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Response to the State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009

“View from Civil Society-NGO Sector”

Wales Council for Voluntary Action (WCVA) represents, supports and campaigns for NGOs, volunteers and communities at a national, UK and European level, and is the key voice of civil society in Wales. With a diverse membership of over 1500 organisations, and contact with thousands more through national and regional voluntary sector networks, WCVA is the leading representative body of the voluntary/NGO sector in Wales.

WCVA’s mission is to strengthen voluntary and community action at the heart of a civil society in Wales that:

- is inclusive and offers equality of opportunity;
- empowers people to participate and fosters community leadership;
- encourages and promotes the independence of voluntary action;
- celebrates and reflects linguistic and cultural diversity and choice;
- engages in genuine partnership with other sectors on a “who does what best” basis.

WCVA has been pro-actively engaged with European policies and programmes for over 10 years. It currently represents the voluntary sector on all Structural Fund Programme Monitoring Committees throughout Wales. It provides designated resources to promote the programmes through advice and training, and operates European projects (ESF and ERDF) to the value of almost £69 million.

1. Introduction

WCVA welcomes the opportunity to comment on the State Aid Action Plan, and to convey to the European Commission the specific difficulties experienced by social enterprise in relation to the application of State Aid rules. The comments made in this response are only in relation to the sections of the consultation document that have direct implications for the third sector.

For the purposes of this report, the **DTI and Welsh Assembly Government definition of social enterprise** is used:

“A social enterprise is a business with primarily social purposes. This means it is engaged in some form of trading, but it trades primarily to support a social purpose. Like any business, it aims to generate surpluses, but it seeks to reinvest those surpluses principally in the business or in the community, to enable it to deliver on its social objectives. It is, therefore, not simply a business driven by the need to maximise profit to shareholders or owners.”

WCVA hosted a consultation event on 9 August 2005, which was attended by 52 representatives of the interests of voluntary organisations. These organisations have practical experience of the application of state aid rules, notably in relation to social enterprise and Structural Fund projects, and therefore have a vested interest in the future proposals.

Specifically WCVA has also consulted with the **Wales Co-operative Centre** and the **Development Trust Association**, both major social economy development agencies in Wales, to gather evidence of the issues faced by credit unions, co-operatives and development trusts in respect of state aid.

The comments are submitted on behalf of the voluntary sector in Wales.

2. A modernised state aid policy

WCVA believes that the existing state aid rules are out-dated for a modern economy, and therefore endorses the move by the Commission to modify state aid rules to give renewed impetus to the achievement of the Lisbon goals, to better contribute to sustainable growth, competitiveness, social and regional cohesion and environmental protection. The proposals for less and better targeted state aid, with a focus on the most distortive types of aid; simplification and efforts to make state aid control more predictable and user-friendly are fully supported. The principle of balancing the positive impact of aid measures against potentially negative side effects in relation to the common interest is also welcomed.

Concern is expressed at the current rigid application of state aid rules, notably in respect of social enterprise. Social enterprises are subject to the same rules as SMEs, in spite of notable differences in terms of their mission, structure and dual economic *and* social focus of their activities; they operate frequently in areas where the market has failed either the geographical community or the community of interest. The Commission's judgement has been that some of these activities have the potential to distort competition, and Structural Funds have either been inaccessible to the organisations, or in the most serious cases, money has been clawed back. In cases where aid has been permitted, the Commission has requested that un-profitable services should be split up from income generating activities, in respect of state aid, and this has proven to be extremely difficult in administrative terms for social enterprise.

WCVA proposes that non-profit-distributing organisations with an explicit social aim, which seek to remedy market failure and make an important contribution to social and regional cohesion, should not be subject to the same treatment as private enterprise.

3. Focusing on the key priorities

3.1 Creating a better business environment and creating entrepreneurship

Firstly, in the context of the State Aid Action Plan, it is assumed that the definition of SME encompasses social enterprise.

The promotion of a culture of entrepreneurship, supported by measures to improve the business climate to facilitate the rapid start-up of new enterprises will make an important contribution to achieving the revised Lisbon objectives. The consultation document mentions improving support measures for young, innovative SMEs, particularly those established in response to market failure. Social enterprise most certainly falls into this category, yet the sources of finance available to such organisations are limited because the financial motives and liability of social enterprise are distinct from that of private enterprise.

The aim of private enterprise is to make a profit, whereas the primary objective of social enterprise is to generate a surplus for re-investment, and to take account of the triple bottom line: the economic, social and environmental impact. A private limited company can re-mortgage private assets in order to finance a business venture; by contrast the management structure of a social enterprise means that trustee's have legal responsibility for finance and are understandably hesitant to take risks. The potential legal and financial repercussions of taking out a private loan for investment are frequently too high risk for not-for-profit organisations, particularly for those that have evolved from an original social purpose to undertake trading activities.

Finance such as risk capital, as mentioned in the consultation document, would therefore not be a practical option for social enterprise as the risks would be too high. **For this reason, it is recommended that there should be a block exemption for social enterprise.**

A large proportion of social enterprises are seeking to move away from grant dependency towards sustainability, however it is proving extremely difficult to accomplish this when finance is in practice limited to public sources, meaning that organisations are not afforded the opportunity to become financially independent or to have the flexibility to be innovative in response to the needs of the market.

State aid rules at present do not allow social enterprise to graduate to sustainability and as such, there is not a level playing field with private enterprise. **If a block exemption for social enterprise is not possible, it is recommended that 100% public funds should be permitted as seed corn funding to establish social enterprise and that there should thereafter be a sliding scale of support i.e. the percentage of state aid that organisations are eligible to receive decreases as surpluses increase. This would support social enterprises to gradually move away from grant dependency, towards sustainability, preventing distortion of competition.**

The proposal for enterprise aid for small firms in assisted areas, with a 3m Euro limit, exceeding that of de minimis, is welcomed as it provides scope for higher levels of assistance from SME start-ups, including social enterprise.

3.2 Investing in human capital

Social enterprises generally operate on a local/regional basis and often provide supported employment and training opportunities for people who face barriers to accessing and remaining in employment. Social enterprises therefore have an important role to play in supporting people from disadvantaged groups into employment, providing informal and formal learning opportunities to enhance the adaptability and skills of workers, and vitally, contributing to social and regional cohesion. Under current state aid rules, social enterprises must attempt to separate economic activity from social activity, but this is felt to be an unnecessarily complex method and a considerable administrative burden for small organisations.

It is recommended that substantial levels of state intervention to support social enterprise, as a means to invest in human capital, should be permitted under the revised training and employment block exemptions.

3.3 High quality Services of General Economic Interest (SGEI)

The extended scope to support the provision of high quality Services of General Economic Interest (SGEI) is of notable importance, particularly in Wales, where the third sector is increasingly providing essential services on a local/regional basis. The recent successful notification by the Scottish Executive regarding credit unions represents an important shift in attitude, recognising the arguments relating to social need and market failure. It is understood that the National Assembly for Wales is seeking to capitalise on this advancement by submitting a similar notification to cover schemes in Wales.

Under the proposals, Member States will have discretion over the option to finance SGEI; the UK Government is asked to publish at an early stage clear guidelines for financing provision of SGEI.

The SGEI guidelines refer to “reasonable profit”. A definition is required for what constitutes “reasonable profit” and is there a distinction to be made between the traditional interpretation of profit, and income surplus (not-for-personal-profit) that is re-invested into the business/local community?

The proposal to exempt notification of small-scale compensations is welcomed as it provides scope for smaller enterprises to operate without fear of reprisals. A clear definition of activities that would fall in this category is required.

3.4 Better prioritisation through simplification and consolidation

The proposal for a simplified general block exemption to consolidate existing exemptions (training, SME and employment) and to integrate a broader range of exemptions is endorsed. However, the inter-relation between the general block exemption, assisted areas and de minimis requires clarification.

The existing level of de minimis aid (100,000 Euro’s over three years) is insufficient pump-prime funding to establish a meaningful social enterprise activity, and the Commission’s proposals to increase the level of aid is very much supported. **The level of de minimis aid should be substantially increased to at least three times the current level, ideally to 500,000 Euro’s over three years, with flexibility between the limits for capital and revenue.**

Will the previous proposals for LASA (Lesser Amounts of State Aid) and SIT (Significant Impact Test) be integrated into the guidelines?

3.5 A focused regional aid policy

Cohesion is one of the three pillars of the Lisbon Strategy and is key to advancing the European Social Model. The Commission's revised cohesion policy and state aid regime must therefore be complementary.

Full convergence regions designated Article 873(a) status for the period 2007-2013 must benefit from the higher level of aid intensities to complement the Structural Fund interventions. "Statistical effect" regions should continue to benefit from higher aid intensities until their relative wealth has increased, followed by a phasing-out period; the opportunity to review the position of these regions in 2009 is sensible.

For 873(c) areas, the flexibility for Member State governments to target very localised regional disparities and to designate other smaller regeneration areas (with a minimum population of 20,000) is welcome as this provides scope for higher levels of support for social enterprise activities. WCVA would wish to see an explicit recognition that social enterprises will be included in this definition, if a block exemption is not agreed. We are also concerned about which criteria would be used to designate these areas, as reliance only on GDP figures below EU average of 75% and unemployment rates above 115% would enable too many areas in the UK to be considered. From the Welsh experience of social enterprise, it would be vital to consider other criteria measuring disadvantage and social exclusion including economic inactivity levels.

The scope for SMEs to undertake local activities in urban deprived areas where trade is not effected is useful, however a clear definition is required for what is considered to be a 'local activity' and the types of activities that would fall into the categories of health and social care and personal services.

4. Modernising the practices and procedures of state aid

4.1 Better governance – a shared responsibility with Member States

The current bureaucracy and administration of state aid controls are problematic, particularly in terms of the long time-scale for decision-making. The proposals for better governance, with more predictable timelines, clear procedures, transparent practices and increased availability of information, are very much welcomed.

The proposal to issue best practice guidelines, after consultation with Member States, would usefully contribute to harmonising the implementation of state aid policy by making available the experience of other Member States of working within the rules. The opportunities for mutual learning and exchange of good practice should be used, and the UK Government and the National Assembly for Wales are encouraged to pro-actively examine good practice in other Member States in relation to social enterprise and to work in co-operation with the third sector to identify solutions to common problems.

Independent authorities in Member States could play a role in terms of state aid enforcement. In order to limit bureaucracy and time delays, it is suggested that there should be an independent authority resident in Wales in order to assist with enforcement.

There is a general lack of understanding around the issue of state aid, and WCVA has amassed anecdotal evidence from credit unions, co-operatives and social enterprise about the complexity of state aid policy, and the fears generated by the rigid application of the regime in the UK.

Whilst the specialist support provided by the DTI State Aid Policy Unit is welcomed, WCVA would urge the Welsh Assembly Government, with the support of the DTI, to provide a clear steer on how state aid rules should be applied, particularly in the case of social enterprise and credit unions.

At present, the time-scale for decision-making is unacceptably long and a number of Structural Funds projects have been unnecessarily held up in the process of approval, whilst the granting authority seeks advice from UK Government and European Commission sources. In addition, staff of the managing authority are not sufficiently skilled or empowered to independently interpret and apply the state aid rules, and are consequently unable to provide high quality timely advice to applicants. There should be explicit, high level guidance and training available to staff of granting authorities to give officers the confidence to advise individual grant applicants on a case-by-case basis and to take decisions.

Currently there are different interpretations through the funding chain in terms liability for state aid, particularly in the administration of key funds. There is a need for clear guidance and defined levels of responsibility for state aid. **WCVA recommends the establishment of a specialist technical advice service, able to provide on-going advice and support, with a named point of contact responsible for liaison with the third sector.**

4.2 Less bureaucracy and better targeted enforcement and monitoring

There is considerable concern by third sector organisations that they risk falling foul of state aid rules, which is exacerbated by the reticence of granting authorities to provide high quality advice. The proposals to promote advocacy, awareness and understanding of state aid controls at all levels are therefore very welcome; this should include the National Assembly for Wales and the Welsh European Funding Office.

In addition, a network of state aid authorities, to facilitate information flow would usefully support the best practice guidelines. Information from the network must be disseminated to regional level to ensure that lessons learned are applied on the ground.

4.3 Adapting procedural rules to an enlarged EU

The intention of the Commission to up-date and adapt procedural rules in light of enlargement, in order to minimise administration and bureaucracy, are both timely and necessary.

The proposal to block exempt additional types of measures, such as culture and heritage conservation, is welcomed.

4.4 Establishing and evaluating the new practice for the future

The Commission's proposal to evaluate and potentially modify the new guidelines in 2009 in light of their application on the ground is essential to ensuring that the new rules are satisfying their intended purpose.

5. Summary of key recommendations

- Social enterprises are a vital tool in promoting the Lisbon agenda in areas of market failure, and in providing innovative job opportunities for disadvantaged people.
- The current state aid guidelines do not take into account neither the niche role nor the specific problems encountered by these enterprises.

- There is a need to create a level playing field to give social enterprise the freedom and flexibility to operate in the same way as private enterprise, whilst recognizing their specific function of delivering social goods and services whilst employing disadvantaged people.
- In the first instance, the third sector would request a block exemption for social enterprises as the best solution to the specificity of the role and function.
- If a block exemption for social enterprise is not possible, it is recommended that there should be a sliding scale of support for social enterprise i.e. the percentage of state aid that organisations are eligible to receive decreases as surpluses increase. The level of support should begin at 100% during the start-up phase. This would support social enterprises to gradually move away from grant dependency, towards sustainability, preventing distortion of competition.
- The level of de minimis should be increased to 500,000 Euro's, with a flexible split between capital and revenue.
- The proposed simplification for a general block exemption is supported.
- SGEI provides scope for social enterprise activity but there is a need for clarification from the UK Government as to which services could be financed.
- More clear and timely information, advice and guidance on a case-by-case basis should be available in Wales at regional level, via a specialist team offering technical advice, with a named point of contact for liaison with the third sector.
- The UK Government and the National Assembly for Wales are encouraged to examine good practice in other member states in areas related to social enterprise and to work co-operatively with the third sector to develop solutions to common problems.
- Lessons learned via the proposed state aid information network and the sharing of good practice between Member States must be transferred in a timely manner to regional level for practical application on the ground. This mutual learning process should involve not only the administrations responsible but enable participation from the sector and the enterprises affected