European Economic and Social Committee

INT/653
The internal market and state aid for the regions

Brussels, 21 March 2013

OPINION

of the

European Economic and Social Committee

on

The internal market and state aid for the regions

(own-initiative opinion)

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On 12 July 2012 the European Economic and Social Committee, acting under Rule 29(2) of its Rules of Procedure, decided to draw up an own-initiative opinion on

The internal market and state aid for the regions.

The Section for the Single Market, Production and Consumption, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 7 March 2013.

At its 488th plenary session, held on 20 and 21 March 2013 (meeting of 21 March), the European Economic and Social Committee adopted the following opinion by 156 votes to 6 with 2 abstentions.

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1. Conclusions and recommendations

1.1 As changes in the state aid system draw nearer, the Committee considers it useful to draw up an own-initiative opinion on state aid for the regions, as viewed by civil society, and its inclusion among the fundamental principles of the internal market.

1.2 This important topic becomes crucial at a time of crisis and widespread economic recession calling for flexible support and intervention mechanisms which respect competition rules. In recent years the Commission has adopted temporary intervention frameworks precisely in order to facilitate appropriate support for the banking and business system.

1.3 As regional state aid is designed to offset the disadvantages faced by the less favoured regions and thus to promote the economic, social and territorial cohesion of the Member States and of the EU as a whole, this form of aid provides a valuable tool for overcoming the crisis and relaunching the economies of the EU's regions. For SMEs, in particular, it is important that these instruments are efficient and effective: access to this form of aid should be made easier by simplifying access conditions, making it more flexible, and providing appropriate information about the possibilities being offered.

1.4 The Committee is thus delighted that as part of the process for modernising state aid[1] launched by Commissioner Almunia, the Commission has also decided to update and modernise the guidelines on public aid for businesses in disadvantaged areas. This revision will ensure consistency between regional policy and competition policy, and respect for the subsidiarity principle.

1 OJ C 11, 15.1.2013, p. 49.

1.5 The Committee therefore calls on the Commission to make EU policies more consistent with competition policy, so that competition policy does not thwart objectives of common European interest such as the harmonious, integrated development of Europe's regions but instead provides an opportunity for relaunching regional economies in the single market after the crisis.

1.6 On 14 January 2013 the Commission launched a public consultation on its paper containing draft regional aid guidelines for 2014-2020[2]. The paper broadly reflects the approach taken in the "non-paper" sent to Member States in December 2011. An initial multilateral meeting has been held on it, during which the Commission intimated that it might be amenable to some of the requests made by the Member States, for example regarding the ceiling for population coverage at EU level. In this context, the present opinion can play a strategic role in putting the Committee's message across to the Commission.

1.7 Accordingly, the Committee requests that the new guidelines on state aid for the regions give Member States a flexible cross-sectoral instrument for achieving the Europe 2020 objectives, by harnessing regional excellence irrespective of the sector or size of companies involved in investment projects for the development of disadvantaged areas.

1.8 The current system has remained largely unchanged for over 40 years. It is based on geographical mapping of the EU, and is inappropriate and rigid. If the current method continues to be used in the new economic and social context facing the Union, it could hamper the development of the internal market.

1.9 The Committee asks the Commission to adopt more flexible parameters that are better tailored to a dramatically changing economic context. These parameters should be based on units of intervention selected on the basis of priorities, needs, the territorial configuration of economic inefficiencies and social exclusion traps, and the institutional context, irrespective of administrative boundaries.

1.10 The Committee therefore stresses that as part of the wider modernisation process, regional state aid should be updated in line with the dynamics and pace of the post-crisis economy, which bring a need for greater flexibility when determining regional disadvantages. In such circumstances, a geographical map which rigidly establishes disadvantaged areas for the whole programming period (seven years) is not appropriate.

1.11 To that end, the Committee considers that the selection of disadvantaged areas under the Article 107(3)(c) exemption should not be decided simply by subtracting the population of the areas assisted under Article 107(3)(a) from the total percentage of the EU population covered (which in any case is arbitrary). Instead, Member States should be able to use a broad set of parameters for determining regional disadvantages.

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2 http://ec.europa.eu/competition/consultations/2013_regional_aid_guidelines/explanatory_note_en.pdf.

1.12 The Committee thinks that it is a mistake to exclude large companies from support for investment projects that promote regional cohesion and development. Such a move creates a serious risk of losing the development potential that is only afforded by synergy and horizontal integration across the whole business system, regardless of company size.

1.13 The Committee calls on the Commission to establish a mechanism that takes account *ex ante* of potential adverse side-effects of regional state aid, such as significant job losses at existing sites within the EU, not only as part of the comparative assessment which is undertaken by the Commission during the notification process (and which currently only concerns major investment projects)[3], but also under the general block exemption regulation.

1.14 The Committee stresses that regional state aid must be fine-tuned to ensure it does not encourage businesses to move or relocate, in "subsidy races" caused by high differentials in aid in neighbouring and bordering regions which fragment the single market.

1.15 The Committee suggests that the Commission should:

- reconsider its intention to reduce aid intensity for large enterprises from 40% down to 35 and 25%. This suggested reduction would in reality lead to the loss of attraction for foreign investment;
- not limit the aid intensity to the amount of additional costs and not toughen the process of proving the incentive effect for large enterprises;
- avoid crippling the ability of "a" areas to attract foreign investment and create new jobs and values, which would put these areas at a competitive disadvantage compared with other regions outside Europe whose investment schemes are in many instances much more generous.

1.16 At the same time the Commission should introduce a safeguard clause obliging large companies which receive regional aid for setting up a new establishment or for purchasing assets directly tied to a particular establishment, to guarantee that for the five years following the granting of the aid:

- they will maintain employment levels at establishments in those Member States where they have not requested aid under Article 107(3)(a), or
- any reduction in employment at establishments in those Member States where they have not requested aid under Article 107(3)(a) will only occur after and in conformity with an agreement with the social partners, at regional or national level, where appropriate, of the Member States involved.

3 2009/C 223/02, p. 54.

1.17 The Committee asks the Commission to reduce aid levels in a more gradual, tapered and balanced manner. The reduction should be in keeping with the reduction of the aid received by the regions under cohesion policy.

1.18 The Committee proposes that alongside per capita GDP (currently the sole parameter, and not indicative of the true state of a regional economy), other parameters should be used such as: unemployment rate, ratio of job losses to total number employed, and others that could fit better with the real situation.

2. The new economic context after the crisis

2.1 Controls on state aid are a necessary instrument of competition policy to ensure that the single market is governed by effective principles of free trade and competition, providing a level playing field for all businesses across the single European market. Article 107 TFEU therefore prohibits Member States from granting aid to businesses that would affect trade between Member States, or distort or threaten to distort competition, by giving unwarranted selective advantages to certain businesses, preventing market forces from rewarding the most competitive firms and thereby reducing overall EU competitiveness.

2.2 Nevertheless, the Treaty allows for possible exceptions in cases where aid pursues objectives of common European interest which cannot be achieved by market forces alone. Articles 107(2) and 107(3) identify the main market failures and list the **exceptions** where certain types of aid "shall be compatible" or "may be considered to be compatible" with the internal market, on the basis of criteria laid down exclusively by the European Commission.

2.3 Under Article 107(3)(a) and (c), the Commission may thus consider state aid to promote the economic development of certain disadvantaged areas within the EU as compatible. This type of aid is termed "regional state aid" or "national regional aid". It may be destined mainly for **large companies** to support investment and job creation or, in certain circumstances, it may take the form of operating aid. In both cases, it is **targeted at specific regions in order to redress regional disparities**, more particularly by encouraging firms to set up new establishments there.

2.4 Being designed to offset the disadvantages faced by the less favoured regions, regional state aid promotes the economic, social and territorial cohesion of the Member States and of the EU as a whole. Its aims are consistent with those of the Structural Funds, which provide possible funding sources for implementing regional development policy alongside national budgets.

2.5 The Committee stresses the vital need to safeguard and in some cases strengthen controls on state aid which can severely distort the proper operation of the internal market. However, it must be ensured that the rules on state aid do not make aid disjointed; these rules must also prevent the serious risk of competition and trade distortions due to Member States' differing capacity to grant investment aid.

2.6 At the same time, the Committee considers that the instruments available to provide exceptional assistance for crisis situations or for areas hit by a crisis must be made effective and flexible.

2.7 The current rigid system of guidelines for regional state aid, based on a geographical mapping of the EU, has obvious shortcomings. It does not fully meet the Treaty objectives set out in Article 107(3)(c) and could potentially distort competition. If the current method is used in the new economic and social context facing the Union, it could hamper the development of the internal market.

2.8 The modernisation of state aid should also apply to this important instrument which completes the range of possible measures for helping disadvantaged areas. It is strange, to say the least, that the Commission not only intends to keep a system that dates back to 1971, with various later amendments, but also to make its application even more restrictive. The Commission's oft-mentioned objectives of growth and job creation are contradicted by inconsistent policies which limit the potential that a careful reform of the guidelines could offer.

2.9 The Commission itself, in the Europe 2020 strategy, recognises that economic conditions change more quickly than political ones, and that in order for Europe to return to sustainable growth and sustainable public finances after the crisis, it needs a new approach which targets resources on particular topics and priorities. As recently stressed by DG Competition in its discussion document of 23 February 2012 on modernisation[4], this should be achieved by a "dovetailed package of reforms" in the various sectors, through "partnership with Member States and stakeholders with a view to developing a broad and balanced agreement on the way forward".

2.10 The Committee welcomes this approach, which it feels is more flexible and dynamic and thus better designed to address the rapidly evolving crisis facing the EU. In particular, the Committee asks that it be adopted when dealing with the Treaty exemptions for regional state aid.

4 Comp/DG/2012/012588 of 23 February 2012.

3. Consistency between regional cohesion policy and competition policy

3.1 The Committee notes that right from the 1998 guidelines which first laid down the principles underpinning national regional aid[5], the Commission has always stressed the need to make regional policy and competition policy more mutually consistent and focused[6].

3.2 This approach ensured the mutual consistency of the two systems up to the 2000-2006 programming period as, for political and economic reasons, the maps of the EU regions eligible for structural aid under objectives 1 and 2 were made to coincide with the maps of the regions eligible for regional state-aid exemptions; however, this practice ceased as of the 2007-2013 programming period.

3.3 On the one hand, changes were made to regional policy in response to the need for a multi-disciplinary or integrated approach that recognises the particular problems presented by different geographical circumstances: this called for "a comprehensive strategy which sets the framework within which specific objectives and actions are pursued"[7]. Regulation (EC) No 1083/2006[8] thus established a new method for implementing structural assistance on the ground, whereby implementation is the responsibility of each Member State at the appropriate territorial level, in accordance with its respective institutional system and socio-economic requirements and characteristics.

3.4 On the other hand, competition policy has continued to pre-determine the areas eligible for regional state-aid exemptions by means of seven-year maps. Regional and cohesion policy has thus not been flanked by an equally flexible competition instrument, undermining the integrity of the internal market and betraying the asymmetric nature of policies which nonetheless pursue the same goal of cohesion.

3.5 The Committee also points out that in its 2008 green paper on territorial cohesion[9], the Commission recognised that eligibility for structural policy support had to be decided at regional level, increasingly aware that in order to improve governance of cohesion policy it had to be made "more flexible, more capable of adapting to the most appropriate territorial scale, more responsive to local preferences and needs and better coordinated with other policies at all levels, in conformity with the principle of subsidiarity".

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5 OJ C 90, 26.3.1998, page 3.

6 Communication from the Commission to the Member States on the links between regional and competition policy – reinforcing concentration and mutual consistency, 98/C 90/03, point 1.

7 Communication from the Commission on Cohesion Policy in Support of Growth and Jobs: Community Strategic Guidelines, 2007-2013, COM(2005) 299 final of 5 July 2005, point 5.

8 Article 12 of Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999.

9 COM(2008) 616 final of 6 October 2008, point 1.

3.6 The Commission also concluded that an effective response to the problems of economic growth in a globalised world economy "requires a policy response on a variable geographical scale "[10].

3.7 If, as the Commission recognises, "competition policy can affect the territorial distribution of economic activity by ensuring that regional aid is concentrated in the most disadvantaged areas and by adjusting the intensity of aid allowed to the nature and scale of problems"[11], it cannot ignore the path already taken by regional policy, based on measures focused on the EU's thematic priorities and on geographical concentration on a variable scale; this necessarily means reviewing the method for identifying areas eligible for regional exemptions under Article 107(3).

4. Reasons why the current mapping of disadvantaged areas is inappropriate

4.1 The Committee points out that the method used by the Commission to identify EU areas eligible for regional exemptions under Article 107(3) gives priority to the regions with the most serious problems (subparagraph a), identified on the basis of GDP/PPS compared to the overall European average. Further criteria should be added in order to measure serious underemployment, which is specifically mentioned in the Treaty. The criterion used by the Commission is indicative of an abnormally low standard of living but does not necessarily indicate serious underemployment. The unemployment rate could be a useful correcting factor for GDP. The Committee would also ask the Commission why disadvantaged areas under Article 107(3)(c) are to be determined simply by subtracting the Article 107(3)(a) areas from the overall population coverage for the Member State concerned. Such a practice means that the possibility of helping disadvantaged areas under Article 107(3)(c) depends on the scale of disadvantaged areas under Article 107(3)(a), creating serious disparities between Member States without making a comparative assessment of the problems faced by the regions selected.

4.2 This leads to distortions: some countries have eligible regions whose development levels are significantly higher than those of regions in other countries that could not be granted regional aid because the country's ceiling for Article 107(3)(c) is low. The distortion of trade caused by any form of aid would not then be justified in the common interest: it would be both unjustified and a total distortion.

4.3 The Committee stresses the importance of continuing to use comparison with the national development level in order to determine Article 107(3)(c) areas, as comparison within a country is the only way that a Member State can address disparities between its regions and apply national regional policies to counter the fragmentation of the internal market.

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10 Ibid, point. 2.3.

11 Ibid, point. 3.1.

4.4 In a highly globalised world and in a European context of rapidly disappearing internal barriers, disparities within the Union are increasingly more apparent at regional than at national level, in areas whose socio-economic problems transcend administrative boundaries and are rooted in specific structural and systemic weaknesses of an economic rather than political nature.

4.5 A rigid planning system which ties the definition of "weak" areas to a geographical map based on average data for 2008-2010, and which covers a seven-year period, is anachronistic in the rapidly changing economic and social context of today.

4.6 Moreover, attempts to make the spatial distribution of economic activity more balanced by investing in the most disadvantaged areas could produce "forced" results that do not reflect the real potential of those areas, impeding efficient groupings in Article 107(3)(c) areas and benefitting "local subsidy hunters" in Article 107(3)(a) areas. Pre-defining disadvantaged areas in a static manner is not at all conducive to competitiveness and innovation. It inhibits the development of the innovation clusters which Europe 2020 identifies as key to smart specialisation strategies for regional growth; the Commission states that support for their development *needs to be concentrated on areas of comparative advantage*[12], i.e. those economic sectors where aid is most cost-effective.

4.7 It has also been widely shown[13] that a regional development policy based essentially on offsetting regional differences related to productivity gaps (in other words, which simply transfers financial resources from the richer regions to the poorest) puts a serious brake on mobility and efficient clustering. Such an approach must leave room for a "place-based development strategy", in which regional and other boundaries are "independent of administrative boundaries … and can change over time".

5. The need to change the method for defining disadvantaged areas: proposals

5.1 The Committee therefore thinks that the mapping of "disadvantaged areas" should enable each administrative region to intervene in all areas which, during the programming period, show signs of disadvantage, identified using parameters that have been defined, recognised and jointly agreed in advance.

5.2 The Committee endorses the model for modernising regional policy that was recommended in Fabrizio Barca's 2009 report on cohesion policy[14]. This uses units of intervention selected on

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12 COM(2010) 553 final of 6 October 2010, Regional policy contributing to smart growth in Europe 2020, point. 3.1.

13 See footnote 14.

14 An agenda for a reformed cohesion policy: A place-based approach to meeting European Union challenges and expectations – Independent report drawn up by Fabrizio Barca in April 2009 at the request of Danuta Hübner, Commissioner for Regional Policy.

the basis of priorities, needs, the territorial configuration of economic inefficiencies and social exclusion traps, and the institutional context, irrespective of administrative boundaries.

5.3 The Committee suggests that the Commission uses the same approach for competition policy, adopting a new method for defining "economic areas" under Article 107(3)(c); this method would not be tied to geographic or administrative boundaries, but would be able to take account of the actual conditions which regions face from time to time.

5.4 The Committee believes that this method could guarantee regional development objectives by means of thematic concentration, while also safeguarding competition principles and the integrity of the market by placing a quantitative limit on the resources to be allocated to national regional aid; this limit would be decided upstream for each Member State and NUTS-II [Nomenclature of Territorial Units for Statistics] region, as already happens in the case of the national *de minimis* ceiling in the fisheries and agriculture sectors, for instance.

5.5 The Committee proposes that the establishment of a ceiling be accompanied by the setting of assessment parameters for crisis situations, designed to ensure that support for undertakings will help to further the development of lagging regions, and that the areas where national regional aid can be deployed at certain times are decided on the basis of a broad set of indicators and minimum thresholds approved in advance by the Commission.

5.6 The Committee thinks that it would make more sense for disadvantaged areas to be designated using a method which takes account of local socio-economic conditions. This could be done by identifying NUTS-III areas where unemployment levels exceed the national average, taking the total resident population there and applying a multiplying factor (to be agreed with the Commission) to establish a ceiling for the aid to be granted to companies in those areas.

5.7 The Committee considers that this method would enable the Commission to safeguard competition more effectively than the current method because while meeting the compatibility requirements laid down in the guidelines it sets an effective ceiling for the aid that Member States can grant within a given area, preventing richer countries from providing undue support for their own businesses at the expense of other countries. The current rules, in contrast, allow Member States to concentrate state aid in a particular eligible area to an extent where the overall sum could distort competition.

6. The need to continue aid for large companies in Article 107(3)(c) areas

6.1 The Committee notes that since its inception, regional state aid has provided assistance for large companies, whose strategic role in the development of regional economies is neatly expressed in the Commission's 1998 communication on the links between regional policy and competition policy[15]. This stressed the need for the two policies to be mutually consistent precisely in order to attract investment by major companies, recognising that "this would be highly desirable in regional development terms because of the knock-on effects and access to world markets it would bring".

6.2 Remembering this, and in the light of the above comments, the Committee thinks that it should remain possible to grant regional aid to large companies in Article 107(3)(c) areas under the conditions laid down in the existing guidelines.

6.3 The Committee points out that denying such aid to large companies in Article 107(3)(c) areas could seriously skew public resources in Article 107(3)(a) areas, in some countries which not only have a particularly high maximum level of aid but which are also in receipt of significant Community resources and have much lower labour costs: this would inevitably distort competition.

6.4 Liberalisation of the financial markets and expansion of the single market now enable businesses to adopt strategies to minimise the tax they pay and "shop around" for the most fiscally attractive location[16]. Whilst awaiting tax harmonisation which would minimise unhealthy fiscal competition, the Committee considers that the Commission should at this time prefer such forms of aid and such aid schemes (e.g. long-term tax relief based on enough "binding" conditions) which can help to minimise distortion of the market better than reduction of aid. The regulatory framework for the next programming period should tighten up the rules on relocation and ensure that there are appropriate coordination channels for cases where the use of EU cohesion funding and state-aid authorisation involve the same company.

6.5 The Committee urges the Commission to take a close look at the regulatory system adopted by one of the EU's main competitors, the USA, on support for the economic development of disadvantaged areas (Title 13 of the Code of Federal Regulations, Business credit and assistance). This mechanism for identifying areas eligible for public assistance provides for the designation of economic development districts and economically distressed areas, and the selection of development projects based not on geographic or administrative boundaries but on intervention goals and priorities and a set of parameters broadly laid down at federal level, which each state then fleshes out, tailoring them according to their own economic structure.

7. Stakeholders' views

7.1 A public hearing on State aid for the development of Europe's regions was held on 29 January 2013. Speakers included representatives of various EU regions (from Spain, Germany and

15 See footnote 5.

16 A new strategy for the single market at the service of Europe's economy and society – Report by Mario Monti to the President of the European Commission José Manuel Barroso, 9 May 2010.

Italy: Andalusia, Bavaria and Emilia Romagna), local and national business associations, and the European Parliament, as well as the expert for the Committee of the Regions' rapporteur, who outlined the opinion adopted by this EU advisory body on 1 February 2013[17]. The opinion puts forward questions and proposals broadly supporting the need to modernise the rules on state aid for the regions.

7.2 Despite their differing standpoints, both regions and businesses stressed that the Commission proposal falls short of providing a satisfactory response to the many calls to modernise and improve the national regional aid system, particularly during the current serious crisis. The EP representative endorsed the proposals set out in the present opinion, feeling that they were better attuned to improving regional balance. Interesting proposals were made for the addition of new criteria alongside GDP for calculating divergence from the EU average and aid eligibility for Article 107(3)(a) regions, such as regional unemployment level. The Committee wholeheartedly supported these proposals.

7.3 Lastly, from both the local and the national standpoint, businesses stressed the need for intervention to be flexible: access to regional aid should be assessed in terms of quality of investment, and of its expected impact on the economy and on competition, and not in terms of company size. It was also pointed out that in order to be able to gauge more effectively the impact on competition of aid for firms larger than SMEs, the company-size parameters contained in the Commission's 2003 recommendation[18] needed updating, as the "non-SME" category includes many businesses which are not large multinationals and, being much smaller than these, should not be treated in the same way.

8. The need to maintain intensity of support for large companies in Article 107(3)(a) areas

8.1 The Committee urges the Commission to reconsider its intention to reduce aid intensity for large enterprises from 40% down to 35% and 25%. The Commission argumentation for aid reduction is not valid. The suggested reduction would in reality lead to the destruction of current schemes in "a" areas established to attract foreign investment.

8.2 The Committee is also seriously concerned about the Commission's intention to limit the aid intensity to the amount of additional costs and to toughen the process of proving the incentive effect for large enterprises.

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17 http://www.toad.cor.europa.eu/corwipdetail.aspx?folderpath=COTER-V/034&id=21792.

18 Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises: OJ L 124, 20.5.2003.

8.3 The measures described above would in reality cripple the ability of "a" areas to attract foreign investment and create new jobs and values, thus putting these areas at a competitive disadvantage compared with other regions outside Europe whose investment schemes are in many instances much more generous.

Brussels, 21 March 2013

The President
of the
European Economic and Social Committee

Staffan Nilsson

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