

REGIONAL AID

2007-2013

**CONSULTATION ON EUROPEAN COMMISSION
PROPOSALS ON REGIONAL STATE AID**

REGIONAL AID 2007-2013

A paper seeking views on the European Commission's proposals to amend the state aid guidelines governing regional support granted by Member States

Consultation on European Commission proposals on regional state aid

This document invites views on European Commission proposals to amend the guidelines governing regional aid (which define assisted areas and aid intensities allowed within them) after 2006. Against the background of EU enlargement and European Council decisions to move towards less and better targeted state aid, the proposals would result in reductions in eligibility for such aid in the UK and the other longer standing Member States, though additional levels of aid would be permitted for SMEs outside the assisted areas. This consultation seeks the views of all interested parties to help inform the Government's response to the Commission proposals.

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|-------------------|--|
| Issued | Date 14 June 2004 |
| Respond by | Date 6 September 2004 |
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Executive Summary

1. This document invites views on European Commission proposals to amend the guidelines governing regional aid (which define assisted areas and aid intensities allowed within them) after 2006. The Commission's proposals are at Annex 1.

2. The Government's economic policy for the Regions is based on boosting wealth - and employment - creating capacity in every region and nation by strengthening innovation, enterprise and skills and modernising regional infrastructure. We aim both to encourage economic growth in every region and, over the longer term, to narrow the gaps in growth rate between the more prosperous regions and the rest. At the heart of this regional economic policy is an approach in which the public and private sectors work together for their regions. In England much of the Government's policy on economic growth and support for business is delivered by regionally based organisations such as the Regional Development Agencies (RDAs) and local authorities. The Devolved Administrations also channel much of their support for business and economic growth through their equivalent bodies. Government funding for the RDAs and similar bodies has been steadily increasing over previous years¹. Levels of Government funding for the regions are not directly affected by the Commission's proposals. One of the routes through which this funding has been spent has been through regional aid – particularly in helping bring forward investment projects by larger firms. However, this is only one of several instruments available through which regional development can be pursued most of which are not affected by the changes to the Regional Aid Guidelines.

3. The Commission explain that their objectives in reviewing the Regional Aid Guidelines are to tackle market failures, promote entrepreneurship and ensure less and better targeted State aid. The aim is to allow a better concentration of regional aid to investment in the least favoured Member States and regions, while increasing the flexibility for other Member States and regions to pursue local development. The Commission proposals would reduce the areas in which regional aid can be provided in nearly all of the longer-standing Member States including the UK. The levels of aid that could be given would also be reduced. Their proposals would at the same time increase levels of aid for capital investment allowed to small and medium sized firms outside the assisted areas. Plans to provide a completely new instrument permitting quicker approval of certain types of aid considered to be less distorting would also introduce greater flexibility to provide lower levels of aid outside the assisted areas. Further reviews of other state aid guidelines, such as those permitting aid for research and development are planned.

4. The Commission's proposals would affect the UK's scope to grant support through Regional aid – in particular Regional Selective Assistance (RSA) and its

¹ E.g. Government funding of the English RDAs has increased from £645m in 1999-2000 to £1,719m in 2003-2004

successor in England and the property gap funding schemes. The Regional Aid Guidelines are only one of several State aid instruments through which the Government provides business support. However, they are the main instrument through which investment aid by larger firms in the assisted areas is supported. The Government is interested in views on the extent to which the proposed changes to the Regional Aid Guidelines will affect the delivery of business support in the Regions.

5. There are other State aid instruments under which business support can be approved – the so called “horizontal” frameworks and guidelines. These allow aid to be granted anywhere including outside the assisted areas and include aid for activities such as risk and venture capital, environmental support, R&D, SME, training and employment aid, though they do not provide the means to give general investment aid to large firms. Numerous schemes have been approved across the UK under the guidelines to provide support in areas including urban and rural regeneration, small business risk capital, developing regional infrastructure and skills bases and facilitating environmental improvement. With the Commission’s proposed reduction of assisted area coverage and regional aid intensities in all Member States it will be increasingly important to ensure that these “horizontal” guidelines and other available instruments are flexible enough to allow aid to be granted to correct market failures and economic underperformance where they occur. The Commission consider that the horizontal guidelines coupled with the increase in SME aid intensities outside the assisted areas and proposed new instruments to give “fast track” approval of modest amounts of aid which are not considered to cause significant market distortion provides such flexibility. In view of this, the Government is seeking respondents’ views on whether the above measures provide sufficient scope in addressing market failures and underperformance outside the assisted areas and, if not, what additional changes will be needed to do so.

6. The Commission are proposing that the Assisted Area maps for the period 2007 – 2013 should be broadly coherent with the proposed “Convergence” Structural Funds areas and that these areas should be defined at “NUTS2” level – i.e. in the UK, areas approximately equivalent to counties or groups of counties. The Government is concerned that basing the assessment of economic performance at such large geographical levels will mean that underperforming areas will be excluded from Assisted Area status because they share their NUTS2 area with more affluent areas. The Government is seeking respondents’ comments on whether the basis for calculating the assisted areas in the Commission proposals set out by the Commission is the most appropriate or whether using a different basis – e.g. geographical areas smaller than NUTS2 or other indicators of economic performance – would provide a greater ability to grant Regional aid to address areas of underperformance.

How to respond

7. When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

8. A response can (also) be submitted by letter, fax or email to:

Julie Evans
State Aid Branch
Department of Trade and Industry
Kingsgate House
66-74 Victoria Street
London SW1E 6SW
Tel: 020 7215 4428
Email: Julie.evans@dti.gsi.gov.uk

9. If your organisation is situated in Scotland, Wales or Northern Ireland, it would be helpful if you could send a copy of your response to the relevant Devolved Administration (contact details below)

10. Questions about the policy issues raised in the document can be addressed to:

Trevor Raggatt
State Aid Branch
Department of Trade and Industry
Room 231
Kingsgate House
66-74 Victoria Street
London SW1E 6SW
Tel: 020 7215 8753
Email: trevor.raggatt@dti.gsi.gov.uk

Sandra Reid
Scottish Executive
Meridian Court
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Glasgow G2 6AT
Tel 0141 242 5473
Fax 0141 242 5691
Email: sandra.reid@scotland.gov.uk

Rob Halford
Economic Policy Division
Welsh Assembly Government
Cathays Park
Cardiff
CF10 3NQ
rob.halford@wales.gsi.gov.uk

Ashley Ray
Department of Enterprise, Trade and Investment
Netherleigh
Massey Avenue
Belfast
BT4 2JP

Tel 028 9052 9224
Email: regional.aid@detini.gov.uk

11. A summary of the circulation of this consultation document is given at Annex 9. A detailed list of organisations consulted can be obtained from DTI State Aid Branch:

State Aid Branch
Department of Trade and Industry
Kingsgate House
66-74 Victoria Street
London SW1E 6SW
Tel: 020 7215 4452
Email: SAPU@dti.gsi.gov.uk

We would welcome suggestions of others who may wish to be involved in this consultation process.

12. An electronic version can be found at www.dti.gov.uk/ewt/stateaid.pdf and at www.dti.gov.uk/consultations/stateaid.pdf

Confidentiality

13. Your response may be made public by the DTI. If you do not want all or part of your response or name made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only to information in your response for which confidentiality has specifically been requested.

14. We will handle any personal data you provide appropriately in accordance with the Data Protection Act 1998.

15. If you have comments or complaints about the way this consultation has been conducted, these should be sent to:

Louisa Renwick
Consultation Co-ordinator
Department of Trade and Industry
Room 723
1 Victoria Street
London SW1H 0ET
Louisa.renwick@dti.gsi.gov.uk

16. A copy of the Code of Practice on Consultation is at Annex 8.

SUMMARY OF CONSULTATION QUESTIONS:

- Views are invited on any aspects of the Commission's proposals.
- To what extent would the Commission's proposed changes to the Regional Aid Guidelines, in your view, limit scope to provide business support in the Regions generally or a particular Region in which you or your organisation is mostly interested?
- Views are invited on the Government's objectives for State aid reform in general and, in particular, reform of regional State aid. Do you consider these are the right objectives?

For Article 87(3)(a) areas:

- Do you support the Commission's proposal to identify areas assisted under Article 87(3)(a) of the EC Treaty at NUTS2 level?
- Do you support the Commission's proposal that areas in the EU eligible for Structural Funds should have state aid coverage?
- Do you support the Government's initial view that Article 87(3)(a) areas should not be restricted to areas eligible for Structural funds? If so, do you agree that identifying these areas at NUTS3 level or by finding a means to take account of a wider range of economic performance within NUTS2 regions would give better targeting?
- Are there any other options for defining the Article 87(3)(a) areas which you consider the UK should argue for, bearing in mind that they would need to be consistent with the legal requirement that the 87(3)(a) areas must be determined on a consistent basis across the EU?

For Article 87(3)(c) areas:

- Do you support the Commission's proposal to identify areas assisted under Article 87(3)(c) of the EC Treaty at NUTS2 level?
- Do you support the Commission's proposals that areas losing 87(3)(a) status purely as a result of EU enlargement should be eligible as 87(3)(c) areas?
- Do you support the Government's initial view that to achieve better targeting, the 87(3)(c) areas should be identified in terms of smaller geographical units than NUTS2 level?
- If so, should these geographical units be at NUTS3 level, or should the Government press for even greater flexibility to define areas?
- Should indicators other than GDP per head be taken into account in defining which areas should be eligible to receive regional state aid?

- Do you support the Commission's proposal to reduce aid intensities within the assisted areas in principle?
- If so, are the levels proposed right or would you prefer to see intensities reduced still further for some or all types of areas and/or sizes of firms? Please give details.
- If you do not support the Commission's proposals to reduce aid intensities, please say what levels you consider would be appropriate and why.
- Do you support the Commission's proposal to define initial investment on the basis of Gross Grant Equivalent rather than Net Grant Equivalent?
- Should the Government argue for additional criteria relating to the quality of projects supported through regional aid to be included in the Regional Aid Guidelines? If so, please give examples of the types of criteria that you consider should be included.
- Should the Government argue for the guidelines to contain provisions to prevent aid from being used to displace projects from one part of the EU to another, and if so how might this best be achieved?
- Should the Government press for retention of the scope for modernisation investment?
- Should the Government support the idea of excluding either land in general, or green-field sites only as eligible costs for Regional Aid investment?
- Do you support the Commission's proposals for transitional status for current 87(3)(a) areas that would not otherwise be eligible ?
- Do you consider that the Commission should provide for some form of transitional status for some or all of the current 87(3)(c) areas that would not otherwise be eligible? If so, on what basis?
- Do you support the Commission's proposal to increase the aid levels allowed to be paid to SMEs outside the assisted areas? If so are the levels proposed sufficient?
- Do you consider that the limits within any of the horizontal guidelines should be increased? If so, which guidelines and what should the limits be? Would you support the UK Government differentiating regionally in terms of the aid intensities permitted in different areas under the horizontal guidelines?
- Do you consider that the Government should argue for Member States to be able to pay additional levels of horizontal aid in areas of local economic under-performance? If so:
 - what should these additional aids apply to;
 - how much flexibility should Member States have in selecting them;

- what criteria could be used for determining local economic under-performance?
- Do you consider any changes are needed to the horizontal guidelines other than in respect of aid intensities to provide greater flexibility?

INTRODUCTION

1 The European Commission have set out in a paper for Member States, their proposals for amending the guidelines that govern what regional aid may be granted in Member States in the period 1 January 2007 to 31 December 2013. The Commission have requested views from Member States on the proposals by 1 July. The Commission's paper is at Annex 1.

2 The purpose of this consultation document is to seek the views of all interested parties on the Commission's proposals in order to inform the Government's response to the Commission. Part 1 of this document summarises the Commission's proposals and explains the general impact of these proposals across the EU and the detailed impact in the UK. Part 2 sets out the Government's initial reactions to the Commission's proposals and identifies particular issues which we believe the Commission's proposals raise for the UK. We would particularly welcome respondents' views on these issues, but views on any aspects of the Commission's proposals and on the Government's initial reactions are invited.

3. It should be noted that the Government has already raised with the Commission its initial views and concerns following publication of the outline of the proposals for regional state aid reform in the Third Cohesion Report. In order to ensure that the Commission has maximum time to consider all relevant issues, the Government is continuing to explore with the Commission on an informal basis ways in which these concerns might be addressed, in advance of submitting the UK's formal response to the proposals. This dialogue will also help us to understand the Commission's concerns and considerations so that we can seek to address these in the UK's response to ensure this is as constructive, and therefore as influential, as possible.

TIMETABLE FOR RESPONSES

4. Responses to this document are requested by **Monday 6 September 2004**. However, if it is possible to provide **early responses (or initial comments) by Monday 28 June 2004** these will help inform the Government's formal response to the Commission proposals, which is due by 1 July.

5. The Government does, however, expect to continue discussions with the Commission on this issue after July. In particular, the Commission is expected to convene a meeting with Member States to discuss its proposals in the early Autumn. Submissions received after 1 July will be taken into account in any on-going discussions or communications with the Commission on this issue.

PUBLICATION OF RESPONSES

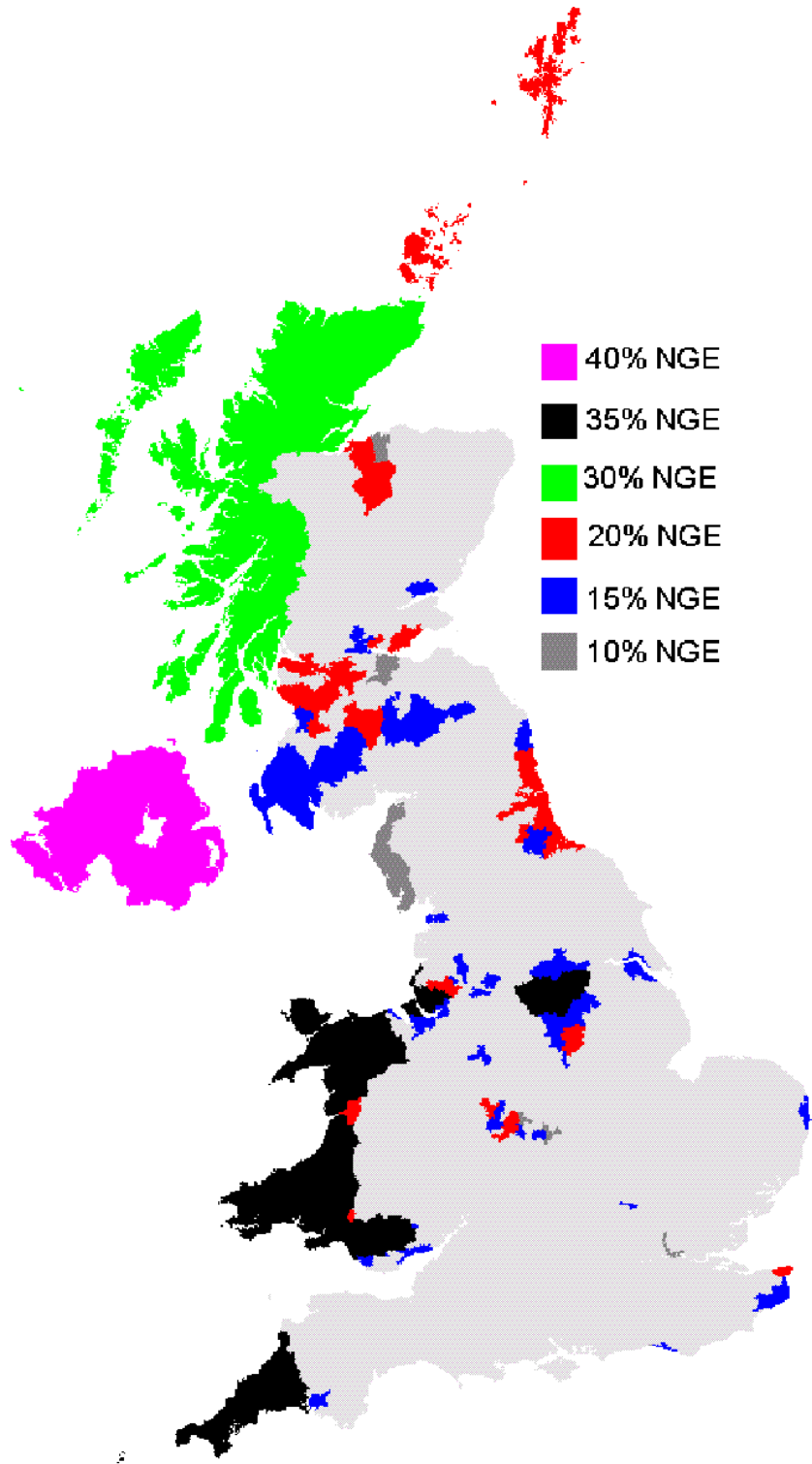
6. The Government intends to publish either the responses to this consultation in full (except where consultees have asked for responses not to be published) or a summary. The Government will also publish its response to the European Commission.

BACKGROUND TO THE STATE AID RULES AND THE REVISION OF THE REGIONAL AID GUIDELINES

7. The Articles relating to the regulation of Competition and the Single Market in the Treaty give the Commission powers to scrutinise aid granted by Member States and to approve that which is compatible with the Treaty and to deny or limit aid which will cause unacceptable distortion of the Market. The European State Aid regime is described in Annex 2. The Commission's Regional Aid guidelines are one of a number of instruments which the Commission uses to assess whether it considers that aid granted by Member States to firms and other economically active entities are compatible with the Treaty of Rome. It is for the Commission to decide on the content of these guidelines. However, in drawing up new or revised guidelines it consults Member States.

8. The present Regional Aid Guidelines came into force on 1 January 2000 and will continue until 31 December 2006. The Commission's proposals refer to the conditions which will apply to Regional aid from 1 January 2007 to 31 December 2013. Further information on the manner in which the current Regional aid guidelines, and related aid maps, were constructed are at Annex 4. The current UK assisted areas are outlined in the map on the following page. Full details of the current UK assisted area coverage can be found at <http://www.dti.gov.uk/regions/assistedareas.htm> .

9. The Guidelines on Regional aid are one of a suite of instruments under which aid may be approved, albeit a significant one. Also among the Commission's State aid instruments are the, so-called, "horizontal" guidelines and frameworks. These apply irrespective of where aid is granted geographically. Examples include the Framework for Aid for Research and Development, the guidelines on aid for Risk Capital, Environmental Protection and the block exemptions for aid to SMEs, training and employment. Many of these instruments are also due to be reassessed and, if necessary, revised by the Commission by 2006-2007, following consultation with Member States. These guidelines are described more fully in Annex 6.



CURRENT REGIONAL AID MAP FOR THE UK – 2000-2006

PART 1: THE COMMISSION'S PROPOSALS AND THEIR LIKELY IMPACT

Introduction

10. The aid maps of Member States setting out their regions eligible for Regional Aid under Article 87(3)(a) and (c) of the EC Treaty will expire on 31/12/2006. See Annex 2 for an explanation of aid permitted under these Articles. The European Commission has set out in the attached paper (Annex 1) its proposed approach for the revision of the Regional Aid guidelines for the period after 2006 until 2013. The Commission's proposals to reform Regional Aid impact on:

- a) the size and location of areas designated as being assisted;
- b) the levels of aid permitted for "initial investment" projects;
- c) levels of aid allowed outside assisted areas and
- d) certain other more technical aspects.

The Commission's objectives

11. The Commission explain that their objectives in reviewing the Regional Aid Guidelines are to tackle market failures, promote entrepreneurship and ensure less and better targeted State aid. The aim is to allow a better concentration of regional aid to investment in the least favoured Member States and regions, while increasing the flexibility for other Member States and regions to pursue local development.

Defining the assisted areas

12. Under the revised guidelines the Commission would designate the assisted areas on the following basis:

| Assisted areas under revised guidelines | Treaty status |
|--|----------------------|
| Areas ² with a GDP per capita level of less than 75% of the average for the whole EU of 25. | Article 87(3)(a) |
| Areas with a GDP per capita above 75% of the average GDP of the newly enlarged EU, but below 75% of the average for the old EU of 15 (“statistical effect” areas). | Article 87(3)(c) |
| Regions losing Article 87(3)(a) status and also not qualifying as statistical effect areas as a result of economic growth (“economic growth” areas) | Article 87(3)(c) |
| Certain other areas qualifying on grounds of remoteness, (such as Reunion and the Azores) or on grounds of low population density (such as northern Sweden and Finland). | Article 87(3)(c) |

13. The Commission has proposed that the Regional Aid Guidelines should make the same distinction between areas as their proposals for the Structural and Cohesion Funds, as outlined in the Third Cohesion Report, published on 18 February. The Commission have taken a broad approach of seeking congruence between the areas proposed to be eligible for Structural Funds and assisted areas status. They have proposed the following:

| Area | Structural Fund Proposals | Regional Aid Proposal |
|---|--|---|
| NUTS2 areas with a GDP per head below 75% of the EU25 average | Eligible for the “Convergence” objective | 87(3)(a) status |
| NUTS2 areas with a GDP per head above 75% of the EU25 average but below 75% of the EU15 average | Eligible for the “Convergence” objective, on a transitional phasing out basis until 2013 | 87(3)(c) status |
| NUTS2 areas with a GDP above 75% of both the EU25 and EU15 average that were eligible for Objective 1 in the 2000-2006 period | Eligible for the “Regional Competitiveness and Employment” objective, at a higher level than non ex-Objective 1 areas, on a transitional basis | 87(3)(c) status |
| All other areas | Eligible for the “Regional Competitiveness and Employment” objective | No status under regional aid guidelines |

² Areas are defined at NUTS2 level

14. However, these are only proposals and the Structural and Cohesion Fund arrangements for the next financial perspective are yet to be agreed. The UK Government has put forward its own proposals³ for reform where such funding would be concentrated on the poorest EU Member States, where we believe it can add most value.

Proposals relating to non-assisted areas

15. The Commission proposals (section 6) note that difficulties can occur outside the assisted areas. Here they note their intention to introduce a new approach to the assessment of lesser amounts of State aid and of aid with a limited effect on intra-Community trade which will allow Member States to tackle problems and to differentiate between regions. See the information on the “LASA” and “LET” significant impact tests at paragraph 68 and Annex 6.

16. The Commission also propose to raise aid levels for investment aid to SMEs outside the assisted areas (see next paragraph).

Aid intensities

17. The Commission proposes different maximum levels of aid intensity in Article 87(3)(a) areas depending on levels of GDP. There would be additional aid intensities permitted for small and medium sized enterprises in the assisted areas and permitted aid levels for SMEs outside the assisted areas would also be increased. The Commission's proposed aid intensities are summarised in the following table.

Table of proposed maximum permissible aid intensities

(Expressed in gross grant equivalents)

| | Large Enterprises | Medium-sized Enterprises | Small Enterprises |
|--|--------------------------|---------------------------------|--------------------------|
| Article 87(3)(a) region ≤ 50% GDP | 50% | 60% | 70% |
| Article 87(3)(a) region ≤ 60% GDP | 40% | 50% | 60% |
| Article 87(3)(a) region ≤ 75% GDP | 30% | 40% | 50% |

³ In *A Modern Regional Policy for the UK* published March 2003 by DTI, HM Treasury and ODPM: <http://www.dti.gov.uk/europe/consultation.pdf>

| | | | |
|--|----------------------|---------|---------|
| Article 87(3)(c) "statistical effect" regions⁴ | 30%→20% ⁵ | 40%→30% | 50%→40% |
| Other Article 87(3)(c) earmarked region | 20% | 30% | 40% |
| Non-assisted areas | 0 | 10% | 20% |

Definition of eligible costs

18. In section 9 of its paper, the Commission expresses a preference for moving from the calculation of aid intensities based on Net Grant Equivalent - i.e. the discounted aid after tax - to calculating these based on Gross Grant Equivalent (before tax and without any discounting of the value of future aid). This would have the effect of reducing the value of aid that could be offered.

19. In section 11 the Commission seeks views on whether either land in general, or virgin land in particular, should be excluded from the definition of costs eligible for aid.

Block exemption for Regional Aid

20. The Commission proposes introducing a block exemption for all regional investment aid schemes other than operating aid schemes, investment aid schemes using less transparent aid instruments and very large cases of investment aid which would continue to have to be notified. A block exemption gives approval to all schemes and projects that meet the conditions of the block exemption, without the need for individual notification in advance to the Commission. This will help reduce unnecessary bureaucracy for both Member States and the Commission, and will allow the Commission to concentrate on the more complex cases. In particular, it will reduce the work that will follow from the new Regional Aid Guidelines. As all existing Regional Aid schemes are limited in time until the end of 2006, without a block exemption Member States would have to re-notify all investment aid schemes.

Impact of the Commission's proposals on Member States

21. The effect of the Commission proposals is that, on current data, 34.84% of EU25 population would be in assisted areas (27.11% would be in Article 87(3)(a) areas, 4.18% in "statistical effect" areas, 2.71% in "economic growth" areas and

⁴ The intensities for "statistical effect" regions will fall over the period the guidelines are in force

⁵ The intensities for "statistical effect" regions will fall over the period the guidelines are in force.

0.84% in areas qualifying on grounds of remoteness and low population density). This compares with a ceiling of 42.7% of the EU population agreed for the current guidelines prior to the accession of the 10 new Member States (the actual percentage of the EU population post enlargement living in assisted areas at present is approximately 52.1%).

22. UK estimate of the impact of the Commission proposals on Member States is as follows:

| EU Member State⁶ | Current % population in assisted areas | % population in assisted areas under Commission proposals |
|------------------------------------|---|--|
| Austria | 27.50% | 3.40% |
| Belgium | 30.90% | 16.80% |
| Cyprus | Not available | N/A |
| Czech Republic | 100.00% | 88.20% |
| Denmark | 17.10% | 0% |
| Estonia | 100.00% | 100.00% |
| Finland | 42.20% | 13.10% |
| France | 36.70% | 2.80% |
| Germany | 34.90% | 16.80% |
| Greece | 100.00% | 100.00% |
| Hungary | 100.00% | 100.00% |
| Ireland | 100.00% | 26.40% |
| Italy | 43.60% | 33.20% |
| Latvia | 100.00% | 100.00% |
| Lithuania | 100.00% | 100.00% |
| Luxembourg | 32.00% | 0% |
| Malta | 100.00% | 100.00% |
| Netherlands | 15.00% | 0% |
| Poland | 100.00% | 100.00% |
| Portugal | 100% | 74.70% |
| Slovakia | 100.00% | 88.90% |
| Slovenia | 100.00% | 100.00% |
| Spain | 79.20% | 58.20% |
| Sweden | 15.90% | 10.00% |
| United Kingdom | 30.90% | 9.10% |

Note: N/A - Estimated figures for Cyprus currently not available.

⁶ Post 1 January 2007, many of the new Member States would, in accordance with their relative economic position, continue to qualify for comprehensive coverage of Article 87(3)(a) or (c) status. The new Member States, during their period as accession states, complied with EC state aid rules. Most of their regions were (and are post accession) eligible under the current regional state aid guidelines.

Impact of the Commission's proposals in the UK

Assisted areas in the UK under the Commission proposals

23. It is important to note that the Commission will assess whether areas qualify on the basis of average data spanning the three year period of 2001 to 2003. At present only data for 2001 is available. The impact analysis below is based solely on 2001 data. If areas, particularly those close to the thresholds, improve or deteriorate relative to the EU average over the period their eligibility may change.

24. On the basis of the Commission proposals outlined above, taking 2001 data, the only areas continuing to qualify as assisted areas in the UK would be as set out in the following table.

| Region | 2001 GDP per head EU15=100 | 2001 GDP per head EU25=100 | Commission proposed Status from 2007 |
|----------------------------|-----------------------------------|-----------------------------------|---|
| Cornwall & Isles of Scilly | 59.5 | 65.3 | 87(3)(a) |
| West Wales & the Valleys | 69.6 | 76.4 | 87(3)(c) "statistical effect" |
| Highlands & Islands | 72.4 | 79.4 | 87(3)(c) "statistical effect" |
| Merseyside | 74.5 | 81.8 | 87(3)(c) borderline "statistical effect". |
| South Yorkshire | 77.1 | 84.6 | 87(3)(c) "economic growth" |

The remaining parts of the UK currently qualifying as assisted areas would lose this status. However, the Commission has recognised, in a footnote to its proposals, that Northern Ireland's specific position will have to be re-assessed.

Aid intensities in the UK assisted areas

25. The aid intensities for assistance for each of the UK assisted areas would be as follows.

| Region | Commission proposed investment aid levels from 2007 (gross) Current levels shown (net) in brackets | | |
|----------------------------|---|--------------------|--------------------|
| | Large firms | Medium firms | Small Firms |
| Cornwall & Isles of Scilly | 30% (35%) | 40% (50%) | 50% (50%) |
| West Wales & the Valleys | 30% → 20% ⁷ (35%) | 40% → 30% (50%) | 50% → 40% (50%) |
| Highlands & Islands | 30% → 20% (30%) | 40% → 30% (30%) | 50% → 40% (30%) |
| Merseyside | 30% → 20% (35%) | 40% → 30% (50%) | 50% → 40% (50%) |
| South Yorkshire | 20% (35%) | 30% (50%) | 40% (50%) |
| All other areas | 0% (0%) | 10% (7.5%) | 20% (15%) |

Impact on aid schemes

26. It should be noted that the ability of many schemes operated in the regions to continue would not be affected by the Commission's proposals. These include, for example, research and development grants, best practice advice and networking, aid for land remediation, community and environmental regeneration and venture capital schemes (for more detail see list at Annex 5). It should be noted, however, that the majority of horizontal instruments permit "top-ups" where higher levels of aid can be provided where an undertaking is in an assisted area (see Annex 6 for details). Areas losing assisted status would also lose these regional top ups. The main effect of the Commission proposals is that Regional Aid schemes covering either capital investment or gap funding in the property sector would have to cease to the extent that they support large firms outside the five named areas listed above. Within the five remaining Article 87(3)(a) and (c) areas above the maximum intervention rates would be limited to those indicated. The exceptions would be schemes which have state aid approval on a basis other than the Regional Aid Guidelines (e.g. if they are approved under the horizontal guidelines or directly from the Treaty) which will continue to operate in a similar manner as currently.

⁷ In the "statistical effect" areas the Commission envisages aid intensities dropping over the period 2007-2013.

27. A full list of schemes approved under the current Regional Aid Guidelines is at Annex 5. These schemes automatically cease with the end of the existing guidelines. The United Kingdom would need to obtain approval for revised or new schemes that were in conformity with the new map and guidelines in force from 1 January 2007.

QUESTION

- **To what extent would the Commission's proposed changes to the Regional Aid Guidelines, in your view, limit scope to provide business support in the Regions generally or a particular Region in which your organisation is mostly interested?**

PART 2: PROVISIONAL GOVERNMENT VIEWS AND REQUEST FOR COMMENTS

THE REVISED REGIONAL AID GUIDELINES IN THE CONTEXT OF COMPETITION AND REGIONAL POLICY

28. The Commission's guidelines on regional state aid need to be considered in the context of both competition and regional policy in the EU. The guidelines need to ensure that Member States can pursue regional policies that are effective but which do not damage competition within the EU.

29. The UK supports an effective state aid regime since state aid can distort competition between firms and impede the effective operation of the Single Market. Greater competition between business leads to lower prices for consumers. An effective state aid regime helps create a level playing field for business across the EU. This will help prevent other, traditionally high-spending, Member States from providing their companies with a competitive advantage through sheer force of subsidy.

30. Therefore, the Government has supported the conclusion of the European Council that state aid should be reduced and re-orientated as part of the aim, agreed at the Lisbon European Council in March 2000, of making the EU the most competitive and dynamic knowledge-based economy in the world. Most recently, at Barcelona on 16 March 2002, the European Council renewed "its call to Member States to reduce the overall level of State aid as a percentage of GDP by 2003, and onwards, and to redirect such aid towards horizontal objectives of common interest, including economic and social cohesion, and target it to identified market failures. Less and better-targeted State aid is a key part of effective competition." Reform of the guidelines also needs to achieve a fair and sustainable solution that actively addresses the historic challenges and opportunities brought about by the enlargement of the EU.

31. Many UK business support instruments do not constitute state aid. Furthermore, where support does involve state aid, the UK seeks to target this in ways that achieve best value for money, rather than simply granting maximum amounts permitted by the state aid rules. This has meant that historically, the overall level of state aid we have given has tended to be among the lowest in the EU. Greater discipline and targeting of state aid across the EU as a whole will, we believe, be in the competitive interests of the UK and indeed the EU as a whole.

32. At the same time, the Government takes the view that state aid can play a positive role in supporting economic development in all Member States where it is used to help tackle the causes of economic under-performance. In particular, the Regional Aid Guidelines, combined with the other horizontal guidelines need to give the UK and other Member States the flexibility to pursue an effective regional policy.

33. Regional economic policy is focused on improving the economic performance of every nation and region, by tackling the diverse market and social failures that are hindering their performance, and promoting opportunities

for all. We aim both to encourage economic growth in every region and, over the longer term, to narrow the gaps in growth rate between the more prosperous regions and the rest. At the heart of this regional economic policy is an approach in which the public and private sectors work together for their regions.

34. To underpin this the Government has significantly increased the level of investment which has been directed towards the regions. For example, Government funding of the Regional Development Agencies (RDA) has risen from £645m in 1999-2000 to £1,719m in 2003-2004. Estimates of regional Gross Value Added (GVA) at current basic prices show that GVA has been increasing in all the UK regions throughout the period 1989 to 2002.

35. The Government's view is that policy should be locally led and substantially devolved. It involves tackling market failures inhibiting the five productivity drivers of skills, investment, innovation, enterprise and competition and ensuring employment opportunities, of which economic performance is also a function. This will enable the less successful regions to build the conditions for economic success, while ensuring the most successful regions continue to flourish.

36. In England, the Government has committed itself to a Public Service Agreement target to:

“Make sustainable improvements in the economic performance of all English regions and over the long term reduce the persistent gap in growth rates between the regions, defining measures to improve performance and reporting progress against these measures by 2006”.

37. In Scotland, the Scottish Executive's aim is to increase prosperity for all the people of Scotland, by supporting business, encouraging enterprise, improving skills and employability. In particular, the Executive is committed to ensuring that all regions of Scotland enjoy the same economic opportunities through, for instance, assisting enterprises to flourish, through removing barriers emanating from regional or social disadvantage.

38. In Wales, the Welsh Assembly Government's vision is of a dynamic, inclusive and sustainable economy based on successful, innovative businesses with highly skilled, well motivated people.

39. In Northern Ireland, under the present direct-rule arrangements taking forward the Northern Ireland's Executive Programme for Government, the strategic aim is a balanced, competitive, innovative, knowledge-based and fast growing economy where there are plentiful opportunities for all.

UK'S OBJECTIVES FOR REFORM OF REGIONAL AID:

40. State aid reform can be used to pursue regional policy objectives in two important ways: it can be used to ensure strong and effective competition across the EU; it can also help to ensure that state aid is used to target the underlying

causes or market failures which drive regional or sub-regional underperformance. To enable both strong competition to be achieved and market failures to be targeted, it is necessary to encourage both stronger state aid control and greater flexibility to focus aid where it is needed the most. To achieve this, the Government believes it is important to:

1. ensure the state aid regime operates efficiently, allowing Member States to implement low-level, non-distorting aid schemes in a pro-active manner which responds to market difficulties as they arise;
2. ensure appropriate horizontal guidelines are in place to target specific market failures effectively; and
3. apply a more targeted approach to regional investment aid.

41. It is also necessary to ensure there are tight and effective controls on the most distortive and significant aids which have the potential to lead to inefficient investment decisions and to undermine competition. The state aid regime should also allow market failures to be tackled effectively at whatever spatial level they occur.

42. The Government's objectives for state aid reform were set out in a letter to the Commission in February (see Annex 7). This letter also requested that the Commission continues to recognise the particular political and economic difficulties of Northern Ireland by maintaining its present status within the areas eligible for regional State aid post 2006.

43. The UK Government has put forward proposals for Structural Funds reform based on a devolved and decentralised approach to the funding of regional development. The European Commission's proposals for reform of the Structural and Cohesion Funds were set out in the Third Cohesion Report. These would involve a substantial increase in the Structural and Cohesion Fund budget. As a net contributor to the EU budget, the effect would be to reduce the resources available for the UK's own domestic programmes, including in support of regional economic development.

44. Under the Government's alternative proposals the Structural Funds would be available only to the less wealthy Member States where additional European assistance is necessary to enable investment on regional development, while the richer Member States, including the UK, would fund their own regional development activities. Using the structural funds to assist the poorer Member States to grow will help the UK. As the income levels of the poorer Member States rise towards the EU average and purchasing power increases, there will be greater opportunities for UK exports to grow.

45. Restricting structural funds to the poorer Member States will mean lower UK budget contributions than under the Commission's proposals. This will give us more resources nationally to put into regional development. We have argued and will continue to argue for a state aid regime which gives us the flexibility to tackle the market failures which cause regional underperformance wherever they arise, while bearing down on distorting aids.

QUESTION

- **Views are invited on the Government's objectives for State aid reform in general and, in particular, reform of regional State aid. Do you consider these are the right objectives?**

ACHIEVING A MORE TARGETED APPROACH TO REGIONAL INVESTMENT AID

Why better targeting is necessary

46. As noted above, it is important that investment aid permitted under the Regional Aid Guidelines is properly targeted so that it can be provided in the areas where there is economic underperformance. Failure to target such aid properly will not only lead to it failing to address regional disparities, but also lead to an increased risk of distortion of competition across the EU, which in turn could damage economic performance.

47. The Government considers that the Commission's proposals as applied to the United Kingdom, will not allow the most effective geographical targeting of regional investment aid and gap funding mechanisms in the UK. It expects that similar concerns will apply in other Member States.

Problems with the Commission's approach to determining the assisted areas

48. The Commission has proposed that all the assisted areas should be determined at NUTS2 level on the basis of GDP per head. For the purposes of regional statistics the European Union is broken down by Eurostat into a series of "NUTS"⁸ areas. A problem is that these areas in many cases cover very

⁸ The Nomenclature of Units for Territorial Statistics (NUTS) is a hierarchical classification of geographic units that provides a breakdown of the European Union's territory for producing regional statistics and analyses that are comparable across the Union.

In the UK there is a five tier NUTS structure:

NUTS level 1: Government Office Regions and Scotland, Wales and Northern Ireland.

NUTS level 2: 37 areas - sometimes referred to as sub-regions.

- In most cases equivalent in size to 1 or more of the former administrative counties.

NUTS level 3: 133 areas - generally groups of unitary authorities or districts, also known as local areas.

NUTS level 4: 443 areas - unitary or local authorities or local enterprise company areas (Scotland) or District Council Areas (Northern Ireland).

NUTS level 5: 11,136 areas - equivalent to electoral wards with boundaries as at 1998.

The current NUTS structure in the EU is, in nearly all cases, based directly on each Member State's existing administrative structure. Therefore although the EU NUTS structure is designed for comparability, there is still some scope for variation (e.g. in terms of population size, density, physical size and characteristics) between the NUTS areas within a given level across the EU.

extensive populations⁹. Consequently, considerable economic variations exist within many of these regions¹⁰. (It should be noted that these types of disparity are not unique to the UK and are also evident in other Member States.¹¹) Furthermore, there are many significantly under-performing areas which will not be within the regions eligible under the Commission's proposals, because they are too small to qualify and the NUTS 2 areas in which they are situated also contain relatively affluent areas.

49. The Government is therefore concerned that determining eligibility entirely at NUTS level 2 on the basis of GDP per head, would not achieve the better targeting of aid on the areas of greatest underperformance that both the European Council and the UK Government seek. Indeed, as a methodology for defining 87(3)(c) areas, this approach is in fact cruder than the methodology used to define the Article 87(3)(c) areas in the current maps (see Annex 4).

50. The Government considers that better targeting could be achieved by defining the eligible areas based on more localised and flexible geographical units - either at NUTS3 level or still lower – where there is likely to be more opportunity to address localised problems of economic performance. This would be likely to increase coverage in absolute terms. For instance, if the Commission's proposed criteria were applied at NUTS3 level, approximately 19% of the UK population would be covered (the actual figure would depend on final GDP per capita data) rather than some 9% of the population when they are applied at NUTS2 level. It is also for consideration whether still better targeting would be achieved by taking account, in the case of 87(3)(c) areas, of indicators other than average GDP per head.

⁹ In the UK, the NUTS2 regions vary in size of population from 369,000 to 4,416,000. Across the Community they vary in size from a population of only 20,000 in Aland in Finland at one extreme, and Andalucia in Spain at the other with a population of 7,300,000.

¹⁰ For example in the UK, the NUTS 2 area of Derbyshire and Nottinghamshire contains two NUTS 3 level areas with Gross Value Added (GVA) per head at opposite ends of the spectrum, Nottinghamshire with a GVA/head of around 154% of the EU15 average and East Derbyshire at 71% of EU.

¹¹ For example, the NUTS 2 area of Sterea Ellada in Greece comprises 2 NUTS 3 areas, Voiotia NUTS 3 with an GVA/head index of 172% of the EU average and Evrytania NUTS 3 at just under 68% of EU 15 GVA per head.

The Commission's reasons for identifying assisted areas at NUTS2 level

51. Following a decision¹² of the European Court of Justice, areas selected under Article 87(3)(a) must be determined on a consistent basis across the EU. However, the Court decision does not require the areas to be determined at any specific geographical level, although since common and consistent GDP data exists for Member States only down to NUTS3 level, there is probably little alternative to 87(3)(a) areas being determined using either NUTS 2 or NUTS 3 areas. The Court decision does not apply to 87(3)(c) areas which, legally, do not have to be determined in the same way in every Member State.

52. The Commission considers it important that, so far as possible, the assisted areas under both Article 87(3)(a) and (c) should correspond with the "Convergence" Structural Fund areas which are proposed in the *Third Cohesion report*. The Commission has proposed that these should be determined at the NUTS2 level. (The Commission has also informally indicated that it is concerned about the quality of data below NUTS2 level, including the impact of commuting which can affect regional per capita GDP data.)

53. Finally, the Commission have proposed limited Article 87(3)(c) coverage in favour of an increased reliance on a thematic approach outside the least favoured areas, with greater flexibility for Member States in the aid they can give outside the assisted areas. The Commission have further indicated informally that they wish to avoid having to negotiate maps with each Member State, partly reflecting the difficulties involved in agreeing the maps for 2000-2006.

Initial Government reactions to these issues

54. The Government does not accept the Commission's view that it is essential to define all 87(3)(a) areas at NUTS2 level in order to ensure consistency with Structural Funds. In past publications, the Government has proposed¹³ that only the poorest countries in the EU should receive Structural Funds in future, while the state aid rules should allow all Member States, including the richer ones, to tackle under-performance wherever this occurs. While there may be a case for regional state aid eligibility in areas that are eligible for Structural Funds in order to ensure that the Funds can be spent on tackling a range of market failures as appropriate, there is no need for the assisted areas under the Regional Aid Guidelines to be restricted to areas eligible for Structural Funds.

55. Given the need for 87(3)(a) regions to be determined on a consistent basis across the EU, the Government accepts that these probably need to be defined either at NUTS2 or NUTS3 level but considers that better targeting than is achieved under the Commission's proposals could be achieved either by applying the criteria at NUTS3 level or by finding a means to take account of a wider range of economic performance within NUTS2 regions.

¹² Germany v Commission, C-248/84

¹³ In *A Modern Regional Policy for the UK* published March 2003 by DTI, HM Treasury and ODPM: <http://www.dti.gov.uk/europe/consultation.pdf>

56. There is potentially greater flexibility to determine Article 87(3)(c) regions than Article 87(3)(a) regions. Again, better targeting would be achieved were the Commission's proposed criteria applied to smaller geographical units. Using alternative or additional eligibility criteria to GDP per capita might also contribute to better targeting.

QUESTIONS

The Government would welcome answers to the following questions:

For Article 87(3)(a) areas

- **Do you support the Commission's proposal to identify areas assisted under Article 87(3)(a) of the EC Treaty at NUTS2 level?**
- **Do you support the Commission's proposal that areas in the EU eligible for Structural Funds should have state aid coverage?**
- **Do you support the Government's initial view that Article 87(3)(a) areas should not be restricted to areas eligible for Structural funds? If so, do you agree that identifying these areas at NUTS3 level or finding a means to take account of a wider range of economic performance within NUTS2 regions would give better targeting?**
- **Are there any other options for defining the Article 87(3)(a) areas which you consider the UK should argue for, bearing in mind that they would need to be consistent with the legal requirement that the 87(3)(a) areas must be determined on a consistent basis across the EU?**

For Article 87(3)(c) areas

- **Do you support the Commission's proposal to identify areas assisted under Article 87(3)(c) of the EC Treaty at NUTS2 level?**
- **Do you support the Commission's proposals that areas losing 87(3)(a) status purely as a result of EU enlargement should be eligible as 87(3)(c) areas?**
- **Do you support the Government's initial view that to achieve better targeting, the 87(3)(c) areas should be identified in terms of smaller geographical units than NUTS2 level?**
- **If so, should these geographical units be at NUTS3 level, or should the Government press for even greater flexibility to define areas?**
- **Should indicators other than GDP per head be taken into account in defining which areas should be eligible to receive regional state aid?**

PERMITTED INTENSITIES OF INVESTMENT AID

57. The Commission has proposed lower aid intensities for all types of assisted area. This builds on the recent reductions in aid intensities for large projects under the Multisectoral Framework. The Commission's proposal to set maximum aid limits by reference to Gross Grant Equivalents rather than Net Grant Equivalents would also have the effect of reducing effective maximum aid levels throughout the EU. The impact would be greatest in those Member States where tax rates are highest.

58. The move to lower intensities can be seen as being consistent with the aim of "less and better targeted" state aid agreed by the European Council. Given that the UK will have less coverage relative to new EU Member States, reductions in aid levels would impact relatively less heavily on the UK. And reducing the scope for all Member States to give levels of aid most likely to distort competition, should benefit the UK relatively speaking.

QUESTIONS

- **Do you support the Commission's proposal to reduce aid intensities within the assisted areas in principle?**
- **If so, are the levels proposed right or would you prefer to see intensities reduced still further for some or all types of areas and/or sizes of firms? Please give details.**
- **If you do not support the Commission's proposals to reduce aid intensities, please say what levels you consider would be appropriate and why.**
- **Do you support the Commission's proposal to define initial investment on the basis of Gross Grant Equivalent rather than Net Grant Equivalent?**

OTHER LIMITATIONS ON REGIONAL INVESTMENT AID

59. The Government suggested to the Commission that the Regional Aid Guidelines should ensure that Member States assess schemes against additional criteria to help ensure aid is directed at encouraging sustainable, high-quality projects which better promote productivity and competitiveness, and to help avoid job displacement. A potential model is the types of criteria required in the UK's regional investment schemes. The Commission have not set out any proposals for such guidelines.

60. However, the Commission have proposed to alter the present definition of initial investment which allows aid for modernisation. The Commission proposes strengthening the definition by excluding modernisation.

61. In its proposals the Commission also notes that one Member State has proposed that the purchase of land should be excluded from the definition of what constitutes an initial investment (that is, only buildings and equipment would be considered eligible among eligible costs). They ask for views as to whether land should be included within project eligible costs or whether, as an incentive for sustainable investment, only brown-field land should be included.

62. This proposal, if accepted, could have significant effects on the types of project costs which could be supported. This could be particularly noticeable in the longer standing Member States where land purchase costs are significantly higher than in the new Member States.

QUESTIONS

- **Should the Government argue for additional criteria relating to the quality of projects supported through regional aid to be included in the Regional Aid Guidelines? If so, please give examples of the types of criteria that you consider should be included.**
- **Should the Government argue for the guidelines to contain provisions to prevent aid from being used to displace projects from one part of the EU to another, and if so how might this best be achieved?**
- **Should the Government press for retention of the scope for modernisation investment?**
- **Should the Government support the idea of excluding either land in general, or green-field sites only, as eligible costs?**

TRANSITIONAL ARRANGEMENTS

63. The Commission have proposed that current Article 87(3)(a) areas where there has been sufficient economic improvement to take GDP per head above 75% of the average for the 15 longer standing Member States would be eligible under 87(3)(c) to provide aid, though at lower levels than for other 87(3)(c) areas (see Part 1 of this document). However, it would mean that some areas, such as Tees Valley and Durham, would not be eligible for coverage notwithstanding that they were worse off in GDP terms than some “economic growth” regions which would continue to qualify on grounds that they were formerly Article 87(3)(a) areas.

64. The Commission have not proposed any transitional arrangements for existing Article 87(3)(c) areas which would not continue to be eligible under the new arrangements. When the map applying until 31 December 1999 was replaced by the 2000-2006 map the Commission agreed to apply a safety net which ensured no individual Member State lost more than 25% of its then population coverage, although no transitional arrangement were made for specific areas losing status. Of the existing Article 87(3)(c) regions only

Highlands & Islands seems likely, on present data to retain coverage because it would qualify as a “statistical effect” region. The Commission have nevertheless recognised that the specific position of Northern Ireland will have to be re-assessed.

QUESTIONS

- **Do you support the Commission's proposals for transitional status for current 87(3)(a) areas that would not otherwise be eligible ?**
- **Do you consider that the Commission should provide for some form of transitional status for some or all of the current 87(3)(c) areas that would not otherwise be eligible? If so, on what basis?**

FLEXIBILITY TO GIVE AID OUTSIDE THE ASSISTED AREAS WHERE IT IS NEEDED

65. As well as allowing investment aid, the assisted areas defined in the Regional Aid Guidelines are also referred to in the horizontal State aid guidelines. In a number of these guidelines additional scope is allowed in the assisted areas to take account of their increased need for economic development and the fact that market failures may be more severe. For example, larger investments are allowed in SMEs under the Risk Capital Guidelines;¹⁴ under the Guidelines for Environmental Protection top-ups (i.e. higher aid intensities) are allowed on investments made in assisted areas.¹⁵

66. As noted above, the Commission see the Guidelines on Regional aid as one of a suite of instruments under which Member States may provide aid for business support and economic development. Their consultation document suggests that these horizontal guidelines (taken in concert with their proposals for a significant impact test – “LASA” and “LET”, see below) will provide sufficient flexibility to address market failures, under-performance and localised economic problems outside the new assisted areas.

67. Even if the assisted areas are defined on a more targeted basis than that proposed by the Commission, they are unlikely to cover all local areas of under-performance. The Government has argued that there are market failures at the local level such as in the UK’s 2000 Enterprise Areas which need additional support beyond that allowed by the horizontal guidelines (where these areas are not within assisted areas).

¹⁴ Under the Commission’s Guidelines on State Aid and Risk Capital the maximum size of investment which can be made in an SME in a single tranche is €500,000. Where the SME is in an Assisted Area this is increased to €750,000 in an Article 87(3)(c) area and €1 million in an Article 87(3)(a) area.

¹⁵ An additional 5% in an Article 87(3)(c) area and an additional 10% in an Article 87(3)(a) area.

68. As noted in paragraph 17 above and in the accompanying table, the Commission proposes to make a modest increase in the aid allowed to small and medium sized enterprises outside the assisted areas. The Commission's proposals for a significant impact test, for limited amounts of state aid (LASA)¹⁶ and aid which is likely to have a limited effect on trade (LET)¹⁷, should also help in allowing small levels of aid outside the assisted areas.

69. In order to allow other local market failures to be tackled, the Government could press for further changes related to the horizontal frameworks and guidelines to assist in providing necessary support outside the assisted areas. There are a number of routes by which this could be achieved. Some of these the Government is already exploring with the Commission while others may become open in the near future. A few of these possibilities are set out in the following paragraphs.

70. **Aid intensities under the SME/horizontal guidelines:** It would be possible for the Government to argue for still higher intensities under the guidelines for SMEs (over and above those already proposed by the Commission) or higher aid intensities in the other horizontal guidelines. However, this would reduce the overall level of control on aid within the EU, although it would be open to the UK (and other Member State Governments) to restrict, as a matter of policy, the levels of aid offered within prosperous regions. However, the Commission may argue that they have already considered the aid intensity for SMEs and that their proposals represent an appropriate level of increase. Similarly they may argue that changes to the aid intensities permitted in the horizontal guidelines should be considered when the individual guidelines are revised.

71. Alternatively, there may also be a case for introducing a mechanism by which higher aid intensities (known as "top-ups") would be permitted in disadvantaged areas which are outside the assisted areas, to tackle local market failures as follows:

- Aid for SMEs;
- Aid for risk capital;
- Aid for training; and
- Aid for employment.

72. These additional aid levels could be allowed in certain areas under the relevant horizontal guidelines. Each Member State could be allocated a proportion of its population which could be eligible for such additional aid on the basis of some measure of national-level relative performance. Member States

¹⁶ The Commission's proposals on Lesser Amounts of State Aid (LASA) would allow for "fast track" approval of small aids (30% aid intensity) in pursuit of "Community Objectives" up to a limit of €1 million per enterprise over three years.

¹⁷ The Commission's proposals on aid with a Limited Effect on Trade (LET) would allow for "fast track" approval of small aids (30% aid intensity) in pursuit of "Community Objectives" up to a limit of €3 million per enterprise per year in defines NACE sectors considered to have limited cross border trade. Member States have not yet seen the Commission's final proposals on LASA and LET but these are expected in the summer.

could then be allowed to allocate the coverage on whatever basis they prefer (subject to Commission approval), and at any level of spatial dis-aggregation. This could allow Member States to allocate coverage at NUTS5 level if they so wished.

73. **Revision of the existing horizontal guidelines:** Most of the Commission's horizontal instruments are due to expire during the period between 2005 and 2007. They will need to be revised and renewed and this work has been included in the Commission's work plan. However, we will also need to consider whether further changes are required in the horizontal guidelines to allow for more effective provision of support for underperformance. In particular, there have been difficulties in approving aid under the Commission's Guidelines for State Aid and Risk Capital (SARC) and the Guidelines on State aid for Environmental Protection. The SARC guidelines will expire in September 2006 while the environmental guidelines will expire on 31 December 2007. The Commission are also committed to reviewing their Framework for aid for Research and Development in 2005.

74. The Government will be continuing its dialogue with the Commission to ensure that, when revised, the UK's comments are taken into account and will be seeking further comments on what changes may be necessary as part of the formal revision processes carried out by the Commission.

75. **Regeneration:** However, in practice, market failures are not uniform in all locations outside the assisted areas. Local areas of disadvantage often have higher levels of market failure which can lead to businesses being reluctant to invest. In view of this the Government has been discussing with the Commission how to approach problems of regeneration where government intervention is the best way to achieve improvements which have economic, social and environmental benefits. The UK has already negotiated a number of approved schemes which go some way to addressing these issues. However, the government has also urged the Commission to consider producing guidelines for state aid for regeneration to allow, amongst other things, local property market failures to be tackled. We consider that guidelines for regeneration could assist both physical regeneration of land and property, and the stimulation of private sector engagement in capital and labour markets, in locations where market failures currently result in under-supply.

76. Effective regeneration guidelines would assist governments to continue to implement targeted schemes to tackle local regeneration market failures. This might allow such schemes to be continued in areas of the UK which will not fall within the assisted areas under the new Regional Aid Guidelines. We understand that the Commission are unlikely to consider developing such guidelines until the new regional aid arrangements are in place but this remains an objective which the Government considers important.

QUESTIONS

- **Do you support the Commission's proposal to increase the aid levels allowed to be paid to SMEs outside the assisted areas? If so, are the levels proposed sufficient?**
- **Do you consider that the limits within any of the horizontal guidelines should be increased? If so, which guidelines and what should the limits be? Would you support the UK Government differentiating regionally in terms of the aid intensities permitted in different areas under the horizontal guidelines?**
- **Do you consider that the Government should argue for Member States to be able to pay additional levels of horizontal aid in areas of local economic under-performance? If so:**
 - **what should these additional aids apply to;**
 - **how much flexibility should Member States have in selecting them;**
 - **what criteria could be used for determining local economic under-performance?**
- **Do you consider any changes are needed to the horizontal guidelines other than in respect of aid intensities to provide greater flexibility?**

LIST OF ANNEXES

1. Commission Proposals
2. The EC State Aid Regime
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 - The UK Regional Aid Map 2000-2006
5. UK Regional Aid schemes and other national schemes supporting regional economic development
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COMMISSION PROPOSALS FOR REFORM OF REGIONAL STATE AID**Review of the Regional Aid Guidelines – a first consultation paper for the experts in the Member States.****1. Introduction and Policy Context**

The aid maps of Member States depicting their regions eligible for regional aid pursuant to Article 87(3)a) and c) EC will expire on 31.12.2006¹⁸. These maps were drawn up on the basis of the Community Guidelines on national regional aid¹⁹ (hereafter: RAG).

By letter dated 2 April 2003²⁰, the Commission informed the Member States that it had decided to carry out a review of the Guidelines. Member States were invited to submit any comments, observations or information they deem useful to assist the Commission in preparing for the review.

The comments thus received from existing and new Member States and from ESA were made available to all other Member States through CIRCA. Two preparatory studies commissioned by DG Competition on assisted areas pursuant to Article 87(3)c) can also be found on CIRCA. One study provides an overview of the methodology and indicators used by Member States to determine their aid maps for the period 2000-2006, as well as summaries of a number of studies on the efficiency and effectiveness of the choices made. The other study examines various aid instruments that might be useful in regions eligible to Article 87(3)c) after 2006.

In their comments to the Commission, several Member States referred to the objectives formulated by the European Councils of, notably, Lisbon, Gothenburg and Barcelona regarding competitiveness, sustainable development and the need for a better targeting of State aid to attain those objectives. Member States also underlined the links between national aid for stimulating regional development and Community funding for this purpose.

DG Competition fully supports these comments.

1.1. RAG and European Council conclusions

The Lisbon European Council called upon Europe to become the most competitive and dynamic knowledge-based economy and formulated objectives to achieve this ambitious goal. The Gothenburg European Council expanded on these objectives, adding the notion

¹⁸ The aid maps of the new Member States are likely to be regarded as existing as from the date of accession, they are also limited till 31.12.2006.

¹⁹ OJ N° C 74 dated 10.03.1998, p. 9, modified in OJ N° C 285 dated 09.09.2000, p. 5.

²⁰ See also the notice published in OJ N° C 110 dated 08.05.2003, page 24.

of sustainability, including cohesion. The Stockholm European Council called for a reduction of the level of State aid “taking into account the need to redirect aid toward horizontal objectives of common interest, including cohesion objectives”. The Barcelona European Council renewed “its call to Member States to reduce the overall level of State aid as a percentage of GDP by 2003, and onwards, and to redirect such aid towards horizontal objectives of common interest, including economic and social cohesion, and target it to identified market failures. Less and better-targeted State aid is a key part of effective competition.”

Applying these conclusions to aid for regional development raises two important questions:

Is the award of aid for initial investment and linked job creation really the most effective way of promoting cohesion?

Can the aid levels allowed under the present guidelines be reduced without decreasing the effectiveness of such aid?

In order to reply to the first question, DG Competition has examined a number of studies on the effectiveness of investment aid. The conclusions of these studies are rather mixed. Some studies indicate that the dead-weight in such aid may be high; most of the investments would also have been carried out without the aid. Other studies indicate that there is some effect at least on the timing of the investment and its localisation. The concern expressed by several Member States about possible delocalisation effects of such aid would also indicate that they believe that investment aid does have an effect on investment decisions, amongst other factors.

DG Competition considers that in the least favoured regions of the EU, investment aid to large companies and to SMEs can contribute to regional development. For other regions the beneficial effects of investment aid are more doubtful. This is because the difficulties such regions may experience are likely to be of a different nature, for which the more appropriate solutions imply investment in human resources or in a more business-friendly environment. Often the most appropriate solution will be found outside the realm of State aid.

Regarding the second question, DG Competition notes that several Member States are in favour of lowering aid intensities, especially when large enterprises are the beneficiaries of such aid. There has also been a call for an integration of the new RAG with the Multisectoral Framework. DG Competition notes that the Multisectoral Frameworks of 1998 and 2002 have contributed to a decrease in aid intensities for large investment projects. But more can be done by lowering the aid ceilings everywhere in the EU, whilst at the same time differentiating more than is done at present between the categories of least favoured regions.

1.2. RAG and Third Cohesion Report

The Third Cohesion Report proposes in its conclusions to organise future cohesion policy around three main objectives: convergence, regional competitiveness and employment, and European territorial co-operation.

The objective of convergence will be promoted by supporting growth and job creation in the least developed Member States and regions. The Third Cohesion Report moreover indicates that these regions should be eligible to the derogations provided for in Article

87(3)a) and c), which will allow Member States to give national regional development aid in complete coherence with Community funding.

The objective of regional competitiveness and employment will be promoted by supporting a limited number of domains of intervention: innovation and the knowledge economy, environment and risk prevention, accessibility and services of general economic interest. In this context the ERDF would distinguish financially between those regions, which are currently eligible to Objective 1 but would not be eligible to the future “convergence” objective, and other regions.

DG Competition believes that a similar distinction between regions should be made under Article 87(3)c), in view of the often still fragile situation of the first category. In line with the current RAG, former Article 87(3)a) regions should be eligible to regional development aid within the derogation in Article 87(3)c). In all other regions, aid to promote the domains of interventions listed in The Third Cohesion report will nevertheless remain possible. Where necessary, the horizontal rules that apply to such aid will be reviewed in order to ensure full coherence between State aid and Community funding.

The objective of European territorial co-operation will be promoted by focusing on integrated programmes in pursuit of key Community priorities linked to the Lisbon and Gothenburg agendas. In so far as these programmes involve State aid, such aid should also be in line with the applicable horizontal rules.

DG Competition notes that the review of the RAG and the conclusions on the future cohesion policy offer a unique opportunity to attain complete coherence between the two. Whereas today²¹ there is a very high level of coherence between Objective 1 and article 87(3)a), large differences exist between areas eligible to Objective 2 and areas eligible to Article 87(3)c). The choice in favour of a thematic approach rather than one based on selected geographic areas (map-based approach) allows for coherence between regional and competition policies. This is the more so as the themes selected derive from objectives common to both policies, which were formulated by successive European Councils, as mentioned in point 1.1.

2. Status of consultation document

In preparing for the review the DG Competition has made use of the following information:

- The conclusions of European Councils regarding State aid and cohesion policy, notably the call for less and better targeted aid in favour of objectives defined by those Councils (see point 1.1);
- The comments submitted by Member States;
- The conclusions of the informal Councils of Halkidiki of 16.05.2003 and Rome of 20.10.2003;
- Commission experience with the present RAG, aid maps and aid schemes;
- Literature (surveys, studies and academic papers) on the economics and effectiveness of regional aid;

²¹ Commission Communication to the Member States on the links between regional and competition policy (OJ N° C 90, 26.03.1998, p. 7).

- The Third Cohesion Report, which was adopted by the Commission on 18.02.2004 (see point 1.2).

At this stage, DG Competition does not intend to present a complete draft for new RAG. The present paper only contains a description of the approach taken by DG Competition as well as an outline for such new RAG. Since the approach implies changes of policy and because the Commission is determined to co-operate closely with Member States in this difficult exercise, consultation at this early stage is considered important.

The new RAG will in principle apply from 1.1.2007 until 31.12.2013.

3. Areas eligible under the derogation provided for in Article 87(3)a) EC

Article 87(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 to be compatible with the common market.

At present, Article 87(3)a) regions are defined as NUTS level II regions, with a GDP per capita (measured in purchasing power standards) that is lower than 75% of the EU average (RAG § 3.5). This eligibility criterion is also used to define Objective 1 regions²².

After enlargement, most regions in the New Member States will have a GDP/cap that is well below the EU25 average, and will therefore continue to qualify for Article 87(3)a) status.

Proposal for new RAG:

DG Competition proposes to maintain the 75% threshold for Article 87(3)a) status. Hence, regions with a GDP/cap level of less than 75% of the EU-25 average would be eligible for this derogation.

The aid intensities for large enterprises in Article 87(3)a) regions are under the present RAG 40% or 50% net and up to 65% net in the poorest outermost regions. SMEs can receive a bonus of 15% gross on top of these ceilings.

In order to follow the European Council’s conclusions on less, but better targeted aid and in view of the comments received from several Member States, DG Competition is of the opinion that these aid ceilings are too high. It suggests to keep three categories, but with lower aid ceilings. The first category would consist of NUTS II regions below 50% of average EU-25 GDP/capita, the second of regions below 60 % and the third below 75% of average GDP/capita. The corresponding aid intensities for large enterprises would become 50%, 40% and 30% in gross grant equivalent terms (see also point 9), with top-ups of 10% gross for medium-sized enterprises and 20% for small enterprises. Those outermost regions fulfilling the 75% GDP/capita test and therefore eligible to Article

²² Since 2000, the former Objective 6 regions (low population density areas) have also been included in the list of Objective 1 regions. Although they actually had a GDP per capita lower than 75% of the average, outermost regions (Madeira, Azores, the Canary Islands and the French overseas departments) have also been granted Objective 1 status on their own right.

87(3)a) would be entitled to a bonus of 10 %, which would place them in a “higher” category. All outermost areas would also continue to have access to operating aid to compensate their handicaps as listed in Article 299(2) EC. Operating aid in other Article 87(3)a) areas, with the exception of aid to cover additional transport cost in low population density areas, can only be accepted for a limited period and with decreasing intensities in exceptional cases to overcome new, specific obstacles to their development.

4. Earmarked regions eligible to Article 87(3)c EC

The present RAG make special phasing-out provisions for regions losing their Article 87(3)a) status. RAG Annex III provides a guarantee that the population ceiling for each Member State will, if necessary, be corrected to ensure that it is sufficiently high “to include all regions that have just lost their Article 87(3)a) status”²³. Under the present RAG, the phasing-out regions were not identified, and Member States had the possibility of not proposing (parts of) former Article 87(3)a) regions under Article 87(3)c)²⁴.

4.1.: Regions losing their Article 87(3)a) status because of the effect of enlargement:

Following enlargement, the average GDP/cap of the Union will be reduced significantly. As a result of this, the GDP/cap of many of the present 87(3)a) regions will exceed the threshold of 75% of the EU25 average. They will therefore no longer qualify under Article 87(3)a).

Proposal for new RAG:

These regions²⁵ will be included in the aid map under Article 87(3)c) with an aid intensity of 30% gross for large enterprises, which corresponds to the intensity they would have had pursuant to Article 87(3)a) without the statistical effects of enlargement. In the course of the period covered by the aid map, the maximum intensity will decrease to 20% gross. Top-ups of 10% gross for medium-sized enterprises and 20% gross for small enterprises will apply. Outermost regions are entitled to a bonus of 10 %.

4.2.: Regions losing their Article 87(3)a) status due to economic reasons:

Certain Article 87(3)a) regions would even in an EU-15 scenario no longer qualify, because their GDP/cap has risen to 75% of the average GDP/cap of the present Member States or higher.

Proposal for new RAG:

²³ In addition, RAG § 5.7 allows for a progressive reduction of aid intensity ceilings in regions losing their Article 87(3)a) status.

²⁴ The only exception is Northern Ireland, which is specifically named in RAG, footnote 44. The specific position of Northern Ireland will have to be re-assessed.

²⁵ Certain NUTS II regions, such as Hainaut in Belgium, had no 87(3)a) status in 2000-2006, but according to the available statistical data, they would qualify for this status after 2006 in a EU-15 context. It is proposed to treat such regions in the same way as the other “statistical effect” regions.

These regions will be included in the aid map under Article 87(3)c) with an aid intensity of 20% gross for large enterprises, with top-ups of 10% and 20% gross for medium-sized and for small enterprises.

4.3.: Outermost regions

The outermost regions are at present all eligible to Article 87(3)a). Some of the regions will no longer qualify for this derogation after 2006 due to the “statistical effect” or due to their own development.

Proposal for new RAG:

In line with the conclusions of the Third Cohesion Report, outermost regions as defined in Article 299 of the Treaty losing their eligibility under Article 87(3)a) will be treated in the same way as the regions mentioned in point 4.1. In particular, they will be included in the aid map under Article 87(3)c) with an aid intensity of 40% gross for large enterprises, which corresponds to the intensity for the most prosperous outermost regions covered by Article 87(3)a). In the course of the period covered by the aid map, the maximum intensity will decrease to 30% gross. Top-ups of 10% gross for medium-sized enterprises and 20% gross for small enterprises will apply. Moreover, such outermost regions will also continue to have access to operating aid to compensate their handicaps as listed in Article 299(2) EC.

4.4.: Low population density areas

Regions of low population density, as defined in the present RAG²⁶, today enjoy an aid ceiling of 30% net²⁷, unless they fulfil the 75% GDP/capita test. Operating aid in the form of aid to cover additional transportation cost is also allowed.

Proposal for new RAG

Low population density areas will be included in the aid map under Article 87(3)c) with an aid intensity of 20% gross for large enterprises²⁸, unless they are already covered by one of the previous provisions. Transportation aid can continue as before.

For arctic areas suffering from continued depopulation, the Commission may authorise other types of operating aid where such aid is necessary to stop depopulation and provided that the aid does not adversely affect trading conditions to an extent contrary to the common interest.

5. EU Population Coverage

In terms of percentages of the EU-25 population living in future Article 87(3)a) regions and earmarked Article 87(3)c) regions as defined in points 3 and 4, the following picture emerges²⁹:

²⁶ NUTS III regions with less than 12.5 inhabitants per km².

²⁷ Without the possibility of a top-up for SMEs.

²⁸ But with the possibility of top-ups of 10% and 20% gross for MEs and SEs.

²⁹ Statistics of the last three available years (1999-2001). This picture may therefore change.

- Abnormally low standard of living: 27.11%
- Other most outward regions: 0.43%
- Statistical effect regions: 4.18%
- Economic growth regions: 2.71%
- Other low population density areas: 0.41%

The population of EU-25 living in earmarked regions under Article 87(3)a) and c) would hence be: **34.84%** of the total population.

6. Other regions experiencing difficulties

Outside of the assisted areas pursuant to Article 87(3)a) and c), specific problems of a geographic, demographic or socio-economic nature may occur. Solutions can often be found outside the realm of State aid. But DG Competition recognises that Member States should continue to have scope for national regional policy in those regions. However, in line with the conclusions of the European Councils, referred to in point 1.1, aid should be better targeted towards defined objectives, so as to maximise their effect in achieving those objectives. Therefore, where Member States consider that the most effective solution would involve aid, the present horizontal rules, many of which will be reviewed before 1.1.2007, together with the development of a new approach for the assessment of lesser amounts of State aid and of certain aids with limited effects on intra-Community trade (significant impact test), provide those Member States with a large margin for manoeuvre to tackle such problems and to differentiate between regions where this is considered to be necessary. Member States and the Commission have accepted to reduce State aid and target it towards Lisbon type objectives, and this fundamental engagement in favour of a thematic approach in State aid, which avoids adversely affecting trading conditions to an extent contrary to the common interest, therefore needs to be reflected in any new Regional Aid guidelines. DG Competition notes in this context the wish expressed by Member States for more flexibility than under the present RAG to address specific regional problems or opportunities. The use of the new ‘significant impact test’ instruments, which were discussed with experts from the Member States on 4.2.2004, offers such flexibility for regional differentiation without the cumbersome process of revising an aid map, which would otherwise be fixed for a long period.

7. Multisectoral Framework

The multisectoral framework on regional aid for large investment projects (MSF)³⁰ limits the aid intensities for large projects as defined in the framework. The new framework adopted in 2002 is valid until 31.12.2009, but may be amended earlier. Several Member States have suggested to merge the MSF with the new RAG.

Proposal for new RAG

DG Competition is in principle in favour of including decreasing aid intensities for large projects in the new RAG in the sense of the MSF, thus making that text obsolete.

³⁰ OJ N° C 70, 19.03.2002, p. 8, modified in OJ N° C 263 dated 1.11.2003, p.3.

8. Consistency with structural funds

Some Member States have referred to the links between State aid and the use of structural funds after 2006.

DG Competition would point out that the approach depicted in the present document is in line with the conclusions of the Third Cohesion Report.

Regarding the future Objective of Regional competitiveness and employment, DG Competition considers that the “thematic approach” will be in line with the horizontal aid frameworks and exemption regulations, many of which are to be reviewed in the years to come. In 2005 and 2006 all State aid exemption regulations, the regional aid guidelines, the framework for R&D aid and the Communication on risk capital are up for renewal. This factor, together with the beginning of a new programming period for the Community structural funds in 2007, provide an opportunity to review the horizontal State aid rules to take account of the Lisbon and other objectives, including cohesion. In this review, special consideration will be given to aid for stimulating technological innovation in SMEs. It is furthermore envisaged to increase the investment aid ceilings in Regulation 70/2001 from 7.5% to 10% for medium-sized enterprises and from 15% to 20% for small enterprises.

9. Net or Gross Grant Equivalents

The present RAG and its predecessors since the early 1970s have expressed investment aid intensities in terms of the Net Grant Equivalent (NGE: the discounted aid element in grants, loans, guarantees, etc. after taxes expressed as a percentage of discounted eligible investment cost). The reason for this is that potential beneficiaries, in view of different tax rates in Member States, are likely to use the net advantage they can receive as a yardstick when deciding when, how and where to invest.

DG Competition has a preference for applying, in the review of the RAG, the Gross Grant Equivalent (GGE) when measuring regional aid. The GGE is used for all other types of aid, is easier to calculate and more transparent. It would also avoid the difficulties in cumulating net and gross equivalents, for example in Regulation 70/2001. DG Competition recognises that the use of gross ceilings instead of net ceilings would also have the effect of reducing investment aid intensities everywhere.

Proposal for new RAG

To use the notion of gross grant equivalent for measuring aid intensities.

10. Introducing a block exemption for regional aid

It should be recalled that Article 1(1)b) of Enabling Regulation 994/98 provides the legal basis for a possible block exemption covering “aid that complies with the map approved by the Commission for each Member State for the grant of regional aid”. It should also be recalled that regional investment aid to SMEs can already be awarded without prior

notification under Regulation 70/2001 and that aid for creating employment can be awarded under Regulation 2204/2002.

Regional investment aid schemes for larger enterprises must still be notified, irrespective of whether awarded on the basis of standard investment cost or wages for created jobs.

DG Competition's assessment of regional investment aid schemes under the present RAG shows that the criteria in the RAG are quite precise. Very few interpretation problems have come up and most schemes are approved without opening of the formal investigation procedure.

DG Competition therefore believes that the Commission should use the possibility offered by the Enabling Regulation to block exempt regional investment aid schemes, provided they use transparent aid instruments.

The use of the block exemption will considerably reduce the work that will follow from the new RAG. It should be recalled that all existing regional aid schemes are limited in time until the end of 2006. Without a block exemption, Member States would have to re-notify all investment aid schemes.

Operating aid schemes, as well as investment aid schemes using less transparent aid instruments, should continue to be notified, as well as very large cases of investment aid, as defined by the individual notification requirement of the 2002 MSF. For large cases with eligible investment exceeding € 50 million, the transparency mechanism in the MSF should also continue to apply.

11. Other issues

Several Member States have submitted other comments, including some interesting suggestions on specific points in the RAG.

Relocation:

Several Member States have expressed the fear that companies might be tempted to shut down factories and to re-invest elsewhere because of the investment aid they can receive there.

Regional aid will and should have the effect of attracting mobile investment. The lower aid ceilings, the even lower aid intensities for large projects, as well as the continued use of the requirement that aided investment must remain in place for at least five years should help to avoid that costly closures might be motivated by too high levels of aid elsewhere. It should be clarified, however, that the beneficiary is perfectly free to substitute the aided equipment by new equipment – but without aid – at the same site if its useful life is less than five years.

Definition of initial investment:

DG Competition would propose to strengthen the definition of what constitutes initial investment, in order to exclude any misunderstanding. It should notably be emphasized that modernisation investment is not eligible, given that each replacement involves some modernisation as well.

It has been suggested by one Member State to exclude land from the definition of what constitutes an initial investment (only buildings and equipment would then be considered eligible), because of the positive return on investments in land.

DG Competition would welcome other views on this issue. Another possibility might be to exclude virgin land from eligibility, in order to promote the reuse of brownfield sites and thus contribute to the goal of sustainable investment.

Suggestions have also been made concerning the definition of intangible investment and possibilities of adding other cost (e.g. studies, advice) to the eligible basis. These suggestions will be looked at in detail, but DG Competition is as a matter of principle not in favour of adding additional expenditure to eligible cost in favour of large enterprises. As regards SMEs, this type of aid is already covered by Regulation 70/2001, which allows an aid intensity of 50%.

12. Invitation

Member States are invited to submit their comments on the present outline before July 1st 2004

Written comments received will be made known to the other Member States through CIRCA. The Commission services are also available for bilateral discussions.

THE EC STATE AID REGIME

1. Although there is no formal definition of what constitutes state aid, a measure is considered under Community Law to constitute a state aid if it fulfils *all four* of the following criteria:
 - It is a transfer of state resources to an economic undertaking;
 - It is selective;
 - It has the potential to distort competition; and
 - It could have an effect on trade between Member States
2. The European Treaty (Article 87) provides that “aid ... in any form whatsoever”, unless otherwise allowed by the Treaty, is unlawful if it distorts or threatens to distort competition and impact on trade between Member States. As well as encompassing grants and subsidies this all embracing approach includes inter alia, tax reliefs and deferrals and public sector support for infrastructure projects benefiting identifiable end users. The provisions apply to assistance given to “undertakings” which include most companies and also apply to any commercial activities undertaken by other bodies, such as public bodies and charities.
3. The Commission is able to authorise aid which is compatible with the Treaty and publishes “guidelines” and “frameworks” which establish the types and levels of support it is prepared to approve. Amongst the most important are the Regional Aid Guidelines and a suite of other horizontal guidelines covering interventions in support of SMEs, training, research & development, the environment, employment creation and risk capital (referred to as the “horizontal guidelines”).
4. The Treaty gives the Commission exclusive competence in the field of state aid. It is able to revise its guidelines at its discretion. Neither the Council of Ministers nor the European Parliament have a role in the process. Commission practice is to publish proposals, to consult Member States and then, subsequently, to publish final guidelines in due course in the Official Journal. The Commission acts in accordance with requests made by successive European Councils and is subject to control only through the European Court of Justice and Court of First Instance.
5. The UK maintains close engagement with the Commission both in respect of its state aid cases and policy reform.

DEFINITION OF ASSISTED AREAS

1. The assisted areas consist of two classes of economic area. “Article 87(3)(a)” areas³¹ are those:

“where the standard of living is abnormally low or where there is serious underemployment.”

2. “Article 87(3)(c)” areas³² are those where aid may be approved 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.

3. With some minor exceptions noted below the aid levels allowed in Article 87(3)(a) areas exceed the levels in Article 87(3)(c) areas. In certain sectors which are considered to be particularly vulnerable to distortion of competition through state aid, such as coal, steel and synthetic fibres, there is a prohibition on investment aid to large firms. In other sectors, notably in the shipbuilding and automotive industries special rules apply limiting the amount of aid which may be paid.

4. It should be noted that where EU Structural Funds are used to provide support to business, they must comply with the state aid rules in a similar way to national state aid.

³¹ Sometimes referred to as Tier 1 within the UK.

³² Sometimes referred to as Tier 2 within the UK.

THE COMMISSION'S APPROACH TO DEFINING ASSISTED AREAS 2000-2006

1. In terms of determining areas qualifying for assisted area status the *Guidelines on National Regional Aid 1998* provided that the Commission should first determine a total ceiling for the EU population to be encompassed and then established a mechanism for weighting this population between Member States depending on their circumstances.
2. The Commission in 1998 established a total assisted areas ceiling of 42.7% of the EU population. This figure, it is understood, made allowance for the accession of some new Member States (on the basis that logically the population in disadvantaged areas could not exceed 50% of the Community's total population) but did not anticipate the accession of 10. The individual population ceilings for each existing Member State are set out below:

| | |
|--------------------------------|-------|
| Belgium: | 30.9% |
| Denmark: | 17.1% |
| Germany: | 34.9% |
| Greece: | 100% |
| Spain: | 79.2% |
| France: | 36.7% |
| Ireland: | 100% |
| Italy: | 43.6% |
| Luxembourg: | 32.0% |
| Netherlands: | 15.0% |
| Austria: | 27.5% |
| Portugal: | 100% |
| Finland: | 42.2% |
| Sweden: | 15.9% |
| United Kingdom ³³ : | 28.7% |
| EU Total | 42.7% |

3. With the arrival of the 10 Accession states into membership on 1 May 2004 the total proportion of EU population in assisted areas increased to around 52.1%.
4. For the purposes of assessing eligibility for Article 87(3)(a) status the *Guidelines on National Regional Aid 1998* provided that NUTS2 regions would qualify where GDP per person was below 75% of the Community average. The Commission adopted the same criterion for designating Objective 1 regions for the purposes of structural funds.
5. Under the *1998 Guidelines* the designation of areas for the purposes of Article 87(3)(c) was, within the population ceilings imposed by the European Commission and subject to their approval, to be made in accordance with objective and quantifiable measures. The *1998 Guidelines* provided that the

³³ This figure does not include Northern Ireland

individual regions should either be NUTS3 regions or some other homogeneous geographical unit. Such regions or contiguous units were generally required to have minimum populations of 100,000.

6. For each area designated as either Article 87(3)(a) or (c) the Commission agreed with the Member State a net grant equivalent ceiling establishing the maximum aid intensity that a large firm is eligible for when making an investment project in the area. In some instances the aid intensities authorised by the Commission reduce during the lifetime of the Member State's map. For example most of the southern parts of the Republic of Ireland qualified at the start of the 2000-2006 map as 40% areas but permitted intensities have since fallen to 20%.

7. Allowable aid intensities for large projects have been reduced by the Commission via the Multisectoral Framework (originally introduced in 1998). This is in recognition of the fact that such projects have a bigger impact on competition, and are more likely to be undertaken by multinational companies which are less affected by regional handicaps and can exert more pressure on regional authorities to grant aid up to the permitted ceilings. A revised version of the Multisectoral Framework³⁴ came into effect on 1 January 2004 and this further tightens the constraints on large investment aids via reductions to the regional aid ceilings as follows:

| Eligible expenditure | Adjusted aid ceiling |
|--------------------------------------|----------------------------------|
| Up to €50 million | 100 per cent of regional ceiling |
| Between €50 million and €100 million | 50 per cent of regional ceiling |
| More than €100 million | 34 per cent of regional ceiling |

THE UK REGIONAL AID MAP AND PERMITTED AID INTENSITIES 2000-2006

8. The UK Regional Aid Map 2000-2006 was approved by the Commission on 17 August 2000.³⁵ Of the 37 UK NUTS2 regions four: Cornwall & the Isles of Scilly; Merseyside; South Yorkshire and West Wales & the Valleys qualified as Article 87(3)(a) regions.

9. The Article 87(3)(c) areas in Great Britain³⁶ are economic areas which were built from NUTS5 ward level areas on the basis of four economic indicators:

1. Residential employment rates (residents in employment divided by residents of working age);
2. Residential unemployment rates (residents International Labour Organisation unemployment divided by economically active residents);

³⁴ http://europa.eu.int/eur-lex/pri/en/oj/dat/2002/c_070/c_07020020319en00080020.pdf

³⁵ A copy can be seen at http://www.europa.eu.int/comm/competition/state_aid/regional/2000/united_kingdom.pdf

³⁶ These are also available at <http://www.hms0.gov.uk/si/si2000/20002038.htm>

3. Workforce unemployment rates (residents claiming unemployment benefits divided by the sum of total employee jobs and residents claiming unemployment benefits);
4. Manufacturing share of employment (number of manufacturing employee jobs divided by total employee jobs).

10. The first two of these indicators permitted the identification of areas where a high proportion of local residents face labour market exclusion; the third suggested areas where there were few jobs of any sort locally available for local unemployed people; and the fourth suggested areas vulnerable to a continued contraction in manufacturing employment.

11. It is understood that other Member States used other indicators for defining their areas.³⁷

12. Except in Northern Ireland (Objective 1 in transition), the UK Article 87(3)(c) areas are not contiguous with Structural Fund Objective 2 areas. See Section 9 for a note on Structural Funds.

13. In the UK's four Article 87(3)(a) areas the maximum aid intensity levels for large firms is 35% net grant equivalent. Where awards are taxed or paid in stages the fact that the limit is in net terms means that gross aid awards can be higher to reflect deductions or changes in the time value of money. In these areas SMEs are eligible for maximum levels of 50% support towards investment.

14. The aid intensity levels for large firm investment aid in the UK Article 87(3)(c) areas varies between 10,15 and 20% net. Exceptionally the aid intensity in the Highlands & Islands is set at 30% on grounds of low population density and Northern Ireland at 40% reflecting its particular political and economic circumstances. Aid intensities for large projects, however, must comply with the Multisectoral Framework (see section 7 of Annex 1).

³⁷ Copies of the Commission decision letters can be seen at http://www.europa.eu.int/comm/competition/state_aid/regional/2000/

UK REGIONAL AID SCHEMES AND OTHER NATIONAL SCHEMES SUPPORTING REGIONAL ECONOMIC DEVELOPMENT

The United Kingdom has a number of support measures approved under the current Regional Aid Guidelines. These schemes³⁸ are:

Great Britain

Regional Selective Assistance (N 731/00)
 Partnership support for Regeneration – Speculative development (N 747A/99)
 Partnership support for Regeneration – Bespoke development (N 747B/99)
 Property for Business – Wales (N 655/99)
 Partnership Development – Wales (N 656/99)
 English Cities Fund (N 82/01)
 Property support scheme – Scotland (N 680/01)
 Enterprise Grants Scheme (N 791/99)
 Regional Development Agencies (SRB and RDP Grants) (N 130/99)
 South Yorkshire productive investment scheme (N 734/00)
 Support by Scottish Enterprise towards capital investment (NN 131/97)
 Highlands & Islands Enterprise aid for initial investment (N 527/01)
 Special areas and key site investment grant scheme – Merseyside (N 817/96)

Northern Ireland

Selective Financial Assistance (N 567/92)
 Northern Ireland Tourism Development (N 444/90)
 Shortfall Guarantee Scheme (NN 58/94)
 Urban Development Grant Scheme (NN78/01)

The schemes generally support capital investment or are measures to “gap” fund the property market where the cost of development exceeds the value of the property upon completion.³⁹

³⁸ Approval letters for the majority of the schemes listed below can be seen at http://europa.eu.int/comm/secretariat_general/sgb/state_aids/index.htm

³⁹ It should be noted that some of these schemes function outside assisted areas in respect of SMEs. Where this is the case, that part of their Commission approval is under SME Block Exemption Regulation (70/2001/EC) – see Annex 6 below concerning horizontal and SME support measures.

NATIONAL SCHEMES SUPPORTING REGIONAL ECONOMIC DEVELOPMENT

The Government operates a range of national schemes (often delivered locally by the RDAs) which can have a major influence on the economic performance of the regions and most of which are not affected by the Regional Aid changes. These include:

KNOWLEDGE TRANSFER, BEST PRACTICE & INNOVATION:

- The Higher Education Innovation Fund (help for universities in developing links with industry).
- Knowledge Transfer Partnerships (creating project-based partnerships between companies and people in academia).
- Grants for Research and Development support companies in the development of innovative products and processes, especially for collaborative R&D.
- Advice, networking and organised visits for all companies wanting to learn from good practice and new ways of working
- Practical support delivered through Business Links for SMEs wanting to develop new ways of working
- **None of the above rely on the Regional Aid Guidelines and will continue to operate after 2006.**

REGENERATION

- The Government has put in place a number of State aid approved schemes which allow regional bodies such as the RDAs, Local Government and English Partnerships to undertake development activities.
- There are seven core regeneration schemes. These are:
 - Bespoke gap funding for land and property development
 - Speculative gap funding for land and property development
 - Aid for remediation of derelict land
 - Aid for additional development costs related to "heritage" issues
 - Community Regeneration
 - Environmental Regeneration, and
 - Direct development (where the Government undertakes development work itself)
- Of these, **only the two gap funding schemes have been approved under the Regional Aid guidelines** and would be affected by the changes. Community Regeneration, Environmental Regeneration and Direct Development do not include State aid.
- The Commission approval of the aid schemes expires at the end of 2006 but it is expected that they will be extended beyond this
- In addition **regeneration projects are, increasingly, being designed so that the government contribution to the schemes does not**

constitute State aid. Two recent examples are the East Kent Spatial Development Programme and the Birmingham to Worcestershire Investment Vehicle (also known as the A38 Technology Corridor Development Programme). These are large "macro development" projects bringing public resources from several sources (RDA, Local Authorities, ERDF and others) together with private sector developers to achieve large-scale development objectives outside the scope of State aid.

VENTURE CAPITAL

- The Regional authorities and Devolved administrations are also increasingly using risk and venture capital as a route for business support. The UK is in the forefront in the use of risk capital funds as a business support instrument.
- Many funds have been designed so that they do not contain State aid – for example, the North East Investment Fund and the Finance Wales Objective 1 & 2 funds – and others approved by the Commission where they contain State aid.
- These include national schemes such as the Regional Venture Capital Fund and the SME Venture Capital and Loan Fund and funds targeted within the regions - e.g. Northern Ireland's Veridian fund and a range of others currently seeking approval.
- **Risk capital state aid schemes are approved on a different basis from regional aid and will continue to operate post 2006.**

REGIONAL INVESTMENT

- Selective Finance for Investment in England, which supports capital investment for new projects in assisted areas, particularly those which make a contribution to the development of productivity and skills in the region.
- **This scheme would be affected by the changes to the Regional Aid guidelines**

OTHER STATE AID GUIDELINES AND INSTRUMENTS

Horizontal Aid

1. During the last five years the Commission has tightened its control significantly over state aid. It has also introduced a growing range of instruments which enable Member States to implement, or obtain approval for, certain types of aid which are consistent with Community objectives.
2. These instruments can be used throughout Member States including support to undertakings not located in assisted areas.
3. Amongst these are instruments allowing aid for environmental purposes, to promote the provision of risk capital and in respect of R&D. There are also three "Block Exemptions" which permit certain types of aid (for training, to SMEs, employment creation) without prior Commission approval of aid. There is also a Commission Regulation on the granting of "de minimis" aid. See below.
4. The majority of these horizontal instruments permit "top-ups" where higher levels of aid can be provided where an undertaking is in an assisted area. The aid intensities permitted under the horizontal guidelines, in both assisted and non assisted areas is shown in the table at the end of this annex.
5. Most of the horizontal guidelines will reach the end of their life between now and 2006 (the R&D Framework will need to be revised in 2005 and the guidelines on aid for environmental protection end in 2007). However, it is expected that the Commission will continue to apply these or comparable measures which will allow broadly similar forms of horizontal aid to be paid.

Aid with a limited effect on trade between Member States and lesser amounts of state aid

6. The Commission has also recently consulted on two new instruments which will enable Member States to provide aid consistent with Community objectives. These mechanisms known as "lesser amounts of state aid" (LASA - €1m per enterprise over a rolling three year period capped at 0.025% EU GDP weighed for Member State population, per year) and aid with "limited effect on trade" (LET - €3m per enterprise per year in certain "less traded" sectors) will involve fast-track approval of aid consistent with Community objectives up to 30% aid intensity. It is possible that these will form a way of obtaining approval for modest aids which would not otherwise be easily approved under the other state aid Guidelines. It is expected that the Commission will introduce new measures along these lines before the end of 2004.

Block Exemption Regulations and “de minimis” aid

7. There are currently three “block exemption” regulations which allow Member States to put in place aid schemes without the need for prior notification to the Commission (although there are *post-hoc* reporting requirements associated with the instrument) provided that the aid complies with the criteria set out in the block exemption Regulation. In addition there is a Regulation on the granting of “*de minimis*” aid – small amounts of support which, under certain conditions, do not constitute State aid.

1) **Training aid** – to both large firms and SMEs. Aid levels allowed are higher for generic skills than for skills specific to a particular employer. Aid levels are higher for SMEs than large firms. Similarly aid levels allowed for undertakings in assisted areas are greater than in non-assisted areas.

2) **SME aid** – aid is allowed to SMEs for either consultancy support or towards capital investment whether or not located in an assisted area. Higher levels of investment aid are however allowed for SMEs in assisted areas. The SME rules also allow aid to be provided for Research & Development activity.

3) **Employment creation** – this block exemption is more restricted than those for SME and Training aid. As such it is of more limited application. In summary, aid can be provided for the creation of employment. Aid may also be granted towards the recruitment of disadvantaged workers (e.g. the long term unemployed, those with few qualifications, others excluded from the job market for various reasons listed in the Regulation). Finally, aid may be granted towards the additional costs associated with the employment of disabled workers.

4) De minimis aid – other than for export subsidies, and excluding the agriculture and transport sectors, such aid may be given to any enterprise, regardless of location or size, subject to a maximum of €100,000 in a three year period.

The table shows the differences in the levels of regional aid and “horizontal” aids in non-assisted areas and assisted areas.

| STATE AID LEVELS – MAXIMA 2000 – 2006 | | | |
|--|-----------------------------|--|-------------------------------|
| | Non-assisted areas | Article 87(3)(c) Areas | Article 87(3)(a) Areas |
| <u>Regional Investment Aid</u> | | | |
| Large Firm | Nil | 10-20% (30% in parts of the Highlands, 40% in N Ireland) | 35% |
| SME | 7½ or 15% (medium or small) | 20-30% (50% in NI) | 50% |
| <u>Aid for Job Creation</u> | | | |
| Large Firm | Nil | 10-20% (30% in Highlands, 40% in N Ireland) | 35% |
| SME | 7½% or 15% | 20-30% | 50% |
| <u>Training Aid (transferable skills)</u> | | | |
| Large Firm | 50% | 55% | 60% |
| SME | 70% | 75% | 80% |
| <u>R& D</u> | | | |
| (industrial research) | | | |
| Large Firm | 50% | 55% | 60% |
| SME | 60% | 65% | 70% |
| (pre-competitive development) | | | |
| Large Firm | 25% | 30% | 35% |
| SME | 35% | 40% | 45% |
| <u>Environmental Aid</u> | | | |
| Large Firm | 30% | 35% | 40% |
| SME | 40% | 45% | 50% |

STATE AID LEVELS – MAXIMA 2000 – 2006

| | Non-assisted areas | Article 87(3)(c) Areas | Article 87(3)(a) Areas |
|---|---------------------------|-------------------------------|-------------------------------|
| <u>Venture Capital Schemes</u> 'safe harbour' limits where the Commission will accept there are market failures) Large Firm SME | Nil €500,000 | Nil €750,000 | Nil €1,000,000 |

UK LETTER TO THE COMMISSION OF 11 FEBRUARY 2004



United Kingdom
Permanent Representation
To the European Union

11 February 2004

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Dear Wouter

Review of the guidelines on national regional aid for the period after 1 January 2007

My authorities have asked me to thank the Commission for its letter C(2003)992fin of 2 April 2003 about the review of the guidelines on national regional aid⁴⁰. This response describes the developing UK thinking on the future of regional aid after 1 January 2007.

Context for reform

Consistent with the Council conclusions at Lisbon, the UK supports state aid reform designed to help achieve strong and fair competition across the EU, and to promote a modern and effective regional policy for an EU of 25. The UK Government's target is both to improve the economic performance of all its regions and to reduce the persistent gap in growth rates between the strongest and weakest regions. As set out in the UK's proposed EU Framework for Regional Policy⁴¹, the UK believes the best way to achieve long-term economic growth in each region is to:

⁴⁰ Hereafter regional investment aid, which refers to aid currently allowed within the regional aid guidelines i.e. aid for initial investment, job creation related to initial investment, and in very exceptional cases operating aid.

⁴¹ A modern regional policy for the United Kingdom, HM Treasury, DTI and ODPM, March 2003

- strengthen market forces by building on the indigenous strengths of each region and encouraging social inclusion and employment opportunities for all;
- enable businesses and communities to maximise their potential by tackling the increasingly different and changing needs of all regions; and
- promote fairness and ensure that the differential in growth rates between regions is narrowed by focusing resources where they are needed the most.

This will need to be supported by a reformed regional policy, which concentrates EU support on the poorest, and a flexible state aids regime that allows better off member states to develop and implement their own regional policy actions in support of achieving our Lisbon goals. Reform should ensure that EU regional policy actively supports the Lisbon agenda; and that it is flexible and substantially devolved, in line with the principle of subsidiarity. Reform should also seek to achieve a fair and sustainable solution that actively addresses the historic challenges and opportunities brought about by enlargement. This will also require sensitive consideration of the needs of those regions which may have reduced scope for regional investment aid by virtue of the statistical effect of enlargement. Transitional arrangements will, therefore, be necessary to allow such regions to adapt to a new regime.

State aid reform

State aid reform can be used to pursue regional policy objectives in two important ways: it can be used to ensure strong and effective competition across the EU; it can also help to ensure that state aid is used to target the underlying causes or market failures which drive regional or sub-regional underperformance. To enable both strong competition to be achieved and market failures to be targeted, it is necessary to encourage both stronger state aid control and greater flexibility to focus aid where it is needed the most. To achieve this, the UK believes it will be important to:

1. ensure the state aid regime operates efficiently, allowing Member States to implement low-level, non-distorting aid schemes in a pro-active manner which responds to market difficulties as they arise;
2. ensure appropriate horizontal guidelines are in place to target specific market failures effectively; and
3. apply a more targeted approach to regional investment aid.

It will also be necessary to ensure there are tight and effective controls on the most distortive and significant aids which have the potential to lead to inefficient investment decisions and to undermine competition. Further research will be required to identify which aids are most in need of tighter control. This should include an assessment of the relative merits of investment aid granted to compensate for regional economic underperformance, and of alternative measures targeted directly at the causes of such underperformance, including through the horizontal guidelines.

The state aid regime should also allow market failures to be tackled effectively at whatever spatial level they occur. This may involve tackling the causes of economic underperformance at the sub-regional level, as well as at the regional level.

1) An efficient state aid system

The Council and Commission have attached considerable priority to the simplification and modernisation of the state aid regime, in their pursuit of less and better targeted state aid. This would allow aid that does not significantly distort competition and trade to be dealt with much more quickly and simply, enabling Commission (and Member State) attention to be focused on the state aid with the largest negative impact on competition and intra-community trade.

In view of the very wide scope of interventions which might potentially amount to state aid, where it is clear that such aid would not have a significantly distortive effect on the relevant market it should be possible for these to be dealt with through a fast-track approach. As well as allowing the Commission to focus its resources on the most distortive forms of aid, this would allow Member States to implement low-level, non-distorting aid schemes in a pro-active manner which responds rapidly to market difficulties as they arise.

The UK therefore welcomes the proposals recently published by the Commission for a simplified economic framework to ensure that aid which is likely to have a low impact on trade and competition, and which pursues clear Community objectives, can be approved more quickly. The UK looks forward to continuing its work with the Commission and other Member States to develop the detail of the new framework with a view to ensuring its swift implementation.

2) Tackling market failures with appropriate horizontal guidelines

It will be necessary to ensure that horizontal guidelines are in place to allow market failures which hold back economic performance at the local level to be tackled, and thereby improve regional performance and social cohesion. This could include allowing for higher intensities of aid in under-performing areas, building on the arrangements allowed by the current guidelines. The UK has identified the following areas that are likely to be priorities for action:

- revising the R&D guidelines to better target market failures which inhibit innovation;
- building on the venture capital guidelines to better address the particular barriers faced by start-ups and expanding SMEs (e.g. with better provision for incubators and loans); and
- developing a regeneration framework to allow Member States to address physical, economic and social deprivation where the market fails rather than just in Article 87(3)(a) and (c) areas.

3) Applying a more targeted approach to regional investment aid

Strong and fair competition across the EU is essential for achieving an effective regional policy.

It is therefore important that tighter controls are applied to the most distortive and significant aids; and also important, more generally, that regional investment aid is better targeted – as we currently seek to do in the UK.

In this way, regional state aid will remain an important tool after 2006 to target multiple market failures and help meet social objectives in persistently underperforming areas.

UK's current approach to regional investment aid

Past experience in the UK has shown that the benefits of investment aid have been greatest where aid has been targeted to ensure an additional outcome. Better targeting is promoted through additional criteria stipulated in the UK's regional investment aid schemes which supplement the Regional Aid Guidelines. These aim to secure better value for money by targeting problems in a more proportionate way through:

- cost per job assessments to inform value for money judgments;
- targeting investment aid mainly at higher skill, higher productivity projects;
- offering the minimum necessary, consistent with value for money considerations, to encourage private sector discipline; and
- taking into account the potential for job displacement impact.

UK proposals for guidelines on regional investment aid

- The guidelines should ensure that all aid is targeted to where it is needed most so that it addresses the problems which drive regional underperformance in a proportionate way⁴².
- To better target investment aid, the guidelines should ensure that Member States assess schemes against measures such as those outlined above which place more focus on encouraging sustainable, high-quality projects which better promote productivity and competitiveness.
- In order to ensure investment aid can be targeted at specific spatial problems more effectively (e.g. to tackle multiple market failures)⁴³, it will also be necessary to devise objective economic and social criteria to identify areas eligible for regional state aid. These areas could be identified on a map, and may individually be of a smaller size than the current guidelines allow.

⁴² The Multisectoral framework is one way of applying constraint to investment aid effectively.

⁴³ The URBAN Community initiative is a good example of objective criteria being used to accommodate spatial targeting.

- The UK also requests that the Commission continues to recognise the particular political development and economic difficulties in Northern Ireland by continuing to maintain its present status within the areas eligible for regional state aid post 2006.

*Relationship between state aid rules and other elements of EU Regional Policy
(including Structural Funds)*

Horizontal aid measures, regional investment aid and EU Structural Funds currently form part of an overall “tool-kit” which Member States can use to address market failures and drive up economic performance to raise the prosperity of all regions. But as distinct policy instruments which can address different issues, they should be capable of being targeted separately. This already occurs under the current arrangements for regional policy.

In the context of a reformed EU regional policy, such as the UK has proposed, the prime objective of Structural Funds would be to aid development in the poorest Member States, while the state aid rules would continue to allow all Member States to provide support to address regional and sub-regional/area underperformance, consistent with the need to ensure state aid discipline. Member States could also use the eligibility criteria for regional investment aid or horizontal aid to inform other aspects of regional policy if they so wished.

Consequently the UK’s proposals for the Structural Funds would not prejudice the ability of Member States which are not in receipt of Structural Funds to use regional investment aid, horizontal aid or insignificant aid as the state aid rules for all of these would apply equally across all Member States irrespective of eligibility for Structural Funds.

Next Steps

These views form the UK’s initial position on the future of regional aid. The complexity of the issues involved, however, mean that further work is required for us to identify the most efficient and effective approach within the framework we have set out. We hope to discuss these issues further with the Commission, as our thinking develops.

Yours sincerely

Lynne Vallance
Second Secretary,
Competition Policy & Company Law

ANNEX 8

THE CONSULTATION CODE OF PRACTICE CRITERIA

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site, address <http://www.cabinet-office.gov.uk/servicefirst/index/consultation.htm>.

Comments or complaints

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to Louisa Renwick, DTI Consultation Co-ordinator, Room 723, 1 Victoria Street, London SW1H 0ET or telephone him on 020 7215 6913 or email to: louisa.renwick@dti.gsi.gov.uk

DETAILS OF DISTRIBUTION OF CONSULTATION DOCUMENT

This consultation document has been widely circulated in hard-copy form. In addition, it is available on line at www.dti.gov.uk/ewt/stateaid.pdf and at www.dti.gov.uk/consultations/stateaid.pdf .

The types of organisation to whom the document has been distributed include: other central Government Departments and the Devolved Administrations (and related contact points including Agencies); regional Government Offices; Regional Development Agencies and their counterparts in Wales, Scotland and Northern Ireland; Local Government Authorities; and, trade and business associations and local Chambers of Commerce.

A detailed list of organisations consulted can be obtained from DTI State Aid Branch:

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We would welcome suggestions of others who may wish to be involved in this consultation process.