EUROPEAN COMMISSION

Brussels, 7.12.2011
SEC(2011) 1524

COMMISSION STAFF WORKING PAPER

Impact Assessment Report

Accompanying the document

Proposal for a

Framework on State Aid to Shipbuilding

{C(2011) 9051}
{SEC(2011) 1525}

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1. Introduction

The Framework on State aid to shipbuilding[1] (hereafter: "the Shipbuilding Framework" or "the Framework") will expire on 31 December 2011.

The Shipbuilding Framework is a Commission soft law instrument that provides the basis for the Commission to authorise State aid in this sector. The principle under this Framework is that shipbuilding is eligible for aid under all horizontal State aid instruments[2], except where the specific provisions contained in the Shipbuilding Framework apply.

Shipbuilding is the only industrial sector that still has a separate set of specific State aid rules deviating from the general rules normally applicable[3]. This is due partly to historical reasons and partly to the special features of this industry in particular that of a global market subject to cyclical overcapacity.

The Shipbuilding Framework reflects these features and is a mix of stricter and more lenient provisions. For example, given the cyclical overcapacity problems of the sector, under the Shipbuilding Framework *regional aid* is only allowed for investments that aim to modernise existing installations, whereas for other sectors regional aid can be given for the setting-up of a new establishment. *Closure aid* in turn aims to facilitate the closure of economically non-viable capacity. *Innovation aid* is tailor-made for this industry and aims to cushion the risks of innovative projects; under these rules, aid can be given for the building of ship prototypes that are also the final commercial product, whereas this is normally not allowed for other industries. Aid for the creation of employment (*employment aid)* must be notified for reasons of transparency in a sensitive sector, whereas notification could be exempted (under now expired rules) for other sectors; *export credits and development aid* reflect the OECD Arrangement on export credits and the "Sector Understanding for Ships" which relate to the conditions under which the ship buyer can obtain financing support from the country producing the ship.

Therefore, this report assesses whether the specific State aid provisions for the shipbuilding industry are still needed, and if so whether changes to these rules are required, or whether the sector could be subject to the general rules. Thus, the present report does <u>not</u> assess all aid given to shipbuilding, since it is limited to aid granted under the specific provisions of the Shipbuilding Framework.

2. Procedural issues and consultation of interested parties

2.1. *Organisation and timing*

2.1.1. Leading service and other services involved

This impact assessment has been prepared by the Directorate-General for Competition (DG COMP), Unit for Industrial Restructuring (Unit E3).

1 OJ C 317, 30.12.2003, p. 11.

2 The compilation of State aid rules can be found under: http://ec.europa.eu/competition/state_aid/legislation/legislation.html .

3 Specific State aid provisions still apply in the steel and synthetic fibre sectors; however these rules have been integrated in the horizontal State aid instruments.

Inside DG COMP, the State aid Policy and Scrutiny Unit (Unit A3), the State aid Case Support Unit (Unit 03), the State aid Unit for R&D, innovation and risk capital (Unit H2), the Regional aid Unit (H1), the State aid Unit for Energy and Environment (Unit B2) and the Unit in charge of Strategy and Delivery (the latter responsible for Impact assessments within DG COMP) were consulted.

An Inter-Service Steering Group was established involving the following Directorates-General: DG COMP (lead service), the Secretariat General, the Legal Service, DG Enterprise, DG Mare, DG Move, DG Employment, DG Environment, DG RTD and DG Trade. DG ECFIN and DG Internal Market were also invited but did not participate in the work of the Group. This Group met three times, on 28 June 2010, 10 March 2011 and 25 May 2011. This report, together with the attached minutes of the last meeting of the Group, is intended to be the final one following consultations of the Group.

2.1.2. Agenda planning and Work Programme reference

For details please refer to Annex I.

2.1.3. Opinion of the Impact Assessment Board

The Impact Assessment Board issued its Opinion on 25 October 2011. Following this opinion, DG Competition revised the report.

In particular, following the Board's recommendation, the report clarifies the role played by the Shipbuilding Framework to address the challenges faced by the EU shipbuilding industry, by providing more information on the policy context and on how the justifications for sector-specific rules have evolved over time. The report also further elaborates on the relative importance of State aid granted to the shipbuilding sector under the specific framework, as compared to aid granted under the general frameworks, on the basis of the available information. The presentation of the policy options has been improved by explaining the rationale underlying the two packages of options that modify the framework, as well as the reasons why some individual options suggested by the external consultant and/or stakeholders were not analysed in detail. Finally, following the Board's recommendations the aggregate impact of the proposed packages of options is examined in terms of their effectiveness, efficiency and coherence.

2.2. Consultation and expertise

2.2.1. Public Consultation

The preparation of this report has been preceded by a public consultation in order to gather as many comments and suggestions as possible from individuals and the bodies concerned. This exercise respected the minimum standards for consultation of interested parties as defined in the Communication from the Commission of 11 December 2002 - COM(2002) 704.

The open internet consultation was carried out between 4 October and 6 December 2010. To this effect, the Commission services published a consultation paper[4]. The paper described the

[4] http://ec.europa.eu/competition/consultations/2010_shipbuilding_framework/index.html#contributions.

problem at hand, the policy objectives and various policy options upon which stakeholders were invited to comment.

In particular, given that shipbuilding is also eligible for aid under the common State aid rules, the consultation aimed at determining whether the sector is still in need of specific provisions or whether State aid to shipbuilding could be aligned to the rules applicable to other sectors. Given that the Framework is a mix of specific rules, stakeholders and Member States were asked to submit comments on each specific provision separately.

The Commission received 35 replies. These included replies from 14 Member States[5] and Norway; the main European professional shipbuilding organisations (Community of European Shipyards Associations – CESA, equipment suppliers – EMEC); the European Community of Ship owners Association – ECSA, several national associations of shipbuilding and individual shipyard groups[6]. The Commission also received a joint statement from the European Shipbuilding Social Dialogue Committee, on behalf of the European Metalworkers' Federation (EMF) and CESA. Some of the contributions, including those from ship owners and equipment suppliers, only stated some limited views on specific topics, without addressing the questionnaire. All the replies, cleansed of confidential elements, were published on the Internet site of DG COMP.

The Community of European Shipyards Associations (CESA), together with the national shipbuilding associations and Germany, France, Italy and Spain are in favour of prolonging the Framework subject to certain changes. Particular emphasis was put on maintaining specific provisions on innovation and extending its scope in order to cover new products not yet covered (such as inland waterway vessels and off-shore platforms for marine exploration), as well as introducing new environmental aid provisions for this sector. The joint statement provided by the sector social dialogue committee also followed CESA's position.

Denmark, the Netherlands and Finland had a more nuanced approach, arguing for keeping specific rules but with stricter innovation aid provisions (Denmark, the Netherlands) and in certain cases, a stricter regional aid approach (Denmark, Finland).

EMEC, representing the equipment suppliers, argued that a major part of the innovation in shipbuilding comes from the equipment suppliers which need to be equally supported as the shipyards.

The European Community of Ship owners Association – ECSA only stated that they are in favour of prolonging the Framework for a longer period without justifying these views.

Only Sweden is in favour of letting the specific rules contained in the Framework expire as they do not believe that subsidies are the drivers of growth and can be the solution to strengthen the long term competitiveness of the shipbuilding industry.

[5] UK, France, Germany, Sweden, Italy, Spain, the Netherlands, Estonia, Poland, Denmark, Bulgaria, Finland, Cyprus and Greece.

[6] STX, Damen shipyards, Technip OY.

Certain Member States (UK, Estonia) also questioned whether the specific provisions on innovation aid, if maintained, could be transferred to the corresponding horizontal aid instrument, as opposed to keeping a separate Framework for shipbuilding.

The details of replies to the public consultation are in Annex II.

2.2.2. Multilateral meeting with Member States

Following the above public consultation, the Commission services prepared a new draft "*Framework on State aid to Shipbuilding*" on which stakeholders were invited to submit further comments. This draft Framework corresponds to the option assessed under Option C1 below, see section 5.3.1 below. In addition, on 13 September 2011 a Multilateral Meeting with Member States, EFTA countries and Croatia took place, in order to discuss this draft Framework.

A very limited number of stakeholders replied to this follow-up consultation, but those who did maintained largely their position as expressed in the first consultation (CESA, ECSA, the German Shipbuilding and Ocean Industries Association (VSM) and Danish Maritime).

As regards the views of Member States during the multilateral meeting, these did not always coincide with the views initially expressed in the first public consultation. A summary of Member States reactions to the proposed draft Framework is provided in Annex VI.

2.2.3. Consultation of other Institutions

The European Shipbuilding Social Dialogue Committee[7] was consulted orally in a plenary meeting on 27 October 2010 concerning the problems affecting the sector and the policy options for the future of the Shipbuilding Framework.

DG COMP also requested input from the relevant Committees in the European Parliament, the European Economic and Social Committee (EESC) and the Committee of the Regions. Only the EESC reacted. The opinion of the EESC adopted on 14 July 2011 largely mirrors CESA's position, as well as that of the social dialogue committee advocating for extending the application of the Shipbuilding Framework and creating new environmental aid for the sector, as well as aid for the maintenance of employment.

2.2.4. Expertise

There is limited up-to-date information regarding the EU shipbuilding industry, which may be due to the very fragmented nature of this industry and the fact that it is in permanent evolution. As sources of expertise, the Commission therefore used a number of studies previously carried out by expert consultants under the auspices of various Directorate-Generals of the Commission, in so far as they contained information that was relevant for this report.[8]

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[7] The dialogue takes place under the auspices of DG Employment.

[8] The following studies were in particularly used: "Assessing Financing mechanisms in EU shipbuilding", Study by Price Waterhouse Coopers for DG ENTR, 25 February 2011 (hereafter referred to as PWC study); "Study on Competitiveness of the European Shipbuilding Industry", Study by Ecorys for DG ENTR, 8 October 2009 (hereafter referred to as Ecorys study); "Comprehensive sectoral analysis of emerging competences and economic activities in the European Union: Building and

In addition, the Commission commissioned an expert analysis with regard to the application by Member States of innovation aid, which is the form of aid that was more frequently used under the Framework. The consultant was *Appledore International Limited*. This study was based on a sample of reports on the application of innovation aid coming from Germany, Spain, Italy, The Netherlands and Finland, covering about 60% of all cases of innovation aid given under the Framework and reported to the Commission. As such, this sample is large enough to draw some valuable conclusions on the functioning of the innovation aid provisions in the Shipbuilding Framework.

An executive summary of this report, cleansed of confidential elements, is in Annex III.

Finally, as data for the sector, the Commission relied frequently on figures available from CESA, which - although not limited to EU Member States - is the most representative source of information concerning the EU shipbuilding industry. CESA represents the shipbuilding industry from 14 Member States (Bulgaria, Denmark, Finland, France, Germany, Greece, Italy, Lithuania, the Netherlands, Poland, Portugal, Romania, Spain and United Kingdom), as well as from Croatia and Norway.

3. Problem definition

3.1. Introduction

The Shipbuilding Framework will expire on 31 December 2011. This Framework came into effect in 2004, it was first reviewed in 2006 and prolonged by two years; it was again reviewed in 2007-2008 and prolonged again by three years, each time without modifications. This Framework contains the rules under which the Commission may authorise State aid for the building, repair and conversion of commercial ships (see below definition of commercial ships). The Commission must decide whether the specific rules contained in this Framework should continue to apply, should be modified or whether they are no longer needed, in which case shipbuilding would be subject to the general State aid rules.

This report assesses first the context in which the specific rules were created, how the industry has developed since the introduction of these rules, and the specific issues raised with regard to each specific provision, as well as proposed modifications to the rules.

3.2. The context

3.2.1. The reasons for specific rules

Specific State aid rules for shipbuilding have existed since the 1970s and have been progressively aligned with the general rules. Until the entry into force of the current Shipbuilding Framework, on 1 January 2004, State aid to shipbuilding was regulated by the Council.

Repairing of Ships and boats sector", Study by IKEI for DG EMPL, April 2009 (hereafter referred to as IKEI study); and "The role of Maritime Clusters to enhance strength and development in the European maritime sectors", Study by Policy Research Corporation for DG MARE, 2009 (hereafter referred to as Cluster study).

Historically State aid to this sector has been influenced by political considerations and by trade distortions in the international market.

The shipbuilding market is considered to be a global market in the sense that shipyards compete for orders against each other all over the world. In addition, vessels do not come on shore and are thus not subject to border controls. In fact, although the notion of "import/export" in shipbuilding is used to designate the situations where the buyer is located in a different country than the country producing the ship, this concept is of limited use. Vessels can be registered in a "flag state" different from the one where they were produced and or where the buyer is located. In most cases vessels are not subject to any import or export controls or tariffs. This makes the use of trade instruments, in particular the WTO rules on the application of anti-dumping and/or anti-subsidy measures difficult to apply to this sector.

In addition, a key feature of the industry is global competition (in particular from China and South Korea) and heavy subsidies granted by certain non-EU countries.

In light of the above situation the shipbuilding sector benefitted for several decades from production aid ("operating aid"[9]), in order to make-up for the cost and price-difference between ships produced in the EU and ships sold on the global market. However, experience has shown that providing operating aid to counter unfair trading practices by others was not the most cost-effective way of encouraging the European industry to improve its competitiveness.

Council Regulation (EC) N° 1540/98[10] that preceded the current Framework, thus abolished operating aid and introduced instead, "innovation aid", i.e. aid for building products and processes that *innovate by comparison to the state of the* art in order to promote innovation in the sector. This form of innovation aid, slightly amended, then passed on to the current Framework. Although innovation aid is still a form of "operating aid" in so far as it covers part of the costs of producing the vessel, it is targeted at promoting innovation and therefore at encouraging the longer term competitiveness of the EU industry.

3.2.2. Policy issues

Some stakeholders[11] claim that in view of the global nature of the market, combined with the fact that there are no efficient international rules to prevent EU's competitors from receiving Government subsidies in this sector, the EU must allow public subsidies to EU producers to balance competition on the global market. In this context attempts to conclude an OECD shipbuilding agreement to restore a level playing field have been finally abandoned in 2010 after twenty years of attempted negotiations. However, as explained above, experience has shown that providing subsides to counter the subsidies given by others is not a cost-effective solution for promoting the competitiveness of the EU industry. Moreover, the above claim does not sit well

[9] In State aid, operating aid is regarded as the most distortive type of aid. Operating aid simply offsets part of a firms' production costs without enhancing efficiency or pursuing any other legitimate objective (i.e. cohesion, RDI, etc.). By reducing production costs, operating aid directly interferes in the market price by distorting the balance of supply and demand.

[10] See Council Regulation (EC) N° 1540/98 that preceded the current Framework, which acknowledged that "*operating aid is not the most cost-effective way of encouraging the European shipbuilding industry to improve its competitiveness*". Operating aid to this sector was thus abolished as of 1 January 2001, after several decades of application.

[11] Mainly the EU industry representatives-CESA, but see also the position of Member States as regards innovation aid – section 6.1.1.

with the fundamental principle of State aid policy in the EU which is to prevent subsidy races and ensure that a level playing field is preserved within the internal market. Finally, allowing State aid may lead to subsidy wars with negative effects on taxpayers and consumers.

As regards trade distortions, the EU is developing a policy of including special State aid provisions in bilateral Free trade agreements ("FTAs"), in order to increase transparency on State aid in general and preventing certain types of more distortive aid (such as bail outs of ailing companies by the State). An example of this is the FTA EU - South Korea, where the inclusion of such provisions may be particularly relevant for shipbuilding, in the light of the practical difficulties of applying WTO trade defence instruments to this sector.

Finally, it is noted that, by contrast to innovation aid which is relatively recent, the other provisions contained in the current Framework were not for the most part introduced by the current Framework but are a remnant of previous regimes. The appropriateness of maintaining or not these provisions must be seen in the light of the development of the general horizontal guidelines that have changed over time, and whether or not they can cater for the characteristics of the shipbuilding market. Section 3.4 of this report further elaborates on the objectives of each specific provision contained in the Framework and the pros and cons of maintaining or not these provisions.

A schematic comparison between the general State aid rules and those specific for the shipbuilding industry is illustrated in Annex IV.

3.3. Market assessment and the EU shipbuilding industry[12]

The evolution of the EU shipbuilding market is examined below for the period 2003/2004 to 2009/2010 which roughly corresponds to the period of application of the Shipbuilding Framework (1 January 2004 to present).

3.3.1. Comparative size of the EU industry

The European shipbuilding and ship repair industry comprises a total of more than 300 shipyards, spread over 14 Member States and several regions. As a result of consolidation within the industry combined with some closures and bankruptcies, the number of yards has decreased significantly. Thus, in 2010 only about 52 *companies*[13] engage in the construction of new commercial vessels ("newbuildings"), compared to an estimated 172 companies in 2003[14]. The industry's annual turnover was about EUR 15 billion in 2009 with regard to commercial new buildings. <u>This turnover represents 0.13% of the EU's 2009 nominal GDP</u>[15].

The EU Member States with a significant shipbuilding industry (in terms of production of new buildings) are: Germany, Italy, the Netherlands, Finland, Spain, Poland, Denmark, France and

[12] In this report the term "shipbuilding industry" designates mainly the activities of shipyards, i.e. not including equipment suppliers.

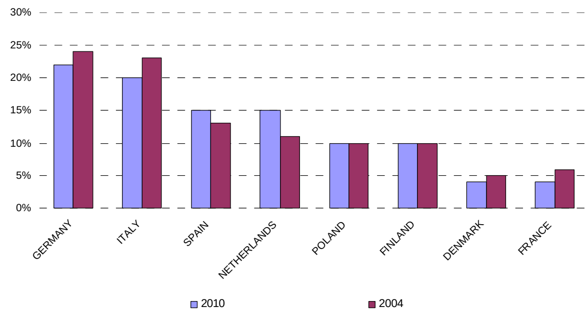
[13] Most of these companies have more than one yard under their umbrella. Some of these yards may be located in Europe, but have Asian owners. Shipbuilding thus shows a growing tendency towards globalisation. Source: Ecorys page 33.

[14] PWC study.

[15] I.e. EUR 12 trillion, IMF data.

Romania. Candidate country Croatia also has a significant shipbuilding industry. The relative market shares (with regard to new buildings) of EU Member States have only changed marginally in the period 2003-2010[16], i.e. during the period of application of the Shipbuilding Framework, as shown by the table below.

Figure 1: Relative market shares within the EU



Source: PWC Study, page 13.

Compared to yards in other parts of the world, EU yards are relatively small. For example, the largest European yard (Meyer Werft in Germany) ranks only 38th worldwide[17]. Conversely, the world's largest shipyard – Hyundai Heavy Industries (South Korea) – has a higher tonnage output (in gross tonnage) than the EU's twenty largest yards added together[18].

The current scope of the Shipbuilding Framework is limited mainly to sea-going commercial vessels and certain special types of vessels (see section 3.4.2), which are mostly exposed to global competition. The current scope has remained unchanged for a very long period[19].

3.3.2. The global market

The European shipbuilding industry has to be put in perspective of the evolution of the worldwide market. The sector has a history of cyclical overcapacity, linked to variations in trade and demand. In particular, demand reached a booming record in the period 2003-2007, generating in turn a boom in construction of new capacity outside of Europe, in particular in China. The ensuing financial and economic crisis that started in mid 2008 completely overturned the situation leading to a sharp drop in demand of about 90% in 2009 that only started to slowly recover in 2010. The consequence of these developments is that worldwide shipbuilding capacity is estimated today to be 50% in excess of the market needs.[20]

In fact, although in the past decade EU production (in volume) remained relatively stable, the EU lost considerable market share due mainly to the loss of market in the standard cargo ship types (tankers, bulk carriers, and, more recently, container vessels) that represent the highest share of

[16] PWC study, page 13.

[17] Measured by compensated gross tonnage orderbook, data of 2008. Source: Ecorys pages 8-9.

[18] Ecorys and PWC study.

[19] The current scope of the Framework is also in line with the scope of the OECD Arrangement on Officially Supported Export Credits and the Sector Understanding for Ships.

[20] CESA reply to the public consultation, page 5.

global demand. The evolution of market share of the main shipbuilding nations worldwide is shown in the table below.

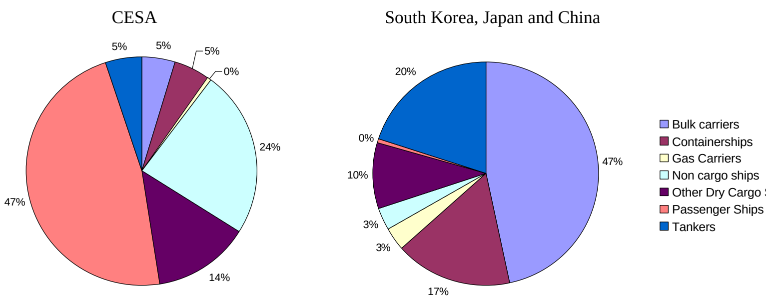
Table 1: Market Shares in shipbuilding calculated on the basis of total orderbook in compensated gross tonnage[21] (CGT) for the years 2000, 2005 and 2010[22]

	2000	2005	2010
European Union[23]	21%	12%	5%
South Korea	32%	36%	31%
Japan	21%	26%	15%
China	8%	15%	38%

Source: Spain's reply to the public consultation

Against this background and that of fierce (subsidised[24]) competition from other shipbuilding nations, the EU industry has tended to specialise in non-conventional market segments, such as cruise vessels, mega yachts, dredgers and offshore platforms for exploration of marine resources.[25] This results in a focus on optimised custom-made products of small series at most. Vessels are often one of a kind, due to their size, complexity, degree of specialisation and variable functionality, which makes them risky products given the small size of the EU undertakings.

Figure 2: Breakdown of production by ship type, year 2010 (CGT)



Source: CESA figures

The solvency ratios and profit margins of the EU industry are generally well below the average in this industry and, in addition, they have decreased constantly since 2006.[26]

[21] Compensated gross tonnage: is an indicator of the amount of work that is necessary to build a given ship, it is used as a measurement for output of shipyards.

[22] Source: data provided by Spain in the reply to the public consultation

[23] Data: EU 27 Member States 2005/2010.

[24] For instance,as a response to the financial and economic crisis South Korea announced an approximately EUR 18 billion direct support package to shipowners and shipyards. Also several other non-EU shipbuilding nations put in place measures comprising preferential domestic treatment, direct subsidies, subsidised loans and guarantees. (CF Ecorys pages 50-51.)

[25] In 2008 European yards held 98.7% of the world's orderbook by value in the cruise vessels market segment. Europe is also market leader in mega yachts, and with regard to the dredging industry, 4 out of 5 the biggest players are European. (Ecorys pages 65-70).

[26] CF PWC study sections 2.3.3-2.3.4, p 22-23: according to this study, in 2008 the average net profit margin of the 10 largest EU yards was 1,9%, in 2009 this figure turned negative. PWC reports an average net profit margin of the top 10 in sales of 6%,

The EU shipbuilding industry continues to lose market share on the world market. The industry has moved from the traditional vessels to the more specialised types, which implies new commercial risks.

3.3.3. Employment

In 2009 about 70 000 people worked in the shipbuilding industry (commercial new buildings, de facto the scope of the Framework) Europe-wide, although employment in the sector has tended to decline. The workforce figure is higher (around 120 000) if we include ship repair and naval shipbuilding.[27] It is generally acknowledged that shipyards drive the activity for supporting local businesses[28], including the equipment manufacturers[29], although in the marine supplier industry business is also largely supported by export markets outside the EU.[30] It is noted that 70 000 people represent only 0.03% of the EU's working population[31]. By nature, shipyards are concentrated on specific geographic (i.e. coastal) areas and some of them may play an important role for employment in those regions. However, there is no comprehensive information available on employment figures in shipbuilding per regions in the EU.

Aid to the sector may have an indirect impact on employment, insofar as it leads to investments (regional aid) and to the development of new technologies (innovation aid). In turn, these subsidies probably induce positive effect on the economic situation of the associated industries, and ultimately on employment level. This impact on employment is however highly difficult to quantitatively assess due to the absence of a clear and unambiguous causality between job creation and State aid to the Shipbuilding industry.

3.4. Legal framework: the current specific rules and the results of their application

3.4.1. Overview

The Commission has approved a total of 36 decisions[32] for granting aid under the Shipbuilding Framework since 2004 (including individual decisions, schemes and renewal of schemes) in relation to 9 Member States[33].

The total amount of aid (innovation and regional aid)[34] in the period 2004-2009 granted under the Framework was EUR 268 million.[35] This amount represents only 0.33% of the industry's compound turnover in the same period.

although warning on the great differences between the global top 10 in sales and the EU companies (which makes comparison difficult), as well as limitations of the data on profits.

[27] CESA figures.

[28] This is acknowledged in several replies to the consultation from Member States, although no concrete figures were supplied to support these views. According to the Cluster study, shipbuilding in Europe has an average of EUR 10 thousand direct added valued. In case of Marine equipment, the added value is higher, EUR 17 600. Cf. Cluster study, page 9.

[29] It is assumed that in shipbuilding 50-70% of the value added comes from external subcontractors and suppliers. The trend is growing and hence the "supply industry" is becoming more and more important. Ecorys, page 35.

[30] Direct employment in the maritime equipment sector is estimated at more than 287 thousand. EMEC website: http://www.emec-marine-equipment.org/marine_equipment/facts_and_figures.asp

[31] I.e. 244 million people (employed plus unemployed). Source: EUSTAT.

[32] I.e. ca. 5 decisions per year. By comparison, in 2009 alone the Commission took a total of ca. 700 State aid decisions.

[33] Germany, Spain, The Netherlands, France, Italy, Finland, Greece, Poland and Slovakia.

Table 2: Total amounts of aid in relation to industry turnover, period 2004-2009 (compound figures)

	million EUR	% of total CESA turnover
Total turnover of CESA (in value of newbuilding completions)	80 000	
Total innovation aid granted	234	0.29%
Total regional aid granted	34	0.04%
Total aid (excluding: export credit and development aid)	268	0.33%

<u>The total of innovation and regional aid given to the industry represents only 0.095% of the total aid given to the manufacturing sector[36] in the period 2004-2009.</u>

It has to be noted that financial support granted under the provisions on export credits and development aid contained in the Framework, are not directly comparable with the financial support granted in the form of innovation aid and regional aid as according to the Framework the direct recipient of the aid is not the shipbuilder but the ship buyer or the developing country. The shipyard is only the indirect beneficiary in this case, and hence it is not possible to quantify the exact aid element to the shipyards in the financial support.

The amounts of *reported* export credits and development aid disbursed by the Member States during the period of application of the Framework are examined under section 3.4.6. No aid was granted under the provisions of closure aid and employment aid. As regards the latter, the rules have become obsolete as they relate to general employment aid rules that have ceased to apply. As regards closure aid, the fact that it was not used may reflect Member States' reluctance to give aid to close shipyards combined with a period of high demand, where shipyards had full order books. Also, general State aid rules for restructuring were used in recent years to restructure shipyards.

To some extent additional aid was also granted under the general rules, although the information is incomplete in this regard. Those grants were mainly awarded under approved schemes.[37] In particular, Spain, Poland, Germany and Finland reported a total of ca. EUR 37 million granted as general RDI aid. Moreover, Poland also reported rather insignificant amounts granted as training aid (EUR 34 thousand) and aid for environmental protection (EUR 842 thousand).

It is also be noted that decisions on individual cases under the general rules have in several instance had a much higher impact on the activities of shipyards than individual decisions under the Shipbuilding Framework. In particular, the Polish Gdansk Shipyard received restructuring aid[38] in the amount of ca. EUR 250 million, i.e. almost the amount that was spent by all Member

[34] The higher proportion is innovation aid. The Commission does not have complete information regarding export credits granted. Development aid is granted to the buyer of the ship, the exact aid element cannot be quantified. No aid was granted under the other aid instruments, i.e. closure aid and employment aid.

[35] I.e. approximately EUR 80 billion in the period 2004-2009. Turnover calculated as total value of completion of newbuildings. CESA figures.

[36] EUR 281 billion. Aid excluding crisis measures.

Scoreboard http://ec.europa.eu/competition/state_aid/studies_reports/studies_reports.html

[37] It is noted that the Commission does not have statistics on State aid granted under these approved schemes specifically for the shipbuilding sector. The only source of information in this respect is the Member States. The public consultation included a clear question on aid given to shipbuilding under different instruments. However, there were very limited replies on aid granted outside the Shipbuilding Framework. E.g.: Germany and Spain have approved RDI schemes for the industry, as reported by their reply to the public consultation. In the period 2004-2010, Germany granted EUR 9.24 million to the Shipbuilding under the general RDI rules. Germany also reported that overall, that support granted under the Framework represented 85% of all aid to the shipbuilding sector, whereas 15% thereof was granted under the general rules.

[38] State aid No. C 18/2005.

States under the Shipbuilding Framework. France also granted restructuring aid to one shipyard in the amount of EUR 26 million. The Commission also ordered recovery of past illegal and incompatible aid from two other Polish shipyards, Gdynia and Szczecin, concerning an amount of over EUR 3.3 *billion*.[39]

Moreover, some Member States have also the so called "non-aid" guarantee schemes in place that allow them to grant guarantees on loans to shipyards under market conditions and therefore not involving State aid.

The limited amounts of aid granted to the industry under the Shipbuilding Framework (i.e. 0.095% of aid given to the manufacturing sector) question the importance of maintaining a special Framework for this industry.

The following paragraphs examine each separate provision of the Shipbuilding Framework, in the light of how they were used and the issues they have raised, as well as the need or not for modifications of these rules.

3.4.2. The Product concerned

The Shipbuilding Framework concerns aid for the building, repair or conversion of "self-propelled seagoing commercial vessels" which means both vessels for the transport of goods and/or passengers, as well as tugs and vessels for the performance of a specialised service (for example, dredgers and ice breakers). This product coverage was inherited from previous State aid regimes. The revision process of the current Framework and the present Impact assessment report give the opportunity to revise the scope of products covered by the Shipbuilding Framework.

In particular, the representatives of the EU shipbuilding industry, supported by some Member States, requested the Commission to enlarge the product coverage of the Framework as the industry's product portfolio has diversified in recent years from self propelled sea-going commercial vessels to "*floating and movable offshore structures*" for exploring marine resources. Here the imminent development of off-shore wind energy must be noted. In addition, it was proposed to also include *inland waterway vessels*. Two Member States also requested the extension of the rules to cover *fishing vessels built for export*. This issue is mainly relevant for the application of innovation aid that allows aid for building prototype vessels.

According to CESA, the revised definitions (offshore structures + inland waterway vessels) would enable an additional average annual production volume of ca. EUR 1 billion to be covered[40], of which three quarters would relate to inland navigation which is characterised by production of larger series compared to sea-going vessels. The frequency of prototype production eligible for innovation aid is assumed to be lower. The potential aid volume resulting from the proposed enlarged definition would remain below 1% of the additional production volume.

The Commission notes, on the one hand, that the inclusion of "offshore structures" might increase the risk of distortion among companies. Offshore structures are produced by shipyards

[39] State aid No. C 17/2005 and C 19/2005.
[40] Thus according to CESA this would be the additional production volume which is currently not covered by the Framework but would covered in case the scope is extended as requested.

but also by companies that do not produce vessels and which are not covered by the Shipbuilding Framework. Indeed, the beneficiaries of the aid under the Framework are mainly shipyards and related entities, except as regards the granting of export credits where the aid is given to ship-buyers. Extending the scope to cover offshore structures might thus lead to additional distortions of competition in the internal market. Further, offshore structures are already produced in the EU without innovation aid[41].

On the other hand, several Member States indicated that offshore structures are an important market segment for the future of the EU shipbuilding industry as the EU industry is increasingly focusing on more specialised products types, given the difficulties of competing on the standard vessels market, which is dominated by Asian producers. Given the general overcapacity in the market and the possibility of shipyards of producing several types of vessels, it cannot be excluded that also these market segments are potentially affected by the overcapacity situation. Indeed, the indications received from the industry are that the rationale underpinning sector specific rules, namely overcapacity (for regional aid) and incapacity of using horizontal rules on research development and innovation due to the imperative of product commercialisation (for innovation aid) can also be considered to apply to these market segments. Nevertheless, the inclusion of offshore structures under innovation aid should be limited, in any case, to 'ship-like' offshore structures in order to limit discrimination with regard to offshore engineering companies that are not subject to the rules of the Shipbuilding Framework.

As regards inland waterway vessels, the latter are part of the industry's traditional portfolio. The reason why they were so far not included in the scope of the Framework may be linked to the fact that they were not exposed to global competition, a fact that according to the available information appears to be now changing.

As regards fishing vessels, even if built for export, maintaining the prohibition of aid is in line with the Commission's State aid policy[42] prohibiting aid for the construction of fishing vessels and the problems of excess fishing capacity worldwide and the EU policy to reduce the fishing fleet[43].

For completeness, it is also noted that the rationale underpinning specific State aid rules for shipbuilding (i.e. specific aid for shipyards, which are the main beneficiaries under the Shipbuilding Framework) does not apply to the supplier market, which is not characterised by overcapacity (the rationale for regional aid) or by the imperative of product commercialisation (the rationale for innovation aid). Hence, the specific State aid rules only apply to shipyards.

[41] Ecorys p. 64.

[42] Commission's Guidelines regarding State aid to fisheries and aquaculture

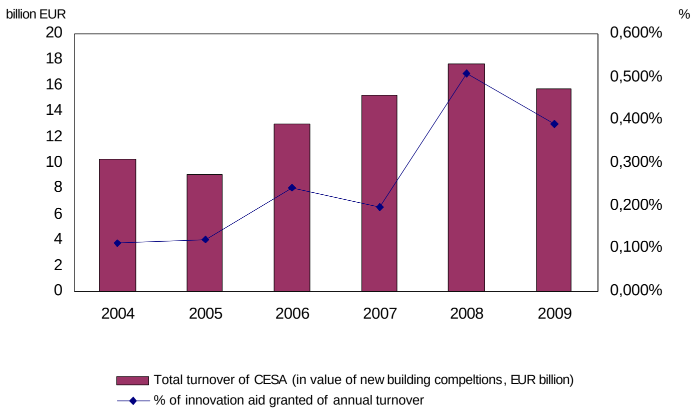
[43] Since January 2003, the EU has imposed Member States to respect a very strict entry-exit, as laid down in article 13 of Council Regulation 2371/2002 and articles 6 and 7 of Commission Regulation 1438/2003.

3.4.3. Innovation aid

3.4.3.1. The use of innovation aid

The total amounts of innovation aid have increased over the years since the entry into force of the Framework, however they remain rather limited[44] compared to the industry's turnover, as shown by the graph below.

Figure 3: The industry's annual turnover and % of innovation aid granted



Source: CESA figures and Commission's own data

<u>On average, in the period 2004-2009, the total amount of innovation aid was less then 0.3% of the industry's turnover</u>. As regards the number of beneficiaries in each Member State, the situation is uneven: in Finland and Italy, there was only one beneficiary shipyard in each Member State. France granted innovation aid to 2 shipyards; and Germany, Spain and the Netherlands to more than 10. The *average* individual grants are below EUR 1 million for France and Spain and in the range of EUR 1-1.5 million for Germany, Italy and the Netherlands. Only Finland granted a significantly higher amount for one specific cruise vessel project.

However, it is noted that the impact of the aid on each specific project also varies considerably: for example, in the above case of the cruise vessel built in Finland, the aid only represented about 2% of the overall cost of the project, whereas in Spain, the aid accounted *on average* for about 16% of the overall cost of the vessels.

Despite the relatively low amounts of innovation aid, the EU industry is today highly specialised.

3.4.3.2 Reasons for applying innovation aid

(a) <u>The general rules are not perfectly suited for shipbuilding</u>

Innovation aid was tailor-made for this industry. Thus, the rules allow aid for the "*industrial application of innovative products and processes, i.e. technologically new or substantially improved products and processes compared to the state of the art in the Union which bear a risk*

[44] The Commission approved 7 schemes and one individual aid grant, totalling 166 individual grants based on the information reported by Member States to the Commission.

of industrial or technical failure". Innovation aid is partly justified by the fact that the possibility of using the general State aid rules for research, development and innovation (RDI Framework) for shipbuilding is more limited than with regard to other industries. Thus, unlike in other industries, ship prototypes are generally produced in short series of 2 to 5 maximum. Part of the "research" may be embedded in the production of the ship which means that that the "innovation" is only tested when the vessel is completed and in operation. In addition, given the size and cost of building a vessel, the prototype is usually the final commercial product. Given that under the general RDI Framework, the aid is normally not allowed for prototypes sold commercially (or only under specific conditions) the scope for using the RDI framework for shipbuilding is rather limited. "Innovation aid" aims to make-up for this gap by allowing that the aid is given for the construction of prototypes that are sold on the market.

(b) The "competitiveness issue"

In addition, it is claimed by the industry that innovation aid is a means to counter unfair competition from outside Europe. As explained before, the EU industry has lost considerable market share to Asian competitors, in particular in the standard market segments. There is concern among the industry that with time Asian competitors will take over the more specialised market segments as well. There is a perceived need for this industry to *"innovate faster than can be copied"* and innovation aid is considered by the industry and by most Member States with a significant shipbuilding industry to help accelerating this process. Indeed, protection of intellectual property and widespread copying is a severe problem in this industry. Protection of the intellectual property in the innovation is difficult under these circumstances.

Also, according to CESA the EU industry cannot compete on labour costs[45]. In fact, labour costs typically account for ca. 20% of the overall production costs. It has to be noted, however, that the low labour costs differences is rather focused on China and the emerging shipbuilding nations (such as India, Vietnam and the Philippines). South Korean and Japan, on the other hand, do not really have significantly lower labour costs. Due to the high specialisation of the European industry in the high value added segment of the market, labour costs seem to be less of an issue for shipbuilding in Europe. In addition, the price of steel is a determining factor in the price of a vessel, the steel prices being clearly higher in Europe than in Asia.[46]

However, the Commission must also ensure that innovation aid is compatible with the internal market, following Treaty principles.[47] In fact, the competitiveness situation of the EU industry does not in itself justify special rules, in particular since experience has shown that providing (operating) aid to the EU shipbuilding industry in order to counter unfair subsidies given by others will not foster the long-term competitiveness of this industry. However, there is a need for the EU industry to continuously innovate in order to remain competitive on the world market. In this sense, the competitiveness situation justifies special innovation aid rules, in so far as the general rules on aid for research development and innovation do not cater for the specific needs of this industry.

[45] According to the Maritime Cluster study (p. 16), non-EU competitors indeed often rely on lower labour costs.

[46] Ecorys, pages 12-13.

[47] Article 107(1) TFEU.

The competitiveness problems of the EU shipbuilding industry seem to relate to a variety of factors. Adequate incentives may be necessary to promote innovation, while safeguarding competition in the internal market.

3.4.3.3 Effectiveness of innovation aid rules

Based on the expert analysis with regard to the application by Member States of innovation aid, (see section 2.2.4 above) each project assisted by innovation aid is likely to have a positive effect on fostering high skills and know how, thus contributing to the specialisation of the shipyards. More than half of the 98 projects assessed were judged to have a positive impact on the environment and on social conditions (lower emission and better safety conditions for the worker and/or the crew).

On the other hand, based on this study not all projects can be considered as real innovation in the terms defined by the Shipbuilding Framework (see 3.4.3.2 paragraph (a)); some projects have aspects that are innovative and others that are not; aid is sometimes given more than once for the same innovative element; the "incentive effect" of the aid is also in many instances questionable, as projects would go ahead with or without aid; the notion of prototype, described as "the first vessel in a potential series of vessels" is too wide and can lead to innovation aid being granted for a project that is a mere development of an existing design. These conclusions also point to a problem with the way the rules are applied and concur with the Commission's initial internal analysis during the 2007-2008 review of the Shipbuilding Framework.

When used, innovation aid may bring tangible effects to the specialisation of the shipyards, but not always to innovation in the sector.

3.4.3.4 Possible modifications to the rules

Introduction of thee incentive effect: In the light of the assessment above, the Commission considers that there may be a need to improve the existing innovation aid for shipbuilding by introducing an explicit requirement of the so called "incentive effect".

Clarification of the notion of prototype: The Commission, for the purposes of authorising innovation aid schemes for the Member States, has developed a definition of *prototype vessel* for which the aid can be given by the Member State. The prototype is described as *"the first vessel in a potential series of ships"*. The report from the external consultant shows that this definition is interpreted by Member States with very wide discretion and that any improvement of an existing design is currently considered as a prototype.

Codifying existing criteria: Finally, certain criteria for approving the aid (such as the need for certification of the innovation by an independent expert and the eligible costs) have been consistently used by the Commission for assessing the compatibility of innovation aid schemes but have not yet been formalised.

3.4.4. Regional aid

Under the general regional State aid rules, regional aid is allowed for investments that promote the economic development of certain disadvantaged regions. The aid promotes the expansion and the diversification of the economic activities of enterprises located in less favoured regions, in particular by encouraging firms to set-up new establishments there.

However, the stricter regime on regional aid that currently applies to shipbuilding aims to prevent aid to create new capacities in an industry with cyclical overcapacity[48]. It also sets lower aid ceilings than in the general rules. Contrary to what is allowed for other sectors under the general regional aid guidelines, State aid for setting up new yards or new capacities is thus not possible under the current provision in the Shipbuilding Framework, the aid being limited to modernisation investments.

The rules have not led to problems in their application[49]. A total of EUR 34 million of regional aid was granted in the period 2004-2009, mainly by Spain, Germany and Greece (the latter in only one case). For comparison, since 2007 *the automobile industry* has received more than *EUR 800 million* of regional aid.

The Commission notes that global overcapacity in this sector is higher than ever, although overcapacity is less prevalent in the non-conventional market segments in which the EU industry has specialised. Shipyards can build many types of different ships and it may be artificial to examine the issue of overcapacity according to different market segments. It cannot be completely excluded, that if the stricter regime was abolished, State aid would be used in certain instances for investments in new capacity (e.g. in new dock(s)) which could potentially aggravate the overcapacity problems and create additional distortions of competition within the internal market. On the other hand, from a global market perspective, given the very low market share of the EU industry, any increase in capacity within the EU would only have a marginal impact on the global market.

Member States have expressed mixed views on this issue: those which have shipyards in assisted regions (e.g. Spain) are in favour of relaxing the rules by aligning regional aid to shipbuilding with the general aid rules, those which have not (e.g. Finland, the Netherlands) prefer maintaining the current more strict approach.

As regards regional aid, it can be questioned whether the stricter rules as they stand are sufficient to support investments the European shipbuilding industry. On the other hand, the Commission must assess what would be the impact on competition in the internal market if stricter rules were allowed to expire and shipbuilding becomes subject to the general rules.

3.4.5. Closure aid

Closure aid is a specific aid instrument to defray the normal costs resulting from the total or partial closure of the shipbuilding activity. It is aimed at facilitating the removal of excess capacity in a sector suffering from overcapacity.[50] Closure aid was never used under the Shipbuilding Framework.

[48] New shipbuilding capacity has mainly been generated in Asia (South Korea, Vietnam, China, Philippines).

[49] The Commission, in a number of decisions clarified that this provision is to be interpreted in the sense that mere capacity increases, which are not linked to a productivity increase are not eligible for aid.

[50] Closure aid is presently also allowed to the coal industry. However, these are different industries and the rules pursue different objectives.

This provision has existed in the shipbuilding rules at least since 1990 and was integrated in these rules within the overall purpose of promoting the restructuring of the sector. The provision has transited to the subsequent 1998 Council Regulation, and then to the current Framework. The Commission has in the meantime approved specific guidelines for the rescue and restructuring of firms in difficulty. These guidelines have been systematically used in recent cases of restructuring of shipyards. In addition, closures of yards have taken place through the years without aid. Under the 1998 regulation, closure aid was only used in four cases, and it was never used under the current Framework. There is therefore almost no experience as regards the efficiency (or not) of the rules. The conditions under closure aid are less restrictive than those under the general rules. Although closure of shipyards may still be necessary in the face of the current economic crisis, there are no elements to suggest that a special provision is still necessary for that purpose. Nor is there any experience to provide guidance on whether and how the closure aid provision as such should be modified.

The fact that closure aid was not used may reflect Member States' reluctance to give aid to close shipyards (as indeed it is a prerogative of Member States to decide whether or not to use aid) combined with a period of high demand, where shipyards had full order books. In addition, as explained below closure aid can be usefully replaced by general State aid rules.

The closure of a shipyard can have negative consequences for employment. Hence, under the closure aid instrument, in case of *partial closure* of the shipyard, aid can be given for example, to cover costs of workers who are made redundant or the costs of counselling services / vocational retraining to workers, as well as costs related to the redevelopment of the yard, for use other than shipbuilding. In case of the *total closure* of the installations, aid for working capital needed to enable the undertaking to complete unfinished works can also be given.

The Commission notes that in the absence of this provision, Member States could still grant aid under other general State aid instruments that pursue the same objectives as closure aid. For example, under the general State aid rules regarding the restructuring of companies in difficulties, all restructuring costs can be covered subject to certain criteria designed to limit the negative impact of the aid on competition.). Moreover, shipyards can also receive aid for the training of their employees under the general rules. In addition, measures to support training and payments granted directly to the employees might not fall within the State aid rules at all, in case they only benefit the employee and not a company as such.

It is also noted that closure aid can be rather distortive for competition in the internal market (in particular partial closure aid), because it does not foresee any of the strict conditions for granting aid under the Rescue and Restructuring guidelines that are designed to limit the impact of this type of aid on competition (demonstration of long-term viability of the restructuring plan, obligation to give compensatory measures to competitors - e.g. in the form of production restrictions -, contribution by the beneficiary to the financing of the restructuring costs. Experience has indeed shown that the restructuring of shipyards is either done under the rescue and restructuring guidelines or with the help of EU Globalization Fund, to help workers adjust to new functions. Finally, companies that are not in a strict sense in difficulties should be able to restructure without aid.

It is questioned whether there is a need to keep an aid instrument that was never used.

3.4.6. Export credits and development aid

The provisions on export credits and development aid reflect the international OECD Arrangement on Export Credits and the Sector Understanding for Ships.

Export credits: these rules concern in fact minimum credit terms determined according to specified criteria (the "Commercial Interest Reference Rates") which OECD members are committed to respect for providing financing support (in the form of e.g. loans or guarantees) to export transactions. The purpose of these rules is to maintain a level playing field among OECD members when they grant financial support for export transactions.

Legally, the OECD Arrangement was transposed into EU law under Article ex-133 EC Treaty (today 207 of the Treaty on the Functioning of the European Union, hereafter: "TFEU")[51]. It is a trade measure, falling within the common trade policy of the EU towards third countries and concerns export transactions between the EU and third countries. The Commission's primary objective in this area is to ensure full compliance to the OECD rules and thus a level playing field across the sector in the EU. In case export credits are used regarding intra EU-trade, these measures can involve State aid. In this regard the Commission has not considered it a priority to scrutinise in detail the territorial application of the Member States' schemes. In case of a complaint the Commission will deal with it according to the obligations stemming from the Court's jurisprudence.

This issue is wider than for shipbuilding, since the OECD rules apply to almost all sectors, but the Shipbuilding Framework is in fact the only State aid instrument where the Commission formally confirms that credit facilities given to ship buyers may be compatible aid if complying with OECD rules[52]. This export credit rules existed already in the previous (Council regulated) State aid regimes for shipbuilding. It is considered by some stakeholders to bring transparency as to the application of export credits to shipbuilding.

Development aid: this is financial support directly given to the Government of an emerging country (listed in the OECD agreement) for "development purposes"[53]. It is called "tied-aid" because the country providing the financial support is also the country that produces the product. As in the case of "export credits", the OECD rules on development aid do not only apply to shipbuilding, but the Shipbuilding Framework "inherited" this provision from previous State aid regimes. The Framework adds a condition for development aid to be authorised (which is not part of the OECD rules) which is that "*the offer of development assistance must be open to bids from different yards*" and EU public procurement rules must be respected where applicable. These

[51] The last version of the OECD Arrangement into force in the EU is the version which was transposed in the ex-Community legal order by the Council Decision of 22 December 2000 replacing the Decision of 4 April 1978 on the application of certain guidelines in the field of officially supported export credits, O.J. L 32, 2.2.2001, p. 1. This decision will probably be replaced sooner or later as there is a pending proposal from the Commission in that sense (Proposal for a Council Decision on the application of certain guidelines in the field of officially supported export credits, COM/2006/0456 final).

[52] Under the Framework, aid to shipbuilding in the form of State-supported credit facilities granted to *national and non-national ship owners* or thirds parties *may* be deemed compatible if it complies with the terms of the 1998 or any subsequent OECD Act.

[53] The OECD Arrangement supplies a list of eligible developing countries. For instance, Netherlands granted development aid to Ghana for the supply of two tugboats. The two ships were delivered by Damen Gorinchem shipyard for the contract price of EUR 9 million. On this amount, 35% (ca. EUR 3 million) was given as an aid element to the Government of Ghana.

conditions aim to limit the impact of the measure on competition, by allowing for the most efficient yard (within the Member State concerned) to win the contract.

Regarding export credits, the Commission approved notified schemes for 5 Member States. The *reported* export credits granted amounted to as much as EUR 8.2 billion; this, however, is the total of the guaranteed amounts and soft loans and hence does not represent the aid element itself, which can be only determined on a case by case basis. The Commission's assessment of these notifications is limited to ensuring that international OECD rules are respected. With regard to development aid, EUR 37 million[54] were granted in the period referred to above to the governments of emerging countries.

It is questioned whether it is justified to formally maintain a special treatment for shipbuilding, whereas the OECD arrangement also applies to other sectors.

3.4.7. Employment aid

The provision on employment aid requires Member States to notify to the Commission their intention to grant aid for the creation of employment. The Commission would then examine whether the aid could be authorised under the (now) expired Employment Block Exemption Regulation that regulated employment aid to all sectors[55]. Shipbuilding is currently eligible (as all other sectors) for aid in relation to the employment of disadvantaged and disabled persons under the general rules (i.e. General Block Exemption Regulation[56]) that replaced the extinct text mentioned above. The specific provision on employment aid has never been used since the entry into force of the Framework, the exact reasons are unknown.

It is questioned whether to maintain employment aid that was not used and is no longer allowed for other sectors.

3.4.8. Request for new environmental aid to shipyards

In the reply to the public consultation, various parties[57] also requested the introduction of practical provisions regarding aid for the development of environment friendly products, because – they claimed – the horizontal rules regarding aid for environmental purposes[58] are not used by the shipbuilding industry.

In addition, in 2015 there will be new compulsory sulphur emission standards in the fuels used in ships. Although this issue concerns primarily the shipping industry which will be accountable for complying with these standards, it is conceivable that aid to shipyards could help achieve this objective.

[54] Mainly granted by The Netherlands.

[55] Commission Regulation (EC) No 2204/2002.

[56] Commission Regulation (EC) No 800/2008.

[57] The EU industry representatives –CESA, the European Economic and Social Committee and the Social Dialogue Committee, aw well as Italy.

[58] Community Guidelines on State aid for Environmental Protection (hereafter: "Environmental guidelines") and the General Block Exemption Regulation.

Under the general environmental guidelines aid for retrofitting of existing ships or less emissive new ships can be given to ship owners (for ships in a EU register[59]) but not to shipyards[60]. According to the EU shipbuilding industry, this provision is hardly ever used. The industry claims that one of the reasons might be that it is unattractive for a Member State to give aid for an investment that is most likely to be carried out in a third country, where the project will be less costly. Therefore, according to the EU shipbuilding industry an alternative would be to channel the environmental aid through the shipyards which could also serve "competitiveness objectives" i.e. help the EU industry win contracts against non-EU competitors that receive subsidies and at the same time maintain employment in the EU.

The environmental guidelines have been used in the shipbuilding sector in particular for inland navigation.

The aid would be a form of "operating aid", as it would pay for the costs (linked to adapting the vessel to the environmental requirement) that should normally be borne by the shipyard. This type of aid has a direct impact on price and thus, on who wins the contract, therefore risking to severely distorting competition within the internal market. As for environmental aid, there are currently two ongoing studies in the Commission that address issues linked to market failures for greening the maritime transport sector[61]. The discussion on this subject can only therefore be very limited at this stage.

Further, assuming that a market failure exists as regards the implementation of "greening" objectives in the maritime sector, in the light of the Treaty's general prohibition of State aid it would still need to be determined that State aid, and specific State aid to shipyards is the most appropriate instrument to address this problem. In this regard, it should be underlined that State aid, (such as environmental aid to shipyards) can lead to more contracts and other benefits, but also leads to economic imbalances between shipyards that receive aid and those that do not.

The Commission must assess the need for new environmental aid provisions, in the light of existing rules and the principles underlying environmental aid.

3.5. Who is affected and how?

Shipbuilders throughout the EU and potentially their employees, Member States and regions where shipbuilding activities are located are directly affected by the rules. The direct effects on individual shipyards are extremely difficult to quantify. Firstly, there is a very wide range of beneficiaries all over Europe, with different product portfolio. Innovation aid has a greater effect on shipyards with an innovative portfolio, however, potentially all shipyards can produce innovative models. Shipyards located in assisted regions can benefit from regional aid, as opposed to shipyards that are not in assisted regions, but this situation is not different from other

[59] Similar provisions exist in the Community guidelines on State aid to maritime transport – Article 5, investment aid.

[60] The following is allowed: aid for the acquisition of new transport vehicles which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards – Article 19 of the General Block Exemption Regulation and chapter 3.1.2 of the environmental aid guidelines. In addition, these guidelines allow aid for more environmentally friendly construction process (e.g. energy savings at the shipyards).

[61] "Green Growth in the EU shipbuilding sector" (DG ENTR) and "Analysis of market barriers to cost effective GHG emission reductions in the maritime transport sector (DG CLIMA).

sectors. Moreover, the Shipbuilding Framework is an aid instrument which gives the opportunity to Member States to grant aid, but not necessarily mean that Member States will make use of it.

Potentially, the equipment suppliers (in case they are contributing to a substantial part to the value of the vessel) and subcontractors[62] may be also indirectly affected, although there is no concrete quantifiable evidence of the impact of the rules on these players. The rules can also have an indirect effect on ship owners as well, insofar as innovation aid in particular, may affect the price of vessels.

Finally, third countries and international competitors are also potentially indirectly affected.

This impact assessment will focus on the *direct* effects subject to the limitation explained above.

3.6. Is EU action justified on the basis of subsidiarity?

State aid control falls under the exclusive competence of the European Commission.

In particular, Article 107 TFEU defines the notion of State aid and a general prohibiton thereof. Moreover, this Article provides for exceptions under this general prohibition of State aid, by defining the so called compatibility criteria. Article 108 TFEU gives the Commission exclusive competence over State aid control.[63]

4. Objectives

The main objective for the review of the Shipbuilding Framework is to determine whether sector specific rules are still necessary or whether the sector could be subject to the common rules. In addition, this review must be seen in the wider context of the EU's policy of the sector as well as EU's State aid policy objectives.

4.1. General objectives

4.1.1. The EU's policy objectives for shipbuilding

In its Communication LeaderSHIP 2015 of 2003[64], the Commission set out its long-term strategy for the Shipbuilding and ship repair industry. Of relevance to the present assessment, the Communication recommended the development of appropriate innovation aid rules as part of package for promoting research, development and innovation in the sector, and considering that the general State aid rules in this area are not perfectly suited for this sector.

LeaderSHIP 2015 also emphasised the importance of a "level playing field in world shipbuilding", as well as the promotion of efficient shipbuilding financing mechanisms and of safer and more environmental-friendly ships.

[62] The turnover of the global marine equipment industry (commercial shipbuilding) is estimated at EU 21 billion, out of which Europe has an estimated share of 36%. (By comparison, the EU shipbuilding industry has a worldwide share of only 5%, as shown above.)

[63] With the exception of the very limited circumstances when the Council may act.

[64] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2003:0717:FIN:en:PDF.

4.1.2. The EU's general policy objectives for State aid

The review of Shipbuilding Framework must be seen in a wider policy context, especially the objectives pursued by the State Aid Action Plan[65] (hereafter "SAAP"). In general terms, the aim of the announced State aid reform is "less and better targeted aid, a refined economic approach, more effective procedures, better enforcement, higher predictability and enhanced transparency as well as shared responsibility between the Commission and Member States (…)". In particular, the SAAP explicitly foresees that the "Commission will decide whether a Framework for state aid to shipbuilding is still needed or if the sector should simply be governed by horizontal rules."

The SAAP also reflects the general objectives of State aid policy, which aim to ensure a level playing field for all undertakings operating within the Internal Market. In this sense, State aid policy is a not a suitable instrument for addressing sector specific industrial policy objectives, such as those defined in LeaderSHIP 2015.

4.2. Specific objectives

In the light of the general objectives above, the review of the Framework should lead to:

- Limiting sector specific rules (including the abolition of rules that are not used) in line with the objectives of coherence and simplification.
- Improving the effectiveness and transparency of State aid rules, in particular as regards aid for the promotion of innovation, while limiting distortions of competition. "Effectiveness" in this context means less and better targeted State aid, i.e. achieving the same objective with less amounts of State aid.
- Promoting research, development and innovation in the sector.
- Promoting regional cohesion objectives, i.e. the economic development of disadvantaged regions, while taking into account the specificities of the sector.[66]

5. Policy options

As mentioned above, the Shipbuilding Framework is a mix of specific provisions applicable to the industry which form an exception from the general rules. For each of these provisions, three different ways forward might be possible: (i) prolongation of specific rules, (ii) expiry of the specific rules, or (iii) prolongation in a modified form. The following policy options with regard to the future of the Framework are examined:

5.1. Option A: Baseline scenario - Prolong the existing specific rules

Under this option the specific rules (i.e. the entire Shipbuilding Framework) would be prolonged without modification. It has to be noted, however, that although a majority of stakeholders asked to prolong a separate Framework for shipbuilding, initially there were no requests to just prolong

[65] COM(2005) 107 http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0107:FIN:EN:PDF.

[66] This may simply mean keeping stricter regional aid rules until the general rules are revised in 2013, when integrating regional aid to shipbuilding rules will have to be assessed.

the Framework in its current form (Italy and Spain later made this request during the multilateral meeting of 13 September 2011– see Annex VI).

This option is partly in line with the specific objective of promoting research, development and innovation in the shipbuilding sector because it maintains the current innovation aid provisions. However it goes against the objective of limiting sector specific rules and improving effectiveness and transparency of the rules, as it maintains unchanged the innovation aid provisions as well the types of aid that were not used (closure aid, employment aid).

5.2. *Option B: Specific rules expire*

This option would imply that the specific provisions contained in the Shipbuilding Framework expire on 31 December 2011 and the general rules become applicable.

This option is fully in line with the specific objective of limiting sector specific rules but does not take into account the specificities of the sector s regards in particular regional aid and innovation aid.

5.3. *Option C: Modified rules*

This option takes the approach that any combination of the specific provisions of the Shipbuilding Framework is possible, as the provisions are not interrelated (i.e. different types of aid concern different eligible costs, they are not mutually exclusive etc.). This report assesses two different sets of modified rules.

5.3.1. Sub-option C(1): Special rules kept for innovation aid, regional aid and export credits, with an extended scope

Option C1, where innovation aid (slightly amended), export credits and regional aid are kept in the Framework and the product scope is extended, is considered to be the most appropriate in the light of the objectives of promoting innovation and improving the effectiveness of innovation aid rules.

In particular, the **modified innovation aid rules** would incorporate **incentive effect**, i.e. explicit requirements whereby aid can only be granted when it leads to a change of behaviour of the beneficiary, as well as reporting obligations as regards the assessment of the incentive effect. The concept of incentive effect is a general principle that is applied in State aid control. Following the indications from the external consultant that some projects could have been completed without aid, it is considered necessary to address this issue by specifically including requirements for Member States to ensure that the aid is determinant for the shipyard to sign the shipbuilding contract. The criteria proposed for assessing the incentive effect are the same as contained in the general rules, i.e. the incentive effect can be assessed by an increase in any of the following: size, scope, amounts spent or speed of the innovation aid project

Moreover, the **notion of prototype** would also be clarified in order to ensure that "any first vessel in a potential series of ships" only qualifies as a "prototype" if it is innovative *by comparison to the state of the art in the Union and bears a risk of technological or industrial* *failure*. This improved definition of prototype addresses a concern of the external consultant whereby the notion of prototype was sometimes misused in the past.

With regard to the **codification of existing "informal criteria"**[67], some of these rules could be officially integrated in the new innovation aid rules in order to ensure transparency. Since this is merely codification of the currently applied rules, no assessment of the impact of the integration of these criteria is required.

Finally, **the scope of the specific rules would be extended to** certain types of **offshore structures as well as inland waterway vessels**.

In addition, the Commission notes that both the general regional aid guidelines and the framework on State aid for research, development and innovation will be respectively reviewed in 2013. Under this option the provisions on regional aid and innovation aid would be integrated in the horizontal rules following their revision.

5.3.2. Sub-option C(2): Framework prolonged and extended

Option C2, on the other hand, reflected essentially the preference of the EU shipbuilding industry, which mainly consists in keeping the provisions that are more favourable (or neutral) by comparison to the general rules and abolishing the others.

Under this option, the Framework as a specific State aid instrument for shipbuilding would be prolonged with the following amendments: the scope of the Framework would be extended (to inland waterway vessels and offshore structures) and a new environmental provision would be introduced for the promotion of the production of greener vessels. Innovation aid, closure aid and export credits and development aid would be maintained, whereas employment aid and regional aid would be abolished.

Since this option maintains most of the provisions unchanged (and extends them with a new environmental provision), it goes against the objective of limiting sector specific rules and improving effectiveness and transparency of the rules. On the other hand, the relaxation of regional aid rules would be in line with the objective of maximising the impact of regional aid on the economic development of disadvantaged regions.

5.3.3. Reasons for not assessing other options

With regard to the fact that no other options were examined, individually or on an aggregate basis, the Commission notes the following.

§ Among Member States there were varied opinions as to which rules should be maintained and which rules were no longer necessary, but there was not a prevalent opinion that would justify additional combined options.

[67] An informal set of rules for the implementation of the innovation aid provisions for shipbuilding regarding, in particular, the eligible costs and the certification of the innovative character of the project was developed in conjunction with the industry and has been applied by the Commission in its decision-making practice.

- Some of the individual options proposed by the consultant regarding innovation aid were dismissed as they relate essentially to the enforcement of the rules. In particular, verification of the independence of the expertise is a responsibility of the Member State and there are no viable ways for the Commission to centrally assess the innovative character of the project in the place of the experts designated by Member States. The option for recovery of innovation aid (which was also suggested by the Danish Maritime Association) could, in practice, annul the objectives of the aid. Given the very low profit margins of EU shipyards, if they would have to reimburse the aid after a second application of the innovation, they might be discouraged from producing the first innovative vessel in the first place.

- The report also dismissed outright any options for revising the closure aid provision, because there is no experience on the basis of which to assess how the rule should be modified and, furthermore, there were no proposals in this regard. The option of an environmental top-up to innovation would to some extent raise similar considerations as explained in this report with regard to innovation aid to shipyards, with a foreseeable additional positive impact for environment. The options regarding different periods of application of the framework are not likely to lead to different impacts and would in any event be difficult to assess in any meaningful way; these options were therefore also not assessed.

5.3.4. Summary of assessed options

Table 3: Summary of assessed options

	Option **A** **Rule prolonged** *Baseline scenario*	Option **B** **Rule expires**	Option **C** **Modified Rules**	
			Sub-option **C(1)** **Special rules kept only for innovation aid and regional aid**	Sub-option **C(2)** **Framework prolonged and extended**
Type of specific provision				
(1) Innovation aid	Prolongation	Expiry, general State aid rules apply	Modified rules	Prolongation
(2) Regional aid	Prolongation	Expiry, general State aid rules apply	Prolongation	Expiry, general State aid rules apply
(3) Closure aid	Prolongation	Expiry, general State aid rules apply	Expiry, general State aid rules apply	Prolongation
(4) Employment aid	Prolongation	Expiry, general State aid rules apply	Expiry, general State aid rules apply	Expiry
(5) Export credits	Prolongation	Expiry, general State aid rules apply	Prolongation	Prolongation
(6) Development aid	Prolongation	Expiry, general State aid rules apply	Expiry, general State aid rules apply	Prolongation
(7) New Environmental aid	Current general rules apply	Current general rules apply	Current general rules apply	New environmental rule
Extended scope of the Framework	Current scope	Not relevant	Extended scope – offshore structures, inland waterway vessels	Extended scope – offshore structures, inland waterway vessels

6. Impact of the various options

For reasons of simplicity, this report will assess the impact with regard to each component (i.e. specific provision) on a stand-alone basis and not for the Framework as a whole.

The two principle options, i.e. prolongation of the current rules on the one hand (Option A, baseline scenario) or alternatively expiry of the rules on the other hand (Option B), are "symmetrical". The positive impacts of one option are identical to the negative impacts of the alternative option. Therefore, the assessment below will first concentrate on the pros and cons of the expiry of the rules against the prolongation. Subsequently, the Commission will assess the impact of modified rules against the baseline scenario.

6.1. *Impact of expiry of the rules (Option B) in comparison to the baseline scenario, prolongation of the rules (Option A)*

6.1.1. Innovation aid

(a) Economic impact/ Impact on competition

If innovation aid expires, the shipbuilding industry can still continue to receive aid for research, development and innovation under the general rules ("RDI Framework")[68], which is already the case although with some limitations (see section 3.4.3).

The expiry of the specific rules is in line with the objective of having horizontal State aid rules. Further, innovation aid finances the production of innovative vessels which, as such, is close to "production aid" (so-called "operating aid"). Operating aid generally has a direct impact on price and thus, on who gets awarded the contract, implying that its distortive effects on competition among shipyards in the EU are also higher[69]. The Commission notes that there is no evidence available as to which extent innovation aid actually contributes to the innovation patterns of European yards. The information available suggests that the percentage of innovation aid compared to the overall costs of building the vessels varies significantly among Member States and projects.[70] In the reply to the public consultation no information was provided regarding the economic impact of innovation aid on the shipyards.

It can however be assumed that even without innovation aid shipyards in the EU would continue to innovate, because innovation is the only driver that allows market players to remain in the market. The report of the external consultant also stated that a considerable number of projects would probably also be carried out in any event without aid (though not necessarily by the same shipyard). This could be a justification for discontinuing innovation aid.

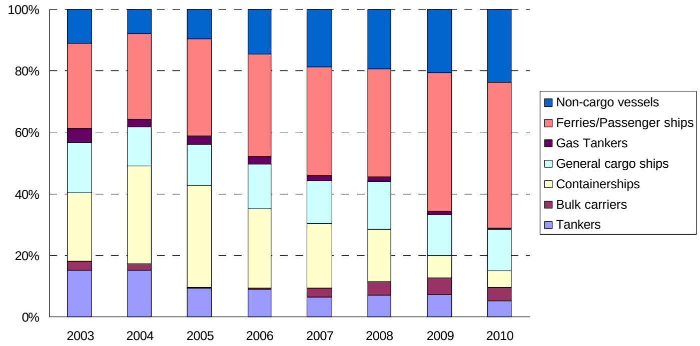
[68] Shipbuilding is eligible for aid under both the general framework on research, development and innovation and the innovation aid provision in the Shipbuilding Framework and some Member States make use of both instruments.

[69] In particular in the market segments with a strong EU presence such as cruise vessels.

[70] E.g.: in the reported projects by Spain in the period 2006-2007, innovation aid amounted on average to 16% of the total costs of the project. In case of Finland, 2% of the total costs of a large cruise vessel were supported by innovation aid. These percentages are not to be confused with the aid intensity (up to 20%) which is the percentage of innovation aid in relation to the *eligible* costs.

Figure 4 below shows that shipyards have increasingly specialised during the period of application of the Framework. It is noted that although the amounts of innovation aid granted during this period were rather limited (0.29% of the industry's turnover) they have also increased over this period[71].

Figure 4: Evolution of the share of orderbook by ship types in European shipyards (CGT)



Source: CESA figures

Given the low profitability of the industry (and the implied low profit margin of the projects), it can be reasonably assumed that in the absence of innovation aid some projects backed by this aid instrument would not materialise. This assumption is taken in view of the high financial and technical risks associated to innovation and prototypes.[72] In this regard, the European industry must be able to complete the project at a reasonable economic cost and innovation aid contributes to mitigating this cost and in certain cases possibly to winning the contract that would otherwise go to competitors outside of Europe. Innovation aid is thus seen by the industry and some Member States as an incentive for the EU industry to keep a front runner advantage in the global market, although this assessment must also take into account the general objectives of less and targeted aid of State aid policy.

(b) <u>Social impact</u>

Although innovation aid does not have a social objective, innovation in shipbuilding has a concrete social impact on project level, as reported by the external consultant. In particular, examples include improved crew safety and living conditions, improved passenger safety and accommodation, reduced vibrations, noise reduction. It also leads to improving crew skills, possibly involving further training and thus, the specialisation of shipyards. Although it is difficult to estimate the direct impact of innovation aid on employment, it cannot be excluded that if innovation aid ceased to apply this would lead to reducing the business of the shipyards with consequent potential negative impact for employment. However, since the projects funded through the innovation aid account for a limited share of the EU turnover, and that no spill-over effect on employment could be clearly identified between subsidised and non-subsidised products, the social impact on unemployment can be deemed not significant.

[71] See table 3 under section 3.4.3.1.

[72] In fact, the external consultant's report confirms that there are risks which can be associated to such projects.

(c) Environmental impact

Innovation aid increases the likelihood of innovative projects which in most cases carry an environmental benefit. Based on Member States' reports and Appledore's assessment of the implementation of innovation aid schemes, out of 98 projects assessed, at least 52% had a positive environmental impact. The beneficial environmental effects include reduced emissions from engines, reduced fuel consumptions, improved waste management systems, improved sanitary/sewage systems and ballast treatment facilities.[73]

Impact of expiry of specific rule vis-à-vis the baseline scenario: On the **positive side**, the expiry of innovation aid may lead to less distortion of competition among European shipyards and as a consequence to maintaining a level playing field among shipyards in the Union. (+) On the **negative side**, the absence of innovation aid might lead to fewer innovative projects (at least to a certain extent) (-), with forgone benefits for environment and employment (-).

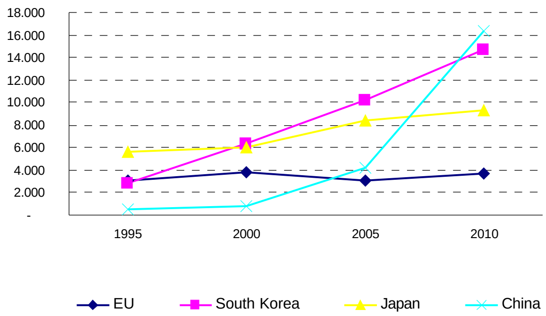
6.1.2. Regional aid

(a) Economic impact/ Impact on competition

Abolishing the stricter regional aid discipline would allow shipyards to receive aid under the general rules on regional aid, which would allow aid for investments for increasing the capacity of an existing yard and the setting up of new yards. The shift to the general rules would also imply an increase in the current maximum aid intensities allowed.

As far as the risk of regional aid being used for the setting up of new yards is concerned the experience of the past years has shown that the EU shipyards did not increase production capacity even during the boom years before the crisis. Further, the massive capacity increases that have been undertaken in Asia are likely to act as a deterrent for any capacity increase in Europe. It is also noted, that the enlarged scope of regional aid that would result from the general rules may help this industry to carry out the necessary investments in order to adapt to market changes, although no data was provided to demonstrate which investments are needed in order for this industry to adapt to market changes.

Table 4: Evolution of production capacity by Shipbuilding region, thousand CGT



[73] Two specific examples are: (i) a project with a design introducing the recovery of naphtha by draining the engines instead of disposing of the drainage products together with sludge plus a system for treating ash in the smoke from the onboard incinerator; (ii) a cruise ship with significant reductions in energy usage and fuel consumption leading to reduced emissions.

On the other hand the Commission notes that the higher the aid intensities allowed for a given project, the higher the potential that the aid distorts competition in the internal market because the aid will cover part of the investment costs of the shipyard, compared to projects by competitors that do not receive this aid.

In this respect, the switch from the specific regional aid rules to the general rules would allow shipyards to receive higher amounts of regional investment aid in certain cases. Thus, the maximum aid intensities allowed under the Shipbuilding Framework (currently 12.5% or 22.5%, depending on the region where the shipyard is located[74]) would become under the general rules 30, 40 or 50% (depending on the region) with possible top-ups of 10% for small and medium sized companies.

The Commission has compared the location of EU shipyards with the aid intensities for the respective regions and came to the conclusion that if the general rules applied to shipbuilding, only a very limited number of yards would fall within the 40%- or even 50%-ceilings. Most of the yards located in the regions eligible for regional aid would fall within the 30%-ceiling group. Finally, the number of yards located outside assisted regions is significant. These yards are already currently excluded from regional investment aid and the situation would therefore not change for these yards if the general rules applied.

On the other hand, in a very competitive sector such as shipbuilding where profit margins are limited, any small amount of aid can create a significant distortion of competition because of the economic advantage it gives to its beneficiary. It cannot be completely excluded, that if the stricter regime was abolished, State aid would be used in certain instances for investments in new capacity (e.g. in new dock(s)) which would potentially have a negative impact on competition in the internal market.

The Commission has experienced the relaxation of the regional aid rules in a different sector with overcapacity problems (automotive/car industry) which has led to regional aid being frequently used and to production overcapacity in the EU. In any event, since the general regional aid rules will be revised in 2013, it can be envisaged to maintain the existing rules for 2-years only and to assess the possibility of integrating shipbuilding in the general rules when these are revised.

(b) Social impact

From an equity perspective, the extended scope and aid intensities of the general regional aid rules applied to shipbuilding would maximise the objectives of the aid contributing to the development of the regions. Regional aid by definition serves and promotes the economic development of these areas. Shipyards are often important employers in coastal regions. New investments assisted by regional aid can potentially lead to increasing jobs. The rule could create an imbalance between Member States that have shipyards in assisted regions and those who have not, but the situation in this respect would not be different from that concerning regional aid to any other sector.

[74] The general principle under regional aid is that the aid intensities can be higher for regions that are less developed in order to encourage investments in these regions.

(c) <u>No environmental impact identified.</u>

<u>Impact of expiry of specific rule vis-à-vis the baseline scenario</u>: The expiry of specific regional aid rules would increase the potential for investments in shipbuilding that could have a **positive impact** on employment and the regions. (+) A **negative impact** on competition in the internal market cannot be excluded in a sector with global overcapacity. (-)

6.1.3. Closure aid

Closure aid could still potentially be a useful instrument to encourage the early closure of shipyards that are no longer economically viable and that keep "polluting" the market. However, as explained in the section "Problem definition", the objectives of closure aid can be replaced in most cases by other existing State aid instruments. Based on the replies to the consultation and the multilateral meeting, it does not appear that maintaining or not closure aid is crucial for a large majority of Member States (only Spain, Portugal and Italy wanted to maintain this provision in the Framework). Closure aid is more permissive than the general rules for granting aid for restructuring of companies in difficulties and can have rather distortive effects on competition Abolishing this provision would also be coherent with the objective of simplifying the rules.

<u>Impact of expiry of specific rule vis-à-vis the baseline scenario</u>: No significant economic, social or environmental impacts were identified. (~). If closure aid is maintained, it can have distortive effects on competition (-). If allowed to expire, other State aid instruments can be usefully used to replace it. Potentially, this provision could still be used in the future to close down economically non-viable shipyards, although experience has shown that its use is not likely. (~) Expiry complies with the objective of having general rules. (+)

6.1.4. Employment aid

The employment aid provision is a rule of procedure and not of substance and has never been used to grant aid to the industry. Moreover it has become obsolete due to the expiry of the general rules that previously allowed aid for the creation of employment. Based on the replies of the public consultation, there is consensus for abolishing this specific rule. Maintaining it would not be coherent with the general applicable rules that no longer allow this type of aid.

<u>Impact of expiry of specific rule vis-à-vis the baseline scenario</u>: No economic, social or environmental impacts were identified. (~) There is general consensus for abolishing this provision. Expiry complies with the objective of having general rules. (+)

6.1.5. Export credits

As regards the interaction between the OECD rules and State aid, the Commission has no specific general guidelines and as regards other sectors it normally takes a case-by-case approach. In this regard, in the reply to the public consultation, there was a preference from CESA, and later by Spain and Norway during the multilateral meeting, for keeping the export credit provision in the Shipbuilding Framework (the same request was not specifically made for development aid) in order to maintain legal certainty that the Commission will continue to see favourably the application of the OECD rules for the shipbuilding sector. On the basis of the text of the Framework, the Commission has in any event some discretion as to whether it authorizes or not exports credits that comply with OECD rules[75]. In fact, this is an issue that has to be addressed horizontally for the future. Maintaining or not these provisions in the Framework is not expected to have a significant economic, environmental or social impact.

Impact of expiry of specific rule vis-à-vis the baseline scenario: No significant economic, social or environmental impacts expected. (~) Expiry complies with the objective of having general rules. (+)

6.1.6. Development aid

The expiry of development aid provisions is likely to have limited impact because OECD rules would in principle continue to apply in any event. It is recalled that in the Shipbuilding Framework, these provisions contain a non-OECD condition, which is that in the EU the offer for development assistance must be open to different yards in the Member State providing the aid. In so far as this measure is only indirect aid to the shipyard, depending on whether or not the buyer passes on the benefit of the aid to the shipyard, the extent of the impact on competition of no longer applying tendering procedures within the Member States concerned is not possible to measure. There were no social and environmental impacts identified.

Impact of expiry of specific rule vis-à-vis the baseline scenario: No significant economic, social or environmental impacts expected. (~) Expiry complies with the objective of having general rules. (+)

6.2. *Impact of modified rules (sub-options under Option C) against Option A, baseline scenario*

6.2.1. Revised products coverage

As regards the extension of the rules to **inland waterway vessels**, this would result in an additional production volume of about EUR 750 million being covered by the innovation aid rules. However, the use of innovation aid to produce these vessels is likely to be limited given that they are produced in longer series compared to sea-going vessels. As regards the extension of the rules to ship-like "**offshore structures**"[76], this would result in an additional production volume of ca. EUR 250 million being covered by the innovation aid rules, according to CESA. Potentially, these products can be important for the future of shipyards, on the other hand, however increasing the scope of the Framework can also lead to distortions of competition between shipyards, that are the beneficiaries of the aid under the Framework, and other entities which are not covered by the Framework.[77]

[75] According to the Shipbuilding Framework, the Commission *may* authorise the aid if complying with OECD rules and has therefore discretion in this regard.

[76] It appears that in the EU offshore structures are built in Poland, the Netherlands and Romania, and to a limited extent also in Germany and Italy.

[77] As reported by an independent expert consultant.

With regard to social impacts, insofar the extended product coverage may lead to more innovation, this might have a positive impact in terms of improving social skills. As regards environmental impact, there might be a potential indirect impact as these ship-like offshore structures serve exploration, exploitation or generation of oil, gas or renewable energy. This impact is, however, not quantifiable.

Impact of revised product coverage vis-à-vis the baseline scenario: likely limited positive economic impact. (+) Likely positive environmental impact (+). Introduction may lead to more distortion of competition. (-)

6.2.2. Impact of modified innovation aid rules

As set out above, the amendment of innovation aid covers two types of potential modifications: ensure effectiveness of the rules (incentive effect) and clarification of the notion of “prototype”.

(a) Effectiveness of innovation aid rules (incentive effect)

The expert report from Appledore clearly indicated that – despite the innovative character of many projects – innovation aid is given on occasions as a general subsidy rather than an incentive for innovation. In line with the general principles applied by the Commission[78], aid can only be granted when it leads to a change of behaviour of the beneficiary (incentive effect, which can be assessed by an increase in either of the following: size, scope, amounts spent or speed), otherwise it would give an advantage to the company (and thus distort competition) without any effect in terms of innovation.

This change may lead to less projects being eligible for innovation aid. On the other hand, the inclusion of explicit requirements regarding the incentive effect will limit the negative impact of the aid on competition in the internal market. No social or environmental impacts were identified.

(b) Clarification of notion of prototype

Innovation aid should only be granted to projects that entail real innovation. The clarification of the notion of prototype should lead to this result.

Impact of amended innovation aid rules vis-à-vis the baseline scenario: More effective innovation aid rules, curbing the negative effects on competition. (+)

6.2.3. New environmental aid provisions

This new type of aid for shipyards would promote the implementation of "green" objectives in the maritime industry, with a positive environmental impact, that might otherwise be more difficult to achieve (for example, the new sulphur emission standards – see "problem definition"). It would also potentially generate more contracts for EU shipyards. These considerations are made on the assumption that Member States would be prepared to give this kind of aid in case it was allowed. Only Italy and France explicitly supported the proposal for specific environmental

[78] See "State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009".

aid provisions. However, France (together with Spain), had also initially suggested an environmental top-up to be applied on innovation aid instead of new specific provisions.

On the negative side of this proposal, the Commission notes, in the first place, that any aid given directly to shipyards for the building of "greener vessels" would be "operating aid" which is normally not allowed under EU State aid rules given the potential for this aid to particularly distort competition among producers in the internal market as compared to aid for acquisition[79]. This is because aid is allowed for the purchaser of green vehicles, but not for the producer, in order to allow for a choice of the most efficient supplier and thus limit the impact of the aid on competition between suppliers. In addition, aid to the production of green products is excluded under the current environmental guidelines because environmental aid is more targeted when it triggers a change in behaviour of the beneficiary with a direct environmental benefit: this means a greener production process for the producer, or the acquisition of a greener ship for the buyer. Therefore, such provision would also discriminate with regard to other industries, given that environmental aid for green products is not allowed to the producer but only to the buyer[80]. Aid to shipyards is already possible under the environmental guidelines when it comes to greening their production processes as compared to existing Community standards.

Nevertheless, the environmental guidelines have been rarely used in this sector. As regards aid for the buyer, one of the reasons might be that it is unattractive for a Member State to give aid for an investment that could then be carried out in a third country, where the project will be less costly, although no evidence exists in this regard. On the other hand, the specific innovation aid rules contained in the Shipbuilding Framework already allow building vessels that meet the environmental objectives, including reduced emissions. As explained under problem definition, on the basis of Member States' reports and Appledore's assessment of the implementation of innovation aid schemes, more than half of the projects examined had a positive environmental impact[81]. The beneficial environmental effects included reduced emissions from engines, reduced fuel consumptions, improved waste management systems, improved sanitary/sewage systems and ballast treatment facilities (as reported by the expert consultant). Nevertheless, it should be seen that going beyond or meeting new environmental standards does not always require innovation in the sense for which innovation aid is allowed (i.e. *by comparison to the state of the art in this industry in the Union and provided the project bears a financial and technological risk).*

Impact of new rules vis-à-vis the baseline scenario: the objective of encouraging "greener" vessels is already covered by the existing rules (-) Creating specific environmental aid provisions could potentially lead to new shipbuilding contracts, and potentially maintaining employment in the sector as well as promoting greener vessels (+) but the aid would distort competition in the internal market as compared to aid for acquisition of such products. (-)

[79] Unlike other sectors, the EU shipbuilding industry benefited during a long period from operating aid, which ended on 31 December 2000, upon recognition that "operating aid" is not the most cost-effective way of encouraging the European shipbuilding industry to improve its competitiveness- see preamble of Council regulation (EC) N° 1540/98 of 29 June 1998, OJ L 202, 18.7.198.

[80] Aid for the production of green products under the Temporary Framework, that was designed to tackle the problems of access to financing during the crisis, is an exception to this principle and it is questioned why the EU shipbuilding industry should benefit form a permanent application of aid as foreseen under the Temporary Framework.

[81] Note that only 60% of the projects examined had sufficient evidence to assess the environmental impact.

6.3. ***Administrative burden***

"Administrative burden" is defined as information obligations that are placed on citizens, businesses and public administration (excluding the EU) by EU legislation and entail financial costs. According to the replies to the questionnaire, the administrative burden resulting from the application of the Shipbuilding Framework is generally judged reasonable. In the options examined, the only changes compared to the baseline scenario that may have an administrative burden are the requirement on Member States to prove the incentive effect of innovation aid and the request for new environmental provisions. As regards the latter, the corresponding administrative burden is not expected to be significant as it would be in line with similar State aid provisions that already exist in the environmental guidelines.

As regards the requirements on the incentive effect of innovation aid, although the Member State has to provide this information to the Commission, it is normally the shipyard in its application for aid that will have to demonstrate that the aid leads to innovation being developed that without aid would not be created. However this impact is also not judged to be significant, given that under the current rules shipyards already have to demonstrate what is the innovation included in the project.

7. Summary of impacts

Type of specific provision	Option **A** **Provision prolonged** *Baseline scenario*	Option **B** **Provision expires**	Option **C** **Modified Rules/new rules** Sub-option **C(1)** **Special rules kept only for innovation aid and regional aid**	Sub-option **C(2)** **Framework prolonged and extended**
(1) Innovation aid	*Prolongation* May continue distortions of competition among European shipyards Is against the logic of having horizontal State aid rules Leads to innovative projects, positive effects on employment and environment	*Expiry* The expiry of innovation aid is likely to lead to less distortion of competition among European shipyards and as a consequence to maintaining a level playing field among shipyards in the Union. The EU industry has continued to specialise despite the low amounts of innovation aid granted, which suggest they would continue to do so in the absence of aid (+) The absence of innovation aid might lead to fewer innovative projects (at least to a certain extent), (-) with possible negative impacts on employment and environment (-)	*Modified* More effective innovation aid rules curbing the negative effects on competition (+) Limited administrative impact (~)	*Prolongation = Option A / Baseline scenario*
		Compared to baseline scenario: (-)	***Compared to baseline scenario: (+)***	
(2) Regional aid	*Prolongation* Maintaining stricter rules for a sector with overcapacity might be justified Stricter rules limit the objective of the aid contributing to the development of the regions and of individual shipoyards	*Expiry* General rules apply, aligning rules to the general State aid regime meets the overall objectives. (+) Possible positive impact for investments and employment in assisted regions. (+) Possible issues of negative impact on competition in the internal market (-)	*Prolongation = Option A / Baseline scenario*	*Expiry = Option B*
		Compared to baseline scenario: (+)		***Compared to baseline scenario: (+)***
(3) Closure aid	*Prolongation* Goes against the overall objective of having general rules	*Expiry* Experience has shown that this provision is not necessary (not used) (~) In case closure aid is allowed to expire, in most cases other State aid instruments can be usefully used to replace it (~) Complies with the overall objective of having general rules (+)	*Expiry = Option B*	*Prolongation = Option A / Baseline scenario*

		Compared to baseline scenario: (+)	***Compared to baseline scenario: (+)***	
(4) Employment aid	*Prolongation* This provision was procedural and has become obsolete	*Expiry* No economic, social or environmental impacts were identified (~) There is general consensus for abolishing this provision. Expiry complies with the objective of having general rules. (+)	*Expiry = Option B*	*Expiry = Option B*
		Compared to baseline scenario: (+)	***Compared to baseline scenario: (+)***	***Compared to baseline scenario: (+)***
(5) Export credits	*Prolongation* Goes against the overall objective of having general rules	*Expiry* No significant economic, social or environmental impacts expected. (~) Expiry complies with the objective of having general rules. (+)	*Prolongation = Option A / Baseline scenario*	*Prolongation = Option A / Baseline scenario*
		Compared to baseline scenario: (+)		
(6) Development aid	*Prolongation* Goes against the overall objective of having general rules	*Expiry* No significant economic, social or environmental impacts expected. (~) Expiry complies with the objective of having general rules. (+)	*Expiry = Option B*	*Prolongation = Option A / Baseline scenario*
		Compared to baseline scenario: (+)	***Compared to baseline scenario: (+)***	
(7) <u>New</u> Environmental aid	*Not relevant*	*Not relevant*	*Not relevant*	*New rules* The objective of encouraging "greener" vessels is already covered by the existing rules (-) Creating specific environmental aid provisions could potentially lead to new shipbuilding contracts (+) The aid would distort competition in the internal market (-) no identifiable social impact (~)
				Compared to baseline scenario: (-)
Extended scope of the Rules	*Not relevant*	*Not relevant*	*Extended scope* Inland waterway vessels + Offshore structures: Negative impact on competition (-) likely limited positive economic impact (+); positive environmental impact. (+)	*Extended scope* Inland waterway vessels + Offshore structures: Negative impact on competition (-)likely limited positive economic impact (+); positive environmental impact(+)
			Compared to baseline scenario: (~)	***Compared to baseline scenario: +)***

8. Conclusion

The main options are to let the Shipbuilding Framework expire (B) or to prolong it subject to modified rules (C1 and C2). As demonstrated in section 7, all the above options have positive and negative impacts and risks.

As regards innovation aid, improving the effectiveness of these rules with stricter criteria regarding the "incentive effect" would maximise the scope for the rules leading to real innovation and contributing to the specialisation of this industry

The situation is less clear as regards regional aid, given the risks, albeit limited, of abolishing a stricter regime in a sector with overcapacity. In any event, under option C1 the proposal is to maintain the stricter regional aid rules until the general rules are revised in 2013, when integrating regional aid to shipbuilding rules will have to be assessed.

The prolongation of closure aid does not seem necessary and would be contrary to the objective of having horizontal State aid rules. There is agreement for abolishing employment aid. As regards export credits and development aid, in practice no significant impact is expected, although there are no general guidelines on the subject.

The following table summarises the impacts of the packages of options vis-à-vis the baseline scenario in terms of efficiency, effectiveness and coherence.

	Option B	Option C1	Option C2
Cost efficiency	Commission and National authorities: Positive impact on cost efficiency. No separate rules for shipbuilding all aid dealt under the general rules. Beneficiaries: No impact, State aid is a prerogative of the MS, and is then controlled by the Commission	Commission and National authorities: Neutral. Situation would not significantly change from baseline scenario except for additional verification of incentive effect of innovation aid by MS. Beneficiaries: Limited higher cost of having to prove the incentive effect of innovation aid when applying for aid to national authorities.	Commission and national authorities: Additional cost of implementing new environmental aid provisions. Beneficiaries: Same as above
Effectiveness	Less specific aid to the sector facilitates assessment, but could decrease effectiveness because the specific features of the industry are not taken into account	Improved effectiveness and transparency of the rules, in particular for the promotion of innovation	Less effectiveness, maintains/adds new aid rules that do not appear necessary.
Coherence	Improves coherence: Fully in	Maintains coherence, in line	Least coherent approach,

	line with the objective of having horizontal State aid rules	with the objective of having horizontal State aid rules and only keeping specific rules where the general rules are not perfectly adapted to the sector.	keeping/adding specific new aid rules that do not appear necessary.
Overall assessment	Overall, Option C1 increases effectiveness and coherence in this policy area by further aligning the Shipbuilding Rules towards the general rules while only maintaining specific rules that are necessary to cater for the features of the sector		

9. Monitoring and evaluation

In case a new (revised) Framework is adopted, its ability to meet the objectives outlined in section 4 above will be continuously monitored and evaluated.

In fact, under State aid procedural rules, Member States are required to notify to the Commission their intention to grant State aid to individual enterprises or under general schemes. The Commission will continue to monitor aid granted to the sector on the basis of Member States notifications or any other source of information, as well as on the basis of reports on the application of approved State aid schemes. The Commission will thus evaluate the effectiveness of the rules as well as the need for their continued application. In particular, the Commission will monitor the amount of aid given under the Shipbuilding Framework, the number of beneficiaries, the project size for innovation and the incentive effect, as appropriate. It would be difficult to measure the success of the future Framework in the development of the sector in general as many other factors will also intervene, such as technological developments, competition from third countries and Member States' budget constraints.

In this regard, the Commission will in particular envisage the integration of the specific State aid rules for shipbuilding in the horizontal frameworks, in the context of the revision of these texts in 2013.

LIST OF ANNEXES

Annex I

Agenda planning and Work Programme reference

In view of its expiry at the end of 2011, the review of Shipbuilding Framework was included in the Commission Work Programme for 2010: http://ec.europa.eu/atwork/programmes/docs/cwp2010_annex_en.pdf .

Chronology of the Impact Assessment:

28 June 2010	First Inter-Service Steering Group meeting. The meeting discussed the timetable for the Impact Assessment and the broad lines thereof and the upcoming consultation of stakeholders
4 October 2010 –	Public Consultation Period
6 December 2010	
10 March 2011	Second Inter-Service Steering Group meeting. Discussion on the results of the public consultation, on the draft impact assessment report and on the proposed follow-up
25 May 2011	Third Inter-Service Steering Group meeting. Discussion of the draft Impact Assessment prior to submission to the IA Board
8 June 2011	Submission of the draft impact assessment report to the IA Board
13 June 2011	Internal consultation of the Commission services on the 1st draft for a revised Framework on State aid to shipbuilding
28 July 2011	Date of publication on the Internet of the 1st draft for a revised Framework on State aid to shipbuilding[82] for comments from stakeholders
13 September 2011	Multilateral meeting with Member States to discuss the 1st draft for a revised Framework
28 September 2011	Submission to the Impact Assessment Board of an updated draft impact assessment report including the results of the Multilateral meeting,
25 October 2011	Opinion of the Impact Assessment Board (written procedure)
10 November 2011	2nd Inter-service consultation on a (revised) draft Framework on State aid to shipbuilding
December 2011	Adoption by the Commission
December 2011	Publication

[82] http://ec.europa.eu/competition/consultations/2011_shipbuilding/index_en.html

Annex II

Detailed replies to the public consultation – 4 October – 6 December 2010
(See also Annex VI for an update of Member State's positions following the multilateral meeting of 13 September 2011)

Innovation aid

On the substance, the main focus of the replies was on the importance of maintaining specific provisions on innovation aid for this industry. This is the position of Germany, Italy, Spain, Finland, UK, Poland Cyprus and Greece, together with Norway, the main European and national industry associations, as well as the individual shipyards that replied to the consultation.

Among Member States, France was of the view that specific innovation aid should only be maintained as long as the general rules on aid for research, development and innovation are not changed to fit the features if the shipbuilding industry. (The same approach was followed by Norway.)

In addition, the UK and Estonia also proposed that innovation aid should be transposed to the horizontal rules.

The main argument in favour of innovation aid is that it helps the European industry counter competition from non-EU competitors, in particular from China and South Korea, which, according to several sources, benefit from heavy State subsidisation.

There seems to be general consensus among Member States and the industry that the only way for the EU shipbuilding industry to remain competitive and maintain a critical mass is to innovate continuously on new products and technologies, as there is concern that with time, non-EU competitors will take over the more specialised market segments as well ("innovate faster than can be copied"). Innovation aid is seen as an essential instrument for this purpose.

It was proposed by Germany, Italy, Spain, Finland and France, together with the Community of European Shipyards Associations (CESA) and national shipbuilding associations to extend the scope of the Framework - and by consequence that of innovation aid - to include new types of products that are now part of the industry's business (such as floating, movable, off-shore structures, or material with or without self-propulsion capabilities for exploring marine resources, such as oil, gas and wind-power), as well as inland waterway vessels. In addition, Spain and France asked for the inclusion of fishing vessels that are built for export.

There was also a request by Spain, the Spanish industry representative Uninave and the European Shipbuilding Social Dialogue Committee to increase the intensity of innovation aid (from current 20% of eligible costs to 25%). France, Spain and Uninave also asked to introduce in the aid intensity a bonus for environment friendly projects. France later requested new specific environmental aid to shipyards for promoting the production of greener vessels, following the multilateral meeting of 13 September (see Annex VI).

Denmark and the Netherlands advocated the innovation rules becoming stricter. The Netherlands argued that they only apply innovation aid in order to maintain a level playing field and that a further reduction of the aid intensity could be considered. Only Sweden requested for the abolition of innovation aid to shipbuilding (together with other specific rules).

Regional aid

Germany, The Netherlands, Italy, Norway, CESA and some national associations[83], expressed preference for abolishing the current stricter regime and let shipbuilding be subject to the horizontal regional aid guidelines, as under the general rules the aid intensities are higher and aid is allowed for investments that lead to capacity creation. Other Member States were in favour of either abolishing regional aid to shipbuilding companies altogether (Denmark, Sweden), or of a balanced approach by comparing the pros and cons of the aid on a case by case basis (Finland). However, various Member States somewhat changed their position on this subject after the multilateral meeting of 13 September (see Annex VI).

Export credits and development aid

This provision reflects the OECD Arrangement on export credits and it's "Sector Understanding for Ships". There was a preference in the replies by a few Member States and industry associations that these rules should be maintained in the Framework as it is seen as providing legal certainty. However, during the multilateral meeting of 13 September only Spain and Norway maintained favourable views on keeping this proposal while Poland expressly asked to abolish it (see Annex VI).

Closure aid

Germany, Italy, Spain, The Netherlands, Denmark and Finland expressed also preference for maintaining this type of aid under the Framework which allows for partial restructuring without the need to go through the fully-fledged restructuring process under the Rescue and Restructuring Guidelines. It is seen as a potentially useful tool that may be needed in the future in the face of the Asian competition and the current crisis, although closure aid was never used under the Framework. However, after the multilateral meeting, in the end only Italy, Spain and Portugal supported maintaining this provision (see Annex VI).

Employment aid

There is consensus to abolish the specific provision on employment aid.

New environmental provision

Finally, the representatives of the EU shipbuilding industry (CESA + Spanish and German national shipbuilding associations) the European Cruise Council, representing the leading cruise companies operating in Europe, Damen Shipyards Group and Italy, requested the introduction in the Framework of practical provisions regarding aid for the development of environment friendly

[83] Uninave, Assonave and Foro Maritimo Vasco.

products, because – they claimed – the horizontal Community Guidelines on State aid for Environmental Protection ("environmental guidelines") are not used by the shipbuilding industry. France later joined this request, after the multilateral meeting of 13 September (see Annex VI).

Annex III

Executive summary consultancy report
Attached as a separate document

<u>Annex IV</u>

Table comparison common rules with specific rules

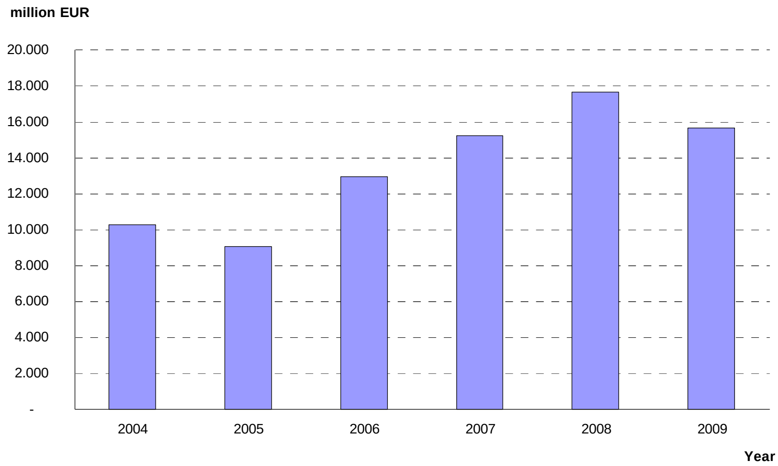
	General rules	Shipbuilding Framework
Regional aid	**Investment**: aid is authorised for new investments. Maximum **aid intensity**: Article 107(3)(a) regions: **30, 40** or **50%** (depending on the region) with possible top-ups of 10% for SMEs. Article 107(3)(c) regions: between **10** and **15%**. **Operating aid**: can be authorised to compensate regional handicap.	***Stricter*** rules apply. **Investment** aid to increase capacities is not allowed, only aid for modernisation of existing installation with a view to increasing productivity. Maximum **aid intensity**: Article 107(3)(a) regions: **22.5%**. Article 107(3)(c) regions: **12.5%** or the regional aid intensity, whichever the lowest.
Closure aid	No special rules exist.	***Specific*** aid instrument to defray the normal costs resulting from the total or partial closure of the shipbuilding activity. **Eligible costs**: Partial closure: – payments to workers made redundant; – the costs of counselling services to workers made or to be made redundant or retired before legal retirement age; – payments to workers for vocational retraining; – expenditure incurred for the redevelopment of the yard, for use other than shipbuilding. Total closure: – aid of an amount not exceeding the higher of the following two values: the residual book value of the installations, or the discounted operational profits obtainable over a projected three-year period, less any advantages the aided undertaking derives from the closure of the installations; – aid for working capital needed to enable the undertaking to complete unfinished works provided that this is kept to the

	General rules	Shipbuilding Framework
		minimum necessary and a significant proportion of the work has already been done.
Employment aid	Rules for the creation of employment were abolished after the entry into force of the Shipbuilding Framework (former: Commission Regulation (EC) No 2204/2002, expired). **Currently**: GBER allows for aid in relation to the employment of disadvantaged and disabled persons.	**No specific substantive rule**, but the Framework required notification obligation under the (now) expired Commission Regulation (EC) No 2204/2002. This provision has thus become obsolete. **General** rule (GBER) applies.
Research & Development & Innovation	Aid for fundamental research, industrial research, experimental development. Basic **aid intensities**: – 100% for fundamental research; – 50% for industrial research; – 25% for experimental development.	**General** rules apply and in addition ***specific innovation aid*** is possible. **Maximum aid intensity: 20%.** **Eligible costs**: industrial application of innovative **products and processes** (only the innovative part of the project), i.e. technologically new or substantially improved products and processes compared to the state of the art in the Union.
Export credit/development aid	OECD rules exist and are applied by MS but **no specific state aid framework addresses the issue**.	The Framework **clearly indicates that OECD export credit rules should be applied**.
Environment aid	Mainly aid for processes but also aid for the **acquisition** of new "**greener**" transport vehicles can be granted.	**General** rules apply.
Rescue and restructuring aid guidelines	**Rescue** aid is authorised for 6 months. **Restructuring** aid is authorised provided return to viability is assured, aid is limited to minimum (own contribution between 25% and 50%) and distortion of competition is limited (compensatory measures must be proposed).	**General** rules apply.
Training aid	Aid for **general training**. Aid for **specific training** (i.e. training not easily transferable to another enterprise).	**General** rules apply.
Temporary Framework	Liquidity in the form of guarantees (max 90%) and loans are authorised. Pricing depends on the rating of the beneficiary.	**General** rules apply.

Annex V

Additional Tables and Charts –evolution of shipbuilding market

Figure 5: Turnover of CESA shipyards (by value of completion of new buildings) 2004-2009



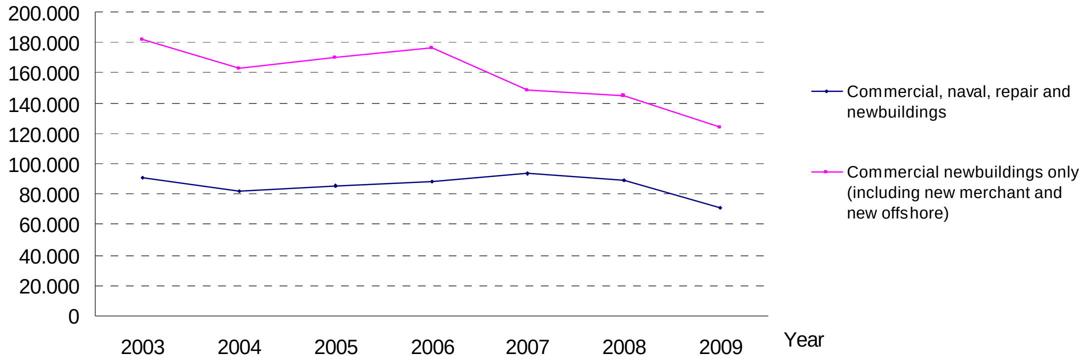
Source: CESA

Table 5: Top 10 European yards by orderbook (CGT) as of 31 December 2008

Rank Europe	Rank world	Yard	Country
1	38	Meyer Werft	Germany
2	41	Daewoo Mangalia	Romania
3	70	STX Europe Saint-Nazaire	France
4	74	Fincatieri Margehra	Italy
5	84	Odense Lindo	Denmark
6	88	Fincaniteri Monfalcone	Italy
7	89	Szczecin Nova	Poland
8	92	Santierul naval	Romania
9	104	STX Europe Helsinki	Finland
10	114	Uljanik	Croatia

Source: Ecorys Study, page 55.

Figure 6: Development of workforce in CESA countries[84]



[84] The trend of this graph is also confirmed by other studies such as IKEI.

<u>Annex VI</u>

Results of Multilateral Meeting with Member States of 13 September 2011

1. The proposed draft "*Framework on State aid to shipbuilding*"

The new draft Framework which was submitted to Member States for comments, maintains unchanged provisions on regional aid and export credits and slightly amended provisions on innovation aid. As regards innovation aid, it integrates criteria on the "incentive effect" of the aid, as well as criteria that were consistently applied by the Commission for assessing the compatibility of innovation aid but which had not until now been formalized (e.g. eligible costs, definition of prototype). This criterion was developed in the past jointly by DG COMP and CESA. The proposal takes out provisions on closure aid and employment aid, which were not used under the Framework (2004-2011), as well as provisions on development aid which reflect OECD rules that are not exclusive to shipbuilding. The scope of the Framework is extended to cover inland waterway vessels and offshore structures, which was a request of the industry and several Member States. The Framework will apply for 2 years, from 1 January 2012 to 31 December 2013; after that it envisages to integrate the provisions on innovation aid (as a sector specific rule) in the future version of the Community Framework for State aid for research and development and innovation (RDI Framework) and regional aid for shipbuilding into the revised Guidelines on national regional aid (RAG).

The draft proposal also highlights that shipyards can receive aid for greening their production processes under the horizontal environmental guidelines and that innovation aid can be used for improving the environmental impact of ships (lower emissions, noise reduction etc.)

2. Position of Member States

A total of 22 Member States, together with Croatia, Norway and EFTA participated in the multilateral meeting of 13 September 2011. However, only a few Member States were particularly active (Spain, Italy, Germany and to a lesser extent Finland, France, Poland and Portugal). Norway also expressed its views at several occasions. Member States expressed varied positions (in certain cases complemented by written submissions) and it was not possible to draw a consistent line for the whole Framework. Also, the views expressed were not always in line with the comments provided during the first public consultation of 4 October - 6 December 2011. However, there were no new issues that would justify modifying the options addressed in this Report.

In general, there was support for the proposal by Germany, Finland, Denmark, Sweden, Poland, the UK and Norway, subject to comments on specific issues. Italy and Spain on the other hand, considered that the Commission's proposal falls short of the needs of this sector and proposed to prolong the current Framework instead. Italy opposed the Commission's proposal mainly because it does not include new environmental aid to shipyards. Spain opposed mainly because it does not include closure aid. France seemed initially to have favourable views, but changed its position after the multilateral meeting. In particular, France joined Italy's request for specific environmental aid to shipyards. The Netherlands did not express any views.

On the detail, there was general agreement on the provisions on **innovation aid,** extended to cover inland waterway vessels and offshore structures, subject to certain drafting suggestions. Spain, France and Portugal asked for a wider coverage of innovation aid to also include fishing vessels. Spain and France suggested in addition extending the scope of the rules to the equipment suppliers. Poland suggested an increase in the innovation aid intensity (from the current 20% to 30% of eligible costs), which is supported by Bulgaria

Regarding **regional aid,** Finland (which was happy with the overall proposal) would nevertheless support even stricter regional aid rules than the existing ones. On the other end, Poland and Norway supported an alignment already at this stage with the general horizontal regional aid guidelines. There were no other strong views on the subject.

Only Spain, Italy and Portugal were in favor of keeping **closure aid** (which the draft proposed to abolish). All others Member States agreed with the proposal to abolish closure aid. Spain argued that they may need this provision to help close down a few large shipyards, because of the crisis, but did not really motivate why the current horizontal rules - in particular the guidelines on aid for rescue and restructuring - would not be sufficient to achieve this objective or why closure of shipyards could not take place without aid.

Also, only Spain and Norway supported maintaining the provision on **export credits** in the Framework, as proposed by the draft Framework. Poland was expressly against maintaining export credits in the Shipbuilding Framework, because they considered that it discriminates vis-à-vis other industries. In Poland's view, export credits in principle should not be considered State aid as long as they are granted in conformity with OECD rules, in order to maintain a level playing field among OECD members. Poland also explained that they do not have an export credit scheme that is only dedicated to shipbuilding and that from their perspective there is no reason to treat this sector differently from other sectors. France supports the views of Poland.

Italy requested **new environmental aid** to shipyards, to promote the production of "greener" vessels. France later joined this request, in a written submission following the multilateral. This is also a specific request from the industry's representatives, CESA.

Regarding the period of **application of the Framework**: Spain, Italy, Portugal, France, Germany and Bulgaria, would like an application period of more than the currently proposed 2-years (of 3 to 5 years). In the case of Germany and France, however, they seemed to also agree to integrating innovation aid in the future version of the RDI Framework after 2 years, as proposed by the draft, provided the rules remain substantially the same.