Much ado about nothing?

Recent developments in EU competition policy and regional aid control

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October 2007

European Policy Research Paper

Number 62

Published by:

European Policies Research Centre
University of Strathclyde
40 George Street
Glasgow G1 1QE
United Kingdom

ISBN: 1-871130-68-9

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PREFACE

This paper was originally drafted for EoRPA (European Regional Policy Research Consortium), which is a grouping of national government authorities from countries across Europe. The paper was presented at the October 2006 annual meeting of the consortium. The Consortium provides sponsorship for the EPRC to undertake regular monitoring and comparative analysis of the regional policies of European countries and the inter-relationships with EU Cohesion and Competition policies.

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The research for this paper was undertaken by EPRC in consultation with EoRPA partners. It involved a programme of desk research and fieldwork visits among national and regional authorities in Member States during Spring/Summer 2006.

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

European Policies Research Centre
October 2007

Disclaimer

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

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1. INTRODUCTION

In the last weeks of 2005 the European Commission adopted new Regional Aid Guidelines that will shape national regional policies well into the next decade.[1] The timing of the decision was no accident: a few days earlier, the European Council had agreed EU Cohesion policy eligibility criteria and budget allocations for 2007-13; the Commission decision ensured future coincidence of the priority eligible areas under both policies. The adoption of the new Guidelines was the culmination of several years of intensive and controversial debate against the backdrop of a range of complex (and often conflicting) issues, notably the impact of enlargement, the reform of Cohesion policy, the so-called Lisbon agenda and, latterly, the Commission's 'road map' for the reform of State aid control, the State Aid Action Plan.

For the Member States the new guidelines are not so much an end-point, but a staging post. They mark the start of a new phase of policy design, for the most part within the parameters of ever more stringent rules. The main aim of this paper is to provide an overview and update of the Regional Aid Guidelines and their implementation. The paper is structured follows: Section 2 sets out the main principles of the 2007-2013 Guidelines, highlighting the 'last minute' changes to the Commission draft; Section 3 considers in detail the implications of the area designation criteria contained in the guidelines; Section 4 gives an overview and update of the approaches and progress of the Member States in drawing up new aid maps; Section 5 reviews some wider developments with implications for national regional policies; and last, Section 6 identifies some discussion issues.

2. REGIONAL AID GUIDELINES 2007-13

The final version of the Guidelines[2] was the last of four documents setting out proposals for regional aid control post 2006.[3] The focus of this section is on the Guidelines adopted. However, it is worth recalling that the evolution of the Guidelines followed a decidedly tortuous path.[4] The first two documents proposed radical changes, especially to regional

[1] In parallel, the EFTA Surveillance Authority adopted substantially the same guidelines applying to Iceland, Norway and Lichtenstein.

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

[3] The earlier documents are: (i) *Review of the Regional Aid guidelines – a first consultation paper for experts in the Member States*, undated but issued May 2004, available at http://europa.eu.int/comm/competition/state_aid/regional (accessed March 2006); (ii) Review of the Regional Aid Guidelines – Non-paper from the services of the Commission for discussion at a first Multilateral Meeting with experts from the Member States, undated but issued December 2004, available at http://europa.eu.int/comm/competition/state_aid/regional (accessed March 2006); and (iii) Draft Communication from the Commission: Guidelines on National Regional Aid for 2007-13, available at http://europa.eu.int/comm/competition/state_aid/regional (accessed March 2006).

[4] A discussion of all the earlier documents and a synthesis of Member State positions on these is contained in Wishlade, F (2004) 'The Beginning of the End or Just Another New Chapter? Recent

aid coverage. These proposals essentially restricted aid areas to Article 87(3)(a) (hereafter called the 'a' areas); there was very limited Article 87(3)(c) coverage (referred to as 'c' areas) and these were designated using only Commission criteria. In short, the initial plans would have outlawed traditional regional aid policy in most EU15 countries. In July 2005, following multilateral discussions and intensive lobbying from several Member States, the Commission produced a third proposal, *reversing* the initial tough line in favour of more flexibility; this involved a partial return to the system introduced under the 1998 Guidelines, with both more 'c' area coverage and the scope for Member States to designate their own aid areas. A further multilateral meeting took place, along with more comments from national policymakers, before the Commission adopted an amended version of the Guidelines shortly after the European Council agreement on the 2007-13 Financial Perspective. This timing enabled the same GDP datasets to be used for both Cohesion policy and competition policy, ensuring 'coherence' of Convergence regions with 'a' aid areas and parallel approaches to transitional arrangements under the two policy areas.

The remainder of this section sets out the key principles of the guidelines adopted.

2.1 Spatial coverage

The underlying principle governing spatial coverage in the Regional Aid Guidelines is the "exceptional nature of regional aid" so that the Commission considers that the total population of the assisted regions should be "substantially" less than that of the assisted regions.[5] On this basis, the Guidelines set the initial ceiling at 42 percent of the EU25 population, this being "similar" to the limit set for the EU15 in 1998 (42.7 percent).[6] However, the application of the safety net, which ensures that no Member States would lose more than 50 percent of its current coverage, raises the overall ceiling to 43.1 percent of the EU25 population or 46.6 percent of the EU27 population, assuming accession of Bulgaria and Romania which have 'a' area status in their entirety.[7]

2.1.1 Coverage of 'a' areas

(i) 'Classic' 'a'areas

Article 87(3)(a) of the Treaty provides that "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious

Developments in EU competition policy control of regional aid' *European Policy Research Paper* 54, European Policies Research Centre, University of Strathclyde, Glasgow; and Wishlade, F. (2005) 'Plus ça change, plus c'est la même chose? Recent Developments in EU competition policy control of regional aid' *European Policy Research Paper* 58, European Policies Research Centre, University of Strathclyde, Glasgow.

[5] Paragraph 12.

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

[7] Paragraph 13.

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

Accordingly, the 'a' areas for 2007-13 are defined as NUTS II regions where GDP(PPS) per head is less than 75 percent of the EU25 average for the period 2000-2002.

(ii) Outermost regions

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

(iii) Statistical effect regions

Last, transitional arrangements are made for so-called 'statistical effect' regions. These are regions with GDP above the *EU25* qualifying threshold, but which would have qualified as 'a' areas had it not been for enlargement (equivalent to Phasing-out regions under EU Cohesion policy); the qualifying threshold is 82.2 percent of EU25 GDP(PPS) per head. Significantly, not all of the eligible regions currently have 'a' area status – namely: Hainaut (Belgium); Lüneburg (Germany); and Highlands and Islands (UK). Statistical effect regions will have 'a' area status at least until 31 December 2010.[11] During 2010 the Commission will review the position of the regions concerned on the basis of the most recent GDP data then available. Regions where GDP per head has fallen to below 75 percent of the EU25 average will retain 'a' area status; the remainder will become 'c' areas from 1 January 2011.

(iv) Changes in 'a' area coverage

The impact of enlargement on average EU GDP(PPS) per head nudges some 4.3 percent of the EU15 population out of 'a' area eligibility – this is around 20 percent of current 'a' area

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

[9] Paragraph 16, footnote 19.

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

[11] In the draft Guidelines the end date was 31 December 2009.

coverage (see Figure 1). The principal 'losers' are Greece, Germany and Spain. In Greece over half the population will have statistical effect status, leaving just over one-third with 'classic' 'a' status; this compares with the current situation in which the entire country has 'a' status. In Germany, around a third of the current 'a' areas will have statistical effect status from 2007. In Spain, less than 10 percent of current 'a' areas move to statistical effect status; however, this reflects the higher growth trends of some Spanish regions, which will qualify as economic development regions from 2007 (see also Figure 2).

Overall, the combined effects of enlargement and GDP(PPS) per head increases result in a fall in 'a' area coverage from 21.9 percent to 15 percent in the EU15; in the new Member States, there is also a modest decrease in 'a' coverage, accounted for by the exclusion of the Budapest region from 'a' status as from 2007.

Figure 1: Coverage of 'a' areas 2000/4-6 and 2007-13 (% of population)

	'Classic' 'a' areas 2007-13	Statistical effect 'a' areas 2007-9(+)	'a' areas 2000/2004-6
EU25	27.7	3.6	34.3
EU15	15.0	4.3	21.9
NMS10	92.9		96.7
Belgium		12.4	
Czech Rep	88.6		88.6
Denmark			
Germany	12.5	6.1	17.2
Estonia	100.0		100.0
Greece	36.6	55.5	100.0
Spain	36.2	5.8	58.4
France	2.9		2.8
Ireland			26.6
Italy	29.2	1.0	33.6
Cyprus			
Latvia	100.0		100.0
Lithuania	100.0		100.0
Luxembourg			
Hungary	72.2		100.0
Malta	100.0		100.0
Netherlands			
Austria		3.4	3.5
Poland	100.0		100.0
Portugal	70.1	3.8	66.6
Slovenia	100.0		100.0
Slovakia	88.9		88.9
Finland			13.4
Sweden			
UK	4.0	0.6	8.6

Note: For the new Member States the Commission approved coverage from accession ie. 2004; Outermost regions are included in the 'classic' 'a' area population.
Source: Own calculations; Guidelines on National Regional Aid for 2007-13 and DG Competition at: <http://europa.eu.int/comm/competition/state_aid/regional/2004/>; and Wishlade F., *Regional State Aid and Competition Law in the European Union,* Kluwer Law International, The Hague (2003), Figure 34 at p 205.

As in the 2000-6 period, the EEA countries, Iceland, Norway and Lichtenstein have no 'a' area coverage.

2.1.2 Coverage of 'c' areas

Article 87(3)(c) provides that "aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest" may be compatible with the common market. The European Court has confirmed that this provision is wider than Article 87(3)(a) and that it gives the Commission the authority to allow Member States to offer regional aid in areas that are disadvantaged in relation to the *national* average.

The Guidelines stress that, because the 'c' areas are less disadvantaged than the 'a' areas, their geographical scope and the aid intensity must be strictly limited and only a small part of the national territory may normally qualify for aid.[12] The determination of the coverage of 'c' areas is a two-stage process: first, the Commission sets a population coverage ceiling for each Member State; second, eligible areas are selected by the Member States, subject to approval by the Commission. In addition, there are transitional provisions for some current 'c' areas.

(i) Calculating 'c' area coverage

Overall 'c' coverage for each Member States comprises the following elements:

- *Economic development areas:* each Member States automatically receives a quota equivalent to the population of areas that have 'grown out' of 'a' area status and are beyond even the threshold for statistical effect regions – in other words, regions that would have ceased to qualify as 'a' regions even without the impact of enlargement on EU average GDP per head. Northern Ireland is added to this group, Although it was not an 'a' area in 2000-6, it is considered to have benefited from the same aid intensities as many 'a' areas.[13]

- *Low population density areas*: in broad terms, these are defined as NUTS II areas with fewer than 8 inhabitants per km^2 or NUTS III areas with fewer than 12.5 inhabitants per km^2. This differs from the definition in the July 2005 draft Guidelines, and from the 1998 Guidelines, which only specified the NUTS III definition.

- *A population quota based on internal disparities in GDP per head and unemployment*: the remaining population (ie. 42 percent, less the 'a' areas, the economic development areas and the low population density areas) is distributed between the Member States. The formula for doing so is set out in the Guidelines[14] and follows the approach in the 1998 Guidelines. The principle of the method is to calculate the population of NUTS III regions where either GDP per head is lower

[12] Paragraph 22.

[13] Paragraph 25.

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

than 15 percent of the national average or the unemployment rate is over 15 percent of the national average. However, these thresholds are adjusted to reflect the *national* situation in the EU context, so that, in more prosperous countries, the GDP disparity must be greater in order for a region to count towards the quota and in poorer countries the disparity required is less. The same applies to unemployment rates. This adjustment means that, for example, the GDP threshold for the Netherlands is lowered from 85 percent to 77.2 percent of the national average, whereas the Greek threshold is raised from 85 percent to 99.5 percent of the national average.[15]

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

New provisions for the phasing out of 'c' areas were introduced into the final version of the Guidelines. These enable a proportion of the current 'c' areas to remain eligible until 1 January 2009. Coverage of the transitional 'c' areas together with the 'c' areas based on the quota and safety net provisions (see Figure 2) cannot exceed 66 percent of 'c' coverage as at 31 December 2006 (excluding areas which qualify as statistical effect, economic development and low population density areas from 1 January 2007).[16]

(ii) Changes in 'c' area coverage

The combined effects of enlargement and the effective retention of the existing EU population ceiling squeeze 'c' area coverage, reduce the eligible population by over a third (see Figure 2). All EU15 Member States lose 'c' area coverage (except Finland, but this reflects the 'downgrading of Itä-Suomi from 'a' to 'c', rather than an overall increase). Moreover, these decreases are significant – in many cases (eg. Denmark, France, the Netherlands) around half of current 'c' area coverage will be lost after the transitional period ends. Moreover, in some cases (eg. Spain and Ireland), the loss is far more significant than it appears because most of the quota is made up of former 'a' areas (see also Figure 4 for the full impact of coverage changes).

[15] Examples given in Annex IV. Note also that, in practice, Greece is entirely covered by 'a' areas or economic development areas, which have 'c' status.

[16] Paragraph 95.

Figure 2: EU25 Coverage of 'c' areas 2000/4-6 and 2007-13 (% of population)

	Economic dev	Low pop density	Quota and safety net	Transitional	2007-13 Total	2000/4-6 Total
EU25	3.8	0.5	7.4	3.8	11.8	18.0
EU15	3.8	0.6	8.7	4.2	13.2	21.1
NMS10	3.8	0.0	0.5	1.8	4.3	3.3
Belgium			13.5		13.5	30.9
Czech				7.7		11.4
Denmark			8.6	2.7	8.6	17.1
Germany			11.0		11.0	17.7
Estonia						
Greece	7.7	0.2			7.9	
Spain	16.1	0.6	1.1	12.4	17.7	20.8
France			15.5	6.9	15.5	33.9
Ireland	26.5		23.5	25.0	50.0	73.4
Italy	2.9		1.0	5.6	3.9	10.0
Cyprus			50.0	16.0	50.0	100.0
Latvia						
Lithuania						
Lux			16.0	5.1	16.0	32.0
Hungary	27.8				27.8	
Malta						
Neths			7.5	2.4	7.5	15.0
Austria			19.1		19.1	24.1
Poland						
Portugal			2.8	19.2	2.8	33.4
Slovenia						
Slovakia				7.5		11.1
Finland	4.9	18.8	9.3		33.0	28.9
Sweden	0.0	13.0	2.3		15.3	15.9
UK	7.3		12.0		19.3	22.1

Note: (i) For the new Member States the Commission approved coverage from accession ie. 2004. **(ii)** Transitional 'c' area coverage is not included in the total for 2007-13.
Source: Own calculations; Guidelines on National Regional Aid for 2007-13 and DG Competition at: <http://europa.eu.int/comm/competition/state_aid/regional/2004/>; and Wishlade F., *Regional State Aid and Competition Law in the European Union,* Kluwer Law International, The Hague (2003), Figure 34 at p 205.

In the European Economic Area (EEA) countries,[17] to which a parallel text adopted by the EFTA Surveillance Authority (ESA) applies, overall 'c' area coverage is marginally higher for 2007-13 than for 2000-6. This reflects the fact that the population quotas for Iceland and Norway are wholly based on the population density criterion, which is unaffected by changes in prosperity at the EU level.

[17] In other words, the EFTA Member States, apart from Switzerland.

Figure 3: EEA Coverage of 'c' areas 2000/4-6 and 2007-13 (% of population)

	Economic dev	Low pop density	Quota and safety net	Transitional	2007-13 Total	2000/4-6 Total
EEA3		29.0			29.0	26.1
Iceland		31.6			31.6	33.2
Lichtenstein						
Norway		29.1			29.1	25.8

Source: Own calculations from Eurostat data and *Icelandic areas eligible for regional aid authorised by the EFTA Surveillance Authority*, ESA Press Release PR(01)15; *The EFTA Surveillance Authority adopts new Regional Aid Guidelines for 2007-13,* ESA Press Release PR(06)18; and *EFTA Surveillance Authority Decision of 16 December 1999 on the Map of Assisted Areas and Levels of Aid (Norway)*, Decision No. 327/99/COL.

2.1.3 Implications of coverage changes

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

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

A further eight EU15 Member States will have coverage reduced by between 15 and 25 percent, while the cutback in the Czech and Slovak Republics is around 11 percent. Sweden stands alone with a reduction of just 3.8 percent, reflecting the role of population density, an absolute criterion unaffected by enlargement, in determining Swedish coverage.

The remaining countries will see no change in coverage; all except Greece are new Member States and all have 100 percent coverage in the 2007-13 period.

Overall, it is clear that the Commission has succeeded in retaining considerable discipline over the extent of the assisted areas. Total coverage has fallen by 17.6 percent, which effectively maintains coverage of the Member States at the same level (43 percent) in 2000/4-6 and 2007-13. However, the brunt of the cuts is borne by the EU15 – a reduction of around a quarter – with coverage in the new Member States reduced by less than three percent.

Figure 4: EU25 total coverage 2000/4-6 and 2007-13

	2000/4-6 total (% of population)	2007-13 total (% of population)	Change (% of 2000/4-6 coverage)
EU25	52.3	43.1	-17.6
EU15	43.0	32.5	-24.4
NMS10	100.0	97.2	-2.8
Belgium	30.9	25.9	-16.2
Czech Rep	100.0	88.6	-11.4
Denmark	17.1	8.6	-49.7
Germany	34.9	29.6	-15.2
Estonia	100.0	100.0	0.0
Greece	100.0	100.0	0.0
Spain	79.2	59.6	-24.7
France	36.7	18.4	-49.9
Ireland	100.0	50.0	-50.0
Italy	43.6	34.1	-21.8
Cyprus	100.0	50.0	-50.0
Latvia	100.0	100.0	0.0
Lithuania	100.0	100.0	0.0
Luxembourg	32.0	16.0	-50.0
Hungary	100.0	100.0	0.0
Malta	100.0	100.0	0.0
Netherlands	15.0	7.5	-50.0
Austria	27.6	22.5	-18.5
Poland	100.0	100.0	0.0
Portugal	100.0	76.7	-23.3
Slovenia	100.0	100.0	0.0
Slovakia	100.0	88.9	-11.1
Finland	42.3	33.0	-22.0
Sweden	15.9	15.3	-3.8
UK	30.7	23.9	-22.1

Note: The 'c' area transitional coverage (ie. to end 2008) is not included in this table.
Source: Own calculations; Guidelines on National Regional Aid for 2007-13 and DG Competition at: <http://europa.eu.int/comm/competition/state_aid/regional/2004/>; and Wishlade F., *Regional State Aid and Competition Law in the European Union,* Kluwer Law International, The Hague (2003), Figure 34 at p 205.

As noted already, in the EEA3, total coverage actually increases – by over 11 percent in total. In practice, however, the increase is only in Norway (which accounts for 93 percent of the EEA3 population), where coverage is 12.8 percent higher; in Iceland coverage is reduced by 4.7 percent.

Figure 5: EEA total coverage 2000/4-6 and 2007-13

	2000/4-6 total (% of population)	2007-13 total (% of population)	Change (% of 2000/4-6 coverage)
EEA3	26.1	29.0	11.4
Iceland	33.2	31.6	-4.7
Lichtenstein			~
Norway	25.8	29.1	12.8

Source: Own calculations from Figure 3 and Eurostat data.

2.2 Selection of eligible areas

Area designation is reviewed in more detail in Section 3 below. This section summarises the main designation criteria and identifies the key changes made in the final version of the Guidelines (compared to the July 2005 draft).

The designation of ‘a’ areas (‘classic’, statistical effect and outermost regions) is essentially a given, based entirely on EU criteria.

For the ‘c’ areas, the Guidelines distinguish two types of assisted area that may be designated within the population quotas: those where large firms may be assisted, comprising comparatively large geographical areas principally meeting EU-level criteria;[18] and those where assistance is more tightly focused on localised disparities and is restricted to SMEs.[19] In principle, the list of regions notified is to apply throughout the period 2007-13, but there is provision for a mid-term review in 2010.[20] However, changes should not involve more than 50 percent of ‘c’ area coverage.

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

a. Economic development regions.

b. Low population density regions.

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

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

e. Islands and “other regions categorised by similar geographical isolation” where either GDP per head is less than the EU25 average or unemployment is more than 115 percent of the *national* average. In the July 2005 draft, the “other regions” were not specified, but the final version gives peninsulas and mountain regions as examples of such areas.

f. Islands with fewer than 5,000 inhabitants and other communities with fewer than 5,000 inhabitants characterised by similar geographical isolation. This provision was not in the July 2005 draft Guidelines.

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

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

[19] Paragraph 31.

[20] Paragraph 104; in the draft, the review date was 2009.

EEA or EFTA. The additional specification of a sea border of less than 30km was added in the final version.

h. A significant change introduced in the final version involves the scope to designate areas undergoing restructuring. These must be "contiguous zones" with a minimum population of 50,000 which are undergoing major structural change or are in serious relative decline "compared with other comparable regions".

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

2.3 Aid values

The Guidelines include some important changes to aid values in relation to the 2000-6 period, notably in respect of rates of award, The new provisions on rates of award, eligible expenditure, operating aid and aid to large projects are reviewed in this section; they are substantially unchanged from the proposals made in the draft Guidelines in July 2005.

2.3.1 Rates of award

The Guidelines reduce maximum rates of award significantly in relation to those applicable in 2000-6. This is partly a consequence of the imposition of lower absolute values, and partly a result of the use of gross (GGE) rather than net grant-equivalents (NGE);[21] this means that, in future (as in all other areas of State aid policy), regional aid values will be assessed without regard to national tax arrangements, ie. they will be valued on a pre-tax basis. This followed a Court of First Instance ruling that:

> "[T]he Commission is not empowered, under the State aid monitoring system established by the Treaty, to take into consideration the incidence of tax on the amount of financial aid allocated when it assesses whether it is compatible with the Treaty".[22]

The maximum award rates set out in the Guidelines are summarised in Figure 6.

A general point to note is that the new Guidelines explicitly preclude the cumulation of *de minimis* support with regional aid in order to exceed these ceilings.[23] The *de minimis* aid rules are under review, but the current *de minimis* rule, laid down in Commission Regulation No 69/2001, provides that subsidies of an amount smaller than €100,000 granted to an undertaking over a period of 3 years do not constitute 'State aid' within the meaning of the EC Treaty's ban on aid liable to distort competition (Article 87). Subsidies below that ceiling are presumed to have only negligible effects on competition and trade between Member States. Regulation 69/2001 expires at the end of 2006. The proposal put forward by

[21] Paragraph 41.

[22] Case T-298/97 *Alzetta and Others v European Commission* [2000] ECR II-02319, para 89.

[23] Paragraph 75.

the Commission on 20 September 2006,[24] which is currently under discussion, raises the threshold to €200,000 over three years and retains the notion that aid below this level does not constitute aid. However, it also states that *de minimis* support cannot be cumulated with State aid in respect of the same project, this apparently irrespective of the impact on ceilings.

Figure 6: Rates of award by firm size post 2006 (gross grant equivalents)

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

Notes: a) Until 1 January 2011 when the rate falls as indicated for those areas that move from ‘a’ to ‘c’ status. **b)** This may be raised in the case of areas adjacent to Article 87(3)(a) regions to ensure that the rate differential does not exceed 20 percentage points. **c)** The lower rate applies to eligible areas where GDP(PPS) per head is higher than the EU average and unemployment below the EU average measured at NUTS III. Some further transitional arrangements apply to Article 87(3)(a) and economic development areas where the fall in award rates would otherwise be especially sharp.
Source: Assembled from information in the 2006 Guidelines, paragraphs 44-48.

The combined effects of enlargement on thresholds, changes in levels of economic development and the shift from net to gross grant-equivalents complicates comparisons between the position under the 1998 and 2006 Guidelines. However, some indication of the impact may be gleaned from Figure 7. This shows that in a ‘standard’ ‘a’ area the maximum would fall from 50 percent NGE to 30 percent GGE; in the low population density regions the rate would be *halved* in nominal terms (and would be even lower in real terms owing to the shift from net to gross); and in other ‘c’ areas maximum rates would typically fall from 20 percent net to 15 percent gross.

Figure 7: Maximum rates of award for large firms under the 1998 and 2006 Guidelines

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

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

[24] See http://ec.europa.eu/comm/competition/state_aid/overview/dm_en2.pdf

It is difficult to generalise about the impact of the change from net to gross values, but in broad terms it is likely to involve a reduction of around a quarter (ie. 20 percent GGE is roughly equivalent to 25 percent NGE). This means that the new award maxima are, for the most part, very significantly lower. However, transitional arrangements may be applied where the reduction is more than 15 percentage points net to gross;[25] in these circumstances, an initial reduction of at least 10 percentage points is applied on 1 January 2007 and the remainder on 1 January 2011.

For large projects, it is also important to bear in mind the impact of the Multisectoral Framework on award values; this is discussed in further detail below but will result in even lower maxima being applicable to projects exceeding certain investment thresholds.

2.3.2 Eligible expenditure

The changes to eligible expenditure[26] proposed in the 2006 Guidelines are modest. Land, buildings and plant/machinery all remain eligible – early on in the reform process it had been proposed that land be excluded, but a number of Member States had opposed this. The reference to a standard expenditure breakdown for each Member State between land, buildings and plant/machinery has been dropped – presumably this is no longer required since aid values are calculated in gross terms and the differing depreciation schedules for tax purposes are no longer relevant. Except in the case of SMEs and takeovers, assets must be purchased new;[27] this was not a requirement under the previous guidelines.

For large firms, the limit on intangible assets expenditure (technology transfers, patent acquisition, licences, know-how and unpatented technical knowledge) has been raised from 25 percent to 50 percent of eligible expenditure.[28] The Guidelines also set out a definition of initial investment.[29] This covers:

- setting-up a new establishment
- extending an existing establishment
- diversifying the output of an establishment into new, additional products[30]
- fundamental change to the overall production process of an existing establishment

This does not appear to be significantly different from the current Guidelines, which also explicitly excluded replacement investment. As before, the Guidelines require aided assets to be retained for at least five years;[31] however, in the 2006 Guidelines, it is made clear

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[25] Paragraph 92.

[26] Paragraphs 50-56.

[27] Paragraph 54.

[28] There is no limit for SMEs.

[29] Paragraphs 34-40.

[30] The July 2005 draft referred to diversification “into completely new product markets”.

[31] Member States may lower this to three years for SMEs.

that this does not preclude the replacement of plant or equipment that has become outdated, provided that the economic activity is retained within the region concerned for the minimum period.

An important change, at least for countries where leasing is prevalent, is that leased assets can only be included in eligible expenditure if there is an obligation to purchase the assets at the expiry of the lease period. For land and buildings the lease must continue for at least five years after the anticipated completion of the project (three years in the case of SMEs).[32]

As before, aid can be taken in the form a wage cost subsidy;[33] the same rate of award applies as to initial investment. Eligible expenditure concerns the wage costs for a period of two years arising from job creation as a result of an initial investment project and refers to a net increase in jobs compared with the average over the preceding year. Jobs must be created within three years of the completion of the works concerned and the posts must be maintained in the region for at least five years.[34]

An important question not directly addressed in the new Guidelines is that of relocation or 'delocalisation', which gained a high profile in some countries during the negotiations. In part, this was in response to general concerns at the potential impact of enlargement on location decisions, but there were also specific worries about whether the aid differentials between the 'a' areas and the remaining regions were sufficient to induce cross-border relocation. In practice, the high rate differentials initially proposed did not find their way into the final draft; however, nor did any express controls over relocation which some Member States had sought.

2.3.3 Large investment projects

As indicated in DG Competition's early proposals, the 2006 Guidelines include rules on aid to large investment projects. These are currently contained in a separate document, the 2002 Multisectoral Framework (MSF-2002),[35] which will cease to apply after 31 December 2006. The provisions on large investment projects[36] contained in the Regional Aid Guidelines are substantially the same as the 2002 Multisectoral Framework, but include some changes of detail. This section outlines the key principles of the amended rules and then identifies the main changes in relation to the current position.

(i) Main principles under the 2006 Guidelines

The essence of the provisions on large investment projects is to reduce rates of award under existing regional aid schemes to projects with eligible investment of more than

[32] Paragraph 53.

[33] Paragraphs 57-59.

[34] Member States may reduce this to three years for SMEs.

[35] Communication from the Commission – Multisectoral framework on regional aid for large investment projects, OJEC No C 70 of 19 March 2003.

[36] Paragraphs 60 to 70.

€50 million. This is achieved through a reduction scale (the larger the project, the lower the rate of award) incorporated into the regional aid schemes operated by the Member States, as set out in Figure 8.

Figure 8: Rate reduction matrix for large investments

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

As Figure 8 shows, projects involving investments of less than € 50 million are unaffected by the matrix. However, for large projects the standard award rates is progressively reduced. This is illustrated in the Framework as follows:

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

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

The impact of this formula on the standard award maxima under the Regional Aid Guidelines is shown in Figure 9. As would be expected, the higher the amount of eligible investment, the lower the rate of award applicable since an increasing proportion of the investment qualifies for aid at only 34 per cent of the prevailing regional aid rate. Thus, for an investment of € 500 million, the maximum rate of award in a 10 percent rate 'c' area would be 4.22 percent of eligible investment – a maximum of € 21.1 million.

Figure 9: Impact of the large investment project provisions on award rates

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

Importantly, however, Individual notification is required where the aid proposed is higher than that which a project involving eligible investment of € 100 million could have obtained on the basis of the application of the formula. As Figure 10 shows, for very large projects the notification thresholds bite at very low levels of aid when expressed as a percentage of investment.

In a 10 percent rate area, the notification threshold in proposed aid would be € 7.5 million, just 1.5 percent of a € 500 million investment.

Figure 10: Individual notification ceilings for large investment projects

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

For notifiable projects where either:

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

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

the Commission will only approve regional aid after opening the Article 88(2) investigative procedure and a "detailed verification… that the aid is necessary to provide an incentive effect for the investment and that the benefits of the aid outweigh the resulting distortion of competition and effect on trade". The Commission is to draw up further guidance on this matter.[37]

The onus is on the *Member States* to demonstrate that the project does not reinforce a high market share or increase capacity in a stagnant sector. Where no such competition concerns apply, the matrix given in Figure 9 is used to determine the maximum rate, as for projects under the € 100 million investment threshold.

(ii) Key changes

The main changes to the 2002 Multisectoral Framework introduced by the 2006 Regional Aid Guidelines are as follows:

- The motor vehicle sector is now subject to the same award matrix as all other eligible sectors; in MSF-2002 a flat rate of 30 percent of the prevailing regional aid ceiling applies.

- No special treatment of 'major projects' under the Structural Funds Regulation is envisaged; in MSF-2002, where a notifiable project is eligible for aid, the maximum aid rate can be increased by a factor of 1.15 if the project is cofinanced as a 'major project' under the Structural Funds Regulation.[38]

[37] Paragraph 68.

[38] Council Regulation (EC) No 1260/1999 of 21 June 1999 laying down general provisions on the Structural Funds, OJEC No L 162 of 26 June 1999, Articles 25 and 26.

- The 2006 Guidelines involve more apparent discretion in the treatment of individually-notifiable projects that either reinforce high market shares or increase capacity in stagnant sectors. For such projects, the investigative procedure will be opened but aid can be authorised if it is established that it is "necessary to provide an incentive effect for the investment and that the benefits of the aid measure outweigh the resulting distortion of competition and effect on trade between the Member States".[39] In contrast, MSF-2002 states that individually-notifiable projects are not eligible for aid if these market share and capacity concerns arise.

- The award reduction formula and notification thresholds are nominally unchanged, but because rates are expressed in gross rather than net terms (and nominal rates have also declined), the rates applicable to large projects and the level at which individual notification is required are typically very considerably lower than previously.

The July 2005 Draft had proposed two further changes, which have not been taken up in the final version. First, it had been proposed to change the individual notification threshold to *eligible expenditure* exceeding € 100 million, rather than an *aid amount* exceeding that which a € 100 million project would have received, as previously. The proposal would obviously have simplified matters, since the threshold would have been an absolute amount; however, the proposals adopted mean that Member States can continue to avoid notification simplify by offering an amount lower than that which a € 100 million project would have received.[40] Second, in the July 2005 Draft, the Commission had proposed that slightly different rules apply to the 'passenger car sector'. There was no prior authorisation requirement proposed for projects exceeding € 100 million eligible investment, but there was a requirement to submit a summary information form for all passenger car projects involving investments of more than € 50 million. These separate rules were abandoned in the final version of the Guidelines.

2.3.4 Operating aid

(i) Basic principles

Under the 2006 Guidelines the Commission continues to regard operating aid as a form of assistance that can only be authorised in exceptional circumstances. For the most part, the provisions on operating aid are substantially the same as under the 1998 Guidelines, however, 'financial and intra-group activities'[41] are generally ineligible for operating aid owing to the high risk of distorting competition and the limited likelihood of promoting regional economic development.[42] On the other hand, the Commission may allow aid to this

[39] Paragraph 68.

[40] This may be regarded as avoiding the notification requirements, however, it also arguably fulfils the Commission's wider objective of reducing aid expenditure since it provides an incentive for policymakers to offer lower levels of aid, especially for projects close to the notification threshold.

[41] NACE code Sections J (65, 66 and 67) and K (74).

[42] In 2002 the Commission issued a conditional decision on operating aid in the Azores allowing the scheme, providing that the financial services sector was excluded from eligibility. This provision would bring the Guidelines into line with that practice.

sector where "such aid is granted under general schemes which are open to all sectors and which are designed to offset additional transport or employment costs"; this takes on board the suggestions made by the Norwegian authorities in response to the July 2005 draft Guidelines.

Operating aid can generally only be offered in 'a' regions and subject to the condition that: (i) it is justified in terms of its contribution to regional development; and (ii) its level is proportional to the handicaps it seeks to alleviate.[43] It is for the Member States to demonstrate the existence of these handicaps and to measure their scale.

The 2006 Guidelines incorporate explicit reporting requirements for operating aid. Member States must submit an annual report for each NUTS II region in which operating aid is granted. This must provide a breakdown of total expenditure or an estimate of revenue foregone for each operating aid scheme; in addition, the ten largest beneficiaries in terms of aid received must be listed specifying the sector of activity and the amount of aid.

In all cases operating aid is to be regularly re-examined and the Commission will only approve operating aid schemes for the duration of the Guidelines.

(ii) Ongoing operating aid: OMRs and least-populated regions

In principle, operating aid must be temporary and phased out over time. Operating aid which is *not* both progressively reduced and limited in time may only be authorised in the OMRs and the least-populated regions. In the OMRs aid of up to 10 percent of the turnover of the beneficiary may be offered without the need for specific justification; aid above this level must be justified in terms of its contribution to regional development and set at a level to offset additional costs linked to their situation as OMRs.[44] Least-populated areas are defined as NUTS II regions (and adjacent and contiguous smaller areas) with a population density of 8 inhabitants per km^2 or less. It is for the Member State to demonstrate that aid is necessary to reduce or prevent depopulation.[45]

For the least-populated regions this provision is a partial reversal of previous decisions which had curtailed operating aid, such as social security concessions, in the Nordic Member States. It also effectively confirms and extends the decision reached by Common Accord of the EFTA Member States to allow a zero rate of social security contributions in northern Norway.[46] Moreover, in parallel with the approval of the Norwegian assisted areas map[47] – apparently the first to be approved under the new Guidelines – the EFTA

[43] Paragraph 76.

[44] Footnote 74. The factors identified in Article 299(2) of the Treaty which may be offset by aid include remoteness, insularity, small size, difficult topography and climate and economic dependence on a few products.

[45] The prevention of depopulation as a justification was added following the Norwegian response to the July 2005 draft.

[46] See EFTA Surveillance Authority Decision of 12 November 2003 with regard to State aid in the form of regionally differentiated social security contributions, 218/03/COL.

[47] EFTA Surveillance Authority Decision of 19 July 2006 on the map of assisted areas and levels of aid (Norway), 226/06/COL.

Surveillance Authority has already authorised a scheme of regionally-differentiated social security contributions in the least-populated regions.[48] These areas cover around 17.7 percent of the Norwegian population and have an average population density of 3.5 persons per km^2.

(iii) Ongoing operating aid: transport aid

Aid partly to offset the additional costs of transport may be authorised in the OMRs and in the low population density regions (basically, NUTS III regions with a population density of less than 12.5 persons per km^2, see also Section 3.3). The criteria for transport aid are substantially the same as before. Specifically:[49]

- Aid may serve only to compensate for the additional cost of transport, taking account of other transport aid schemes. Aid may be calculated on a 'representative basis' but systematic overcompensation must be avoided.
- Aid is restricted to the extra transport costs within national boundaries; it must not be allowed to become export aid. Aid is not available to sectors with no alternative locations (eg hydroelectric power, extractive industries).
- Aid must be objectively-quantifiable in advance on the basis of an aid-per-passenger or aid-per-ton/kilometre ratio, and the subject of an annual report which sets out the operation of this ratio.
- Estimates of additional cost must be based on the most economical form of transport and the shortest route between production or processing and commercial outlets using that form of transport. A new element is that "external costs to the environment should also be taken into account"; it is not specified how this should be done.
- For the OMRs only, aid may cover the cost of transporting primary commodities, raw materials or intermediate products from the place of their production to the place of final processing in the region.

2.4 Aid for enterprise

The 2006 Guidelines propose a new model for aid to promote new businesses in the assisted areas.[50] Aid is restricted to small firms,[51] is limited to € 2 million in the 'a' areas and € 1 million in the 'c' areas; it is linked to expenses incurred in the first five years of a business, but need not be investment related.

[48] EFTA Surveillance Authority Decision of 19 July 2006 on the notified scheme concerning regionally differentiated social security contributions (Norway), 228/06/COL.

[49] Paragraph 81.

[50] Paragraphs 84 to 91.

[51] As defined in the Regulation on aid to small and medium-sized enterprises.

Eligible expenditure includes:

- legal, advisory and other costs directly related to new firm formation
- interest on external finance and a dividend on own capital employed
- rental of production facilities and equipment
- energy, water, heating, administrative charges, except VAT and corporate taxes on business income
- depreciation, leasing and wage costs, provided that the underlying investments or jobs created have not benefited from other forms of aid

The award ceilings are as follows:

- 'a' areas: 35 percent of eligible expenditure in the first three years and 25 percent thereafter, subject to a ceiling of € 2 million;[52]
- 'c' areas: 25 percent of eligible expenditure in the first three years and 15 percent thereafter, subject to a ceiling of € 1 million;[53]

These rates are increased by 5 percentage points in the following areas: 'a' regions with GDP per head of less than 60 percent of the EU average; regions with population density of less than 12.5 inhabitant per km^2; small islands with a population of less than 5000; other communities of the same size suffering from similar isolation.

Beneficiaries would also, in principle, be eligible for aid for initial investment under the Regional Aid Guidelines. However, Member States are required to put in place mechanisms to ensure that the relevant aid ceilings in relation to eligible costs are not exceeded; aid for enterprise cannot be cumulated with other forms of aid, including *de minimis* aid, to circumvent the ceilings applicable.

2.5 Other new developments under the Guidelines

There are a few other aspects of the Guidelines to which it is worth drawing attention.

First, the Commission intends to adopt a block exemption Regulation for regional aid schemes. This means that transparent aid schemes conforming with the Regional Aid Guidelines and within the national assisted areas map approved by the Commission (which would be considered an integral part of the Guidelines) would not require prior authorisation.[54] The draft Regulation[55] adopted by the Commission on 21 December 2005

[52] In the draft guidelines this was €3 million, rising to €4 million in regions with GDP per head of less than 50 percent of the EU average.

[53] In the draft guidelines this was €2 million, rising to €3 million in regions with population density of less than 12.5 persons per km^2 and in islands with a population of less than 5000.

[54] Operating aid and *ad hoc* aid (ie. aid to an individual firm offered on a one-off basis rather than in the context of an aid scheme) will not be exempt from prior notification. The notification

was open to consultation; this ended on 3 July 2006. The Commission's intention is that the Regulation should come into force from 1 January 2007. The latest draft is discussed in more detail below.

Second, with a view to increasing transparency, the Commission will seek an undertaking from all Member States that the full text of aid schemes will be published on the internet so that third parties can access details of all regional aid schemes operated in the EU.[56]

Third, the draft Guidelines had required the submission of assisted area maps within three months of the publication of the Guidelines; this requirement has been dropped. Progress with map submission (which is discussed further below) suggests that many Member States, especially those with a tradition of consultation, would have found this deadline extremely tight.

Last, the draft Guidelines attempted to introduce some constraints on timing of applications and decision-making with a view to improving the incentive effect of regional aids. In particular, Member States were to make a decision on applications with 12 months of submission and within six months of work beginning on the project. Moreover, an express reference to these requirements was to be included in all aid schemes. It is unclear how this requirement was relevant to competition considerations; it might properly be viewed as an internal matter for aid administrators in the Member States. It seems that this view prevailed and the proposed timing constraints were not included in the final text.

3. AREA DESIGNATION UNDER THE 2006 GUIDELINES

3.1 General issues

As described earlier, the basic distinction between 'a' and 'c' areas is maintained in the 2006 Guidelines. Moreover, as before, the designation of 'a' areas is a given, based on EU averages in GDP(PPS) per head. The selection of 'c' areas remains the preserve of the Member States, subject to scrutiny and approval by the European Commission. However, there are some significant differences between the area designation requirements under the 1999 and the 2006 Guidelines. Superficially, at least, the new version appears more flexible – there is no requirement for a single ranking of areas, nor for the use of a single geographical building block. On the other hand, there is greater emphasis on criteria specified by the Commission, namely EU average GDP(PPS) per head and national unemployment rates.[57] Moreover, for most countries, the designation of 'c' areas takes

requirements for aid to large projects still apply, even under schemes which are exempted from notification.

55 Draft Commission Regulation on the application of Articles 87 and 88 of the EC Treaty to national regional investment aid, OJEU No C 120 of 20 May 2006.

[56] Paragraph 108.

[57] In practice, unemployment rates were used by almost all countries in the designation of the 2000-6 maps.

place within the context of significantly reduced population coverage. In addition, although the criteria may appear more flexible, there is still scope for Commission discretion in their interpretation. How this discretion will be exercised in practice is, for the time being, an unknown.

The remainder of this section considers 'c' area designation criteria in more detail.

3.2 Paragraph 30(a): Economic development areas

Economic development areas (current 'a' areas which will be over the qualifying threshold even if measured in EU15 terms) may automatically be designated as 'c' areas for 2007-13.[58]

Figure 11: Coverage of economic development areas in the 'c' area total

	Economic development areas	'c' area total 2007-13
EU25	3.8	11.8
EU15	3.8	13.2
NMS10	3.8	4.3
Greece	7.7	7.9
Spain	16.1	17.7
Ireland	26.5	50.0
Italy	2.9	3.9
Hungary	27.8	27.8
Finland	4.9	33.0
UK	7.3	19.3

Source: Figure 2.

The coverage of economic development areas as a proportion of the EU population is modest – just 4 percent of the total – but for several individual countries it is significant. In Spain and Italy it accounts for almost all 'c' area coverage. In Hungary all 'c' area coverage is accounted for by economic development areas, but this is less significant because the remainder of the country has 'a' area status; the same holds for Greece, of which a very small part is covered by the population density criterion and the remainder by 'a' areas. The Guidelines allow economic development areas to be designated as 'c' areas, but do not require it. The implication of this is that Member States could use all or part of the population quota generated by economic development areas to designate other areas.

3.3 Paragraph 30(b): Low population density

Low population density areas are essentially NUTS II areas with a population density of less than 8 inhabitants per km^2 or NUTS III areas with a population density of less than 12.5 inhabitants per km^2. Within the population generated by this definition, some flexibility is allowed in the actual designation to enable parts of adjacent NUTS III areas which meet the criteria to be included. To prevent double counting, low population density is treated as a

[58] Canarias (Spain) and Madeira (Portugal) also fall into this category but, although treated as Phasing-in regions for Cohesion policy purposes, are classed as 'a' areas for competition policy purpose owing to their status as Outermost regions.

residual criterion - ie. ‘a’ areas are excluded. As a result, the low population density criterion applies to Finland and Sweden together with very small parts of Spain and Greece. In Sweden it accounts for almost all ‘c’ area coverage – which explains why assisted area coverage in Sweden has been largely unaffected by the new guidelines; this is also true of Norway where coverage exceeds 29 percent of the national population, and this entirely on the basis of population density. Parts of the Highlands & Islands (UK) and Cuenca (Spain) also meet the population density criterion, but are already classed as ‘a’ areas.

As with the economic development areas, there is no indication in the guidelines that the entire quota generated on the basis of low population density must be used for this purpose, so it appears that it could be used elsewhere, provided that other criteria are met.

Figure 12: Coverage of low population density areas in the ‘c’ area total

	Low population density	‘c’ area total 2007-13
EU25	0.5	11.8
EU15	0.6	13.2
NMS10	0.0	4.3
Greece	0.2	7.9
Spain	0.6	17.7
Finland	18.8	33.0
Sweden	13.0	15.3
EEA3	29.0	29.0
Iceland	31.6	31.6
Norway	29.1	29.1

Source: Figure 2 and Figure 3.

3.4 Paragraph 30(c) to (e): EU GDP and national unemployment rate

The most generally applicable criteria are contained in paragraphs 30(c) and (d), and, to a lesser extent, paragraph 30(e). These enable areas where either GDP(PPS) per head is less than the EU average or where the unemployment rate is more than 15 percent over the national rate to be designated as ‘c’ areas. The data are calculated on the average of the most recent three years of Eurostat data.

This differs considerably from the provisions under the previous Guidelines where no ‘framework’ criteria applied. Instead Member States could select their own statistical indicators, which had to satisfy the following conditions:[59]

- “their number, including both simple indicators and combinations of indicators, must be limited to five,
- they must be objective and relevant to the examination of the socio-economic circumstances of the regions,

[59] 1998 Guidelines, Paragraph 3.10.2.

- they must either be based on statistical series relating to the indicators used over a period including at least the three years prior to the moment of notification, or be derived from the last survey carried out, if the relevant statistics are not available on an annual basis,

- they must be drawn up by reliable statistical sources."

In other words, there were no universally applicable criteria (ie, GDP per head and unemployment rates as under the 2006 Guidelines). In practice, almost all Member States used unemployment rates (or a subset thereof, such as long-term unemployment) among their selected indicators, but GDP per head was hardly used at all. In all cases, 'c' area indicators referred to the national situation, not EU averages.

Under Paragraph 30(c), areas must form 'contiguous zones' with a minimum population of 100,000 and be located within NUTS II or III areas which meet the GDP or unemployment criteria.

Under Paragraph 30(d) NUTS III regions with a population of less than 100,000 which meet the GDP or unemployment criteria may be designated as 'c' areas.

Last, under Paragraph 30(e) islands and other areas categorised by similar geographical isolation (peninsulas and mountainous regions are given as examples) which meet the GDP or unemployment criteria may be designated as 'c' areas.

Figure 13 shows the population of NUTS II and III regions meeting the GDP or unemployment criteria, set against the quota and safety net population (ie. that which Member States are free to designate on the basis of their own criteria) and the total 'c' area population – ie. including economic development and low population density areas. In principle, as noted, it would appear that Member States can use the population generated by these criteria to designate other areas, based on national priorities.

For most countries, the proportion of the population that meets the criteria is significantly higher than the quota available. The principal exception to this is Ireland, where the proportion of the population meeting the GDP or unemployment criteria at either NUTS II or III is significantly lower than the total 'c' area population.

Figure 13: Coverage of potentially eligible NUTS II and III areas

	Potentially eligible as 'c' areas (%)	'c' area quota and safety net population (%)	'c' area total (%)
Belgium	43.1	13.5	13.5
Denmark	45.7	8.6	8.6
Germany	60.7	11.0	11.0
Spain	4.2	1.1	17.7
France	61.0	15.5	15.5
Ireland	10.8	23.5	50.0
Italy	5.1	1.0	3.9
Cyprus	~	50.0	50.0
Luxembourg	~	16.0	16.0
Neths	39.3	7.5	7.5
Austria	59.2	19.1	19.1
Portugal	26.0	2.8	2.8
Finland	41.7	9.3	33.0
Sweden	30.3	2.3	15.3
UK	56.9	12.0	19.3

Note: Cyprus and Luxembourg have no NUTS II or III breakdown. This table concerns only NUTS II and III areas meeting the GDP or unemployment criteria; islands and 'other isolated regions' would be in addition to the potentially eligible population indicated here. Transitional areas are not included in the totals.
Source: Own calculations from Eurostat data and Figure 2.

Within the population meeting the GDP and unemployment criteria, areas must be designated in 'blocks': (i) a minimum population of 100,000; or, (ii) NUTS III areas with a population of less than 100,000; or (iii) islands or other isolated areas. Regarding this last criterion, although Eurostat data are specified, there does not appear to be any published data at this level. A plausible interpretation is that it concerns islands or isolated areas *within* NUTS II or III areas meeting the criteria.

The standard minimum population requirements do not apply to Cyprus and Luxembourg, owing to their small size, and which do not have NUTS III breakdowns. In these countries it is considered sufficient that the areas have GDP per head lower than the EU average or an unemployment rate more than 15 percent above the national average and have a minimum population of 10,000.

The minimum population criteria are largely carried over from the 1998 Guidelines, but there are some potentially important differences. In particular, the 1998 Guidelines constrained the geographical units or 'building blocks' from which maps could be built up:[60]

> "the regions must conform to NUTS level III or, in justified circumstances, to a different homogeneous geographical unit. Only one type of geographical unit may be submitted by each Member State..."

This is absent from the new Guidelines which do not specify the types of units that may be used. In addition, the 1998 Guidelines stated that:

[60] 1998 Regional Aid Guidelines at Paragraph 3.10.3.

> "the individual regions proposed or the groups of contiguous regions must form compact zones, each of which must have a population of at least 100 000. If the population of the regions is less, a fictitious figure of 100 000 inhabitants will be used for the calculation of the percentage of the population covered. Exceptions to this rule are the NUTS level III regions with a population of less than 100 000, islands and other regions categorised by similar geographical isolation."

In the 2006 Guidelines there is no requirement for zones to be "compact", only "contiguous". Moreover, there is no mention of the imputation of a fictitious 100,000 population where this is not achieved. It is not clear whether a population of 100,000 would be imputed, or whether Member States would be obliged to justify the designation of an area on the basis of Paragraph 30(h), which allows for a minimum population of 50,000. The 2006 Guidelines give mountains and peninsulas as examples of other regions characterised "by similar geographical isolation", where this was left unsaid in the 1998 Guidelines. Last a minimum population requirement (10,000) is imposed on Luxembourg (and Cyprus); previously there were no such explicit constraints.

In some respects the new Guidelines are clearly more flexible than the current version. However, the reduced population coverage applicable almost everywhere reduces the room for manoeuvre, even in the context of a generally more flexible system. Some measure of the population coverage constraints can be gleaned from Figure 14. This gives population coverage expressed in number of inhabitants, rather than as a proportion of the population, and translates this into the number of 100,000 building blocks. It also identifies the number of NUTS III areas with a population of less than 100,000 meeting the GDP and unemployment criteria.

The first point to note about Figure 14 is the very small number of population blocks in some Member States. The minimum population requirement of 100,000, which is generally applicable, translates into very few 'contiguous zones' in Spain and Italy, for example. Clearly both countries have some economic development 'c' areas, which, whilst 'entitled' to 'c' area status, need not be used, allowing somewhat greater flexibility in other regions. Nevertheless, these constraints seem likely to make area designation administratively costly and politically delicate.

The second point to note is that while NUTS III regions with a population of less than 100,000 can escape the minimum population requirement of 100,000, this provision is really only relevant to Germany (and to a lesser extent Belgium). In other words, most countries must designate zones with a minimum population of 100,000, unless using Paragraph 30(h) (structural change or decline) or Paragraph 31 (SME only aid).

Figure 14: Impact of minimum population requirements

	'c' area quota and safety net population 2007-13	No. of 100,000 population blocks	Population of NUTS III < 100,000 pop meeting criteria	No. of NUTS III regions < 100,000 pop meeting criteria
EU25	33,632,946	325	5211.3	72
EU15	33,275,396	325	5211.3	72
NMS10	357,550	0	0.0	0
Belgium	1,394,551	13	510.2	9
Denmark	462,336	4	44.3	1
Germany	9,073,020	90	3967.0	52
Spain	446,007	4	0.0	0
France	9,491,681	94	74.1	1
Ireland	922,674	9	0.0	0
Italy	571,570	5	89.9	1
Cyprus	357,550	~	0.0	0
Luxembourg	71,392	~	0.0	0
Neths	1,211,024	12	52.5	1
Austria	1,544,007	15	156.4	3
Portugal	290,316	2	0.0	0
Finland	483,693	4	161.3	2
Sweden	205,275	2	57.4	1
UK	7,107,851	71	98.0	1

Notes: (i) Population coverage does not include the quota generated by economic development areas or sparsely-populated regions. **(ii)** The standard minimum population requirements do not apply to Cyprus and Luxembourg owing to their small size and the absence of NUTS III units; a minimum population of 10,000 applies instead.
Source: Own calculations from Eurostat data.

Overall, it can be argued that this element of the new Guidelines offers more flexibility than 1998 methodology: although 'framework criteria' (ie. GDP per head or unemployment rates) apply, there are fewer constraints on building blocks and the selection of national indicators than previously; moreover, the requirement to produce a ranked list of eligible areas (which, in practice, was not actually imposed on all countries by the Commission) has been dropped. Nevertheless, the reduced population coverage means that policymakers in most countries have to operate within tight constraints.

3.5 Paragraph 30(f): Small islands

A new provision in the 2006 Guidelines is the scope to designate islands and other isolated communities with a population of less than 5000, without any other criteria applying. This was absent from the 1998 Guidelines and responded to calls made by several Member States in the consultation process.

Overall, given the low population limit of 5000, the provision is unlikely to have a significant impact on total coverage, but may resolve some specific area designation issues in individual Member States.

3.6 Paragraph 30(g): Border areas

The 2006 Guidelines enable NUTS III areas or parts thereof that border 'a' areas to be designated (whether or not in the same Member State). It is not clear whether, in this

context, ‘a’ areas include the statistical effect regions and, if so, whether designation would be affected by the potential loss of ‘a’ status after the transitional period.

The main implications of this provision are for Austria, Germany and Italy. For Austria, the issue is purely external and concerns ‘a’ regions in the Czech Republic, Slovakia and Slovenia. In Germany and Italy it could be used as a ‘buffer’ against ‘a’ areas within those Member States, as well as with neighbouring countries (Slovenia in the case of Italy; and the Czech Republic in the case of Germany).

It is also relevant to Spain and the UK which have ‘a’ areas and, assuming the statistical effect areas *are* included, to Belgium and France (parts of Nord Pas-de-Calais in France border the Belgian region of Hainaut, which is a statistical effect region).

The potential impact of this provision is difficult to quantify because of the scope to designate *parts* of NUTS III areas on this basis. It is noteworthy that no ‘framework criteria’ (GDP per head and unemployment rates) apply, nor is there any minimum population requirement.

Paragraph 30g also allows for all or parts of NUTS III regions with a land or maritime border (of less than 30 km) with a non-EEA or EFTA Member State to be designated. In practice, most such areas, which lie along the eastern frontier of the EU (Estonia, Latvia, Lithuania, Poland, Slovakia, Hungary, Slovenia and Greece) are designated as ‘a’ areas. As a result, this provision would appear to apply only to Finnish NUTS III regions bordering Russia.

3.7 Paragraph 30(h): Structural change or relative decline

A significant new provision was introduced in the final draft of the Guidelines. This concerns the possibility to designate smaller areas – minimum population 50,000 – “which are undergoing major structural change, or are in serious relative decline, when compared with other comparable regions”. There is no requirement for such areas to meet the GDP and unemployment rate criteria; however:

> “it will be the task of Member States which wish to use this possibility to demonstrate that the award of regional investment aid in the region concerned is justified, using recognised economic indicators and comparisons with the situation at Community level.”

The fact that the burden of proof rests with the Member State, and that the criteria are so vague, makes it difficult to forecast the practical importance of this criterion. It may be that Member States will be inclined to opt for the more concrete criteria outlined elsewhere than open up proposals to detailed Commission scrutiny with unpredictable outcomes.

3.8 Paragraph 31: SME aid only areas

A further innovation, set out in Paragraph 31, concerns the scope to designate even smaller areas – minimum population 20,000 (except in the case of islands and other areas characterised by similar geographical isolation). Aid in such areas will be restricted to SMEs

(the relevant SME aid bonus will apply) and will be available only to projects with eligible investment of less than € 25 million.

As under Paragraph 30(h), there are no explicit requirements in relation to GDP per head or unemployment rates, but the onus is on the Member States:

> "to demonstrate that the areas proposed are relatively more in need of economic development than other areas in that region, using recognised economic indicators such as GDP per capita, employment or unemployment levels, local productivity or skills indicators."

3.9 Transitional 'c' areas

Transitional arrangements for areas losing 'c' status were a late addition to the proposals for the guidelines and were apparently made largely in response to French pressures for a phasing-out mechanism. In practice these arrangements are not generous. First, coverage is for a period of two years only – ie. until 1 January 2009; and second, aid intensity is limited to a maximum of 10 percent of eligible investment. As far as the actual selection of areas is concerned, the only stipulation appears to be that the area has 'c' status for 2000-6. In other words, there are apparently no minimum population or contiguity requirements. The importance of the 'c' area transitional arrangements varies widely between countries. As Figure 15 shows, in Spain, Ireland, Cyprus and Portugal transitional areas cover between 12 and 25 percent of the population; by contrast, coverage in Denmark and the Netherlands is less than three percent and seven of the EU15 countries have no transitional areas. Given the short time span of the transitional period, it is unclear how important this provision will be in overall area designation decisions.

Figure 15: EU25 Coverage of transitional 'c' areas 2007-13 (% of population)

	2000/4-6 'c' areas	Transitional 2007-9	2007-13 'c' areas
EU25	18.0	3.8	11.8
EU15	21.1	4.2	13.2
NMS10	2.4	1.8	4.3
Czech	11.4	7.7	
Denmark	17.1	2.7	8.6
Spain	20.8	12.4	17.7
France	33.9	6.9	15.5
Ireland	73.4	25.0	50.0
Italy	10.0	5.6	3.9
Cyprus	100.0	16.0	50.0
Lux	32.0	5.1	16.0
Neths	15.0	2.4	7.5
Portugal	33.4	19.2	2.8
Slovakia	11.1	7.5	

Source: Figure 2

4. MEMBER STATES APPROACHES TO AREA DESIGNATION[61]

4.1 The State of play

On 13 September 2006 the Commission approved a first batch of assisted area maps under the 2006 Guidelines. These decisions concerned seven Member States: Estonia Greece, Latvia, Hungary, Poland, Slovenia and Slovakia. Of these, six are covered by 'a' or 'c' areas in their entirety. Slovakia is mainly covered by 'a' status, but has a small transitional area quota. It is clear from Figure 16 that many of these assisted area maps were submitted later than others which have yet to be approved (for example Finland and France) – a clear indication that the Commission is making the least contentious decisions first and, at the risk of setting unwanted precedents, leaving potentially more controversial decisions until later.

Figure 16: Map submission and approval status

	Submission date	Status at September 2006
Belgium		
Czech Rep		
Denmark		
Germany	July 2006	
Estonia	14 July 2006	COM approval 13 September 2006
Greece	23 June 2006	COM approval 13 September 2006
Spain		
France	1 June 2006	Under negotiation with COM
Ireland	June 2006	
Italy		
Cyprus		
Latvia	5 July 2006	COM approval 13 September 2006
Lithuania		
Luxembourg		
Hungary	18 July 2006	COM approval 13 September 2006
Malta		
Neths	Anticipated late October 2006	Seeking domestic political agreement
Austria	Anticipated July 2006	
Poland	8 August 2006	COM approval 13 September 2006
Portugal		
Slovenia	4 July 2006	COM approval 13 September 2006
Slovakia	13 July 2006	COM approval 13 September 2006
Finland	28 March 2006	Under negotiation with COM
Sweden	June 2006	Under negotiation with COM
UK	Autumn 2006	Second domestic consultation phase
Iceland		
Norway	12 June 2006	ESA approval 19 July 2006

Source: Policymaker interviews; *ESA Decision of 19 July 2006 on the map of assisted areas and levels of aid* (Norway), 226/06/COL and DG Competition at: http://ec.europa.eu/comm/competition/state_aid/overview/ram.html.

[61] This section is based on documentation kindly provided by national policymakers and on EPRC fieldwork: Austria (Tobias Gross); Belgium (Frederike Gross); Finland (Heidi Vironen); France (Frederike Gross); Germany (Sara Davies); Ireland (Irene McMaster); Italy (Laura Polverari); Netherlands (Douglas Yuill); Sweden (Heidi Vironen); and UK (Martin Ferry and Rona Michie). At the time of writing, many countries were still engaged in the process of drawing up maps. The need to respect the confidentiality of the information provided means that coverage of national situations in this section is rather uneven.

The remainder of this section focuses on the information available about those Member States with the flexibility to select 'c' areas under the 2006 Guidelines. These are primarily among the EU15 (except Greece). As Figure 4 shows, most of the new Member States are designated in their entirety as 'a' areas. The Czech and Slovak Republics are mainly designated as 'a' areas, but each also has a quota of transitional 'c' areas amounting to around 8 percent of the population. Among the new Member States, only Cyprus is concerned with the designation of 'c' areas.

4.2 Arrangements for area designation

Arrangements for area designation have varied widely between the Member States. This reflects a number of factors, including administrative traditions, institutional structures and responsibilities and the perceived sensitivity of the process.

Austria and *France* have, to some extent, adopted a similar approach. In both countries the 'c' area population quota has been divided between the regions and the task of selecting the eligible areas delegated to that level. However, in France the process was essentially *deconcentrated* rather than *devolved.* The main responsibility for the task lay with the *Préfets*, the government representative in the region, which were charged with consulting with Regional Councils and local partners as they saw fit. By contrast, in Austria the process has been led by *Land* level governments which have produced draft maps, which have later been subject to negotiation at a political level. The population quota was divided between the *Länder* in proportion to their shares of current coverage.

In *Ireland* too the process has been partly devolved. The Border-Midlands-Western (BMW) region has economic development status and it was taken as a given that the whole region should have 'a' status; the decision about which parts of the Southern and Eastern region was devolved to the regional authority which put forward proposals on the basis of a study which it commissioned.

The process has been even further devolved in *Belgium* where each of the three regions (Brussels, Flanders and Wallonia) is drawing up a separate map, although ultimately a single map will be submitted to the Commission. However, a major obstacle has been the lack of agreement on how to divide the 'c' area population quota between the three regions, notably in the light of the Hainaut region (Wallonia) having 'a' status as a statistical effect region.

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

In *Italy* the designation of the 'c' areas is being handled in tandem with decisions about the allocation of Structural Funds resources in the Centre-North and has been delegated to the regional level. As far as the aid area map is concerned, the task has been complicated by the very small population quota available. This is about 3.9 percent, most of which – 2.9 percent – is accounted for by Sardegna, an economic development area which has *a priori*

'entitlement' to 'c' status. To date, discussions have been at a political, rather than a technical level, and have involved the Presidents of the Regional Councils. No agreement has yet been reached, but it is mooted that Sardegna will concede some of its 'c' area quota for the designation of areas elsewhere in Italy.

In the *United Kingdom*, as in the past, there has been an extensive public consultation process. This has been led by the Department of Trade and Industry (DTI) in liaison with the devolved administrations for Scotland and Wales. The first stage of the consultation outlined the requirements of the new Guidelines and raised a number of specific questions concerning appropriate approaches and designation criteria.[62] In the second stage the government published its response and a draft assisted areas map for further consultation.[63]

By contrast, in some countries the process has been conducted internally within the lead ministries: this is the case in *Finland*, the *Netherlands*; and *Sweden*.

4.3 Area designation philosophy

In the context of the reduced assisted area coverage imposed on most EU15 countries under the new Guidelines, Member States must reconcile Commission constraints with domestic considerations. These often comprise a mix of policy options such as indigenous or inward investment, areas of need or opportunity – and political considerations, such as the perceived equitable distribution of assisted areas between regions.

As noted, in *France* the task of proposing the assisted areas was largely decentralised to the *Préfets de region.* In the first instance Corsica was proposed for designation in its entirety.[64] For the remainder of the country a population quota for each region was determined on the basis of five criteria: unemployment, employment trends, manufacturing and service employment, qualifications, disposable income; a safety net was applied to ensure that no region lost more than two-thirds of current coverage and that no region had a population quota of less than 150,000. Interestingly a 'reserve' of 430,000 inhabitants has been retained by the government to deal with major economic development issues that might arise in the future. This reserve was deducted from the initial quota for the Île de France (Paris) region. Instructions to the *Préfets* highlighted the fact that the assisted areas map had two objectives: to contribute to the attraction of inward investment and to enable the development of SMEs.

In *Germany* the approach to area designation largely followed the model used in the past; the key difference was that the same model was used for evaluating all German regions – in the past separate systems have been used for the old and new *Länder*. Large scale regional

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

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

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

aid is perceived to be one of the most effective instruments of regional policy and it is considered important in the attraction of investment, especially to the new *Länder.* As far as the map is concerned, the underlying philosophy is that regional aid should be concentrated on regions with clear socio-economic structural weaknesses; it is argued that using objective socio-economic indicators for designating areas ensures that regions with similar problems are treated equally.

In *the Netherlands* the goal of regional development policy is "to stimulate economic growth in all regions by exploiting region-specific opportunities of national significance".[65] However, at the national level, little weight is attached to regional *aid* under this philosophy. On the other hand, the *decentralised* element of the regional investment premium (IPR) operated in the north is well used and consideration is being given to the introduction of a similar mechanism for parts of the south. Moreover, there are important considerations arising from the presence of designated areas in neighbouring Member States and the perceived need to ensure a 'level playing field' for potential cross-border moves.

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

In the *United Kingdom* the government "considered where the flexibility provided by Assisted Area coverage is justified by both need and opportunity" and used the existing map as the baseline for developing new proposals. As far as the philosophy underlying the map is concerned, in its response to the first consultation it expressed the view that the primary purpose of assisted area coverage is to provide flexibility to support larger firms; it therefore, opted not to propose areas under Paragraph 31 – ie. SME only aid areas. This is rather a surprising outcome in the UK context since Paragraph 31 appears to respond to a suggestion put forward by the UK authorities in the course of the consultation on the Guidelines.[66]

4.4 Building blocks

The choice of building blocks for area designation was a highly contentious issue in the negotiation of the 2000-6 maps. In particular, the Commission sought the use of a single unit across all indicators within a given country and disallowed the splitting of the chosen unit (except to achieve coherence with Objective 2 areas, but even then not in all Member States). In the 2007-13 Guidelines the requirements in respect of building blocks are much less stringent. In informal discussions the Commission has accepted the use of LAU1 and LAU2[67] as building blocks, but has emphasised that any breakdown below NUTS III must be

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

[66] Letter from UKRep dated 1 March 2005.

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

'traditional' and not simply generated on an *ad hoc* basis for the purposes of the area designation exercise.

Figure 17: Building blocks proposed by the Member States

Belgium	Gemeenten (LAU2) in Flanders;
Denmark	
Germany	Labour market regions (*Arbeitsmarktregionen*); Transport areas (*Verkehrszelle*) in Berlin
Spain	
France	Commune (LAU2); *Cantons urbains* in cities
Ireland	Counties (LAU1)
Italy	Municipality (LAU2) (?)
Cyprus	
Luxembourg	
Netherlands	
Austria	
Portugal	
Finland	Maakunnat /Landskap (NUTS III); Seutukunnat (LAU1)
Sweden	Municipalities (LAU2)
UK	Wards (LAU2)

The information currently available suggests that, where Member States have changed the unit of analysis since the designation for the 2000-6 period, they are opting for smaller units. This reflects the constraints of the population ceilings set by the Commission, which create an imperative to optimise the designation of assisted areas, coupled with apparently greater flexibility on the part of the Commission.

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

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

The *United Kingdom* has also chosen the smallest possible unit of analysis, the ward, of which there are around 10,660. In the government's proposals, the ward level is used to 'build up' zones with a minimum population of 100,000.

4.5 National indicators and Commission criteria

As described earlier, the Guidelines set out a series of parameters within which Member States can propose assisted areas.

Economic development areas[68] (ie. areas that have outgrown 'a' status) and sparsely-populated regions[69] will be accepted by the Commission as 'c' areas; however, Member States may, apparently, use the population quotas generated by these areas to designate other areas – provided that these meet the criteria in Paragraphs 30 or 31.

Most eligible areas are likely to have to meet the framework criteria,[70] ie. GDP(PPS) per head less than the EU average or unemployment more than 15 percent above the national average. A Commission illustration, based on the July 2005 draft of the Guidelines is annexed to this paper in the form of a 'pre-eligibility map' (see Appendix, Map 1). In practice, as discussed earlier, in most countries these areas are more extensive than the national population ceilings allow, requiring further selection criteria at the national level.

Alternatively, there are further specific criteria under which areas may be proposed[71] (small islands and border areas) or criteria under which the onus is on the Member State to demonstrate that regional aid is justified[72] (areas undergoing structural change and small aid areas for SMEs).

Figure 18 summarises what is known so far about the criteria which Member States have proposed to use. For the Member States there are several issues to address, including: how the Commission parameters intersect with national priorities and indicators; whether to designate solely within the framework criteria; whether to use the quotas from economic development and sparsely-populated areas to designate other 'c' areas; and whether to designate areas justified on the basis of national arguments. Member States have addressed these questions in a variety of ways reflecting national traditions in area designation, the flexibility allowed by the framework criteria and the need for expedient and pragmatic solutions to complex and politically sensitive tasks.

[68] Paragraph 30(a).

[69] Paragraph 30(b).

[70] Paragraph 30(c) to (e).

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

[72] Paragraphs 30(h) and 31.

Figure 18: Commission parameters for areas designation: paragraphs 30-31

	30(a)	30(b)	30(c)-(e)	30(f)	30(g)	30(h)	31
	Econ dev	Pop density	EU GDP/nat unemp	Small islands	Border areas	Struct. change	SME aid
Belgium	n/a	n/a		n/a			
Denmark	n/a	n/a					
Germany	n/a	n/a	Y	N	Y	N	Y
Spain							
France	n/a	n/a	Y	N	N	N	Y
Ireland	Y	n/a		Y			
Italy		n/a					
Cyprus	n/a	n/a		n/a			
Luxembourg	n/a	n/a		n/a			
Netherlands	n/a	n/a					
Austria	n/a	n/a		n/a			
Portugal	n/a	n/a					
Finland	Y	Y	Y	Y	Y	N	N
Sweden	n/a	Y	Y	N	N	Y	N
UK	Part	n/a	Y	N	N	N	N

Note: This figure summaries information for those countries for which information is available; n/a means 'not applicable'.

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

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

Regions were ranked according to these criteria and classed into five groups; Groups 4 and 5 were proposed for designation in the map submitted to the Commission. Reflecting the designation system outlined above, no areas were proposed simply on the basis of low population density. However, it is clear from the map that there is a high degree of correlation between population density and other measures of disadvantage. The map submitted to the Commission is appended to this paper (see Appendix, Map 2).

In *France*, as described, the task of devising the assisted maps was undertaken at the regional level, led by the regional *Préfets* and involving local partners. It was decided at the outset that Corsica would be designated as a 'c' area in its entirety; the remaining 21 regions were each assigned a population quota. A circular from DIACT[73] to the *Préfets*

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

outlined the parameters set by the Commission in the Guidelines. In addition, DIACT provided a database of 19 statistical indicators to assist in the exercise. The maps proposed by the regional level were then brought together into a single national map for notification. This approach means that there is no single system applicable to all French regions; the *Préfets* were free to choose their own combinations of indicators and criteria. The map submitted to the European Commission is appended to this paper (see Map 3).

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

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

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

The weightings given to each indicator are slightly different from the 2000-6 exercise: more weight has been given to unemployment and less to infrastructure and the employment forecast. Labour market regions were ranked on the basis of these indicators and a 'cut-off' applied to respect the population quota. The *Länder* were then invited to identify areas with problems not properly reflected in the model and to swap eligible areas, within the eligible population for the *Land*. The German proposal as submitted to the Commission is appended to this paper (see Map 4).

In the *United Kingdom* one of the questions raised in the consultation paper was whether the economic development areas (Merseyside and South Yorkshire) should be designated as 'c' areas in their entirety; more generally the paper sought feedback on what indicators should be used. The responses to these questions, together with the decision to include Northern Ireland in its entirety, formed the basis for the map proposals which have been the subject of a further consultation.

The starting point for the government proposal was the existing map in conjunction with what it terms the Commission's "filter" (ie. the EU GDP and national unemployment rate criteria) to eliminate a number of areas from the map.[74] In other words, in the current proposals, there is in effect a requirement that areas meet the criteria in Paragraph 30(c)-(e) AND fall within the 2000-6 assisted areas map; moreover, there is an explicit decision *not* to use the scope to designated small areas for SME aid only.

The consultation showed little support for the total designation of economic development areas as 'c' areas, except among stakeholders in the regions concerned. The government proposal is to cover 81 percent of the population of Merseyside and 76 percent of the population of South Yorkshire.

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

- Employment rate
- Adult skills (level 2 and above)
- Incapacity benefit claimants
- Manufacturing share of employment

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

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

The resulting map (see Annex, Map 6) has been the subject of further consultation prior to submission to the European Commission. The responses to that consultation are currently being considered by the government. It is anticipated that the proposed will be submitted to the Commission after the end of the parliamentary summer recess (8 October).

5. OTHER RECENT DEVELOPMENTS

The major event of the past year or so has been the finalisation and implementation of the Regional Aid Guidelines for 2007-13. In addition, and related, the Commission is in the process of formalising certain administrative aspects of the new guidelines. Also important, recent case law has clarified the circumstances in which regionally-differentiated taxation constitutes State aid. Last, the Commission is pursing its wider State aid reform agenda,

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

with some general and indirect implications for economic development policies in the problem regions. Developments in these three areas are briefly reviewed in turn.

5.1 Procedural and administrative issues

5.1.1 Appropriate measures

The 2006 Guidelines make provision for the expiry of all existing approved regional aid schemes through so-called "appropriate measures".[75] These are as follows:[76]

- The limitation of all existing regional aid schemes to 31 December 2006
- The amendment of all aid schemes offering bonuses in the assisted areas (eg. aid for environmental protection, training and research and development) to reflect the new assisted areas map after 31 December 2006.

Member States were asked to confirm their acceptance of these appropriate measures within one month. Acceptance by the Member States of the appropriate measures binds the Member States under the Guidelines; without their acceptance, the Guidelines bind only the Commission, which must then open the formal investigative procedure in order to impose the Guidelines. By end May 2006 all Member States except Germany had agreed to the appropriate measures.[77]

The German objection lies principally with the operation of guarantee schemes. The Commission is seeking a reduction in the value of the schemes and differentiation in award values between regions, instead of the flat rate currently operating. While all German regional aid schemes will automatically expire at 31 December 2006, this is not so for the guarantee schemes and the Federal Ministry concerned is opposed to closing down and reopening the affected measures. Although the area of dispute is apparently limited to the operation of guarantees, the Commission has opened the formal investigative procedure against *all* German regional aid schemes.[78]

5.1.2 Regional aid block exemption

An important procedural change is the proposal to adopt a block exemption Regulation for regional aid. In broad terms, the effect of this would be to exempt from *prior* notification and approval all transparent regional investment schemes which comply with the national assisted areas map.

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[75] Pursuant to Article 88(1) of the EC Treaty.

[76] Paragraph 107 of the 2006 Guidelines.

[77] *State aid: Guidelines on national regional aid for 2007-2013: Acceptance by 24 Member States of the Commission's proposal of the appropriate measures pursuant to Article 88(1) of the EC Treaty,* OJEU No C 153 of 1 July 2006.

[78] OJEU No C 194 of 18 August 2006.

In May 2006 the Commission published a draft Regulation on national regional investment aid.[79] This was subject to consultation; the deadline for comments was 3 July 2006. A second draft of the Regulation was produced in response to these comments for discussion with the Member States on 26 September 2006.[80]

The Regulation, coupled with the Guidelines and the assisted area maps (once approved), which are binding on the Member States which have agreed to the appropriate measures, provide a framework within which administering bodies can design regional aid schemes. Member States (and subnational authorities) may implement regional aid schemes without first obtaining Commission authorisation. Instead, Member States must submit electronically a summary of the scheme in a format prescribed in the Regulation, with a view to its publication in the Official Journal.

The block exemption Regulation only applies to regional aid schemes which are deemed to be *transparent*. These are considered to be measures where it is possible to calculate precisely the gross grant equivalent as a percentage of eligible *ex ante* without the need to undertake a risk assessment (examples given are grants, interest rates subsides and capped tax exemptions). Public loans are considered transparent if backed by normal security and not involving abnormal risk. Public shareholdings and aid comprised in risk capital measures are not considered transparent and require prior notification and approval. Operating aid (as allowed in 'a' areas and sparsely-populated areas under the Guidelines) must be assessed on a case-by-case basis, as must aid for newly-created small enterprises under the new provisions (Section 6) of the Guidelines.

In the second draft of the Regulation the definition of transparent aid was expanded slightly in two respects. First, State guarantees may be considered transparent if the Commission has accepted the methodology for calculating aid intensity following the adoption of the block exemption Regulation.[81] Second, so-called *ad hoc* aid (ie. an individual award not made on the basis of a scheme) may be considered transparent if it is used to supplement support under a transparent regional aid scheme and if the *ad hoc* component does not exceed 50 percent of the total aid granted. This would, for example, enable a local authority to 'top-up' national regional aid, even where a scheme is not in place at the local level, provided that the aid ceilings and other criteria were complied with. It does not allow for *ad hoc* aid to be offered in isolation.

The second draft of the Regulation dropped references to the *de minimis* Regulation. As noted earlier, the Guidelines explicitly preclude the cumulation of *de minimis* support with regional aid in respect of the same eligible expenditure, to the extent that the regional aid ceilings would be exceeded. Broadly consistent with this, the first draft of the block exemption Regulation stated that regional investment aid could not be cumulated with *de*

[79] *Draft Commission Regulation on the application of Article 87 and 88 of the EC Treaty to national regional investment aid*, OJEU No C 120 of 20 May 2006.

[80] See: <http://ec.europa.eu/comm/competition/state_aid/overview/rber2.pdf>

[81] That is, if the method is notified to the Commission and approved by it before the implementation of the scheme.

minimis support "in respect of the same eligible expenditure or investment project, if such cumulation would result in an aid intensity exceeding that fixed by this Regulation".[82] The latest version of the *de minimis* proposals, which is currently the subject of consultation, appears to go further, stating that *de minimis* aid may not be cumulated with State aid in respect of the same project.[83]

Once adopted, alongside the approved maps which will form an integral part of the Guidelines, the Regulation should ease the administrative burden on the Commission. For national and subnational authorities too the process of implementing straightforward aid schemes will be swifter.

5.2 Regional taxation

The last few months has seen an important clarification in the relationship between State aids and regional taxation. The interface between fiscal affairs and competition policy has always been controversial. This is partly because sovereignty in tax matters is jealously guarded by the Member States and partly because the Commission has exclusive competence over State aid: the question of whether a tax measure constitutes State aid is therefore one of crucial importance.

5.2.1 Regionally-differentiated taxation

Tax and social security concessions that discriminate in favour of certain regions have consistently been treated by the Commission as constituting State aid; an early example is the German coal closure areas case.[84] More recently, in the context of membership of the European Economic Area the Norwegian system of social security was challenged by the EFTA Surveillance Authority (ESA).[85] The system involved different rates of employers' social security contribution based on the zone in which the employee had his/her registered permanent residence. The Norwegian authorities argued that because the regional differentiation was neutral with regard to sector, occupation, size of undertaking, etc. and was linked to municipality of residence, not workplace, it was an integral part of the general tax and transfer system in Norway. In line with earlier Commission decisions, however, this argument was not accepted by ESA which considered the system to constitute State operating aid.[86] The ESA decision was challenged by the Norwegian authorities, but

[82] Article 6(3) of *Draft Commission Regulation on the application of Article 87 and 88 of the EC Treaty to national regional investment aid*, OJEU No C 120 of 20 May 2006.

[83] See http://ec.europa.eu/comm/competition/state_aid/overview/dm_en2.pdf

[84] Case 70/72 *Commission v Germany* [1973] ECR 813.

[85] EFTA Surveillance Authority, State aid (95-010) Norway, OJEC No C 38 of 5 February 1998.

[86] EFTA Surveillance Authority Decision No 165/98/COL of 2 July 1998 with regard to State aid in the form of regionally differentiated social security taxation, OJEC No L 327 of 3 December 1998.

the EFTA Court upheld ESA's decision.[87] This was not a surprising outcome given the precedents that had already been established.[88]

5.2.2 Regional tax autonomy

In most countries a range of services are financed from taxes raised at the subnational level. Where all local authorities are free to set the tax rate for their jurisdiction, and that rate applies to the whole area, no State aid is involved even though there may be considerable variation in subnational tax rates across the country as a whole. In this case, lower tax rates set in a given jurisdiction, if such should arise, are not viewed as an exception from the general application of the system.

More complex issues arise where there is regional tax autonomy over taxes 'normally' levied by central government. In Spain, for example, the Basque country has greater autonomy than most of the Spanish regions under a special regime dating back to the 19th century. As a result, the Basque government levies its own taxes in place of the national taxation system. In 1996, this resulted in different (lower) rates of corporation tax in the Basque country than elsewhere in Spain.[89] What then is the benchmark given that the Basque country has the autonomy to set the tax rate? This point was not addressed, but the Commission has had occasion to consider tax concessions offered within the Basque country in a number of cases dating back to 1993. A constant theme in these disputes has been the historic tax agreement (*conciertos económicos*) and the issue of fiscal autonomy. In the first of these cases[90] proposals to offer tax concessions were condemned on the basis of Article 43 (then Article 52) since they were restricted to firms with all plants located in the region, a condition which was considered to restrict freedom of establishment. In consequence, the Commission did not need to become embroiled in questions of fiscal autonomy. This was perhaps fortuitous since it seems that the Commission was deeply divided on the issue.

Subsequently, however, a revised form of the concessions became the subject of a preliminary reference to the European Court of Justice from the Basque courts in a case involving the Basque and the Spanish authorities.[91] In this context, Advocate-General Saggio addressed the question of whether regional autonomy in taxation could amount to State aid. He observed that:

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[87] Case E-6/98 Government of Norway v EFTA Surveillance Authority.

[88] In practice, as described earlier, although such concessions have been classified as aid, the 2006 Regional Aid Guidelines introduce greater flexibility in the interpretation of Article 87(3), allowing the Commission and ESA to authorities such measures to continue in the sparsely-populated areas where duly justified by the Member States.

[89] 'Basques' tax plan upsets Madrid', *Financial Times*, 4 February 1997.

[90] Commission Decision of 10 May 1993 concerning a scheme of tax concessions for investment in the Basque country, OJEC No L 134 of 3 June 1993.

[91] Joined cases C-400/97, C-401/97 and C-402/97 *Administración General del Estado v Juntas Generales de Guipúzcoa and Diputación Foral de Guipúzcoa*, Opinion of AG Saggio delivered on 1 July 1999. (Case removed from the register of the Court of Justice on 16 February 2000 following discontinuance of the applicant in the cases in the main proceedings and a compromise over the so-called *Concierto económico*).

> "The fact that the measures at issue were adopted by regional authorities with exclusive competence under national law is… …purely a matter of form, which is not sufficient to justify the preferential treatment reserved to companies which fall within the scope of the provincial laws. If this were not the case, the State could easily avoid the application, in part of its own territory, of provisions of Community law on State aid by making internal changes to the allocation of competence on certain matters, thus raising the general nature, for that territory, of the measure in question."

Subsequent developments suggest a more robust approach on the part of the Commission to the exercise of fiscal autonomy. Building on the Opinion of AG Saggio, the Commission rejected part of a tax regime for the Azores[92] and refused the implementation of proposed tax reforms for Gibraltar[93] (the latter partly based on its decision in the Azores case); both of these decisions were appealed before the European courts,[94] with the ECJ recently ruling on the Azores case and the CFI due to hear the Gibraltar case.

The importance of these cases lies in the fact that the measures proposed were only selective to the extent that they applied in the territories concerned – there was no sectoral or other targeting of the type that had confused matters in the Basque country cases. As a result, the Court's findings in the Azores case set out some important principles about the precise form of regional autonomy that can be exercised without contravening the State aid rules.

5.2.3 Regional tax autonomy and the classification of a measure as aid

The Azores case concerns the decision of the Autonomous Government of the Azores to reduce rates of income and corporation tax in the region. This measure was not notified to the Commission as State aid, but the Commission opened a formal investigation, following its request for information on the scheme. The Commission found the measure to constitute State aid, but, given the status of the Azores as an 'a' area, authorised the lower tax rate *except* for specified financial service and coordination centre activities. For these activities, the Commission ordered the recovery of aid received in the form of the lower tax rate, with interest.

This Decision was challenged by the Portuguese authorities, whose principal argument was that the reduction in tax rates did not constitute a State aid at all: the Commission should not have taken the whole of the Portuguese territory as the reference framework, but only the region of the Azores, over which the Autonomous Government had jurisdiction. In the absence of any other 'selective' characteristics (such as targeting specified sectors) which

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[92] Commission Decision of 11 December 2002 on the part of the scheme adapting the national tax system to the specific characteristics of the Autonomous Region of the Azores which concerns reductions in the rates of income and corporation tax, OJEC No L 150 of 18 June 2003.

[93] Commission Decision of 30 March 2004 on the aid scheme which the United Kingdom is planning to implement as regards the Government of Gibraltar Corporation Tax Reform, OJEC No L 85 of 2 April 2005

[94] Action brought on 27 February 2003 by Portuguese Republic against the Commission of the European Communities (Case C-88/03), OJEC No C 112 of 10 May 2003; Action brought on 9 June 2004 by the Government of Gibraltar against the Commission of the European Communities (Case T-211/04), OJEC No C 217 of 28 August 2004.

would have condemned the measure as aid, the case hinged on defining the circumstances in which the decision of an autonomous regional authority to lower tax rates may constitute State aid. As noted earlier, this question has never been addressed by the European Court.

The case was first considered by Advocate General Geelhoed, whose opinion was followed by the ECJ. In his view, the crucial question concerned whether the decision was taken by an authority that was truly autonomous from the central government of the Member State. For this purpose, AG Geelhoed put forward a three-part test with a view to determining whether a local authority is institutionally, procedurally and economically autonomous. More specifically:[95]

- Institutionally autonomous means that "the decision must be taken by a local authority with its own constitutional, political and administrative status separate from central government"

- Procedurally autonomous means that the central state does not have the power "to intervene directly in the procedure of setting the tax rate" and the local authority is not obliged "to take the interests of the central state into account in setting the rate"

- Economically autonomous means that the lower tax rate applicable must not be "cross-subsidised or financed by central government, so that the economic consequences of these reductions are borne by the region itself."

This test was taken up by the ECJ in confirming the Advocate General's view that the Azores government was not truly autonomous from central government. This stemmed from the Portuguese legislation which gives rise to a duty incumbent on both the national and regional authorities to promote the correction of inequalities arising from insularity by reducing the local tax burden and by ensuring an appropriate level of public services and private activities. In addition, reductions in tax revenue may be offset by a centrally-managed financing mechanism. For this reason, the Court concluded that the Azores government was not 'truly autonomous' – it did not have procedural or budgetary autonomy - and that the lower rates of tax in the region constituted State aid.

This is a landmark case which confirms that, in certain circumstances, subnational authorities can set rates of tax below those prescribed by central government, without infringing the State aid rules. Indeed, it seems certain that, on the basis of the test outlined in the Azores case, the Commission decision outlawing the tax regime in Gibraltar will be quashed.[96]

[95] At paragraph 54. The Opinion of the Advocate General and the Judgment of the ECJ in this case (C-88/03) are available at <www.curia.eu.int>

[96] See footnote 93.

Some aspects of the test have already come in for criticism.[97] In particular, it has been argued that some degree of cooperation and consultation between national and regional governments in setting tax rates is inevitable. As such, it has been suggested that what is more important is whether the decision is reversible – ie. can central government intervene to alter the decision of the subnational authority? It has also been argued that the existence of budgetary transfers from the central to regional level should not be conclusive as to the lack of budgetary autonomy. Even where regions have a high degree of autonomy there are explicit or implicit transfers mechanisms that can be regarded as an integral component of what it means to be part of a nation state. Instead, the decisive factor should be whether the central government makes up any shortfall in revenue resulting from lower tax rates.

There is also an important policy dimension to this new development. Although the emphasis of the Commission and Court is ostensibly on the *effect* of a measure and not its form, there is a risk that the test discriminates against the less prosperous regions. For example, a prosperous region meeting the autonomy test could lower the rate of national taxation within its jurisdiction, assuming that this falls with the range of powers delegated to it. On the other hand, a poorer region, with the same degree of autonomy, may not be in a position to risk the loss of revenue that might arise from lower tax rates.[98] Equally, in a poorer region with no tax autonomy in respect of national taxation rates, the national level could not lower the tax rate for a given region without the measure constituting State aid. In short, while the decision clarifies the distinction between variable taxation rates that arise from true regional autonomy and those that are really regionally differentiated taxation, there is a risk that the clarification is one that may be exploited only by the more prosperous regions.

5.3 Other State aid policy developments

The last few years has been a highly active period in the development of State aid policy, with a number of existing frameworks under review following their actual or imminent expiry. This process has been influenced by the adoption of the State aid action plan (SAAP) which has attempted to recast State aid control to address four sets of issues in current policy practice.[99]

The first of these concerns the so-called Lisbon agenda. The Commission has stressed that State aid policy can contribute to the Lisbon objectives,[100] but there has been criticism that the existing rules do not facilitate the design of aid schemes that contribute to enterprise

[97] P. Nicolaides, 'The Boundaries of Tax Autonomy: Comment on the Opinion of A-G Geelhoed on Case C-88/03, Portuguese Republic v European Commission', *European State Aid Law Quarterly* 2006(1) pp119-121.

[98] Some might argue that lower tax rates could actually increase overall revenues, but this is unlikely to be known in advance.

[99] Annex to the State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009 (Impact Assessment) – Commission Staff Working Paper, SEC(205) 795, 7 June 2005, Brussels.

[100] European Commission, *A pro-active competition policy for a competitive Europe*, COM(293) final, 20 April 2004, Brussels.

and innovation; it is perceived to be difficult to devise and implement measures that contribute to the Lisbon objectives, even though the measures involved might have only a very limited impact on trade and competition. Related, the SAAP aims to respond to criticism that the current rules are out of touch with economic realities and are insufficiently based on economic analysis; at present, schemes with very limited effects on trade and competition are subject to the same constraints and administrative requirements as those which involve serious risks of distortion.

A second set of considerations relates to the impact of the recent (and forthcoming) enlargement. This has implications both for the administration of policy and the need for 'better governance' to ensure effective control and for the tools of economic analysis used for assessing the effects of State aid.

A third series of issues concerns inefficiency within the Commission and the Member States in the administration and enforcement of policy: the Commission's decision-making procedures are often too lengthy; there is a perceived need to involve Member States more closely in the enforcement of State aid policy; and the record on recovering illegal State aid is viewed as unsatisfactory. In addition, the increasing number and complexity of State aid rules has created an imperative to streamline policy to make it more predictable, in order to minimise legal uncertainty and the administrative burden for the Commission and national authorities.

Last, the general understanding of State aid issues, as well as transparency and enforcement at national levels are viewed as inadequate. Notification of State aids is not systematic – Commission decisions on unnotified aid account for 10 percent of all its decisions. The national courts are viewed as having a vital role to play in ensuring (partly through actions brought by third parties) that aid which has not been notified is subject to a 'standstill' requirement.

Against this background, the SAAP identifies a number of substantive priorities to which the reform of State aid control can contribute:

- Targeting innovation and R&D
- Creating a better business climate and stimulating entrepreneurship
- Investing in human capital
- Providing high quality services of general economic interest (SGEI)
- Focusing regional aid policy
- Encouraging an environmentally sustainable future
- Establishing modern transport, energy, information and communication technology infrastructure.

The SAAP also identifies some procedural and administrative priorities. It proposes to address a number of 'governance' issues in State aid control, including a consideration of what role independent national authorities might play. The need for less bureaucracy but better targeted enforcement and monitoring, including through the national courts, is also highlighted. The SAAP outlines some options for adapting the procedural rules in response to enlargement and proposes a comprehensive review of the remaining documents (ie. those not covered by the substantive priorities listed above). Last, an evaluation exercise will be conducted to ensure that the new rules and practice function properly.

The SAAP sets out a broad timetable for the adoption of new guidelines, Regulations and other documents over the period 2005-9. To date, under the broad framework of the SAAP, the Commission has published new guidelines on State aid to risk capital;[101] is in the process of revising the rules on *de minimis* aid;[102] has issued a draft framework on State aid for research, development and innovation (R&D&I);[103] and is consulting on the future of the environmental aid guidelines.[104]

A detailed review of these developments is beyond the scope of this paper. However, it is worth noting that the draft R&D&I guidelines contain no provision for support to favour investments in the problem regions; this is distinct from the current guidelines, which allow for higher rates of award in designated 'a' and 'c' areas. On the other hand, there is scope to support innovation clusters which aim to encourage a critical mass of R&D,I activity; there are no spatial restrictions proposed on the location of such clusters and it is noteworthy that in notifying such proposals Member States must:

> "provide an analysis of the technological specialisation of the innovation cluster, existing regional potential, existing research capacity, presence of clusters in the EU with similar purposes and potential market volumes of the activities in the cluster."[105]

This largely reflects the point made by the Commission in the consultation process that:

> "Whereas the regional bonus approach is appropriate for dealing with cohesion issues, it may not address perfectly the geographical dimension of market failures and restrictions of competition in the field of innovation."[106]

By contrast, the new guidelines on risk capital (which are restricted to SMEs) *do* explicitly provide for firms in the assisted areas to be favoured both through a 'lighter touch' in the approval process and through less stringent requirements on levels of private sector participation.

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[101] *Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises*, OJEU No C 194 of 18 August 2006.
[102] Not yet published in the OJ, but see: http://ec.europa.eu/comm/competition/state_aid/overview/dm2_en.pdf

[103] Not yet published in the OJ, but see: http://ec.europa.eu/comm/competition/state_aid/others/action_plan/rdi_frame_en.pdf

[104] See: http://ec.europa.eu/comm/competition/state_aid/others/00910_questionnaire_env_en.pdf

[105] Draft R&D&I guidelines, point 5.2.9.

[106] *Consultation document on state aid for innovation*, COM(2005)436 final, point 30.

It remains to be seen whether the new environmental aid guidelines will allow for higher rates of award in the assisted areas; the consultation document raised the question of whether such discrimination has had a positive effect and continues to be justified. The Commission analysis of the consultation and its response to it is currently awaited.

6. DISCUSSION ISSUES

The principal focus of this paper has been on the reform of the Regional Aid Guidelines for the post 2006 period. These emerged from a highly contested negotiation process which pitched Commission attempts to restrict regional aid to the poorest regions (mainly in the new Member States) against pressures from many EU15 Member States to retain the scope to offer regional aid.

Overall, the new Guidelines can be seen as a carefully crafted document that responds to a wide range of often conflicting pressures and demands (albeit without necessarily satisfying those demands). It sidesteps the Advocate General's criticism of the 1998 methodology, succeeds in reducing award values across the board and limits coverage in the more prosperous Member States, but allows regional aid to continue in all countries.

At present most Member States are finalising or negotiating their assisted area maps; a first batch of maps, the least contentious, have already been approved by the Commission. The remainder must be agreed by end 2006 for regional aid to continue uninterrupted. While the reform of regional aid control is not quite complete (once approved, the regional aid maps will form an integral and binding part of the guidelines) it is possible to draw some preliminary conclusions about the process as a basis for further discussion.

(i) The controversy over negotiating the guidelines may have removed the sting from negotiating the maps.

The Commission's approach to the approval of national regional aid maps has long been controversial. Prior to 1988 it was criticised for its lack of transparency. In 1988 it published the methodology underpinning its system for approving maps and exposed itself to yet more criticism. During the 1990s it worked towards a system of approving maps which the Member States would endorse, culminating in the 1998 Guidelines. The negotiation of some aspects of the 1998 Guidelines – notably the area designation criteria - was surprisingly easy, but national policymakers had failed to anticipate how intransigent the Commission would be in applying the rules in practice; many of the ensuing map negotiations were highly controversial.

Two main issues drove the initial Commission proposals for the 2006 Guidelines: first, the focus on the poorest regions (mainly in the new Member States); and second, the desire not to become embroiled in detailed analyses of individual assisted area maps. As is well-documented, these initial proposals essentially restricted regional aid to the 'a' regions and some limited areas, also selected on the basis of the EU criteria. This was fiercely resisted by many Member States, which sought to retain some scope to pursue regional aid policy in areas selected according to domestic criteria. Over the course of four texts, and against the

backdrop of dozens of position papers and meetings, the Commission reversed its initial position.[107]

Few maps are yet approved by the Commission, but early signs are that there are relatively few difficulties anticipated in compliance. In contrast with the negotiation of the maps for 2000-6, discussions with the Commission appear to centre on relatively low- key matters of technical detail, rather than issues of principle. In part this is the result of a deliberate strategy on the part of the Commission to disentangle itself from the *minutiae* of the maps, especially where those details could, arguably, have no conceivable impact on the competition and trade effects of the aid; in addition, following the experience of the 1998 Guidelines, it seems plausible to argue that the Member States were willing to agree only to rules with which they could fairly readily comply, rather than assume scope for negotiation about the interpretation of those rules at a later stage.

(ii) The new area designation requirements are more easily met by Member States and better suited to devolved policy environments, but may still compromise regional development objectives

The area designation requirements under the 1998 Guidelines were a severe constraint on national regional policy designs. Although ostensibly modelled on the German approach to regional aid targeting, the methodology lacked the flexibility that made the German model workable. Technical difficulties arose from the requirement to use a single building block (preference being given to NUTS III) where not all indicators were available at that level; and political tensions resulted from the obligation to use a single area designation system within federal or semi-federal Member States, or indeed to address different types of spatial problem. In practice, as is documented elsewhere, many Member States found it difficult to comply with the model and in a number of cases the Commission simply did not enforce some of the requirements.

Many of the difficulties which arose from the 1998 Guidelines are dealt with in the 2006 Guidelines which offer greater flexibility to address specific issues of national or local importance, without requiring a nationwide ranking system. There are some indications that this has facilitated decentralised decision-making on area designation – in France, for example, the task has been ‘deconcentrated’ to the *Préfets* to be undertaken in partnership with the regional councils. In Italy, too, the selection of assisted areas is being led by the Presidents of the regional councils in the Centre-North. This enables the development of maps that are more responsive to local perceptions of policy needs. A more cynical view is that the reduced spatial coverage renders the task more delicate and more politically sensitive; at the same time, in many countries, national regional aid policies have continued to decline in importance; there is therefore some logic in delegating this ‘poisoned chalice’ to be dealt with locally.

[107] How far the Commission was really pushed and how far its initial proposal was simply a negotiating stance is open to debate; even though the 2006 Guidelines are much less stringent than the initial proposals, they are still much more constraining than the 1998 Guidelines.

Notwithstanding the greater flexibility in the selection of areas, it is important to recall the *scale* of the reductions involved – on average around a quarter of existing coverage, and up to a half in the EU15 Member States. Restricting coverage to this extent may compromise policy objectives, especially where the targeting of rural, urban and restructuring areas has to be shoe-horned into a single regional aid map. In this context, there might have been a case for 'micro-targeting' aid for SMEs *in addition* to the 'c' area quota, rather than within it.

(iii) The Commission has successfully limited assisted area coverage and cut maximum award values; could it also have reduced the incentive effect of regional aid?

Much of the concern at the reform of the Regional Aid Guidelines, as expressed by EU15 Member States, centred on relocation within the EU and the border effects of high aid differentials. A more general issue is whether the reductions in aid area coverage and rates might affect the EU's global competitiveness for mobile investment – will award ceilings and aid areas become so limited as to be of no interest to mobile investment? Some are sceptical about the capacity of incentives to offset locational disadvantages and rightly point to the importance of the general business environment in improving competitiveness. However, all EU Member States retain the scope to aid large mobile projects and the effectiveness and efficiency of such measures is a domestic consideration; the Commission's remit should be limited to preventing distortions of competition that are not in the common interest. Moreover, it is worth noting that the EU system of state aid discipline is unique; alternative locations do not display similar self-restraint and may offer tax and other advantages that prove irresistible to mobile investors. This possibility has been noted by national policymakers; the Spring 2006 European Council concluded that:

> "taking into account the external aspects of competitiveness, it considers that the review of state aid should encourage a high level of investment in Europe and make Europe attractive for future investment."

It remains to be seen how the Commission will address this issue, but for now there is no mechanism to deal a situation in which a single EU location is competing with non-EU alternatives.

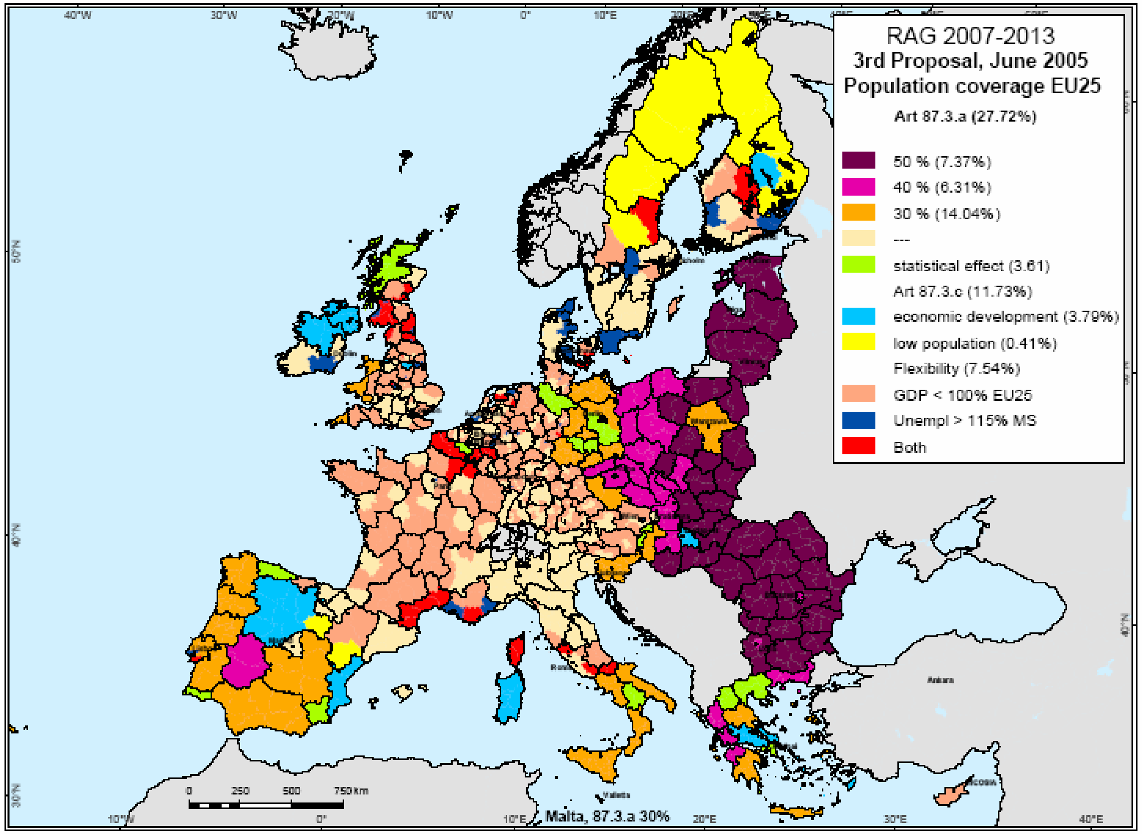
(iv) Tighter controls over regional aid and more flexibility for horizontal measures raise questions about the relationship between regional development and the Lisbon agenda, at both EU and national levels

Recent developments in State aid control and EU Cohesion policy are changing the economic development landscape. At both national and EU levels the scope to favour problem regions (outside the Convergence / 'a' regions) has been radically reduced. The new Regional Aid Guidelines have cutback the coverage of 'c' areas and substantially decreased maximum award values; the Regional competitiveness & Employment objective of the new Cohesion policy abandons the targeted approach inherent in the previous Objective 2.

The ‘flattening’ of regional prioritisation under the EU frameworks is in line with more general trends to shift away from targeting problem regions, towards a demand-led approach centred on regional competitiveness. The R&D aid guidelines respond to some of the concerns expressed in the Lisbon Agenda and increase aid flexibility overall, but cease explicitly to favour the problem regions; and the environmental guidelines may follow this pattern. The Commission has been keen to stress that there is no conflict between the Lisbon Agenda and cohesion policy. However, some vigilance may be required to ensure an appropriate balance of economic activity, especially in the context of the trend to devolve economic development policy.

APPENDIX I: MAPS

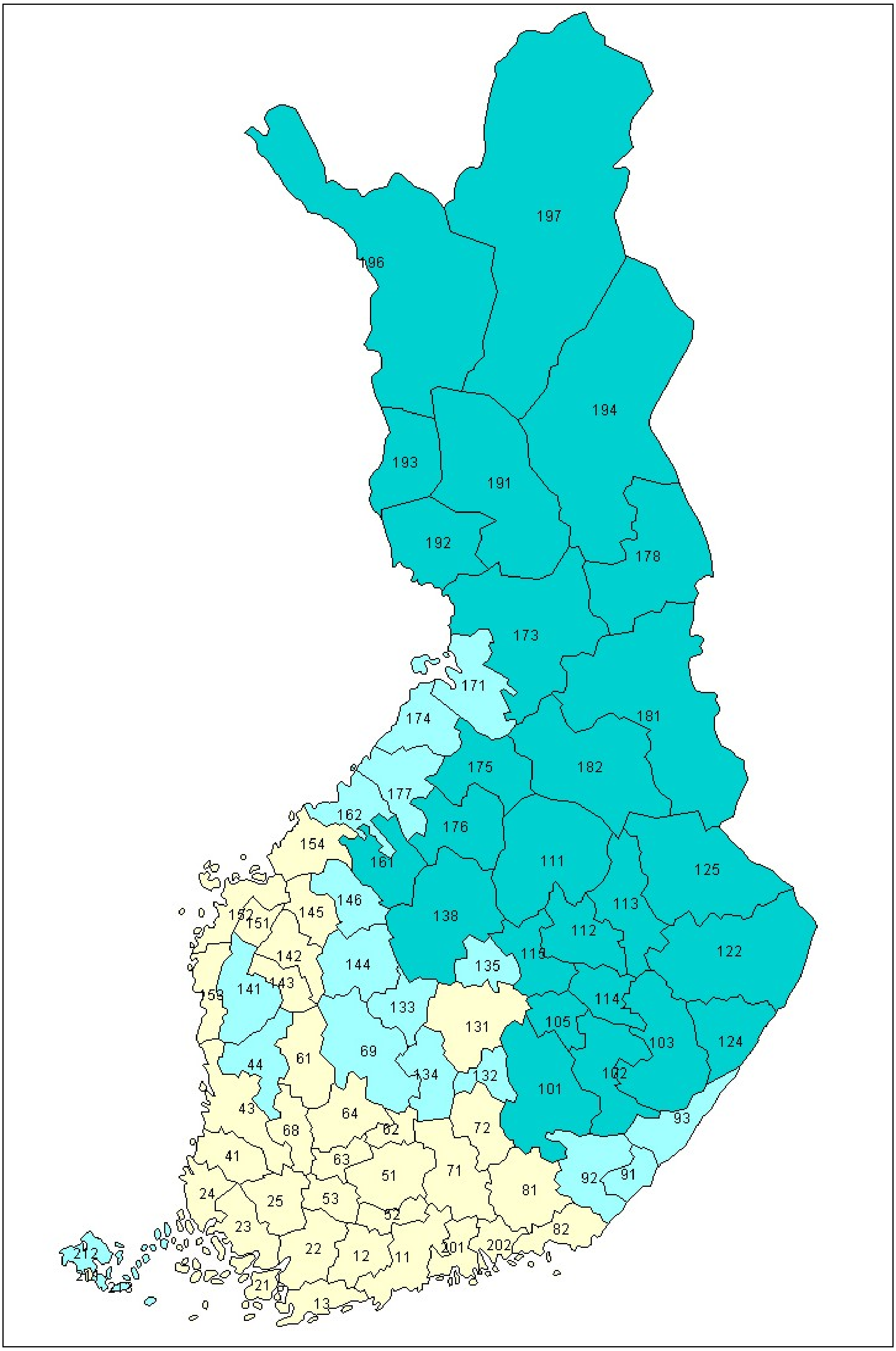
Map 1: European Commission 'pre-eligibility' map



Based on EUROSTAT statistics of 7.4.2005 (GDP in PPS per Capita 2000-2002 Avg) and 6.6.2005 (unemployment 2001-2003 Avg) / Cartography: DG COMP - G1 9/2005 / © EuroGeographics for the administrative boundaries

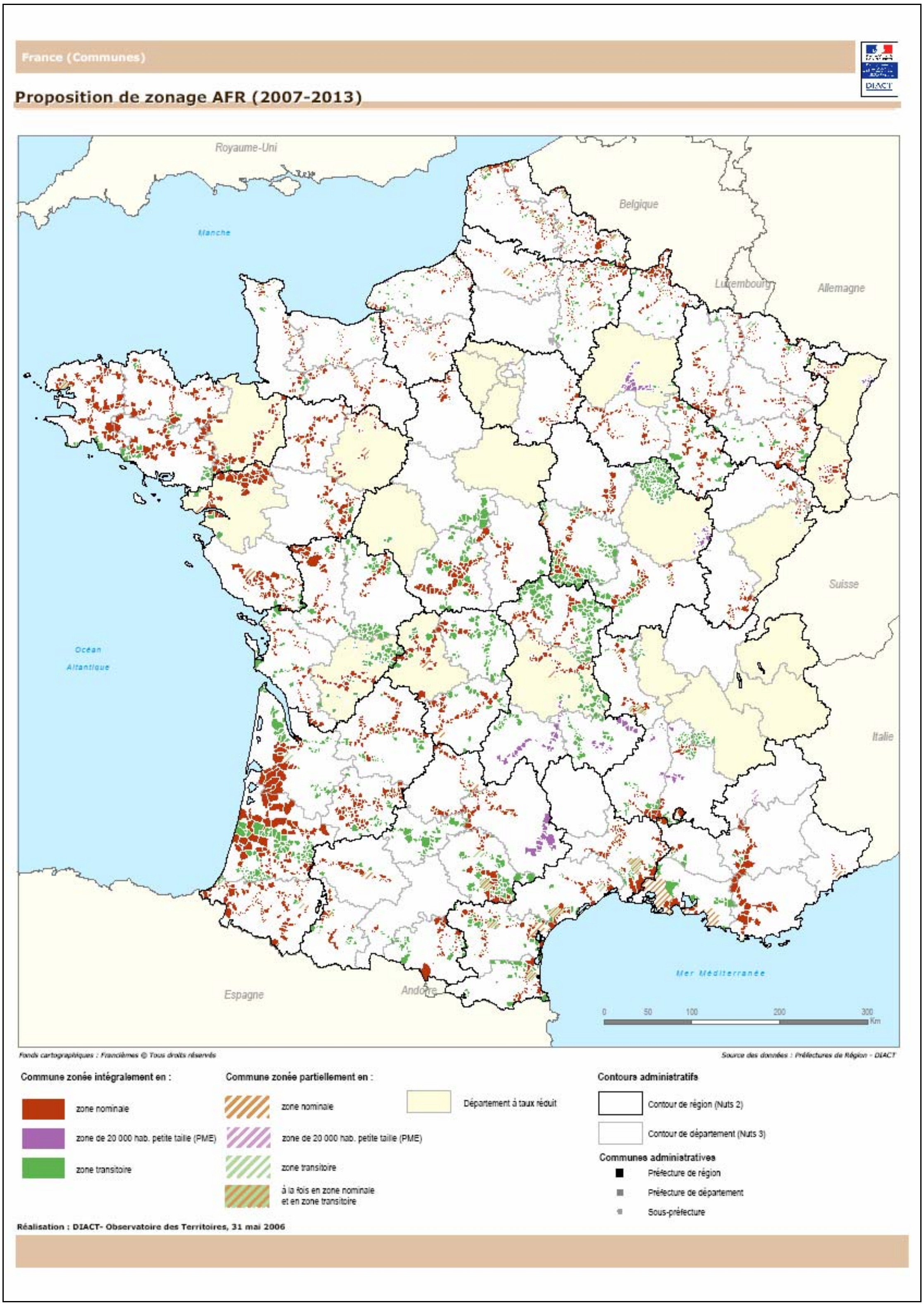
Source: European Commission

Map 2: Proposed assisted areas in Finland, 2007-13



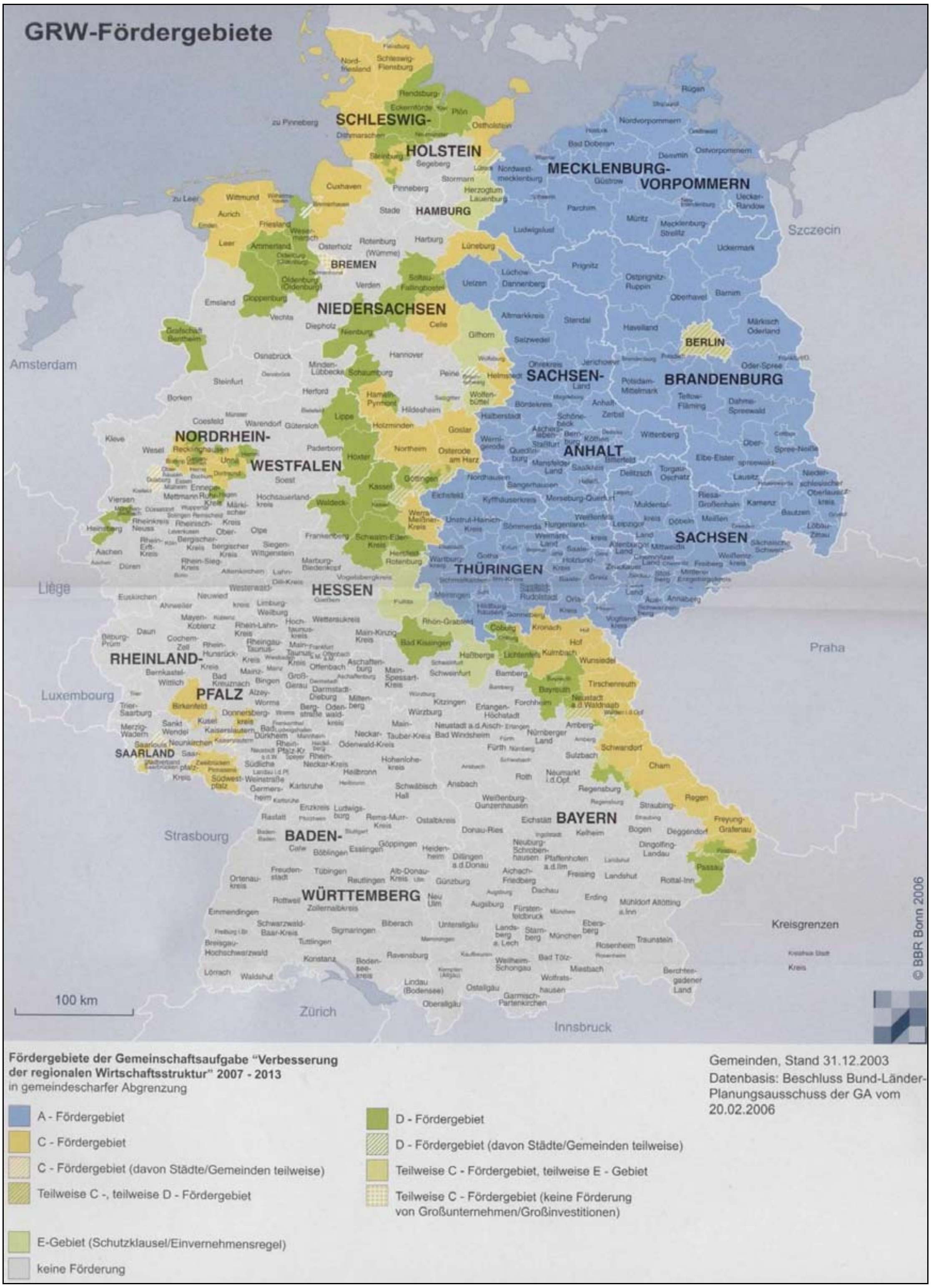
Source: Sisäasiainministeriö (Ministry of the Interior).

Map 3: Proposed assisted areas in France, 2007-13



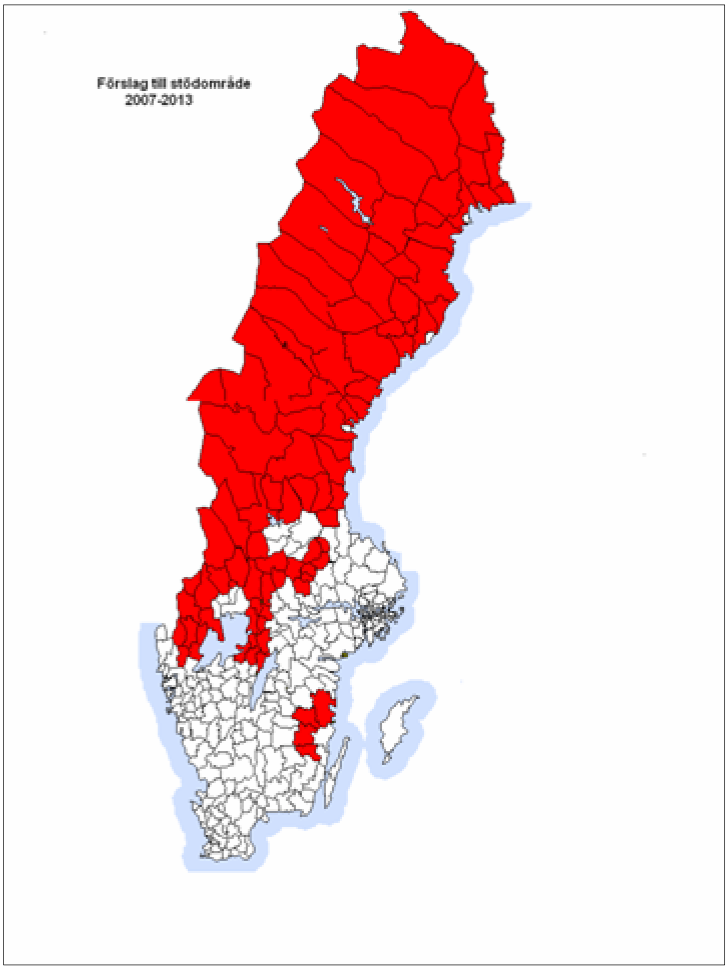
Source: DIACT

Map 4: Proposed assisted areas in Germany, 2007-13



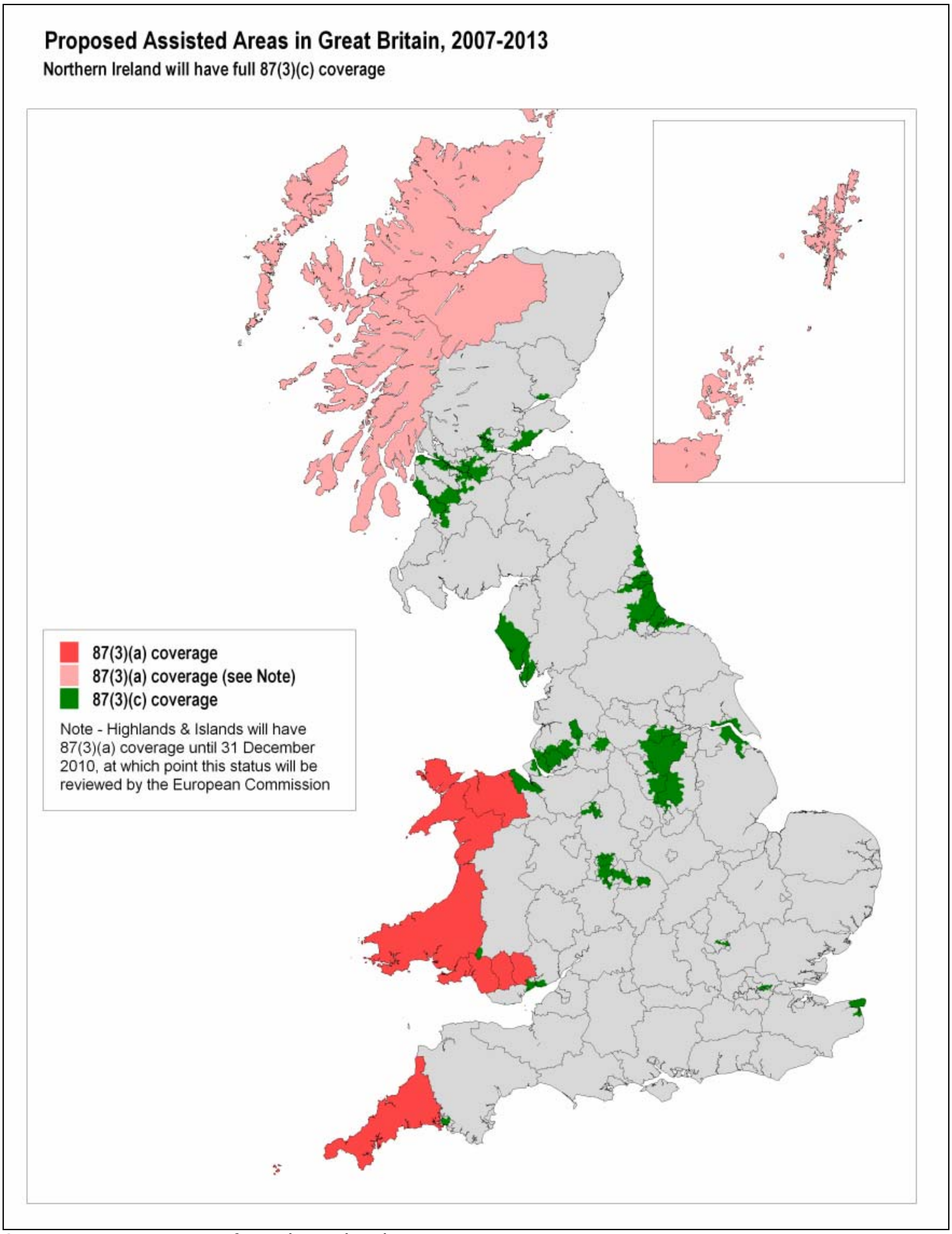
Source: Federal Ministry of Economic and Technology.

Map 5: Proposed assisted areas in Sweden, 2007-13



Source: Näringsdepartementet (Ministry of Industry, Employment and Communications).

Map 6: Proposed assisted areas in the UK, 2007-13



Source: Department of Trade and Industry