

COM-1/011

Brussels, 26 November 1999

OPINION

of the Committee of the Regions

of 18 November 1999

on

The impact of regional policy on incentive packages for investment: a different approach in the use of Structural Funds

The Committee of the Regions

HAVING REGARD TO the decision of the Bureau of 10 March 1999 to draw up, in accordance with the fourth paragraph of Article 198c of the Treaty establishing the European Community, an opinion on the subject, and to instruct Commission 1 for Regional Policy, Structural Funds, Economic and Social Cohesion, Cross-Border and Inter-Regional Cooperation in liaison with Commission 6 to prepare the Committee's work on the subject;

HAVING REGARD TO the contribution of Commission 6 for Employment, Economic Policy, Single Market, Industry and SMEs (rapporteurs: **Mrs Oldfather** (UK, PSE) and **Mr Schranz** (A, PPE));

HAVING REGARD TO the draft opinion (CdR 127/99 rev. 2) adopted by Commission 1 on 6 October 1999 (rapporteurs: **Mrs Klasnic** (A, PPE) and **Mr Färm** (S, PSE));

adopted the following opinion at its 31st plenary session of 17 and 18 November 1999 (meeting of 18 November):

1. General background

1. Many business activities are becoming increasingly global. Technological progress and the rapid internationalisation of business markets are contributing factors. The

capacity of Community companies to compete on this market is of key importance for future growth and prosperity in the EU.

2. The attainment of EMU has resulted in the disappearance of some of the traditional means of attracting investment. A fixed rate of exchange puts an end to currency fluctuations. Member States can no longer be tempted to resort to devaluation to boost their competitiveness.
3. EMU also changes conditions on the credit market and the evaluation of other economic factors. Competition is becoming fiercer and companies can more easily compare lenders' terms. A common currency also highlights discrepancies between salaries, taxes and charges.
4. A uniform common market with a common currency makes it easier for firms to divide up their activities. Labour-intensive components that do not require a particularly skilled workforce are assigned to areas with low labour costs. Research and development, along with activities requiring highly-trained workers, are sited in expanding areas with top universities. This is a natural development, where comparative advantages are weighed up; however, if taken to extremes, it creates major problems.
5. In the more favoured regions a large number of low-skilled jobs are disappearing. The result can be a two-tier labour market, where a strong market for highly trained workers may co-exist with high unemployment in vulnerable groups. In less prosperous regions there is a risk of perpetuating a structure dominated by manufacturing jobs. This highlights the need to focus support measures in less-favoured regions on developing infrastructure, education and training and other social services.
6. Imminent EU enlargement is already influencing companies' investment decisions. The countries concerned represent a large, important future market, with potential growth and increased demand. The accession of these countries will have an enormous effect on the labour market, especially in the neighbouring states. During a transitional period the lower costs of labour and the fact that environmental and social standards will not be reached immediately will be significant factors for investment.

2. **The role of European regional policy in the context of promoting the establishment of enterprises**

1. One of the major aims of the EU is expressed in Art. 158 (2) of the Treaty establishing the European Community. "The Community shall aim at reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions or islands, including rural areas."
2. Furthermore the task of the European Regional Development Fund is defined in Art. 160 of the Treaty. The ERDF is intended to help to redress the main regional imbalances in the Community through participation in the development and structural adjustment of regions whose development is lagging behind and in the conversion of declining industrial regions.
3. One key aim of EU regional policy is to support development in vulnerable regions which will generate new, sustainable jobs. For many years the EU Structural Funds have provided valuable support in promoting the development of ailing regions. There are many good examples of how EU aid has made a positive contribution in less favoured regions and in industrial areas hit by recession. The Structural Funds are a

major common instrument in creating new jobs and strengthening EU competitiveness.

4. However, the Committee of the Regions is concerned about distortions of the Structural Funds' fundamental aims. The aim of EU regional policy should be to ensure that direct subsidies do not simply lead to a shift in existing jobs from one area of Europe to another one. For this reason, if it comes to a lowering of the subsidies available to industry in Europe, support should be given to a policy which aims to take consistent account of the regional development disparities referred to in Article 158 of the EC Treaty. In this regard, the Structural Fund programme for 2000-2006 adopted with Agenda 2000 at the Berlin European Council will have a key role to play.
 5. Demographic trends mean that Europe has an ageing workforce. At the same time it is experiencing very rapid technological change. Great efforts are needed to ensure that the skills of the workforce keep pace with changes in general, and to cope with sharp international competition. When the supply of young and newly-trained workers declines, companies have to find new ways of meeting their recruitment needs¹.
 6. The primary role of the national programmes now being introduced in the Member States to implement the EU's new Structural Fund programme should therefore be to support training measures to boost the skills of the labour force throughout the Union. Further, the Structural Funds' main task should be to continue to assist the development of infrastructure, training and R&D, and productive investment, and generally to help foster a stable, advantageous basic conditions and development momentum in less-favoured areas. The aim here should be to find long-term solutions to foster a local environment which is more conducive to growth so as to generate sustainable job opportunities. The Member States will then be able to live up to the aim, set out in the Amsterdam Treaty's employment chapter, of achieving a high level of employment.
3. **Incentive packages as an instrument of attracting investments within European regions**
1. The right of companies to transfer their operations to other locations in the European Union is conferred by the European Treaties and by the creation of the Single European Market. There can be major concerns when public aid is offered to encourage companies to change location and these concerns can be magnified when relocation decisions seem to have been motivated by incentives which do not promote sustainable employment.
 2. EU regional policy has done much to develop Europe's regions and improve the Union's balance and cohesion. However, there is a growing public debate about incentive packages for companies, because of the failure to comply with Community rules in a few exceptional cases. The main aspects which are questioned are as follows:
 - subsidising, or providing free of charge, land, premises and other facilities for companies shifting their production from one part of the EU to another;
 - the combination of such support with a proliferation of local/regional/national aid which falls completely outside EU structural support regulations and seems directly at odds with the EU's competition policy and rules on state aid;

- in addition to these two forms of support, employers may cut back terms of employment in some Member States. This poses a serious risk to social cohesion in the European Union, one of the defining features of which is a high level of social protection for workers. It is therefore essential to avoid social dumping by aligning working conditions within the framework of the Community Charter of the Fundamental Social Rights of Workers, enshrined in the Treaty on European Union;
 - in some cases, special tax incentives (fiscal dumping). For instance, it is an established fact that capital and company taxes differ sharply from one Member State to another, and even from one region to another within individual Member States, and that this is currently tending to stimulate extensive business relocations at regional level solely on tax grounds. The risk is that level of taxation may be compressed so far that major difficulties arise in funding education and social security.
3. Measures need to be taken to ensure that incentive packages do not distort competition and give unfair subsidies. State aids must be used to promote competition which generates economic efficiency, sustainable growth and the generation of viable jobs. Aid packages are important in some regions to compensate for the region's structural disadvantages for economic development and to help economic and social cohesion within the EU.
 4. The competition to attract companies - facing a persistently high level of unemployment - is becoming increasingly fierce. The danger is that sustainable employment will be undermined by short-term measures designed to entice companies.
 5. If a company's location decision is based more on a variety of subsidies than on a region's more permanent relative advantages, it is also likely to be short-lived. The offer of new, more advantageous subsidies can trigger further location decisions. There are several examples of this happening. When regions go in for this kind of game, where companies could play them off against one another, they should be aware that they are in danger of being the ultimate losers. The obligation to meet the Maastricht-criteria on the one hand and the race to offer a maximum of state-aid including tax-reduction can lead to serious problems, which may have an adverse effect, for Member States as well as regional and local authorities.

4. Relocation as a consequence of the use of incentive packages

1. Restructuring is a natural and necessary facet of industrial and internal market development. An inevitable side-effect is the total or partial closure of companies, the setting up of new companies and the relocation of businesses or activities. Some 10% of jobs disappear every year, to be replaced by roughly the same number of new ones. This places a heavy strain on the adaptability of individuals, companies and regions.
2. In a healthy market economy, businesses weigh up the respective advantages of different areas and regions when taking a decision on location. This process also calls for a variety of measures on the part of society, taking due care to respect basic EU principles regarding fair competition and a ban on aids which can cause distortion.
3. In the early 1990s the European Commission investigated the regions' competitiveness in terms of attracting investors. This survey was conducted in connection with work on completion of the single market. Regions were divided into three categories (developed regions, ailing industrial regions and less-favoured regions) and 37 different factors for

regional competitiveness were identified. The firms which participated in this survey were asked to indicate the factors to which they gave the highest priority.

4. Despite differences between the three categories of regions, the following factors came consistently top of the list:

- borrowing costs
- income and company tax
- access to a qualified workforce
- indirect labour costs
- labour market legislation
- degree of economic growth
- payroll costs.

5. In this connection, the European Commission also drew attention to a large number of measures to boost regional competitiveness for which local and regional authorities bear responsibility. These included factors as the educational system, infrastructure, regional policy, the regional economy and social services.
6. Assessments are partly influenced by the nature of the activity concerned. A company which is looking for a skilled, highly trained workforce will come to a rather different conclusion than another which is seeking a site for labour-intensive industry. Several other surveys show that companies in sunrise sectors with a highly skilled workforce place increasing emphasis on "soft" factors such as availability of good schools, the environment, recreational facilities, health care and other social services; a low crime rate is important too.

5. The actual role of the European Commission

1. In 1997 the EU Commission adopted new guidelines for national aid to regions. These guidelines include in points 4.10 and 4.14 a provision that Member States may only grant regional aid to a company if the investment and the jobs remain in the area for a period of no less than five years. By 1 January 2000 the Member States must undertake an overhaul of their national state aid regimes so as to bring them into line with the new rules. These guidelines also define the concept of initial investment, which may be funded with regional aid.
2. As regards the forthcoming EU regional aid programme 2000-2006, the Regulation on the general provisions for the Structural Funds contains a corresponding rule in Art. 30 (4) regarding relocation of businesses. It is specified that a company may only continue to receive support from the Funds if it does not undergo substantial restructuring primarily caused by plant closure or a transfer of location. This rule is to take effect within five years of the date on which the competent national authority has taken a decision on EU Structural Fund support.
3. The guidelines being drawn up by the Commission for the next programme period include a statement that the Structural Funds should not be used solely to relocate existing activities.
4. One of the European Commission's most important tasks is to monitor compliance with competition legislation and the rules on state aids. In principle state aids which distort terms of competition are precluded. The balance between, on the one hand, the

need for support to develop less-favoured areas and, on the other, fair terms of competition in a single market is not always easy to achieve. Since April 1998 multisectoral framework provisions on regional support for large investment projects have been in force². These provisions seek to provide a basis for more stringent control over state aids in connection with major investments. At the same time a balance should preferably be struck between three key EU policy aims, viz. to prevent distortion of competition in the single market, strengthen economic and social cohesion and sharpen industrial competitiveness.

5. The global importance and the high mobility of the car-industry convinced the Commission to also focus especially on this industry-sector in order to avoid distortion of competition among enterprises by receiving outranging state-aid offers. A special regime was established with the Community framework for state aid to the motor vehicle industry³, where a detailed analysis of the investment decision has to be provided to the Commission before approval. Depending on the experience with this framework there should be similar provision for other sectors like telecommunication. Furthermore, the framework should be applied to other highly competitive and shrinking industrial sectors.

5.6 At the end of March 1999 the European Commission published its seventh report on state aids, in which it observed that national state aids were as high as 95 billion euro per annum, of which 38 billion euro was allocated to manufacturing industry. Though the Commission noted a consistent downwards curve, state aids were still excessive and frequently inconsistent with fair competition in the single market.

5.7 In addition, there were sharp differences from one Member State to another. Admittedly the downwards trend had been visible for some time, but not in all Member States. In half of them state aids had increased or remained static during the period 1995-1997 compared with 1993-1995. Hence Commission monitoring of aids will continue be a top priority. The Commission observes that rules already exist, but many Member States fail to observe them. Is it also important to give the Commission the resources it requires in order to maintain high standards of monitoring.

5.8 The relocation of existing jobs has been the subject of discussion between the relevant Commission directorates-general on many occasions in recent years, especially when such relocation has been combined with EU support or national state aids. In a number of cases attention has focused on the role played by the workforce's conditions. Large sections of EU labour law and worker protection legislation result from the drive to curb social dumping. The five year rule for Structural Fund support can also be seen in this light.

5.9 The Amsterdam Treaty steps up cooperation on the social dimension as well as environmental protection. The social partners jointly bear major responsibility for ensuring that common rules are observed and working conditions improved for the workforce. Such closer cooperation also gives the EU Commission greater authority in monitoring compliance with the common rules. The Commission needs to be provided with the requisite resources. The forthcoming accession of new Member States from central and eastern Europe will make this even more necessary.

5.10 The discussions in progress within the Commission between the relevant directorates-general have resulted, among other things, in the instigation of a study of business relocation decisions. This study, which has been commissioned from an external consultancy firm and should be ready for autumn 1999, is intended to identify the factors which condition decisions concerning business relocation.

5.11 On taxes and fiscal dumping, the Commission has set up a group of experts headed by the UK Paymaster General, Dawn Primolo. Criticism is mounting against the inclusion of tax and charge concessions in incentive packages to attract investors.

6. A different approach of local and regional authorities to regional policy

1. During the 1990s we have seen a number of examples of jobs being relocated from one area of the EU to another. In many cases, various state aids (with or without Structural Fund resources) have been included. Worse conditions for the workforce (not just pay but also terms of employment in general) have also played a role. In areas hit by plant closures, it has often been hard to find alternative jobs, resulting in increased unemployment bringing economic and social problems in its wake. This goes to show that the current agreements within the EU need to be strengthened. An overhaul must therefore be undertaken, to prevent EU support leading to unhealthy competition among local and regional authorities.
2. At the November 1997 Employment Summit in Luxembourg it was decided to set up a high level group of experts headed by the former Volvo chairman, **Mr P.G. Gyllenhammar**, with the task of analysing the social and economic implications of structural changes within industry. This group has focused on providing guidance on measures to promote employment and sharpen competitiveness, foster a labour market that operates smoothly and pave the way for changes in these areas. Its final report was completed in November 1998 (an interim report was presented in April 1998) and is addressed to political decisionmakers, captains of industry and the social partners⁴.
3. The group of experts observes that extensive structural changes lie ahead and will affect many industrial sectors and regions. Its report contains a long list of recommendations to place the Member States in a better position to cope with the inevitable socio-economic side-effects of change. These recommendations include measures to develop modern education and training, as well as infrastructure systems, schemes to boost small and medium-sized firms, and special promotion of sunrise sectors. One major conclusion was that firms themselves ultimately bore responsibility for restructuring. The single market must be completed. Any form of concealed obstacle to free, fair competition must be removed. That includes the ending of any aid which distorts terms of competition; all aid, including tax incentives, must be fully visible and transparent so as to ensure an even playing field.
4. Partnership among all the various players is one of the key issues in the group's report. Social dialogue must be stepped up and play a full part at all levels. Broad cooperation on the part of those concerned is a prerequisite for effective, successful implementation of structural change. On a basis of broad consensus, action is needed in firms and regions affected by restructuring to encompass, for instance, training programmes to develop workers' capacity to cope with change as well as measures to promote small and medium-sized firms in the regions concerned. An economic development strategy needs to be framed to enable regions in the throes of structural change to combat social problems.
5. The Committee of the Regions regards the work accomplished by the group of experts as a valuable contribution to the Community's objective of promoting social and economic cohesion within the EU. Taking this work as starting point, the Committee calls for a code of conduct for the implementation of structural change.
6. The social partners' role and responsibilities in such matters should be stepped up. Moves in that direction are already discernible in several places and the social dialogue

needs to be further reinforced at all levels.

7. A code of conduct should be drawn up in the form of a list of recommendations to be adopted with the broad consensus of the parties concerned (governments, regions, social partners). The aim should be to foster a sound basis for economic and social cohesion via a regional policy designed to boost competitiveness and economic growth. The aim is for this code to serve as an instrument in curbing unfair competition rooted in social, fiscal and environmental dumping. Its core component should be to provide European regional policy with a streamlined set of rules and policy programme, with dynamic investment in education, training and infrastructure and with productive investment, and to ensure that Structural Fund support is not used for purposes of relocating existing jobs.

7. Conclusions

The Committee of the Regions:

- 1) notes that the right of companies to relocate within the European Union is enshrined in the European Treaties but that this movement must not be promoted through the unfair use of incentives, and that there needs to be a strict enforcement of the state aids policy which outlines eligible aids and which promotes fair competition;
- 2) believes that EU regional policy is a key policy area which promotes economic and social cohesion. Aid packages are important in some regions to compensate for the regional and structural disadvantages which hamper economic development. It is essential that these packages promote sustainable economic development and viable jobs;
- 3) states that one of the concerns of EU policy should be to reduce gradually direct subsidies for industrial locations, taking into account the objectives set out in Article 158 of the EC Treaty, i.e. reducing disparities between the levels of development of the various regions and the backwardness of the least favoured regions;
- 4) will keep a close eye on the inquiry into business location decisions commissioned by the European Commission, especially when it comes to ascertaining how, and to what extent, Structural Fund resources are included in the incentive packages offered to attract firms to establish activities in various regions;
- 5) recognises that the European Commission's Seventh Report on State Aids has pointed out that state aids in manufacturing industries are being reduced. While the COR welcomes this reduction, it is important that surveillance of state aids continues because every example of company relocation due to unjustified subsidies can have severe consequences for the regions and localities which have lost employment. A programme should tighten up existing rules and monitoring arrangements but also put forward proposals for a code of conduct for the relevant players in this sphere. The code of conduct should be based, inter alia, on the guidelines proposed in the report of the group of experts directed by the European Council to investigate the economic and social implications of structural change;
- 6) calls upon the European Parliament and the Council to support the European Commission in its efforts to reorganise the monitoring of state aids and to combat social and environmental dumping more effectively;
- 7) proposes that a proactive drive be made to focus the EU structural programme for the

forthcoming period 2000-2006 more closely on the challenges facing the EU. Measures to support the creation of new jobs in eligible regions should concentrate on programmes to promote investment, infrastructure, education, research, public services and similar schemes aiming to promote growth and help boost competitiveness and the capacity to meet new challenges, as well as generating a larger number of sustainable jobs. To this end measures to support productive investment that generates new jobs should include the requirement that they do not involve direct aid for a relocation alone, i.e. aid not considered as an "initial investment" under the terms set out in the Community guidelines for state aid for regional purposes;

8) recommends that a special Community framework for state aid in highly competitive and shrinking industrial sectors should be drawn up. This should be similar in nature to the Community framework for state aid to the motor vehicle industry.

Brussels, 18 November 1999.

The President

The acting Secretary-General

of the

of the

Committee of the Regions

Committee of the Regions

Manfred Dammeyer

Vincenzo Falcone

¹ see also Directorate-General V's "Demographic Report 1998" and "A Society for All Ages", a conference paper prepared by Directorate-General V for the similarly named conference held in Vienna on 12-13 October 1998.

² OJ C 107, 7.4.1998, p. 7-12

³ OJ C 279, 15.9.1997, p. 1-8

⁴ "Managing change - Final report of the high level group on economic and social implications of industrial change", published by the European Commission, Directorate-General V.

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