



# Non-paper - Non-Starter or Non-Negotiable? EU Competition Policy and Regional Aid Control Post 2013

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## Preface

This paper was originally prepared by the European Policies Research Centre (EPRC) under the aegis of EoRPA (European Regional Policy Research Consortium), which is a grouping of national government authorities from countries across Europe. The paper was originally produced as EoRPA Paper 12/5 in the EoRPA report series. The Consortium provides sponsorship for 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. Over the past year, EoRPA members have comprised the following partners:

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The report was drafted by Fiona Wishlade and draws on the responses to the Non-paper kindly provided by the EoRPA partners.

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#### **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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## EXECUTIVE SUMMARY

The process of reform EU Competition policy control of regional aid is taking place against a complex background: the economic context is difficult, with the timing and depth of the recession varying between and within countries; the Commission has initiated a wide-ranging State aid modernisation programme (SAMI); and EU Cohesion policy is under review.

DG Competition issued a Non-paper to Member States in December 2011, and draft Regional aid Guidelines were expected to be published in September 2012. The Non-paper does not cover all the aspects of the guidelines, but with the exception of the notification thresholds and compatibility assessment (in relation to large investment projects) most of the excluded items are fairly uncontroversial. The most significant elements of the non-paper may be summarised as follows:

- **Scope:** restriction of regional aid to large firms located in ‘a’ regions only; in ‘c’ areas only SMEs would be eligible. This is arguably the most fundamental change since it would end the use of investment aid to large firms, except in the ‘a’ regions.
- **Coverage:** reduction in coverage to an initial ceiling of 42 percent of EU27 population (down from 42 percent of EU25 population, plus Bulgaria and Romania, equivalent to around 45.5 percent of EU27 population at present).
- **‘a’ regions:** abolition of the ‘statistical effect’ category; economic development areas (former ‘c’ areas now over the threshold) retained, *but only for ex-‘a’ regions with GDP per head below 90 percent of the EU27 average.*
- **‘c’ area coverage:** the allocation of the remaining ‘c’ population quota distributed according to the share of regions with GDP below an EU threshold or unemployment rate above an EU threshold; previously *national* averages were used. Safety nets apply only to some countries, rather than being universal, as at present.
- **‘c’ area designation criteria:** adjustments are made to how ‘c’ area maps may be drawn by Member States.
- **Rates of award:** lower rates of award are applied across the board (zero for large firms in ‘c’ areas).

Member State reactions have been varied. Regarding *scope*, 12 Member States are signatories to a joint letter opposing the exclusion of large firms from aid in ‘c’ areas. Countries are divided on *spatial coverage* - with debates focusing on whether the 42 percent ceiling should be retained and whether there should be a mid-term review given the volatility of the data. Most countries view the definition of ‘a’ regions as firmly entrenched, but there is considerable debate about the coverage of ‘c’ areas, especially regarding ‘predefined’ ‘c’ areas and the use of EU averages to determine quotas. Other concerns are with the definition of sparsely-populated regions and the safety net, while some question the fundamentals of the ‘c’ area approach.

The proposals are neither complete nor confirmed, but nevertheless raise some interesting issues and questions, specifically:

- Is the elimination of large firms from eligibility in 'c' areas really sustainable or will DG Competition back down? Is this a negotiating tactic or does the Commission mean it this time?
- The 'magic number' for population coverage remains 42 percent - but why? Is it time to rethink how the Commission disciplines regional aid? What appetite do Member States have for a more thorough appraisal of the rationale and underpinnings of regional aid control?
- Can the new approach to 'c' area coverage be justified against case law, which refers to areas 'disadvantaged in relation to the national average'?
- Some important data issues remain to be resolved and the choice of GDP data set has potentially significant implications for the planning, stability and coordination of policy.
- Lower rates of award are proposed, but a rationale for the new matrix is absent, other than a general principle that 'less is better'. While there may be some merit in this view, there is also a debate about whether there is a point below which incentive effect is eroded and windfall gains are increased.
- What plans does the Commission have for the scrutiny of very large aid cases? Will the shifts in SAMI from concerns about the impact of aid on competition expressed in terms of market dominance or subsidising overcapacity to a preoccupation with the effectiveness of policy, feed through into the screening and appraisal of large investment projects?

## 1. INTRODUCTION

The process of reforming the Regional aid guidelines for the post 2013 period has been underway for some time. As far back as autumn 2010 DG Competition began sounding out Member States regarding their views on the operation of the guidelines. This yielded rather little in the way of feedback and was followed up with a workshop in March 2011 which considered virtually all aspects of the guidelines. Member States were encouraged to share domestic experiences, especially in the field of evaluation and incentive effect, and to comment on the detailed functioning of the rules and how they could be improved.<sup>1</sup> Most Member States responded over the course of 2011 and, towards the year end, DG Competition outlined its thinking in a so-called Non-paper<sup>2</sup> intended as the basis for discussion at a first multilateral meeting held in February 2012.

There are a number of important contextual factors to the reform. In particular, the revision of the Regional aid guidelines is taking place in a difficult economic climate. This has direct implications for policymaker attitudes towards support for business investment and for the budgetary capacity of regional policy. At a practical level, differences between Member States in the depth and duration of the recession have rendered EU-wide measures of GDP per head rather volatile, with direct implications for the designation of assisted areas.

In addition, in May 2012 the Commission launched the State aid modernisation initiative (SAMI).<sup>3</sup> This is essentially a successor to SAAP<sup>4</sup> which had provided a so-called ‘road map’ for reform over the 2005-9 period. SAAP was set in the context of the Lisbon agenda and the perception that the State aid rules did not facilitate the design and implementation of measures to support innovation and aimed also to respond to criticism of the lack of economic analysis in State aid cases.<sup>5</sup> At the same time, the implications of enlargement and a perceived need to reduce the bureaucracy associated with ‘routine’ aid schemes culminated in the adoption of the General Block Exemption Regulation covering a range of policy areas, including regional aid.<sup>6</sup> While SAAP succeeded in putting some order into the State aid rules, there was limited progress in simplification and disproportionate Commission resources are still spent scrutinising cases of limited practical significance. SAMI provides for a re-focussing of State aid control against the backdrop of Europe 2020.<sup>7</sup>

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<sup>1</sup> These responses, as well as some possible options for the reform of the guidelines were covered in Wishlade, F (2011) Setting the scene for Competition Policy control of Regional aid 2014+, European Policy Research Paper no 80, EPRC, University of Strathclyde, available at: [http://www.eprc.strath.ac.uk/eprc/documents/PDF\\_files/EPRP\\_80\\_Setting\\_scene\\_for\\_CP\\_control\\_of\\_regional\\_aid\\_2014+.pdf](http://www.eprc.strath.ac.uk/eprc/documents/PDF_files/EPRP_80_Setting_scene_for_CP_control_of_regional_aid_2014+.pdf)

<sup>2</sup> DG Competition (2011) Revision of the Regional aid Guidelines - Non-paper from the services of DG Competition for discussion at the first multilateral meeting with experts from the Member States.

<sup>3</sup> European Commission (2012) EU State aid modernisation - SAM, COM(2012) 209 final, 8 May.

<sup>4</sup> European Commission (2005) State aid action plan, COM(2005) 107 final, 7 June.

<sup>5</sup> This view underpinned the guidance on regional aid to large investment projects - see Commission from the Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects, OJEU C223/3 of 16 September 2009.

<sup>6</sup> Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty [now Article 107 and 108], OJEU L214/3 of 9 August 2008.

<sup>7</sup> European Commission (2010) Europe 2020: a strategy for smart, sustainable, inclusive growth, COM(2010) 2020 final, 3 March.

Accordingly, the *substantive* objective<sup>8</sup> of SAMI is ‘to foster sustainable, smart and inclusive growth in a competitive internal market.’ Behind this inevitable rhetoric, what is more interesting is the perception that ‘State aid control is crucial in order to improve the efficiency and effectiveness of public spending’; this is accompanied by an emphasis on the identification and targeting of market failure and the promotion of measures with ‘incentive effect’. In practice, and as for SAAP,<sup>9</sup> the timing of the regional aid reform agenda is somewhat out of kilter with SAMI. As a result, it is unclear what the impact of reconsidering / redefining concepts like incentive effect will be on regional aid.

A third important context element concerns the reform of EU Cohesion policy. At the time of writing, the spatial dimension of policy remains in some flux - in its proposals for a new Cohesion policy regulation, the European Commission has introduced a ‘transitional’ category comprising regions with GDP(PPS) per head between 75 and 90 percent of the EU average.<sup>10</sup> The proposals are still under negotiation in Council, but potentially raise some interesting issues of policy coordination. In addition, the stated ambition of the Cyprus Presidency is to conclude the budget negotiations by end 2012. It is unclear whether this is realistic, but it raises the question of whether the same datasets will be used for both policies and, again, wider issues of spatial coincidence and policy coordination.

Given this background, the context for the reform of the regional aid guidelines is characterised by a degree of uncertainty. The aim of this paper is to provide a ‘stock take’ of progress to date. It proceeds as follows. Section 2 provides an overview and analysis of DG Competition’s Non-paper using the latest available statistical data. Section 3 considers Member State responses to the Non-paper, drawing principally on the reactions of the EorPA partners. Section 4 concludes by drawing out some questions and issues for discussion. The paper is complemented by an annex comprising a review of the 2007-13 Regional aid guidelines, and a comparative analysis of national approaches to area designation.

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<sup>8</sup> There are three stated objectives. The other two are: to focus Commission *ex ante* scrutiny on cases with the biggest impact on the internal market while reinforcing Member State cooperation in enforcement; and to streamline the rules and provide for faster decision-making.

<sup>9</sup> This led to the GBER being adopted after the 2007-13 Regional Aid Guidelines were in place and some inconsistencies between the two.

<sup>10</sup> Article 82(2)(c), COM(2011)615 final of 6 October 2011.

## 2. DG COMPETITION NON-PAPER

The DG Competition Non-paper issued to the Member States in December 2011<sup>11</sup> was provided as the basis for discussions at the first multilateral meeting held on 8-9 February 2012. However, it explicitly does not cover all the aspects of the guidelines subject to review. In particular, the Non-paper notes that issues such as the form of aid, eligible expenditure, cumulation rules, notification thresholds and compatibility assessment rules would be covered during subsequent stages of the review process. In practice, with the exception of the notification thresholds and compatibility assessment (in relation to large investment projects), most of the excluded items are fairly uncontroversial. The main focus of the Non-paper is on the determination of assisted area coverage. As noted elsewhere,<sup>12</sup> this is the most contentious aspect of regional aid control but discussion of this topic was almost entirely absent from the March 2011 workshop mentioned above. In consequence, some insight into DG Competition thinking on this was eagerly anticipated. The most significant elements of the non-paper may be summarised as follows:

- **Scope:** restriction of regional aid to large firms located in ‘a’ regions only; in ‘c’ areas only SMEs would be eligible. This is arguably the most fundamental change since it would end the use of investment aid to large firms, except in the ‘a’ regions.
- **Coverage:** reduction in coverage to an initial ceiling of 42 percent of EU27 population (down from 42 percent of EU25 population, plus Bulgaria and Romania, equivalent to around 45.5 percent of EU27 population at present).
- **‘a’ regions:** abolition of the ‘statistical effect’ category; economic development areas (former ‘c’ areas now over the threshold) retained, *but only for ex-‘a’ regions with GDP per head below 90 percent of the EU27 average.*
- **‘c’ area coverage:** the allocation of the remaining ‘c’ population quota distributed according to the share of regions with GDP below an EU threshold or unemployment rate above an EU threshold; previously *national* averages were used. Safety nets apply only to some countries, rather than being universal, as at present.
- **‘c’ area designation criteria:** adjustments are made to how ‘c’ area maps may be drawn by Member States.
- **Rates of award:** lower rates of award are applied across the board (zero for large firms in ‘c’ areas).

The remainder of this section provides an overview of the each of these changes in turn and its implications for the Member States.

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<sup>11</sup> The Non-paper was followed-up by a letter dated 27 January which detailed a number of errors in the Non-paper.

<sup>12</sup> Wislade, F (2011) Setting the scene for Competition Policy control of Regional aid 2014+, European Policy Research Paper no 80, EPRC, University of Strathclyde, available at: [http://www.eprc.strath.ac.uk/eprc/documents/PDF\\_files/EPRP\\_80\\_Setting\\_scene\\_for\\_CP\\_control\\_of\\_regional\\_aid\\_2014+.pdf](http://www.eprc.strath.ac.uk/eprc/documents/PDF_files/EPRP_80_Setting_scene_for_CP_control_of_regional_aid_2014+.pdf)

## 2.1 Scope

The most fundamental change proposed in the Non-paper is arguably that regional investment aid would only be available to large firms if they are located in 'a' regions. This in turn means that, for many countries, the function of the assisted area map is simply to determine where small and medium-sized firms can benefit from higher than standard rates of award.

The impact of this change would vary between countries depending, among other things, on: the industrial structure of the country; the extent to which regional aid is used to support investment cycles in existing firms; and the use of regional aid to influence potential mobile investment or to attract inward investment.

The justification for this in the non-paper is that deadweight is higher among large firms than small and medium-sized ones (although only one of the studies cited in the paper is concerned with regional aid - the remainder deal with R&D aid).

Also in connection with the treatment of large projects, the non-paper proposes a cap on eligible investment of €500 million (beyond which no further investment could be aided within a single project). In practice, this would affect few projects, but it could be argued that it has the potential to damage EU competitiveness for exceptionally large internationally-mobile projects.

## 2.2 Coverage

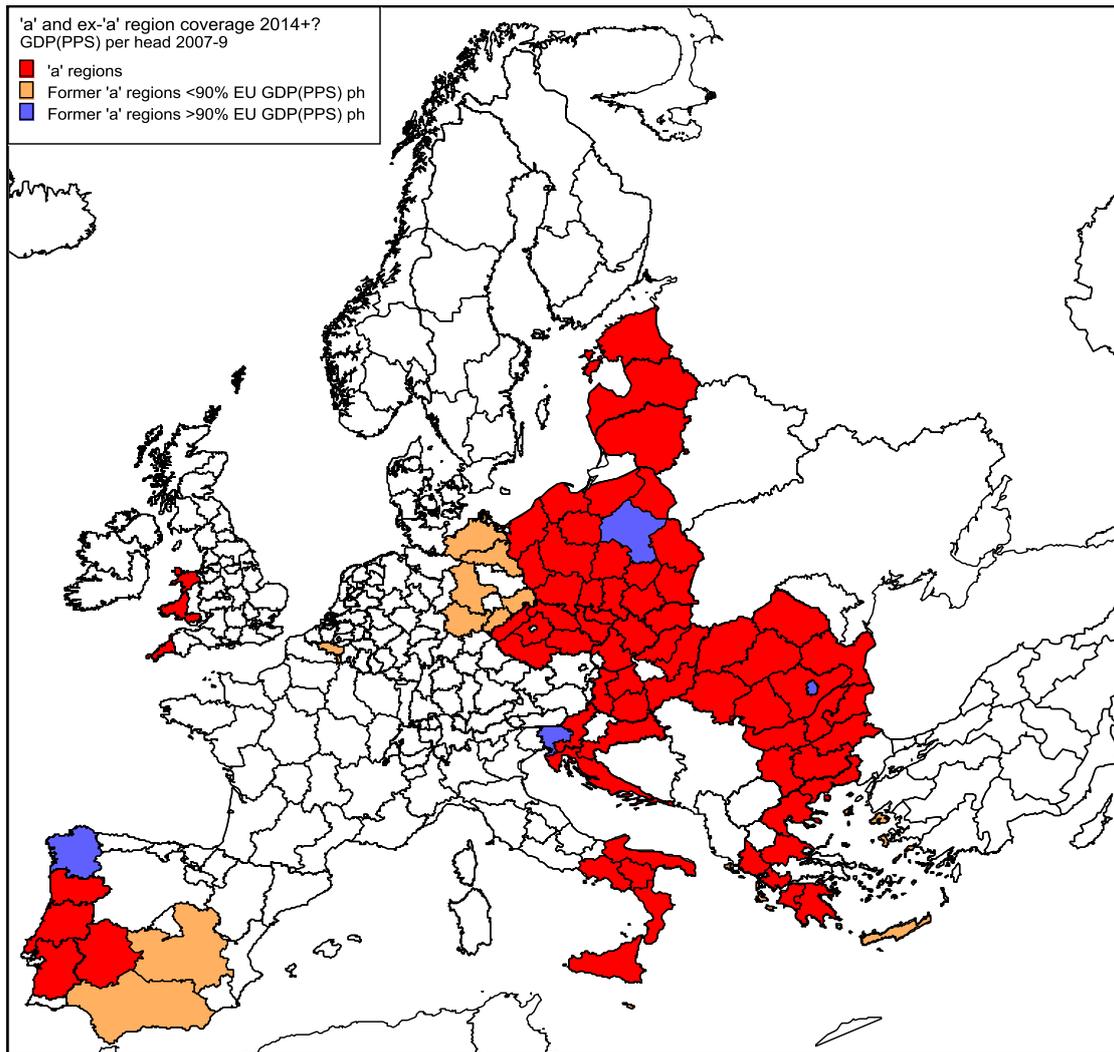
Initial overall coverage ostensibly remains the same at 42 percent of the population. However, the population base has changed, so that in effect this represents a further reduction in coverage: for 2007-13, the initial population ceiling was 42 percent of the EU25 plus Bulgaria and Romania, which amounted to around 45.5 percent of the EU27 population (but rising to 46.6 percent once safety net coverage was added).

Several points are worth making about the data to be used in the analysis. First, the Non-paper proposes that GDP data for 2008-10 should be used. This is noteworthy because this information would not, all else being equal, be available until March 2013, well after DG Competition apparently intends that the new guidelines should be adopted (autumn 2012). Second, it is not clear what data would be used for defining EU Cohesion policy intervention - as noted earlier, the Cyprus Presidency aims to complete the negotiations on the Multiannual Financial Framework by end 2012, implying the use of 2007-9 regional GDP per head data for Cohesion policy; there are therefore potential implications for policy coherence. Third, the Non-paper does not specify what period the regional unemployment rate data should cover. Historically, this data has become available a year earlier than regional GDP data, implying that 2009-11 data would be used, if GDP data for 2008-10 were used. Last, it is important to note that the depth and timing of the economic crisis has varied between countries, with the result that data are more volatile and outcomes likely to be more sensitive to the impact of updating. This in turn raises the issue of whether a mid-term review might be appropriate and if so what form that might take.

### 2.3 Definition of ‘a’ regions

The Non-paper proposes that the basic definition of ‘a’ regions should not change. As such ‘a’ regions would remain NUTS 2 regions where GDP(PPS) per head is less than 75 percent of the EU average on the basis of the latest three years data (see also section 2.2 above). By contrast, there are significant changes proposed for regions *losing* ‘a’ region status. First, the statistical effect category would be abolished. For 2007-13 this concerned regions which would have retained ‘a’ status had it not been for the effect of enlargement from EU15 to EU25 on EU average GDP per head. Clearly, enlargement from EU25 to EU27 has a much more modest impact anyway.

**Map 1: ‘a’ regions and former ‘a’ regions 2014-20?**



**Note:** Croatia is included in the map (two of the three regions qualify as ‘a’ regions), but the basis for the calculation is EU27, not EU28.  
**Source:** Own calculations from Eurostat data.

More significant is the fact that former ‘a’ regions are only proposed to be earmarked as ‘c’ areas if GDP(PPS) per head is below 90 percent of the EU average. This is an important change since, previously, *all* areas losing ‘a’ status were ‘pre-determined’ as ‘c’ areas in the subsequent period (although it was up to Member States whether they actually

designated those regions in their entirety). The outcome of applying this approach is illustrated in Map 1.<sup>13</sup> This shows four regions Galicia (ES), Mazowieckie (PL), Bucuresti-Ilfov (RO) and Zahodna Slovenija (SI) losing 'a' status and exceeding the 90 percent GDP per head ceiling.

On the basis of 2007-9 data, the 'a' regions would fall from around a third of the EU27 population to about a quarter of the EU27 population. However, reductions in coverage are not evenly spread. For most countries containing 'a' regions (BG CZ EE FR IT LV LT HU PT SK UK), population changes notwithstanding, there is no difference in coverage between the two periods. On the other hand, in some countries the changes are significant. Germany and Malta (a single NUTS 2 Member State) lose all 'a' regions. Also significant, as noted, the capital regions of Poland, Romania and Slovenia would all lose 'a' status and all three are also above the 90 percent EU27 GDP(PPS) per head threshold. In the case of Slovenia, it is worth mentioning in passing that the country was previously a single NUTS 2 region and is now split in two; had it remained a single region, Slovenia as a whole would have been under the 90 percent ceiling, though above the 75 percent threshold.

**Figure 1: 'a' regions post-2013? (% of population)**

	2011-13	2014-20?	Key changes
<b>EU27</b>	33.0	25.2	
<b>BE</b>	12.4	0.0	Hainaut loses 'a' status
<b>BG</b>	100.0	100.0	
<b>CZ</b>	88.6	88.2	
<b>DE</b>	12.5	0.0	All DE regions lose 'a' status
<b>EE</b>	100.0	100.0	
<b>EL</b>	56.6	44.2	Kentriki Makedonia, Ionia Nisia, Voreio Aigaio, Kriti lose 'a' status
<b>ES</b>	36.2	6.9	Andalucia, Castilla-la-Mancha, Galicia lose 'a' status
<b>FR</b>	2.9	2.9	
<b>IT</b>	29.2	29.1	None, but note that Basilicata gained 'a' status at the 2010 review and retains it
<b>LV</b>	100.0	100.0	
<b>LT</b>	100.0	100.0	
<b>HU</b>	72.2	70.7	
<b>MT</b>	100.0	0.0	Malta loses 'a' status
<b>PL</b>	100.0	86.3	Mazowieckie loses 'a' status
<b>PT</b>	70.1	69.4	
<b>RO</b>	100.0	89.5	Bucuresti-Ilfov loses 'a' status
<b>SI</b>	100.0	53.1	Zahodna Slovenija loses 'a' status
<b>SK</b>	88.9	88.6	
<b>UK</b>	4.0	3.9	
<b>AC1</b>			
<b>HR</b>		62.2	

**Note:** Coverage of the 'a' regions was revised from 2011 when the status of four regions - Hainaut (BE), Dytiki Makedonia and Kentriki Makedonia (EL) and Basilicata (IT) changed from statistical effect to full 'a' region status; these figures reflect that change. Croatia (HR) is not included in the EU total but its designation is based on the EU27 GDP per head average at NUTS 2.

**Source:** Own calculations from RAG 2007-13, Communication on the review of the statistical effect regions, OJEU C222/2 of 17 august 2010 and Eurostat data.

<sup>13</sup> It is important to note that this map differs from the map in the non-paper in several respects. This reflects the fact that the calculations presented here use 2007-9 GDP data, whereas those in the non-paper use 2006-8.

There is also a significant reduction in coverage in Spain where, on the basis of the latest data, only Extremadura retains 'a' status. In Belgium Hainaut loses 'a' status having only gained it in the 2010 review, giving the lie to the volatility of the data. The situation in Greece is more complex. Although Figure 1 suggests a loss in coverage, this relates to the period following the 2010 review which resulted in an increase in 'a' coverage by 20 percentage points (ie. from 36.6 to 56.6 percent of the population). This means that coverage of 'a' regions in Greece in 2014-20 would still be higher than in 2007-10.

## 2.4 Coverage of 'c' areas

In the Non-paper proposals 'c' area coverage comprises two elements, as under the 2007-13 Regional aid guidelines: first, predefined or 'earmarked' areas - those that are in effect 'entitled' to be classified as 'c' areas; and second, coverage that is determined on the basis of regional GDP per head and unemployment rates, up to the overall initial ceiling determined by the Commission. In addition, as will be seen, a safety net is applied for some countries.

### 2.4.1 Predefined 'c' areas

The 'c' area population comprises two elements that are 'predefined'. These are:

- Former 'a' regions where GDP(PPS) per head remains below 90 percent of the EU average, and
- Low population density areas - NUTS 3 areas where population density is less than 12.5 inhabitants per km<sup>2</sup>.

Figure 2: 'Predetermined' 'c' area coverage

	Former 'a' regions <90% EU27 GDP(PPS) per head	Low population density
EU27	4.8	0.5
BE	12.1	0.0
DE	12.9	0.0
EL	11.8	0.2
ES	22.2	0.5
MT	100.0	0.0
FI	0.0	18.3
SE	0.0	12.4
UK	0.0	0.4
IS		36.9
NO		25.8

Source: Own calculations from Eurostat data.

Overall, a relatively modest proportion of the EU population is predefined with 'c' area status. In absolute terms, approaching 90 percent of the population is accounted for by Germany and Spain, but, with the exception of the United Kingdom, the population involved as a percentage of the *national* population is significant.

### 2.4.2 Allocation of 'c' population quotas

The population available for distribution among the Member States as potential 'c' areas (ie. non-predefined 'c' areas) is determined by the initial ceiling (42 percent), less the population classified as 'a' regions (25.2 percent), the transitional 'a' regions (4.8 percent) and the low population density regions (0.5 percent). This yields around 11.5 percent of the EU27 population as 'c' areas, prior to the 'safety net', which is discussed below.

The non-paper provides for a *significant* change in the way in which the 'c' area population is distributed among Member States. As described in Annex I, the 2007-13 Guidelines provide for a distribution key whereby the share of 'c' population is determined according to *internal* (ie. within the Member State) disparities in GDP per head and unemployment rates adjusted by the EU average: NUTS 3 regions that count towards the share are those where either GDP per head is less than 85 percent of the national average or the unemployment rate is 15 percent above the national average.<sup>14</sup>

In the Non-paper, it is proposed that the share of 'c' population be determined by the shares of NUTS 3 regional population where: GDP(PPS) per head is below 90 percent of the EU average; or where the unemployment rate is 15 percent above the EU average.<sup>15</sup>

This detailed change in the distribution key has dramatic implications for some Member States. This is shown in Figure 3, which contrasts the results obtained from the Non-paper methodology (using EU averages) and the 2007-13 Regional aid guidelines methodology, which is based on national averages.

Overall, the use of EU averages results in a higher qualifying population - 136 million as opposed to 117 million. However, this figure is not important in itself since it is the *share* of a given Member State in the total that determines ultimate 'c' areas coverage. For some countries this share varies very significantly between the two methods. Some benefit from the Non-paper method:

- Most dramatically of all, in Spain the qualifying population increases more than threefold from 10 million to 31 million and its share of the 'c' area population rises from 8.7 percent to 23 percent
- Ireland also gains significantly with a markedly increased share under the Non-paper method.
- Portugal, Poland, Romania and France also gain under the Non-paper methodology, although the gains are not as significant as in Ireland and Spain.

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<sup>14</sup> The national thresholds are themselves adjusted to reflect the situation of the Member State in an EU context.

<sup>15</sup> The Non-paper does not specify which time period should be used for unemployment. Based on previous patterns of analysis by DG Competition, it has been assumed that unemployment rate data for 2008-10 would be used. However, this data is poor. There is no country for which there is a complete NUTS 3 data set for the period. DG Competition does not specify its approach to dealing with incomplete data. However, informally, it was been indicated that where NUTS 3 data are unavailable, NUTS 2 data are used. This approach has been replicated here. I am grateful to the EorPA partners for providing this clarification.

By contrast, a number of Member States lose significantly, notably the Netherlands, Austria, Denmark, Germany and the United Kingdom. Finland would also lose, becoming, like Sweden, reliant on the low population density criterion for 'c' area coverage.

**Figure 3: Impact of EU and National Averages on 'c' area quotas**

	Non-paper proposal		RAG 2007-13 method	
	Total qualifying pop '000s	Share of qualifying pop %	Total qualifying pop '000s	Share of qualifying pop %
<b>EU27</b>	136035	100.0	116780	100.0
<b>BE</b>	3606	2.7	3756	3.2
<b>BG</b>	0	0.0	0	0.0
<b>CZ</b>	0	0.0	0	0.0
<b>DK</b>	629	0.5	863	0.7
<b>DE</b>	22743	16.7	26238	22.5
<b>EE</b>	0	0.0	0	0.0
<b>IE</b>	3249	2.4	1699	1.5
<b>EL</b>	843	0.6	732	0.6
<b>ES</b>	31299	23.0	10216	8.7
<b>FR</b>	31541	23.2	26893	23.0
<b>IT</b>	5218	3.8	5014	4.3
<b>CY</b>	0	0.0	0	0.0
<b>LV</b>	0	0.0	0	0.0
<b>LT</b>	0	0.0	0	0.0
<b>LU</b>	0	0.0	0	0.0
<b>HU</b>	1222	0.9	1222	1.0
<b>MT</b>	0	0.0	0	0.0
<b>NL</b>	152	0.1	1007	0.9
<b>AT</b>	2087	1.5	4240	3.6
<b>PL</b>	3501	2.6	2754	2.4
<b>PT</b>	1226	0.9	794	0.7
<b>RO</b>	1944	1.4	0	0.0
<b>SI</b>	321	0.2	202	0.2
<b>SK</b>	0	0.0	0	0.0
<b>FI</b>	0	0.0	784	0.7
<b>SE</b>	0	0.0	0	0.0
<b>UK</b>	26456	19.4	30367	26.0

Source: Own calculations from Eurostat data based on information in Non-paper and methodology in Regional aid guidelines 2007-13, Annex IV, adjusted for EU27.

### 2.4.3 Safety net provisions

The Non-paper also proposes a reform of the safety net provisions. For the current period, the principle is that no Member State should lose more than 50 percent of existing (ie. 2000-6) coverage.

For 2014-20, the Non-paper does not propose a *universal* safety net but instead one that would apply only to:

- Countries receiving support under the Greek loan facility or the European Financial Stabilisation Mechanism (EFSM) - Greece, Ireland, Portugal, to date.

- Countries where there is no NUTS 2 or 3 breakdown so that the distribution mechanism described above cannot be applied (Cyprus, Luxembourg).

#### 2.4.4 'c' area coverage outcomes

The outcome of the Non-paper methodology for distributing 'c' area population is shown in Figure 4. As mentioned already, these calculations are based on 2007-9 GDP(PPS) per head and 2008-10 unemployment rate data (to the extent that this is available). The outcomes therefore differ from those in the Non-paper.

Figure 4: Estimated 'c' area coverage under the 'Non-paper' methodology (%)

	Predefined 'c' areas			Other 'c' areas		2014-20?	2007-13
	'a' regions	ex-'a' regions	low pop dens.	'c' quota	Safety net	Total	Total
<b>EU27</b>	25.2	4.8	0.5	11.5	0.5	42.5	46.6
<b>BE</b>		12.1		14.1		26.2	25.9
<b>BG</b>	100.0					100.0	100.0
<b>CZ</b>	88.2					88.2	88.6
<b>DK</b>				4.8		4.8	8.6
<b>DE</b>		12.9		11.7		24.6	29.6
<b>EE</b>	100.0					100.0	100.0
<b>IE</b>				30.8	6.7	37.5	50.0
<b>EL</b>	44.2	11.8	0.2	3.2	15.6	75.0	100.0
<b>ES</b>	6.9	22.2	0.5	28.8		58.4	59.8
<b>FR</b>	2.9			20.7		23.6	18.4
<b>IT</b>	29.1			3.7		32.8	34.1
<b>CY</b>					37.5	37.5	50.0
<b>LV</b>	100.0					100.0	100.0
<b>LT</b>	100.0					100.0	100.0
<b>LU</b>					12.0	12.0	16.0
<b>HU</b>	70.7			5.1		75.8	100.0
<b>MT</b>		100.0				100.0	100.0
<b>NL</b>				0.4		0.4	7.5
<b>AT</b>				10.5		10.5	22.5
<b>PL</b>	86.3			3.9		90.2	100.0
<b>PT</b>	69.4			4.9		74.2	76.7
<b>RO</b>	89.5			3.8		93.3	100.0
<b>SI</b>	53.1			6.7		59.8	100.0
<b>SK</b>	88.6					88.6	88.9
<b>FI</b>			18.3			18.3	33.0
<b>SE</b>			12.4			12.4	15.3
<b>UK</b>	3.9		0.4	18.1		22.4	23.9
<b>HR</b>	62.2					~	~
<b>IS</b>			36.9			36.9	37.7
<b>NO</b>			25.8			25.8	29.1

Notes: It is not clear whether Croatia would also have 'c' area coverage.

Source: Own calculations from Eurostat data and data in Annex I.

The impact of the Non-paper varies widely among countries:

- For seven Member States (BG EE LT LV MT CZ SK) there would be no change in overall coverage<sup>16</sup>
- Two Member States (BE FR) would see an increase in coverage
- Four countries (AT DK NL SI) would have coverage cut by more than 40 percent of 2007-13 coverage
- Four countries would rely on the safety to restrict cutbacks to 25 percent (CY EL IE LU)
- Three countries would have coverage cut by between 15 and 25 percent (SE DE HU)
- The remainder would see cutbacks in the range 9.8 percent (PL) to 3.3 (ES).

These changes are essentially a function of four interrelated factors: (i) the reduction in ‘a’ region coverage owing mainly to economic change;<sup>17</sup> (ii) the exclusion of former ‘a’ regions with GDP per head exceeding 90 percent of the EU27 average from predefined ‘c’ area status; (iii) the use of EU GDP per head and unemployment rate averages in the ‘c’ area distribution key; and (iv) the absence of a universal safety net.

The reduction in ‘a’ region coverage from 33 percent to 25.2 percent increases the population available for ‘c’ areas *even though the overall population coverage is also reduced*. The fact that some former ‘a’ regions are not predefined as ‘c’ areas (eg. Mazowieckie, Bucuresti-Ilfov) also serves to increase the ‘c’ area population quota for distribution. However, the revised approach to distributing the ‘c’ population tends to disadvantage Member States where unemployment is low compared to the EU average. This is reflected in Figure 5 which shows the outcome based on retaining the 2007-13 approach to distributing the ‘c’ area population - ie. based on adjusted national averages.

The outcomes in Figure 5 illustrate why DG Competition has proposed an alternative method to distributing the ‘c’ area population: the use of national thresholds would result in coverage increasing by between ten and 27 percent of 2007-13 coverage in four (more prosperous) Member States (AT BE FR UK) while in some of the less prosperous countries coverage would decline by up to ten to 42 percent of current coverage (PL RO EL HU SI).

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<sup>16</sup> In the Czech Republic and Slovakia there are small reductions in the population coverage owing to population decline in the ‘a’ regions; there is no ‘c’ coverage in the Czech Republic and Slovakia.

<sup>17</sup> A small proportion of the change owes to the statistical effect of the shift from EU25 to EU27 averages, but this is compensated for by the inclusion of such regions as predefined ‘c’ areas.

Figure 5: Estimated 'c' area coverage using RAG 2007-13 'c' area quota method (%)

	Predefined 'c' areas			Other 'c' areas		2014-20?	2007-13
	'a' regions	ex-'a' regions	low pop dens.	'c' quota	Safety net	Total	Total
<b>EU27</b>	25.2	4.8	0.5	11.5	0.6	42.6	46.6
<b>BE</b>		12.1		17.1		29.2	25.9
<b>BG</b>	100.0					100.0	100.0
<b>CZ</b>	88.2					88.2	88.6
<b>DK</b>				7.7		7.7	8.6
<b>DE</b>		12.9		15.8		28.6	29.6
<b>EE</b>	100.0					100.0	100.0
<b>IE</b>				18.8	18.7	37.5	50.0
<b>EL</b>	44.2	11.8	0.2	3.2	15.6	75.0	100.0
<b>ES</b>	6.9	22.2	0.5	11.0		40.6	59.8
<b>FR</b>	2.9			20.5		23.4	18.4
<b>IT</b>	29.1			4.1		33.2	34.1
<b>CY</b>					37.5	37.5	50.0
<b>LV</b>	100.0					100.0	100.0
<b>LT</b>	100.0					100.0	100.0
<b>LU</b>					12.0	12.0	16.0
<b>HU</b>	70.7			6.0		76.7	100.0
<b>MT</b>		100.0				100.0	100.0
<b>NL</b>				3.0		3.0	7.5
<b>AT</b>				24.9		24.9	22.5
<b>PL</b>	86.3			3.6		89.9	100.0
<b>PT</b>	69.4			3.7		73.0	76.7
<b>RO</b>	89.5					89.5	100.0
<b>SI</b>	53.1			4.9		58.0	100.0
<b>SK</b>	88.6					88.6	88.9
<b>FI</b>			18.3	7.2		25.5	33.0
<b>SE</b>			12.4			12.4	15.3
<b>UK</b>	3.9		0.4	24.2		28.5	23.9
<b>HR</b>	62.2					~	~
<b>IS</b>			36.9			36.9	37.7
<b>NO</b>			25.8			25.8	29.1

Notes: Only the mechanism for distributing the 'c' area population is changed in this table - the treatment of former 'a' regions and the safety net provisions remain as in the Non-paper proposal. Source: Own calculations from Eurostat data and data in Annex I.

## 2.5 Designation of 'c' areas

The criteria for designating 'c' areas (which is primarily a Member State responsibility, subject to Commission approval) remain substantially unchanged in the Non-paper, but there are some proposed changes to the size and definition of the 'building blocks' to be used. The criteria are identified as follows:

- **Criterion 1** (paragraph 30c of RAG 2007-13): contiguous zones of at least 100,000 inhabitants located in NUTS 2 or 3 regions which have either:

- GDP per capita below the EU average or
- Unemployment rate above 115 percent of the *national* average
- **Criterion 2** (paragraph 30d of RAG 2007-13): NUTS 3 regions with population of less than 100,000 which have either:
  - GDP per capita below the EU average or
  - Unemployment rate above 115 percent of the *national* average
- **Criterion 3** (paragraph 30e of RAG 2007-13): islands or other regions characterised by similar geographical isolation which have either:
  - GDP per capita below the EU average or
  - Unemployment rate above 115 percent of the *national* average
- **Criterion 4** (paragraph 30f of RAG 2007-13): islands with fewer than 5000 inhabitants or other communities of less than 5000 inhabitants characterised by similar geographical isolation.
- **Criterion 5** (paragraph 30g of RAG 2007-13): NUTS 3 regions or parts thereof that are adjacent to ‘a’ regions or that have a border with non-EEA/EFTA countries
- **Criterion 6** (paragraph 30h of RAG 2007-13): contiguous zones of at least 50,000 inhabitants which are undergoing major structural changes or are in serious relative decline in relation to comparable EU regions
- **Criterion 7** (paragraph 31 of RAG 2007-13): areas of at least 20,000 inhabitants which are relatively more in need of economic development than other areas. The Non-paper notes that this criterion only concerns SME projects involving eligible investment of less than €25 million.<sup>18</sup>

Where ‘c’ area coverage is less than 1 million inhabitants, the non-paper proposes to lower the minimum population to 50,000 for Criteria 1 and 2 and to 10,000 for Criteria 6. This would appear to apply to Austria, Cyprus, Denmark, Finland, Greece, the Netherlands, Hungary, Luxembourg, Portugal, Romania and Slovenia.<sup>19</sup> The aim is clearly to increase flexibility in the case of countries with very low coverage.<sup>20</sup> Even so, as Figure 6 shows, the scale of the population involved is, in some cases, very small and it may be doubted that meaningful maps can be drawn at this level.

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<sup>18</sup> In principle, of course, the Non-paper specifies that only SMEs are eligible in ‘c’ areas.

<sup>19</sup> The Non-paper identifies Austria, Finland, Greece, Hungary, Ireland, the Netherlands and Portugal as being affected by this provision, but calculations in this paper are based on more recent data.

<sup>20</sup> The 2007-13 Guidelines make special provision for Cyprus and Luxembourg requiring either GDP per head less than the EU average or unemployment over 115 percent of the national average and a minimum population 10,000; this provision is not repeated in the Non-paper, though clearly there is scope to include similar provisions in the final draft.

**Figure 6: Non-predefined 'c' area coverage and building blocks**

	Non-predefined coverage 2014-20?	Building blocks used in 2007-13
BE	1,523,370	LAU2 and parts of LAU2 (Brussels)
DK	265,880	LAU 1
DE	9,609,067	NUTS 3; <i>Verkehrszelle</i> (Berlin)
IE	1,672,088	LAU 2
EL	2,121,400	n/a
ES	13,223,901	LAU 2; Census districts
FR	13,326,104	LAU 2; cantons urbains
IT	2,204,399	LAU 2; census areas
CY	300,000	LAU 2
LU	59,736	LAU 2
HU	516,127	n/a
NL	64,262	LAU 2; part Gemeenten
AT	881,548	LAU 2
PL	1,479,261	n/a
PT	517,817	LAU 2
RO	821,511	n/a
SI	135,665	n/a
UK	11,177,518	LAU 2

Source: Own calculations from Eurostat data based on Non-paper and Annex I.

The Non-paper also seeks to improve the 'concentration' of aid by specifying that, in general, assisted area maps must be composed of entire LAU 2 units;<sup>21</sup> where part LAU 2 are used, these should contain 75 percent of the minimum population requirement (ie. 75 percent of 100,00 or 20,000). A consideration of the approaches used for the 2007-13 maps (see Figure 6) suggests that this is not likely to be a major constraint for most countries, but that it may nevertheless prove to be an obstacle in some countries, and especially in the case of urban areas.

## 2.6 Rates of award

The Non-paper proposes a general reduction in award rates. The proposal is summarised in Figure 7, which compares the current position with the non-paper proposals. In practice, direct comparisons cannot readily be made since EU GDP per head refers to EU25 in the current period, but EU27 in the next. Nevertheless, it is evident that the reductions suggested, in respect of large firms especially, are significant. Most significant of all, of course, is the proposal that it would only be possible to support large firms if they are located in 'a' regions.

<sup>21</sup> Local administrative unit. LAU2 corresponds to, for example, Gemeinden in Germany, communes in France, comuni in Italy and wards in the UK.

**Figure 7: Proposed award rates in the non-paper**

Region type	Large firms, %		Small/medium firms, %	
	Proposed	Current	Proposed	Current
'a' regions <45% EU GDP per head	35	50	45/55	60/70
'a' regions >45% <60% EU GDP per head	30	40	40/50	50/60
'a' regions >60% <75% EU GDP per head	25	30	35/45	40/50
Ex-'a' regions <90%	-	30/40	25-35	40-60
Standard 'c' areas	-	10/15	20/30	30-50
Non-assisted	-	-	10/20 (GBER)	10/20

**Note:** The Non-paper mentions four year transitional arrangements for former 'a' areas gaining 'c' status, but does not specify award rates. No mention is made of former 'a' areas *not* gaining 'c' status.

**Source:** Assembled from Non-paper and 2007-13 Guidelines.



### 3. MEMBER STATE PERSPECTIVES

Member States have been given a number of opportunities to express their views on the future of the Regional aid guidelines, both before and since the issue of the Non-paper. Overall, most Member States have done so. This section provides a brief summary of national views on the Non-paper proposals focusing on the views of the EoRPA partners. At the request of several of the partners, these views are anonymised,

#### 3.1 Scope

In a joint letter to Commissioner Almunia 12 Member States (FR DE HU IE LV LU PL PT RO SI ES UK) raised their concerns about the scope of the non-paper proposals, specifically the exclusion of large firms from eligibility for aid in the 'c' areas. Four reasons were cited: first, that large investment projects can bring benefits to all types of assisted areas and bring net benefits to the EU as a whole; second, that excessive restrictions on support for large firms may create distortions of competition between EU and non-EU locations; third, that there is strong evidence of the positive impact on subcontracting, the role of large firms as 'lighthouse' projects in less developed regions and as an anchor for potential sector clusters. Last, that assisted areas of all types are particularly affected by the current climate of economic uncertainty and that this justifies maintaining the possibility of support for job and growth-creating projects in 'c' areas.

Several other countries that were *not* signatories to the joint letter also expressed their opposition to this proposal, citing similar reasons. However, opposition to the exclusion of large firms from aid in 'c' areas is not universal. Moreover, several Member States that do support aid for large firms also note the need to curb it by, for example, supporting the proposal to limit eligible expenditure to €500 million, finding ways to ensure the 'incentive effect' of aid to large firms or reviewing (and lowering) rates of award for very large projects.

#### 3.2 Spatial coverage

Comments on the spatial coverage aspects of the proposal are concerned with two issues: the overall ceiling; and time period to be used for eligibility.

Member States are divided on the question of overall population coverage. Some endorse the proposal to lower the initial ceiling to 42 percent; other argue that there is no justification for a further reduction - current coverage (around 46.6 percent) is well below half of the EU population and prospective enlargements do not have significant implications.

Regarding eligibility, a number of Member States oppose the use of 2008-10 GDP data for determining coverage post-2014. The main arguments for this are (i) the GDP data proposed for Cohesion policy concern 2007-9 so that there would inevitably be inconsistency between the national and the cohesion policy maps; and (ii) that awaiting 2010 data leaves too short a timescale for domestic consultation over area designation and preparation of new maps.

The problem of volatility of the data is nevertheless recognised by Member States. A number propose mid-term reviews at various points in the cycle; one country suggests retaining existing maps for another year before reviewing, while another argues that longer time periods should be used in order to iron out fluctuations.

### **3.3 Definition of ‘a’ regions**

The definition of ‘a’ regions is largely viewed as a given and firmly entrenched in regional aid control policy - indeed some country positions make precisely this point and most support the dropping of the Statistical effect category, which would anyway affect very few regions. On the other hand, one Member State recalls the precise terms of Article 107(3)(a), that ‘aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment’ shall be compatible with the internal market. It observes that the Commission has never implemented the employment-related criterion and that GDP per head alone is insufficient to measure regional economic problems. It calls on the Commission to complement the assessment of ‘a’ regions with an analysis of the unemployment situation, as for ‘c’ areas.

Whilst it is true that the employment-related criterion has not been implemented, it is also questionable whether some form of unemployment measure is relevant here - the Treaty refers to *underemployment*. Moreover, it is also arguable that the GDP per head is not suitable for measuring standards of living and some measure of household or personal income would be more pertinent.

### **3.4 Coverage of ‘c’ areas**

The coverage of ‘c’ areas attracts considerable comment, as might be expected given the potentially significant impacts for some countries. The comments span a range of issues, including the scope of the predefined ‘c’ areas, the definition of the low population density areas, the proposed method for distributing ‘c’ area population and the safety net. They are not surprisingly marked by a degree of self-interest.

Regarding the predefined areas, some national policymakers propose an extension or redefinition of these. One Member State proposes the extension of the predefined ‘c’ areas to include all NUTS 2 regions with GDP(PPS) per head below 90 percent of the EU27 average, in line with the proposed approach to Cohesion policy. Another argues that the current Statistical effect areas should be predefined areas, irrespective of whether GDP(PPS) per head is over the 90 percent threshold. A further suggestion is that countries which border ‘a’ regions in other Member States should have additional ‘c’ area population allocations.

Several countries propose adjustments to the criteria for defining low population density areas. One suggests that the definition should include not only NUTS 3 areas with fewer than 12.5 inhabitants per km<sup>2</sup>, but also NUTS 2 areas with fewer than eight inhabitants per km<sup>2</sup>.<sup>22</sup> However, another argues that while NUTS 2 and 3 should be used for population

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<sup>22</sup> This corresponds to the definition of the former Objective 6 regions for Cohesion policy.

density, the threshold should be set at 12.5 inhabitants per km<sup>2</sup> for both. A further suggestion is that the area taken into account in measuring population density should take account of inland water, not least since this has implications for distance and travel.

The proposed method for distributing the 'c' area population is controversial. Most of the EoRPA partners are opposed to the method (though this is not unanimous). The main criticisms are two-fold. First, the proposed method takes insufficient account of disparities *within* countries - and arguably runs counter the Court's position that Article 107(3)(c) 'gives the Commission power to authorize aid intended to further the economic development of areas of a Member State which are disadvantaged in relation to the national average'.<sup>23</sup> A counter to this argument is that this part of the process is concerned with establishing *coverage*, and not with the selection of the *actual areas*, which is at the initiative of the Member States, and which may be disadvantaged in the national context. The second criticism is the fact that the proposed method use EU wide measures of unemployment; these are not viewed as being comparable across countries owing to the impact of factors like female participation rates and welfare benefits.

National policymakers are divided on the issue of the safety net, with some arguing that it should be restricted to countries where crisis measures have been introduced (PT IE EL - and presumably excluding CY LU), while others claim that the safety net should be applied across the board at the rate of 75 percent.

More fundamentally, one Member State is critical of the whole approach to distributing the 'c' area population and calls for a radical review of the methodology, including the possibility for aid to be payable up to a given budget limit to be agreed with the Commission, rather than in relation to strictly delimited 'c' area maps.

### **3.5 Designation of 'c' areas**

By contrast, the proposed area designation criteria for 'c' areas attract comparatively little comment. This is at least in part because some clarification is required, as several national positions note.

Notwithstanding this, several countries question the logic of smaller population blocks in countries with lower coverage. Others argue that 100,000 is too high and that self-containment is as important as population size. Those affected by the potential loss of flexibility in the use of building blocks tend to be opposed to it. Partly related, there are some concerns at the 'contiguity' requirements, particular for certain types of geography, notably mountain regions.

### **3.6 Aid values**

There is no real consensus among countries on aid rates. Several (but not all) support the proposal to lower rates across the board, but some are concerned at the rate differentials. These concerns vary: some would seek a maximum of 15 percentage points between 'a' and

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<sup>23</sup> Case 284/84 *Germany v Commission* [1987] ECR 4013, p 4042.

'c' areas; others are concerned that the differential between the 'c' areas and the non-assisted areas should not fall too low. One country argues that the minimum rate for large firms, even under the special provisions for large investment projects, should not be less than ten percent in order to avoid creating windfall gains (since aid is perceived to have limited incentive effect below this level). A further suggestion is that aid rates should be set at NUTS 3, rather than NUTS 2.

An alternative proposal to a general reduction in aid rates is to introduce a requirement for Member States individually to assess the funding requirements for large firms; a reconsideration of the reduction matrix for large firm awards is also among the suggestions from Member States.

Other proposals include the need for longer transitional periods for former 'a' regions in relation to aid values.

### **3.7 Other observations**

Most of the other concerns raised by countries concern the need to clarify the Commission's intentions regarding specific sectors such as steel, synthetic fibres, transport and shipbuilding, which have historically been subject to separate provisions, the relevance of which is now being questioned.

## 4. DISCUSSION ISSUES

The aim of this paper has been to provide a first assessment of DG Competition's Non-paper and its implications for domestic regional aid policies. The proposals are neither confirmed nor complete, but the indications given in the Non-paper have significant implications for many countries. The objective of this last section is to draw out concluding issues and questions.

(i) *Is the elimination of large firms from eligibility in 'c' areas really sustainable or will DG Competition back down?*

The most significant change proposed in the non-paper is the exclusion of large firms from eligibility in 'c' areas. This has been robustly opposed by a number of Member States in a joint letter, but is not rejected by all.

This hardline approach carries echoes of DG Competition's early proposals for the 2007-13 period, in which the opening gambit was to propose the elimination of regional aid in all areas, save the 'a' regions, former 'a' regions, Outermost regions and sparsely-populated areas.<sup>24</sup> This too was fiercely opposed by a number of Member States in a joint letter. The Commission ultimately retreated from its proposal, but opinion is divided as to whether its initial proposal was a deliberate negotiating strategy to enable the Commission ultimately to impose rules that were much more constraining than those for 2000-6, even if much less radical than the ideas initially floated.

It may be that the retention of the existing provisions of the selection of 'c' areas, reveals DG Competition's real intention. If the Commission is serious about eliminating aid for large firms in 'c' areas, the designation criteria for 'c' areas seem like overkill. As described, the existing rules for the actual selection of 'c' areas by Member States are largely retained. There is somewhat more flexibility for countries with very low assisted area coverage, but is countered by some 'anti leopard skin' provisions in the choice of building block. Why are such constraints required if the Commission remains comparatively relaxed about the impact of aid on competition between SMEs?

(ii) *The magic number remains 42 - but why?*

The coverage of the regional aid maps has always been the most controversial dimension of Commission control of regional aid schemes. Since the 1990s, and especially since the 2000-6 regional aid guidelines, coverage expressed as a percentage of EU and national populations have been a key part of regional aid discipline. The starting point has been EU coverage of 'around' 42 percent of the population. The origin of this figure lies in a dispute between the Member States, DG Competition and DG Regio in the 1990s where some expressed concern at the lack of coincidence between the national assisted area maps and those designated for Cohesion policy (Objective 1, 2, 5b and 6). For 2000-6 the EU population ceiling was set at 42.7 percent of the EU15 population, this having been calculated as the minimum necessary to accommodate those Member States that wished

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<sup>24</sup> See Wishlade, F (2008) 'Competition and Cohesion - Coherence or Conflict? European Union State Aid Reform Post 2006', *Regional Studies* 42(5), 753-765, for a history of the reform process.

national and EU Cohesion policy maps to coincide. For 2007-13 a 'similar' initial ceiling of 42. percent of of the EU25 population - was retained, although by then the Cohesion policy imperative for coincidence longer applied (at least in the same way) - since all regions were designated as either Convergence or Regional Competitiveness and Employment Regions. The Non-paper also proposes 42 percent as the starting point (but of the EU27 population). Looking forward, a number of Member States dispute continued adherence to this ceiling - why, for example, should coverage fall again when regional disparities are growing and there is no enlargement to accommodate? There are also more fundamental questions: the overall ceiling coupled with the parameters for 'a' and 'c' areas has arguably pushed this approach to regional aid discipline beyond its logical limits. Is it time to rethink how the Commission disciplines regional aid? What appetite do Member States have for a more thorough appraisal of the rationale and underpinnings of regional aid control?

*(iii) Can the new approach to 'c' area coverage be justified against case law?*

A key change in the Non-paper proposals lies in the detail of the methodology for distributing 'c' areas - specifically the use of EU GDP and unemployment rate averages, rather than adjusted national averages as now. As described above, this had significant implications (negative and positive) for many Member States. A fundamental issue, however, is that this approach removes the *national* context from the determination of 'c' area coverage. This in turn raises two questions: first, whether it undermines the capacity of some Member States to pursue legitimate domestic regional policy concerns; and second, whether it runs counter to the European Court's interpretation of Article 107(3)(c), that 'it gives the Commission power to authorize aid intended to further the economic development of areas of a Member State which are disadvantaged in relation to the national average.'<sup>25</sup> The answer to the first is probably yes, but the answer to the second is probably not.

*(iv) Some important data issues remain to be resolved*

As described in this paper, the Non-paper proposes the use of regional GDP data for 2008-10. This raises a number of issues. First, this data will not be released until March 2013, leaving little time for the preparation of revised assisted area maps. Second, the Commission schedule implies the adoption of Regional aid guidelines for 2014-20 in advance of that data release. This is unrealistic; Member States are unlikely to agree to new principles for regional aid control without knowing what their practical effects are. These will not be known until the new data is released. Third, the regionally (and nationally) differentiated impact of the recession and the consequent volatility of the data raise the question of interim reviews. (How) could these be accommodated? Last, the period proposed is a year later than the data proposed for Cohesion policy, which could result in a lack of coincidence between 'a' regions and less developed regions, in particular. In short, the choice of GDP data set has potentially significant implications for the planning, stability and coordination of policy.

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<sup>25</sup> Case 248/84 *Germany v Commission* [1987] ECR 4013, p4042.

There are also issues surrounding the use of unemployment data. The methodology proposed in the Non-paper for the distribution of 'c' area population is contingent on NUTS 3 disparities in unemployment rates. Setting aside doubts about the cross-country comparability of such data, there is no Member State for which there is a complete and up-to-date data set available.

(v) *Lower rates of award are proposed, but a rationale for the new matrix is absent.*

As in previous revisions of the Regional aid guidelines, the Non-paper proposes a reduction in rates of award. In the long distant past, rates of award set by the Commission tended to be uncontroversial - often because they were set at levels that national policymakers did not wish to reach for budgetary or value-for-money reasons. In the 2000-6 and 2007-13 Guidelines the Commission progressively reduced aid ceilings across the board. However, there is no obvious rationale underpinning how rates are set - other than a general principle that 'less is better'. While there may be some merit in this view, there is also a debate about whether there is a point below which incentive effect is eroded and windfall gains are increased.

(vi) *What plans does the Commission have for the scrutiny of very large aid cases?*

The screening of very large notified aid cases is not discussed in the non-paper, but seems likely to be influenced by the State aid modernisation initiative (SAMI) in the next period, in the same way as SAAP underpinned the approach in the guidance<sup>26</sup> for scrutiny of very large cases in the 2007-13 Guidelines. Moreover, there are indications that the screen or filter that would trigger in-depth scrutiny would also change. The Chief Economist of DG Competition, Kai-Uwe Kühn outlined some of the issues in a recent presentation,<sup>27</sup> and while his views are explicitly personal and not the formal position of the Commission, it seems unlikely that they would be totally at odds with one another.

At present, the criteria for in-depth analysis of large projects are related to the market share of the beneficiary in the affected markets and the potential increase in capacity in declining markets. Kuhn notes that these criteria bear 'no relationship to the main distortions of regional aid (ie. subsidy races, distributional concerns, cost of taxes)' and proposes a stronger focus on incentive effect in the analysis, while arguing that there is often no incentive effect in the case of large investment projects. Accordingly, the Commission should outlaw aid which experience has shown has a low likelihood for an incentive effect (investment aid in 'c' areas, notably) and place the burden of proof of an incentive effect onto beneficiaries and governments.

If carried through, these proposals reflect a marked shift in emphasis - from concerns about the impact of aid on competition expressed in terms of market dominance or subsidising

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<sup>26</sup> Communication from the Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects [2009] OJ C 223/3

<sup>27</sup> Kai-Uwe Kühn (2012) *Making State Aid Rules More Effective: the Reform of the Regional Aid Guidelines*, 10<sup>th</sup> annual Experts' forum on European State Aid Law, Brussels, 7 June.

overcapacity to a preoccupation with the *effectiveness* of policy, echoing the perception that ‘State aid control is crucial in order to improve the efficiency and effectiveness of public spending’, as indicated in SAMI, which argues for an emphasis on the identification and targeting of market failure and the promotion of measures with ‘incentive effect’. It could be argued that the effectiveness of policy is not primarily an EU competition policy issue and it is questionable whether Commission perceptions of its *ineffectiveness* justify outlawing regional aid in ‘c’ areas (for that matter, why not also ‘save ‘a’ regions from themselves’?). In any event, it is clear that national authorities *are* concerned about the incentive effect of regional aid, but opinion is divided about how and whether this can assured, and the extent to which this is a concern of the Commission.

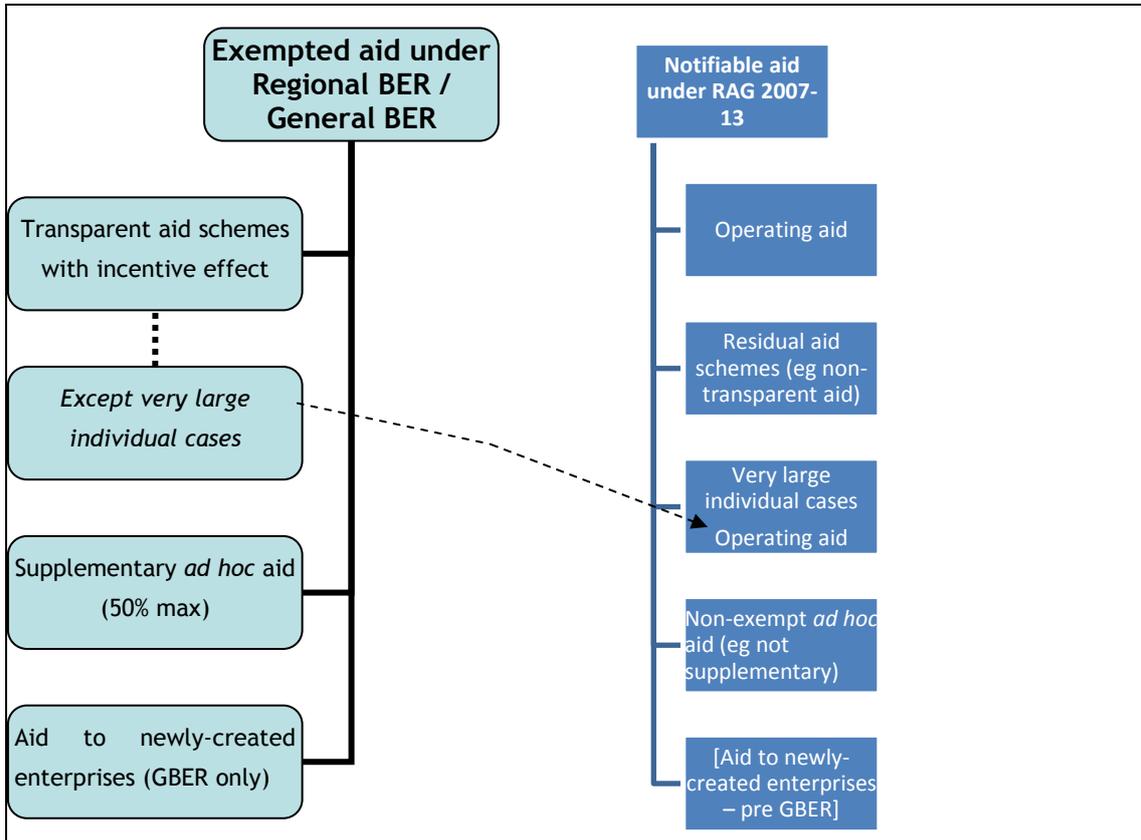
# ANNEX I: SCOPE AND PRINCIPLES OF THE 2007-13 REGIONAL AID GUIDELINES

## THE REGULATORY ARCHITECTURE FOR REGIONAL AID

In recent years the Commission has increasingly pursued a two-pronged approach to regional aid discipline, in line with objectives set out in the State Aid Action Plan (SAAP).<sup>28</sup> On the one hand, it takes a more relaxed approach to schemes meeting clearly specified criteria; on the other, large individual aids and certain types of measure are subject to scrutiny. In consequence the responsibilities of the Member States in relation to transparency, monitoring and reporting have increased - in part shifting the burden of policing regional (and other) aid to the national level.

The overall system for regulating the use of regional aid is summarised below. This illustrates the filtering and threshold approach which aims to target Commission resources on the scrutiny of those measures which it considers raise the most competition concerns.

Figure 0.1: The regulatory architecture for regional aid control



The key elements of the system are threefold:

- the exemption from notification and prior approval of certain aid schemes and supplementary *ad hoc* aid under the General Block Exemption Regulation (GBER) (or Regional BER);

<sup>28</sup> European Commission (2005) State Aid Action Plan, COM(2005) 107 final, 7 June 2005.

- the notification and prior approval of non-exempt schemes under RAG 2007-13
- and the scrutiny of individual awards either because of their size or because they involve *ad hoc* aid which does not qualify for an exemption.

In effect, the Commission's approach is calibrated according to its perception of risk to competition. In the 'low-risk' category are measures which meet the tightly prescribed criteria of the GBER, with the *qui pro quo* that the burden of policing falls largely to the Member States. In the 'medium-risk' category are measures which lack the transparency for exemption or which involve the subsidisation of ongoing costs; these require case-by-case scrutiny of the scheme, but not, in general, of individual awards under approved schemes. In the 'high-risk' category, and meriting individual analysis at the level of the firm, are very large awards, even when offered under schemes that are either approved or exempted, together with *ad hoc* awards offered independently of any aid scheme.

### Regional aid under the Block Exemption Regulation

In order to fall within the scope of the GBER,<sup>29</sup> aid schemes must be 'transparent',<sup>30</sup> must comply with the geographical coverage<sup>31</sup> and aid ceilings<sup>32</sup> of the approved regional aid map and aid must have 'incentive effect'.<sup>33</sup> In addition, eligible expenditure must meet certain criteria, notably that investment be retained in the recipient region for at least five years (three for SMEs).<sup>34</sup>

In the context of the Regulation, *transparency* means regional investment aid schemes under which it is possible to calculate *ex ante* the gross grant equivalent (GGE) as a percentage of eligible expenditure. Such schemes include grants, interest rate subsidies and capped fiscal measures. Schemes which comprise a guarantee element may be considered transparent if the Commission has accepted the methodology used to calculate the aid intensity of the guarantee. Repayable advances are transparent if the total advance does not exceed the aid ceiling expressed as a percentage of eligible expenditure. The following are not considered transparent:<sup>35</sup> aid comprised in capital injections (without prejudice to the specific provisions on risk capital); and aid comprised in risk capital measures (except for risk capital aid schemes for SMEs that comply with the BER).

Regarding *incentive effect*, the GBER only exempts schemes from notification if, prior to work on the project starting, the beneficiary has submitted an application for aid. In the

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<sup>29</sup> The Regional BER applied to schemes put into effect between 31 December 2006 and 31 December 2008. The Regulation enabled schemes meeting certain criteria and whose legal basis cites the Regional BER to be exempted from prior notification and Commission approval. After 31 December 2008, the Regional BER was repealed by the GBER, but schemes already introduced under the Regional BER were unaffected and may remain in place until 31 December 2013. The remainder of this section outlines the terms of the GBER, which came into force on 29 August 2008.

<sup>30</sup> GBER, Article 5(1).

<sup>31</sup> GBER, Article 13(2).

<sup>32</sup> GBER, Article 13(3).

<sup>33</sup> GBER, Article 8(1).

<sup>34</sup> GBER, Article 13(7).

<sup>35</sup> GBER, Article 5(2).

case of SMEs, fulfilment of this condition is sufficient to show incentive effect.<sup>36</sup> In the case of large firms, Member States must in addition, and prior to granting aid, verify that the documentation provided by the beneficiary establishes the incentive effect of aid on the basis of one or more of the following criteria:

- i. a material increase in the size of the project/activity due to the aid;
- ii. a material increase in the scope of the project/activity due to the aid;
- iii. a material increase in the total amount spent by the beneficiary on the project/activity due to the aid;
- iv. a material increase in the speed of completion of the project/activity due to the aid; and/or
- v. that the project would not have been carried out as such in the assisted region concerned in the absence of aid.<sup>37</sup>

These requirements do not apply to fiscal measures granted automatically without any discretion on the part of the awarding authorities and where the measure has been adopted prior to project start.<sup>38</sup>

*Ad hoc* aid which is used to supplement aid granted on the basis of transparent regional aid schemes, and which does not exceed 50 percent of the total aid, is also exempt from notification provided that the *ad hoc* aid fulfils all the criteria of the Regulation.<sup>39</sup> This provision enables, for example, a local authority to complement national level incentives (subject to the prevailing regional aid ceiling); however, it does not allow for the use of *ad hoc* aid independently, which must be notified and assessed on the basis of RAG 2007-13.

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

- Non-transparent regional aid schemes or those not meeting the criteria with respect to incentive effect.
- Regional aid schemes targeted at specific sectors of economic activity within manufacturing or services (schemes targeting tourism are not considered specific).
- Regional aid schemes which involve operating aid.
- Regional aid for large projects on the basis of existing schemes where the amount of aid exceeds the notification threshold - i.e. the amount that a €100 million investment could receive.

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<sup>36</sup> GBER, Article 8(2).

<sup>37</sup> GBER, Article 8(3).

<sup>38</sup> GBER, Article 8(4).

<sup>39</sup> GBER, Article 2(5).

- *Ad hoc* aid, other than that which supplements exempted aid (as mentioned above).
- Aid to firms which are subject to a recovery order following the award of illegal and incompatible aid.

Member States must provide summary information on schemes they deem to be exempted from notification within 20 days of implementation.<sup>40</sup> The full text of the aid scheme must be published and the direct internet address of the publication provided.<sup>41</sup> Regional aids to large projects (those involving eligible expenditure exceeding €50 million) must be reported within 20 days of aid being granted.<sup>42</sup> Records of aid awarded under exempted schemes must be maintained; these must be sufficiently detailed for the Commission to establish that the conditions of the Regulation have been complied with. These records must be maintained for ten years from the date of any individual award or, in the case of aid schemes, from the date of the last award made under the scheme.<sup>43</sup> Last, the GBER provides for the monitoring of the implementation of the terms of the Regulation.<sup>44</sup>

### Approval of schemes under the 2007-13 Regional aid guidelines

The 2007-2013 Regional aid guidelines (RAG 2007-13) set out the circumstances in which the Commission will approve regional State aid that does not fall within the ambit of the block exemption. RAG 2007-13 deals with three categories of aid scheme: regional investment aid;<sup>45</sup> operating aid;<sup>46</sup> and aid for newly-created enterprises.<sup>47</sup> Under the Regional BER, aid for newly-created enterprises was subject to authorisation under Article 107(3); however, the GBER brought this category within the scope of the exemption. The provisions for those categories of aid apply to all sectors apart from coal and fisheries, agricultural production,<sup>48</sup> steel and synthetic fibres.<sup>49</sup> In general, regional aid should be part of a multisectoral scheme which forms part of a regional development strategy with clearly defined objectives.<sup>50</sup>

In practice, the vast majority of *regional investment aid* schemes fall within the scope of the GBER, not least since many of the assessment criteria (for example, compliance with the regional aid map and accompanying aid intensities, eligible expenditure and eligible investments) under RAG 2007-13 are identical to those under the GBER. The principal exceptions are regional investment aids that do not meet the transparency criteria in the GBER, together with individual cases; these are assessed in relation to the provisions of RAG 2007-13 on a case-by-case basis.

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<sup>40</sup> GBER, Article 9(1).

<sup>41</sup> GBER, Article 9(2).

<sup>42</sup> GBER, Article 9(4).

<sup>43</sup> GBER, Article 10(2).

<sup>44</sup> GBER, Article 10(3).

<sup>45</sup> RAG 2007-13, paragraph 33-75.

<sup>46</sup> RAG 2007-13, paragraph 76-83.

<sup>47</sup> RAG 2007-13, paragraph 84-90.

<sup>48</sup> As specified in Annex I to the Treaty

<sup>49</sup> RAG 2007-13, paragraph 8.

<sup>50</sup> RAG 2007-13, paragraph 10.

**Operating aid**, i.e. aimed at reducing a firm's current expenses, is normally prohibited and cannot be exempted under the GBER; it is always subject to notification and Commission scrutiny. However, under RAG 2007-13, such aid may be granted in Article 87(3)(a) regions provided that it is justified in terms of its contribution to regional development, and provided that its level is proportional to the handicaps it seeks to alleviate. Member States are responsible for demonstrating the existence and scale of any such handicaps. In addition, certain specific forms of operating aid can be authorised in the low population density and least populated areas.<sup>51</sup> Operating aid should in principle only be granted for a pre-defined set of eligible expenditures (such as replacement investment, transport or labour costs) and should be limited to a certain proportion of those costs.<sup>52</sup> Operating aid intended to promote exports is excluded.<sup>53</sup>

**Aid for newly-created enterprises** was expressly provided for under RAG 2007-13, but has since been subsumed within the GBER. This means that schemes targeting this group of firms, provided that they meet all the conditions of the GBER, may be exempted from notification and no longer fall to be assessed under the guidelines (unless, for example, they do not meet the transparency criteria of the GBER).

### Individual cases: very large awards and ad hoc cases

At the 'high-risk' end of the spectrum in terms of competition effects, RAG 2007-13 sets lower rates of award to large investments and requires case-by-case prior approval by the Commission of awards to very large investment projects.

The provisions on **large investment projects** reduce rates of award under existing regional aid schemes<sup>54</sup> to projects with eligible investment of more than €50 million. This is achieved through a reduction scale (the larger the project, the lower the rate of award) incorporated into the regional aid schemes operated by the Member States, as set out in Figure 0.2.

**Figure 0.2: 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 0.2 shows, projects involving investments of less than €50 million are unaffected by the matrix. However, for larger projects the standard award rate is progressively reduced. The impact of this on the standard award maxima under RAG 2007-13 is shown in Figure 0.3. 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

<sup>51</sup> RAG 2007-13, paragraph 76.

<sup>52</sup> RAG 2007-13, paragraph 77.

<sup>53</sup> RAG 2007-13, paragraph 78.

<sup>54</sup> Whether block-exempted or notified and approved investment aid schemes.

million, the maximum rate of award in a ten percent rate 'c' area would be 4.22 percent of eligible investment - a maximum of €21.1 million.

Figure 0.3: Impact of the large investment project provisions on award rates

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

Crucially, 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.

Figure 0.4: 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)					
€ 50m	~	~	~	~	~	~
€ 100m	~	~	~	~	~	~
€ 150m	5.0	7.5	10.0	15.0	20.0	25.0
€ 200m	3.75	5.63	7.5	11.25	15.0	18.75
€ 300m	2.5	3.75	5.0	7.5	10.0	12.5
€ 500m	1.5	2.25	3.0	4.5	6.0	7.5

As Figure 0.4 shows, for very large projects the notification thresholds bite at very low levels of aid when expressed as a percentage of investment. In a ten percent rate area, the notification threshold in proposed aid would be €7.5 million, just 1.5 percent of a €500 million investment.

Where a project is notified to the Commission because of the size of the award, the Commission has a degree of discretion in the assessment criteria and the decision about whether aid up to that stipulated in the matrix can be awarded. The key issues in the assessment of aid to notified projects concern the market share of the beneficiary and the capacity created by the project.

For individually notifiable projects where either:

- 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
- the capacity created by the project is more than five 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 108(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'. This verification is based on detailed guidance published by the Commission.<sup>55</sup>

The onus is on the *Member States* to demonstrate that a given project does not reinforce a high market share or increase capacity in a stagnant sector. Where no such competition concerns arise, the matrix given in Figure 0.2 is used to determine the maximum rate, as for projects under the €100 million investment threshold.

## 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 non-assisted regions.<sup>56</sup> 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).<sup>57</sup> 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, with the accession of Bulgaria and Romania which have 'a' region status in their entirety.<sup>58</sup>

### Coverage of 'a' regions

#### 'Classic' 'a' regions

Article 107(3)(a) provides that 'aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment' may be considered compatible with the common market. The European Court of Justice has held that this provision applies only to areas which are disadvantaged in relation to the Community as whole.<sup>59</sup> 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.'<sup>60</sup> This seems a debatable interpretation both of the Treaty provisions and the statistical indicators: Article 107(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 Convergence regions under EU Cohesion

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<sup>55</sup> Communication from the Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects, OJEU No C 223/3 of 16 September 2009.

<sup>56</sup> Paragraph 12.

<sup>57</sup> 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 107] 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, pp 205, Wishlade, F. (2003) *Regional State Aid and Competition Policy in the European Union*, Kluwer Law international, The Hague.

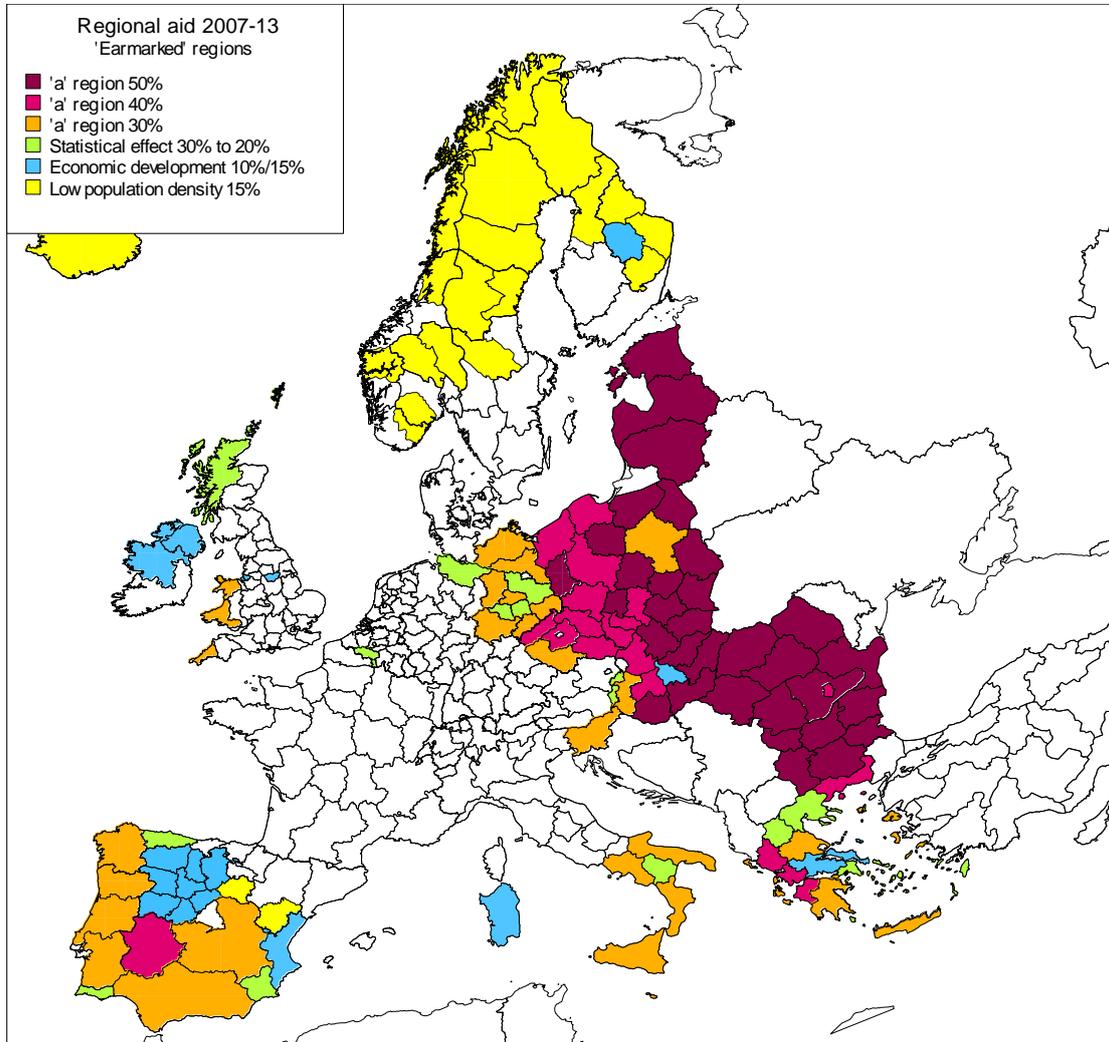
<sup>58</sup> Paragraph 13.

<sup>59</sup> Case 248/84 *Germany v Commission* [1987] ECR 4013 at 4042.

<sup>60</sup> Paragraph 16, footnote 19.

policy. Accordingly, the ‘a’ areas for 2007-13 are defined as NUTS 2 regions where GDP(PPS) per head is less than 75 percent of the EU25 average for the period 2000-2. The ‘a’ regions, together with the other ‘earmarked’ areas (described below) are illustrated in Map 0.1.

**Map 0.1: ‘Earmarked’ areas 2007-13**



Source: Own elaboration after DG Comp regional aid map available at: [http://ec.europa.eu/competition/state\\_aid/regional\\_aid/map.pdf](http://ec.europa.eu/competition/state_aid/regional_aid/map.pdf)

### *Outermost regions*

In addition, under the 2007-13 Guidelines, the seven Outermost regions (OMR)<sup>61</sup> have ‘a’ region status, irrespective of whether they meet the GDP per head threshold. Five of the seven are below the threshold, but Canarias and Madeira both had per capita GDP of around 88 percent of the EU25 average under the dataset used for 2007-13. 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,

<sup>61</sup> Açores, Madeira, Canarias, Guadeloupe, Martinique, Réunion and Guyane.

rather than Convergence status, although special additional budgetary allocations were made to all OMRs for 2007-13.

### *Statistical effect regions*

Last, transitional arrangements were made for the so-called ‘statistical effect’ regions. These are regions with GDP per head above the *EU25* qualifying threshold, but which would have qualified as ‘a’ areas had it not been for enlargement (equivalent to Phasing-out regions under EU Cohesion policy); the qualifying threshold was 82.2 percent of *EU25* GDP(PPS) per head. Significantly, not all of the eligible regions had ‘a’ region status in the pre-2000 period - namely: Hainaut (Belgium); Lüneburg (Germany); and Highlands and Islands (UK). Statistical effect regions will retain ‘a’ region status at least until 31 December 2010. During 2010 Commission reviewed the position of the regions concerned on the basis of the most recent GDP data available (2005-7). Regions where GDP per head had fallen to below 75 percent of the *EU25* average retained ‘a’ region status; the remainder became ‘c’ areas from 1 January 2011. Consequently, Hainaut (Belgium), Basilicata (Italy), Kentriki Makedonia and Dytiki Makedonia (Greece) have full ‘a’ region status for 2011-2013 while the remaining statistical effect areas have ‘c’ area status.

### **Coverage of ‘c’ areas**

Article 107(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 107(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.<sup>62</sup> 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 areas which previously had ‘c’ status.

Overall ‘c’ coverage in 2007-13 comprises the following elements.

- *Economic development*: each Member State automatically received a quota equivalent to the population of areas that had ‘out-grown’ ‘a’ area status and were also beyond the threshold for statistical effect regions - in other words, regions that would have ceased to qualify as ‘a’ regions even without the impact of enlargement on *EU* average GDP per head. Northern Ireland was added to this group; although it

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<sup>62</sup> Paragraph 22.

was not an 'a' area in 2000-6, it was considered to have benefited from the same aid intensities as many 'a' areas<sup>63</sup> - see Map 0.1.

- *Low population density*: NUTS 3 areas with fewer than 12.5 inhabitants per km<sup>2</sup> - again, see Map 0.1.
- *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<sup>64</sup> and follows the approach in the 1998 Guidelines. The principle of the method is to calculate the population of NUTS 3 regions where either GDP per head is more than 15 percent below the national average or the unemployment rate is more than 15 percent above 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 per head 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. For 2007-13, this adjustment meant that, for example, the GDP threshold for the Netherlands was lowered from 85 percent to 77.2 percent of the national average, whereas the Greek threshold was raised from 85 percent to 99.5 percent of the national average.<sup>65</sup>
- *Safety net*: special provision was made to ensure that no Member State lost more than 50 percent of its total population coverage under the 2000-6 Guidelines. The application of the safety net raised the initial 42 percent ceiling to around 43.1 percent (excluding Bulgaria and Romania).

Provisions for the phasing out of 'c' areas were also included in the Guidelines. These enabled a proportion of previous '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 could not 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).<sup>66</sup>

### Overall outcomes 2007-13

The outcome of the application of this methodology is illustrated in Figure 0.5. This shows that while 46.6 percent of the EU27 population falls within assisted areas, this is heavily skewed towards the 12 'new' Member States (hereafter EU12),<sup>67</sup> where 98 percent of the

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<sup>63</sup> Paragraph 25.

<sup>64</sup> 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.

<sup>65</sup> Examples given in Annex IV of the Guidelines. Note also that, in practice, Greece is entirely covered by 'a' areas or economic development areas, which have 'c' status for the 2007-13 period.

<sup>66</sup> Paragraph 95.

<sup>67</sup> Hereafter EU10 refers to the countries which joined in 2004.

population is covered; by contrast, in the EU15, coverage is under one-third of the population.

Figure 0.5: Coverage of assisted areas 2007-13 (% of population)

	'a' areas	'a' - Stat effect	'c' - Econ dev	'c' - low pop dens	'c' - quota	'c' trans.	2007-13 Total
EU27	32.2	3.4	3.6	0.5	6.9	3.5	46.6
EU25	27.7	3.6	3.8	0.5	7.4	3.8	43.0
EU15	15.0	4.3	3.8	0.6	8.7	4.2	32.4
EU10	92.9	0.0	3.8	0.0	0.5	1.8	97.2
EU12	94.9	0.0	2.7	0.0	0.3	1.2	98.0
BE		12.4			13.5		25.9
BU	100.0						100.0
CZ	88.6					7.7	88.6
DK					8.6	2.7	8.6
DE	12.5	6.1			11.0		29.6
EE	100.0						100.0
IE			26.5		23.5	25.0	50.0
GR	36.6	55.5	7.9				100.0
ES	36.2	5.8	16.1	0.6	1.1	12.4	59.8
FR	2.9				15.5	6.9	18.4
IT	29.2	1.0	2.9		1.0	5.6	34.1
CY					50.0	16.0	50.0
LV	100.0						100.0
LT	100.0						100.0
LU					16.0	5.1	16.0
HU	72.2		27.8				100.0
MT	100.0						100.0
NL					7.5	2.4	7.5
AT		3.4			19.1		22.5
PL	100.0						100.0
PT	70.1	3.8			2.8	19.2	76.7
RO	100.0						100.0
SI	100.0						100.0
SK	88.9					7.5	88.9
FI			4.9	18.8	9.3		33.0
SE			0.0	13.0	2.3		15.3
UK	4.0	0.6	7.3		12.0		23.9
EEA3				29.4			29.4
IS				37.7			37.7
LI							0.0
NO				29.1			29.1

**Note:** All the Statistical Effect regions became either 'a' regions or 'c' regions from 1 January 2011. Transitional 'c' area coverage is not included in the total for 2007-13; the Iceland total applies from 2008-13, follows a reorganisation of the NUTS regions.

**Source:** Own calculations from: Eurostat data; RAG 2007-13; *Icelandic regional aid maps authorised by the EFTA Surveillance Authority*, ESA Press Release PR(06)54; *The EFTA Surveillance Authority adopts new Regional Aid Guidelines for 2007-13*, ESA Press Release PR(06)18.

## ELIGIBLE AREAS

As mentioned earlier, under RAG 2007-13 'a' areas are designated 'top-down' in the rules themselves, while the 'c' areas are designated by the national authorities, subject to parameters set out in the Guidelines.

For the 'c' areas, RAG 2007-13 distinguishes two types of assisted area that may be designated within the population quotas: those where firms of any size may be assisted, comprising comparatively large geographical areas principally meeting EU-level criteria;<sup>68</sup> and those where assistance is more tightly focused on localised disparities and is restricted to SMEs.<sup>69</sup> In principle, the list of regions notified applies throughout the period 2007-13, but there is provision for a mid-term review in 2010.<sup>70</sup> However, changes should not involve more than 50 percent of 'c' area coverage.

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

- a. Economic development areas (areas which outgrew 'a' status at end 2006)
- b. Low population density (LPD) areas (NUTS 3 regions with fewer than 12.5 inhabitants per km<sup>2</sup>)
- c. Regions 'which form contiguous zones' with a minimum population of 100,000. These must be within NUTS 2 or 3 regions where either GDP per head is less than the EU25 average or unemployment is more than 115 percent of the *national* average. These criteria GDP and unemployment are sometimes referred to as the pre-eligibility criteria.
- d. NUTS 3 areas with a population of less than 100,000, subject to the same pre-eligibility criteria - i.e. either GDP per head is less than the EU25 average or unemployment is more than 115 percent of the *national* average.
- e. Islands and 'other regions categorised by similar geographical isolation' where either GDP per head is less than the EU25 average or unemployment is more than 115 percent of the *national* average.
- f. Islands with fewer than 5,000 inhabitants and other communities with fewer than 5,000 inhabitants characterised by similar geographical isolation.
- g. Border areas. These concern all or parts of NUTS 3 regions that are adjacent to 'a' areas and those which share a land border or a sea border of less than 30km with a country that is not a member of the EEA or EFTA.
- h. Areas undergoing restructuring. These must be 'contiguous zones' with a minimum population of 50,000 which are undergoing major structural change or are in serious relative decline 'compared with other comparable regions'.

In paragraph 31 of the Guidelines, there is scope to target very localised regional disparities. However, aid is restricted to small and medium-sized enterprises (SMEs) and the

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<sup>68</sup> Paragraph 30 (a) to (h).

<sup>69</sup> Paragraph 31.

<sup>70</sup> Paragraph 104.

areas targeted must involve a minimum population of 20,000. Obviously these areas also count towards the ‘c’ area population quotas.

Member States adopted diverse **area designation strategies** to reconcile Commission constraints with domestic considerations.<sup>71</sup> These considerations often comprised a mix of policy options such as indigenous or inward investment, areas of need or opportunity - and political issues, such as the perceived equitable distribution of assisted areas between regions and the sensitivity of de-designating some areas, while according assisted area status to others for the first time. More prosaically, an important factor was often the ease with which the map could be approved, sometimes leading to rather pragmatic, as opposed to strictly policy-oriented, approaches to area designation.

The choice of **building blocks** for area designation was an important consideration for most countries, since most NUTS 3 regions have a population in excess of 100,000, so that smaller units were sought in order to build up ‘contiguous units’ of at least 100,000. In informal discussions early on in the process the Commission accepted the use of LAU1 and LAU2<sup>72</sup> as building blocks, but emphasised that any breakdown below NUTS III must be ‘traditional’ and not simply involve units generated on an *ad hoc* basis for the purposes of the area designation exercise.

**Figure 0.6: Building blocks proposed by the Member States**

<b>Belgium</b>	<i>Gemeenten / Communes</i> (LAU2) (Flanders and Wallonia); parts of communes (Brussels)
<b>Denmark</b>	Municipalities
<b>Germany</b>	Labour market regions ( <i>Arbeitsmarktregionen</i> ); Transport areas ( <i>Verkehrszelle</i> ) in Berlin
<b>Spain</b>	Municipios (LAU2); Census districts
<b>France</b>	<i>Commune</i> (LAU2); <i>Cantons urbains</i> in cities
<b>Ireland</b>	Counties (LAU1); District Electoral Divisions (LAU2)
<b>Italy</b>	Commune (LAU2) and Census areas
<b>Cyprus</b>	Communes
<b>Luxembourg</b>	<i>Commune</i> (LAU2)
<b>Netherlands</b>	Gemeenten (LAU2) and part Gemeenten
<b>Austria</b>	<i>Gemeinden</i> (LAU2)
<b>Portugal</b>	<i>Freguesias</i> (LAU2)
<b>Finland</b>	<i>Maakunnat / Landskap</i> (NUTS III); <i>Seutukunnat</i> (LAU1)
<b>Sweden</b>	Municipalities (LAU2)
<b>UK</b>	Wards (LAU2)

Source: Assembled from COM decisions on regional aid maps.

As outlined above, RAG 2007-13 set out a series of parameters within which Member States could propose assisted areas. Economic development areas (ie. areas that have outgrown ‘a’ status) and sparsely-populated regions would be accepted automatically by the Commission as ‘c’ areas; however, Member States were also able to use the population quotas generated by these areas to designate other areas - provided that these meet the

<sup>71</sup> Detailed descriptions are available in Wishlade, F. (2007) *All's Well that Ends Well: Recent Developments in EU Competition Policy and Regional Aid Control*, EoRPA paper 07/7 to the EoRPA Regional Policy Research Consortium, Ross Priory, Loch Lomondside, 7-9 October 2007.

<sup>72</sup> In Eurostat's geographical classification system NUTS IV and V have been redesignated as Local Administrative Units and renamed LAU1 and LAU2 respectively.

other criteria in Paragraphs 30 or 31. However, the transfer of quotas was not allowed where a Member State opted not to designate an 'a' area in its entirety.

The broadest category for 'c' eligibility concerns areas with GDP(PPS) per head of less than the EU average or unemployment more than 15 percent above the *national* average - the pre-eligibility criteria.<sup>73</sup> These must be either: 'contiguous zones' with a population of at least 100,000; NUTS 3 areas with a population of less than 100,000; or islands or other geographically isolated areas. In most countries the areas meeting the pre-eligibility criteria were more extensive than the national population ceilings, requiring further selection criteria at the national level. In addition, there are specific criteria under which areas could be proposed<sup>74</sup> (small islands and border areas) or criteria under which the onus was on the Member State to demonstrate that regional aid is justified<sup>75</sup> (areas undergoing structural change and small aid areas for SMEs).

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

Figure 0.7 summarises the criteria under which the Commission approved the map proposals of the Member States for 2007-13. Where available, national assisted area maps are annexed to this report. Regarding the 'c' areas, two main points emerge. First, the EU criteria aside (low population density and economic development areas), the single most important basis for coverage is paragraph 30c - areas with a minimum population of 100,000 with either GDP(PPS) below the EU average or unemployment 15 percent above the *national* average. In Austria, Denmark, France and the UK, these areas account for more than 50 percent of the assisted areas. Second, and related, Member States largely shunned the scope to designate assisted areas outside the Commission's pre-eligibility criteria and select on the basis of nationally-justified criteria. There are two main options for designating areas which do not meet the pre-eligibility criteria: paragraph 30h enables areas with a minimum population of 50,000 'undergoing major structural change' to be designated as 'c' areas; paragraph 31 enables smaller areas (minimum population 20,000) to be targeted for SME support only.

Seven countries used the structural change option (paragraph 30h) - Belgium, Germany, France, Spain, Italy, Finland, Sweden - but coverage is arguably significant only in France and Sweden where it accounts for around one-fifth or more of total coverage. Seven countries also opted for the micro-targeting of SME aid under paragraph 31: Belgium, Denmark, Germany, France, Ireland, Italy and Finland. In Denmark and Ireland these areas

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<sup>73</sup> Paragraphs 30(c) to (e).

<sup>74</sup> Paragraphs 30(f) and (g).

<sup>75</sup> Paragraphs 30(h) and 31.

account for about a quarter of the assisted area total, but elsewhere coverage is not significant.

One interesting point to note is that France opted to retain a population reserve for use as the need arose - for example in response to industrial restructuring. The criteria for the use of the reserve are tightly drawn at national level, in order to reduce political pressures for designation; the reserve has not been fully drawn down, with the agreement of the Commission to the amended maps.

Figure 0.7: Assisted areas by type under the 2007-13 Guidelines (% of national population)

	'a' regions	Stat effect	Econ dev	LPD	CY/LU	Pop 100K	NUTS 3	Islands / isolated	Islands <5k	Border	Struct chg.	SMEs	'c' areas	TOTAL	Res.	Trans
Para	15	18	30a	30b	Note 32	30c	30d	30e	30f	30g	30h	31	30-31	ex Res /Trans		95
BE		12.3				9.8				0.97	1.2	1.5	13.5	25.7		
BU	100.0													100.0		
CZ	88.5													88.5		7.6
DK						4.5	0.8	0.80	0.189			2.2	8.5	8.4		2.6
DE	12.5	4.9				8.4	0.2		0.002	1.71	0.5	0.1	10.9	28.4		
EE	100.0													100.0		
GR	36.6	55.5	7.8										7.8	100.0		
ES	36.2	5.8	14.3	0.3		1.8				0.70	0.6		17.7	59.6		12.4
FR	2.8					10.5		0.51		0.02	3.5	0.6	15.1	18.0	0.4	6.9
IE			26.5			10.8			0.014			12.7	50.0	50.0		23.5
IT	28.9	1.0	1.6			0.5		0.01		0.86	0.74	0.28	4.0	33.8		5.6
CY						44.9		5.14					50.0	50.0		
LV	100.0													100.0		
LT	100.0													100.0		
LU					15.8								15.8	15.8	0.2	4.6
HU	72.2		27.8										27.8	100.0		
MT	100.0													100.0		
NL						7.5							7.5	7.5		2.4
AT		3.4				15.1	0.3			3.74			19.1	22.5		
PL	100.0													100.0		
PT	70.2	3.8								2.72			2.7	76.7		17.6
RO	100.0													100.0		
SI	100.0													100.0		
FI			12.6	12.0		2.9			0.736	2.20	1.0	1.4	32.8	32.9		
SK	88.9													88.9		7.2
SE				7.8		3.4					4.0		15.2	15.3		
UK	4.0	0.6	6.4			12.6				0.30			19.3	23.9		
IS				32.0									32.0	32.0		
LI														0.0		
NO				27.5									27.5	27.5		
EU27	32.1	3.2	3.3	0.3	0.01	5.5	0.05	0.08	0.010	0.66	0.78	0.31	11.0	46.3	0.04	3.5
EU15	15.0	4.0	3.4	0.4	0.02	6.9	0.06	0.09	0.013	0.83	0.98	0.39	13.1	32.1	0.05	4.1
NMS12	94.8		2.7			0.3		0.04					3.0	97.8		1.1
EEA3				27.8									27.8	27.8		

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

## AID VALUES, ELIGIBILITY AND FORMS OF AID

### Aid values under RAG 2007-13

The key principle underlying rates of award under RAG 2007-13 is that ‘aid intensity must be adapted to take account of the nature and intensity of regional aid problems that are being addressed.’<sup>76</sup> In practice, the principal driver of award maxima is the level of GDP per head in relation to the EU average. Maximum award rates set out in RAG 2007-13 are summarised in Figure 0.8.

**Figure 0.8: Rates of award by firm size 2007-13 (percent 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 <sup>a</sup> → 20	40 <sup>a</sup> → 30	50 <sup>a</sup> → 40
Low population density ‘c’ areas	15 <sup>b</sup>	25 <sup>b</sup>	35 <sup>b</sup>
Economic development ‘c’ areas	15 <sup>b</sup> /10 <sup>c</sup>	25 <sup>b</sup> /20	35 <sup>b</sup> /30
Other ‘c’ areas	15 <sup>b</sup> /10 <sup>c</sup>	25 <sup>b</sup> /20	35 <sup>b</sup> /30
Non-assisted	0	10	20

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

Source: Assembled from RAG 2007-13, paragraphs 44-48.

These rates represent a significant lowering of award values in relation to the previous Guidelines (2000-6), which themselves had lowered maximum rates compared to those in the late 1990s.

### Forms of aid

RAG 2007-13 refers to two **types of aid** - investment aid and operating aid. Most aid is so-called investment aid, i.e. aid related to a particular project, rather than ongoing costs. However, operating aid is exceptionally authorised in the low population density areas and the outermost regions; there is also provision for operating aid in ‘a’ regions other than outermost regions.

In terms of **instruments** the Guidelines are not restrictive and note that aid may take the form of ‘grants, low-interest loans or interest rebates, state guarantees, the purchase of a shareholding or an alternative provision of capital in favourable terms, exemptions or reductions in taxes, social security or other compulsory charges, or the supply of land, goods or services at favourable prices.’<sup>77</sup> This reflects the Treaty provisions, which emphasise that aid may be in any form whatsoever. Nevertheless, the form of aid has implications for whether prior approval from the Commission is required, or whether the measure can simply be reported under the GBER. In order to fall within the scope of the

<sup>76</sup> RAG 2007-13, paragraph 42.

<sup>77</sup> RAG 2007-13, paragraph 37.

GBER, aid schemes must, among other things, be ‘transparent’.<sup>78</sup> In this context, *transparency* means regional investment aid schemes under which it is possible to calculate *ex ante* the gross grant equivalent (GGE) as a percentage of eligible expenditure. Such schemes include grants, interest rate subsidies and capped fiscal measures. Schemes which comprise a guarantee element may be considered transparent if the Commission has accepted the methodology used to calculate the intensity of the guarantee. Several countries<sup>79</sup> have notified methodologies for calculating the grant-equivalent of measures. Clearly these measures do not involve expenditure *per se*, but instead seek the endorsement of a methodology that effectively renders aid transparent.<sup>80</sup> This enables the Member State concerned to report schemes under the GBER that use the methodology to calculate aid values and increases the scope to include measures - notably guarantee schemes - that would otherwise lack the transparency for exemption. Repayable advances are transparent if the total advance does not exceed the aid ceiling expressed as a percentage of eligible expenditure. The following are explicitly not considered transparent:<sup>81</sup> aid comprised in capital injections (without prejudice to the specific provisions on risk capital); and aid comprised in risk capital measures (except for risk capital aid schemes for SMEs that comply with the GBER).

### Eligible expenditure

Eligible expenditure for investment aid includes land, buildings and plant/machinery. Except in the case of SMEs and takeovers, assets must be purchased new.<sup>82</sup>

For large firms, the limit on intangible assets expenditure (technology transfers, patent acquisition, licences, know-how and unpatented technical knowledge) is set at 50 percent of eligible expenditure.<sup>83</sup> The Guidelines also set out a definition of initial investment.<sup>84</sup> This covers:

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

The Guidelines require aided assets to be retained for at least five years,<sup>85</sup> however, it is made clear that this does not preclude the replacement of plant or equipment that has

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<sup>78</sup> GBER, Article 5(1).

<sup>79</sup> For example, France, Germany and Hungary.

<sup>80</sup> GBER, Article 5(1).

<sup>81</sup> GBER, Article 5(2).

<sup>82</sup> Paragraph 54.

<sup>83</sup> There is no limit for SMEs.

<sup>84</sup> Paragraphs 34-40.

<sup>85</sup> Member States may lower this to three years for SMEs.

become outdated, provided that the economic activity is retained within the region concerned for the minimum period.

Importantly, at least for countries where leasing is prevalent, leased assets can only be included in eligible expenditure if there is an obligation to purchase the assets at the end 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).<sup>86</sup>

Investment aid can be taken in the form a wage cost subsidy;<sup>87</sup> 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.<sup>88</sup>

The Commission regards **operating aid** as a form of assistance that can only be authorised in exceptional circumstances and only in 'a' regions, low population density regions and the outermost regions (OMR). Operating aid can generally only be offered in 'a' regions 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.<sup>89</sup> It is for the Member States to demonstrate the existence of these handicaps and to measure their scale. It appears, however, that all the operating aid measures notified and approved to date have involved the special cases of the OMRs or the low/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 **Outermost Regions** aid of up to ten percent of the turnover of the beneficiary may be offered without the need for specific justification.<sup>90</sup> 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.<sup>91</sup>

**Least-populated areas** are defined as NUTS 2 regions (and adjacent and contiguous smaller areas) with a population density of eight inhabitants per km<sup>2</sup> or less. It is for the Member State to demonstrate that aid is necessary to reduce or prevent depopulation. On this basis, the EFTA Surveillance Authority authorised a scheme of regionally-differentiated social security contributions in the least-populated regions.<sup>92</sup> These areas cover around 17.7

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<sup>86</sup> Paragraph 53.

<sup>87</sup> Paragraphs 57-59.

<sup>88</sup> Member States may reduce this to three years for SMEs.

<sup>89</sup> RAG 2006, paragraph 76.

<sup>90</sup> On this basis the Commission authorised reduced excise duty on locally-produced beer in Madeira - Case N 293/07.

<sup>91</sup> RAG 2007-13, footnote 74. The factors identified in the Treaty which may be offset by aid include remoteness, insularity, small size, difficult topography and climate and economic dependence on a few products. Thus in the Spanish notification of aid regimes for the Canary Islands, the authorities cited research which quantified the additional costs to businesses located in the Canaries compared to those in mainland Spain - see Cases N 377/2006 and N 376/2006.

<sup>92</sup> EFTA Surveillance Authority Decision of 19 July 2006 on the notified scheme concerning regionally differentiated social security contributions (Norway), 228/06/COL.

percent of the Norwegian population and have an average population density of 3.5 persons per km<sup>2</sup>.

Aid partly to offset the *additional costs of transport* may be authorised in the OMRs and in the low population density regions. The criteria for transport aid are that:<sup>93</sup>

- 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; 'external costs to the environment should also be taken into account'.
- 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.

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<sup>93</sup> RAG 2006, paragraph 81.