The Scottish Parliament

Submission by the Scottish Parliament's Enterprise and Culture Committee to the European Commission's consultation on state aid reform

September 2005

Introduction

This document is a submission by the Scottish Parliament's Enterprise and Culture Committee to the European Commission's consultation on state aid reform. As such, the views expressed do not necessarily represent those of the Scottish Parliament as a whole or the devolved government in Scotland; the Scottish Executive.

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General aid reform

1. The Committee recognises the value of providing more flexibility to support the Lisbon agenda across the EU, since this is very much in line with the government's *Smart Successful Scotland Strategy*[1] and reform will help us focus our efforts on improving Scotland's competitiveness. We must be able to take steps to implement key elements of the Lisbon agenda at home - a key priority has to be to raise the proportion of private sector spending on research and development, currently only at 0.59% of GDP in Scotland, to the UK wide target of 1.7% by 2014. A key focus of this investigation should be to suggest reforms to wider state aid rules which will promote innovative ways of levering private sector capital into the commercialisation of patents and research at home and help Scotland - and other parts of the EU - meet these important targets.

2. The Committee also recognises the importance of state aid control across the EU in seeking to provide a level playing field for Scottish firms doing business in the expanded single market. While the focus of regional aid has shifted to the new Member States given their weak economic position vis-à-vis long established EU Member States, the maintenance of strict state aid controls is necessary to guard against unfair competition.

> *Recommendation 1 - The Committee therefore underlines the importance of the European Commission taking "all appropriate measures" to achieve the recovery of illegal aid.*

[1] http://www.scotland.gov.uk/library3/enterprise/sss-00.asp

Regional Aid:

3. Regional Selective Assistance (RSA) is the main national scheme of financial assistance to industry, helping create and safeguard jobs and encourage investment in the Assisted Areas (AAs) of Scotland. RSA, an approved regional aid scheme, plays an important role in tackling regional imbalances, and achieving the *Smart Successful Scotland* agenda.

4. In Scotland, the original Commission proposals would limit coverage to the Highland & Islands, reducing current population coverage from 48% to around 8% and there would be no scope for regional aid to large firms in lowland Scotland. The Scottish Executive has informed the Committee that while the UK supports the Commission's aim of less and better targeted aid, the proposals prevent aid being targeted at some of our most underperforming areas.

5. The UK response of 1 March offered ideas for determining additional population coverage which would provide additional flexibility for regional aid while reducing overall EU coverage. The Committee believes that to reduce the area of the country where large firms can be supported by RSA from 48% to 8% is too severe a step to take at one throw. There are pockets of unemployment, deprivation and post industrial decline in other parts of Scotland where attracting investment by large firms may be the only way to make a real difference to the lives of the local community. It is important that the reality of industrial support in Scotland is factored into the Commission's reform plans.

6. The Committee welcomes the fact that Commission has published a revised draft of its proposal which would allow for a smaller reduction in coverage in Scotland to better reflect the requirement for support to large firms in deprived areas as part of the mix of support available to promote economic development and trusts that this will allow the Scottish Executive to work with the UK Government to ensure that the new state aids map reflects the real areas of need in Scotland.

7. The Committee also welcomes the provision in the revised draft proposal to provide Article 87(3)(a) status to statistical effect convergence regions and in the importance of recognising factors such as remoteness and sparsity of population in the longer term state aids framework.

8. The Committee has looked at the Commission's case that evidence from across Europe shows that in many cases the payment of large sums of regional aid, particularly to large firms, has only served to displace investment from one are to another and not been an efficient use of public resources.

9. The Committee learnt during its recent visit to Brussels about the recent Commission decision to find illegal planned state aids by the Irish Government to the major microchip manufacturer INTEL for a planned investment in a new research, development and manufacturing facility on the outskirts of Dublin. The Commission found that such aids were not

economically justified in an area as prosperous as Greater Dublin and could affect competition within the EU. The Irish Government on the other hand still believes that support of this type to a major innovative investment project is justified where the competition comes from outwith the EU (in this case the alternatives sites being considered by Intel were in the USA and Singapore) and will be putting proposals to this effect to the Commission during the reform process.

10. The Committee sees parallels with our own situation in Scotland, since Scotland has a similar structure of high technology investments as the Republic of Ireland and is seeking to maintain its position at the forefront of technology on a global scale. It recognises the concerns of the Commission that in certain cases state aid payments may not be required to secure investments, since investors often have other considerations in mind when making decisions on location. At the same time it would seem unfair - and harm Europe's competitiveness - if locations in third countries could offer enticements to attract crucial hi-tech investments such as these which the only EU competitor in the running could not match.

> *Recommendation 2 – The Committee recommends that the Commission look at the overall framework for regulating such payments as it takes forward its overall reform programme for state aid and also continues to take steps through the WTO to challenge such unfair state aid.*

Specific points on horizontal aid reform

11. The Committee attaches great importance to stimulating **risk capital provision**, especially for start up SMEs. In its Action Plan, the Commission has stated that it will review the **Communication on risk capital,** with the aim of further stimulating investment in the form of risk capital, in particular in favour of start-ups and young, innovative SMEs, where this can properly address identified market failures. Here the equity gap has risen above current limits set in the guidelines in many cases.

> *Recommendation 3 - The Committee believes that the guidelines on risk capital provision should more closely reflect the market failures involved and provide greater flexibility to determine approvable levels of aid for individual cases.*

12. The Committee is aware that the Commission is planning amendments to the framework on **innovation** in order to increase the incentives to innovate and to promote private sector take up of new ideas. The Action Plan indicates that the Commission will be considering changes to the rules to deal with the specific situation of small and medium-sized enterprises, the role of intermediaries (e.g. clusters, technology centres) and to provide incentives to highly-skilled researchers working in the area of innovation. In this context, it is important that the definition of innovation includes the entire range of enterprises and is not confined to technology or scientific spheres.

Recommendation 4 – The Committee urges the Commission to ensure that the focus of any reform to the framework on innovation is on ensuring that support to companies which receive a specific competitive benefit from such new ideas is carried out in a non discriminatory way which minimises market distortions but also seeks to achieve the Lisbon objectives. The Committee recommends that the Commission take a broad definition of 'innovation' as something applicable to all businesses and enterprises.

13. Similarly, the Committee understands that the Commission is planning amendments to the framework on **research and development** designed to target market failures and provide the right incentives for industry to invest more in R&D, as well as to promote cross border collaboration and an interactive industrial innovation process which can also take account of continuous feedback from the market. The Scottish Executive has told the Committee that it believes that the existing rules are in general working effectively and changes should only be made if supported by clear evidence. Nevertheless, the Scottish Executive would like more generous levels of support for SMEs and continued and more flexible scope to encourage *pre competitive collaborative* research.

Recommendation 5 - The Committee agrees that the framework on research and development needs to be maintained and made more flexible, especially in respect of SMEs, and encourages the Commission to take steps to ensure that Government support to the private sector can be made in such a way as to help increase significantly the amount of private sector input to research and development in line with the Lisbon and UK targets.

14. The Committee welcomes the Commission's plan to extend existing **block exemptions** in order to simplify the way in which state aid controls on training, SME support and employment aid are exercised. The Committee welcomes the plan to extend these to R&D, regional and environmental aid. The Committee also agrees with the Scottish Executive that the proposed increase in limits for SME initial investment from 15% to 20% for small firms and 7.5% to 10% for medium sized firms should be agreed.

15 The Committee notes that the Commission has also considered increasing the **de-minimis threshold** below which state aid to a single company over a rolling 3-year period is not deemed to be state aid in that it has no appreciable effect on competition. The threshold currently stands at €100,000. The Committee regrets that the previous suggestion for a framework for Lesser Amounts of State Aid, which was welcomed by the UK and would have effectively raised this threshold to €1 million, is no longer on the table and backs the Scottish Executive's wish to see the threshold raised, perhaps to €400,000.

Recommendation 6 – The Committee would favour an increase in de minimis as it would enable smaller non-distortive measures to be *implemented more quickly. But the cumulation rule is extremely burdensome (both for recipients and administrators) and we support the case for reform*

16. The Committee notes that the Commission plans to provide state aid guidance on the operation of **services of general economic interest** (SGEI), which are regarded in EU law as a key component of the European welfare state and as essential for ensuring social and territorial cohesion, including in the field of education, training and culture, and for the exercise of an effective citizenship. High quality SGEI also contribute to the competitiveness of the European economy. Member States enjoy a wide margin of discretion when deciding whether and in what way to finance the provision of services of general economic interest. However, to avoid distortion of competition the Commission believes that the compensations granted should make the performing of public service missions feasible without leading to overcompensation and undue distortions of competition.

Recommendation 7 - The Committee stresses the importance of the EU state aid rules recognising the way in which services of general economic interest are delivered in Scotland, including in respect of the provision of infrastructure designed to meet the Lisbon goals.

17. The Committee welcomes the fact that the Commission has decided to bring forward to this year its plans to revise the **environmental guidelines to promote sustainable development goals and to provide more flexibility for support,** e.g. ensuring a full internalisation of environmental costs and encouraging innovation and improvements in productivity through resource efficiency. The current guidelines are inflexible and do not give sufficient flexibility to promote incentives to the private sector for valuable environmental goals such as waste management and recycling. The Committee points to the importance of such a revision if we are to meet the ambitious goals for sustainable development set as part of the Lisbon and Gothenburg strategies.

18. The Committee also notes that the Commission is considering clarifying the state aid rules for the assessment of public resources involved in **Public Private Partnerships** (PPP) as part of its aim to promote modern transport and energy infrastructures. PPPs are important to public investment in Scotland generally since they allow the public sector to deal with infrastructure and social problems in areas of deprivation in partnership with the private sector, with the state providing the minimum necessary to lever private sector investment.

Recommendation 8 – The Committee urges the Commission to ensure that the new rules reflect the Scottish and wider UK position on the use of Public Private Partnerships and the Committee trusts that the Commission will liaise with the UK and Scottish authorities so that the rules are being prepared to ensure that this is addressed.