THE POLICY RELEVANCE OF THE EU STATE AID RULES

*Paper to European Community Studies Association 5th Biennial Conference,
Panel Session Two: The EU's State Aid Regime: Multi-Disciplinary Perspectives
29 May to 1 June 1997, Madison Renaissance Hotel, Seattle, Washington*

Fiona G. Wishlade, Senior Research Fellow, European Policies Research Centre, University of Strathclyde

European Policies Research Centre
University of Strathclyde
141 St James Road
Glasgow G4 0LT

Tel: +44-141-552-4400 ext 3061
Tel: +44-141-548-3061 (direct)
Fax: +44-141-552-1757
e-mail: fiona.wishlade@strath.ac.uk

THE POLICY RELEVANCE OF THE EU STATE AID RULES

1. INTRODUCTION

The past decade or so has seen a substantial reinforcement of EU policy on the control of State aid. European Commission guidelines and communications on State aid control have been built up into a substantial body of rules. At the same time, the European Court of Justice has buttressed the Commission's overall approach through its reticence to intervene on the substance of Commission decisions and its support for Commission reinforcement of the penalties for transgression of the rules. Much of the impetus for the renewed vigour with which the Commission addresses the issue of State aid discipline came from the Single Market programme. In particular, there were warnings that, as other barriers to trade fell, Member States might be tempted to resort to subsidies to protect domestic industry; at the same time, the absence of other barriers would mean that the *effect* of State aids would be more keenly felt[1].

A consequence of this heightened activity is that the EU rules on State aid have become a major consideration for national policymakers seeking to support industrial activities or attract inward investment. Related, the penalties (and the political embarrassment) for failure to notify have resulted in a significant increase in the number of State aid proposals notified annually.

Outwardly, EU State aid policy gives the impression of a rational and linear process: aids are prohibited, subject to certain exceptions; Member States must notify any plans to offer aid in advance of their implementation; it is for the European Commission to decide what is an aid and whether one of the exceptions can be applied. In practice, however each aspect of this process raises difficult policy questions, beginning with, what is an aid, and, if it is for the Commission to decide what an aid is, how do Member States decide what to notify? Further, how can the Commission judge *ex ante* that a measure will be compatible with the common market?

This paper argues that Commission State aid policy is characterised by a formalism which may be undermining its policy relevance. The definition of a State aid, to the extent that one exists, renders seemingly innocuous policy instruments unlawful whilst failing to catch measures that are purposely designed to distort competition. The issuing of numerous aid guidelines acts as a straightjacket on aid instruments across a range of policy areas. These often constrain minute policy details, but none set limits on the overall level of spend. Last, the benefits in terms of transparency which could flow from the existence of these aid guidelines has not been exploited – the vast majority of Commission decisions are positive and concern aid schemes which it has *de facto* approved to the extent that they conform with a published framework.

---

[1] Most notably, Padoa-Schioppa, T. *et al* (1987) *Efficiency, Stability and Equity: A Strategy for the Evolution of the Economic System of the European Community*, Economica, Paris; and Cecchini, P. (1988) *The European challenge 1992: The Benefits of a Single European Market*, Wildwood House, Aldershot, England.

In short, Commission State aid policy has been built up into an apparently robust structure but the foundations of this policy are less than secure. This raises issues of major concern in the context of the EU's apparently growing appetite for exporting internal guidelines and the extraterritorial application of those rules through trade agreements.

Against this background, this paper begins by considering the definition of the term State aid, with particular reference to the identification of so-called "general measures". A second section reviews some of the substantive aspects of Commission interpretation of Article 92(3), focussing on the most developed area of policy, the control of regional aids. A final section highlights some keys areas for discussion.

2. STATE AID AND GENERAL MEASURES

2.1 Policy Background

In spite of over 30 years of Commission decisions and Court jurisprudence, and as many commentators have noted, no *concrete* definition of the term "State aid" exists. A particularly elusive aspect of the concept concerns the selectivity element: in other words, at what point, and in what way, does a measure so favour certain undertakings or certain goods that it falls within the scope of Article 92?

The purpose of the distinction is to differentiate between general measures of economic policy and measures which directly or indirectly assist certain firms or products. In some respects, the divide might be viewed as clear cut. For example, the setting of interest rates is typically used as an example of a general measure; the base rate set applies throughout the economy and no particular groups are favoured. In practice, however, changes in rates of interest impact very differently on different firms - cash rich firms will clearly benefit from higher interest rates whilst those with loans to service will be disadvantaged. Similarly, government decisions about the burden of revenue raising - ie. whether it should be on labour or capital-related contributions - impact very differently on different activities. Nevertheless, such broad policy decisions are viewed as part of general economic policymaking and few would argue otherwise.

The Court of Justice has given scant guidance on the interpretation of Article 92(1) with respect to general measures. The issue first arose in the Italian textiles case[2] where the Court had to consider the legality of separate social security provisions for the textile industry, and this remains the leading case in the area. Part of the Italian argument had been that the social security concession provided to the sector was intended to rectify an imbalance arising from the fact that the workforce was predominantly female. This was rejected by the Court which viewed the concession as:

> "a measure intended partially to exempt undertakings of a particular industrial sector from the financial charges arising from the normal

[2] *Italian Government* v *Commission* [1974] ECR 709.

> application of the general social security system, without there being any justification for this on the basis of the nature or general scheme of the system."

This statement has formed the starting point for much subsequent Commission decision-making. In practice, however, there have been few explicit policy statements which have taken this interpretation further. In its 1985 annual report the Commission stated that it endeavoured "to distinguish between general measures designed to stimulate economic activity as a whole and specific measures with identifiable beneficiaries whose competitive position is improved by the intervention."[3]

The mention of "design" is interesting in this context since the role of policymaker intent in the Court and Commission interpretations of the concept of State aids does not always appear consistent. In the Italian textiles case just cited, the Court held that if the *effect* of a measure was to benefit a particular undertaking or category of goods then it should be regarded as an aid *even if a benefit was not the primary intention of the measure.* This may be contrasted with the following remarks taken from *Sloman Neptun*[4]:

> "The system at issue does not seek, through its object and general structure, to create an advantage which would constitute an additional burden for the State or the abovementioned bodies, but only to alter in favour of shipping undertakings the framework within which contractual relations are formed between those undertakings and their employees. The consequences arising from this, insofar as they relate to the difference in the basis for the calculation of social security contributions, mentioned by the national court, and to the potential loss of tax revenue because of the low rates of pay, referred to by the Commission, are inherent in the system and are not a means of granting a particular advantage to the undertakings concerned"

In line with general trends to increase the transparency of policymaking, the Commission has sought to clarify the definition of State aids in relation to general measures in various policy statements. This began in 1990 with the Second Survey on State aid expenditure[5] which noted that:

> "General measures comprise any state interventions that apply uniformly across the economy and which do not favour certain enterprises or sectors. For example, the generally applied fiscal system and system of social security contributions usually constitute general measures (e.g. rules of depreciation applied to capital equipment and charges on employers and employees to finance social benefits)."

At the same time, the Survey emphasises the point that certain fiscal and social security measures can constitute aid when they are applied in a discriminatory manner

---

[3] CEC (1985) Fourteenth Report on Competition Policy, OOPEC, Luxembourg at p 129.

[4] *Firma Sloman Neptun Schiffahrts AG* v *Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts* [1995] 2 CMLR 97.

[5] CEC (1990) Second Survey on State Aids in the European Community, OOPEC, Luxembourg.

to the advantage of certain enterprises or sectors, or where their effect is to favour such activities. This is simply a reiteration of the long-standing practice of the Commission and takes definitional issues little further.

The Second Survey also sets out the basis for needing a distinction between State aids and general measures and justifies the stricter approach to State aids on *economic* grounds. The Commission view is that the direct effect of most *general measures* is likely to be diluted across the spectrum of economic activity, be compensated or counteracted by other general measures, or be neutralised to a large extent by exchange rate changes. Its greater tolerance of general measures is also based on the premise that it is not the function of competition policy to attempt to remove fundamental differences between Member States' costs structures which contribute to the wider economic and social framework within which firms operate in each Member State. As far as aids are concerned, the Commission considers that:

> "aids have a direct and immediate impact on competition because by definition of their specificity they are targetted [*sic*] at certain objectives often in a selective and discriminatory way. In order to favour the aided enterprise, taxes must be levied on the rest of the economy. Thus not only are enterprises in other Member States put at a competitive disadvantage by the aid because the aided enterprises are favoured in a way outside the normal fiscal or social security systems that contribute to the equilibrium between Member States, but also enterprises not receiving aid in the same Member State are disadvantaged and pay higher taxes directly or indirectly."

The Second Survey also noted that the Commission had begun to investigate in greater detail the distinction between general measures and State aids and that the results of this would be incorporated into a later edition of the Survey. To date, this has not happened; indeed, it is understood that the Commission is still working on this issue.

The most recent policy statement on the question appears in the 1995 annual report on competition policy[6]:

> "To rank as State aid, a measure must favour certain undertakings or the production of certain goods in a Member State. Article 92(1) of the Treaty does not apply to general measures applicable to all undertakings in a Member State which meet objective, non-discriminatory and non-discretionary requirements. The application of these criteria means that measures potentially open to all undertakings may still be deemed by the Commission to constitute State aid under Article 92(1) if the public authorities can decide on a discretionary basis, which and/or to what extent undertakings may benefit from the measure, or if the effect of the objective requirements is that only certain undertakings may benefit from the measure."

---

[6] CEC (1995) XXVIth Report on Competition Policy, OOPEC, Luxembourg.

None of the statements quoted in this section provide national policymakers, national courts (or indeed the Commission itself) with a working definition of the difference between State aids and general measures. In the quotation above, the Commission deems general measures to be those that are "objective, non-discriminatory and non-discretionary", but it goes on to say that these criteria are not in themselves sufficient to be sure that the measure is not an aid. Moreover, as will be seen, there are a number of measures which *do not* meet these criteria but which the Commission has still deemed to be general measures rather than State aids.

2.2 Selectivity and Eligibility Criteria

The key element in distinguishing between State aids and general measures is the selectivity of the measure and the extent to which it favours "certain undertakings or the production of certain goods". This discrimination can take place on different levels: it might involve the implicit exclusion or inclusion of certain activities or firms; it might involve active discrimination in favour of some firms within a measure that applies to all; or it might involve indirectly benefiting some firms more than others. This discrimination (or exclusion) can usefully be considered with respect to a number of features:

- administrative discretion
- spatial coverage
- sectoral coverage
- other eligibility criteria

2.2.1 Administrative Discretion

The existence of administrative discretion typically condemns measures to fall within the scope of Article 92(1). In its examination of a package of Danish employment schemes, the Commission had to consider whether the measures constituted aid or not. A key factor was the extent of the discretion available to the administering authorities. In the case of one of the schemes, the Commission took the view that the "scheme was automatically applied to any firm and unemployed person meeting the conditions, which were precise and well defined in most important respects such as the terms of the employment contract". On this basis it was considered to be a general measure and not an aid scheme. However, in the case of a modified version of the same scheme, a greater degree of discretion was found to have been introduced and the scheme was viewed as "potentially" selective, bringing it with Article 92.[7]

This is a difficult area in which to attempt to apply demarcations. For a significant range of measures, especially in the field of taxation, there is no direct policymaker input into the claiming of benefits by individual firms. An obvious example is depreciation allowances which are simply claimed when firms make their tax returns.

---

[7] CEC (1994) XXIIIrd Report on Competition Policy, OOPEC, Luxembourg at point 390.

At the opposite end of the spectrum, many countries operate highly discretionary regional or research grant schemes where policymakers control eligibility on a case-by-case basis. In between, however, there are many possible shades or degrees of discretion. In particular, to what extent does authorisation for particular tax status involve administrative discretion? In Belgium, for example, Co-ordination Centres[8] must be approved by the government in order to benefit from the tax advantages set out in the legislation, but it is unclear to what extent any discretion is involved in allowing or rejecting applications. Elsewhere, tax administrations are frequently prepared to give "advance rulings" on the tax treatment of particular transactions; to what extent might these involve administrative discretion?

2.2.2 Spatial Discrimination

It is well-established that measures which apply only to certain regions of a Member State are caught by Article 92. Tax and social security exemptions granted on a regional basis have consistently been treated by the Commission as constituting State aid; an early example is the German coal closure areas case[9]. However, this view is largely based on the assumption that there is a national level of tax or social security contribution and that certain areas benefit from a departure from that "benchmark". In practice, this involves taking a formalistic view of definitional issues. A number of examples can be used to illustrate this point.

First, the internal institutional and constitutional arrangements vary widely between Member States. In Spain, for example, País Vasco and Navarra have greater autonomy than the remainder of the Spanish regions in relation to taxation to the extent that these regions levy some of their own taxes in place of the national taxation system. This can result in different rates of corporation tax in different parts of the country, without there being any departure from the benchmarks simply because the benchmarks are different. The Commission had occasion to consider tax concessions offered within País Vasco in 1993[10]. Ultimately the proposals to offer these concessions were condemned on the basis of Article 52 since they were restricted to firms with all plants located in the region, a condition which was considered to restrict freedom of establishment. In consequence, the Commission did not need to address the specific issue of whether different tax arrangements in the region constituted State aid or not. This was perhaps fortuitous since it seems that the Commission was deeply divided on the issue.

Second, the extent to which regional and local authorities raise taxes, and the relative importance of those taxes in the overall burden on firms varies considerably. In addition, there can be wide regional variations in the tax burden on firms purely as a consequence of the exercise of local tax autonomy. In Germany, for example, the municipalities (*Gemeinden*) levy, amongst other taxes, a municipal trade tax on income. Within broad parameters set by Federal legislation, the *Gemeinden* are free to

---

[8] Co-ordination Centre status provides a range of tax and other benefits to the headquarters of multinational enterprises located in Belgium.

[9] *Commission* v *Germany* [1973] ECR 813.

[10] Commission Decision of 10 May 1993 concerning a scheme of tax concessions for investment in the Basque country, OJEC No. L 134; 3.6.93.

set the coefficient (the so-called *Hebesatz*) which determines the rate of taxation in the locality. The *Hebesatz* varies from zero (20 municipalities, of which 16 are in the new *Länder* have opted not to apply the *Hebesatz*) to 515 percent. This means that the effective rate of trade tax on income varies between 5 percent and 25.75 percent. In other words, what firms pay differs widely between different parts of the country. Whilst the *effect* is arguably the same as a regional grant towards running costs, this type of differentiation falls outwith the scope of Article 92.

Third, an extension of this point is the extent to which taxation paid should reflect services provided. It could be argued that different rates of local taxation reflect different policy decisions about the level of amenity. As part of the voting constituency, firms in a given locality can vote for local politicians whose views about the level of services required and the costs associated coincide with their own. In practice, however, this link is at best indirect. In France, for example, rates of local business tax (*taxe professionnelle*) tend to be higher in communities that are primarily residential and involve high social costs; in mainly industrial areas, rates of local business tax tend to be lower simply because there are more businesses to share the burden and fewer social amenities required. As elsewhere, this has led to differentiated levels of central government funding to local authorities to reflect local needs. Moreover, as in most European countries, the bulk of local and regional government resources come in the form of central government transfers or block grants, diluting the link between the level of tax paid and the services received in return.

The recent reform of the United Kingdom business rating system raises some interesting issues in this context, and ones which appear not to have been considered by the Commission. The reform involved the introduction of the so-called "uniform business rate" in England, Wales and Scotland. Rates are paid by firms to local authorities and channelled to central government which then redistributes the funds to local authorities in line with a formula to establish the financial needs of the area concerned. Several points are of interest in this context. First, the arrangements for the collection and redistribution of the rates differ between England and Wales, on the one hand, and Scotland, on the other. Second, the level of business rates set for Wales is lower than that in England. Third, the system of uniform business rate does not apply at all in Northern Ireland where local taxes are raised differently.

For historical reasons the different constituent parts of the United Kingdom have different relationships with the UK Parliament, often resulting in the need to pass separate legislation, especially for Scotland and Northern Ireland. Nevertheless, it remains the case that the arrangements for local taxation are based on legislation passed by the *national* legislature (ie. the UK Parliament) and not subnational authorities. In other words, the cumulative effect of the different pieces of legislation providing for local taxation in different parts of the UK is to differentiate between different parts of the country. Amongst other issues, this raises the question of whether the difference between the level of business rates payable in Wales (at 39 pence in the pound) could constitute State aid (the rate payable in England is set at 43.2 pence in the pound). One consideration here is whether businesses located in Wales are receiving different services for the level of rates payable, and this is unclear. However, even *within* jurisdictions - ie. where the same rate is payable by all firms - it is clear that different levels of service (and the different costs of providing

those services) are not reflected in the business rates payable since these are set at a uniform amount (and this is indeed the policy intention). An inevitable consequence of this is that firms in some areas contribute more towards the costs of local services than others, with the result that firms in some areas are indirectly subsidised.

It is scarcely surprising that the Commission should not wish to become embroiled in issues of local taxation and the financing of local government. However, it is important to raise these issues since it exposes the extent to which a formalistic approach to defining State aids involves disregarding measures of *equivalent effect* simply because of their form.

2.2.3 Sectoral Discrimination

The issue of sectoral discrimination raises some important questions. In the Italian textiles case[11], the Court held that the measure was intended to partially exempt undertakings from *the normal application of the general social security system.* In this sense, the scheme was clearly selective. Notwithstanding this judgement, it is still possible for different sectors to be treated differently without infringing Article 92. This different treatment can take several forms. It may involve a derogation from a general system of tax or social contributions; alternatively, completely separate legislation may provide for particular arrangements for particular sectors.

There is a distinction between different treatment of a particular sector *justified by the distinctive characteristics of that sector* (which does not constitute an aid); and different treatment of a particular sector which *does* constitute an aid, but which may be justified on policy grounds and therefore qualifies for one of the Article 92(3) exemptions. The distinction between the two is illustrated in *Sloman Neptun,* where the different social security contributions for the shipping sector were not considered to constitute aid; and in the recent Commission approval of a special depreciation and tax reduction scheme for ships operating under the German flag[12], which apparently was viewed as aid, but was considered to be acceptable. For the purposes of the discussion that follows, the key issue is: *in what circumstances does differentiated treatment of specific sectors not constitute an aid?*

A number of countries operate separate taxation regimes for the banking and insurance sectors; these would not normally constitute State aid. For the most part, the Commission considers that differentiated treatment is justified by the special nature of the activities involved and the fact that separate regimes effectively "normalise" the tax treatment of sectors that would be inappropriately disadvantaged by the application of the general system.

Similarly, the levying of special taxes on particular sectors can be considered part of the general tax system. In the UK for example, oil production is subject to an additional form of corporation tax; it would clearly be absurd if all other sectors of UK industry were deemed to be recipients of State aid because they were *not* subject

---

[11] See Footnote 2.

[12] *Commission authorizes depreciation/tax reduction scheme for ships operated under the german flag,* Commission press release 2/10/96.

to petroleum revenue tax! On the other hand, this example does raise the benchmark issue once more; it seems certain that if oil production were to be exempted from corporation tax, then this would be regarded as a sectoral aid - what then is the norm?

The difficulties in identifying the norm are most amply illustrated in the context of the reduced rate of corporation tax applicable to manufacturing industry in Ireland[13]. This is apparently not considered to constitute an aid by the Commission, but rather is viewed to be a part of the general fiscal system; it is, however, known that this view is not shared by all directorates in the Commission.

The basic premise for not considering the reduced rate of corporation tax for manufacturing as an aid appears to be the breadth of the sector concerned (and the fact that the rate applies nationwide); were the rate only to apply to parts of Ireland, then it would certainly be viewed as constituting aid - this is confirmed by Commission treatment of the 10 percent rate to international service firms which is restricted to particular centres as well as a closely-defined sector of activity[14].

In considering the Commission view that the reduced rate is not an aid, it is useful to return to the issue raised in the Italian textiles case: *is there any justification for this treatment on the basis of the nature and general scheme of the system*? In other words, what are the characteristics of the manufacturing sector that merit a lower rate of taxation being applied to it than all other activities? Is the different rate seeking to address an anomaly that would arise from the application of the standard rate? As mentioned above, this is usually the case with the special rules applicable to banking and insurance, but it is difficult to justify with respect to manufacturing.

A related consideration is the *effect* of the measure. The Commission and Court have argued consistently that it is not the *form* of the measure but its *effect* which are key in establishing whether a measure constitutes State aid. It is widely recognised that the reduced rate of corporation tax is a major factor in international location decisions and has been key in attracting industry to Ireland. To ignore this is to take only a partial view of the measure.

It is also useful to take a wider view of how manufacturing is treated for corporation tax purposes elsewhere in Europe. The 10 percent rate is very substantially below the norm for corporation tax rates generally and other countries do not distinguish between manufacturing as against other activities in setting tax rates. This is not to argue that national policy design should be constrained by the policies operated in other Member States, but a consideration of the wider context can help a view to be formed on the justification for the measure; in this case it can be argued that there is no justification for the reduced rate other than the attraction of mobile investment.

Similar issues have apparently arisen in the context of Irish proposals to operate a distinct tax system for agriculture. The outcome of these proposals is unclear, but, as with the special rate for manufacturing, the proposals have divided opinion within the Commission. On the one hand, it is argued that agriculture is a broad sector of the

---

[13] The rate of corporation tax for manufacturing in Ireland is 10 percent throughout the country. The "standard" rate of corporation tax of 38 percent applies to services and other activities.

[14] This reduction (also to 10 percent) is treated as an aid by the Commission.

economy being treated in a specific way; however, the sector is *too* broad for a special regime applied to it to be considered a State aid. A counter argument to this is that the sector is readily identifiable, sufficiently specific and anyway accounts for a only small proportion of the Irish economy. Whichever line is taken, it is, however, difficult to sustain the view that a reduced rate for manufacturing *does not* constitute aid but that special treatment of agriculture *does*, especially where the economy of a single Member State is concerned.

Another aspect of the discussion concerns the fact that one of the justifications given for different treatment of the agricultural sector is that incomes in the sector are extremely volatile and the application of the standard system of taxation (whatever this might be considered to be in the Irish context) would result in disadvantageous treatment of the sector. However, if the volatility of incomes is to be used as the justification for separate treatment of agriculture, then there also needs to be a consideration of other activities in which incomes are volatile and the extent to which special fiscal provisions are made for these.

2.2.4 Other Eligibility Criteria

The EU Member States operate a considerable number of tax advantages designed to favour particular types of investment or activity. Many of these do constitute State aids, but the Commission has found grounds to grant exemptions under Article 92(3) within the context of its approach to regional policy, SMEs, and so on. Beyond these uncontroversial measures, however, there are a number of tax advantages which have either been regarded as falling outwith Article 92(1) or which have not been reviewed at all. In practice, it is often difficult to establish whether the Commission has reviewed particular measures since it is only relatively recently that decisions not to oppose particular measures have been published systematically.

The Commission's broad definition of general measures was quoted earlier. This states that:

> "Article 92(1) of the Treaty does not apply to general measures applicable to all undertakings in a Member State which meet objective, non-discriminatory and non-discretionary requirements."

As already mentioned, the Commission goes on to note that even measures which are objective, non-discriminatory and non-discretionary may ultimately be viewed as State aids. Of particular interest to this section, however, is the fact that the reverse also appears to be true: *not all of the measures which the Commission deems to be general are in fact objective, non-discriminatory or non-discretionary.*

One example of this is Co-ordination Centre status in Belgium, which is viewed as a general measure. Whilst it is true that the criteria are clear and published (in relation to international status, activities, minimum levels of employment, and so on) and application for Co-ordination Centre status appears to involve authorisation rather than appraisal by policymakers, a system for which only a few hundred organisations in the Member State can qualify could hardly be described as non-discriminatory.

Also of interest is the extent to which countries operate different tax systems for different categories of firm. In Greece, for example, there is evidence of measures that are restricted to quoted companies[15], a feature which effectively eliminates small and medium-sized firms from eligibility. It is unclear to what extent this could be "objectively justified" if the tax system as a whole were taken into consideration. Nevertheless, it is clear that if a closer examination is undertaken of the extent to which wholly separate tax arrangements exist for different categories of enterprise, then the margins between general measures and State aids begin to blur and the relevance of the distinction itself becomes increasingly questionable. This is reflected in the 1994 Commission Recommendation on the taxation of SMEs[16] which seeks to encourage Member States to adopt tax structures that are more neutral with respect to the legal status of undertakings. Moreover, the Recommendation explicitly recognises that "the current structure of rates of personal tax and corporation tax distorts competition between enterprises". More generally, it is of wider significance that the Commission should have to resort to *persuading* Member States on the basis of Article 155 to reform tax structures that disadvantage certain groups but are considered to be part of the benchmark system; were the same measures to take the form of State aids (and the *effect* might be no different), then Commission scope for action would be far greater.

2.3 Further Considerations

This section has exposed some of the difficulties in attempting to distinguish between State aids and general measures. The Commission approach purports to be *effects*-based, but in reality general measures of *equivalent* effect to State aids are treated differently. This is because the Commission can only address State aids under Article 92; it cannot use Article 92 to attack general measures which distort competition.

The requirement for measures to favour certain undertakings or the production of certain goods has put considerable emphasis on identifying the "norm" from which selective measures depart. This quickly becomes problematic as an approach and runs into difficulties when, for example, a sector is particularly broad (as illustrated by the Irish corporation tax rate for manufacturing) or where there is separate treatment of a given sector because of the specific characteristics of that sector. The emphasis on identifying departures from benchmarks is a product of the combined forces of legal formalism, political imperatives and historical context and one that produces decisions that sometimes lack overall policy coherence.

The *formalistic* approach flows from the fact that the Commission's power to act is based on the Treaty. It has explicit and wide-ranging powers in respect of measures that amount to State aid; however, the Member States retain sovereignty over direct taxation. As such, Member States are free to design tax structures, decide on systems of local taxation, regulate the balance between taxes on capital and on labour and set rates of taxation; all of this falls outwith the Commission's authority. It is only if Member States create exceptions within the overall framework that the State aid rules

---

[15] Price Waterhouse (1992) Information Guide: Doing Business in Greece.

[16] OJEC No. L 177; 9.7.94.

come into play. This means that regional variations in the tax burden that arise as a consequence of regional tax autonomy are *not* caught by Article 92, but regional variations in the tax burden that arise as a consequence of a decision to favour problem regions *do* fall foul of Article 92. Interestingly, however, no attempt appears to have been made by the Commission to establish just how great regional variations in taxation are; moreover, there is no evidence that the Commission is even concerned at the scale of these variations, preferring to address only those variations that can be classed as State aid.

Related to this, the Commission lacks a legal basis to address general tax measures that are considered "unfair" but that do not constitute State aid. Recent work by the OECD on fiscal degradation has isolated a number of factors considered relevant to identifying "unfair" regimes[17]:

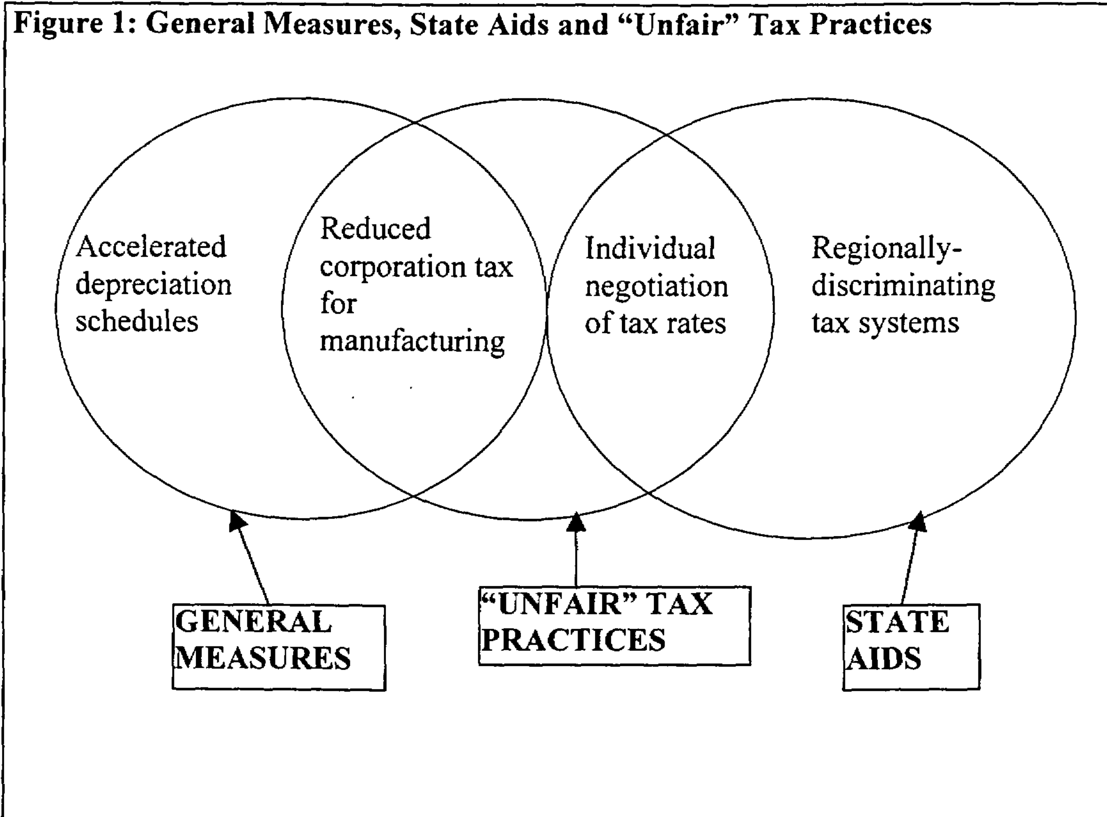
- the special tax regime merely results in a shift of activity to the country providing it, without the creation of significant additional activity
- the tax burden on internationally-mobile tax bases is significantly lower than that on immobile bases
- the effective level of taxation applied to activities of non-residents is lower than that applying to residents' activities
- the tax incentive is large enough to make it a primary factor in the decision on business location
- there is no time limit on individual benefits under a preferential regime, or no sunset clause for the regime as a whole
- the regime does not have a justifiable economic objective (eg. the requirement to create a significant number of jobs)
- taxpayers may be able to negotiate the level of taxation.

Some of these factors coincide with those that would condemn particular measures to be State aids; however, this is not true of all. Moreover, the converse is true; a regionally-discriminating tax or social security system would not, on the basis of the above listing, appear "unfair" in an international context, but it is established Commission policy that such measures constitute State aid. In short, the legal formalism of the Treaty means that the Commission's sphere of intervention in addressing measures that distort competition is necessarily partial. This is illustrated in Figure 1 which shows that there is no direct correlation between measures classed as State aids by the Commission and those classed as "unfair" according to the OECD typology.

---

[17] Quoted in *Tax Competition in the European Union*, Note for the Economic and Policy Committee and the Monetary Committee, Directorate General for Economic and Financial Affairs.

Figure 1: General Measures, State Aids and "Unfair" Tax Practices



The *political* dimension is key. The treatment of taxation under the State aid rules lies at the heart of questions about the relationship between Article 92 and general measures. However, control over the raising of revenues is a key function of national governments and widely viewed as an almost inalienable right. The reluctance of national governments to relinquish any freedom of action in the field of taxation largely explains why progress on fiscal harmonisation has been so limited.

Political factors perhaps also underlie the Commission's acceptance of the Irish corporation tax rate for manufacturing as a general measure. First, for the Commission to dictate what the level of taxation should be for such a large part of the Irish economy would be likely to be viewed as an excessive encroachment on the exclusive competence of the Member State; it is easier for the Commission to take decisions on minor aid schemes than it is to question fundamental aspects of the taxation structure. Second, the introduction of the lower rate coincided with the withdrawal of export sales tax relief for Ireland's accession to the Community. The Commission was deeply opposed to export sales tax relief because coverage included exports to other Member States and the scheme self-evidently affected trade within the common market. It seems likely that the Commission would have found it difficult to object to the reduced corporation tax rate at a time when this was replacing a scheme which was being withdrawn at its instigation. In other words, perhaps the reduced corporation tax rate was simply viewed as the "lesser of two evils". Third, the whole of Ireland is classified as an Article 92(3)(a) region; whilst this is wholly irrelevant to the question of whether a measure constitutes a State aid, it may be that the relative poverty of Ireland in an EU context made the reduced rate more palatable to the Commission. It would be interesting to know how the same measure would have been viewed had it been proposed by Belgium or the Netherlands, for example.

Political and legal factors frequently conspire to exclude economic considerations from the Commission analysis. In the context of the Irish corporation tax rate, it was suggested above that there could be a more detailed consideration of the extent to which the reduction could be objectively justified - for example with reference to the special characteristics of the sector or the motivation for the rate. Conversely, for measures which formally *do* amount to State aids (such as regionally-discriminating taxation rates), the Commission could take a wider perspective in reaching its decisions and consider the extent to which similar effects are produced by policies that are outside the scope of Article 92, most notably regional variations in rates of taxation arising from local tax autonomy.

3. COMMISSION INTERPRETATION OF ARTICLE 92(3): SOME POLICY ISSUES

The categorisation of a measure as a State aid is, of course, only the first stage in the review required of the European Commission. Article 92(1) provides for a general ban on State aids insofar as they distort competition, but the Commission must further decide whether the aid qualifies for one of the categories of exemption provided for in the Treaty.

Article 92(3) provides for types of aid that "may" be compatible with the common market; it is for the Commission to decide whether one of the exceptions provided for in Article 92(3) shall apply, a process which involves balancing the impact on competition against the "common interest". In developing its policy with respect to these exceptions, the Commission has made increasing use of frameworks and guidelines, which now run to several hundred pages[18]. For the most part, these are intended to improve the transparency of Commission decision-making and the quality of the notifications by the Member States. These rules have had a significant impact on aid policies, with many national policymakers trying to ensure conformity with the relevant framework prior to formal notification.

The first and amongst the most complicated areas in which the Commission has sought to establish guidelines concerns regional aids. According to the Commission, these account for most aid spending in the EU (53 percent of the total in 1992-4)[19]. Moreover, largely as a consequence of Commission policy, regional aids have become the only legitimate source of general investment aid to large firms in the EU.

This section considers some of the substantive aspects of Commission policy in relation to the control of regional aids. It argues that much of its approach is characterised by the kind of formalism underpinning the definition of State aid. This has impacted, to a greater or lesser extent, on the *form* of aid offered, the *spatial* coverage of policy and the *value* of regional incentives. It is, however, questionable whether Commission policy has served to quell competitive outbidding between

---

[18] These are collected in European Commission (1995) *Competition law in the European Communities: Volume IIA – Rules Applicable to State Aid*, OOPEC, Luxembourg.

[19] CEC (1997) Fifth Survey on State Aid in the European Union in the Manufacturing and Certain Other Sectors, COM (97) 170 final, Brussels, 16 April 1997.

regions – the stated objective of policy. Also significant, there is a risk that Commission inflexibility with respect to some aspects of policy could lead Member States to resort to less transparent measures which fall outside the scope of Article 92 altogether.

3.1 The Form of Aid

It is clear from the Treaty that aid may be in any for whatsoever, but the Commission has been influential in determining which types of aid can qualify for one of the Article 92(3) exemptions. Underlying this is the desire to make aid "measurable". The Commission approach to this dates back to the late 1960s when it began to develop a methodology for the control of regional aids. This identified, *inter alia*, the need for transparency of aid and, related, the need to establish a common method of establishing the value of aid across countries[20].

Reflecting this, the Commission's position has been to accept aid for capital investment or job creation (and capable of being related back to this spend) but to remain opposed to so-called "operating aid" - ie. aid not conditional on initial investment or job creation. This opposition is clearly expressed in the 1979 principles[21] which set out the view that such aids merely reduce the running costs of recipient firms, enabling them to survive in the market without making necessary "structural" adjustments; in addition, it doubtless also reflects the difficulties inherent in subjecting operating aids to the common method of assessment. In the 1979 principles the Commission stated that, within a three-year period, it would specify the circumstances, if any, in which operating aids could be considered to be compatible with the Common Market. In practice, however, the Commission did not do so until the 1988 Communication[22] in which it stated that operating aids could be made available in Article 92(3)(a) regions in specific circumstances. Interestingly, the Communication notes that "island regions in peripheral locations can suffer permanent cost disadvantage with respect to trade because of the burden of additional transportation expenses"; however, it goes on to say that the Commission will only authorise operating aid which "is limited in time and designed to overcome the structural handicaps of enterprises located in Article 92(3)(a) regions"; this seems somewhat inconsistent with the recognition that the cost disadvantages are permanent.

Commission insistence on transparency has been influential in shaping the incentive policies of the Member States over the past two decades. In the field of regional policy, for example, largely (although not entirely) as a consequence of Commission pressure, the main incentive on offer in all the EU countries (except Greece) takes the form of a grant contingent upon initial investment or job creation[23]. However, Commission insistence on *its particular interpretation of transparency* has caused considerable difficulties in the context of the new Nordic Member States, Finland and

---

[20] Council Resolution of 20 October 1971 on General Systems of Regional Aid, OJEC C 111; 4 November 1971.

[21] Communication on Regional Aid Systems, OJEC C 31; 3 February 1979.

[22] Communication on the Method for the Application of Articles 92(3)(a) and (c) to Regional Aid, OJEC C 212; 12 August 1988.

[23] Yuill, D., Bachtler, J and Wishlade, F. (1996) *European Regional Incentives 1996-7*, 16th edition, Bowker-Saur, London.

Sweden, and continues to be problematic for Norway through the application of the *acquis communautaire* by the EFTA Surveillance Authority[24].

The current dispute between ESA and Norway concerns a system of differentiated employers' social security contributions. The system is part of a regional development strategy to maintain a population settlement in the northern areas by reducing employment costs; the lower rates of contribution are graduated in five bands through the country and apply to public and private sector employers. It is clear from the discussion on the definition of State aid that such measures are caught by Article 92(1); it has long been established that regionally differentiated tax measures constitute aid. However, such forms of assistance also fall foul of the Commission's approach to interpreting the Article 92(3) exceptions. In its view, measures of this type lack transparency – and this in spite of the fact that the levels of concession are fixed, advertised and apply to all sectors of activity – because the aid is deemed to be operating aid. At the time of writing, the future of the Norwegian concession is still under discussion, but ESA looks set to propose "appropriate measures"; in Sweden, which faced the same issue but with the Commission as adjudicator, steps have already been taken to convert the concession into a transport subsidy[25] on the lines agreed in the revision to the 1988 Communication on regional aids[26].

Again, it can be argued that this approach is characterised by the formalistic attitude described in relation to the definition of an aid. These measures are, in fact, far more transparent than the operation of different levels of central government block grants to local authorities, which in turn create different levels of local taxation burden. It is questionable whether the interests of fair competition are served by the prohibition of measures that fail to comply with a particular view of transparency; this is especially doubtful given the regional economic context of the areas concerned. Most economic activity involves servicing local markets and few undertakings are in competition with other domestic, let alone other European, operators; however, those that *are* involved in exporting out of the region are those who will benefit most from the transport subsidy.

3.2 Spatial Coverage

The most active and controversial aspect of Commission control of regional aids has been its disciplining of the coverage of assisted areas. This has been an influential form of Commission intervention in Member States regional policies. However, since the early years of the European Community, both the approach of the Commission and the substance of policy itself has changed considerably[27].

---

[24] EFTA Surveillance Authority (1997) Annual Report 1996, ESA, Brussels.

[25] IP/97/91 Commission approves aid for transport in northern regions of Sweden.

[26] *Commission notice, addressed to the Member States and other interested parties, concerning an amendment to part II of the communication on the method for the application of Article 92(3)(a) and (c) to regional aid,* Official Journal of the European Communities No. C 364, 20 December 1994.

[27] See Yuill, D., Bachtler, J and Wishlade, F. (1996) *European Regional Incentives 1996-7*, 16th edition, Bowker-Saur, London, for a fuller description of the history and methodologies for regional aid area designation.

In a first phase up to 1988, the Commission approach was widely viewed as opaque; the only published policy documents on the principles underlying area designation approval dated back to the 1970s and these principles were expressed in very general terms.

A second phase began in 1988 when the Commission published its methodology for approving assisted areas; however, it was never very clear whether in fact its earlier decisions had been based on this methodology or whether its publication represented a new policy stance involving an apparently more consistent approach. Publication of the methodology exposed the Commission to much criticism since it provided the Member States with the ammunition to identify the weaknesses and anomalies of the approach, whereas previous complaints had been concerned mainly with Commission secrecy and obstinacy.

A number of criticisms can be identified. First, Member States have been concerned at the extent of the discretion available to the Commission in operating Article 92(3)(c) in respect of regional aids, notably the fact that neither the first nor the second stage of analysis is conclusive. Second, many policymakers took the view that reliance on GDP per head and unemployment data was inadequate. Regional level GDP figures often produce anomalous results because of the location of particular activities[28]; nor is unemployment always a reliable guide to the existence of a regional problem - in rural areas, in particular, out-migration can pre-empt high levels of unemployment but contribute to desertification and urban congestion. Third, there were criticisms of the territorial units used as the basis for the analysis. Not only do these vary very widely across the EU in terms of population and size, meaning that they are in no sense really comparable, but also, the focus is on the use of administrative rather than economic units. Last, national policymakers claim that the emphasis on statistical indicators has meant that insufficient account has been paid to the more qualitative aspects of policy and to the geographical dimension.

In the early 1990s the nature of the relationship between competition policy and regional aids changed further. The effects of the negative reactions of many Member States to the 1988 methodology were compounded by the impact of the reformed Structural Funds. In all of the Member States (except Greece, Ireland and Portugal) there were significant differences between the maps approved for Structural Fund intervention and the maps used for national regional aid policies. A number of complicated practical, political and policy issues arose from these discrepancies in spatial coverage. Ultimately, this culminated in a much more flexible approach to applying the Commission methodology.

A third policy phase has emerged as a consequence of the general criticisms outlined above and the conflict over the coherence of national and EU assisted areas; the Commission has, in its recent reviews of the assisted area maps of the Member States, moved to a much less rigid application of the 1988 methodology in respect of Article 92(3)(c)[29]. This places less emphasis on the GDP and unemployment thresholds and is

---

[28] For example, in Grampian and Groningen GDP is artificially inflated by the fact that income from offshore oil and gas extraction activities are included in the regional figure.

[29] A new framework for the control of regional aids is currently under discussion between the Commission and the Member States; if agreed, this framework will, *inter alia*, incorporate this approach.

more flexible about the territorial units used; instead, the Commission focuses more on overall levels of problem region coverage expressed as a proportion of the national population. This is based on the assumption that the greater the level of national prosperity, the lower the coverage of the assisted areas should be. Within a given population ceiling agreed between the Member State and the Commission, national policymakers have greater freedom in selecting areas eligible for assistance.

Overall, this new flexibility has, not surprisingly, been broadly welcomed by the Member States. However, its relevance the interests of fair competition are perhaps questionable; more fundamentally, the reasons for the Commission's attachment to spatial coverage as the main measure of regional aid discipline are unclear. Certainly, from a regional development perspective, reliance on population coverage could be regarded as quite arbitrary. The Commission view is that less prosperous countries should have greater assisted area coverage. This implies a correlation between national prosperity and internal regional disparity; however, it is questionable whether such a relationship exists. Within France, for example, regional disparities in GDP outside Paris are not particularly wide; however, there *is* a wide disparity between the capital region and the rest of the country, leading national policymakers to seek wide spatial coverage of policy.

The issue of relevance is perhaps more pertinent still from a competition policy perspective; the ability to constrain spatial coverage does not, of itself, prevent the distortion of competition. Indeed, it can be argued that a range of other factors are of more importance: the situation of the region in which the aid is offered, notably with respect to the cost advantages of the location; the level of aid on offer and the extent to which this offsets or even over-compensates for cost disadvantages; and the EU-wide situation of the sectors receiving assistance.

These are important issues because the combined effects of the emphasis on spatial coverage and the allocation of population "quotas" for assisted area coverage in each Member State creates the temptation to focus development area status on strategic locations for the attraction of mobile investment. Recent area designation exercises carried out in France and the UK, amongst others, support the view that Member States are being led to target assistance in way, potentially contributing to competitive outbidding between regions.

3.3 Aid Values

A further important area of Commission influence concerns the value of aid available in any given instance. This involves setting a ceiling on the proportion of expenditure eligible for support. There are two points of note about these ceilings. First, with respect to the form in which the ceiling is expressed, the rules[30] provide that the "single ceiling for aid intensity shall be fixed as a net subsidy-equivalent calculated according to the common method of assessment" and that the maximum levels of assistance that may be offered should vary with the severity of the regional problem.

---

[30] Council Resolution of 20 Oct 1971.

The aim of the so-called common method of assessment developed by the Commission is to enable different forms of aid to be measured as a percentage of the investment after tax - the so-called "net grant-equivalent" (nge). To this end the methodology makes a number of assumptions about the nature and composition of assisted investments, the expenditure eligible for assistance and the profitability of the recipient firm. In practice, however, it is clear that the net grant-equivalent value of a given aid can only be measured *ex post* and on a case-by-case basis. This arguably raises serious questions about the genuine contribution of the method to improving transparency with regard to the value of aid.

Notwithstanding reservations about the relevance of the net grant-equivalent calculation, close examination of what happens in reality reveals considerable inconsistencies in the use of the method. In practice, the Commission has set regional aid ceilings in *gross* rather than *net* terms in six out of the 15 Member States[31] (see Table 1). There would seem to be no clear reason why the aid ceilings for this particular group of countries should be expressed in gross terms. The group includes one of the four Cohesion countries and two of the three Member States which have most recently joined the EU. Moreover, it consists of both Article 92(3)(a) areas (the whole of Portugal and the new *Länder* in Germany) and Article 92(3)(c) regions (the remainder). There would, thus, seem to be no obvious rationale for the choice of gross rather than net grant-equivalent ceilings.

Table 1: Commission Award Ceilings for Member States where Maxima are Expressed in Gross Terms

	Gross Award Ceiling (%)	Pop Coverage (%)
Finland	35	12.7
	27	12.8
	20	16.1
Germany	35	20.8
	18	11.1
	15	1.8
	12	3.9
Luxembourg	25	34.6
	17.5	8.1
Netherlands	25	1.5
	20	9.1
	15	6.7
Portugal	75	100.0
Sweden	35	5.9
	25	12.6

Source: DGIV, European Commission.

For the remaining countries where regional aid ceilings are set in nge terms, the position is further confused by the scope for assistance to SMEs under regional aid programmes. The Commission will generally authorise a "supplement" for SMEs of 10 or 15 percentage points, on top of the existing aid ceiling. However, the SME

[31] Wishlade, F. and Yuill, D. (forthcoming) *Regional Incentive Policies in the European Union: Rates of Award and Award Values*, Regional and Industrial Policy Research series, European Policies Research Centre, University of Strathclyde, Glasgow.

ceilings are expressed in gross terms, resulting in a complex task of combining gross and net limits.

There must be serious doubts about the usefulness of the Commission approach to controlling regional aid values. First, net grant-equivalent values can only be compared *ex post*, which limits their relevance for comparing the aid on offer in different locations; second, the Commission does not always set ceilings in net grant-equivalent terms, making any practical comparison impossible.

The maximum award *values* set by the Commission also raise issues of policy relevance. The early principles on which the control of regional aid is based specify that maximum values should vary with the severity of the regional problem. At the same time, the starting point for setting the ceilings were the advertised rates already being offered in the Member States. This approach led to a 75 percent net grant-equivalent ceiling in many areas approved under Article 92(3)(a) simply because that was the prevailing rate in the Italian *Mezzogiorno* at the time that the basic principles on aid intensity were first enunciated. Indeed, the general practice of adopting Member States' advertised maxima as ceilings has resulted in a large number of different authorised ceilings - around 50 different levels[32] with little rigour applied to establishing a relationship between the maximum award level and the severity of the regional problem. The absence of such a relationship is illustrated in Chart 1.

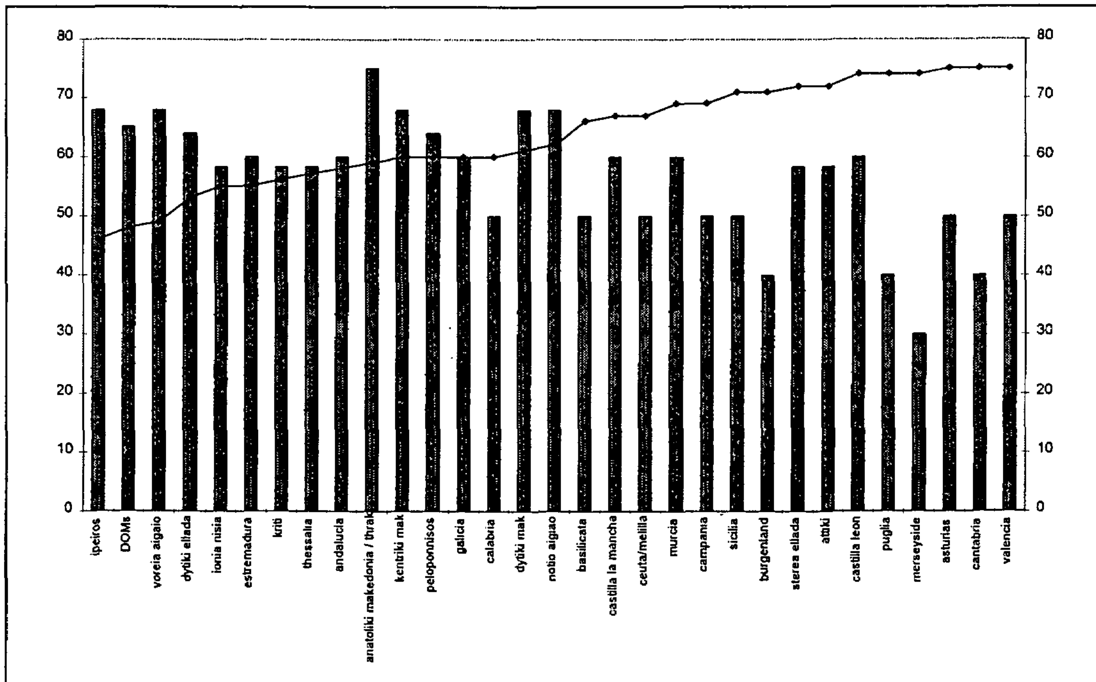
Most of the areas shown in Chart 1 are concerned by Article 92(3)(a), that is, the basis for their designation is that levels of regional GDP per head (measured in purchasing power terms) are less than 75 percent of the EU average. Given the Commission's stated methodology, one might expect a clear pattern to emerge from the chart; at best, the relationship between regional prosperity and the rate of award authorised is indistinct.

Similar degrees of inconsistency apply to those regions where the ceiling has been set in *gross* terms. The rates applicable for all such regions are plotted against levels of GDP per capita in Chart 2.

Of course, such illustrations must be treated with some caution. In the Article 92(3)(c) areas, levels of unemployment are combined with levels of *per capita* regional GDP and regions are assessed against both the EU and the national averages; this is not reflected in these charts, which take account only of GDP.

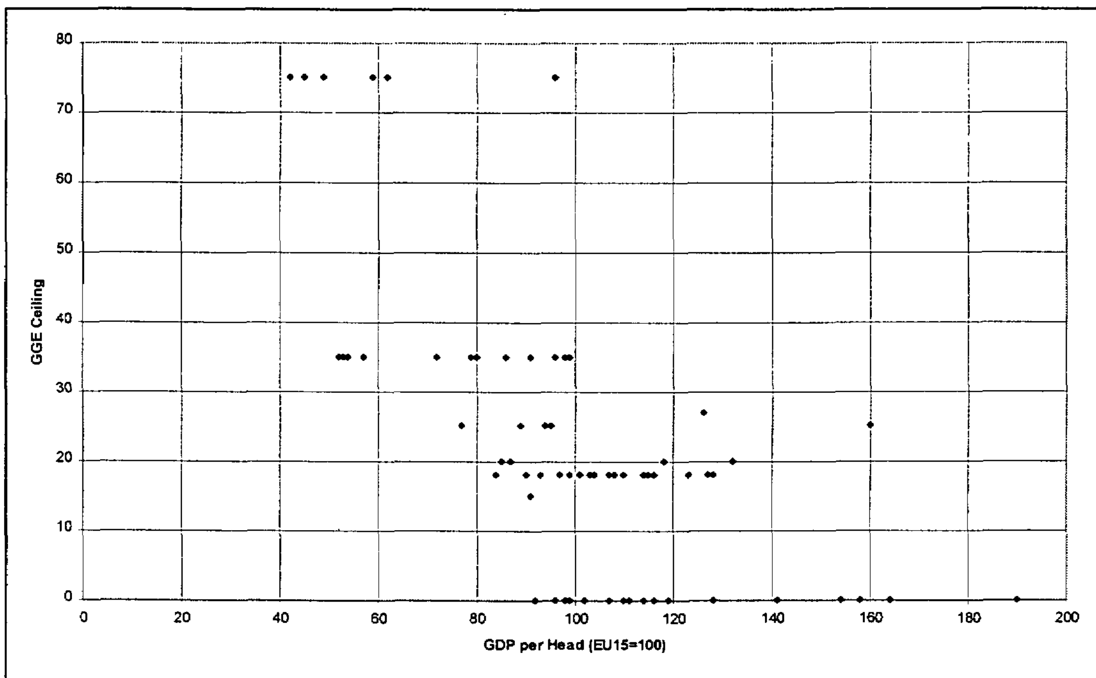
[32] Marques, A. (1993) *Incentivos Regionais e Coesão: Alcance e limites de acção communitaria*, Notas Economicas 1, Coimbra, Portugal.

Chart 1: The Relationship between GDP/PPS and NGE Ceilings in Europe's Poorest Regions



Source: Wishlade and Yuill.
Note: Regions are presented in ascending order of GDP/PPS (plotted against the right hand Y axis) where EU15=100. The bar chart shows EU nge ceilings.

Chart 2: The Relationship Between Gross Grant Equivalent Ceilings and GDP per Head



Source: Wishlade and Yuill.

There is, however, a more fundamental reason why the Commission approach to setting aid ceilings is of questionable relevance. This is not so much because the conceptual basis is questionable and that the concept is anyway applied inconsistently, but rather because the Commission ceilings tend not constrain regional aid administrators in making award offers. On the contrary, the average awards under the main regional incentive grants are typically between a quarter and a half of the maxima permitted. As such, the award ceilings authorised by the Commission are of limited impact in terms of disciplining regional aids. This is principally because, since the early 1980s, regional policy expenditure has tended to decline as most countries have experienced budgetary pressures; a consequence of this is that policymakers have increasingly sought "value-for-money" in making grant offers with the result that the advertised maxima are rarely attained in practice.

3.4 Further considerations

The focus of this section has been on the Commission's interpretation of Article 92(3) with respect to regional aids. This has involved a high degree of interventionism on the part of the Commission which has sought to influence the form of assistance, the spatial coverage of policy and the value of aid, albeit with varying degrees of success. The Commission has certainly impacted on the *form* of assistance on offer, although it has been argued that its particular definition of transparency is one which, perhaps unnecessarily outlaws visible and predictable forms of assistance. The Commission has also influenced the *spatial coverage* of regional aid policies, but it is by no means clear what the rationale is for the emphasis on this aspect of regional aid control; at the same time, it can be argued that current policy may actually reinforce competitive outbidding for mobile investment. Last, the Commission has developed a highly technocratic approach to setting aid maxima, and one with a dubious conceptual basis. In practice, however, it applies the methodology inconsistently; more fundamentally, however, the aid ceilings permitted by the Commission are so high that policymakers are constrained by domestic budgets before the Commission maxima bite.

Given the level of detailed scrutiny over regional aids generally, it is notable that the Commission has apparently paid scant attention to levels of spending on regional aids, in spite of the fact that budget information is required at the time of aid programme notification. The vast differences in levels of aid spending are evident from the Commission's regular survey (see Table 2). Of course, these figures are not adjusted for the size of national or assisted area population, or for the size of the economies concerned, nevertheless, the differences in levels of spend are striking. In part these differences result from different national policy choices about the importance of regional development and the appropriate instruments to use. On the other hand, a common complaint from policymakers in the four so-called Cohesion countries is that their regional policy budgets simply cannot compete with those of the richer Member States and that there is no real benefit form the higher award ceilings authorised by the Commission; they simply cannot afford to reach them.

Table 2: Regional Aid Spending Annual Average 1992-4 (MECU)

Belgium	196.57
Denmark	13.70
France	514.55
Germany	13,643.52
Greece	216.58
Ireland	342.91
Italy	5988.49
Luxembourg	33.06
Netherlands	119.90
Portugal	151.21
Spain	251.12
United Kingdom	704.37

Source: Fifth Survey.

4. CONCLUSIONS

This paper has called into question the policy relevance of a number of aspects of the EU State aid regime. The purpose of this regime is, of course, to prevent undue distortion of competition in the EU through the use of State aids. This concluding section argues that the formalistic approach taken by the Commission in a number of spheres leads to a partial view of the competition impacts of State aids and one that bodes ill for the continued export and extraterritorial application of the rules.

The Commission approach to defining State aids and general measures is more driven by legal formalism and political imperatives than economic context.

Commission competence derives exclusively from the Treaty. Under Article 92 it has wide-ranging discretionary powers to decide whether a measure is an aid and, if so, whether it qualifies for an exemption from the general ban. The scope for Commission action in respect of measures that are not State aids, but that also distort competition, is much more limited making the distinction between general measures and State aids of paramount importance.

This has distinction has been the subject highly formalistic interpretation of Article 92 by the Commission. The reference to "favouring certain undertakings or the production of certain goods" has resulted in considerable emphasis being put on identifying the norm from which selective measures depart. This approach quickly runs into difficulties, especially where the category of undertakings is so broad that it might be considered to be the norm, or where the characteristics of a particular sector are so specific that it is difficult to assess whether it is being favoured in comparison with other economic activities.

The treatment of taxation under the State aid rules lies at the heart of questions about the relationship between Article 92 and general measures. However, the relationship between the distortion of competition and taxation systems raises complex issues of considerable national sensitivity. The scope for the Commission to intervene in

matters of direct taxation is limited by the Treaty. Moreover, the emphasis on the principle of subsidiarity since the Treaty on European Union has increased pressures on the Commission to limit the extent to which it becomes involved in the internal affairs of the Member States. However, just because the Commission has greater influence in one sphere of policy than another does not mean that the wider economic context should be absent from its approach. Commission thinking on State aids would benefit from a more teleological stance and a consideration of the principles of proportionality and objective justification that are now well enshrined in the approach of the Court of Justice.

The Commission approach purports to be *effects-based* but in practice the Commission limits its consideration of effects to measures that are State aids.

The Court and Commission have reiterated on a number of occasions that it is not the *form* of a measure but its *effect* which brings it within the scope of Article 92. In practice, however, the Commission tends to take a one-dimensional stance in assessing effects. For example, in considering a regionally-discriminating tax schemes, the Commission analysis is limited to finding that the measure favours firms in a given region; its assessment does not extend to considering whether there are other measures that have *equivalent effect*, but which fall *outwith* Article 92.

The most obvious example of such other measures concerns regional differences in the tax burden on firms that arise as a consequence of local autonomy in raising taxes. If the benchmark approach is used, then the appropriate level of analysis, certainly from a political perspective and probably from a legal perspective, is the unit or level of government that is responsible for levying the tax. In other words, it would be inappropriate for the State aids rules to be used to attack systems of local government finance; however, it *is* appropriate for information on regional differences in the tax burden on firms to inform Commission decision-making and to be used as part of the context for considering regionally-discriminating tax systems. Instead, such measures are condemned because of the level of government which has responsibility for the tax, in other words because of their *form*, rather than their effect.

The Commission has been influential in shaping the form of State aids, but its antipathy to so-called operating aid is based on a particular view of the notion of transparency and one that ignores the policy context.

Commission opposition to support which is not related to initial investment or job creation is largely based on the view that such forms of aid reinforce existing structures and allow the survival of inefficient enterprises. This is a narrow view. Moreover, it is difficult to reconcile the Commission's own recognition of the fact that remote and island regions can suffer *permanent* cost disadvantages with its willingness to approve operating aids in Article 92(3)(a) areas, *provided that they are time-limited.* If the disadvantages are permanent, why should the support be temporary? After all, the higher central government grants received by poorer local authorities also mean that firms in the locality are not bearing the full cost of the services received; this too effectively amounts to an operating aid.

The detailed nature of Commission intervention in State aid policies may encourage Member States to seek less transparent mechanisms to support firms, and ones which impact on other areas of EU policy.

The regional policies of the Member States have been subject to considerable Commission scrutiny over the last two decades or so, often involving a highly-prescriptive approach to area designation. The regional aids operated by the Member States mainly take the form of grants and are visible and transparent. There is, in consequence, a degree of exasperation among policymakers at the extent of Commission intervention and a widespread suspicion at the activities of other Member States, especially with respect to taxation and the attraction of foreign investment.

Excessive Commission scrutiny of visible and transparent State aid policies may be counterproductive. A number of Member States operate tax advantages for mobile investment which are at the margins of the distinction between general measures and State aids. In the absence of a notification from the Member State, detailed consideration of the measure will only result from Commission scrutiny of national tax legislation (which it has not the resources to do) or from complaints. Such measures are particularly opaque and some would be deemed "unfair" under the OECD classification. Continued pressure from the Commission with respect to regional investment aids may encourage the proliferation of such measures as Member States seek instruments that are sheltered from scrutiny under Article 92. As well as contributing to a loss of transparency in government assistance, it would also risk undermining progress towards fiscal harmonisation.

Recent developments in international subsidy discipline have been heavily influenced by the EU State aid regime, but more consideration needs to be given to the substance of the rules before applying these extraterritorially *en bloc*.

The EU experience in controlling State aids is reflected in a growing number of international agreements concerned with disciplining subsidies. There are, however, considerable problems associated with simply transposing existing rules into other jurisdictions or economic contexts.

This is evidenced in the potential policy conflict arising from the incorporation of EU principles into the WTO regime[33]. In addition, within Europe, recent experiences with applying the State aid rules to new the Member States revealed significant difficulties. Apart from changes to the national aid measures concerned, there were also revisions to the State aid rules themselves in order to adapt to the policy practices of the Member States. Moreover, the extraterritorial application of the EU rules to the remaining EFTA countries under the EEA Agreement has not been without difficulties; however, the application of the rules to an environment where levels of economic development and forms of economic undertaking differ much more widely is likely to be yet more problematic. It has been suggested that the EU approach to State aids "may not necessarily be well adapted to the problems of countries

---

[33] Wishlade, F. (1996) *Subsidies and State Aids: The Definition of Acceptable Measures under the European Union and World Trade Organisation Rules*, Regional and Industrial Research Paper Series, 21, European Policies Research Centre, University of Strathclyde.

undergoing economic transformation"[34]. It is also probable that eastern enlargement, and the consequent wider application of the rules would cause severe strains within the EU15 – GNP per head in the central and eastern European states is just over 10 percent of the EU average, a factor which will provide a serious test for the approach to approving regional investment aid in the current membership.

---

[34] Evans, A. (1996) *The Integration of the European Community and Third States in Europe: A Legal Analysis*, Clarendon Press, Oxford.