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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL

Progress report concerning the reduction and reorientation of State aid

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PART I: INTRODUCTION

1. In its conclusions of 24 March 2001, the Stockholm European Council indicated that “the level of state aids in the European Union must be reduced and the system made more transparent”.... “To that effect, Member States should demonstrate a downward trend in State aid in relation to GDP by 2003, taking into account the need to redirect aid toward horizontal objectives of common interest, including cohesion objectives.”
2. 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.”
3. On 5 December 2001, the Council adopted Conclusions concerning State aid. In those conclusions, the Council invited the Member States to:
 - continue their efforts to reduce aid levels, in terms of percentage of GDP;
 - reduce, by way of priority, with a view to eliminating, aid which has the greatest distortive effects;
 - reorient aid towards horizontal objectives, including cohesion and, where appropriate, small and medium-sized enterprises (SMEs);
 - further develop the use of "ex ante" and "ex post" evaluations of aid schemes, so as to rebalance them in a more effective way; such evaluations should focus on the quality of aid packages, their effects on competition and their impact;
 - improve the transparency and the quality of reporting to the Commission, particularly by national control and follow-up procedures as well as, where possible, by the provision of relevant statistics;
4. In addition, the Council invited the Commission to:
 - develop, together with the Member States, statistical tools enabling these Conclusions to be followed up and devise indicators of effectiveness and efficiency; those indicators should thereafter, where appropriate, supplement the Scoreboard;
 - intensify the assessment of the impact of aid on competition, on the basis of economic criteria;
 - encourage exchanges of experience and concerted evaluation exercises, in order to benchmark the effectiveness of instruments on a European scale;
 - continue its efforts to simplify European rules on State aid, to modernise them and clarify them in order to make them more effective, particularly in terms of the length of processes;
 - submit an initial assessment of progress in 2002;

5. As requested in the final indent above, Part II of this report describes the first steps which have been undertaken within the Commission with a view to following up these conclusions. In view of the fact that the European Council Conclusions are addressed to the Member States, Part III sets out some suggestions for the next stages of this work.

PART II : IMPLEMENTATION OF THE COUNCIL CONCLUSIONS OF 5 DECEMBER 2001

Development of statistical tools enabling the follow-up to the Council recommendations

6. This request to the Commission is closely linked to the request made by the Council to Member States to improve the transparency and quality of reporting to the Commission, particularly by national control and follow-up procedures, and where possible, by the provision of relevant statistics. As a first step towards its implementation the Commission has therefore launched a comprehensive review of the current arrangements for the provision by Member States of annual reports and statistics, which are set out in the Commission letter to Member States of 2 August 1995 concerning the joint procedure for reporting and notification under the EC Treaty and under the WTO Agreement.¹ Following the completion of this internal review, the Commission services will shortly be consulting experts from Member States on a revised and simplified reporting format for the submission of Annual Reports to the Commission. It is envisaged that the new reporting format would be adopted in the form of an implementing regulation pursuant to Article 27 of Council Regulation (EC) n° 659/1999 of 22 March 1999² laying down detailed rules for the application of Article 93 of the EC Treaty, following formal consultation of the Member States through the Advisory Committee on State aid.

Devise indicators of effectiveness and efficiency of State aid

7. In the context of state aid control, the Commission's assessment of State aid focuses on the effects of aid on competition and its compatibility with the criteria set out in Article 87, paragraphs 2 and 3 of the EC Treaty. In a broader context, the State aid Scoreboard³ has made some first attempts to assess whether State aid is always the most appropriate instrument to correct certain market failures. However, the specific development of indicators for the effectiveness and efficiency of State aid highlights another aspect of State aid policy for which Member States are primarily responsible. This is also reflected in the Stockholm and Barcelona conclusions, which invite Member States to further develop evaluations of aid schemes, so as to rebalance them in a more effective way. For its part, the Commission intends to facilitate such processes and to provide a forum for exchanges of experience and concerted evaluation exercises.
8. The Commission has also decided to procure a study from outside consultants. The purpose of this study is two-fold. First, to devise a methodology for assessing the contribution of different forms of State aid towards the achievement of various clearly defined policy objectives. Second, to develop general indicators that can be

¹ Published on the Commission web site at http://europa.eu.int/comm/competition/state_aid/legislation/20506_en.html

² OJ L 83, 27.3.1999, p. 1

³ COM(2001)782 final and COM(2002)242 final

used by Member States to facilitate the assessment of the effectiveness of their State aid.

9. In assessing the effectiveness of State aid, the study does not attempt to identify and measure market failures directly nor to compare the level of aid intensity with regional gaps, but rather to define policy objectives of State aid and to investigate the effectiveness of State aid as a policy instrument for achieving these objectives. The methodology to be developed should, amongst other things, help policymakers to assess the impact of potential State aid cuts in terms of objectives. The empirical work so far, based on an econometric approach, has focussed largely on aid for research and development but will be extended to cover other areas including small and medium-sized enterprises. In a second step, the study examines the other factors which interact with State aid to determine the degree of success in achieving the policy objectives. It is hoped that, if satisfactorily validated, the application of the methodology that is being developed will help to draw up a list of criteria that will make it possible to help identify the circumstances in which aid is likely to be more or less effective. This work should be seen as complementary to in-depth case studies which will clearly remain necessary.
10. The Commission intends to make the final results of the study available to the Member States.

Intensify the assessment of the impact of aid on competition on the basis of economic criteria

11. The Commission is committed to ensuring that its State aid control policy is based on sound economic criteria. In particular, it takes account of economic considerations in developing the various frameworks, guidelines and regulations which set out detailed conditions for the compatibility of aid with the common market. Thus for example, in preparing the Communication on State aid and risk capital⁴, the Commission took account of the available information concerning market failure in risk capital markets in order to define the safe harbours and the criteria to be used for assessing the compatibility of aid. It also accepted that there were sound economic arguments for departing from the usual requirement for a link to eligible costs, and explicitly provided for mechanisms which harness the interests and expertise of market operators. Because such mechanisms should ensure that investment decisions are driven by market incentives and bear market risks, economic reasoning suggests the potential for distortion of competition is reduced by comparison with measures implemented entirely by public authorities.
12. The Commission has recently completed a review of the multi-sectoral framework for large investment projects which has led to the adoption of a new Commission communication on 19 March 2002.⁵ In that communication the Commission considers that large investments, while effectively contributing to regional development, are less affected by region-specific problems. As a result, large investments can be successfully attracted into disadvantaged regions with relatively smaller aid amounts than smaller projects. Furthermore the Commission recognises that certain types of investment projects are more likely to give rise to distortions of

⁴ OJ C 235, 21.8.2001, p. 3

⁵ OJ C 70, 19.3.2002, p. 8

competition. This is the case in particular for investments in a sector where a single company has a high market share and in cases where the sectoral production capacity is increased significantly without a corresponding increase in demand. More generally, distortion of competition is likely in sectors suffering from structural problems where demand is persistently declining. Accordingly the Commission has decided to undertake in 2003 a systematic analysis of the situation in the Community with a view to identifying the sectors concerned, which will thereafter be subject to more restrictive rules on aid for large-scale regional investment projects.

13. The Commission has also recently undertaken a review of the Community guidelines for State aid for research and development. In order to do this, the Commission published an open invitation to Member States and interested parties to submit their observations on the experience of the current framework and the need for change. After considering these comments, the Commission concluded that the current State aid rules were not an obstacle to the achievement of the target set by the Barcelona European Council that overall spending on R&D in the Union should be increased with the aim of approaching 3% of GDP by 2010, with two-thirds of this investment coming from the private sector. The Commission therefore decided to extend the current guidelines until the end of 2005⁶, and will review them at that time in the light of the progress achieved towards the Barcelona target, including progress made on reorientation of state aid measures towards R&D as indicated in the Commission communication "More research for Europe: Towards 3% of GDP"⁷.
14. As regards State aid measures which are not covered by the existing frameworks, guidelines and regulations, the Commission will consider whether it is possible to define better the economic criteria used in determining whether the distortions of competition to which they give rise should be considered to affect trading conditions to an extent contrary to the common interest, having regard to the need to ensure legal certainty and predictability in its State aid decisions. One of the factors to be taken into consideration in this respect would appear to be whether a measure is open to a large number of beneficiaries on the basis of objectively defined criteria or whether it is limited to a single beneficiary or a small number of beneficiaries.
15. The Commission is also considering to what extent economic criteria should be taken into consideration in the design of State aid procedures so that it can simplify procedures for the approval of straightforward cases which do not present significant competition concerns and focus its scarce resources on the more problematic cases.

Encourage exchanges of experience and concerted evaluation exercises

16. In order to encourage the peer review process by way of the Scoreboard, the Commission has established a Member State Forum in order to encourage exchanges of experience on various aspects of their State aid policies, including experiences about national evaluation exercises. To date, this resource remains substantially under-utilised and the Forum currently consists of a series of internet links to the web sites of the authorities of some, but not all, of the Member States. The Commission intends to further develop such a Forum in close collaboration with the Member States.

⁶ OJ C 111, 8.5.2002, p 3

⁷ COM (2002) 499 final

17. For its part, the Commission considers that evaluation exercises and benchmarking exercises undertaken outside the framework of competition policy per se may also provide useful experience to be taken into consideration in the State aid context. For example the exercises of benchmarking national RTD policies and on improving the effectiveness of public support mechanisms for RTD, which are being undertaken in order to facilitate the achievement of the Barcelona objective of increasing R&D expenditures may provide useful information for considering the efficiency and effectiveness of different types of State aid measures when compared with other available policy instruments.⁸ Similarly the work of the Business Environment Simplification Task-Force (BEST)⁹ may provide valuable indicators of the effectiveness of different forms of support for SMEs.

Continue its efforts to simplify, modernise and clarify State aid rules

18. The Commission has continued its efforts to modernise, simplify and clarify State aid rules. The adoption of the new multi-sectoral framework referred to in paragraph 12 above constitutes a major step in that direction. The new framework sets out a much clearer set of rules for the evaluation of State aid for large regional investment projects and at the same time eliminates the need for prior notification of many aid projects, provided the aid is granted in the framework of an approved regional aid scheme. At the same time, the new framework brings together and consolidates in a single text the different sectoral texts which previously applied in the steel, synthetic fibres and automobile sectors.
19. As regards the coal and steel sectors, the Commission has adopted a Communication clarifying certain aspects of the treatment of competition cases resulting from the expiry of the ECSC Treaty, which also explains the application of State aid procedures following the expiry of the ECSC Treaty.¹⁰ The Commission also adopted a Regulation which lays down rules for the granting of State aid to the coal industry with the aim of contributing to the restructuring of the coal industry¹¹.
20. Following the completion of the procedures for consultation of Member States and third parties laid down in Regulation (EC) 994/98, the Commission is in the process of adopting a block exemption regulation for State aid for employment, which will eliminate the need for prior notification of many State aids for the purposes of creating employment or aiding disadvantaged or disabled workers.
21. The Commission is currently completing a review of the Community definition of 'Small and Medium-sized enterprises', which is used by the Commission for a variety of purposes, including State aid control. As soon as possible after a new definition is agreed, the Commission will bring forward for consultation draft amendments to the block exemptions for aid for SMEs and for training aid in order to incorporate the new definition. At the same time, the Commission will consider the extension of the scope of the block exemption for aid for SMEs to include aid for research and development.

⁸ See for example, Benchmarking National RTD Policies, First Results, SEC (2002) 129, 31.1.2002
⁹ http://europa.eu.int/comm/enterprise/enterprise_policy/best/best_procedure.htm

¹⁰ OJ C 152, 26.06.2002, p.5

¹¹ Council Regulation (EC) No 1407/2002 of 23 July 2002 on State aid to the coal industry

22. Within the framework of the Commission Communication to the European Parliament and the Council on the Mid Term Review of the Common Agricultural Policy¹², the Commission is actually examining the possibilities of adopting exemption regulations such as a block exemption for various types of State aid. This would accelerate the implementation of the new State aid regimes and avoid ex-ante notification of various types of agricultural State aid.
23. The Commission has also published communications on the application of State aid rules to public service broadcasting¹³ and on certain legal aspects relating to cinematographic and other audio-visual works¹⁴.
24. The Commission has published a communication to clarify that unlawful aid which has been granted without prior notification to the Commission will be assessed in accordance with the relevant frameworks in force at the time the aid is granted.¹⁵
25. In addition, the Commission is continuing its work to clarify the relationship between the State aid rules and the provision by Member States of compensation for the cost of providing services of general economic interest. In accordance with the request of the Seville European Council, this work will be the subject of a separate report to the Copenhagen European Council.
26. So far as State aid procedures are concerned, the Commission has recently undertaken a detailed internal review with a view to identifying the possibilities for simplifying procedures and reducing their duration. As a result of this review, the Commission services have identified a number of possible changes which will be the subject of detailed consultation with experts from Member States. This work may lead to the preparation of implementing provisions under Article 27 of Regulation (EC) n° 659/1999 concerning the form, content and other details of notifications, the form, content and other details of annual reports, details of time-limits and the calculation of time-limits, and the interest rate for the recovery of unlawful aid, as well as other suggestions to improve current procedures and working methods.
27. More specifically, with regard to State aid procedures in the fisheries sector, the Commission has proposed to eliminate the separate state aid scrutiny of Member States' obligatory financial contributions to projects co-financed as part of the Community structural assistance in this sector.¹⁶

PART III: NEXT STEPS

28. As noted at the beginning of this report, the Stockholm and Barcelona conclusions calling for a reduction in overall aid levels and for the reorientation of aid towards horizontal objectives of common interest, including economic and social cohesion objectives, are addressed to the Member States. The Council has, however, asked the Commission to take an active role in following-up the implementation of those

¹² COM (2002) 394 final of 10.7.2002

¹³ OJ C 320, 15.11.2001

¹⁴ COM (2001) 534 final, 26.09.2001

¹⁵ OJ C 119, 22.05.2002, p. 05

¹⁶ Proposal for a Council Regulation amending Regulation (EC) No 2792/1999 laying down the detailed rules and arrangements regarding Community structural assistance in the fisheries sector, Art. 19 on "Obligatory financial contributions and state aid", COM(2002) 187 final of 28.5.2002, p. 11.

conclusions and in providing a forum for the exchange of information and best practices. The Commission intends to further develop the existing forum for this purpose.

29. Accordingly, the Commission invites all Member States to forward, if possible before 31 December 2002, a contribution on the actions they have undertaken to follow-up the Conclusions of the Stockholm and Barcelona European Councils on State aid as well as the Council conclusions of 5 December 2001. For its part, the Commission would forward the contributions received to the other Member States together with the results of the study on criteria for the efficiency and effectiveness of aid referred to above. The Commission services would then organise a multi-lateral meeting with experts from the Member States at which the different contributions could be discussed in depth, and would include a synthesis in the 2003 State aid scoreboard. A short report to the Athens European Council could also be envisaged.
30. Depending on the outcome of this first exercise, consideration could then be given to the usefulness of repeating it on an annual basis.
31. Apart from this, the Commission will continue its efforts to simplify, modernise and clarify the State aid rules, with particular emphasis on trying to simplify and shorten State aid procedures. In view of the expiry in 2004 of the Community guidelines for rescue and restructuring of firms in difficulty, a type of aid which is widely regarded as potentially among the most distortive of competition, the Commission intends to launch in 2003 a detailed assessment of the operation of the current guidelines.