88(2) (to undertake a fuller investigation) within two months of the receipt of a completed notification; in the

event of the full investigation being required, the Commission expects that a decision would normally be reached within six months.

The Framework carries with it rather detailed monitoring requirements designed to ensure that the conditions for the award which the Commission has authorised are respected. Moreover, not only must the Commission receive a copy of the award contract, but this contract must contain a reimbursement clause in the event of non-compliance with the contract and provide for a portion of the aid to be payable only when the Commission has indicated its approval or raised no objections.

4.2 The 1998 Multisectoral Framework in Practice

By summer 2002 the Commission had reviewed around 30 proposed awards under the 1998 Multisectoral Framework.[35] Even allowing for proposals about which no details have yet been published, and the fact that all cases may not have been identified, this is rather fewer than original estimates of the Commission; it was thought that around 20 cases a year would be examined under the Framework. In practice, the distribution among of cases among countries varies very widely indeed, with the majority of Member States making no notifications to date. Germany and Italy together account for about two-thirds of the cases with Spain, Greece, France and the United Kingdom each with three cases or fewer. In part this distribution results from the nature of the schemes operated in the countries concerned, and the probability of aid exceeding 50 percent of the maximum applicable. It is also affected by the willingness of policymakers and recipient firms to undergo the notification process; the discretion available under most of the main regional incentive schemes can readily be used to bring the amount of aid below the notification threshold. There is some evidence that policymakers have sought to avoid the procedure in this way. At one level this can be viewed as deliberate evasion of the scrutiny process; however, it can also be argued that the Commission's purpose (ie. reducing aid levels for large firms and projects) is anyway served by this type of self-restraint.

4.2.1 Use of the investigative procedure

As mentioned earlier, the Commission must open the investigative procedure if it has doubts about the compatibility of aid. In practice, this has happened on very few occasions; moreover, the impact of the procedures has been limited. The Article 88(2) procedure has been opened in six cases; in one of these, planned Greek aid to *G. Polychronos Spinning Mills*, the procedure was closed following the withdrawal of the proposal by the Greek authorities.[36]

In *Infineon Technologies SC 300 GmbH & Co KG*, the Commission opened the Article 88(2) procedure in November 2001,[37] but closed it four months later with a

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[35] In spite of improvements in transparency and information provided by the Commission, it remains quite difficult to track cases comprehensively; there is no listing of cases notified and decided on the basis of the Multisectoral Framework.

[36] EU Bulletin 10/2001 at point 1.3.84.

[37] OJEC No C 368 of 22 December 2001.

positive decision – ie. it approved the level of aid initially proposed.[38] Similarly, in aid to *Bahía de Bizcaia* for a combined cycle power station, the Commission opened the procedure,[39] but a year later announced its decision to close it with a positive decision.[40] This case was interesting because the aid proposed was not offered under an approved regional aid scheme, but involved *ad hoc* aid. In consequence, the Commission was obliged to establish that the benefits for the region concerned offset any distortions of competition which the aid might produce; in other words, a more in-depth assessment of the measure was required simply because assistance was not proposed under an existing approved scheme, even though the aid intensities fell within the levels approved under the Spanish assisted areas map. The procedure opened in relation to aid to *Capro Schwedt GmbH*[41] has not yet been concluded, so that in only two cases to date has the Commission sought to change the initial aid proposals of the Member State concerned: *Solar Tech* and *Hamburger*. Of course, it should be borne in mind that national policy administrators can use the matrices contained in the Multisectoral Framework in order to ascertain for themselves with reasonable accuracy what level of award the Commission might accept. The absence of investigative procedures resulting in negative decisions is not, *of itself*, indicative of the fact the Multisectoral Framework has had limited impact on award values.

In *Solar Tech srl*, the Italian authorities had proposed an aid level of 50.14 percent net grant-equivalent (nge), this corresponding to 40 percent nge (the maximum applicable in the area concerned) plus an SME ‘top up’ of 15 percent gross. The project involved setting up a plant to manufacture amorphous silicone film and solar panels in Manfredonia, Foggia, an area with Article 87(3)(a) status.

The market for silicone film and solar panels was considered by the Commission to be rapidly expanding, giving a competition factor (T) of 1; there would be a modest number of jobs created in relation to capital investment, giving a capital-labour factor (I) of 0.9; and a fair number of indirect jobs would be created, giving a regional impact factor (M) of 1.25. Using the formula illustrated above, this gave a maximum rate of 45 percent, which was reduced to 40 percent nge in order not to exceed the relevant ceiling for the region.

The Commission opened the investigative procedure against the planned aid because of doubts about the eligibility of the firm for the SME top-up which the Italian authorities had proposed.[42] The main issue arose from the fact that, although three individuals owned 76 percent of the shares of Solar Tech srl, the remainder (ie. 24 percent) was owned by Permasteelisa; moreover, the three individual shareholders were also shareholders in, and or executives of, Permasteelisa, a large firm active in the same part of the building materials sector as Solar Tech. The SME Guidelines[43] set out employment and capital-related criteria for the definition of SMEs together with an ‘independence’ criterion. For these purposes, an enterprise is considered

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[38] Bulletin of the European Union 4/2002 at point 1.3.67. Decision not yet published in the Official Journal.
[39] OJEC No C 231 of 17 August 2001.
[40] Rapid Press Release, *Commission authorises aid for two Basque energy projects,* IP/02/886 of 19 June 2002, Brussels. Decision not yet published in the Official Journal.
[41] OJEC No C 63 of 12 March 2002.
[42] OJEC No C 142 of 20 May 2000.
[43] OJEC No C 213 of 23 July 1996.

independent unless 25 percent or more of the capital or of the voting rights is owned by an enterprise falling outside the definition of an SME or jointly by several such enterprises; as stated, in Solar Tech's case, the proportion owned by Permasteelisa was 24 percent. Nevertheless, the Commission considered that:[44]

> "purely formal compliance with the Community rules does not constitute sufficient justification for allowing the bonus for SMEs, which… …should be reserved exclusively for enterprises which suffer from handicaps on account of their size. Thanks to its links with Permasteelisa, Solar Tech does not suffer from such handicaps.

As a result, the Commission did not authorise the SME top-up, allowing aid of 40 percent nge, this being the maximum applicable for *large* firms in the area concerned. This Decision has since been challenged by the Italian authorities before the European Court of Justice;[45] the outcome of this application is not yet decided.

In the case of *Hamburger AG*, the German authorities proposed aid of 35 percent gross for the construction of a new plant manufacturing corrugated paper. The project was to be located in Schwarze Pumpe, Brandenburg, an Article 87(3)(a) area where the ceiling is 35 percent gross.

The Commission considered that the market concerned was in relative decline, so that the competition factor (T) was set at 0.75; the capital intensity of the project was calculated as €553,790 per job, giving a capital-labour factor (I) of 0.8. The main source of uncertainty in evaluating the project concerned the assessment of indirect jobs. The Commission considered that a maximum of 177 jobs could be considered for this criterion, and perhaps even fewer, as against the 356 claimed by Germany. According to the Commission's calculations, this gave a regional development factor (M) of 1 or 1.25, resulting in a rate of award of 21 percent or 26.25 percent gross, as against the 35 percent gross proposed.

Because of its doubts about the degree of indirect job creation, the Commission was obliged to open the investigative procedure.[46] Several issues were raised in this context, the most interesting of which concerns the possible application of the regional impact (ie. indirect job creation) criterion to employment in the Czech Republic and Poland. Under the Multisectoral Framework, jobs created with first-tier suppliers and customers in the assisted region where the company is located or in any adjacent assisted region can be taken into account for the purposes of the regional impact factor. Germany had claimed the creation of 356 jobs, of which 109 with suppliers in the Czech Republic and Poland and 30 with a customer in Poland. As Brandenburg has no border with the Czech Republic, it was not considered to be adjacent. Regarding Poland, the Commission considered that:

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[44] Commission Decision of 15 November 2000 on the State aid which Italy is planning to grant to Solar Tech srl, OJEC No L 292 of 9 November 2001.

[45] Case C-91/01 Italy v Commission; the case was heard in April/May 2002. (*Les activités de la Cour de Justice et du Tribunal de Premiere Instance des Communautés Européennes:* semaines du 23 au 27 avril et du 30 avril au 4 mai 2001).

[46] OJEC No C 342 of 5 December 2001.

> "the decision of the EU-Poland Association Council to regard Poland as an area identical to those areas of the Community described in Article 87(3)(a) of the EC Treaty is clearly limited to the assessment of public aid granted by Poland. Moreover, no regional aid map has been established for this country, yet. It is thus not possible to establish the adjacent assisted regions in Poland on a NUTS II level, which is the level on which the assisted region and adjacent assisted regions are defined for the purpose of the calculation of the regional impact factor."

The Commission therefore considered *a priori* that jobs in the Czech Republic and Poland should not be considered. The Commission was also of the view that a satellite project for recycling should be considered part of the main project and that the 40 jobs involved should not be included for the purposes of the regional impact factor. Last the Commission doubted whether all the 107 transport jobs claimed by Germany would be created in adjacent assisted areas.

Some six months later, the Commission decided to authorise aid of 26.25 percent gross, suggesting that its doubts about the transport jobs had been resolved, but that those concerning jobs in the Czech Republic and Poland had not.[47]

4.2.2 Unchallenged aid proposals

Around 20 cases have been identified (see Figure 9) where notification under the 1998 Multisectoral Framework has not resulted in any change to the level of award proposed by the Member State concerned. This owes to a number of factors.

First, for internal budgetary reasons, given the relatively large size of the projects concerned, Member States may be keen to limit award offers to the minimum necessary.

Second, the Multisectoral Framework enables policymakers to predict with some accuracy the factors that are likely to result in reductions in award levels, and to adjust aid proposals accordingly. There is some motivation in making this calculation since, if the Commission is in doubt about the compatibility of the award offer with the common market, it must open the investigative procedure. Although the Commission envisaged that a full investigation would take around six months, in practice this has proved to be a rather ambitious timetable; moreover, even if this *were* adhered to, the entire process (from notification to final decision) would not take much less than a year. As the final decision might involve a reduction in the aid levels proposed, there are strong reasons for opting for more modest aid levels in the first place, notably in order to avoid the incentive element of the assistance being eroded by delays and uncertainty.

The third reason why a significant proportion of the cases notified involve no adjustment to aid levels concerns the adjustment factors themselves. Regarding the *competition factor (T),* in only one case, *General Electric Plastics*, has the factor

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[47] RAPID Press Release, *Commission approves three-quarters of the proposed aid in favour of paper company Hamburger AG,* IP/02/516 of 9 April 2002, Brussels. Decision not yet published in the Official Journal.

applied been 0.5; there are no instances of a factor of 0.25 being applied. In the majority of cases the competition effect of the aid has been perceived to be neutral – ie. the factor applied has been 1.0. However, under the formula, the *regional development factor (M)*, is always 1.0 or higher so that, even in cases where the competition factor is less than one, or the project is relatively capital intensive leading to a low *capital-labour (I)* ‘score’, these adjustments may be ‘neutralised’ by the level of indirect job creation. This is the case for aid proposals to *Sächsische Faserwerke Pirna, BASF, Wacker Chemie* and *Kartogroup*. This phenomenon is even more extreme in the cases of aid to *Marina di Stabia*, *Glunz*, *Villa Romana* and *Hellenic Petroleum*. In these cases, application of the formula leads to a theoretical maximum that is actually greater than the relevant aid ceiling, although this result is outlawed by the Multisectoral Framework which states that the relevant aid ceiling shall constitute the maximum.

The combination of these factors means that in most cases, the maximum rate that would be allowed by the Commission is actually higher than that sought by the Member States.

Figure 9: Unchallenged aid proposals under the 1998 Multisectoral Framework

	Member State	Area status	Aid ceiling (R)	Rate proposed	Competition factor (T)	Capital-labour factor (I)	Regional development factor (M)	TxIxM	Max allowable
Rockwool	Spain	3c	15.0 nge	13.2 nge	1.00	0.8	1.10	0.88	13.2 nge
Marina di Stabia	Italy	3a	49.9 nge (SME)	47.4 nge	1.00	0.8	1.50	1.20	*[59.9 nge]*
Nuove Industrie Molisane	Italy	3c	25.0 nge	15.6 nge	0.75	0.7	1.20	0.63	15.8 nge
Sächsische Faserwerke Pirna	Germany	3a	35.0 gge	35.0 gge	1.00	0.8	1.25	1.00	35.0 gge
BASF	Germany	3a	35.0 gge	26.0 gge	1.00	0.8	1.25	1.00	35.0 gge
Motorola	UK	3c	20.0 nge	5.8 nge	1.00	0.6	1.00	0.60	12.0 nge
Pilkington/Interpane	France	3c	15.0 nge	10.3 nge	0.85	0.8	1.20	0.82	12.2 nge
Wacker Chemie	Germany	3a	35.0 gge	26.8 gge	1.00	0.8	1.25	1.00	35.0 gge
Kronopoly	Germany	3a	35.0 gge	31.5 gge	0.75	0.8	1.50	0.90	31.5 gge
Cotonificio di Capitanata	Italy	3a	50.4 nge (SME)	42.5 nge	0.75	0.9	1.25	0.84	42.5 nge
Kartogroup	Germany	3a	35.0 gge	35.0 gge	1.00	0.8	1.25	1.00	35.0 gge
Glunz	Germany	3a	35.0 gge	35.0 gge	1.00	0.8	1.50	1.20	*[42.0 gge]*
Villa Romana	Italy	3a	50.4 nge (SME)	50.0 nge	1.00	0.9	1.25	1.13	*[56.7 nge]*
General Electric Plastics	Spain	3a	40.0 nge	17.9 nge	0.50	0.6	1.50	0.45	18.0 nge
Technologie Diesel	Italy	3a	35.0 nge	28.0 nge	1.00	0.8	1.00	0.80	28.0 nge
ATMEL Rousset	France	3c	20.0 nge	11.8 nge	1.00	0.7	1.00	0.70	14.0 nge
Hellenic Petroleum	Greece	3a	40.0 nge	30.9 nge	1.00	0.7	1.50	1.05	*[42.0 nge]*
STMicroelectronics	Italy	3a	35.0 nge	26.3 nge	1.00	0.6	1.25	0.75	26.3 nge
Tessival Sud	Italy	3a	60.1 nge (SME)	50.7 nge	0.75	0.9	1.25	0.84	50.7 nge
Benfil	Italy	3a	59.9 nge (SME)	50.6 nge	0.75	0.9	1.25	0.84	50.6 nge
Drewsen	Germany	3c	18.0 gge	14.3 gge	1.00	0.8	1.00	0.80	14.4 gge

4.2.3 Assessment of the 1998 Multisectoral Framework

A full assessment of the impact of the 1998 Multisectoral Framework is currently premature given the stringent monitoring component to the rules and the need to look at actual outcomes in relation to predictions, especially in relation to job creation. Nevertheless, some analysis is possible and the early experience enabled the Commission to devise proposals for a revised version of the rules (the 2002 Multisectoral Framework discussed below).

A key issue in the application of the Multisectoral Framework concerns the competition factor. The guidelines provide for an analysis of whether the proposed project takes place in a sector or subsector suffering from structural overcapacity. For these purposes, the Commission considers at a Community level the difference between the average capacity utilisation rate for manufacturing industry as a whole and the rate for the relevant sector or subsector. In the absence of sufficient data on capacity utilisation, the Commission looks at whether the investment takes place in a declining market. Several points arise from this.

First, in the vast majority of cases considered under the Multisectoral Framework, the Commission has concluded that there is insufficient information available regarding capacity. In consequence, competition considerations have hinged on whether a project takes place in a declining market. In practice, however, it has proved almost as difficult for the Commission to obtain appropriate information on the evolution of the relevant market.[48]

Second, the data on market evolution in some sectors is volatile and can be misleading. This is illustrated in a recent review of projects in the semiconductor industry.[49] For example, in *Motorola* the competition factor (T) was set at 1.0. This reflected the fact that “there is neither absolute nor relative decline in the demand for the products in question”[50] (the semiconductor market for mobile communications), there were no concerns at overcapacity and that the project did not take place in a declining market; however, past trends were far from being indicative of future developments and, following the global downturn in demand for semiconductors for the telephone market, the planned investment was mothballed while other local plants in related activities were closed.

Third, some of the projects assessed (*Villa Romana, Marina di Stabia*) are in the service sector; the relevance of comparing trends in parts of the tourism sector with those of manufacturing as a whole is doubtful. More generally, it has been observed that the competition factor has not substantially reduced award levels and that there is a case for lowering rates for firms with market power and prohibiting aid to firms in

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[48] G. Dancet, ‘The Multisectoral Framework on Regional Aid for Large Investment Projects: Original Objectives, Current Practice and Early Appraisal’ *paper to workshop on State Aid as part of the EU’s Industrial Policy in the 21st Century*, Danish Competition Authority, Copenhagen, 27 March 2000.
[49] For an overview see A. Seinen and S. Crome, ‘Application of the Multisectoral Framework to State aid in the semiconductor industry’ *Competition Policy Newsletter*, No 2, June (European Commission, Brussels, 2002).
[50] State aid No N 480/2000 – United Kingdom, Motorola Limited, SG(2000) D/ 106291 of 17 August 2000, Brussels. Available on the WebSite of the Secretariat General of the European Commission at: <www.europa.eu.int/comm/secretariat_general/sgb/state_aids/>.

capital intensive sectors with a declining market, where no firm wants to adjust its capacity.[51]

Concern has also been expressed at the combined effects of the capital-labour factor (I) and the regional impact factor (M).[52] In particular, it has been argued that the number of jobs created or safeguarded is counted twice but used in contradictory ways in the two assessment criteria. As a result, the product of the two coefficients is always very close to 1.0 and it therefore has little impact on allowable aid ceilings.

A further consideration is the application of Multisectoral Framework to aid for SMEs. This has arisen in a number of Italian cases: *Marina di Stabia; Cotonificio di Capitanata; Villa Romana; Tessival; Benfil;* and, as noted, *Solar Tech*¸ (where the issue is the subject of an application before the European Court of Justice). This has been attributed to:[53]

> "clever investors that create a new company to host the new project in such a way that they fit the definition now applicable. Yet, de facto, the new companies will belong to an industrial group that is usually already active in the sector concerned by the investment."

Higher rates of award apply to SMEs by dint of the Guidelines on aid to SMEs, which, in turn, use the 1996 Recommendation on the definition of SMEs.[54] This definition is currently the subject of consultation, with the preliminary draft seeking to address the specific issue of linked enterprises.[55]

A final consideration that was relevant to the reform of the Multisectoral Framework concerns administration. Although the 1998 Multisectoral Framework was intended to provide a transparent approach to reducing aid levels for large projects, it has been criticised for being too complex and placing considerable burdens on firms and the Commission.[56] Moreover, even though fewer cases have been notified than anticipated, the two-month target for decision-making has proved over-optimistic.[57]

4.3 The 2002 Multisectoral Framework

In February 2002 the Commission approved a new version of the Multisectoral Framework, hereafter referred to as the 2002 Multisectoral Framework.[58] The

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[51] L. Sleuwaegen and E. Pennings, 'Avoiding distortion of competition from regional aid for large investment projects – theory and application in the multisectoral framework', *Final report to DG Enterprise, European Commission,* August 2001.
[52] Cised Consultores, 'Review of the economic and industrial consistency of the labour-related criteria of the current Multisectoral Framework on regional aid for large projects,' *Final report to DG Enterprise, European Commission,* August 2001.
[53] G. Dancet, *op cit*.
[54] Commission Recommendation of 3 April 1996 concerning the definition of small and medium-sized enterprises, OJEC No L 107 of 30 April 1996.
[55] See: <www.europa.eu.int/comm/enterprise/consultations/sme_definition/>
[56] UNICE, *Preliminary comments: Working paper on the revisions of the Multisectoral Framework on Regional Aid for Large Investment Projects,* Brussels, 23 October 2001.
[57] G. Dancet, *op cit.*
[58] Multisectoral Framework on regional aid for large investment projects – Rescue and restructuring aid and closure aid for the steel sector, OJEC No C 70 of 19 March 2002.

provisions of the 2002 Multisectoral Framework are discussed in more detail below, but the main changes can be summarised as follows. First, a new system for calculating aid intensities is introduced. This no longer relies on a case-by-case assessment of competition impacts, capital intensity and indirect job creation; instead, a reduction matrix, similar in operation to a progressive tax rate, is applied automatically. Second, in general, there are no prior notification and authorisation requirements; for projects exceeding € 100 million, notification is only required if the aid proposed is more than that which a € 100 million investment would have received on the basis of the new scale. Third, coverage of the 2002 Multisectoral Framework is extended to include steel, synthetic fibres and motor vehicles, and there is provision for more stringent rules to apply from 1 January 2004 to a list of sectors to be established.

The 2002 Multisectoral Framework applies generally from 1 January 2004, but from 24 July 2002 regarding investment aid in the steel sector and from 1 January 2003 for investment aid in the motor vehicle and synthetic fibres industries, replacing the existing rules for these sectors. The Framework applies until 31 December 2009.

The Communication provides for various changes to be introduced by the Member States as 'appropriate measures' within the meaning of Article 88(1). These include: modifying the current regional aid ceilings to take account of the new award matrix; adjusting all existing regional aid schemes, including those exempted from notification on the basis of a block exemption regulation, to ensure that the conditions of the 2002 Multisectoral Framework are met; ensuring that the monitoring requirements are fulfilled; and complying with the 1998 Multisectoral Framework until the 2002 Multisectoral Framework becomes generally applicable. Member States are asked to give their explicit approval to the proposed appropriate measures within 20 days of the letter notified to them; in the absence of reply, the Commission will assume that the Member State(s) in question do not agree with the appropriate measures. In practice, it seems likely that, in such an eventuality, the Commission would open the Article 88(2) procedure against any aid scheme implicated by the appropriate measures and effectively impose the 2002 Multisectoral Framework on recalcitrant Member States by Decision.[59]

4.3.1 Aid levels

Under the 2002 Multisectoral Framework case-by-case calculation of aid levels on the basis of competition, capital-intensity and job creation is replaced by an award matrix that reduces maximum rates of award for investments exceeding specified thresholds. These are set out in Figure 10.

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[59] A precedent for this lies in Commission action under the 1998 Multisectoral Framework, see: Commission Decision of 14 July 1998 concerning aid schemes in Germany under which aid could be awarded which is subject to the notification requirement of the multisectoral framework on regional aid for large investment projects, OJEC No L 304 of 14 November 1998.

Figure 10: Rate reduction matrix for large investments

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

As Figure 10 shows, projects involving investments of less than € 50 million are unaffected by the matrix. In fact, this investment threshold is the same ‘trigger point’ for the 1998 Multisectoral Framework and for aid to the motor vehicle industry. Importantly, however, the notification threshold under the 1998 Multisectoral Framework also referred to the capital intensity of the aid; this criterion is absent so that potentially more projects are affected by the 2002 Multisectoral Framework than its predecessor.

The scale operates in a progressive way so that the larger the project, the lower the rate of award for the project as a whole. This is illustrated in the Framework 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 Regional Aid Guidelines is shown in Figure 11. 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 percent of the prevailing regional aid rate.

Figure 11: Impact of the 2002 Multisectoral Framework on Award Rates

	Regional aid ceiling (R) %					
	10	**20**	**30**	**40**	**50**	**65**
Eligible expenditure						
€ 50 million	10.0	20.0	30.0	40.0	50.0	65.0
€ 100 million	7.5	15.0	22.5	30.0	37.5	48.8
€ 200 million	5.5	10.9	16.4	21.8	27.3	35.4
€ 500 million	4.2	8.4	12.7	16.9	21.1	27.4

4.3.2 Notification of large awards

Notification is still required for some large projects. This applies 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. For example, in a 30 percent rate area, the maximum award for a € 100 million project would be € 22.5 million; this means that the rate given for a € 200 million investment in the same region in Figure 11 is not automatically applicable (since this yields an

award of € 32.8 million – above the € 22.5 million threshold). The notification thresholds that follow from this are set out in Figure 12.

Figure 12: Notification Thresholds Matrix

	Regional aid ceiling (R) %					
Eligible investment	**10**	**20**	**30**	**40**	**50**	**65**
€ 200 million	3.75	7.50	11.25	15.00	18.75	24.40
€ 500 million	0.75	1.50	2.25	3.00	3.75	4.88
€ 1000 million	0.08	0.15	0.23	0.30	0.38	0.49

According to the Guidelines, these individually notifiable projects will not be eligible for aid if either: the aid beneficiary accounts for more than 25 percent of sales of the product (before or after the investment); or the capacity created by the project is more than 5 percent of the size of the market measured in apparent consumption, except in rapidly growing markets. The onus is on the Member States to demonstrate that the 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 11 is used to determine the maximum rate, as for projects under the € 100 million investment threshold. The maximum rate of award for notifiable projects is raised by 15 percent where the project is co-financed by the Structural Funds as a 'major project',[60] subject to a ceiling of 75 percent of the unadjusted regional aid ceiling.

4.3.3 Aid for the motor vehicle, synthetic fibre and steel industries

One of the aims of controls over aid to large investment projects was to move towards a 'horizontal' approach to aid discipline and replace existing sectoral frameworks, although this was strongly resisted by the UNICE, the federation of employers' organisations, which considered that 'tailor-made' rules were more appropriate to the regulation of aid to sensitive sectors.[61] The 2002 Multisectoral Framework does move towards a horizontal approach, but a key provision is that the Commission is to draw up further rules concerning identified sensitive sectors. Specifically, a list of sectors where "serious structural problems prevail" is to be drawn up by the Commission by 31 December 2003. Before this list comes into force (1 January 2004) the Commission is to decide whether and to what extent the motor vehicle and synthetic fibre industries should be included on the list. In principle, *no* regional investment aid will be authorised in the listed sectors. From 1 January 2003 until the 2002 Multisectoral Framework becomes generally applicable (1 January 2004), transitional provisions apply to aid for the motor vehicle and synthetic fibres sectors. Investment aid in the steel sector is ruled out altogether by the 2002 Multisectoral Framework with effect from 24 July 2002.

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[60] Within the meaning of Article 25 of Council Regulation (EC) No 1260/1999 of 21 June 1999, OJEC No L 161 of 26 June 1999.

[61] UNICE, *Preliminary comments: Working paper on the revisions of the Multisectoral Framework on Regional Aid for Large Investment Projects,* Brussels, 23 October 2001.

Under the transitional provisions for the motor vehicle sector the current thresholds above which more stringent rules apply are retained. These concern aid under approved schemes[62] to projects that involve either eligible expenditure above € 50 million or aid of more than € 5 million. For 2003, the maximum rate of award for firms in the motor vehicle sector is 30 percent of the relevant regional aid ceiling. This approach replaces the cost-benefit analysis under the motor vehicle framework, which seeks to balance the benefits for regional development against possible adverse effects on the sector, such as the creation of significant overcapacity. This may lead it to accept, reject or amend the Member States rate proposals. These transitional arrangements would take rates of award down to just 3 percent net grant equivalent in some assisted areas,[63] to under 7 percent in the Article 87(3)(c) 'standard' rate areas and to maximum of 15 percent in the majority of Article 87(3)(a) areas. It has been argued that, in comparison with the current rules, a larger number of projects and higher eligible costs will be covered so that the reduction will be less substantial than might appear.[64] On the other hand, the impact can be expected to be quite variable. For example, in December 2001, the Commission slightly reduced aid to DaimlerChrysler for an investment in Thüringen, allowing aid of 30.93 percent of eligible investment.[65] The prevailing regional aid ceiling in Thüringen is 35 percent. By contrast, following initial doubts about the compatibility of the aid proposal, in May 2002, the Commission authorised aid to Ford España in Valencia at a rate of 5.11 percent of eligible costs.[66] The prevailing regional aid ceiling in Valencia is 37 percent. On the basis of the transitional provisions for 2003 in the 2002 Multisectoral Framework, the rate applicable to both projects would have been around 11 percent of eligible investment – in one case double the amount recently agreed, in the other a little more than a third of the aid authorised.

For the synthetic fibres industry, no investment can be authorised in the transitional year 2003. Under the arrangements provided for in the 1996 Code, in principle investment aid to large firms in the sector can only be authorised if it would result in a significant reduction in capacity or if the market for the relevant products is characterised by structural shortage of supply and the aid would not result in a significant increase in the relevant capacity.

Following the expiry of the European Coal and Steel Community (ECSC) Treaty (the Treaty of Paris), the treatment of aid for the steel industry is brought within the scope of the mainstream rules on State aid to industry. Under the 2002 Multisectoral Framework, State aid to the steel industry is prohibited. This is in line with the original provisions of the Treaty of Paris which prohibited "subsidies or aid granted by States, or special charges imposed by States, in any form whatsoever",[67] although in practice the steel sector became "one of the most aided sectors in the

[62] *Ad hoc* aid that is above the *de minimis* threshold must obviously be notified too.
[63] Those where GDP per head is higher and the unemployment rate lower than the Community average.
[64] A. Barbera del Rosal, 'The new Multisectoral Framework for large investment projects' Competition Policy Newsletter, No 2 (European Commission, Brussels, June 2002).
[65] RAPID Press Release, *Commission slightly reduces planned aid to DaimlerChrysler for new engine plant in Kölleda (Germany)*, IP/01/1878 (Brussels, 20 December 2001).
[66] RAPID Press Release, *Commission partially approves regional aid for Ford España in Valencia*, IP/02/66 (Brussels, 8 May 2002).
[67] Article 4(c) of the ECSC Treaty.

Community"[68] owing to crisis conditions, industry pressure and a series of political compromises.[69] Nevertheless, the Commission considers that the prohibition on investment aid has been factored into the business strategies of steel companies and is justified, irrespective of the size of the investment, given global overcapacity and the high capital intensity of the sector. Regional aid to the steel industry is therefore deemed incompatible with the common market. For these purposes, the steel industry includes those activities *not* covered by the ECSC but which are considered to have similar characteristics and form part of an integrated production process. These were previously defined in a separate framework.[70]

4.3.4 Other sensitive sectors

As part of the process of introducing 'horizontal' aid controls – ie. bringing sectoral aid discipline within a general framework, the 2002 Multisectoral Framework provides for the Commission to draw up a list of sectors where serious structural problems prevail. This is to be done by 31 December 2003 and will apply from 1 January 2004.

"Serious structural problems" will be measured on the basis of apparent EEA consumption data at the appropriate level of the classification of products by activity[71] or if such information is not available, "on the basis of any other market segmentation generally accepted for the products concerned and for which statistical data are readily available." Serious sectoral problems will be deemed to exist when the sector is declining – according to the Framework, a strong presumption of sectoral decline can arise from a negative average annual growth rate in apparent consumption in the EEA over the past five years.

For projects in listed sectors, any regional investment aid for eligible expenditure over a given ceiling (indicatively € 25 million)[72] must be notified individually to the Commission. In general, eligible expenditure exceeding an amount to be determined by the Commission when the list of sectors is drawn up will not be eligible for investment aid. The exception to this is where the Member State can demonstrate that, although the sector is deemed to be in decline, the market for the product concerned is fast-growing. If this is shown to be the case, then the award rate matrix given in Figure 10 applies.

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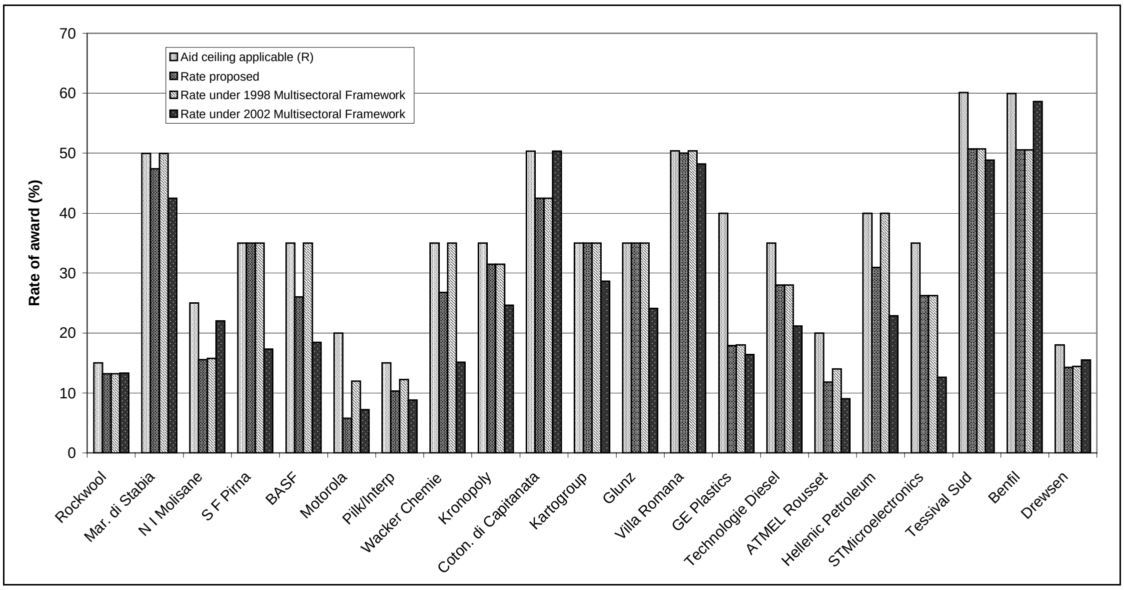
[68] A. Schaub, 'State aid in the ECSC Steel Sector,' *EC Competition Newsletter*, Vol 3 No 2 (European Commission, Brussels, 1997).
[69] L. Perrotti, 'Actor of Integration? The EC Commission's Use of State Aid Policy Instruments in the Management of the Crisis of the Steel Industry' *paper to UACES research conference*, University of Lincoln, 9-11 September 1998.
[70] Framework for certain steel sectors not covered by the ECSC Treaty, OJEC No C 320 of 13 December 1988.
[71] Council Regulation (EEC) No 3696/93 of 29 October 1993 on the statistical classification of products by activity (CPA) in the European Community, OJEC No L 342 of 31 December 1993, as amended.
[72] The threshold for notification is to be set when the list of sectors is established and may vary from sector to sector.

4.4 Implications of the 2002 Multisectoral Framework

It is difficult to make direct comparisons between the 1998 and 2002 Multisectoral Frameworks in the abstract since the nature of the mechanisms underlying the adjustments is completely different. On the other hand, it is possible to compare levels of aid authorised by the Commission in specific cases considered under the 1998 Multisectoral Framework and the rates that would have applied under the 2002 Multisectoral Framework and to set these against the levels of aid proposed by the Member States. This is illustrated in Figure 13.

One complication concerns aid levels to individually-notifiable projects, that is those exceeding € 100 million of investments where the Member State proposes to offer more than a project involving € 100 million could have received. As discussed earlier any extra amount is only allowable under the 2002 Multisectoral Framework where the Member State can demonstrate that the aid will not reinforce high market share or increase capacity in a stagnant sector. The data illustrated in the figures below assume that Member States *have been* able to demonstrate this. In practice, this will not always be so. As a result, the discussion below almost certainly underestimates the impact of the 2002 Multisectoral Framework.

Figure 13: Rates of Award under the 1998 and 2002 Multisectoral Frameworks



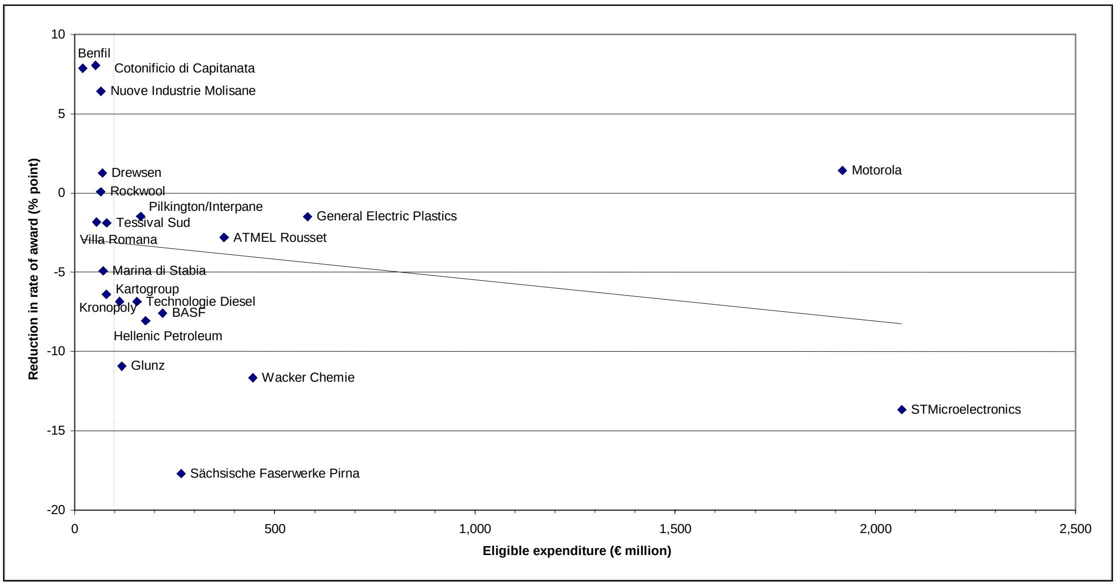
Note: The figures underlying this chart assume that for all projects over € 100 million Member States *are* able to demonstrate that the project does not reinforce market share or take place in a declining market.

In practice, the impact of the 2002 Multisectoral Framework would have been variable. In a few cases (*Rockwool, Nuove Industrie Molisane, Cotonificio di Capitanata, Benfil* and *Drewsen*), the 2002 Multisectoral Framework could actually result in *higher* award values than could be authorised under the 1998 Multisectoral Framework. In all of these cases, the rate of award proposed by the Member State was virtually the same as that which resulted from the application of the 1998 Multisectoral Framework. In the majority of cases, however, the 2002 Multisectoral Framework would result in lower rates of award than proposed by the Member States

and than those resulting from the 1998 Multisectoral Framework. This would be lower still for investments exceeding € 100 million where the level of award was limited to the maximum for which a € 100 million project could qualify.

The scale of the impact on award rates under the 2002 Multisectoral Framework compared with its predecessor depends on the interaction between project size factors (which drive the 2002 Framework) and the competition and job creation factors which underpin 1998 Framework. Figure 14 shows the percentage point change in award rates (compared with the aid proposed by the Member States) which would have been induced by the 2002 Multisectoral Framework set against the eligible investment in the project concerned.

Figure 14: Impact of 2002 Multisectoral Framework by Project Size



Note: The figures underlying this chart assume that for all projects over € 100 million Member States *are* able to demonstrate that the project does not reinforce market share or take place in a declining market.

As Figure 14 shows, the *overall* trend is for larger projects to suffer a larger reduction in award rates under the 2002 Multisectoral Framework although, in the *Motorola* case, aid allowed would still be higher than the UK government sought to offer – reflecting, among other things, the budgetary impact of aiding very large scale projects. A further factor is the *relative* automaticity of award rates. In countries where there is less case-by-case discretion and award values tend toward the maximum, the impact is likely to be greater. This is reflected in the number of awards to firms in Germany that would be impacted by the 2002 Multisectoral Framework, notably *Sächsische Faserwerke Pirna*, *Wacker Chemie* and *Glunz;* in all these cases the aid proposals of the German authorities would have been cut by more than 10 percentage points under the 2002 Multisectoral Framework.

In reality, the impact for very large projects is likely to be more significant than the discussion above implies. As described, where a project involves investment of more € 100 million and the aid proposed is higher than a project of € 100 million would

receive under the matrix, the aid must be notified individually. Reflecting the progressive nature of the matrix, the notification thresholds bite at very low rates in the case of very large projects. This is illustrated in Figure 15 which concerns only those projects decided under the 1998 Multisectoral Framework which involved investments exceeding € 100 million.

Figure 15: Notification Thresholds for Exceptionally Large Investment

	Eligible investment (€ million)	Aid ceiling applicable (R) (%)	Rate proposed (%)	Rate under 1998 MF (%)	Notification threshold 2002 MF (%)
S F Pirna	265.9	35	35.0	35	9.9
BASF	220.0	35	26.0	35	11.9
Motorola	1,917.9	20	5.8	12	0.8
Pilkington/Interpane	164.7	15	10.3	12	6.8
Wacker Chemie	444.8	35	26.8	35	5.9
Kronopoly	112.5	35	31.5	32	23.3
Glunz	117.8	35	35.0	35	22.3
GE Plastics	581.8	40	17.9	18	5.2
Technologie Diesel	155.2	35	28.0	28	16.9
ATMEL Rousset	373.0	20	11.8	14	4.0
Hellenic Petroleum	177.0	40	30.9	40	16.9
STMicroelectronics	2,066.0	35	26.3	26	1.3

As Figure 15 shows, in every case, the rate proposed by the Member State under the 1998 Multisectoral Framework is higher than the level at which the notification requirement would bite under the 2002 Multisectoral Framework. This is so even where the rate proposed by the Member State is relatively modest in comparison with the aid ceiling. For example, the UK government proposal for aid to Motorola was 5.8 percent compared with a regional ceiling of 20 percent. Under the 2002 Multisectoral Framework any proposal to provide aid in excess of 0.8 percent of eligible investment would require notification to the Commission; the national authorities would then have to demonstrate that the criteria in respect of market share and capacity in stagnant markets were met.

The 2002 Multisectoral Framework makes some significant changes to the consideration of sectoral and competition issues in the context of investment aid to large projects. As mentioned, the approach to regulating aid to the motor industry in the transitional period is radically simplified compared with the 1997 Motor Vehicle Framework, with a straight reduction in award rates to 30 percent of the prevailing maximum applying to all projects involving eligible investment of more than € 50 million or aid of more than € 5 million. It remains to be seen whether this will be carried over in the post-2003 period and whether this model (ie. investment / aid thresholds and capped rates) will be applied to other sectors deemed to be sensitive.

A major issue concerns the definition of those sensitive sectors. Assessments of the state of a given market turned out to be difficult in the application of the 1998 Multisectoral Framework, with market segments often displaying highly volatile rates

of apparent consumption – for example, in *GE Plastics*,[73] in the product under consideration apparent consumption rates ranged from 17 percent to – 4.1 percent within a five-year period during which the average growth rate was 4.2 percent. As a result, the analysis was not always convincing. It remains to be seen to what extent the Commission take up the possibility of identifying further sensitive sectors and how far industry bodies will lobby for them. A further question is whether the award rates and thresholds will vary between sectors. At one level it can be argued that this will undermine the horizontal nature of the 2002 Multisectoral Framework; on the other hand, the capital intensities of investments in different sectors vary so widely that some variation may be appropriate. In other words, there are sound pragmatic reasons why different thresholds may apply to different industries.

More generally, the 2002 Multisectoral Framework marks a withdrawal by the Commission from the case-by-case analysis of the competition effects of State aid to large projects.[74] The 1998 Multisectoral Framework attempts to make this assessment, albeit at a rather schematic level, in a way that is quantifiable and transparent in order to address the resource issues arising from the analysis of such cases and to reduce the scope for legal challenge of the resulting decisions. In practice, the application of the competition criteria were effectively thwarted by the lack of relevant statistical data and the tendency to anomalous outcomes. To the extent that market analysis *does* play a role in individual cases under the 2002 Multisectoral Framework the onus is on the Member States to demonstrate that the conditions of the market are *not* such that aid would be incompatible with the common market. Specifically, individually-notifiable projects are ineligible for assistance in excess of that for which a € 100 million project would qualify if either the beneficiary wields significant market power or the relevant product market is stagnant (see 4.3.2 above). It is for the Member States to prove that neither of these situations pertains. Similarly, in the case of the list of sensitive sectors for which, in principle, no regional investment aid will be authorised, there is provision for a derogation from this ban "provided that the Member State demonstrates that, although the sector is deemed to be in decline, the market for the product concerned is fast growing."[75]

5. OTHER RECENT DEVELOPMENTS

Away from the two main frameworks - the Regional Aid Guidelines and the Multisectoral Framework - that regulate the use of the regional aid, a number of other recent developments in the control of State aids have direct or indirect implications for regional and spatial development policies.

5.1 Proposed NUTS Regulation

A relatively technical development with potentially important consequences for national and Community regional policies is the proposal for a Regulation on the

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[73] N 295/01 *Ayuda en favor de GE Plastics SL*, SEC (2001) 1379 fin of 19 September 2001, Brussels.
[74] Where aid is offered on an *ad hoc* basis, that is, outwith an approved scheme or under a measure covered by the *de minimis* or SME aid exemption Regulations, then case-by-case analysis is still required. For a recent example, see Commission Decision of 25 April 2001 on the State aid implemented by Finland for Ojala-Yhtymä Oy, OJEC No L 304 of 21 November 2001.
[75] 2002 Multisectoral Framework, point 34.

classification of NUTS areas.[76] Although the NUTS classification has featured in Structural Fund Regulations, and is the basis for area designation under the Regional Aid Guidelines, the definition has no legal basis of its own. As a result, the compilation and updating of the system has tended to be settled by informal agreements between Member States and Eurostat, often following prolonged and difficult negotiations, and sometimes with controversial outcomes.

At the time of writing, the original text of the proposed Regulation has been amended by the European Parliament[77] and the finalisation of a common position in Council is currently awaited. The final outcome is not, therefore, known, but the main objectives of the original proposal are:

- to ensure the comparability of data across the EU
- to fix the current classification of NUTS regions in EU15
- to set objective criteria for the definition of regions
- to establish objective criteria for future amendments
- to assure the stability of data over time.

Regarding *comparability*, a key issue is the vast divergence in the scale and population of the current NUTS regions in the Member States. This is illustrated in Figure 16. There is an inherent contradiction in this objective with the fact that the proposal fixes the *current* breakdown as the starting point. In other words no changes are required by the proposed Regulation, which instead ossifies existing inconsistencies, but attempts to introduce a measure of convergence for future amendments.

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[76] Proposal for a Regulation of the European Parliament and of the Council on the establishment of a common classification of Territorial Units for Statistics (NUTS) COM (2001) 83 final of 14 February 2001, OJEC No C 180 of 26 June 2001.

[77] European Parliament Committee on Regional Policy, Transport and Tourism, *Report on the proposal for a regulation of the European Parliament and of the Council on the establishment of a common classification of Territorial Units for Statistics (NUTS),* A5-0335/2001 of 11 October 2001.

Figure 16: Comparison of NUTS populations, 1996 ('000s)

	NUTS II			NUTS III		
	Average	**Minimum**	**Maximum**	**Average**	**Minimum**	**Maximum**
Austria	895	275	1595	231	21	1599
Belgium	923	242	1633	235	40	954
Denmark	5263	5263	5263	354	45	633
Finland	854	26	1813	258	26	1266
France	2295	160	10890	600	74	2555
Germany	2048	507	5291	186	36	2133
Greece	806	184	3449	206	21	3450
Ireland	1813	965	2661	463	208	1088
Italy	2870	119	8942	559	92	3806
Luxembourg	427	427	427	427	427	427
Netherlands	1294	277	3339	395	53	1322
Portugal	1418	242	3538	332	45	1835
Spain	2182	133	7128	757	64	5028
Sweden	854	391	1755	421	58	1773
UK	1589	373	4355	445	20	1753
EU15	1702	26	10890	391	20	5028
		Äland (Finland)	Ile de France		Orkneys (UK)	Madrid

Source: REGIO

The proposal provides that existing administrative units within the Member States shall provide the starting point for the definition of NUTS areas. Average size of the relevant class of NUTS area is to fall within the following thresholds:

	Minimum	Maximum
NUTS I	3 million	7 million
NUTS II	800,000	3 million
NUTS III	150,000	800,000

Only in Denmark and Luxembourg do the average size of the NUTS II regions fall outside these limits. In the case of Denmark, the country constitutes the NUTS II level; the Luxembourg population is smaller than the NUTS II limit. Non-administrative units may be aggregated where no administrative units of a suitable size exist in a Member State; any such units must fall within the thresholds above. In practice, however, a significant number of existing non-administrative NUTS areas fall outside these limits.

A key objective of the proposal is to provide a framework for future change. The proposal provides for the Member States to inform the Commission of any changes to administrative units with implications for the NUTS classification; regarding non-administrative NUTS units, the proposal states that these would only be amended if, at the NUTS level in question, the change would reduce the standard deviation of the population of all EU regions. A further consideration implicit in the proposal is that of providing basic principles for NUTS classification in the new Member States. In

practice, as Figure 17 shows, these display somewhat more homogeneity in size than the classification with the current membership.

Figure 17: NUTS II and III Population in the Accession Countries

	NUTS II			NUTS III		
	Average	**Minimum**	**Maximum**	**Average**	**Minimum**	**Maximum**
Bulgaria	1369	590	2142	323	140	1206
Czech Rep	1285	1110	1659	735	305	1283
Estonia	1442	1442	1442	289	159	534
Hungary	1438	977	2851	503	217	1825
Lithuania	3700	3700	3700	370	130	894
Latvia	2432	2432	2432	486	331	998
Poland	2416	1023	5065	902	294	2128
Romania	2807	2031	3833	535	231	1980
Slovenia	1986	1986	1986	136	47	319
Slovak Rep	1349	617	1876	674	551	783
CEEC	1974	590	5065	576	47	2128

Note: NUTS areas have not yet been defined for Cyprus or Malta.
Source: Calculated from REGIO.

This has led to criticism from the Committee of the Regions that the Commission proposal is contradictory, requiring homogeneity from the applicant countries while endorsing serious anomalies within the existing membership.[78]

An important issue in the debate surrounding the Regulation has been the question of administrative and non-administrative units and what the relationship of the NUTS definition should be to subregional autonomy. NUTS levels II and III are of most relevance for EU policy purposes, but some countries have no corresponding administrative structures at one or even either level (this is the case for Portugal and the UK). A further issue has been the relevance of focusing exclusively on population as the measure around which the NUTS classification should converge; this focus conceals massive differences in the size and population density of the areas, characteristics which are also relevant to the comparability of regions. Nevertheless, the importance of the definitions for the distribution of the Structural Funds and for Article 87(3)(a) and (c) status in the State aid rules reinforce arguments for maintaining the current, albeit imperfect, classification rather than reopening the definition to extensive lobbying.

5.2 State Aid, Regional Development and Services of General Economic Interest

An important issue in the evolving relationship between competition policy and regional development concerns services of general interest.[79] This has come to the

[78] Opinion of the Committee of the Regions on the ‘Proposal for a Regulation of the European Parliament and of the Council on the establishment of a common classification of territorial units for statistics (NUTS)’, OJEC No C 107 of 3 May 2002.
[79] “This covers market and non-market services which the public authorities class as being of general interest and subject to specific public service obligations”; “services of general economic interest…

fore for a variety of reasons. Liberalisation and deregulation have altered the context for providing public services and raised new issues about universal service provision. At the same time, and in parallel with the decline in the use of financial incentives to support firms in problem regions, growing attention has been paid to the quality of the wider business environment.

5.2.1 Treaty provisions

Public services *per se* are not a central concern of the EU Treaties; however, their provision is affected by the complex interaction of a number of Treaty articles. The basic principles of the Treaty concerning the free movement of goods, the right of establishment and the freedom to provide services inevitably conflict with the special arrangements introduced by all countries to protect certain activities in the public interest. Moreover, the competition rules in relation to anti-trust, abuse of dominant position and the prohibition of State aids in principle apply to a significant proportion of services with a public interest component. However, there are important derogations from these market integration principles on the grounds of public health or security and to enable the transport sector to fulfil “obligations inherent in the concept of a public service”.[80] More generally, and most importantly, Article 86 allows for special treatment of undertakings providing “services of general economic interest.”[81] The key provisions in this context are Article 86(1) and (2):

> 1. “In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in this Treaty, in particular to those rules provided for in Article 12 and Articles 81 to 89.”
>
> 2. “Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue producing monopoly shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.”

Services of general economic interest have a fundamental role in economic and social cohesion within countries, ensuring the universal provision of key services at costs and of a quality that could not be provided on a commercial basis. This role implicitly underpins that of more proactive regional policies (such as financial incentives to influence the location of businesses) since basic infrastructure, communications and energy supplies are a prerequisite for regional economic development.

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refers to market services which the Member States subject to specific public service obligations by virtue of a general interest criterion. This would tend to cover such things as transport networks, energy and communications” (European Commission, *Services of General Interest in Europe*, COM (2000) 580 final of 20 September 2000, Brussels).

[80] Article 73: Aids shall be compatible with this Treaty if they meet the needs of coordination of transport or if they represent reimbursement for the discharge of certain obligations inherent in the concept of a public service.

[81] Article 86 does not apply to non-economic activities such as compulsory education or matters of vital national interest that are the prerogative of the State, such as security and justice.

Recent developments in policy and case law in relation to services of general interest have focused on two key issues of relevance to regional development and the funding of services of general interest. First, the consequences for public service obligations of liberalising previously State-controlled activities; and second, the question of whether the financial compensation to undertakings for providing such services constitutes State aid.

5.2.2 Cohesion and competition in the provision of services of general economic interest

The liberalisation agenda of the European Commission has given rise to significant actual and potential changes in the accounting and operations of a range of activities.[82] In particular, network industries which had largely been shielded from competition were radically altered by European legislation.[83] The resulting competition was intended to improve productivity and consumer choice, but it has also sparked concerns over the accessibility, continuity and affordability of key services and has potentially important consequences for the preservation of universal service obligations and the provision of services justified on grounds of social equity or territorial cohesion. This in turn has given rise to pressures from some Member States for competition policy to be relaxed in relation to public utilities and for a public service charter to be introduced.[84] Reflecting this, the 1995 Cannes European Council stressed:[85]

> "that the introduction of greater competition into many sectors in order to complete the internal market should be compatible with the general economic tasks facing Europe, in particular balanced town and country planning, equal treatment for citizens - including equal rights and equal opportunities for men and women - the quality and permanence of services to consumers and the safeguarding of long-term strategic interests."

The Commission responded with a Communication in 1996[86] reaffirming that "general interest services are at the heart of the European model of society" and outlining the principal mechanisms through which the liberalisation initiatives had preserved universal service obligations. It explicitly opposed any change to Article 86 (then Article 90), but argued for an additional 'activity' to be added to Article 3 of the Treaty at the forthcoming Intergovernmental Conference, this being "a contribution to the promotion of services of general interest." This proposal was not taken up, but the Treaty of Amsterdam introduced a new Article 16 providing that:

> "Without prejudice to Articles 73, 86 and 87, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Community and the Member States, each within their respective powers and within the scope

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[82] Notably telecommunications, transport, energy, postal services, broadcasting.
[83] In some northern European countries and in some sectors national liberalisation preceded EU legislation.
[84] F. McGowan, 'Competition Policy' in H. Wallace and W. Wallace (eds), *Policy-Making in the European Union*, (OUP, Oxford, 2000).
[85] Cannes European Council, 26 and 27 June 1995, Presidency Conclusions.
[86] Services of General Interest in Europe, OJEC No C 281 of 26 September 1996.

> of application of this Treaty, shall take care that such services operate on the basis of principles and conditions which enable them to fulfil their missions."

The Lisbon and Feira European Councils in 2000 again emphasised that the concerns and significance of public services of general interest should be taken into account in a dynamic single market and called on the Commission to update its 1996 Communication. A further Communication[87] from the Commission in 2000 took account of the new context produced by Article 16 and noted that:

> "Efficient services are a major determinant in the location of production activities on account of the benefits both for the firms using them and the workers living in the area. The existence of a network of services of general interest is an essential element of social cohesion; conversely, the disappearance of such services is a telling sign of the desertification of a rural area or the degradation of a town."

The Commission proposed to promote a European perspective on general interest services on three fronts: making the most of market opening; strengthening European co-ordination and solidarity; and developing other contributions in support of services of general interest. In practice, however, there appeared to be no new tangible elements to this strategy, but rather a repackaging of initiatives already underway. In France, the CNADT[88] expressed the view that the balance between competition policy and the discharge of public service obligations had swung too far in favour of the former and called for the latter to be the subject of measures of equivalent binding force.[89]

To date the Commission has been rather resistant to calls for formalising the principles of Article 16. In its report to the Laeken European Council,[90] the emphasis of the Commission was on the extent to which existing liberalisation measures provided for safeguards to ensure that services continued to meet defined quality standards; the Commission considered that: "For many services of general economic interest open markets have proven to be best suited to ensure that the needs of citizens and businesses are met." This view is, of course, questionable.[91] Nevertheless, it renewed its 1996 suggestion to include "a contribution to the promotion of services of general interest" in a new subparagraph to Article 3, which would place the performance of these services clearly among the objectives of the Community. It also agreed to examine the suggestion of consolidating and specifying the principles on services of general interest underlying Article 16 in a framework directive. This proposal was endorsed by the Barcelona summit which noted that the Commission would produce a report on the matter by the end of 2002.

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[87] European Commission, *Services of General Interest in Europe*, COM (2000) 580 final of 20 September 2000.
[88] *Conseil nationale d'aménagement et de développement du territoire*, the national council for regional development, a consultative body.
[89] *Avis du CNADT sur les services d'intérêt économique général*, 27 November 2001: <www.datar.gouv.fr>
[90] European Commission, *Report to the Laeken European Council: Services of General Interest*, COM (2001) 598 of 17 October 2001.
[91] D. Hall, 'EU competition policy and public services', *paper to EPSU Conference*, Brussels, 12 December 2001.

5.2.3 State aid and financial compensation for the provision of services of general interest

In parallel with these general concerns at the relationship between liberalisation and cohesion some confusion has arisen as to the nature of the financial compensation to providers of services of general economic interest.

The Commission position had been that financial assistance granted by Member States to undertakings entrusted with provision of services of general economic interest did not constitute State aid within the meaning of Article 87(1) provided that assistance was limited to the amount needed to offset the additional costs resulting from the public service obligations imposed by the State.

This was called into question by a ruling of the Court of First Instance in the FFSA case,[92] upheld by the European Court of Justice. The case concerned tax concessions provided by the French government to the national postal operator, *La Poste*, associated with its regional development role and the obligation to service the entire territory. The legality of these concessions was challenged by several insurance federations. The essence of the CFI ruling was that, because the tax concession placed *La Poste* in a more favourable position than that of other taxpayers, it constituted State aid. However, on the basis of Article 86(2), the CFI found that payment of aid may escape the Article 87(1) prohibition:

> "provided that the sole purpose of the aid in question is to offset the additional costs incurred in performing the particular task assigned to the undertaking entrusted with the operation of a service of general economic interest and that the grant of aid is necessary in order for that undertaking to be able to perform its public service obligations under conditions of economic equilibrium".

In short, while the Commission had previously found such compensation not to constitute aid at all, the CFI found that it did, but that it may be found compatible with the common market on the basis of Article 86(2); in this case, the CFI held that the aid did not infringe Article 87 since it did not exceed the amount necessary for *La Poste* to maintain a presence in rural areas. Importantly, however, the Court of Justice confirmed in *CELF*[93] that: "even if the Member State takes the view that the aid measure is compatible with the common market, that fact cannot entitle it to defy the clear provisions of Article 93 [*now Article 88*] of the Treaty." In other words, Article 86(2) does not obviate the need for prior notification of aid or alter the obligation to suspend aid under Article 88(3).

In considering the Commission's 2000 Communication on services of general interest,[94] the Nice European Council expressed the need for "clarification of the relationship between methods of funding services of general economic interest and application of the rules on State aid."[95] The follow-up report[96] to the Laeken European

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[92] T-106-95 *Fédération française des sociétés d'assurance (FFSA) and others v European Commission* [1997] ECR II-229.
[93] C-332/98 *France v European Commission* [2000] ECR I-4833
[94] Communication from the Commission, *Services of General Interest in Europe*, COM (2000) 580 final of 20 September 2000.
[95] Nice European Council, 7-10 December 2000, Conclusions of the Presidency.

Council in December 2001, written in the light of the FFSA judgement, proposed a two stage approach. First, it planned a Community framework for State aid granted to undertakings entrusted with the provision of services of general economic interest which would specify the conditions under which State aid granted as compensation for the imposition of public service obligations could be authorised by the Commission. Second, on the basis of this experience, and if appropriate, the Commission would adopt a Regulation exempting certain aids in the area of services of general economic interest from the obligation of prior notification.

The position of the Court of Justice shifted in *Ferring*,[97] which was decided shortly after the report to the Laeken European Council was published. This case involved a reference for a preliminary ruling from a French social security tribunal. The case concerned whether different tax arrangements applying to wholesale distributors of medicinal products with public service obligations, as opposed to pharmaceutical laboratories which had no such obligations, amounted to State aid to the wholesalers. The Court found that, provided that the amount of tax relief given to the wholesalers did not exceed the cost of discharging their public service obligations, it did not constitute State aid within the meaning of Article 87. The Court took the view that, this being the case, the wholesalers were not enjoying any real advantage, since the only effect of the tax was to put the distributors and laboratories on an equal footing. It was, however, for the national court to decide whether this condition was met.

Following the *Ferring* decision, the Barcelona European Council pressed the Commission for a report to the Seville European Council on the state of work on the guidelines for State aids and for the Commission to propose, if necessary, a block exemption Regulation in this area. Given the status of the issue, the Commission's report to the Seville Council[98] was, of necessity, rather tentative and a further report to the Copenhagen summit has been requested.

At the time of writing, it remains to be seen whether the *Ferring* judgement will be confirmed. The Commission has followed the *Ferring* reasoning in several cases. For example, in considering a capital injection into the Irish national postal operator *An Post* which discharges public services obligations, the Commission considered that:[99]

> "Discharging this obligation entails additional costs for An Post which other retailers and banks do not have to bear. The equity injection is a compensation for this cost. Provided that this compensation does not exceed the net additional cost of the universal counter coverage obligation, it does not confer an advantage on An Post because the effect of the equity injection will be only to reduce An Post's disadvantage relative to its retailing and banking competitors, disadvantage caused by the fulfilment of its universal service country-wide counter cover obligation."

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[96] European Commission, *Report to the Laeken European Council: Services of General Interest,* COM (2001) 598 of 17 October 2001.

[97] C-53/00 *Ferring SA v Agence centrale des organismes de sécurité sociale* [2001] ECR I-09067

[98] Report from the Commission on the status of work on the guidelines for state aid and services of general economic interest, COM (2002) 280 final of 5 June 2002.

[99] State aid No N 650/01 – Ireland Equity injection to An Post for the purpose of restructuring the counter network , <www.europa.eu.int/comm/secretariat_general/sgb/state_aids/industrie/>

The Commission accordingly concluded that the equity did not involve any State aid: the Commission reached the same conclusion in a similar case involving the Swedish national postal operator.[100]

In spite of these Decisions apparently following the *Ferring* reasoning, and as the Commission noted in its report to the Seville Council, uncertainty remains because in two recent cases the Advocates General have called for alternative interpretations of the compensation / State aid question. In the *Altmark* case[101] AG Léger called for the *Ferring* judgement to be set aside arguing *inter alia* that it confused "the question of characterising a measure as State aid and the question of the justification for a State measure", that it deprived Article 82(2) of its utility and that it sheltered the financing of services of general interest from necessary Commission scrutiny. The Advocate General took the view that the subsidies granted to Altmark by the administrative district of Stendal are advantages liable to distort competition and may affect trade between Member States since several Member States have already opened up their markets to undertakings established in other States. Accordingly, the local or regional nature of the transport services cannot exclude the application of the rules of the EC Treaty on State aid. The implication of this view is that the aid should have been notified by the local authority and authorised by the Commission prior to implementation; it is therefore, an Opinion with considerable implications for subnational authorities seeking to subsidise public transport (or indeed other activities) in areas where commercial operations would not be viable.

In the *GEMO* case[102] AG Jacobs argues that the analysis under Articles 87(1) and 86(2) should be based on distinguishing two categories of case and that this in turn should be based on the nature of the relationship between the financing granted and the general interest duties imposed and on how clearly those duties are defined.

Neither *Altmark* nor *GEMO* have yet been decided by the European Court of Justice. The Commission is to await to these judgements before proceeding with its own proposals to clarify the relationship between State aid and compensation for public service obligations.

5.3 State Aid Expenditure – Less But Better?

Levels of expenditure on State aid have been of long-standing concern to the European Commission. However, there has always been some doubt that the Commission has the competence directly to intervene on aid budgets.[103] In the sphere

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[100] Rapid Press Release, *Commission gives go ahead to the Swedish Government's annual compensation to Posten AB, the universal postal operator, for delivering the universal cash service conferred to it by the Swedish State*, 2 July 2002, Brussels.

[101] C-280/00 *Altmark Trans GmbH, Regierungspräsidium Magdeburg v Nahverkehrsgesellschaft Altmark GmbH*, Opinion of AG Léger delivered on 19 March 2002, not yet reported but provisional text available on the European Court of Justice WebSite: <www.curia.eu.int>

[102] C-126/01 *Ministre de l'économie, des finances et de l'industrie v GEMO SA*, Opinion of AG Jacobs delivered on 30 April 2002, not yet reported but provisional text available on the European Court of Justice WebSite: <www.curia.eu.int>

[103] Although it has been argued that the collective effect of various Treaty provisions (Articles 2, 10, 98, 99 and 159) is to provide adequate legal authority for a co-ordinated programme to cap budgets; see T. Frazer, 'The New Structural Funds, State Aids and Interventions on the Single Market [1995] *European Law Review*, 3-19.

of regional aid, it is the one dimension of policy which the Commission has not addressed directly – the Commission has had a significant impact on forms of regional aid and assisted area coverage and some, albeit more limited, influence on award values. Although the proposed budget for a given scheme is among the elements required for a complete notification, the Commission has not, to date, prohibited a measure on the grounds that its budget was excessive. Nevertheless, it has often expressed the view that regional aid spending in particular countries – notably Germany – is too high; moreover, increases in budgets for particular schemes have on occasion triggered a wider-ranging review of the scheme itself and a tightening of the conditions under which aid is authorised: when the Italian authorities refinanced a package of measures which the Commission had earlier approved, albeit without notifying the budget increase, the Commission took the opportunity to enforce changes to the aid package, including lower award maxima.[104] While the Commission may be critical of large budgets, it is not the case that the Commission is more relaxed in its scrutiny of schemes with small budgets: it has been resistant to suggestions that it should be more flexible in relation to the assisted area coverage of schemes for which budgets are modest, an argument that has often been advanced by French policymakers,[105] reflecting the comparatively small annual budget allocated to the main regional grant, the *prime d'aménagement du territoire.*

Although Commission influence over individual aid scheme budgets has been virtually non-existent, since the mid-1980s it has taken a growing interest in aggregate levels of spend. In 1988 the Commission published the first of a regular series of State aid 'surveys', providing a statistical overview of expenditure. The First Survey[106] was, in fact, an annex to an inventory of aid schemes or programmes, which, apparently owing to resistance from the Member States, was never made public. Initially published every two years, the State aid surveys are now published annually.[107]

Issues of State aid control have also been addressed in the Broad Economic Policy Guidelines (BEPG). The overall objectives have been framed in terms of reducing State aid, especially *ad hoc* aid, redirecting it towards horizontal goals and improving the monitoring of State aid and assessments of its efficiency. This reflects the view expressed within the DG for Economic and Financial Affairs that the most practical approach might be to establish benchmarks at the aggregate level, expressed as a percentage of GDP and achieve a consensus about the types of aid on which reductions should be focused.[108] Since 1999, several Member States have been the target of BEPG recommendations regarding State aid control, namely France, Germany, Italy, Luxembourg, Portugal and Spain. These have mainly concerned either overall levels of State aid expenditure or the share of *ad hoc* or sectoral aid in

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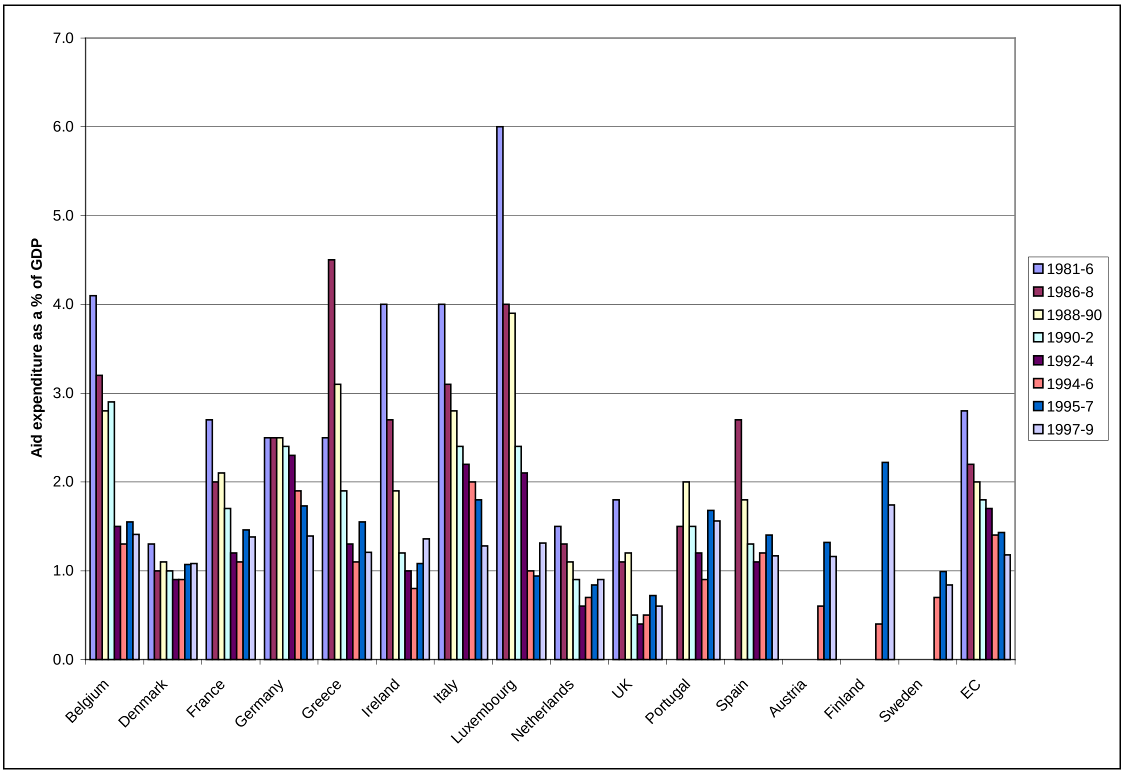
[104] Commission Decision of 9 December 1992 on Italian Decree-Law No 14 of 21 January 1992 relating, *inter alia,* to the overall refinancing of the aid measures provided for by Law No 64 of 1 March 1986 on special aid to the Mezzogiorno, OJEC No L 117 of 13 May 1993.
[105] C. Chicoye, 'Regional Impact of the Single Market in France' (1992) *Regional Studies* 26(4), 407-411
[106] Commission of the European Communities, *First Survey on State Aids in the European Community* (OOPEC, Luxembourg, 1988).
[107] This follows from the signature of the Europe Agreements which require annual reporting by each party.
[108] F. Ilzkovitz, R. Meiklejohn, and J. H. Schmidt, 'The control of state aid: A proposal for a co-ordinated approach', *paper to EU Competition Workshop*, Florence 1999.

the total, but in the case of Italy and Luxembourg, the Commission commented negatively on the scale of regional aid expenditure. Regarding overall levels of aid, the key measure employed has been State aid expenditure as a percentage of GDP. According to Ninth Survey on State Aid,[109] expenditure for 1997-99 was about 1.2 percent of GDP across the EU as a whole, but this average conceals relatively wide differences – from 0.6 percent in the UK to 1.7 percent in Finland. Trends in State aid expenditure are illustrated in Figure 18. State aid levels have, according to Commission figures, fallen fairly steadily over the two decades or so since the Commission started to collate data. As evinced in the Surveys themselves, the collection and analysis of this information is fraught with practical and technical difficulties; they nevertheless provide the single most comprehensive insight into State aid expenditure across the EU.

Figure 18: Trends in State aid spending as a proportion of GDP



Source: Commission surveys on State aids.

Political impetus has been given to reducing State aid expenditure levels by successive European Councils. The Dublin (1996), Cardiff (1998) and Lisbon (2000) summits had all called for the reinforcement of State aid control and a reduction in overall levels of aid. In advance of the 2001 Stockholm Council, the Spanish and UK Prime Ministers had apparently sought to concretise the commitment to a reduction in State aid spending, calling for targets of 0.9 percent of Community GDP by 2003 and

[109] European Commission, *Ninth Survey on State Aid in the European Union*, COM (2001) 403 final of 18 July 2001.

0.7 percent by 2005.[110] This proposal was considerably diluted in negotiations and the Stockholm Summit concluded that:[111]

> "Member States should demonstrate a downward trend in State aid in relation to GDP by 2003, taking into account the need to redirect aid toward horizontal objectives of common interest, including cohesion objectives".

Nevertheless, the Belgian Presidency (2001) announced with some enthusiasm the intention to "agree a methodology for the implementation and follow-up of the Stockholm summit from the twin points of view of the reduction and reorientation of public aid". However, the Industry Council conclusions fell considerably short of these ambitions, but rather reaffirmed the "less aid, but better" mantra and the need for the Commission to improve statistical information available through the regular publication of 'Scoreboards' on State aids.[112] This now provides more frequently updated statistical information than is in the regular Surveys as well as an online "Member State forum" established "with a view to encouraging an exchange of information between Member States on various aspects of their respective State aid policies". The latter is, in practice, a highly eclectic collection of links to various national websites, some of limited relevance to State aid control issues; the overall quality of the forum perhaps casts some doubt on the genuine commitment of all the Member States to improve transparency in this area.

The issue of State aid control was scarcely addressed in the Spanish Presidency (2002); on the Danish Presidency agenda for the latter half of 2002 there is a rather low key commitment to carrying forward the Stockholm conclusions, suggesting that the matter may have ceased to be a burning issue. Notwithstanding this rather modest outcome in terms of concrete commitments, there are two interesting aspects to these developments. The first concerns Commission attempts to increase the scope of State aid discipline through the Council. Given the doubtful legal basis for Commission control of State aid budgets *per se*, the Commission has tried to achieve restraint through greater policy coordination and political agreement. There are perhaps interesting parallels here with recent developments in tax coordination in the EU, and particularly the emergence of a Code of Conduct on Harmful Tax Measures. This resulted from Commission pressures for a political discussion of the issues surrounding tax competition and resulted in essentially voluntary action on the part of the Member States. This in turn arguably provided the Commission with both a factual basis and the confidence to undertake further action on fiscal State aid, and to reinforce its stance in significant respects.

The second element of interest is the qualitative dimension to the debate. The Broad Economic Policy Guidelines have stressed the need to assess the *effectiveness* of State aids; the Commission has suggested that *ex post* analysis of whether the market failures that aid aims to correct are addressed and at what cost could be carried out at

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[110] Belgian Presidency, *Reduction / Reorientation of public aid to business*: < http://www.eu2001.be/>
[111] Presidency Conclusions, Stockholm European Council, 23 and 24 March 2001.
[112] See: <www.europa.eu.int/comm/competition/state_aid/scoreboard/> for online versions of the Scoreboard.

Member State and EU levels with a view to designing more efficient measures.[113] State aid design is increasingly being considered in a wider economic and political arena. More specifically, Commissioner Monti has argued that: [114]

> "the compatibility of national state aid measures with the rules does not necessarily imply that they represent an effective policy response to, for example, sectoral or unemployment problems, or an appropriate budgetary policy at a time when budgetary measures should be increasingly coherent in the EU."

In practical terms it remains to be seen whether attempts to set a quantitative cap on State aid expenditure have reached their limits. It is evident from Figure 18 that expenditure targets as a percentage of GDP have different implications for different Member States, with some likely to favour ambitious targets given their current low levels of spend. It is also questionable whether GDP is the appropriate measure against which to set State aid expenditure targets. Moreover, there are arguments for disaggregating expenditure targets for different policy areas – for instance, higher regional aid expenditure targets in countries with wider regional disparities. On the other hand, this would be likely to lead to mechanistic solutions of the type that characterise calculations of the assisted area coverage under the Regional Aid Guidelines.

6. CONCLUSIONS

This paper has highlighted a number of important developments of direct or indirect relevance to the relationship between regional development and competition policy control of State aids. Although the two main bodies of rules that regulate regional aid (the Regional Aid Guidelines and the Multisectoral Framework) are set for several years to come, enlargement, recent Treaty changes and a number of smaller apparently technical issues as well as wider macroeconomic debates, mean that policy change is almost permanently on the agenda and takes place in an ever more complex environment. This final section seeks to draw out some discussion points that arise from the issues highlighted in this paper.

(i) The progressive codification of State aid control places too much emphasis on inappropriate policy linkages.

The clarification of the State aid rules across a range of policy areas is to be welcomed. In principle, such rules offer clear advantages in terms of transparency and predictability and enable aid schemes to be designed with relative certainty about their acceptability to the Commission. In practice, the rules are taking on a life of their own, driving the design of aid policies along lines that are neither relevant to the

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[113] Directorate General for Economic and Financial Affairs European Commission, 'Proposals for a coordinated strategy to reduce state aid volumes' *Note for the Economic Policy Committee*, ECFIN/643/99.

[114] *Hearing at the European Parliament before the Committee on Economic and Monetary Affairs with the participation of the Committee on Legal Affairs and Internal Market* (1st September 1999), Written replies presented by Mario Monti Commissioner-designate for Competition Policy Brussels, 16 August 1999.

market failures which policy seeks to address nor to the prevention of distortions of competition.

This is most in evidence in the context of SME and urban / regeneration policy discussed in this paper. The issues are two-fold. First, there is, in effect, a presumption that any aid distorts or threatens to distort competition between the Member States. Whilst in theory this might be true, in practice, much greater distortions often result from other factors in the fiscal, regulatory or economic environment; this context is absent from the Commission analysis of whether a measure is caught by Article 87(1). In reality, however, the presumption that aid at least potentially distorts competition is too embedded in Commission policy to be susceptible to change. Second, the Commission now automatically assesses spatially-restricted measures against the Regional Aid Guidelines. The effect of this is to tie SME aid rates and urban and rural aid policies to the regional aid map. The impact of this is perverse. The emphasis of the regional aid rules has traditionally been on limiting the scope and scale of general investment aid for large firms and controlling competitive-outbidding for mobile investment. This objective is itself questionable, and Commission policy can be criticised for being too concerned with competition between countries and regions to the detriment of competition between firms; however, the point at issue here is that the resulting map is typically inappropriate for SME, urban and rural policy considerations.

The matrix of codes and frameworks that is emerging is becoming overly complex and formal. It often responds poorly to the real situations faced by policymakers who are forced to ‘reverse engineer’ measures to fit with the various codes, rather than respond to the market failures identified. Inevitably, rules designed to set the parameters for acceptable aid measures involve a compromise between predictability and arbitrariness. However, there is a risk that, unless carefully designed, the resulting trade-off can both block quite innocuous measures and shelter from scrutiny awards that do raise serious competition concerns.

There is a strong case for decoupling the rules for State aid in different policy areas, and especially for reviewing the practice of assessing all spatially-targeted aid against the approved regional aid map. The issue is likely to be made more acute by the prospect of tightening spatial coverage in the context of enlargement, which will further limit the scope for overlap between regional, rural and urban development areas. A disentanglement of policy objectives is required for Member States to be able operate urban, rural and SME policies separate from the constraints of the regional aid map.

(ii) It is questionable whether the Regional Aid Guidelines can be reapplied as they are in the context of enlargement.

This paper has considered the implications of a reapplication of the Regional Aid Guidelines post-2006 in the context of enlargement to EU27. An overall coverage target of 50 percent of the EU27 population implies that coverage in the EU15 must fall from 43 percent to around 36 percent of the population – considerably more than the cutback required in 1999/2000. To some extent, national regional policymakers seem resigned to the prospect of further reductions in assisted area coverage, but the implications of simply reapplying the rules go further than this.

There are serious questions about the role of *relative* levels of prosperity and unemployment in the Regional Aid Guidelines. A significant number of regions will lose Article 87(3)(a) status simply because of the accession of poorer Member States, rather than because their absolute position has improved. Clearly, there will be pressures from the regions in this band (ie. those with GDP(PPS) per head between 75 percent of the EU27 and 75 percent of the EU15 averages) for special consideration to be given to the 'victims' of shifting statistical averages.

A less immediately apparent consequence of simply rolling forward the rules is the emphasis placed on unemployment rates as the 'qualifying criterion' for Article 87(3)(c) coverage among the current membership. This is because the inclusion of the candidate countries in the statistical analysis drags down average GDP(PPS) per head, but does not really affect unemployment rates. This in turn means that the Article 87(3)(c) GDP per head thresholds are predominantly met by former Article 87(3)(a) areas; the unemployment thresholds are met mainly by regions in countries where the national level of unemployment is high. In other words, outside the ex-Article 87(3)(a) areas, the unemployment rate is the principal criterion for determining Article 87(3)(c) coverage. There are several concerns with this. First, there are major doubts about the comparability of unemployment rates across countries. Second, the implication of this emphasis is that, for the Article 87(3)(c) areas, regional policy is essentially a labour market policy. Third, the appropriateness of the criterion is called into question by the fact that a significant proportion of the Article 87(3)(c) qualifying population is generated by the most prosperous city regions in the respective Member States: Athens, Barcelona, Brussels, Madrid and Rome are among those that meet the criterion. Of course, this part of the process is about determining the *initial share* of Article 87(3)(c) population, not the *actual regions* designated, but the absence of any connection between these two further undermines the credibility of the method rather than being a mitigating factor.

The process of adjusting the initial Article 87(3)(c) quota is likely to be the subject of considerable debate. As discussed, the German authorities failed in their attempt to challenge the Commission Decision concerning their regional aid map. The court itself did not examine the substance of the matter, having ruled the application inadmissible. However, it seems likely that the Advocate General's criticism of the method for distributing the Article 87(3)(c) population among countries will be sufficient to motivate the Commission to revise this aspect of the rules, rather than risk further challenges.

The impact of enlargement on a reapplication of the rules is not limited to spatial coverage. The effect of enlargement on average GDP(PPS) per head would mean lower rates of award in almost all Article 87(3)(a) areas in the current Member States. Perhaps more significantly, the imposition of the 10 percent ceiling in Article 87(3)(c) areas would be widespread – it would apply to the majority of the population of the current Member States except in Finland, France and Spain, where levels of unemployment are generally higher than the EU27 average.

An interesting issue is the situation of regions assessed against absolute criteria. The provisions on sparsely-populated regions would ostensibly be unchanged by enlargement since these hinge on meeting population density *thresholds*, not *averages*. The Article 87(3)(c) adjustments include an allowance for these regions to be contained within Article 87(3)(c), although in practice the calculations in this paper

suggest that no correction is required, provided that the minimum Article 87(3)(c) and ex-Article 87(3)(a) adjustments remain unchanged. The aid intensities for sparsely-populated regions also appear generous by comparison to the rates that would be applicable elsewhere, as do the special provisions for Northern Ireland. While these will doubtless be staunchly defended by national policymakers, it remains to be seen whether this exceptional treatment is sustainable in the context of spatial cutbacks and reduced award rates elsewhere.

(iii) There is a need for a reappraisal of the relationship between national and Community regional policies.

The ‘coherence’ of national and Community regional policies has been debated since the early 1990s following the reform of the Structural Funds. Coherence has primarily been perceived in terms of the coherence of the assisted area maps and the view that the Community should not intervene in regions not eligible for national regional policy. Superficially, this seems a plausible perspective. How could problems be serious enough for the Community policy to address them but for national policy not to?

In practice, there are compelling reasons why spatial coincidence is not necessarily an imperative. The main reason is the difference in policy objectives and associated instruments. Partly as a consequence of competition policy discipline, regional incentive policy in all countries implicitly (although not exclusively) targets large, potentially mobile investments; inherent in the selection of assisted areas is consideration of the capacity to absorb large investment. The typology of regions addressed by the Structural Funds is distinct and focuses on specific types of spatial or sectoral decline (industrial, rural, fisheries, urban). Moreover, the range of instruments cofinanced by Community regional policy extends beyond State aids - only a part of the package of measures contained in the CSFs and SPDs falls within the scope of the State aid rules. Since the objectives and instruments differ, there is no need for the areas of intervention to be identical - though they are likely to coincide.

Notwithstanding this argument, the lack of coincidence between the national and Community assisted areas is frequently the source of incomprehension and frustration at the subnational level, notably among those responsible for implementing Structural Funds policy on the ground.

The reduction in assisted areas for both national and Community regional policy in 1999/2000 led to a slight decrease in the ‘coherence’ of the maps (in the Commission’s sense of the term). Moreover, the ‘coherence’ derogation (whereby Objective 2 areas could be accepted under Article 87(3)(c) and escape the building block requirement) was frequently used as a device to secure Commission approval of national area designation proposals which did not otherwise meet the criteria in the Guidelines. These tactics frustrate the intended purpose of the policies concerned, but are an almost inevitable consequence of the interaction of the various Guidelines, Communications and Regulations.

In the context of further reductions in coverage, there is a need to review the nature of the relationship between national and Community regional policies. Clearly there is a need for policy coordination, but rather than coincident maps, the emphasis should be on the coherence of the Structural Funds with national policies for SMEs and urban

and rural development, preferably within the context of the decoupling of these policies from the national regional aid map.

(iii) The Multisectoral Framework could reduce the competitiveness of problem region and European locations for mobile investments.

The 2002 Multisectoral Framework clearly seeks to address directly some of the perceived shortcomings of the 1998 Multisectoral Framework. It decreases the number of projects subject to notification which should reduce some of the administrative burden for which the 1998 Multisectoral Framework was criticised. It also seems likely to have more impact on award rates, especially for very large projects. Some issues are, however, outwith its reach. The question of the definition of SMEs must await the outcome of the ongoing consultation process. More significantly, perhaps, the definition of sensitive sectors seems likely to be hampered by the paucity of statistical data, a major practical problem under the 1998 Multisectoral Framework.

The corollary of these attempts to address competition considerations is the potential impact on incentives and their capacity to attract projects to the problem regions. It can be argued that the 2002 Multisectoral Framework may reduce rates of award for large projects to a level at which they no longer entice the investors targeted. The impact of the Multisectoral Framework will be particularly severe if, as seems likely, the application of a maximum award rate of 10 percent of eligible investment becomes widespread. Related, the increasingly stringent controls over investment aid in Europe may indirectly enhance the attractiveness of north American or Asian locations where no comparable system of subsidy discipline exists.

(iv) How will the relationship between services of economic interest, territorial cohesion and competition policy evolve?

In recent years, the scope of regional policy has shifted to questions of competitiveness and the quality of the business environment. At the same time, progressive liberalisation and deregulation, partly at the behest of Commission policy, has altered the context for universal service provision and the conditions in which accessibility, security and affordability of network and other public services can be assured. The delicate balance between the free-market orientation of the Treaty provisions and public service considerations is of crucial importance for regional development policy. The French and German consultative bodies on regional development recently called for a substantive debate in Council arguing that competition policy should be sufficiently flexible to enable Member States to intervene to address regional inequalities or specific problems resulting from trade liberalisation and that competition policy should not threaten the provision of services of general economic interest on which regional competitiveness depends.[115] It remains to be seen what the implications of pressures to take forward Article 16 and of the pending court cases will be.

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[115] Recommandation commune du Beirat für Raumordnung et du CNADT, *L'avenir de la politique régionale européenne et les impacts territoriaux des politiques communautaires*, 28 June 2002, Limoges.

(vi) How important will the wider macroeconomic perspective become in determining the future of State aid control?

A final point concerns the growing influence of the wider economic context on State aid control, and especially the pressure on spending. The Commission has never *directly* attempted to reduce expenditure on State aid, probably judging it to be outwith its competence. It has nevertheless consistently exhorted Member States to spend less in successive State aid surveys, and the Regional Aid Guidelines were explicitly aimed at achieving a reduction in the overall volume of spend – presumably through a combination of smaller assisted areas and reduced aid maxima. In practice, the Commission has, to some extent, been pushing against an open door. State aid has generally declined across the Community since the regular surveys were first published, partly because of national budgetary constraints, and partly because the general climate of political opinion in most countries has favoured a less explicitly interventionist approach. In recent years, Commission pressure to reduce aid spending has been actively supported by the European Council, with some Member States favouring explicit spending ceilings. This ultimately proved too ambitious a goal on which to reach agreement, but there was consensus for a downward trend in expenditure as a proportion of GDP. At the same time, the Broad Economic Policy Guidelines have emphasised the need to assess the *effectiveness* of State aids and whether the market failures that aid aims to correct are addressed.

These questions touch on, but are different from, those addressed under the State aid provisions of the Treaty. It is important to draw a distinction between measures that distort competition in the internal market and those that are simply inefficient or ineffective; the Commission has the legal authority to control the former, but it is outwith the scope of competition policy for it to concern itself with the latter. Further, it is questionable whether there is a direct correlation between the volume of aid and the distortion of competition, but in any case, the Treaty provisions do not provide a basis for an evaluation of the impact of State aid spending on European economic performance.[116] Nevertheless, the practice of competition policy has tended to muddle these issues. It is as yet unclear what the tangible effects of macroeconomic considerations on State aid control might be. However, the appropriate balance between competition and cohesion is ultimately a matter of political choice and can only benefit from wider policy debate.

[116] A. Houtman, 'EC State Aid Control: in Search of the Right Balance' in C.-D. Ehlermann and M. Emerson (eds) *European Competition Law Annual 1999: Selected Issues in the Field of State Aids* (Hart Publishing, Oxford, 1999).