Competition Policy and Regional Aid:
How did it come to this and where can it go from here?

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CONTENTS

FIGURES

1. INTRODUCTION

In the last few years the relationship between competition policy and regional aid has been dominated by the development and implementation of the 1998 Guidelines on National Regional Aid. By autumn 2000 the assisted areas maps of all the Member States had been approved until end 2006. To this extent, the control of regional aids is entering a quiescent period: the Commission is set to review the Guidelines within five years of their becoming applicable, but imminent policy announcements seem unlikely; for their part, the Member States have the option to propose changes to their assisted areas (subject to the population coverage ceiling), but, with the possible exception of Germany, few countries appear to have any appetite for map revisions for the foreseeable future.

The 1998 Guidelines represent the latest iteration in the evolution of regional aid control – a process which began over 30 years ago. The development of regional aid discipline has been shaped by the competing pressures of transparency, on the one hand, and discretion, on the other. Successive enlargements have been influential in forming the basis for change. Indeed, the new Guidelines were explicitly framed in the context of enlargement to embrace a number of central and eastern Europe countries. The 1998 Guidelines represent the culmination of attempts to formalise the control of regional aid with respect both to the substance of policy and the timetabling of reviews. However, policymakers in many countries were perhaps surprised at the rigour with which the Guidelines were applied and may be unwilling to accept renewal or proposed revisions as readily as most accepted the Guidelines initially. Moreover, the impact of enlargement, coupled with the role of the negotiated "adjustments" for population coverage in 2000-6, mean that a simple rolling forward of the existing rules is unlikely to suffice.

Following this introduction, the paper is structured as follows: it begins by setting out the main provisions of the 1998 Guidelines and their impact on the Member States; Section 3 looks at longer-term trends in the development of controls over regional aids and sets the 1998 Guidelines in historical context; Section 4 outlines possible scenarios for the operation of the Guidelines in the light of recent economic change and potential enlargement; last, and looking forward, the paper considers some issues and options in regional aid control.

2. THE 1998 REGIONAL AID GUIDELINES

The essence of the Treaty provisions on regional aid discipline is that, although Article 87 provides for a general ban on State aids, there are two regional policy related exceptions to this prohibition. Article 87(3)(a) allows aid in areas where the "standard of living is abnormally low or where there is serious underemployment"; Article 87(3)(c) enables aid for the development of certain activities or areas, where trade is not affected "to an extent contrary to the common interest". These basic provisions have been extensively interpreted by the European Commission, mainly through published Guidelines and Communications.

The 1998 Guidelines replaced the previous 1988 Communication and a number of other related documents which are discussed further below. The main features of the Guidelines were as follows: [1]

- a reduction in the overall spatial coverage of assisted areas across the Community as a whole
- greater apparent freedom for the Member States in area designation
- emphasis on "coherence" of national and Community regional policy assisted areas
- lower maximum award values in all eligible areas

These are now reviewed briefly.

2.1 Spatial Coverage

The Commission's approach to controlling the spatial coverage of national regional aid represents the most fundamental change introduced by the Guidelines. The Commission has long considered EC-wide and national spatial coverage of regional aids (as a percentage of the relevant population) to be a measure of the discipline to which regional aids are subjected; in particular, there is a view that, in the more prosperous countries, the assisted areas should include a lower proportion of the national population.

Under the 1998 Guidelines, population coverage took on a pre-eminent role in regional aid discipline. The starting point was the Commission view that, across the Community, spatial coverage should amount to less than 50 percent of the population; in practice, the Commission established a ceiling of 42.7 percent for EU15.[2] This compared with previous coverage of 46.9 percent.

In December 1998, the Commission announced the overall assisted area coverage that it would accept for each Member State. This is set out in Figure 1.

[1] Wishlade, F. G. (1999) 'RAGS and LIPS: New Weapons in the Commission's Regional Aid Control Armoury' *Regional and Industrial Research Paper Series*, 31, European Policies Research Centre, University of Strathclyde, Glasgow.

[2] This is not specified in the Guidelines, but has been mentioned in press releases and other announcements. This appears to have been calculated to accommodate the entire populations of the five CEE countries expected to join during the 2000-6 period (all of which would be expected to fall within the Article 87(3)(a) derogation) whilst remaining within a ceiling of 50 percent of an enlarged Community (ie. EU21).

Figure 1: Population Ceilings for Article 92(3)(a) and (c) 2000-6

Belgium	30.9 %
Denmark	17.1 %
Germany	34.9 %
Greece	100.0 %
Spain	79.2 %
France	36.7 %
Ireland	100.0 %
Italy	43.6 %
Luxembourg	32.0 %
Netherlands	15.0 %
Austria	27.5 %
Portugal	100.0 %
Finland	42.2 %
Sweden	15.9 %
United Kingdom	28.7 %

Source: *National ceilings for regional aid coverage under the derogations provided for in Article 92(3)(a) and (c) of the Treaty for the period 2000 to 2006*, OJEC No. C 16; 21 January 1999.

Interestingly, the distinction between Article 87(3)(a) and (c)[3] is not made in the published notice; however, this difference is now entrenched through Community case law and is maintained in the new Guidelines. Moreover, the Commission did inform the Member States of the relevant breakdown bilaterally. Importantly, Article 87(3)(a) is determined on a "bottom-up" basis using statistical criteria, whereas, for Article 87(3)(c), a "top-down" population-ceiling-based approach is used to set coverage.

Under the Guidelines, Article 87(3)(a) areas are defined as NUTS II regions where GDP per head in purchasing power standards (PPS) is less than 75.0 percent of the EU average for the last three years for which data is available; this is the same as the basic definition of Objective 1 areas provided for in the Structural Funds Regulation.

Coverage of Article 87(3)(a) effectively determines coverage of Article 87(3)(c) - assuming that the overall ceiling (42.7 percent) is maintained. The overall ceiling less those areas classified as Article 87(3)(a) leaves a "quota" for Article 87(3)(c) to be distributed among the regions *not* covered by Article 87(3)(a).

The allocation of an Article 87(3)(c) population quota to each Member State involves a decidedly arcane and laborious procedure. 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

[3] The notice refers to the pre-Amsterdam Treaty numbering – Article 92 to 94 having been renumbered to Articles 87 to 89.

national average are taken into account in determining the national share of the Article 87(3)(c) population quota

- 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 – ie. 42.7 percent.

The Guidelines do not provide any information on the outcomes which arise from this process; as mentioned above, the Commission published only global population figures for each country, and these do not distinguish between Article 87(3)(a) and (c).

2.2 Area Designation

A key change introduced under the Guidelines was that Member States were required to notify to the Commission the methodology and quantitative indicators which they wished to use to determine the eligible areas for Article 87(3)(c), as well as the list of regions they proposed for the Article 87(3)(c) derogation. More specifically:

- the *methodology* had to be objective, enable socio-economic disparities to be measured, highlighting significant differences, and be presented in a clear and detailed manner to enable the Commission to "assess its merits"

- up to five simple and “combined” *indicators* could be used. They were to be:
  - objective and relevant
  - based on time series including “at least the three years prior to the moment of notification” or derived from the latest survey, in the case of non-annual surveys
  - drawn up by reliable statistical sources.
- the *regions* had to fulfil the following conditions:
  - be NUTS III, or, where justified, a different homogeneous unit - importantly, however, only one type of unit could be used by each Member State
  - individual regions or groups of contiguous regions must generally have a minimum population of 100,000; a fictitious population of 100,000 was to be imputed to calculate the population coverage if the population was less. Exceptions to this are:
    - NUTS III regions with a population of less than 100,000
    - islands and “other regions characterized by similar geographical isolation”
    - Luxembourg
  - the list of regions “must be arranged on the basis” of the chosen indicators; the selected regions must show “significant disparities (half of them the standard deviation) compared with the average of the potential 92(3)(c) [Article 87(3)(c)] regions of the Member State concerned”
  - subject to the population ceiling, regions with a population density of less than 12.5 km^2 may also qualify for the Article 87(3)(c) derogation
  - regions eligible under the Structural Funds may also qualify, subject to the population ceiling *and* to the conditions set out in the second indent of the condition relating to eligible regions, ie. that designated areas must generally involve a minimum 100,000 population.

2.3 Maximum Award Values

The final aspect of the new Guidelines with significant implications for national regional aid policies were the provisions related to maximum award values. The rates previously authorised by the Commission varied very widely, but were, in principle, not more that 75 percent net grant-equivalent in Article 87(3)(a) areas and not more than 30 percent net grant-equivalent in Article 87(3)(c) areas. The 1998 Guidelines reduced these amounts and sought to relate award rates more closely to levels of GDP per head.

Figure 2: Maximum Rates of Award under the 1998 Guidelines

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

It is important to note that these ceilings are cited as upper limits; the Guidelines envisaged that actual aid ceilings be adjusted to reflect the severity and intensity of the regional problems addressed when set in a Community context.

2.4 The 1998 Guidelines in Practice

The Guidelines proposed that the redrawn assisted area maps be submitted to the Commission by 31 March 1999, with a view to the maps entering into force on 1 January 2000. The application of “appropriate measures” effectively withdrew the approval of existing regional aid schemes and maps from 1 January 2000; the net result of was that any country failing to gain approval of the new map and schemes by this date would be left without a regional aid policy that could be operated lawfully.[4]

In practice, there were significant slippages in the proposed timetable; only four countries (Denmark, Finland, Germany and the Netherlands) submitted their maps on time; and only four (Denmark, Finland, Greece and Ireland) had their maps approved by the Commission before end 1999.

By September 2000, all the national assisted area maps had been approved but the length and nature of the negotiations varied widely between countries. The main areas that were subject to discussion following notification are summarised in Figure 3.

[4] Obviously Member States could (and did) make award offers conditional on approval of the maps / schemes by the Commission; provided that aid was not actually paid out until approval was secured, this was not unlawful.

Figure 3: Negotiation Issues in Map Notification

	Coverage	Choice of unit	Use of unit	Indicators	Rate modulation	Other
Austria			Y			
Belgium	Y	Y	Y	Y	Y	Y
Denmark						
Finland			Y			
France			Y		Y	
Germany	Y		Y	Y	Y	Y
Greece						
Ireland					Y	
Italy						Y
Luxembourg						
Netherlands		Y		Y	Y	
Portugal					Y	
Spain				Y	Y	
Sweden					Y	
UK	Y	Y	Y		Y	

2.4.1 Population coverage

Population coverage was one of the most disputed aspects of the new Guidelines and policymakers in many Member States struggled with the area designation in the context of severely reduced coverage. In the negotiation of the assisted areas maps with the Commission it caused particular difficulties in Germany, Belgium and the UK.

When the Guidelines were first issued, the Member States were asked to agree to them, and all but Germany did so; Germany eventually capitulated in the absence of support from other Member States. Nevertheless, German opposition to the way in which the population ceilings were calculated remains. Underlying German opposition to the ceiling imposed were the “adjustments” made to the Article 87(3)(c) population quota in order to obtain the ceilings given to the Member States. For Germany, the adjustments applied to the Article 87(3)(c) population meant that the initial quota of 23.4 percent of the population was reduced to 17.6 percent. Reflecting this, the German map initially submitted to the Commission covered 23.4 percent of the population; this was rejected by the Commission. The German authorities recognised that, unless they agreed to the Commission’s 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 and that this Decision would probably be negative. The German authorities therefore agreed to reduce the assisted areas to the Commission’s target quota, but are now challenging the Commission Decision in the European Court of Justice.

In Belgium, the population quota for Article 87(3)(c) was also exceeded. However, this seems to have been more due to lack of co-ordination between the three regions, which have responsibility for economic development policy in their respective

territories, rather than a matter of principle. The Belgian proposal was, not surprisingly, rejected by the Commission.[5]

In the UK, the issues surrounding population coverage differed again, and remain somewhat unclear. The origin of the uncertainty lies in the Guidelines themselves, specifically the provisions dealing with rates of award in areas losing Article 87(3)(a) status. Footnote 44 to these states that:

> "In view of its particularly difficult situation, Northern Ireland will retain its status as an exceptional region and its ceiling will be 40%".

This footnote is peculiar for several reasons: it appears in the section of the Guidelines dealing with rates of award for areas losing Article 87(3)(a) status; this would imply that Northern Ireland is among those regions. This is supported by the fact that no mention of special status for Northern Ireland is made in the section dealing with the definition of Article 87(3)(a) areas. On the other hand, the footnote states that the province will *retain* its status as an exceptional region, which implies that it continues to be included in Article 87(3)(a), as it has since the Commission's 1988 Communication on regional aid. Perhaps the most plausible interpretation of the Commission's intent is that the Commission would have expected the UK authorities to have included Northern Ireland in the Article 87(3)(c) assisted areas and was prepared to allow a higher rate of award than in other former Article 87(3)(a) regions because of its particular difficulties. In practice, however, Northern Ireland appears to have been included in the map on the basis of Footnote 44 – according to the Commission in its letter to the UK authorities approving the map:[6]

> "The proposed Article 87(3)(a) and (c) areas in Great Britain cover 28.7% of the population. Northern Ireland is proposed as an exceptional region based on footnote 44 of the Regional Aid Guidelines. This footnote retains the status of Northern Ireland as an exceptional region in view of its particularly difficult situation.
>
> In view of footnote 44 of the Regional Aid Guidelines and of the Commission Decision of 16 December 1998, the population coverage proposed by the UK authorities is compatible with the common market."

Thus, in announcing its approval of the UK map, the Commission stated that:[7]

> "28.7 percent of the population of Great Britain and the whole of the population of Northern Ireland live in eligible areas."

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[5] OJEC C 351; 4 December 1999. The investigative procedure was subsequently closed following the Belgian decision to withdraw the proposal.

[6] SG(2000) D/106293 - State aid no N265/2000 – United Kingdom; Regional aid map 2000-2006, 17 August 2000.

[7] IP/00/849 Commission approves UK regional aid map, Brussels, 26 July 2000.

As Figure 4 shows, this is at odds with the assisted area coverage published in the Official Journal which set United Kingdom coverage at 28.7 percent of the population. Moreover, the addition of Northern Ireland and the reinterpretation of the total population quota as pertaining to Great Britain takes UK coverage to 30.7 percent, 2 percentage points higher than that announced by the Commission. This in turn increases coverage across the Community from the anticipated 42.7 percent to 43 percent of the population.

Figure 4: Final Coverage Figures for 2000-6 under Article 87(3)(a) and (c)

	Total Pop ('000) 1996	Article 87(3)(a)	Article 87(3)(c)	Total assisted area %
Austria	8054.8	3.5	24.1	27.6
Belgium	10143.0	0.0	30.9	30.9
Denmark	5251.0	0.0	17.1	17.1
Finland	5116.8	13.4	28.9	42.3
France	59857.0	2.8	33.9	36.7
Germany	81817.5	17.2	17.7	34.9
Greece	10465.1	100.0	0.0	100.0
Ireland	3615.6	26.6	73.4	100.0
Italy	57333.0	33.6	10.0	43.6
Luxembourg	412.8	0.0	32.0	32.0
Netherlands	15493.9	0.0	15.0	15.0
Portugal	9920.8	66.6	33.4	100.0
Spain	39241.9	58.4	20.8	79.2
Sweden	8837.5	0.0	15.9	15.9
UK	58710.8	8.6	22.1	30.7
EU15	374271.5	21.9	21.1	43.0

Note: This table assumes that Northern Ireland has Article 87(3)(c) status.
Source: Own calculations: population data from REGIO; Article 87(3)(a) and (c) coverage information from various national and Community sources.

2.4.2 Building Blocks

The choice and use of building blocks for the area designation exercises were among the most contentious aspects of the negotiations.

Critical issues arose in the choice of unit for determining Article 87(3)(c) coverage; however, it seems almost to have passed unnoticed that there was also an issue regarding the designation of Article 87(3)(a) areas. In the Commission's letter to the Member States of February 1998, it had been stressed that the breakdown of NUTS II and III regions applicable at 15 October 1997 would be used when the population ceilings were updated at end 1998.

In Ireland and the UK, changes to the NUTS boundaries took place *after* 15 October 1997. This resulted in new NUTS II regions that met the criteria for Article 87(3)(a) (and Objective 1): Border-Midlands-West (Ireland) and Cornwall and West Wales & the Valleys (UK) gained Article 87(3)(a) status just because of boundary changes. In short, the Commission backed away from its insistence in the letter that it would retain the existing NUTS breakdown.

With respect to building blocks for Article 87(3)(c) areas, as Figure 3 shows, the *choice* of unit was questioned in three countries: Belgium, the Netherlands and the UK.

In Belgium, the Commission found fault with almost all aspects of the proposal, largely reflecting the fact that the three Belgian regions had undertaken area designation exercises separately, rather than collaborating in a national area designation system, as implied by the Guidelines (however inappropriate this may be in the Belgian context).

In the Netherlands, the first map submitted to the Commission used NUTS III units, but a part of the northern NUTS III region was omitted in order to remain within the population ceiling. Reflecting the Guidelines, the Commission opposed the subdivision of the chosen unit. The Dutch government then redrew the map on the basis of NUTS V areas; the outcome remained virtually unchanged, but there was no subdivision of the chosen unit.[8] The Commission sought justification for the use of NUTS V and claimed that this had given rise to a lack of "compactness" in the map. The Dutch authorities provided further justifications, but eventually were required to submit a new map following discussions between the Dutch Minister of Economic Affairs and Commissioner Monti. Overall, the impression given was of a much more compact map than was previously the case. While the Commission remained opposed to the use of NUTS V, the Dutch authorities argued strongly for it and it was ultimately accepted.

The UK authorities also experienced difficulties regarding the choice of unit. The basis for area designation was the NUTS V level (wards). These had been used to build up an alternative form of travel-to-work-area (TTWA) to reflect more accurately the labour market objectives of policy. This aimed to mirror the *potential* commuting patterns of the unemployed, rather than the *actual* commuting patterns of those in work. This involved smaller areas than TTWAs, but enabled the UK authorities to deal with difficult issues such as how to designate parts of London. The intended approach was mentioned to DG Competition while the proposal was under preparation, and the UK authorities were not given to understand that it would be opposed; they were therefore surprised when the map was rejected. The main problem appears to have been that, because the units proposed were smaller than traditional TTWAs, they could involve assistance to firms drawing labour from a wider geographical area, thereby indirectly increasing the population covered by the map. In addition, like the Dutch map, the UK proposal was perceived by DG Competition to "have too many white spots" and lack contiguity. The disagreement between DG Competition and the UK culminated in revised proposals being put out to consultation.[9] The main focus of the revisions was on grouping the original blocks into new zones and finding optimal ways of merging units into larger contiguous areas. This was difficult: the original map was considered to be a successful attempt at combining the Commission Guidelines with the labour market aims of UK regional

[8] See Spokesman's Service of the European Commission (1999) *Commission takes issue with Dutch proposals for a regional aid map*, IP/99/588, Brussels, 28 July.

[9] DTI, DETR, Welsh Office and Scottish Office (2000) *Amendments to the Government's Proposals for New Assisted Areas,* URN 00/776, DTI, London.

policy; the revised map is considered to have compromised national regional policy objectives. Moreover, DG Competition provided no substantive economic rationale for its objections, nor any guidance on the changes required to achieve its definition of compactness. Overall, the changes to the UK map involved a transfer of around 1 million people between the original and amended maps.

Elsewhere, it was not the choice of building block *per* se, but how the chosen unit was used which posed problems. In Austria, Finland and France coherence with Objective 2 areas was used as a device to get around the general rule that the selected unit should not be subdivided. In Finland, problems arose from the proposal to designate the Åland islands. These were included in the map for political reasons arising from the devolved powers to the Swedish-speaking minority population, but the islands have relatively high GDP *per capita* and low unemployment. DG Competition agreed to accept their inclusion in the map as the main town was excluded, but only on condition that the area concerned was included in the Objective 2 map proposal.[10] In Austria, negotiations over the Structural Funds and the national assisted area maps seemed to be closely intertwined; however, DG Competition drew a line between the informal and the formal discussions, arguing that full negotiations on the national map could not begin until the final approval of the Structural Funds map. On the substantive question of the relationship between the two maps, DG Competition allowed the inclusion of partial NUTS III areas for Article 87(3)(c) on the basis that they had Objective 2 status. In France, one of the areas of dispute concerned the subdivision of the chosen unit, the *zone d'emploi*. For the areas concerned - at least where the subnational level wished it - the derogation on coherence was used. The initial French map proposal was formally withdrawn and the *Préfets de région*, which had responsibility for drawing up the Objective 2 maps, were asked by the national authorities to consider the inclusion of the partial employment zones in the Objective 2 proposal; according to the instructions issued, such proposals would automatically guarantee the inclusion of those areas in the national assisted area map. Approval of the national map, which was substantially unchanged from the initial proposal, followed in March 2000.[11]

By contrast, the German and Italian authorities were less fortunate. The Commission did not accept the proposal to include of parts of German labour market areas in the Structural Funds map. In Italy, a longstanding dispute with the Commission over the choice of unit for Objective 2 delayed the submission of the Structural Funds assisted area map proposals.[12] These proposals were anyway highly contentious internally; the already complex situation was compounded by the Italian proposal to use the Objective 2 derogation as an "indicator" for the national assisted areas map, even though the Objective 2 map had not been agreed. The Commission objected to the

[10] Both the national and the Structural Funds assisted areas for Finland appear to have been approved on the same day.

[11] IP/00/207 *Commission approves France's regional planning grant map (PAT) for 2000-2006, Brussels, 1 March.*

[12] At a meeting to prepare for the new Structural Funds planning period held in Catania in December 1998 a Commission official agreed that the use of *sistemi locali del lavoro* was acceptable as a building block for Objective 2 designation; this position was later reversed.

national map proposal on the grounds that, as the Structural Funds map had not been agreed, the Commission could not consider whether the areas proposed on the basis of the coherence derogation were compatible with Article 87(3)(c).

2.4.3 Indicators

By contrast with other aspects of the map negotiations, the choice of indicator appears, in general, to have been less controversial. It is highlighted in Figure 3 in respect of four countries. In Spain, the Commission objected to the use of GDP per head at NUTS IV, which had been used to justify the inclusion of Baleares; the issue was resolved by including the areas concerned in the Objective 2 map, in other words, by making use of the "coherence" derogation. In Germany, the authorities experienced considerable difficulties in gaining acceptance for the infrastructure indicator and for an indicator based on a forecast of future labour market conditions – reflecting the Commission's attachment to *historic* trends in disparities as opposed to *projections*. In the Netherlands, the second map proposal, which was NUTS V based, used selection criteria which included only those municipalities which had development potential. The Commission doubted whether this was "in conformity with the spirit of the Guidelines on national regional aid."[13]

More interestingly, perhaps, the use of indicators appears as the only significant aspect of the Guidelines on which the Commission gave way for a number of countries. The Guidelines provide that the list of regions "must be arranged on the basis" of the chosen indicators; and the selected regions must show "significant disparities" in respect of one or other indicator used in the method. It seems clear that the initial intention was that Member States should submit a single list of regions ranked on the basis of the indicators chosen; in practice, only Germany and Austria used such an approach. Elsewhere, indicators were used as separate measures of particular types of problem rather than as elements of a composite index. In France, for example, the selection of areas involved four different processes, working the population proposed up to the ceiling set by the Commission; a given area only needed to qualify on the basis of one of these measures. Similarly, in Spain, *comarcas* needed only to be above or below average on one of the chosen indicators. Moreover, in a number of countries, proposed areas were selected from *among* those that fell above or below the relevant thresholds. These approaches do not seem to have been a source of contention in negotiations. Indeed, this appears to be one area where the Commission backed down – possibly because it recognised the technical complexities of a combined indicator approach, or perhaps because it became aware of the anomalies that straight rankings can produce.

2.4.4 Rate Modulation

Policymakers in some countries were unclear about whether proposed rates of award should accompany the map notified or whether the Commission would itself set aid limits; in practice, the Commission preferred to receive the proposals of the Member States, then amend them. Key areas of dispute concerned: the imposition of the 10

[13] OJEC C 326; 13 November 1999.

percent rate on certain regions and the reduction of award rates in relation to those proposed by the Member States.

In addition, in several countries confusion seems to have arisen over the relationship between the regional aid and the SME Guidelines with respect to award values. The Commission apparently insisted that the latter apply where regional aid to small and medium-sized firms are concerned. This interpretation has most impact on Member States containing regions that benefit from the derogation in favour of sparsely populated areas; the regional aid Guidelines provide for a maximum rate of 30 percent net grant-equivalent in these areas, compared with the standard rate of 20 percent. However, the SME Guidelines state that:

> "In the assisted areas the Commission may approve aid to SMEs which exceeds the level of regional investment aid it has authorized for large enterprises in the area:
>
> - by 10 percentage points gross in areas covered by Article 92(3)(c) [Article 87(3)(c)], provided the total does not exceed 30% net;
>
> - by 15 percentage points gross in areas covered by Article 92(3)(a) [Article 87(3)(a)], provided the total does not exceed 75% net."

The net effect of this rather surprising interpretation is that SMEs in sparsely-populated regions do not benefit from any supplement in relation to the ceilings applicable to large firms.

2.4.5 Overall Assessment

In September 2000, the Commission announced that it had approved the Belgian and Italian maps, completing its review of the national assisted area maps.[14] In the announcement. the Commission refers to the overall population ceiling having fallen from 46.7 percent to 43.7 percent of the EU population, as opposed to the 42.7 percent set in the Official Journal (or coverage of 43 percent, as suggested by Figure 4). It unclear how these differences arise. Nevertheless, it appears that target coverage of 42.7 percent was not ultimately sacrosanct.

For many Member States the process involved significant delays in implementing policy and the task of redrawing the assisted areas within the parameters of the Guidelines proved a technically demanding exercise of questionable relevance to regional policy priorities. In addition, some Member States had bruising encounters with the Commission which resisted providing guidance on the new rules and was intransigent on many issues. Although the Commission was apparently satisfied with the process, viewing it as administratively efficient compared with the more *ad hoc* approaches of the past, many national policymakers found the process frustrating and were irritated by the Commission's capacity to exploit the lack of clarity in the Guidelines to the disadvantage of the Member States. Many national policymakers

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[14] IP/001024 *Commission brings its review of regional policy to a successful conclusion with the approval of the maps for Belgium and Italy*, Brussels, 20 September 2000.

appear to have been surprised by the intransigence of the Commission on points which they had perhaps expected to be negotiable. Moreover, the Commission was reluctant to provide guidance on the rules, preferring instead to review and reject successive proposals from the Member States rather than indicate what changes were required in order to conform to the Guidelines. There are also indications that the Commission has been inconsistent in the application of the Guidelines: the negotiation processes were determinedly bilateral and opaque; this engendered a climate of suspicion and led to a perception among countries that Member States were not treated equally. Indeed, for many countries it is possible to identify at least one aspect of the approved map and regional aid scheme that has benefited from what can most generously be described as a liberal interpretation, if not a clear breach, of the rules.

3. ORIGINS AND TRENDS IN REGIONAL AID CONTROL

The 1998 Guidelines are the latest in a succession of principles and communications aimed at disciplining regional aids. The control of regional aids in the EU is arguably more evolved than that of any other aid policy area; regional policy was the first policy area for which the Commission established principles to discipline the use of aid, and these have been progressively amended as a consequence of successive Treaty revisions, Community enlargements, the introduction and development of the Structural Funds and a range of policy and political pressures. The 1998 Regional Aid Guidelines are the outcome of this complex array of factors. A fundamental difference between the 1998 Guidelines and earlier rules concerns their legal force and finite timescale. Never before had the Commission required the suspension of regional aid schemes from a given date on the basis of "appropriate measures" and nor had it simultaneously reviewed the regional aid schemes of all the Member States. In other words, the Guidelines entailed a much more formal and legalistic approach to the Commission's task of keeping "under constant review all systems of aid" and proposing any "appropriate measures required by the progressive development or by the functioning of the common market".[15]

Notwithstanding this more formal approach, the 1998 Guidelines represented both continuity and change in European Commission control of regional aids. The origins of policy date back to the late 1960s. The rationale for controlling regional aids was expressed in terms of concern at the risks of competitive outbidding which required "that a first system of co-ordinating measures intended to limit those risks be evolved without delay". In 1968, the European Commission had proposed to the Member States that significant awards under general aid schemes be notified to it in advance. Discussions with the Member States culminated in the adoption of a series of principles aimed at the gradual co-ordination and adaptation of systems of regional aid. These principles were contained in a Commission Communication to the Council which in turn adopted the Commission text as a Resolution.[16] These concerned:

[15] Article 88.

[16] Council Resolution of 20 October 1971 on General Systems of Regional Aid, OJEC C 111; 4 November 1971.

regional specificity; transparency; aid intensity; and consideration of the sectoral repercussions of regional aid.

3.1 Regional Specificity

The provisions on the “regional specificity” or spatial coverage of regional aid have been subject to more change, and more controversy, than any other aspect of regional aid control. Initially, the principles of coordination applied only to the central or industrial regions. Under the 1971 principles, Berlin and the German Zonal Border Area, the *Mezzogiorno* and the areas eligible for the *prime de développement industriel* in France, were all excluded from the rules, pending the adoption of an “appropriate solution” for coordinating aid in the peripheral regions. This did not emerge until the 1975 principles,[17] which grouped all the regions of the Community (by then enlarged to nine members) into five categories and set differentiated ceilings. In so doing, the principles took as their starting point the existing assisted area maps of the Member States.

As far as area designation was concerned, there were five key elements to the 1971 principles:

- that regional aids should not cover the whole country (except in the case of Luxembourg)
- that general systems of aid should clearly identify the boundaries of eligible areas or regions through quantitative criteria or geographical terms
- that regional aid should not be granted in a pin-point manner, except in the case of growth poles
- that rates of award or aid intensities should be varied according to the severity of the regional problem
- and that the graduation and variation of aid intensities should be clearly shown.

These rather broad requirements were used as the basis for an increasingly interventionist approach to the control of regional aids by the European Commission. During the 1970s the Commission increasingly questioned the appropriateness of Member States’ assisted area maps and sought more detailed socio-economic information on the situation of the regions proposed; in addition, there was growing emphasis by the Commission on trying to phase-out assistance in certain regions. The mid 1970s marked the beginnings of a highly prescriptive phase in the Commission’s approach to regional policy, with Member States forced to amend proposed assisted areas following Commission analysis. The detailed nature of the Commission’s involvement is all the more striking given the absence of any published explanation of its approach, which appeared to be based largely on *ad hoc* appraisals of regional problems as and when the Commission reviewed assisted area maps. It was scarcely surprising that relations between national regional policymakers and DGIV (now DG Competition) were characterised by long-running disputes and considerable acrimony.

[17] COM(75) 77 final of 26 February 1975.

The 1988 Communication[18] marked a significant change in policy in a number of respects. First, there was explicit reference to the two derogations from the general prohibition on State aid that are relevant for regional policy – Articles 87(3)(a) and (c)[19] respectively; this followed a 1984 European Court of Justice ruling which had held that:

> "the use of the words 'abnormally' and 'serious' in the exemption contained in Article 92(3)(a) shows that it concerns only areas where the economic situation is extremely unfavourable **in relation to the Community as a whole**"[20] [emphasis added]

Article 87(3)(c) is potentially wider:

> "inasmuch as it permits the development of certain areas without being restricted by the economic conditions laid down in Article 92(3)(a), provided such aid 'does not affect trading conditions to an extent contrary to the common interest'. That provision gives the Commission power to authorize aid intended to further the economic development of areas of a Member State which are disadvantaged in relation to the national average."[21]

Second, the Commission proposed to make systematic use of the Article 87(3)(a) derogation for the first time. Notwithstanding the importance of the differences between Articles 87(3)(a) and (c), the early policy of the Commission did not make reference to these provisions, but successive enlargements had widened regional disparities justifying a more differentiated approach.

Third, and related, the eligibility of regions for one of the derogations was to be based on socio-economic indicators rather than the existing assisted area maps of the Member States and a core-periphery approach to problem region appraisal. In broad terms, areas eligible for the Article 87(3)(a) derogation were to be those where GDP(PPS) per head was less than 75 percent of the Community average. Moreover, the Commission revealed that it had devised a method for applying Article 87(3)(c) in 1983 and had used this for all decisions taken since.

For Article 87(3)(c), the methodology involved a two-stage analysis: the first, essentially quantitative; the second, more qualitative. The first stage involved an assessment on the basis of GDP(PPS) per head and unemployment. In principle regions had to have GDP per head at least 15 percent below the national average; and/or unemployment at least 10 percent above the national average. In order to take the Community context into account, national averages were themselves adjusted on the basis of European indices of GDP per head and unemployment. The net result of

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[18] OJEC C 212; 12 August 1988.

[19] Then Article 92(3)(a) and (c).

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

[21] Ibid.

applying the formula was that the better the situation of a Member State in relation to the EC average, the greater must be the disparity of a region within the national context for the availability of regional aid to be justified. The second, qualitative, stage of analysis under Article 87(3)(c) took other factors into account. These included the trend and structure of unemployment, demographic pressures, structure of economic activity, etc. and were used in a discretionary manner; there was no set formula for analysis. Initially, neither stage of analysis was conclusive as to whether regional aid was justified, but a subsequent amendment to the rules stipulated that the second stage was essentially a complement for regions at the margins of eligibility under the first stage.

An alternative to the GDP per capita and/or unemployment thresholds was introduced as a result of the accession negotiations with the Nordic countries.[22] The population density test concerned NUTS III regions where the population is less than 12.5 per km^2. It is not clear how this threshold was arrived at, although the population density of the existing assisted areas of the Nordic countries seems to have played a major role in determining the threshold, again reflecting the role of Member States existing policies in influencing the Commission's approach.

In practice, it could be said that the Commission's attempts to improve regional policy relations with the Member States by increasing transparency via the 1988 Communication was an approach that backfired; disclosure of the methodology simply fuelled Member State criticism. The methodology was further undermined by the reform of the Structural Funds which introduced a new Europe-wide typology of assisted areas in 1989, but one which did not always coincide with the national assisted areas. The ensuing dispute between many Member States and DG Regio, on the one hand, and DG Competition on the other, led to a series of compromises, including the effective suspension of DG Competition's regular reviews of the national assisted area maps until the start of 1994.[23] The mid-1990s, however, saw the Commission retreat from the 1988 methodology; in 1993 it announced that:

> "In order to correct imbalances in the current method, the Commission asked the Services to propose a simplified method in order to provide the Member States with greater room for manoeuvre in designating the assisted areas within a global percentage of the population concerned and at the same time respecting the rules of transparency."[24]

Given the growing criticisms of the 1988 Communication, a mechanism to give the Member States more flexibility, while still restraining overall population coverage,

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

[23] Wishlade, F. (1994) 'Achieving Coherence in Community Approaches to Area Designation', *Regional Studies* 28(1).

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

had some attractions. Moreover, there was a precedent for this approach in the 1991 negotiations between the German authorities and the Commission.[25]

During the course of 1993-4, DG Competition developed an internal (unpublished) methodology for setting population ceilings. The population ceilings resulting from these calculations were generally communicated individually to Member States as and when reviews of national assisted area maps were undertaken; however, the 'global' Article 87(3)(c) ceiling was not made public, nor was the list of country ceilings that DG Competition had arrived at. Moreover, it is clear that the ceilings initially proposed by DG Competition were themselves the subject of negotiations with the Member States and were often revised as a result before the final map was agreed. This experience with the 'population coverage' method laid the foundations for the new guidelines on regional aid described in Section 2 above. As far as the application of Article 87(3)(c) to regional aid is concerned, the 1998 Guidelines involve a significant policy shift in relation to the 1988 Communication.

Under the 1998 Guidelines, population coverage takes on a pre-eminent role in regional aid discipline. The starting point is the Commission view that, across the Community, spatial coverage should amount to less than half of the population. Article 87(3)(a) areas were designated broadly on the same basis as before; however, Article 87(3)(c) coverage was determined first by "sharing out" the potential Article 87(3)(c) coverage between the Member States; and second, by making national area designation methodologies subject to stringent conditions. A special derogation concerning coincidence between national and Structural Fund assisted areas sought to resolve the "coherence" issue without allowing EU regional policy to undermine regional aid discipline.

[25] Yuill, D. *et al* (1992) *European Regional Incentives 1992-3*, 12th edition, Bowker-Saur, London.

Figure 5: Trends in Assisted Area Coverage (% of national population)

	1980	1985	1990	1995	1999	2000-6
Belgium	39.5	33.1	33.1	35.0	35.0	30.9
Denmark	27.0	24.0	20.7	19.9	20.2	17.1
France	38.2	39.0	41.9	40.9	42.4	36.7
Germany	36.0	28.4	42.5*	38.5*	37.6	34.9
Ireland	100.0	100.0	100.0	100.0	100.0	100.0
Italy	34.2	35.6	35.6	48.8	48.9	43.6
Luxembourg	100.0	100.0	100.0	79.9	42.7	32.0
Netherlands	27.4	25+	19.9	15.6	17.3	15.0
UK	45.4	37.8	37.8	36.8	38.1	28.7
Greece	65.0	100.0	100.0	100.0	100.0	100.0
Portugal	100.0	100.0	100.0	100.0	100.0	100.0
Spain	52.0	41.0	58.6	58.6	75.9	79.2
Austria				35.2	35.2	27.5
Finland				41.6	41.6	42.2
Sweden				18.5	18.5	15.9

Note: * By this time, Germany was reunified; in 1991 coverage in the west amounted to 27 percent of the west German population, falling to 22 percent in 1995.
Sources: Yuill D *et al* (eds). European Regional Incentives, various editions; unpublished European Commission memorandum of November 1997; *National ceilings for regional aid coverage under the derogations provided for in Article 92(3)(a) and (c) for the period 2000-2006,* OJEC No. C 16; 21.1.1999.

Commission reviews and revisions of national assisted areas maps have tended to be the mainstay of its policy for controlling regional aids. As Figure 5 shows, the pattern of Commission impact on national regional policies has varied widely. As might be expected, given the evolution of policy outlined above, Commission requirements with respect to spatial coverage have had much more impact on the wealthier northern Member States, where coverage was anyway lower than on the less prosperous Member States – Greece, Portugal and Spain.

The Commission's record in disciplining the coverage of regional aids is marked by a growing formalisation of approach and the search for an appropriate balance between discretion, transparency and discipline. Significantly, Commission pressure on general systems of aid[26] has meant that regional aid schemes have progressively become the only source of general investment aid to large firms. Moreover, the regional aid map for each Member State has taken on a pre-eminent role in determining rates of award for other forms of aid – notably support for SMEs and R&D. The Commission's role and approach to disciplining coverage has also changed radically over time. In its early rather opaque and prescriptive phase, the Commission "chipped away" at the coverage of many assisted areas maps, without disclosing the basis for its assessment. An attempt to improve transparency by revealing in 1988 the socio-economic analysis it had been using provoked considerable criticism. This and

[26] Those not restricted to designated assisted areas or to small and medium-sized firms.

the controversy surrounding area designation for the Structural Funds resulted in the emergence of a superficially more flexible method based more on the Member States' appraisal of the regional problem, but with population coverage playing a pre-eminent role in imposing discipline. It remains to be seen whether exposure of this method in the 1998 Guidelines will lead to their demise, as it arguably did with the 1988 Communication.

3.2 Transparency

The Commission's approach to aid transparency has proved to be remarkably resilient. The 1971 principles considered that transparency of aid "constitutes an essential condition for the coordination and assessment of systems of aid." For the purposes of the principles of coordination, aid was considered to be transparent or measurable when the "common method of assessment" could be applied to it. This method involves a number of conventions and assumptions in order to express the amount of aid as a proportion of investment. In particular, a certain composition of fixed asset investment is assumed. In addition, the method aims to compare the after tax values of aid, which involves assuming that aid recipients are profitable.

These conventions gave rise to the notion of "net grant-equivalent". From the 1970s onwards, aid ceilings have, in principle, been set in net grant-equivalent (nge) terms; in practice, however, the Commission has often set ceilings in gross terms,[27] which has rather undermined the stated purpose of the method. Perhaps surprisingly, the 1998 Guidelines retained the nge concept as the basis for calculating award values; this could have been seen as an opportunity to dispense with what is a rather arcane and theoretical construct. Confusingly, however, the subsequent Regulation on aid to SMEs[28] sets SME aid levels in gross terms, but subject to net ceilings in the assisted areas.

More fundamentally, the requirement for transparency has underpinned the Commission's attitude to *forms* of aid. The 1971 principles considered that using the common method of assessment enabled aid to be classified as being transparent, semi-transparent or opaque. These concepts were not carried through into later iterations of the regional aid rules, but rather found their expression in Commission opposition to so-called "operating aid" – ie. that not conditional upon initial investment. The view of the Commission is that such aid merely reduces the running costs of recipient firms, enabling them to survive without making the necessary "structural" adjustments. In the 1979 principles[29] the Commission undertook to specify within three years the circumstances in which it might consider operating aid to be compatible with the common market. In fact, it did not do so until the 1988 Communication, which allowed operating aid to be approved in the Article 87(3)(a)

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[27] Wishlade, F. G. and Yuill, D. (1997) 'Regional Incentive Policies in the European Union: Rates of Award and Award Values', *Regional and Industrial Research Paper Series*, 23, European Policies Research Centre, University of Strathclyde, Glasgow.

[28] OJEC L 10; 13 January 2001.

[29] OJEC C 31; 3 February 1979.

areas, but subject to quite restrictive conditions – these included the requirement that aid must be "limited in time and designed to overcome the structural handicaps of enterprises located in Article 92(3)(a) regions."

EU enlargement to include Finland and Sweden proved testing for Commission opposition to operating aid; it was clear that the nature and scale of the regional problem in the northern territories of these countries differed markedly from the existing membership, and that the disadvantage resulting from distance and climate was permanent. This led to an amendment to the 1988 Communication enabling transport-related aid to be allowed in the sparsely-populated regions – as mentioned earlier, the definition of sparsely populated means that these are only found in the Nordic countries.[30] Although this was arguably a major concession on the part of the Commission, adapting to the rules still required major reforms to regional aid policies in the Nordic countries.

The 1998 Guidelines reiterate Commission opposition to operating aid and puts the onus on Member States to prove that such aid is justifiable. A significant innovation under the 1998 Guidelines was the facility to relate aid to job creation linked to an investment project. This was largely motivated by the importance of the expansion of the service sector since the origins of the regional aid rules, a factor which had not been reflected in their evolution. The provisions of the Guidelines restrict such aid to a percentage of the additional wage costs associated with net jobs created and calculated over a period of two years; the percentage applicable is the same as the aid intensity applied to eligible investment in the region concerned.

The Commission's attachment to the need for transparency has had a significant impact on the forms of aid operated in the Member States. In the context of successive enlargements a variety of measures have come under Commission scrutiny and progressively been brought into line. This has tended to reinforce the dominance of capital grants in the regional aid packages of the Member States. On the other hand, the Commission has found it difficult to deal with some "newer" types of instruments – notably support for venture capital and transactions involving partnership between the public and private sectors – while its approach to the relationship between State aid and taxation contains serious anomalies that remain unresolved.

3.3 Aid Intensity

Until the 1998 Guidelines, aid intensity was arguably the least controversial of the principles underpinning regional aid control. The 1971 principles set a ceiling of 20 percent net grant-equivalent in the so-called central regions,[31] while specifying that this was not an invitation to raise award levels and that aid was not justified in all areas. Reflecting the tendency to base policy on precedent, the 1975 principles set the ceiling in Ireland, Northern Ireland and the *Mezzogiorno* (the worst-off group in the

[30] OJEC C 364; 20 December 1994.

[31] As noted earlier, the early regional aid rules were based on a core-periphery approach and did not apply to the peripheral regions – Berlin and the Zonal Border Area, the *Mezzogiorno*, and areas eligible for the French *prime de développement industriel.*

then current membership) as “the maximum attainable by measurable aid”. In the French, UK, Italian and Danish assisted areas maximum rates were 25 or 30 percent net grant-equivalent, with 20 percent applying elsewhere.

The 1979 principles introduced alternative aid ceilings expressed in cost per job terms; these are set out in Figure 6. Cost-per-job ceilings were introduced in response to the employment situation in the 1970s which gave rise to pressures for an alternative denominator - aid per job created by the initial investment - to be used in the calculation of aid values. The award ceiling for the most disadvantaged areas was explicitly set at a net grant-equivalent of 75 percent, this being the prevailing maximum under Italian regional policy for the *Mezzogiorno*.

Figure 6: Maximum aid intensities under the 1979 principles

Region	**Maximum capital intensity**	**Aid per job ceilings**
Ireland, *Mezzogiorno*, Northern Ireland, West Berlin	75 per cent nge	ECU 13,000
French and Italian designated areas; UK assisted areas	30 per cent nge	ECU 5,500, subject to overall maximum of 40 per cent nge
Zonenrandgebiet; Danish Special Development Area and islands	25 per cent nge	ECU 4,500, subject to overall maximum of 30 per cent nge
Group 5: other regions	20 per cent nge	ECU 3,500, subject to overall maximum of 25 per cent nge

There was no explicit change to Commission policy on award levels for almost 20 years – the 1988 Communication stressed the need for aid intensities to be adjusted in line with the severity of the regional problem, but gave no indication of how this would be done. Appended to the Communication was a listing of regions and the corresponding award maxima; somewhat surprisingly given the emphasis on the common method of assessment and the need for comparability, this noted that:

> “unless otherwise indicated aid intensity ceilings are given in gross terms in France, Germany, Luxembourg and the Netherlands and in net terms in Belgium, Denmark, Italy, Spain and the United Kingdom.”

Also surprising, the 1988 Communication did not adjust the cost-per-job ceilings. In the mid to late 1990s, the Commission began to reduce the rates of award it would authorise – particularly in the Article 87(3)(a) regions. There was little resistance from the countries concerned to the lowering of aid levels; indeed, Portugal and Spain, in particular, were vocal in their criticism of the policy on aid ceilings, arguing that the differences in authorised aid levels between the more and less prosperous Member States was merely of theoretical interest – actual differences in award values were much less simply because the poor Member States could not afford to offer the higher levels allowed.

The 1998 Guidelines sought both to lower rates of award and make the relationship between prosperity and award values more direct. "Standard" award maxima in the Article 87(3)(a) and (c) areas were reduced from 75 percent net grant-equivalent to 50 percent and from 30 percent to 20 percent; as before, however, these are ceilings and actual award maxima have frequently been set at lower levels. Rather more controversial has been the introduction of a 10 percent ceiling for designated areas where unemployment is below the EU average and GDP per head is above the EU average.

The consequence of the 1998 Guidelines is that maximum aid intensities are being brought down to levels where they may begin to bite. This is particularly so in the Article 87(3)(c) regions where the 10 percent ceiling applies, and also in the context of the Large Investment Projects framework (LIPS) discussed later. At these levels, it can be argued, windfall gains are more likely since aid levels are less likely to be taken into account in investment location decisions.

3.4 Sectoral Repercussions

Concerns at the sectoral repercussions of regional aid have been addressed in two main ways. First, the early principles contained a requirement that Member States were to produce sectorally-disaggregated information on regional aid awards. Second, the Commission has introduced special rules for certain sectors – notably synthetic fibres and motor vehicles; however, the introduction of these codes has primarily been motivated by sectoral rather than regional development considerations.

Approval of regional investment aid schemes is subject to the proviso that special rules apply to awards to firms in specific sectors. The common themes of these frameworks are that the sectors concerned are considered to be in "overcapacity" and that all or specified awards must be notified individually for consideration by the European Commission. Beyond this, however, the frameworks diverge considerably. The Motor Vehicle Framework,[32] for example, requires only aid to investments exceeding €50 million or aid exceeding €5 million to be notified. In contrast, the Synthetic Fibres Code[33] makes no reference to size of project or level of award.

The sectoral rules also diverge considerably in substance and in the discretion afforded to the Commission. The Motor Vehicle Framework provides the basis for the Commission to evaluate the regional development benefits of aid against its possible adverse effects on the sector as a whole. The approach taken by the Commission involves undertaking a cost-benefit analysis with a view to identifying, and compensating for, the cost disadvantages of a problem region location.[34] In contrast, the Synthetic Fibres Code states that the "fundamental consideration is the effect of that aid on the markets for the relevant products"; in short, there is no explicit

[32] *Community Framework on State Aid to the Motor Vehicle Industry,* OJEC No. C 279; 15 September 1997.

[33] *Code on Aid to the Synthetic Fibres Industry,* OJEC No. C 94, 30 March 1996.

[34] Of course, problem region locations are not necessarily more costly.

provision for balancing potential regional benefits against possible sectoral consequences.

In addition to the widely divergent nature of the frameworks themselves, there is also the issue of the sectors covered by the frameworks. There are two aspects to this question: on the one hand, is a sectoral approach appropriate at all? If so, are the sectors affected by frameworks appropriate? In other words, should more or fewer sectors be covered by specific guidelines? These issues have become of increasing importance as various sectors lobby for codes to be introduced to discipline subsidies for particular industries. As well as a desire to avoid a proliferation of sectoral codes, such issues tended to reinforce moves towards a sectorally-neutral approach covering all large investment projects.

As a result of these considerations, and others, a new dimension to controlling the sectoral repercussions of regional aid was first mooted in the early 1990s; this culminated in the adoption of a so-called multi-sectoral framework on regional aid for large investment projects.[35] This was set to apply for an initial period of three years from September 1998, but has since been extended to 31 December 2001 pending Commission consultations with the Member States over whether the framework should be renewed, revised or abolished.[36] The LIPS framework requires the prior notification of proposed awards where either project costs exceed €50 million and the aid level proposed is more than 50 percent of the authorised ceiling or €40,000 per job *or* total aid is more than €50 million. Although horizontal in approach, the framework seeks to address the sectoral repercussions of regional aid to large projects with reference to "structural overcapacity" in the sector concerned, whether the project takes place in a declining market and whether it will result in an increase in capacity.

It remains to be seen what impact the LIPS framework actually has: certainly, evidence from the Member States suggests that policymakers are keen to avoid notification, resulting in award levels marginally under the notification thresholds; it could be argued that, if this is the case, the Commission's objective of reducing aid levels is achieved quite efficiently – ie. without the notification and review process. However, some policymakers argued that negotiations prior to adoption of the framework resulted in thresholds above a level at which they would have significant impact.

4. THE FUTURE OF THE 1998 GUIDELINES

Looking forward, a key question is to what extent, if at all, can the Regional Aid Guidelines simply be "rolled forward" after 2006? The starting point for any such discussion is an analysis of the data used as the basis for the methodology. However, there are two further major considerations. The first is the extent to which the "adjustments" which emerged from the multilateral negotiations of the 1998 Guidelines are at all valid or would have to be renegotiated; the second concerns the impact of enlargement. In addition, and more difficult to assess, is whether the

[35] OJEC 107; 7 April 1998.

[36] OJEC C 226; 11 August 2001.

Commission would have the cooperation of the Member States in securing renewal of the Guidelines. A further unknown is the outcome of the German challenge of the Commission's Decision based on the Guidelines which is pending before the European Court of Justice.

The discussion which follows is based around three possible scenarios for determining assisted area coverage in the future. All three take as their starting point the methodology described in the 1998 Guidelines and use the latest data available.[37]

4.1 Scenario 1: Status Quo

Scenario 1 simply shows the impact of using the most recent data (1996-8 for GDP; and 1997-9 for unemployment rates) and reapplying the methodology as if maps were to be redrawn now.

This scenario assumes that target coverage of 42.7 percent for EU15 is retained; in fact, this appears not to have been met in the 1999-2000 negotiation, although the Commission claims that it has been met in its annual report.[38] As discussed earlier, it would appear that actual coverage in the current period amounts to just over 43 percent of the EU population. The outcome of the negotiations between the Commission and the UK authorities was that UK assisted area coverage was 28.7 percent of the population of Great Britain (*not the UK*), PLUS Northern Ireland. This means that UK coverage rises to 30.7 percent of the population, rather than the original 28.7 percent.

Scenario 1 also assumes that Article 87(3)(a) concerns NUTS II regions with GDP(PPS) per head of less than 75 percent of the EU15 average. Similarly, the indices for calculating the Article 87(3)(c) "quotas" have been based on the same methodology (insofar as this is transparent) as in the 1988 Guidelines. Last, the same "adjustments" to the initial quotas of Article 87(3)(c) coverage have been applied.

4.1.1 Article 87(3)(a)

The first stage of the methodology involves an assessment of the NUTS II regions eligible for the Article 87(3)(a) derogation. Annex I shows the ranking of regions by GDP(PPS) for 1994-6, the period used for the current designation of Article 87(3)(a) areas. Annex II updates this ranking on the basis of 1996-8 data. Clearly any calculations for the period post 2006 will use later data, but even in the short time that has elapsed since the implementation of the 1998 Guidelines, there are some significant changes.

The first point to note is that the basis for calculating GDP has changed. From 1999, for data from 1995 onwards the ESA95 version of the European System of Accounts has been used, as opposed to the earlier ESA79 version. The change from ESA79 to

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[37] These are 1998 for gross domestic product and 1999 for unemployment.

[38] European Commission (2001) *Report on Competition Policy – XXXth Report: 2000*, OOPEC, Brussels at point 346.

ESA95 has involved *inter alia* changes to the definition of final household consumption, a widening of the definition of investment to include intangibles such as software and more attention being given to financial transactions and services and the income derived from them. These changes have had relatively little impact on *national* GDP (resulting in a slight increase in all countries) since the effects of the changes tended to offset one another when aggregated; however, at the *regional* level, reflecting the differences in the composition of GDP at the subnational level, the impact is more dramatic. There is limited overlap in the data available;[39] however, a comparison of the 1996 figures in Annex I (based on ESA79) and Annex II (based on ESA95) reveals some significant differences in the positions of regions in relation to the European average. At one end of the spectrum, 1996 GDP(PPS) per head in Central Greece (Sterea Ellada) rises from 65 percent of the European average under ESA79 to 85 percent under ESA95; there are also marked apparent increases in prosperity in the east German regions. Conversely, around half the regions of the EU show an apparent, but less marked, *decrease* in prosperity as a consequence of ESA95 – at its most extreme, in the German region of Kassel 1996 GDP(PPS) per head falls from 116 percent to 101 percent of the European average.

Second, partly as a consequence of the change from ESA79 to ESA95, but also as a result of changes in relative levels of prosperity in the last two years for which data are available, Annex II suggests that, if designation of Article 87(3)(a) areas were taking place now, coverage would already be different from current coverage (see Annex I). Only one region – Cantabria (Spain) – not currently covered would be eligible on the basis of the new data; in contrast, eight regions would lose Article 87(3)(a) status: Border, Midlands and West (Ireland); Canarias and Valencia (Spain); Halle, Dresden and Leipzig (Germany); and the Northern Aegean (Greece). In other words, for the first time, part of Greece, parts of the new *Länder* and all of Ireland would cease to have Article 87(3)(a) status. As a result of these changes, Article 87(3)(a) coverage would fall from around 21.9 percent of the EU population to around 18.6 percent.

4.1.2 Article 87(3)(c)

The process for setting the Article 87(3)(c) population ceilings under Scenario 1 is illustrated in Annex III. Assuming that the target for coverage remains the same at 42.7 percent, the designation of 18.6 percent of the EU population as Article 87(3)(a) leaves 24.1 percent of the population to be distributed as the quota for Article 87(3)(c). In other words, this increases the scope for Article 87(3)(c) areas within the overall total. As described earlier, the first stage of the process for determining Article 87(3)(c) coverage involves assessing internal disparities in GDP per head and unemployment rates in the Member States. The basic principle is that only NUTS III regions which have either GDP per head of less than 85 percent of the national average or unemployment rates of more than 115 percent of the national average are taken into account in determining the national share of the Article 87(3)(c) quota. These basic thresholds (ie. the 15 disparities in unemployment or GDP per head) against which the NUTS III regions are measured are adjusted to take account of the

[39] REGIO contains only two years – 1995 and 1996 - where the data overlap.

national situation in relation to the EU 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 given region in order for it to count towards the national Article 87(3)(c) quota. The thresholds that would apply using the latest data are set out in Figure 7, alongside the corresponding figures for calculating coverage for 2000-6.

Figure 7: Current and "New" Thresholds as Distribution Keys for the Article 87(3)(c) Population Quota

	Current Thresholds (EU15=100)		"New" Thresholds (EU15=100)	
	GDP(94-9)	Unemp (95-7)	GDP (96-8)	Unemp (97-9)
Austria	81	150	81	150
Belgium	80	124	81	121
Denmark	79	148	78	150
Finland	85	115	85	115
France	83	115	85	115
Germany	81	127	82	118
Greece	85	123	85	115
Ireland	87	115	84	131
Italy	84	115	84	115
Luxembourg	67	150	67	150
Netherlands	83	150	81	150
Portugal	85	144	85	150
Spain	85	115	85	115
Sweden	85	122	84	122
UK	85	135	85	147

Source: Own calculations from REGIO data.

In Annex III, the initial Article 87(3)(c) quota corresponds to each Member State's share of the population of the NUTS III regions which meet one or other of the thresholds. A number of key points emerge from this first stage of the process. First, unemployment rates have a major impact on the initial outcome. This is reflected in the high coverage of countries with high unemployment rates – notably France, Finland and Spain. These countries emerge with initial Article 87(3)(c) coverage of 44.8 percent, 38.1 percent and 37 percent respectively. Second, two countries (Denmark and Luxembourg) have no Article 87(3)(c) quota at all and in a further two (the Netherlands and Sweden) coverage is negligible at under 3 percent of the national population. As Annex III shows, the adjustments outlined in the Guidelines are then applied to these initial quotas.

Under the first adjustment, minimum and maximum coverage limits are applied; these ensure that each country has Article 87(3)(c) of at least 15 percent and at most 50 percent of the population not included in Article 87(3)(a). The 15 percent "floor" applies to Denmark, Luxembourg, the Netherlands and Sweden; the 50 percent ceiling applies to Spain (and theoretically to Greece, although this is superseded by the second adjustment).

The second adjustment enables regions losing Article 87(3)(a) status to be covered by Article 87(3)(c). This leads to an increase in the Article 87(3)(c) coverage in Greece

and Ireland. In Greece, this means that the one region losing Article 87(3)(a) status is covered by Article 87(3)(c); in Ireland, Article 87(3)(c) coverage is increased from 21.1 percent to 26.6 percent of the population to cover the Article 87(3)(a) population in the current period – all of which ceases to qualify for the derogation.

The third adjustment involves applying a "safety net" such that no country loses more than 25 percent of its current coverage. This also applies to Ireland where Article 87(3)(c) coverage is increased by 48.4 percentage points to take the total to 75 percent of the population; in Luxembourg a 9 percentage point increase is applied.

In the fourth adjustment, Article 87(3)(c) coverage in those countries not affected by the first three adjustments is reduced proportionately in order to meet target coverage. Eight countries are concerned by the fourth adjustment: Belgium, Germany, France, Italy, Austria, Portugal, Finland and the UK. However, the reduction required across the EU is quite small (0.7 percent of the EU population) so that the cutbacks required at this stage are quite modest – the largest reduction is in France (1.4 percentage points).

In terms of overall outcomes from Scenario 1, there are a number of key point. First, as already noted, the relative shares of Article 87(3)(a) and (c) regions in the overall total changes, with Article 87(3)(c) accounting for a bigger share of the total and covering significantly more of the population than previously.

Second, the weight of unemployment rates within the Article 87(3)(c) calculation means that countries with high rates of unemployment see increased population coverage under Scenario 1. this is most obviously the case for France and Finland which see increases of 9.4 and 8.1 percentage points respectively.

Third, the expiry of transitional provisions for ex-Article 87(3)(a) regions has a dramatic impact on coverage in Ireland and Portugal. Significant parts of these countries lost Article 87(3)(a) status at the end of 1999, but under the second adjustment were covered under Article 87(3)(c) on a transitional basis. Scenario 1 assumes that no further transitional measures applied to these regions. As a result, Ireland and Portugal see the largest reductions in assisted area coverage – 25 and 21.8 percentage points respectively.

Fourth, Austria, Luxembourg and Spain also see significant absolute reductions (over 6 percent of the national population); in Austria and Luxembourg, the changes are significant in relative terms too, involving reductions of over 23 percent in relation to current coverage.

Even a simple updating of the data two years on suggests that the current methodology cannot simply be rolled forward. First, the weight of unemployment must be a matter of concern, especially given widespread doubts about the international comparability of the data. Second, the absence of a "no increase" rule (or at least a cap on increases) means that, largely on the basis of unemployment data, two countries – Finland and France - see significant increases in coverage, which must be "paid for" through reduction in coverage elsewhere. Third, the effective expiry of the adjustments for Article 87(3)(a) areas means that coverage falls substantially in Ireland and Portugal. In short, while it is possible that the starting

point for applying the methodology could hold, it seems unlikely that the same "side conditions" could be acceptable.

4.2 Scenario 2: Two-Speed Europe

In Scenario 2, account is taken of the possibility of enlargement to include 10 Central and Eastern European countries (CEEC10). Scenario 2 retains the Commission principle that assisted areas should cover less than 50 percent of the population (in this case, the EU25 population). On the basis that all of the CEEC10 would qualify for Article 87(3)(a) (or (3)(c)) in their entirety, the overall ceiling for EU15 is reduced from 42.7 percent to 36.1 percent. Importantly, in this scenario, EU15 data continues to be used: accordingly, Article 87(3)(a) is defined as NUTS II regions with GDP(PPS) per head for 1996-8 of less than 75 percent of the EU15 average; similarly, the indices for calculating the Article 87(3)(c) "quotas" have been based on the most recent EU15 data – see Figure 7.

The outcome of applying Scenario 2 is shown in Annex IV. As would be expected, coverage of Article 87(3)(a) in this scenario is the same as in Scenario 1 and amounts to 18.6 percent. However, the overall reduction in coverage from 42.7 percent to 36.1 percent of the EU15 population means that Article 87(3)(c) coverage is squeezed. This falls from 24.1 percent (in Scenario 1) to 17.5 percent in Scenario 2 – substantially less than current Article 87(3)(c) coverage of 21.1 percent.

Under the first adjustment, the 15 percent minimum Article 87(3)(c) coverage applies to six countries: Denmark, Italy, Luxembourg, the Netherlands, Austria and Sweden. The maximum coverage rule (50 percent of the areas not by Article 87(3)(a)) does not bite for any country.

The second adjustment results in an increase in Article 87(3)(c) coverage in two countries - Greece and Ireland - in order to ensure that ex-Article 87(3)(a) areas are covered by the Article 87(3)(c) derogation.

The 25 percent safety net provided for in the third adjustment applies to four countries – Belgium, Ireland, Luxembourg and Austria.

These three adjustments result in an increase in Article 87(3)(c) coverage from the initial 17.5 percent to 19.7 percent. The fourth adjustment involves reducing the Article 87(3)(c) coverage of the Member States not affected by the first three adjustments in order to achieve the initial coverage target. Six countries – Germany, Spain, France, Portugal, Finland and the UK - have to take a reduction to this end. In the case of Portugal, the 25 percent safety net bites so that a further iteration of this adjustment is needed to meet the initial target.

The overall picture that emerges is similar to that in Scenario 1; however, no country increases coverage and the reductions required are generally much more severe (reflecting the lower overall ceiling for EU15). As in Scenario 1, coverage in Greece and the Netherlands remains unchanged compared to the current situation. In Greece the entire territory is either covered by Article 87(3)(a) or by Article 87(3)(c) on the basis of the second adjustment. In the Netherlands, as in the current period, the 15 percent floor applies. In Scenario 1 only Ireland and Luxembourg suffered the maximum cutback of 25 percent provided for in the Guidelines. In Scenario 2,

Belgium, Austria and Portugal also experience the maximum cutback; in Germany and the UK, cutbacks are only just short of the maximum.

4.3 Scenario 3: Enlargement

In Scenario 3, the impact of enlargement is integrated more fully into the application of the Guidelines. For both GDP(PPS) per head[40] and unemployment rates, EU25 rather than EU15 data are used; this is the key difference between Scenarios 2 and 3.

As in Scenario 2, the overall ceiling is assumed to be 50 percent of the EU25 population. Again, in this scenario it is assumed that all of the CEEC10 regions which did not qualify for Article 87(3)(a) would be covered by Article 87(3)(c) – in effect an application of the second adjustment under the 1998 Guidelines, since the entire territories of the CEEC10 are currently covered by the Article 87(3)(a) derogation.[41] Scenario 3 is illustrated in Annex V.

4.3.1 Article 87(3)(a)

The use of EU25 data has a major impact on the application of the Article 87(3)(a) derogation. This is illustrated in Annex VI. This ranks the NUTS II regions of EU25 by GDP(PPS) per head for the years 1996-8. Current Article 87(3)(a) regions are shown in bold. As Annex VI shows, a “re-basing” of the threshold EU25 means, in effect, that the new threshold for Article 87(3)(a) is equivalent to 64.4 percent of the EU15 average. On this basis, only 7.5 percent of the EU15 population would qualify under the Article 87(3)(a) derogation – compared with 21.9 percent at present and 18.6 percent under Scenarios 1 and 2. Most of Greece would continue to be covered by Article 87(3)(a), but elsewhere there would be significant cutbacks – especially in east Germany, Italy and Spain – or Article 87(3)(a) would cease to apply altogether – as in Austria, Finland, Ireland and the UK. Although Article 87(3)(a) coverage within the EU15 would be considerably reduced by the use of EU25 data, in Scenario 3 overall coverage within EU15 would remain at 36.1 percent of the population – as under Scenario 2. In other words, the main impact of using EU25 rather than EU15 data is that it shifts the balance between Article 87(3)(a) and (c) within the EU15.

4.3.2 Article 87(3)(c)

Under Scenario 3, Article 87(3)(c) coverage would be 28.6 percent of the EU15 population (compared with current coverage of 21.1 percent and Scenario 2 coverage of 17.5 percent). Scenario 3 uses the same method to distribute the Article 87(3)(c) population among the Member States as Scenarios 1 and 2 (see 4.1.2); however, the thresholds have been adjusted to take account of GDP(PPS) per capita and

[40] GDP figures for EU25 are not currently provided in REGIO by Eurostat. This figure has therefore been calculated by EPRC for the purposes of this paper and is in no sense official. Accordingly, conclusions reached on the basis of this data should be treated with some caution.

[41] See Wishlade, F. (2001) *Regional Policy Design and Competition Policy Constraints*, paper to Benchmarking Regional Policy in Europe Conference, Forest Hills Hotel, Loch Ard, Scotland, 9-12 September 2001

unemployment rates in the CEEC10. These are shown in Figure 8 which provides the thresholds for EU25, but expressed in terms of EU15 averages.

Figure 8: Article 87(3)(c) Thresholds Adjusted for Enlargement

	GDP (96-8) EU15=100	Unemployment (97-9) EU15=100
Austria	69	150
Belgium	70	119
Denmark	67	150
Finland	73	115
France	73	115
Germany	70	116
Greece	73	115
Ireland	73	131
Italy	72	115
Luxembourg	58	150
Netherlands	70	150
Portugal	73	150
Spain	73	115
Sweden	72	123
United Kingdom	73	150
Bulgaria	73	115
Czech Republic	73	150
Estonia	73	118
Hungary	73	123
Latvia	73	115
Lithuania	73	115
Poland	73	116
Romania	73	150
Slovak Republic	73	115
Slovenia	73	136

Source: Own calculations from REGIO data.

The use of the indices based on EU25 data, coupled with the exclusion of a large number of regions from Article 87(3)(a) (and their potential inclusion in Article 87(3)(c)) means that the initial Article 87(3)(c) quotas are differently distributed under Scenario 3 compared with Scenarios 1 and 2 – the chief beneficiaries being Spain and Italy. Taking Article 87(3)(a) and the initial Article 87(3)(c) coverage together, Belgium, Spain, France and Finland all see significant increases in overall coverage compared to Scenario 2.

As in Scenarios 1 and 2, Denmark and Luxembourg have no initial Article 87(3)(c) quotas and those for the Netherlands and Sweden, together with Ireland are negligible.

Seven countries benefit from the first adjustment to provide each country with Article 87(3)(c) coverage of at least 15 percent of the population not covered by Article 87(3)(a). The ceiling on Article 87(3)(c) coverage of 50 percent of the areas not covered by Article 87(3)(a) bites for Spain and Finland. Somewhat perversely, it also applies to Greece and Portugal, but this is wholly or partially reversed by the second

adjustment which seeks to ensure that ex-Article 87(3)(a) areas are covered by the Article 87(3)(c) derogation. The third adjustment – the 25 percent safety net – also applies to Ireland and Portugal, as well as Austria and Luxembourg.

These successive adjustments take Article 87(3)(c) coverage to 30.3 percent of the EU15 population – above the target of 28.6 percent. As a result, Belgium, Germany, France and Italy see a further reduction in order for the target to be met. A second iteration of this process is required to ensure that German Article 87(3)(c) coverage does not fall below the safety net.

Looking at the overall outcomes, as in Scenarios 1 and 2, coverage in Greece and the Netherlands remains unchanged – Greece benefiting from the transitional provisions for ex-Article 87(3)(a) areas so that coverage remains at 100 percent of the population, and the Netherlands qualifying only for the minimum 15 percent coverage under all three Scenarios. Similarly, in all three Scenarios, Ireland and Luxembourg suffer the maximum cutback of 25 percent. As in Scenario 2, Austria and Portugal also rely on the safety net to limit the erosion of coverage in Scenario 3.

As mentioned earlier, total coverage under Scenarios 2 and 3 is the same; the main difference lies in the proportion of Article 87(3)(a) and (c) areas. The impact on any given country is then determined by the possible loss of Article 87(3)(a) areas set against possible gains from increased Article 87(3)(c) coverage. Again, unemployment plays a significant role in determining the outcome. This is mainly because the EU25 average unemployment rate is not significantly different from the EU15 average; by contrast, GDP(PPS) per head is markedly lower for EU25 than for EU15. In consequence, as Figure 8 shows, the GDP threshold for NUTS III regions to contribute to the Article 87(3)(c) quota is much more rigorous for the existing membership. As a result, the regions which contribute to the quota do so mainly on the basis of their unemployment rates. This is reflected in the modest reduction in coverage for France and the substantial increase for Finland under Scenario 3. Under Scenario 3, Spain and Italy lose substantial parts of Article 87(3)(a) coverage, but this is not wholly compensated for through increased Article 87(3)(c) coverage so that these countries lose significant coverage overall.

4.4 Other Considerations

The scenarios discussed in the sections above are but three of a large number of possible options. A further dimension which would alter the results of all three scenarios is the use of the euro. With 12 Member States now part of the Eurozone, it is likely to become increasingly unsustainable for the gross domestic product of those countries, at least, to be adjusted for purchasing power parities. Presenting NUTS II GDP data in € per head instead of PPS alters the GDP regional rankings significantly, reflecting the different situations of the Member States. As Figure 9 shows, the relative situation of the Member States changes according to which denominator is used; the use of PPS suggests that disparities in GDP per head are much more modest than when calculated in euros.

Figure 9: GDP per head – PPS and € compared (EU15=100)

	GDP (PPS) per head 1996-8 average	GDP (€) per head 1996-8 average
EU15	100.0	100.0
Eurozone11	100.6	100.7
Austria	111.6	118.2
Belgium	111.1	110.2
Denmark	119.4	146.3
Finland	98.9	108.5
France	99.6	107.7
Germany	108.6	119.2
Greece	66.3	51.5
Ireland	102.0	96.1
Italy	102.2	91.8
Luxembourg	173.2	187.5
Netherlands	111.0	111.4
Portugal	73.6	48.8
Spain	80.2	65.7
Sweden	102.1	123.0
United Kingdom	100.9	97.6

Source: Calculated from Regio
Note: Greece is not included in the eurozone figures.

These differences impact directly on the GDP per head rankings of NUTS II regions – see Annex VII. Applying the 75 percent threshold to these figures would produce broadly the same coverage as at present – around 21 percent of the EU population - but less than the corresponding PPS rankings for the same period (see Annex II), where the resulting coverage would be under 19 percent. However, the shift resulting from the use of € rather than PPS would increase Article 87(3)(a) coverage in Portugal, Spain and the UK but decrease coverage in Germany and Finland.

A further variation for all three possible Article 87(3)(a) rankings (see Annexes II, VI and VII) could involve limiting Article 87(3)(a) coverage to a set proportion of the EU population. The rationale for this would be that Article 87(3)(a) status would be reserved for the "worst-off" 20 percent or so of the EU15 or EU25 population. However, in an enlarged Europe, using the same coverage as at present (about 21 percent) would concentrate Article 87(3)(a) areas even more heavily in the candidate countries[42] and exclude the poorer regions of the existing membership from automatic eligibility for the derogation. Moreover, there is no obvious rationale for a particular population "cut-off", with the consequence that the Commission would be subject to intense pressure from countries with regions just above the chosen threshold. In addition, the question of overall coverage would remain, with the more prosperous members of the EU15 bearing the brunt of attempts to maintain overall discipline on the spatial coverage of national regional policies.

[42] Although two further Czech regions as well as Slovenia, Central Hungary, Bratislava and Prague – see Annex VI – would, in theory, lose Article 87(3)(a) status.

5. CONCLUSIONS: ISSUES AND OPTIONS IN REGIONAL AID CONTROL

This paper has sought to set the current approach to disciplining regional aid in a wider historical context – looking both backwards to the origins of policy and forwards to consider the impact of the current regional aid Guidelines in the future. A clear trend over the last three decades has been the Commission's attempt increasingly to formalise the control of regional aids. This is evident in the scheduling of reviews and approvals under the 1998 Guidelines, the introduction of population ceilings on assisted area coverage, the imposition of a framework on area designation methodologies and a more explicit link between award values and the severity of the regional problem. It is also apparent in the interlinking of the Regulations and Communications for different aid areas, resulting in the emergence of a complex matrix that determines the permissibility of aid by sector, firm size and location, as well as the forms and value of aid that is permitted. A key question is whether the future of regional aid control must follow this trend, and if not, what the alternatives are. This final section highlights some discussion issues that flow from this question.

(i) Major obstacles to a simple rolling forward of the Regional Aid Guidelines are the manner in which the Guidelines were imposed and the climate in which the 1999-2000 negotiations were conducted.

In some respects it is surprising how readily Member States agreed to the Guidelines in 1998. For most countries the rules imposed not only cutbacks in assisted area coverage but also area designation methodologies which were quite at odds with existing national traditions. It seems probable that countries expected a wider margin for negotiation at the notification stage; in practice, it appears that the Commission adopted an inflexible stance on aspects of the Guidelines which national policymakers expected would be negotiable or which were not specified clearly in the Guidelines.

There is clear evidence that, at the map negotiation stage, aspects of the Guidelines were simply not enforced for pragmatic reasons and that the Commission was not consistent in its application of the rules. The lack of clarity in the Guidelines tended to be exploited by the Commission to the disadvantage of the Member States. Moreover, the essentially bilateral nature of the map negotiations engendered an atmosphere of suspicion and a perception that Member States were not treated equally. As already mentioned, for many countries, it is possible to identify aspects of the map and scheme approvals that sit uneasily with a straight reading of the Guidelines. In short, the Commission managed a divide and rule strategy that offered some countries concessions, but avoided creating precedents.

Looking forward, it seems unlikely that the Commission will succeed in this strategy twice. In reviewing the Guidelines, the Commission must consult with the Member States and national policymakers will be much less ready to accept provisions without knowing how they will be applied in practice.

(ii) The current methodology relies on unconvincing statistical calculations coupled with "adjustments" that seem unlikely to be sustainable.

Even if the Member States were to accept the principle of renewal of the Guidelines after 2006, there must be some concerns about the statistical basis for the calculations.

First, as noted, it seems difficult to justify the continued use of national purchasing power standards in the context of monetary union. Second, as all the scenarios show, unemployment rates have a significant impact on the allocation of Article 87(3)(c) quotas; not only is the international comparability of unemployment rates rather doubtful, but the figures are also volatile. Third, it is worth recalling that the data on which the scenarios are based use GDP figures for 1996-8 and unemployment rates for 1997-9. In other words, the latest data currently available do not even extend into the 2000-6 period, and yet they already show different outcomes from those used to determine coverage for 2000 onwards. These factors, not to mention the enduring arbitrariness of the NUTS breakdowns and their limited relevance for measuring unemployment rates and GDP per head, must cast serious doubt on the legitimacy of the method for determining initial population coverage.

Assuming, however, that the Member States were prepared to accept a renewal of the basic method, it seems unlikely that the same "side conditions" could be reapplied. In Scenario 1 – a straight repeat of the current method using new data and rolling forward the adjustments – the absence of a cap on increases in coverage and the expiry of the transitional provisions for ex-Article 87(3)(a) areas results in significant increases in coverage for France and Finland, and significant decreases in Ireland and Portugal. It seems improbable that this would readily be accepted – even by the Commission. As before, negotiation of the population ceiling methodology would certainly be an integral part of any renegotiation of the Guidelines – Scenario 1 suggests that even if the basic method remained intact, the adjustments would have to be renegotiated.

(iii) EU enlargement has implications for the capacity of the existing regional aid rules to deal with both the existing membership and potential new members.

If the Commission retains the principle that less than 50 percent of the EU population should be eligible for the Article 87(3)(a) or (c) derogation, then extensive cutbacks in assisted area coverage in EU15 seem unavoidable in the context of enlargement. Scenarios 2 and 3 consider different approaches to integrating potential new Member States into the application of the regional aid Guidelines; both involve reducing coverage in EU15 to 36 percent of the population. It is worth recalling here that EU15 assisted area coverage at end 1999 was 46.9 percent – the redrawing and renegotiation of all the assisted area maps of the EU15 that consumed the time and energy of so many policymakers sliced less than 4 percentage points from existing coverage. Given the domestic difficulties often involved in achieving even this modest overall reduction, it is difficult to imagine that the existing membership will readily agree to a further 7 percentage point reduction.

The key characteristic of the Article 87(3)(a) derogation is that it takes the EU average as its starting point. Scenario 2 retains the EU15 index as the basis for Article 87(3)(a) designation for both the existing membership and the accession countries. However, this approach has some significant drawbacks. As a matter of principle, it makes little sense not to incorporate the data relating to new Member States into the system in order to generate new indices; it also reinforces the notion of a two-tier system within an enlarged Union – at what stage would EU25 indices be thought appropriate? On a practical level, within the existing membership, such an approach would lead to a sharp reduction in Article 87(3)(c) coverage. The Commission would be forced to choose between limiting coverage to 50 percent of the EU25 population

(reducing coverage among the current membership) or accepting an overall increase in assisted area coverage.

Scenario 3 anticipates that, in the context of accession to the EU of some or all of the 10 CEE candidate countries, the indices would be altered to take account of the new membership (as was the case with the last enlargement to include Austria, Finland and Sweden). The impact of this on the current membership would be a significant reduction in Article 87(3)(a) coverage, but a modest increase in Article 87(3)(c) coverage, even although overall coverage would be the same as in Scenario 2. Germany, Spain and Italy would be more seriously affected by cutbacks under Scenario 3 than Scenario 2, with Finland making a substantial gain.

In short, “technical” decisions on the choice of indices and averages will have major repercussions on the outcomes of applying the 1998 methodology in the context of enlargement.

(iv) The proportionality of Commission action on regional aid is questionable, but Member States too need to make choices about the appropriate balance between transparency and discretion.

This paper has outlined the evolution of regional aid discipline over the decades. A striking feature of the rules is the priority accorded to restricting the spatial coverage of regional aids. From the Commission perspective, spatial coverage has the merit of being measurable, so that its success in imposing discipline can be assessed. However, the link between the spatial coverage of regional policy and the distortion of competition is, at best, not proven.

From the Commission perspective, it may be that arbitrariness in disciplining regional aids is better than no rules at all, but it is worth questioning how serious a threat regional aids are to fair competition: the role and importance of regional aid schemes has altered significantly in recent years; the large-scale automatic regional aid schemes that were commonplace have been abolished and regional aid spending has declined dramatically. Moreover, many countries increasingly view capital support for fixed asset investment as an outmoded form of support. Ironically, the regional aid rules may be reinforcing the use of such instruments: the rules demand the existence of a map and associated award values and prefer the use of direct aid rather than forms that might more accurately address market failures (such as venture capital) or structural disadvantage (such as tax concessions). Moreover, the matrix of maps and associated award values means that the rigidity of the Commission’s approach to regional aid spills over into support for SMEs and assistance from sources other than national authorities. By its nature, it can be argued, support for SMEs is less likely to distort competition than support for large firms.

Over the years, pressure from the Member States has led the Commission to codify its approach to controlling regional aid in increasing detail and to rely less on *ad hoc* decisions based on unpublished rules. The emerging body of rules can best be characterised as an elaborate edifice with no visible theoretical basis. There are serious weaknesses in the Regional Aid Guidelines – they impose quite arbitrary restrictions on assisted area coverage and methodologies and constrain the use of legitimate and innocuous aid measures; however, arbitrariness may be an inevitable consequence of transparency. An approach that seeks genuinely to balance the

negative competition effects of an aid against their positive impact on the problem regions may involve more case-by-case scrutiny of aid than the Commission can resource or the Member States would tolerate.

NOTES TO ANNEXES

1. All calculation are based on the May 2001 edition of REGIO produced by Eurostat.

2. Annex I: figures for the French DOMs and the Irish NUTS II regions are not available in the July 2001 version of REGIO. Figures given for the Irish NUTS II regions in the table have been calculated by EPRC from NUTS III data.

3. Annexes III-V: GDP data for Italy is not available at NUTS III; this almost certainly has an impact on the initial Article 87(3)(c) quotas for Italy for all the Scenarios, but the extent of this cannot be known.

Annex VI: EU25 indices are based on own calculations.