REFORM OF THE REGIONAL AID GUIDELINES: EVOLUTION OR REVOLUTION?

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1. BACKGROUND

The current (2007-13) Regional Aid Guidelines (RAG)[1] expire on 31 December 2013. On 14 January 2013 the Commission issued Draft Regional Aid Guidelines for 2014-20 for public consultation.[2] The Draft RAG imply significant changes to regional aid in the EU, particularly regarding the spatial coverage of policy and the targeting of aid to large firms and, at the time of writing, are the subject of discussion among the European institutions and the Member States. In practice, most regional aid measures currently fall within either the Regional Block Exemption Regulation or the General Block Exemption Regulation (GBER),[3] which superseded it. The GBER is also set to expire on 31 December 2013. On 8 May 2013, the Commission published a Draft GBER for consultation.[4] Against this background, the aim of this note is to outline the key features of the proposed reforms to regional aid; however, it is important to stress that policy is presently in a state of flux and further changes can be expected in the texts actually adopted. This note begins with a brief overview of the current system of regional aid control before reviewing the changes proposed.

2. THE CURRENT (2007-13) SYSTEM OF REGIONAL AID CONTROL

2.1 Overall 'architecture'

Together, the 2007-13 RAG and the GBER establish the following system for the assessment of new regional aid:

- The RAG set out the criteria for determining the regional aid maps and associated award values for 2007–2013. This incorporates a 'reduction matrix' to lower aid intensities for large projects (those with eligible investments exceeding €50 million).
- The GBER enables aids that meet transparency and other requirements, and that comply with the regional aid maps approved under the RAG, to be implemented without prior notification and approval. This accounts for the vast majority of regional aid schemes.
- Any measures not exempted under the GBER, in particular, operating aids and other measures which do not meet the transparency criteria, are assessed under the RAG. Operating aid may be approved on the basis of the RAG, notably in the Outermost Regions (OMR) and low population density (LPD) areas.

[1] Guidelines on National Regional Aid for 2007-13 [2006] OJ C54/13.
[2] http://ec.europa.eu/competition/consultations/2013_regional_aid_guidelines/index_en.html - closed 11 March.
[3] Regulation (EC) 800/2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty [2008] OJ L214/3.
[4] http://ec.europa.eu/competition/consultations/2013_gber/index_en.html

- Any individual awards not exempted under the GBER, notably certain *ad hoc* awards and proposed aid to large projects are assessed under the RAG.

2.2 Spatial coverage and eligible areas

Regional aid is designed to promote the development of disadvantaged areas defined on the basis of Article 107(3)(a) and (c) – ‘a’ regions and ‘c’ areas. This effectively restricts the use of general investment aid to large firms to those located in designated areas and determines the areas where SMEs may benefit from higher rates of award. Spatial coverage is determined by a number of factors:

- An initial limit on spatial coverage (expressed as a percentage of the EU population) is established. For 2007-13 this was 42 percent of the EU25 population. After adjustments and enlargement coverage is around 46 percent of the EU27 population.
- Reflecting early case law,[5] ‘a’ regions are deemed disadvantaged in relation to the EU situation. For 2007-13, in line with long-standing practice, these were defined as NUTS 2 regions with GDP(PPS)[6] per head below 75 percent of the EU25 average. OMR also have ‘a’ status. Total coverage of the ‘a’ regions is around 33 percent of the EU27 population.
- Two types of region were ‘earmarked’ as ‘c’ areas: (i) regions losing ‘a’ status (ie. regions that had ‘a’ region status in 2000-6, but had ‘outgrown’ the GDP threshold); and (ii) LPD areas (NUTS 3 with fewer than 12.5 inhabitants per km^2). Together regions these amount to around four percent of the EU27 population.
- Designation of the remaining ‘c’ areas was a two-stage process. First, the Commission allocated a population ‘quota’ to each Member State based on internal disparities in GDP(PPS) per head and unemployment rates; these disparities were adjusted to reflect the national situation in the EU context. Second, national authorities were responsible for selecting assisted areas, subject to the criteria set out in the RAG and Commission approval. The ‘non-earmarked’ ‘c’ areas total around 10 percent of the EU27 population.

2.3 Award values

The RAG provides for complex matrix of maximum aid intensities – ie. rates of award expressed as a percentage of eligible investment. These vary by type of area, regional GDP(PPS) per head and firm size. There are also special provisions for OMRs and border areas. Note that these intensities are ceilings, not necessarily the rates authorised by the Commission nor those applied in practice by granting authorities.

Figure 1: Maximum aid intensities (‘standard’ matrix) gross grant-equivalent

	Large firms	**Medium-sized firms**	**Small firms**
‘a’ regions GDP <45% EU25 av.	50%	60%	70%
‘a’ regions GDP < 60% EU25 av.	40%	50%	60%
‘a’ regions GDP <75% EU25 av	30%	40%	50%
‘c’ areas	15%	25%	35%
‘c’ GDP >EU av. *and* unemp. < EU av	10%	20%	30%

Source: RAG 2007-13, para 44 et seq.

[5] Case 248/84 *Germany v Commission* [1987] ECR 4013, para 19.
[6] Gross domestic product measures in purchasing power standards, which is intended to reflect national differences in the cost of living.

2.4 Aid to large investments

Regional aid for large investments, defined as projects with eligible expenditure exceeding €50m, is subject to an adjusted ceiling, as set out in the reduction formula below; SME bonuses do not apply to large investment projects irrespective of firm size.

Figure 2: Aid intensity reduction formula for eligible investment exceeding €50m

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

Source: RAG 2007-13, para 67.

Specific rules apply if, under this reduction formula, the aid proposed exceeds that which an eligible investment of €100m could obtain in the area concerned. Where the proposed aid exceeds the thresholds set out below, it must be notified.

Figure 3: Notification thresholds expressed as amounts of aid against prevailing aid ceilings

Prevailing ceiling	**10%**	**15%**	**30%**	**40%**	**50%**
Notification threshold	€7.5m	€11.25m	€22.5m	€30m	€37.5

Source: RAG 2007-13, para 64.

The Commission will open a formal into a notified aid investigation if:[7]

- the beneficiary of the proposed award has (or will have after the investment) more than 25% of the sales of the product concerned
- or the production capacity created by the project is more than 5 percent of the market.

In around three-quarters of cases to date, the Commission has raised no objections having been satisfied that the market share and capacity thresholds (sometimes referred to as 'screens' or 'filters') were not exceeded. If the investigation finds that these limits are indeed exceeded, the Commission will only approve the aid in excess of the notification threshold once it has verified, on the basis of the relevant criteria,[8] that the aid is necessary to provide an incentive effect, and that the benefits of the aid outweigh the resulting distortions of competition and trade effects. To date, only *Dell Poland* has been assessed under the large project guidance.[9]

[7] The Commission is not precluded from opening the formal procedure if the market share or capacity criteria are not exceeded – see Case T-304/08 *Smurfit Kappa v Commission* (judgment of 10 July 2012) para 88.
[8] Communication from the Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects [2009] OJ C223/3.
[9] Decision 2010/54/EC *Dell Poland* [2010] OJ L29/8.

3. KEY CHANGES PROPOSED UNDER THE DRAFT RAG

3.1 Architecture

Under the Draft RAG, the overall architecture would remain the same insofar as the RAG would set the basic parameters for spatial coverage and most measures would be covered by the GBER so would not require notification. Moreover, the GBER is extended to cover certain types of operating aid which have been routinely approved under RAG 2007-13 for OMR and LPD regions. According to the Draft RAG, four categories of would require prior notification and assessment against the RAG, namely:[10]

- Investment aid schemes targeted at particular sectors and those available to shipbuilding
- Individual investment aid above the notification thresholds (which remain as in Figure 3)
- Individual investment aid potentially linked to a closure of a similar activity in the EEA
- Operating aid schemes not covered by the GBER.

3.2 Spatial coverage

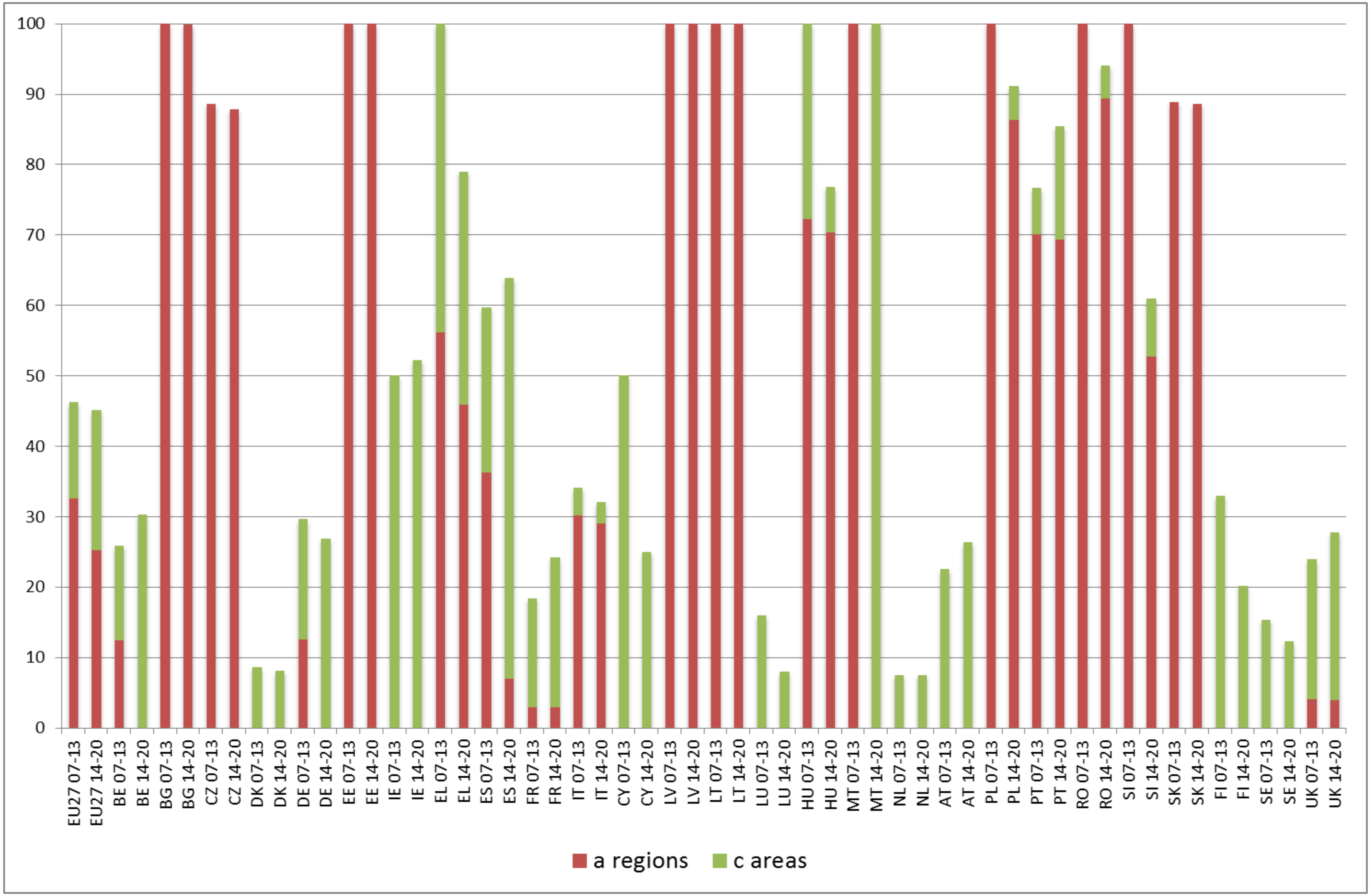
As would be expected, the underlying distinction between ‘a’ regions and ‘c’ areas is maintained, but a fundamental difference is that the Draft RAG proposes to exclude large firms from eligibility for regional investment aid in the ‘c’ areas. Other points to note are:

- The initial **population ceiling** proposed in the Draft RAG is 42 percent of the EU27 population, lower in absolute terms than the 2007-13 ceiling (42 percent of EU25+(BG+RO)); however, Commissioner Almunia has indicated that a ceiling of 45 percent will apply.[11]
- The **definition of ‘a’ regions** as NUTS 2 regions with GDP(PPS) per head below 75 percent of the EU average would stay, (but coverage would fall due to regional economic change).
- The **coverage of ‘c’ areas** would comprise two elements: ‘predefined’ areas and ‘non-predefined’ areas. This is broadly as now, but the distinction is made more rigid.
- There would be **two categories of predefined ‘c’ area** (as now): (i) regions with ‘a’ status in 2007-13 that are now over the 75 percent threshold, *but only if GDP(PPS) per head is below 90 percent of the EU average* – on this basis four current ‘a’ regions would *not* have predefined ‘c’ status post-2013: Galicia (ES), Mazowieckie (PL), Bucureşti-Ilfov (RO) and Zahodna Slovenija (SI); and (ii) low population density areas.
- As now, the **population of non-predefined ‘c’ areas** is calculated by subtracting the ‘a’ regions and the predefined ‘c’ areas from the initial ceiling. The population would be distributed between countries on the basis of both national *and* EU disparities in GDP per head and unemployment rates – a detailed but, for some countries, significant change from the current approach.
- A **‘safety net’** would apply such that no Member State loses more than 50 percent of existing coverage (as now), and each would have a minimum of 7.5 percent of the population (new).
- The actual **selection of ‘c’ areas** would continue to be undertaken by domestic authorities, based on parameters set in the RAG; some modest changes are proposed to these criteria.

[10] Ad hoc aid to large firms is not mentioned in the Draft RAG and the Draft GBER raises the treatment of ad hoc aid as a specific question for the consultation. In addition, the Draft GBER does not extend to schemes where the planned expenditure exceeds 0.01 percent of national GDP and an annual budget of €100 million.

[11] Almunia, J. (2013) ‘State aid reform and the new Regional State Aid Guidelines’, speech to Committee of the Regions plenary session, 1 February, Brussels, available at: http://europa.eu/rapid/press-release_SPEECH-13-92_en.htm

Figure 4: Population coverage 2007-13 and 2014-20 (% of total)



Note: In fact, 2007-13 figures relate to 2011-13, i.e. following the 2010 review when Statistical effect areas were re-designated as 'full' 'a' regions or 'c' areas.
Source: Own calculations from Eurostat data, RAG 2007-13 and Draft RAG 2014-20

Respondents to the public consultation could not know how the Draft RAG would affect assisted area coverage because the Draft RAG proposes the use of 2008-10 regional GDP data, which was only published after the consultation had closed. Calculating spatial coverage under the Draft RAG also relies on 2009-11 unemployment data; these have been available since 2012, but have been subject to frequent revision. The results presented in Figure 4 aim to illustrate the impact of the changes implied by the Draft RAG.[12] The calculations are based on the indications given in the Draft RAG, but with an overall population ceiling of 45 percent, as indicated above. At the EU level, the most striking point to note is that, while overall coverage decreases slightly, there is a pronounced shift in the *composition* of this coverage – with 'a' region coverage falling from around 33 percent to around 25 percent of the EU27 population and 'c' areas rising from around 14 percent to 20 percent.

At country level, patterns of change vary widely. In *relative* terms, the biggest 'losers' would be Cyprus and Luxembourg, which would see coverage halved, as both countries depend on the 50 percent safety net for coverage. In *absolute* terms, the biggest loser would be Slovenia, which would lose approaching 40 percent of existing coverage. Finland, Greece and Hungary would lose over 20 percent of current coverage, while Poland and Romania would see their capital regions excluded from the regional aid map for the first time. Sweden and Germany would see reductions of around three percentage points. In Denmark and Italy there would be more modest reductions in coverage. Note, however, that the outcomes for Italy, in particular, may be distorted by GDP data availability.[13]

Some countries would see no change in overall coverage: Bulgaria and the three Baltic states would retain 100 percent 'a' region coverage; the Netherlands would rely on the minimum 7.5 percent coverage, (the same as current coverage); and Malta would have 100 percent coverage, but with 'c' area rather than 'a' region status. Coverage in the Czech Republic and Slovakia would be unchanged; the differences shown in Figure 4 are the result of demographic change. Croatia is not mentioned in the Draft RAG, but on the basis of the latest data would qualify as an 'a' region in its entirety.

At the opposite end of the spectrum, the biggest 'winner' in relative terms would be France, which would see an increase in existing coverage of over 30 percent. In absolute terms, the main gains would be in Portugal – where coverage would increase by almost nine percentage points. Spain, Austria, Belgium and the United Kingdom would also see coverage increase by around four percentage points and there would be modest gains in Ireland.

Though it is striking that many of the more prosperous Member States might see an increase in coverage while many less prosperous ones would see a reduction, it should also be recalled that, under the Draft RAG, large firms would not be eligible for investment aid in 'c' areas; if the Draft RAG provisions hold, 'c' area maps would serve only to determine those areas in which the SME 'bonus' applies.

[12] These calculations use Eurostat population density data updated on 20 March 2013, GDP data updated on 21 March and unemployment rate data updated on 4 April 2013; they are based as closely as possible on the indications given in the Draft RAG. In practice, however, undertaking these calculations is both challenging and constrained by data availability; they involve certain assumptions that may or may not be confirmed in the final draft. For these reasons, the results presented here should be treated with considerable caution.

[13] Following a change in the NUTS boundaries, the Italian data are incomplete.

3.3 Award values

In most cases, the Draft RAG proposes a reduction in aid intensities: except for the very poorest regions, aid maxima are reduced for all size of firm – to zero in the case of large firms in 'c' areas. Note, however, that the rate 'bands' are adjusted to reflect enlargement to EU27, so direct comparisons cannot be made as such.

Figure 5: Draft RAG proposed Maximum aid intensities ('standard' matrix) gross grant-equivalent

	Large firms	Medium-sized firms	Small firms
'a' regions GDP <45% EU27 av.	50%	60%	70%
'a' regions GDP < 60% EU27 av.	35%	45%	55%
'a' regions GDP <75% EU27 av	25%	35%	45%
'c' areas	0%	20%	30%

Source: Draft RAG 2014-20, para 157 et seq.

3.4 Aid to large investments

The Draft RAG propose to retain the same definition of large investment projects and the same rate reduction formula as now (see Figure 2). However, two changes are proposed. First, eligible expenditure is capped at €500m; in practice, based on a consideration of past reporting and notifications, this would bite in few cases. Second, the market share and production capacity screens beyond which aid is subject to a more detailed assessment are dropped. This reflects the implication of the judgment in *Smurfit Kappa*, which itself has led to the Commission opening an investigation into aid to *Propapier,*[14] but perhaps also doubts about the effectiveness and utility of the screens.[15] As a result, *all* notified projects would be subject to the compatibility assessment set out in the Draft RAG.

3.5 Other new proposals

New transparency obligations are proposed in the Draft RAG. These include online publication of the full text of the aid scheme, its implementing provisions and award data, notably names of beneficiaries, aid amounts and intensities and expected benefits of the project for regional development. In principle, Member States are already required to provide online information on aid *schemes* approved under the GBER, though in practice the links to such information are often poorly maintained and the information limited in detail; it remains to be seen whether and how this requirement will be enforced. Reporting is currently required under the RAG for aid to all *large* investment projects; the Draft RAG extends this to *all* projects and the requirement to record the expected benefits for regional development is new.

A further innovation is the emphasis on evaluation. The Draft RAG mentions the possibility of limiting the validity of aid schemes to four years in order for an evaluation to be carried out. The precise terms of any requirement to undertake an evaluation[16] (which would be done by an expert independent from

[14] Commission opens investigation into public financing for German paper mill Propapier after Court judgment, 15 May 2013, http://europa.eu/rapid/press-release_IP-13-435_en.htm

[15] Kai-Uwe Kühn (2012) *Making State Aid Rules More Effective: the Reform of the Regional Aid Guidelines,* 10th annual Experts' forum on European State Aid Law, Brussels, 7 June; Friederiszich, H. and Tosini, N. (2013) *Implications of the State aid Modernisation for the Assessment of Large Investment Projects,* European State Aid Law Quarterly, 1, pp46-60.

[16] See also recent Commission issues paper on evaluation: http://ec.europa.eu/competition/state_aid/modernisation/evaluation_issues_paper_en.pdf

the granting authority) would be defined in the approval of the aid measure. However, it is not clear what the extent of the evaluation requirement would be in practice since – according to the Draft RAG - most aid schemes would not require Commission approval but instead fall within the scope of the GBER. On the other hand, the Draft GBER proposes that the notification exemption would not extend to schemes above certain budget thresholds,[17] so it may be that these thresholds will be used to trigger an evaluation requirement.

4. RELATIONS BETWEEN STATE AID CONTROL AND EU COHESION POLICY

Since the 1988 reform of the Structural Funds relations between Cohesion policy and Competition control of regional aid have often been strained. Historically, this has been especially so in context of the coverage of the assisted areas – indeed the origin of the 42 percent population coverage for 'a' regions and 'c' areas can be traced back to tensions in the 1990s; this coverage was calculated to be the minimum necessary to enable national assisted areas approved under Article 107(3)(a) and (c) to coincide with Objective 1 and 2 areas designated for EU Cohesion policy, if so desired by the Member States. A discussion of the 'co-evolution' of these policy areas goes well beyond the scope of this background note, but the Draft RAG appears to signal a shift away from earlier attempts to align the two policy areas. In particular, while Cohesion policy classifies regions on the basis of 2007-9 GDP data,[18] the Draft RAG proposes 2008-10 data. This results in some modest discrepancies between Competition policy's 'a' regions and Cohesion policy's Less-developed regions: the Greek regions Peloponnisos and Voreio Aigaio have 'a' region status on the basis of 2008-10 data, but were classified as Transition regions for Cohesion policy purposes. Moreover, EU Cohesion policy's 2014-20 three-way classification of areas as Less-developed, Transition and More-developed is only partially reflected in the Draft RAG (i.e. in the 'predefined' 'c' status of former 'a' areas). Considerable prominence was given to the issue of consistency in the recent EP debate, although the Commissioner noted that this did not mean that the maps needed to coincide exactly.[19]

Nevertheless, the extent to which the national and Cohesion policy assisted regions coincide has been less controversial since 2000, when Member States had greater flexibility in choosing both sets of areas, and especially since 2007, when Cohesion policy ceased to be spatially restricted at all. In this context, the interface between Cohesion policy and the GBER is now of more relevance than relations with the RAG. On the other hand, it is still the case that State aid issues are a source of difficulty for many Cohesion policy managing authorities – especially regarding the precise contours of the notion of State aid, the design and implementation of so-called financial instruments (essentially non-grant measures) and support for infrastructure, notably in the wake of the Leipzig-Halle decision. These are, however, 'horizontal' rather than regional aid issues.

[17] See footnote 10, above.
[18] European Council 7/8 February 2013, Conclusions (Multiannual Financial Framework) EUCO 37/13 at para 6, available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135344.pdf
[19] European Parliament Regional State aid Debate, 16 April 2013, PV 16/04/2013-20.

5. RECENT DEVELOPMENTS AND OUTSTANDING ISSUES

As noted at the outset, the reform of the regional aid guidelines is in a state of flux. Since the publication of the Draft RAG in January, there have been a number of new developments. This final section highlights three areas where further change seems likely. These concern the relationship between the RAG and the GBER, spatial coverage and the treatment of aid to large firms in 'c' areas.

The publication of the Draft GBER implies that some further 'dovetailing' of the RAG and the GBER is to take place. In particular, the Draft RAG implied that all ad hoc aid that otherwise met the conditions of the GBER would fall within it; the Draft GBER leaves open to consultation the treatment of ad hoc aid. Further, as already noted, the Draft GBER excludes from its scope aid schemes where the planned budgets exceed certain thresholds; these would be assessed under the RAG, and perhaps subject to tighter conditions associated with authorisation, such as limited duration and evaluation requirements. In short, the Draft GBER suggests that the range of measures subject to notification and assessment against the RAG might be more extensive than originally planned.

As already noted, there has also been shift in the Commission position on spatial coverage: in February, Commissioner Almunia indicated that the proposal to limit initial coverage to 42 percent of the EU27 population had been reconsidered and that a ceiling of 45 percent was justified.[20] One point to note in passing is that if the population ceiling is raised without any other adjustments being made, this tends to have the effect of benefiting the more prosperous countries disproportionately. It is not known what further flexibility might flow from Commissioner Almunia's reference to countries 'in very deep crisis'[21] - is this restricted only to Greece and Cyprus, which were cited as examples? Would this result in increased coverage even beyond the 45 percent initial ceiling? It could be observed that increasing the scope for a country in crisis to offer more regional aid is a hollow gesture unless accompanied by funds to exploit the concession.

The specific situation of regions losing 'a' region status but not eligible for pre-defined 'c' area status also seems to be under review – the Commissioner indicated in the EP debate that the 'Slovenian problem' will be resolved but did not say whether the solution would also extend to Poland, Romania and Spain. According all four affected regions predefined 'c' area status would add over two percentage points to overall coverage.

Somewhat oddly (but reflecting specific Member State concerns), the Council conclusions on the 2014-20 EU budget make explicit reference to the RAG reform and note that the Commission 'will ensure that Member States can accommodate the particular situation of regions bordering convergence regions'. [22] It is not yet clear how this will feed through into the final version of the RAG, along with the other (sometimes conflicting) demands from Member States and the output from the public consultation.

It is now apparent that the proposal to exclude large firms from eligibility in 'c' areas will not hold in its entirety. Initially, in a speech to the Committee of the Regions, Commissioner Almunia defended this

[20] Almunia, J. (2013) 'State aid reform and the new Regional State Aid Guidelines', speech to Committee of the Regions plenary session, 1 February, Brussels, available at: http://europa.eu/rapid/press-release_SPEECH-13-92_en.htm

[21] European Parliament Regional State aid Debate, 16 April 2013, PV 16/04/2013-20.

[22] European Council 7/8 February 2013, Conclusions (Multiannual Financial Framework) EUCO 37/13 at para 6, available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/135344.pdf

element of the proposals.[23] If implemented, this would have implied a profound change in regional aid policies in many countries since the sole purpose of the 'c' assisted area map would have been to determine those areas in which SMEs could receive higher aid intensities; in 'c' areas it would, among other things, have ended the use of regional aid for the attraction and retention of most mobile investment. However, it is now clear that the exclusion of large firms from regional investment aid in 'c' areas will not be absolute – an option mentioned in the recent European Parliament debate is to allow aid to greenfield investment where there is a real incentive effect.[24] This approach is largely confirmed in the Draft GBER which allows for regional aid to large firms in 'c' areas, but only in respect of 'initial investment in favour of new activity'.[25] Broadly, this appears to mean that the activity must either be in a different NUTS 3 region from existing operations owned by the same undertaking or that the activity is in a different sector.[26] This is markedly less radical than the Commission's initial proposal, but would nevertheless represent a significant change, since it excludes the possibility of using regional aid to fund expansion investment in the 'c' areas. This, together with other aspects of the proposals, notably the individual assessment of aid associated with plant closure elsewhere, represents a distinct sharpening of the approach to controlling regional aid.

[23] Almunia, J. (2013) 'State aid reform and the new Regional State Aid Guidelines', speech to Committee of the Regions plenary session, 1 February, Brussels, available at: http://europa.eu/rapid/press-release_SPEECH-13-92_en.htm
[24] European Parliament Regional State aid Debate, 16 April 2013, PV 16/04/2013-20.
[25] Draft GBER, Article 15(4).
[26] This is defined with reference to the NACE Rev 2 classification of economic activities.