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Subject: Your Article 10 Council Regulation (EC) 479/2009 request for Ex-Post advice on the statistical sector classification of Local Action Groups (LAGs)

Reference: Your letter dated 25.01.2024, our holding reply dated 29.03.2024, our draft reply dated 27.05.2024 and your comments thereto received on 31.05.2024

Dear Ms Ridzoňová,

Thank you for the letter requesting Eurostat's opinion on the sector classification of Local Action Groups (LAGs). In accordance with Council Regulation (EC) No 479/2009 article 10, paragraph 1, after examining your request, please find below Eurostat's view on the sectorisation of the above-mentioned units in the light of ESA 2010.

1. THE ACCOUNTING ISSUE FOR WHICH A CLARIFICATION IS REQUESTED

The issue to be analysed is the sector classification of Local Action Groups (LAGs).

LAGs are institutional units established on the basis of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common and general provisions on 5 European Structural and Investment Funds ('ESIF': *the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development, and the European Maritime and Fisheries Fund*).

The LAGs are currently classified in the general government sector in Slovakia. The Ministry of Agriculture and Rural Development of the Slovak Republic has objected to this classification,

based on the argument that LAGs are non-profit institutions able to determine their own policies or programmes to a significant extent (in reference to ESA 20.15), despite being mainly financed by public resources. Additionally, the Ministry considered that despite this public funding, the controls on that funding stream were not restrictive enough to dictate the general policy as per ESA 20.309(i).

The Statistical Office of the Slovak Republic (SOSR) provided an analysis underpinning its decision with regard to the classification of LAGS in the general government sector.

2. METHODOLOGICAL ANALYSIS

2.1. *Applicable accounting rules*

Institutional units and groupings of units are defined in ESA 2010 chapter 2. The distinction between market and non-market producers is introduced in ESA 2010 chapter 3. ESA 2010 chapter 20 defines the general government sector. The sector classification for Non-profit institutions (NPIs) is being described under paragraphs 20.13 to 20.16. Chapter 20 also includes specific provisions for public control (20.18) and public sector control (20.309-20.310) as well as for the market/non-market delineation (20.19-20.31). Moreover, chapter 1.2.3.2. of the Manual of Government Deficit and Debt ¹(‘MGDD’, 2022 edition) deals with the specific case of Control of non-profit institutions (paragraphs 36 to 39), while MGDD chapter 1.2.3.1 (paragraph 28) refers to the control indicators sufficient to establish government control.

2.2. *Description of the case*

Community-led local development (CLLD) is one of the economic and social cohesion goals of the Treaty on the Functioning of the European Union (TFEU). Such local development is typically carried in certain regions, often aimed at supporting the local agriculture or tourism activities. Regulation (EU) 1303/2013² articles 32 and 33 stipulate that CLLD shall be supported by European Structural and Investment (ESIF) funds, with the main responsibility given to **local action groups (LAGs) composed of representatives of public and private local socio-economic interests**. LAGs design and implement local development strategies, while taking into consideration local needs and potential. Article 33 spells out the requirements for local development strategies, which should contain at least:

- the definition of the area and population covered,
- an analysis of the development needs and potential of the area,
- a description of the strategy and its objectives, including measurable targets for outputs or results (the strategy shall be consistent with the relevant programmes of all the EU funds that are involved),
- a description of the community involvement process in the development of the strategy,

¹ec.europa.eu/eurostat/documents/3859598/16029761/KS-GQ-23-002-EN-N.pdf/77a75b07-61c3-7d34-5243-70d09bc00e44?version=3.0&t=1677163672121

² <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R1303>

- an action plan demonstrating how objectives are translated into actions, a description of the management and monitoring arrangements of the strategy, demonstrating the capacity of the local action group to implement the strategy and a description of specific arrangements for evaluation,
- the financial plan for the strategy, including the planned allocation from each of the EU funds concerned.

Article 32(2b) also stresses that, at LAGs' decision-making level, "neither public authorities, as defined in accordance with national rules, nor any single interest group represents more than 49% of the voting rights".

Article 33 also states that it should be the Member States, which define the criteria for the selection of CLLD strategies. These strategies should be selected by a committee set up for that purpose by the managing authority. In the case of the Slovak Republic, the managing authority for CLLD strategies is the Ministry of Agriculture and Rural Development aided by the Agricultural Payment Agency (APA) – a governmental budgetary agency, classified within the central government sector (S.1311), fulfilling the role of a market regulatory agency. The CLLD strategy sets out the allocations for each of the ESIF funds concerned and, as well as the responsibilities for the management and the control tasks as well.

In Slovakia, the main source of financing for the activities of LAGs is the ESIF funds, which financing is subject to a governmental agency (APA's) approval. Majority of the LAGs also collect membership fees from their local-interest-group members, however, such membership fees typically represent not more than 15-20% of the total LAG cash revenues. The requirements of Regulation (EU) 1303/2013 are reflected in the Slovak legislation via Act 292/201 Coll from 17/09/2014, which act also further elaborates on the processes and procedures applied for the financing of CLLD activities carried by the LAGs, and particularly the involvement of the Slovak public authorities represented by the Ministry of Agriculture and Rural Development, as well as the Agricultural Payment Agency.

2.3. Availability of national accounting analysis

Together with the request for an ex-post advice, Eurostat received a comprehensive sector classification analysis prepared by the Statistical Office of Slovakia. This analysis relied mainly on the paragraphs 20.14, 20.15 and 20.309(i) from ESA 2010, as well as on MGDD chapter 1.2.3.1 sub-paragraph 23.3. In particular, SOSR elaborated on the application of the non-profit institutions control criteria of ESA 20.15: sub-letters (b) provisions of the enabling instrument; (c) control through contractual agreements; and (d) degree of financing. Based on these criteria, the analysis concluded that there was a significant presence of public authorities in LAGs' decision-making and public acts defined the binding provisions of LAGs' statutes. As a consequence, the SOSR concluded that LAGs are non-profit units controlled by the government and therefore should be classified in the general government sector (S.13). The methodological topic for the classification of community-led development entities established in conformity with Regulation (EU) 1303/2013 was also presented during the June 2023 EDP Statistics Working Group (EDPS WG), with the general recommendation that such entities be classified inside the general government sector (for statistical purposes).

SOSR also sent to Eurostat the letter by the Ministry of Agriculture from January 2024, which lays down arguments contesting the SOSR's national accounts classification decision. The arguments of the Ministry have been duly considered in the Eurostat's analysis presented below.

2.4. *Eurostat's analysis*

a) *Institutional units*

As presented under section 2.2 above, in order to obtain LAG status, a group of interested people or entities should fulfil certain conditions, as well as have their CLLD strategy approved by the APA government agency.

Such group needs to have the **legal form of a non-profit institution (NPI)** and have members, which can be separated into 3 interest groups (public, business and civil) with voting rights established in a such way that neither public authorities nor any interest group have more than 49% of voting rights at the decision-making level. The LAG should be a legal entity represented by a civil association pursuant to Act no. 83/1990 Coll. on association of citizens.

Furthermore, the LAG should have a structure of bodies that are capable of managing public funds and managing the CLLD activities of the LAG with a limit to certain regions/ territories. LAGs thus seem to fulfil the condition to have autonomy of decisions and maintain their own set of accounts, in the form of non-profit institutions recognised as independent legal entities (ESA 2010 paragraph 2.30(a)(4)).

b) *Control*

The public control analysis is a multi-factor analysis in the ESA 2010 framework. ESA 2010 paragraph 20.15 sets the requirements for establishing control over the LAGs as non-profit institutions (NPIs): *“To determine whether an NPI is controlled by the government, the following five indicators of control should be considered:*

- (a) the appointment of officers;*
- (b) other provisions of the enabling instrument, such as the obligations in the statute of the NPI;*
- (c) contractual agreements;*
- (d) degree of financing;*
- (e) risk exposure.*

A single indicator can be sufficient to establish control. However, if a NPI that is mainly financed by government remains able to determine its policy or programme to a significant extent along the lines mentioned in the other indicators, then it would not be considered as being controlled by government. In most cases, a number of indicators will collectively indicate control.”

In Slovakia, civil associations become LAGs, only after a selection by the Ministry of Agriculture and the APA agency, on the basis of their CLLD strategies. With the LAG status establishing decision by APA, LAGs receive the main financial support for the implementation of their CLLD strategy, by way of allocations from the ESIF funds. At the moment the Ministry of Agriculture and the public APA agency approve the CLLD, they also decide on the specific ESIF financial source(s) to be used for the LAGs implementing the CLLD strategy. ESIF financing to LAGs takes the form of public subsidies (non-returnable financial contribution) and typically represents the majority of the financing that LAGs receive.

The local Slovak legal Act 292/201 Coll provides for the establishment of a CLLD Management System³, which is approved by public authority (the Ministry of Agriculture), acting through an established special-purpose Committee (for the approval of CLLD strategies and the selection of LAGs). The Committee is also acting in compliance with the requirements of Article 33(3) of Regulation (EU) 1303/2013: “*Community-led local development strategies shall be selected by a committee set up for that purpose by the managing authority or authorities responsible and approved by the managing authority or authorities responsible*”.

Chapter 6.1 point 2 of the CLLD Management System stipulates that “*LAGs are a grouping of representatives of public and private local socio-economic interests in which, at the decision-making level, neither the public authorities nor any interest group have more than 49 % of the voting rights. The LAG bodies, which have decision-making power, must comply with the condition laid down in the preceding sentence in the composition of the body and in the performance of CLLD/LEADER tasks and throughout the implementation of the CLLD/LEADER strategy.*” The bodies of LAGs must therefore be comprised of representatives by the following interest groups (Chapter 6.1 Points 3-6 of the CLLD Management System):

- a) the government sector interest group (which is further defined in CLLD 6.1(4)),
- b) the business sector interest group, and
- c) the civil sector interest group.

Furthermore, the CLLD chapter 6.1 requires that one representative (LAG member) cannot represent more than one interest group. Municipalities can also be a member of not more than one LAG each. In this way, the government effectively controls the number of LAGs in operation. The requirement of CLLD Management System chapter 6.3.3.4 goes even further: “the minimum number of municipalities making up the LAG is 7 (a municipality can be represented by an association or a micro-region)”. The Rural Development Program also imposes additional limitations as to the density of the population covered by LAGs (a region is ‘rural’ only below a certain density). In addition, the government has the obligation to ensure a certain balance of grant allocation at the NUTS III regional level. Municipalities, as LAG sponsors, are thus notably constrained (which would not have been the case if a municipality could participate in many LAGs simultaneously), giving municipalities an effective leading role, as well as strong blocking rights. LAGs’ activities thus do not only depend on public demand, but also, notably, on the actions (supply) of the government.

According to CLLD 6.1(8), the LAG General Assembly (the governing body) is able to resolve if the members of the LAG are present, which have a supermajority of all the votes; i.e. more than 50% of all votes (regardless of affiliation to interest groups). This condition needs to be spelled out in the LAG statute, and it must be observed when the LAG performs tasks stemming from the implementation of the CLLD strategy. It thus seems that effective control can be achieved, in practice, with 50% + 1 of the votes.

Among others, this public authority Committee ensures the organization of the entire LAG-CLLD strategy selection process, including also the evaluation of submitted project plans and verification (appropriateness) of LAG selection criteria and evaluation (scoring) criteria for the selection of projects within the CLLD strategy to be carried out by LAGs. The Committee also ensures the selection, approval and appointment of expert evaluators for LAG activities related to their CLLD

³ Published on the website of the APA public authority <https://www.apa.sk/system-riadenia-clld>

strategy mandates, as well as checks the results of the evaluation of CLLD strategies and confirms the fulfilment of the conditions for providing the financial contribution to LAGs.

The *enabling instrument* contain provisions that effectively allow the government not only to decide if an entity is established as an LAG, but also to determine significant aspects of the general policy/programme of the LAG. The enabling instrument specifies the functions, objectives and other operating aspects of the LAG. This is evidenced by the fact that the provisions of the CLLD management system (Chapter 6) are binding for LAGs. These provisions must be stated in LAGs' statutes of incorporation (including a mandatory clause that LAGs perform tasks and activities dictated by the CLLD Management System). There is evidence that some LAGs require supermajorities for change in status, dissolution etc, in a manner that gives general government control under the enabling decision criterion.

c) *Contractual agreements*

LAGs enter into *contracts* with government units in order to perform tasks defined by the government and the EU. Such contracts represent the main part (in some cases potentially all) of the LAGs' activities. It is therefore clear that the government is able to influence the critical policies of the LAGs. In the event that an LAG ceases to exist, by way of dissolution or merger with another NPI, during the period of validity of the contract on the provision of non-returnable financial contribution for the operation, the LAG is obliged to return the funds to the ESIF funds.

Also, LAGs thus engage in activities generally carried out by government agencies (mobilisation of EU funds in favour of local development). It is therefore highly questionable if LAGs could be classified in S.15, given that such S.15 units should serve households, such as for example political parties, churches, hospitals or schools. LAGs de facto can be seen as an instrument to organise government functions, benefiting the expertise of non-public entities, without necessarily relinquishing the control which is inherently linked to the distribution of public subsidies/ grants.

The Ministry has stated that “a potential problem that may arise in the interpretation of Section 5 of Act No 83/1990 on association of citizens, according to which *‘associations may not perform the functions of state bodies, unless a special law provides otherwise. They may not run state bodies and impose obligations on citizens who are not members’*. In this case, Eurostat considers that LAGs perform functions which are set out under and EU regulation with the aim to promote regional development policies, and therefore the afore-mentioned restriction of Act No 83/1990 should not seem relevant.

The official selection criteria for LAGs stipulate that LAGs have to be designated by the public authorities (APA and the Ministry), following an opinion of a public authority Committee, approving also their CLLD strategies and organisation/ action plan. LAGs' calls for grants are also reviewed and the selection of each grant beneficiary – while made at the LAG level using LAG committees – must also be approved by APA and the Ministry. The Ministry signs a contract with LAGs, while the signatory on the contracts with the beneficiaries is either APA, or the LAGs, depending on whether the financing is procured by the Rural Development Program or the Integrated Regional Operational Program. In the latter case, LAGs have to send reports to the Ministry of Investments and Regional Development. All these constrains/ arrangements suggest that LAG have very little room of manoeuvre for their general policy. It can be presumed that these constrains are not sufficient enough to question the LAG autonomy of decision – although a certain view could be that the parameters are so strictly defined that LAGs can be viewed as essentially ancillary to the participating municipalities.

It is also to be noted that, while an EU regulation may not be considered as sufficient to set the general policy of the concerned organisations, in this case, the EU regulation (1303/2013) involves the distribution of EU funds. The Ministry of Agriculture has stated that LAGs exercise their activities to a significant extent independently and maintain independent decision-making processes of management within the organisation, which is not the same as the ability “to determine policies/ programmes to a significant extent” (ESA 20.15). This may be enough to establish LAGs’ autonomy of decision, however, it is insufficient to establish control by the private sector. In the case of LAGs, controls on the funding streams are restrictive enough to be reasonably considered as determining their general policies. The Ministry also claims that the APA agency “will only carry out a formal review of the criteria”, however, APA also plays an important role in approving the calls for submission of request for grants/ subsidies, in addition to its general advisory role (intermediating the relations between the Ministry and the LAGs).

The *enabling instrument* and the *contracts* arrangement arguments laid out above should be considered together. Without prior government agreement, the delisting of an LAG and/ or the terminating of its main contracts represent likely only theoretical possibilities, not yet experienced in practice. Termination of an LAG contract, without prior government agreement, will necessitate the return of any grants allocated via the contract, however it is not clear if this concerns the grants to the LAG itself, or it also concerns the grants to the final beneficiaries channelled via the LAG. In such a case, future grants, as well as contracted grants not yet paid out will implicitly be forfeited.

d) *financing*

LAGs rely principally on *financing* other than receipts from sales to cover their operating costs. Their principal source of financing are transfers from public institutions (ESIF funds plus government co-financing) rather than regular subscriptions paid by the LAG members. A non-negligible part of the LAG members are in fact government units. A narrow monitoring by the government for the use of the LAG funds is evidenced by monitoring reports, which LAGs are obliged to deliver. A strong influence from government on the general policy of the entity is evidenced by majority of public financing, which LAGs are obliged to spend or distribute by specific guidelines.

The main source of financing for the activities of Slovak LAGs is the public ESIF funds, which financing is subject to a governmental agency (APA’s) approval. This ESIF financing is typically received by LAGs in the form of public subsidies. Majority of the LAGs also collect membership fees from their local-interest-group members, however, such membership fees typically represent not more than 15-20% of the total LAG cash revenues.

The nature and the amounts of LAG membership fees are insufficient to establish that LAGs could be considered to charge economically significant market prices for their activities. LAGs thus have the nature of non-market non-profit institutional (NPI) units.

The above arrangements demonstrate the critical involvement by public authorities in LAGs’ establishing provisions with regard to the main LAG enabling instruments, contractual agreements, critical degree of financing, as well as LAGs’ risk exposure. One of the ESA 20.15 indicators may not be sufficient to entail control, but taken together, including the general arrangement of the LAGs, public control is established reasonably unequivocally. The public authorities can also decide to withdraw the LAG status of groups not fulfilling their CLLD strategies. These clearly point towards restrictive controls exercised by public authorities, not only related to the financing of LAGs, with these controls dictating CLLD strategies and the general policies of LAGs.

e) Legislative versus statistical treatment of LAGs

Eurostat takes note that the Article 32(2b) of Regulation (EU) No 1303/2013 stipulates that, at LAGs' decision-making level, "neither public authorities, as defined in accordance with national rules, nor any single interest group represents more than 49% of the voting rights". It is thus questionable if LAGs, by themselves, represent public authorities, from a legislative point of view, unless considered ancillary to the two public authorities (APA and the Ministry). It should be noted that the Regulation does not contain direct requirements as to the statistical sector classification of LAGs.

The Ministry states that there will be additional costs if LAGs are statistically classified within government (mentioning, among others, the requirements of Act 69/2018 on Cybersecurity, Act 95/2019 on Information Technologies, e-Government provisions, etc). Eurostat considers this not directly relevant to the statistical classification of LAGs, especially given that LAGs are predominantly funded by the EU, and that these alleged additional costs concern all LAGs, such that no distortion of competition is created. LAGs are chosen as a form to perform government functions, precisely due to the fact that this form is less costly than if the same functions are performed by the public authorities, whereas LAGs are physically closer to the final beneficiaries under Rural Development programmes. The spirit of the EU policy is promoting cooperation with local civil and business interest groups, and not to exempt the application of ESA rules on the classification of government units.

In Slovakia, the term 'Public Authority' is not defined in any legal regulation as a uniform term for the entire legal system. However, there is a definition of 'Public Authority' for the purposes of Act no. 272/2015 Coll. on the Register of Legal Entities, Entrepreneurs and Public Authorities and on amendments to certain laws [§1a letter d)] stating that public authorities include: "1. state authorities; 2. territorial self-government bodies; 3. self-governing bodies of interest; or 4. another persons who implement its mission, activity, tasks, goals or part of them in a materially defined area in the public interest and for this purpose a special regulation entrusts it with the authority to decide on the rights, legally protected interests and obligations of a natural person or legal entity or otherwise interfere directly with these rights, legally protected interests and obligations; a public authority is not a person who issues administrative acts exclusively in the areas of free access to information, complaints or petitions."

Following the clarification provided in point 4 of the Act, in general, Public Authority includes a person issuing administrative acts in the areas of free access to information, complaints or petitions, but for the purposes of Act no. 272/2015 Coll., it is not considered a Public Authority (and thus does not receive a business ID number), i.e. the Act foresees a narrower definition than other legal acts. This leads to the conclusion that there is no direct link between entities classified within the government sector, for statistical purposes, and entities considered to be within the definition of a 'Public Authority'.

3. CONCLUSION

Based on the information available, it appears evident that LAGs are publicly controlled and that have a non-market nature. Therefore, Eurostat confirms the opinion of the Statistical Office of the Slovak Republic, that LAGs should be classified within the general government sector, for statistical purposes.

Procedure

This preliminary view of Eurostat is based on the information provided by the Slovak authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information currently available and the assumptions made above, Eurostat reserves the right to reconsider its view.

In this context, we would like to remind you that Eurostat is committed to adopt a fully transparent framework for its decisions on debt and deficit matters in line with Council Regulation 479/2009 and the note on ex-post advice. Eurostat therefore publishes all official methodological advice (ex-ante and ex-post) given to Member States on its website.

Yours sincerely,

(e-Signed)

Rasa Jurkoniene
Acting Director