

STATE AID ACTION PLAN

Less and better targeted state aid: a roadmap for state aid reform 2005-2009

1 Highlands & Islands Enterprise Network (HIE) is government funded and is responsible for economic and community development across a diverse geographical area which covers more than half of Scotland and is home to around 435,000 people.

The aim of the HIE Network is to enable people living in the Highlands and Islands to realise their full potential on a long-term sustainable basis. The HIE Network has four strategic objectives:

Strengthening Communities
Growing Business
Making Global Connections
Developing Skills

2 As the EU State Aid rules are designed to regulate public interventions into competition and trade, this has a significant impact on the Network's activities in each of its objectives, especially in Growing Business. We have considerable experience of the application of the rules and a keen interest in the revisions currently under consideration in the "Roadmap".

The HIE Network's Response:

3 HIE welcomes the Commission's intention to review state aid rules and procedures. On the one hand, with a responsibility for economic development in a region with lagging development due to peripherality and dispersed population we are keenly aware of the significant benefits of European state aid policies that help foster both competition and cohesion. We see the constraining of aid levels in richer regions and allowing differentiated aid levels for the disadvantaged regions as vital to the EU. On the other hand we are conscious of increasing complexity in the procedures for regulating aid and of more uncertainties and difficulties in providing incentives for private sector participation in public services and infrastructure. We are also concerned about the barriers which current procedures present to cases even where there is an insignificant distortion of trade.

I.I Rationale for State aid policy

4 HIE welcomes the Commission's strong re-statement of the role state aid regulation as a means of maintaining a level playing field for undertakings in a single European Market, where market forces reward the most competitive firms and thereby increases Europe's overall competitiveness. We agree that State Aid should be used sparingly to bring about development that the market would not generate alone and that produces net economic benefit. We believe one of the most important roles for the Commission lies in the powers given to it in the Treaty to clarify what might be permitted in the common interest, and in the past it appears to us that there has been insufficient definitive guidance which has resulted in uncertainty amongst National officials and more delays and referrals to the courts than is really justified. An example of delays caused as much by uncertainty as by the procedures themselves has been the process to approve broadband interventions in remote areas such as in the cases of the schemes for Scotland or Cumbria.

I.2 New challenges

5. The cumulative number and complexity of documents concerning State aid is now a serious concern to us, and we suspect many other aid practitioner bodies throughout Europe. This combined with the additional population in the recently enlarged EU make a strong case for simplification of procedures now. We would also agree that the need to modernise and restructure many parts of the European economy in order to increase international competitiveness as expressed in the Lisbon Council conclusions suggest there may need to be increased public intervention in some cases and there is an assumed role for permitting generative State aid here. We would fully support this, especially where it launches new technology sectors and stimulates business innovation. We would, however, wish to emphasise that an important aspect of the Lisbon conclusions was the need to bring about more balanced regional development (i.e. cohesion) and we would comment that a 1% growth in EU GDP achieved in the more disadvantaged regions is just as beneficial to European aspirations as 1% generated in the most wealthy regions. We would therefore make a plea that in pursuing the growth aspirations of the Lisbon Council that European cohesion is not undermined by weakening of regional policy by the expansion of aid for economic growth in all regions irrespective of their relative state of development.

I.3 How to face the new challenges

6. HIE supports the basis for reform being the four elements described as:

- Less and better targeted State aid
- A refined economic approach (in justifying tackling market failure and the acceptability of aid)
- Better procedures and more predictability
- Shared responsibility.

7 HIE fully supports the principle that aid should be permitted selectively where it has least impact on trade and the greatest benefits to society. We would agree that Rescue and Restructuring aid is potentially the least desirable form of aid. We agree particularly with the view that market failure alone is not an adequate justification for State aid, if this means the state intervenes when a particular investment that may be desirable for local development is not profitable. We fear however that if this interpretation of market failure were to be used as justification in these cases this could easily be used to support the less competitive firms generally, thus undermining the competitive stimulation of market forces. In our view the choice to permit aid should be based on a combination of a criteria based on the objective of the aid having priority at a European level (e.g. environmental or regional aid) together with strategic guidance as to the acceptable level of distortion of trade, all with the additional constraint that aid must be the minimum necessary.

II.1 Targeting Innovation and R&D to strengthen the knowledge society

8. We agree with the basic premise in this section that strengthening the knowledge economy and business innovation are the key to sustainable growth. We also agree that there are some difficulties in funding intermediaries such as technology centres and business incubators for innovative firms and we would welcome further clarification of permissible aid.

II.2 Creating a better business climate and stimulating entrepreneurship.

9. Risk capital and seed corn finance for new and rapidly growing small firms is an area where HIE perceives both significant gaps in market provision and major potential for a net benefit to society from public intervention. The problem for fragile and peripheral areas such as the Highlands & Islands is that the ratio of management costs to deal flow is higher than in more central regions where there are higher densities of businesses.

II.3 Investing in Human Capital

10 HIE endorses the effectiveness of the current Block Exemption for training, and has no suggestions for changes to it. As regards Employment aid, we have not so far seen the need for it in the Highlands & Islands of Scotland. We can envisage the social need for such aid may be great when a locality faces major job losses, although as a form of aid very close to operating aid we suggest it has the potential for negative effects on competition and competitiveness and so must be used with care. This sort of aid is most likely to be of net value to development when integrated with other measures designed to re-structure productive and workforce capacities. One way the Commission might encourage this integration and reduce the time spent in administration might be to integrate the Employment Block Exemption not just with training but with other types of aid relevant to economic re-structuring such as SME, R&D, brown-field regeneration and etc.

II.4 High Quality Services of General Economic Interest

11 HIE welcomes the Commission's recent White paper on SGEI and applauds the clarification of where aid is not involved, in response to the Altmark decision of the European Court, and also the introduction of a Block Exemption for certain cases that cannot meet the Altmark criteria.

II.5 Better prioritisation through simplification and consolidation

12 HIE accepts that it is legally difficult under the Treaty to deal with aid that results in insignificant distortion of trade as if it were not State aid, and the next best thing is the use of the Block Exemption mechanism. If the proposed Exemptions can clearly define where aid is acceptable, as we believe the ones for Training and SME have already done, then the benefits of making such aid more certain, simpler and quicker to implement and less likely to be involved in lengthy formal proceedings are very much supported by HIE. A further simplification we would suggest would be to permit a variety of State Aid types to be covered in a single Block Exemption scheme, such as we suggested in II.3 above might be appropriate in tackling economic re-structuring in an area suffering sudden job losses.

13 As regards the proposed revisions of the De Minimis ceiling outwith Agriculture, Fisheries and Transport we support the Commissions proposal for an increase, but limited a level related to inflation since the level was initially set. We do not support a larger increase, as we see an increasing risk of undermining regional aid differentials with increasing real values of De Minimis aid.

14 We do, however, see an overwhelming need to revise the obligation to check De Minimis approvals to the same beneficiary over three years. Whilst we can see entirely the argument for controlling the amounts of De Minimis aid to avoid them being aggregated and creating significant impacts on competition, the mechanism is so difficult to administer that we doubt even the best administration could guarantee success. The problem is that the

agency responsible to check the previous aid has no way of knowing what un-related projects may have been funded, nor the involvement by other agencies that may have grant aided projects undertaken by the beneficiary (short of operating in a monolithic state system). It is therefore impossible to check out a statement by a beneficiary as to aid in the previous 3 years, hence the process has no real meaning. It does, however, involve a disproportionate amount of effort trying to undertake the due diligence for the three year cumulation ceiling. Our alternative proposal is that the cumulation ceiling should apply to the particular project (whether there is one or more beneficiary and no matter how many providers of State resources there are). At the time of approving aid for a project it is normal for the public bodies to have complete knowledge of the funding package for the project, and the cumulation rule would therefore be capable of being satisfied with certainty.

15 As to worries that allowing a firm to be aided to De Minimis levels in subsequent projects would somehow allow an unacceptable level of trade distortion, we do not think this would be the case. If the De Minimis level of aid is not significant for one project, it is unlikely to be any different for a second project. The beneficiary would not be able to benefit the first project in any direct way from the aid in a second project, and by undertaking the project the purpose of the State aid in stimulating additional development would have been met.

16 If the Commission were to remove the 3 year cumulation rule, we believe it would reduce the frustration and inefficiency involved in this type of aid, which has its greatest potential benefit amongst new and very small firms which are the natural target for so many of the objectives of the positive aspects of State Aid. This may well have the added benefit of reducing the workload on the Commission by reducing the demand for notified or Block Exempt schemes.

II.6 A focused regional aid policy

17 HIE welcomes the Commission's re-statement of the value of Regional aid in achieving the Lisbon objectives. In the review of the guidelines we are of the opinion that the concentration should be on SMEs. However we are concerned that regional differentiation be respected, in some degree, across the spectrum of State Aid. For example, even tightly focused horizontal aid is likely to have some effect on the competitiveness of firms in the areas where it is applied, and for this reason we would favour the retention of regional supplements in the geographically horizontal aid guidelines and block exemptions.

II.7 Encouraging an environmentally sustainable future

18 The current guidelines on Environmental aid have proven to be difficult to use and are in need of revision. The problems revolve around having a very limited set of eligible costs and the need to perform calculations of additional cost and to deduct net benefit from grant awards. This may be a product of the fact that there are two fundamentally different types of Environmental aid being covered by a single set of guidelines. In one scenario companies are deemed to be receiving State aid in some circumstances where they are in fact being recompensed for additional expenditure that would not be justified on market terms and has no effect in increasing the scale of production or of reducing the running costs of its business. In these cases, the guidelines should permit Member States to pay whatever is the minimum necessary to give incentive to the private operator, and to leave the choice concerning priorities and value for money to the Member States whose finite budgets these funds will be

drawn from. The other type of environmental aid not only produces an additional environmental gain for society, it also produces a business gain for the firm – for example, reducing carbon emissions may also reduce the energy costs of production. In these situations the aid would need to be both proportionate to the community benefit whilst still respecting the overall business need to finance all of the costs of the project, not just the additional costs. However, these aids must also bear some element of regional differentiation in favour of less developed regions as there will be an effect on regional competitiveness as well as environmental improvement. This sort of environmental aid is therefore probably better treated as regional aid and SME aid with an environmental supplement.

II.8 Setting up modern transport, energy and information and communication technology infrastructures.

19 HIE welcomes the commitment of the Commission to consider the need for further guidance in the area of public-private partnerships in these vital areas of activity for the future development of less-developed regions such as the Highlands & Islands of Scotland.

III.1 Better Governance – a shared responsibility with Member States.

20. HIE welcomes the proposal to produce best practices guidelines.

21 We are concerned that proposals to use independent authorities in the Member States to assist the Commission in control activity runs the danger of slowing down procedures through the introduction of a further process. There might also be the risk of implementation standards varying from one Member State to another due to differing interpretations. We doubt whether it will be legally and operationally possible for the Commission to fully delegate responsibility to independent authorities in Member States, which we would expect to be a necessary condition for effective delegation.

III.3 & III.4 Adapting procedures.

22. HIE welcomes all measures that would increase transparency, greater certainty and efficiency. As a general point, we would suggest that measures to remove both the uncertainty over when State Aid rules apply, and cutting the un-necessary or disproportionate application of the rules would do far more to improve procedures than increasing the vigour of legal enforcement. Therefore, the suggestion of a revision of the Block Exemption rules to help clarify incompatible aid and compatible aid at the same time (rather than being restricted to the latter) has merit in our view. However, there would need to be retained the capacity and flexibility in the Commission to deal with exceptional cases that might have been ruled incompatible by the procedures when there may be a good case for State Aid. As a final comment on these sections, we consider that the application of Regional aid rules and SME rules to shipbuilding investments by SMEs seems to us to be desirable, with little prospect of impacting on shipbuilding internationally. In support for this, we would comment that such cases can be locally significant in peripheral and island regions, where such investment is more about fostering local employment, sustainability of a peripheral economy and the overall quality of life.

Conclusion

23 In conclusion, Highlands & Islands Enterprise welcomes the Commission's determination to bring about major reform in State Aid procedures aimed at simplification. We support the extension of the use of Block Exemptions as a method of keeping insignificant distortions of trade out side of formal procedures. We have expressed some concerns that the pursuit of horizontal growth aids following the Lisbon conclusions should not be allowed to undermine Regional aid. We expressed similar concerns at any suggestion that the De Minimis aid ceiling might be increased beyond sustaining its real value, but made a strong plea for the removal of the 3 – year cumulation rules on the grounds of practicality.