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 31.12.2006\(^1\). These maps were drawn up on the basis of the Community Guidelines on national regional aid\(^2\) (hereafter: RAG).

By letter dated 2 April 2003\(^3\), 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 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.”

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\(^1\) 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.


\(^3\) See also the notice published in OJ N° C 110 dated 08.05.2003, page 24.
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 today⁴ 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;
- 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

⁴ Commission Communication to the Member States on the links between regional and competition policy (OJ N° C 90, 26.03.1998, p. 7).
with Member States in this difficult exercise, consultation at this early stage is considered important.


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 regions.

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 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.

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.
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”. 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).

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 EU average. They will therefore no longer qualify under Article 87(3)(a).

Proposal for new RAG:

These regions 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:

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

6 In addition, RAG § 5.7 allows for a progressive reduction of aid intensity ceilings in regions losing their Article 87(3)(a) status.
7 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.
8 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.
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 RAG⁹, today enjoy an aid ceiling of 30% net¹⁰, 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 enterprises¹¹, 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 emerges¹²:

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

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⁹ NUTS III regions with less than 12.5 inhabitants per km².
¹⁰ Without the possibility of a top-up for SMEs.
¹¹ But with the possibility of top-ups of 10% and 20% gross for MEs and SEs.
¹² Statistics of the last three available years (1999-2001). This picture may therefore change.
• 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)\(^{13}\) 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.

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\(^{13}\) 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.
### Annex: Table of proposed aid intensities

(Expressed in gross grant equivalents)

<table>
<thead>
<tr>
<th></th>
<th>Large enterprises</th>
<th>Medium-sized enterprises</th>
<th>Small enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Article 87(3)a) region ≤ 50% GDP</strong></td>
<td>50%</td>
<td>60%</td>
<td>70%</td>
</tr>
<tr>
<td><strong>Article 87(3)a) region ≤ 60% GDP</strong></td>
<td>40%</td>
<td>50%</td>
<td>60%</td>
</tr>
<tr>
<td><strong>Article 87(3)a) region ≤ 75% GDP</strong></td>
<td>30%</td>
<td>40%</td>
<td>50%</td>
</tr>
<tr>
<td><strong>Article 87(3)c) “statistical effect” regions</strong></td>
<td>30% → 20%</td>
<td>40% → 30%</td>
<td>50% → 40%</td>
</tr>
<tr>
<td><strong>Other Article 87(3)c) earmarked region</strong></td>
<td>20%</td>
<td>30%</td>
<td>40%</td>
</tr>
<tr>
<td><strong>Non-assisted areas</strong></td>
<td>0</td>
<td>10%</td>
<td>20%</td>
</tr>
</tbody>
</table>

Outermost regions eligible to Article 87(3) c) are treated as “statistical effect” regions. Furthermore, all outermost regions are entitled to a bonus of 10 %.

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14 See notably paragraph 4.1.