UK Response to Commission Roadmap for State Aid Reform

I. Summary

1. The UK welcomes Commission recognition of the need for State aid reform and is willing to help in any way it can in designing, applying and if necessary trialling any new approach.

2. Our view is that the State aid regime requires more simplicity and clarity, more flexibility for Member States within safeguarded limits, more transparency and a more economics-based approach. We need much faster approval of economically insignificant aid and tighter controls on distortive aids. Member States especially need to be able to implement economically sound measures aimed at achieving the Lisbon objectives with less delay where there is little risk of serious distortion of competition. The Commission emphasis is rightly on eliminating the most distortive aids rather than on requiring the notification of as many aids as possible.

3. The UK supports State aid discipline and recognises the need for vigorous and principled enforcement of the rules by an authority independent of the Member States. However, we agree with the Commission that the current system has many flaws. In our view these include:

   - Much too complex – uncertainties over what constitutes aid and ignorance over detailed application of the rules are real obstacles to uniform application of coherent state aid principles across Europe;

   - Assessments involve insufficient economic assessment, markets are often not analysed in detail and the potential impact of aid on competition is sometimes not examined carefully – the result is that innocuous aid is sometimes blocked while highly distortive aids are sometimes allowed through;

   - The rules are too intrusive, catching aid involving small amounts being offered to local undertakings performing public interest activities on the periphery of markets with no appreciable distortion resulting. This is disproportionate.

   - State aid investigations are too slow, creating a serious disincentive to notify in the many cases where there is doubt over whether State aid is present and imposing serious delays even when measures are clearly unlikely to have a material impact on cross-border competition and trade.

   - The rules are perceived to apply differently in practice to public bodies and private and non-profit bodies performing the same activities. State aid complexities seem to multiply when Member States seek to engage the private or social economy sector to offer education, health, social and cultural services or to develop land. The rules must be seen to apply equally whether activities are performed in the public, private or non-profit sector.

   - Sometimes the Commission tries to apply the regional aid guidelines to aid which is not investment aid, but rather designed to meet a market failure or

steer the market towards results which are socially, environmentally or culturally more desirable. In these cases Member States should be allowed to pay the minimum necessary to achieve their legitimate objective, as long as they can do so without appreciable market distortion.

4. In our view the key to resolving these problems lies in a more economic approach to State aid control, assessing early whether aid has the potential to seriously distort competition, taking account of the desirability of remedying market failures and focusing resource on combating the most distortive aids. State aid procedure also needs to be tightened.

Market Failure

5. We therefore welcome the Commission's recognition in its State Aid Action Plan that State aid policy must take account of the desirability of tackling market failures. In fact the UK would suggest that State aid is generally **only** justified as a response to market failure and exceptions to this (such as regional aid and restructuring aid) should be tightly defined.

6. There is a huge economic difference between on the one hand a gratuity or "subsidy" (payment without consideration), which clearly distorts competition, and on the other a payment to obtain a particular behaviour, which is in the broader public interest and which the market would otherwise fail to deliver. The UK often supports payments to undertakings to procure a change of market behaviour for the public good, whilst retaining the fundamentals of competitive, market-based delivery. These solutions involve payments or tax incentives to businesses or often non-profit bodies to achieve social, environmental, educational, cultural and sometimes economic objectives. Such payments will not significantly distort competition if the following conditions are met:

- The market failure is genuine
- They are the minimum necessary to procure the desirable change of behaviour
- They are auctioned or offered equally to all relevant market participants, with no risk of upstream or downstream distortions.

7. Revised "horizontal" guidelines should set out how such tests should be applied in practice and thus how such responses to market failure could be easily approved. They should contain economic tests and indicators designed to reveal whether payments would genuinely be distortive of competition. As far as possible the tests should be underpinned by common principles, making the various Guidelines and Block Exemptions easier to integrate and consider together, but this should not be at the expense of having the right Guidelines for each type of horizontal aid.

8. The UK therefore welcomes the Commission's willingness to analyse relevant markets in future and the future emphasis on whether aid is **appropriate**, **effective** and **proportionate** to the problem it is designed to remedy. We believe that aid will be **appropriate** if targeted at a market failure, **effective** if paid at the minimum necessary level and **proportionate** if offered equally or competitively to all market players. These three tests therefore closely resemble our proposed

three conditions outlined above.

9. We also welcome the Commission's recognition that distortions of competition will be different according to:

   - The method of selecting aid beneficiaries
   - The market characteristics
   - The amount and type of aid

10. We look forward to these factors being better taken into account by the Commission in its case handling and incorporated into the new Guidelines and Frameworks. New Guidelines must also give greater scope for a wider range of market failures to be tackled. Market failures in land and property are hard to address under the current rules and there are gaps in relation to environmental aid and aid to support innovation and enterprise.

Improved procedure

11. In terms of procedure we welcome the Commission'c commitment to review this area. We would like to see the Commission placing more emphasis on there being a much lower burden of state aid administration where competition is not or is hardly distorted at all. Such aid should be covered by Block Exemptions or approved rapidly, if that is not possible. On the other hand, we would like to see more market impact assessments so that the most distortive aids can be readily identified.

12. The revised horizontal Guidelines should acknowledge that market failures can arise in particular circumstances and that State payments to offset such failures can be justified, subject to certain conditions. The conditions would be designed to ensure that the payments did not give rise to undesirable distortions of competition, Our preference would be for most Guidelines to operate on two levels.

    - At the lowest levels there would be Block Exemptions, with clear limitations on which aids fall under the bar. We support an increase in De Minimis levels and looser, more practicable requirements on cumulation. We also favour increased Block Exemption limits in other areas and extension of Block Exemptions into new areas such as environmental aids and risk capital, if possible, but we accept that many relatively innocuous aids will fall outside the Block Exemption limits nevertheless.

    - A second level would cover aid which goes beyond Block Exemption levels, but which falls within the revised, economically-focused Guidelines These should set out principles and indicators for assessment of cases, rather than being interpreted as detailed, prescriptive and limitative laws on what can and cannot be approved. Initial investigations must focus on whether such aids give rise to a risk of **significant** distortion of competition. If there is no such risk, there must be much more rapid decision-making within fixed timeframes for approval of these aids. (We propose some options for this in the section on Modernising Practices and Procedure below). If there is a risk of serious

distortion of competition, an article 88(2) investigation should be opened promptly.

13. Notifications of proposed aids falling outside the revised Guidelines should be required to contain an analysis of the market failure they are designed to correct and an assessment of how the proposed payment will remedy that market failure. Subject to this, they should be handled in the same way as aid dealt with under the Guidelines at the second level described above.

II. State aid and Innovation and Entrepreneurship

14. We strongly support the broad shift in the Commission's emphasis away from the more distortive aids and towards the Lisbon/horizontal objectives, including innovation, entrepreneurship. The State aid rules must seek to facilitate Member State efforts to tackle market failures which inhibit innovation and balance the risk of distortion of markets against the EU's wider policy agenda.

15. Particularly where Member States seek to encourage universities and entrepreneurs to commercialise technology and start-up and develop small, technology-based companies, the risk to competitive markets is very small and the benefit to the EU's knowledge economy base is potentially great. The State aid rules must not delay innovative projects which carry little risk to competitive markets by 18 months or, for example, squeeze support for incubation and innovation centres into an inappropriate regional aid framework, which is not designed to remedy innovation or land and property market failures.

16. The UK will comment in detail when the Commission issues its draft Communication on State aid and Innovation later this year and welcomes the Commission commitment in this regard. We have already submitted detailed comments on reform of the R&D guidelines.

17. Some of the issues where we will be seeking clearer rules and in some cases a different approach are as follows:

- **Innovation-related activities of Universities and Public Sector Research Establishments**

18. The close proximity of businesses and universities/public research centres can result in substantial innovation spillovers and external benefits which are economically advantageous. It is in this context that measures to support universities and university/business clustering must be considered.

19. Many universities and research centres conduct their own public function research activity and perform joint research services with businesses. The R&D Guidelines offer substantial clarity on the State aid status of funding for this work.

20. But universities and public sector research establishments (hereafter called "universities") also conduct proof of concept tests on innovations to see if they

have market potential and license out ideas which have value. Sometimes they fund some of the seed capital which spin-out companies require, and establish incubators in which such companies may grow. Some have built small-scale science parks on University land into which successful companies may expand or to which other companies may be attracted with a view to exploiting synergies with the University research efforts. Some have established "open access" facilities for business R&D, making it easier for businesses to co-locate with universities and/or make use of the research infrastructure they possess. The revenue from such operations enables the university to invest in infrastructure and academic human resources it might otherwise not be able to afford.

21. All of the above are potentially "economic activities" which can result in Unversities being classified as undertakings in certain circumstances, and their funding classed as state aid. The Universities (and university-owned non-profit subsidiaries with these functions) are, however, performing all such activity in the public interest with a view to furthering their academic research and teaching functions. Any revenue is ploughed back into the public function activity of the university. The risks to distortion of competition at the level of the university are very low and the benefits for European economic competitiveness are substantial.

22. The UK would like to see a relaxed approach to all this university activity, in state aid terms, with more clarity and legal certainty on where the universities stand. Ideally the Commission would clearly state that any such activities be block exempted to the extent that they might involve State aid at the level of the University. In order to prevent abuse there could be Block Exemption limits on amounts to be invested in spin-out companies, for example, and rules to ensure that users of incubators and science parks be charged market rates.

23. On the other hand, external businesses collaborating with universities or receiving services from them will be in receipt of state aid if not charged commercial rates for services received. The UK favours the maintenance of robust rules on subsidies for competitive businesses. Clearly the spin-outs will be subject to the rules as well, once established, and aid to them must fit within the relevant frameworks.

- **The application of the R&D Guidelines to collaborative research**

24. The Guidelines on State aid for R&D and the Block Exemption on R&D aid for SMEs broadly work well. The UK supports the current distinction between different stages of research and the current aid intensities. These broadly reflect the market failures attached to R&D activity. The Commission could consider, however, extending the Block Exemption to cover some R&D aid to larger businesses and/or introducing a second level of cases outside the Block Exemption but unlikely to raise substantial distortions on a European scale, where decisions could be taken subject to strict time limts.

25. Further clarity could be offered on how finance for public research bodies and aid to businesses for collaborative R&D may interact in practice. A clearer definition of collaborative research would help. The UK also welcomes the Commission intention to make the rules take better account of the variety of mechanisms for

sharing access to and exploitation of intellectual property in collaborative research scenarios. Flexibility in support for collaboration between public research establishments and businesses is important for cluster development and encouraging SME involvement in the EU Framework programmes. The rules must allow private retention of IPRs or a share of IPRs as long as fair, market-based payments or risk and cost-sharing is offered.

26. The current SME definition is also a problem in an R&D aid context. Both scheme administrators and businesses find it confusing and unnecessarily complicated, and are especially concerned that it has the potential to prevent companies from securing investment. Aid is often critical for technology and R&D-based SMEs with significant external funding needs. The current rules cause companies to lose SME status if they are more than 25% owned by a business angel holding more than a Euro1.25m stake (but not if a similar investment is held by venture capitalists.) This impacts on the ability of angels to protect their investment in high-growth companies seeking capital increases and thus deters business angel investment at the lower end.

- **The new concept of aid for Innovation**

27. The UK accepts that there may be market failures in relation to certain types of innovation, which are not caught by the definition of R&D. We welcome Commission attention to this issue and will await the Commission's proposals with interest, but have concerns that it will be difficult to define "innovation" such that desirable combatting of market failures can be encouraged, without opening the door to distortive aid. Most businesses already face commercial pressures to innovate so aid to them for this purpose has the potential to be distortive.

28. It is possible that a large part of any relative failure by the EU to produce innovative business may relate to market failures in financial services markets, regulatory and perhaps fiscal barriers to the growth of young, innovative businesses, barriers to takeovers and new market entry and the entrenchment of relatively less innovative national champions. These problems cannot be resolved by means of a new facility for State aid for innovation.

29. The UK does support, however, (as explained above) state aid flexibility for the generation of innovative ideas in public sector research bodies and universities and clear, simple and generous rules governing attempts to transfer such ideas and expertise to business and to generate further innovation through public/private collaboration.

30. Demonstration projects might also merit more favourable treatment under any new Innovation Guidelines, but Member States would have to provide evidence of the market failure to be addressed including explaining the novelty of the application of technology in the particular way, setting out the public interest to be achieved and indicating how lessons from the demonstration would be widely disseminated. There should always be competitive process to select the business to perform the demonstration.

31. Another area that may merit attention would be support for innovation (and R&D) networks between companies as well as between companies and universities. As long as such networks are open, they will create minimal distortions of competition and yet may generate external benefits.

- **Support for business infrastructure**

32. The Commission has always taken a pragmatic approach to aid for basic infrastructure such as roads. The UK supports the view that the benefit to end-users is so diffuse in such cases that it is generalised and lacks specificity and that there is no aid to the intermediary supplying the road or operating it under a concession as long as the contractor/concessionaire is selected through a competitive process and paid the minimum necessary.

33. There is increasing recognition in Member States, however, that the supporting "infrastructure" for successful knowledge economy businesses is much more complex than just transport and energy. The UK considers that the Commission has missed an opportunity in its recent cases to extend the principles underpinning aid for infrastructure to cover payments for a range of other physical assets and services, which offer a generalised benefit.

34. Broadband infrastructure, for example, could perhaps have been introduced faster, if Member States had clearer guidance on how to avoid State aid problems when supporting the infrastructural investment. Next generation networks may provide new examples of market failure, with the potential to widen the "digital divide". Clearer guidance and faster approvals where market failure justifies intervention would help to transform Europe's knowledge-based infrastructure.

35. The telecoms sector is a particularly difficult one in competition law terms, because of the market dominance of the former monopoly providers. This perhaps justifies caution in some cases about whether an element of aid may be present, even when a competitive tender has been held. Advantage beyond the normal course of trade for a successful bidder for funds to to extend telecoms infrastructure may be difficult to rule out, but competitive procurement should at least minimise the aid and ensure that no distortion is serious as long as the public expenditure is clearly related to a market failure. And the possibility of distortions must be set against the benefit of wider infrastructural provision.

36. In principle, the UK believes that all infrastructure-type cases should be looked at the same way:

- Is there proof of market failure
- Is there evidence that remedying the market failure would be in the Community interest and that a State payment would be effective in procuring that result?
- Has the intermediary to deliver the infrastructure been chosen through a genuinely competitive process taking into account the relevant market dynamics? (If so, it is arguable that there is no aid (as the Commission itself argues in road transport funding cases). If not, or in cases of doubt, the payment might contain an element of aid but would be approvable if the

payment can be shown to be broadly the minimum necessary). If the Member State conducted a competitive tender in compliance with EU procurement rules, this should be sufficient evidence for approvability.

- Will the contract protect wholesale access to infrastructure for service companies seeking to compete at the retail level with the infrastructure supplier?
- Will end-users of the infrastructure be charged market rates or if not, will the benefit be general, rather than specific or clearly De Minimis?

37. The UK believes that any payment for supply of physical infrastructure will create no serious distortion of competition as long as it is made available to any potential end user at market price (i.e. not in practice for the benefit of particular, identifiable businesses) and the intermediary building and delivering it is chosen through a genuine competitive process in a competitive market. Alternatively, the intermediary could be a state or non-profit body performing the particular investment on behalf of the State, but where there is no competitive process, there is always the possibility of distortive State aid if the activity is "economic".

38. The principles used to assess aid for infrastructure could also be used to determine approvability of aid for the broader supply of support services to small business. Where Member States set up incubators and incubator services, cluster support bodies or financial advisory services for growth businesses, for example, the benefits are often diffuse (or can be caught by the *De Minimis* Block Exemption) and there should be little or no aid to the intermediaries as long as they are chosen competitively. If the market does not supply the necessary intermediaries and the services are deemed to be in the public interest, the State could alternatively appoint and finance public bodies or non-profit organisations to supply the necessary infrastructure with little risk to competition.

39. Greater clarity over the application of the principles governing aid to infrastructure in other scenarios thus offers an opportunity for the Commission to take a range of state payments with little or no discernible impact on competition outside the realm of State aid controls or into Guidelines or Block Exemptions which allow easy approvability.

40. The UK would like to see aid to support small business enterprise dealt with in this way and through Guidelines which allow the targeting of market failures in small business finance, wherever they occur, rather than trying to cover such matters in the Regional Aid Guidelines.

- **Support for Risk Capital**

41. The existence of market failures preventing optimal supply of risk capital to certain small business is now widely accepted. The Commission's recent approval of the UK's proposed Enterprise Capital Funds was very much welcomed in that it showed the Commission's willingness to be flexible over the application of the risk capital guidelines when faced with evidence about the extent of the market failures.

42. It is however, regrettable that that Decision took over 18 months to emerge. This

highlights the need for less burdensome procedures. Member States need to be allowed to react more speedily to market failures. The clear lack of concern over such measures expressed by businesses and Governments across the EU indicates that the distortion of competition they entail is probably minimal.

43. The UK would wish to ensure that faster approvals can be managed in future at least where the evidence of market failure is persuasive, the intermediaries and funds suppliers are chosen competitively, the measures are aimed at SMEs, the funds are commercially managed and where private capital must be put at risk alongside any Government funds. There should be room for block exemption treatment of small-scale aid on this basis. The UK has already submitted comments to the Commission on this subject in March of this year.

III. Services of General Economic Interest

44. The UK is broadly content with the Commission's approach towards aid for SGEI at present and welcomes the recent adoption of the 3 Commission texts in this area. Much uncertainty remains, however, even after the Commission's Decision granting an exemption from notification for several types of aid. Clarification of how the Commission intends to interpret the "Altmark" test is still needed but clarity may in the end only be achieved through expanded case law from the European Courts.

45. It sometimes feels that the Commission is always looking for arguments for why "Altmark" does **not** apply, rather than looking for practical ways of applying the principles to take cases with low risk of distortion of competition outside State aid territory.

46. There is a risk that because the Commission Decision only block exempts SGEI payments to companies with turnover below certain thresholds, that competition might be distorted by public authorities avoiding paying larger companies to perform SGEIs, even if the larger companies offer the best economic terms or lowest price. If a tender has been held, in particular, it is probably undesirable that the result be distorted by fear of greater State aid bureaucracy and delay if one option is chosen over another. In these cases, interpretation of "Altmark" may determine the outcome.

47. The Commission should investigate, after a period of time, whether its recent Decision may be having such unwanted effects and be prepared to review the scope of the Block Exemption, for example by exempting any notification even when large companies are selected to perform SGEIs, as long as genuinely competitive tenders have been held.

48. The UK views the principle underpinning the Ferring and Altmark decisions as economically sound. There cannot be a State aid if there is no element of advantage outside the normal course of trade and where an undertaking is simply paid a commercial price to perform an activity in the public interest which it would not otherwise perform, there will be no advantage outside the normal course of trade.

49. Indeed this principle is economically sound also in some other cases which are not technically SGEI. This has been explored in relation to infrastructure (above). There are other potential applications.

50. The minimum necessary payment to a property developer to develop an unfavoured plot of land in a particular, socially beneficial way will not confer a subsidy if the market would not have delivered that outcome by itself. For example, a developer may face a cost, applied through the planning system, in terms of a restriction on his freedom of use of his asset. He is asked to develop the plot in a particular way on a non-economic basis. It is reasonable that he should be compensated for his direct loss and loss of opportunity. As long as the minimum necessary is paid to procure the socially desirable development, there should be no advantage outside the normal course of trade and the State aid rules should recognise this.

51. The problem in all such cases and in "pure" SGEI cases is how it can be **proved** that the minimum necessary has been paid. In our view a competitive tender or auction in a competitive market and following EU procurement rules offers such proof. If that is not possible, we accept the need for independent assessment of whether the minimum has been paid and whether, as a result, competition is distorted.

52. Any independent assessment would, of course, have to look at "the minimum necessary" in the context of administrative efficiency of aid delivery. Tax incentives, for example, offer an efficient way of combatting certain market failures, but cannot be calibrated to vary for each beneficiary, so any assessment would have to look at "minimum necessary" within this context, taking account of the benefits to be achieved and the risk of distortion of competition.

IV. Regional Aid

53. The UK will be commenting separately and in more detail on the Commission's revised proposals for reform of the Regional Aid Guidelines. Generally we support the Commission's overall approach and welcome the revised set of guidelines, particularly the fact that the Commission has taken on board our idea of allowing for additional coverage to be allocated at the national level.

54. The UK accepts that regional investment aid may distort competition. Apart from anything else, the need for compensation for offsetting negative regional factors will be different in every single case and impossible to quantify with any accuracy. There can therefore be no guarantee that there has been no overcompensation, though Government Accounting Rules in the UK at least seek to ensure that the minimum necessary is nevertheless paid.

55. The UK recognises, however, the importance of differentiated regional aid in a European context and the need to concentrate investment aid in the least developed regions. We believe also that there is a residual place for regional aid in a national context. Some investments (e.g. distribution centres for the national market) are in practice bound to be tied to particular countries and Member States value some flexibility in encouraging such investment to flow to their own least

favoured regions.

56. So regional aid has an important role to play in targeting underperforming areas and the guidelines are a suitable way of assessing and approving or rejecting proposed investment subsidies. But the regional aid guidelines should not be used in inappropriate circumstances.

57. One of the biggest problems with state aid enforcement in recent years has been the tendency of the Commission to try to assess almost all State aid within a regional aid context. Much of what Member States try to achieve is to remedy market failures, which may be national or regional and may not coincide with assisted area maps. Other payments to undertakings may be designed to nudge markets in directions favourable to public policy but may not distort markets like an investment aid. Much intervention in designed to secure suitable "infrastructure" and public services for societal and business development in the broadest sense. Such infrastructure needs to be supplied in all areas, not just the assisted ones.

58. In all the above areas the amount of public finance required to achieve the objective will depend on the extent of the market failure, the extent of the market impediment to change or the extent to which the necessary "infrastructure" cannot be supplied by the market. Member States should be able to (and in fact only allowed to) pay the minimum necessary to achieve the desired result. Regional aid maximum aid intensities (or regional bonuses under some other aid frameworks) in these situations could lead to excessive subsidy being awarded or to projects being cancelled because inadequate support is available to overcome the market barriers. The Commission has recognised this to some extent by introducing other types of guidelines and routes for state aid approval, but too often the default setting of the Commission machine is still on regional aid, even when this is inappropriate.

59. The UK has accepted that certain types of aid framework outside the regional aid Guidelines themselves, can legitimately offer regional top-ups. This is because they reflect problems which are likely to be at their most acute in assisted areas and are a response to market failures which are in any case impossible to measure exactly. Thus we accepted regional top ups for risk capital in some circumstances, training aids are more generous inside assisted areas as is employment aid to support the recruitment of the long-term unemployed. Investment aid for SMEs is regionally based as well. But where a market failure can be more accurately quantified, there is no case for paying more than the minimum necessary and aids for social, cultural and environmental benefit, for example, should be available across all regions in the Community interest.

V. Environmental Aid

60. The UK view is that the current approach to environmental aid is a good example of the Commission's wish to push too much State aid into the regional aid mindset. The current environmental aid guidelines are good in places but in others they are too prescriptive and much too limited in scope and do not permit the awarding of many types of aid which the UK believes would improve the

environment and which would not lead to serious distortions of competition.

61. Particularly in the area of environmental technologies, there is also an overlap between environmental and innovation aid. The Commission's own Environmental Technologies Action Plan (ETAP) makes clear that developing and making better use of environmental technologies will contribute to technological innovation and increase European competitiveness as well as improving the environment. In such cases our views on aid for innovation and entrepreneurship above also apply. The ETAP acknowledges that the current environmental aid guidelines are 'not properly adapted to the increasing sophistication of investments in environmental technologies, nor to new forms of public/private partnership.' We support this view.

62. The UK has prepared a paper on environmental aid reform, which is attached to this document as Annex 1. It illustrates the practical application of many of the theoretical arguments floated here. The main line is as follows:

63. The UK believes that the Commission should allow Member States more flexibility of response and assess proposed measures according to simple economic criteria designed to avoid serious distortions of competition.

64. Where a company is under no obligation to undertake environmental improvement, which is in the broader public interest, and such improvement involves a net cost to the company, the relevant permitted aid intensity should be "the minimum necessary", within the context of what is administratively efficient.

65. Where companies are subject to a regulatory obligation or environmental tax, helping some of them to meet the cost may at times be necessary to maintain fair competition, depending on the situation of their competitors. The Commission should allow state aid to counterbalance higher environmental standards in order to encourage such higher standards to exist.

66. In both the above cases the application of arbitrary maximum aid intensities, especially those which vary by region, is inappropriate. Such an approach risks leading to far more aid than is necessary being paid in some circumstances and too little aid being available to meet the environmental challenge in others. It permits selectivity and therefore distortion of competition and the EU does not want to see environmental gain only in its assisted areas.

67. The Commission should instead focus on ensuring the following:

- That the environmental purpose is valid
- That the environmental purpose would not be delivered by the market by itself (i.e. that there is a market failure)
- That the payment is the minimum necessary to achieve the objective, taking into account the need for administrative effectiveness in delivering the aid
- That the payment is offered equally or competitively to all companies in the same position and that there are no upstream or downstream distortions

68. If the Guidelines consisted of largely economic tests such as the above, the Commission could envisage review beyond Block Exemption limits of all but the biggest cases according to fixed timescales.

69. If the total amount of the aid and/or the aid intensity and/or the size or market share of the beneficiary, for example, were below certain "safe harbour" limits, for example, the Commission might only need to verify that no serious risk of distortion of competition was present. If market impact analysis had been performed and proposed aid was also more transparent, allowing rival undertakings chance to complain, for example, decisions should be able to be made very quickly.

VI. Public versus Private Delivery and Partnership

70. The UK supports the Commission desire to offer greater clarity on how the State aid rules apply to PPPs. UK PPPs have always been designed as far as possible to avoid State aid and distortion of markets, but often the State aid assessment has been complex. Many of the principles outlined above would in our view be relevant. In particular:

- The private partner must be selected by competitive tender process in compliance with EU procurement Directives
- The PPP must operate financially at arm's length from its "parent" public body
- The end users or customers must (if they are undertakings) be charged commercial prices, or if there is aid to them, this must be approvable under the normal state aid frameworks.

71. The UK view is that payments to companies to deliver services must be assessed for State aid purposes in exactly the same way as payments to state bodies to perform the same services. This equality of treatment is mandated by the European treaty (article 295). In practice, however, the Commission is apt to only intervene when an activity is privatised or awarded to a specific body outside the mainstream public sector.

72. The ultimate example of this is in relation to land development, where public authorities all over Europe are directly engaged in the purchase and development of specific pieces of land which would not otherwise be developed in the desired way by the market. This is seen as an essential part of local planning and infrastructure provision. State aid questions are never or hardly ever raised.

73. But the Commission's approach to payments to spun-off public undertakings or to private companies or non-profit bodies to develop land in particular ways is usually to apply the regional aid guidelines, which prevents the regeneration of many pieces of land in the private sector and drives public authorities into public ownership of the land to achieve the necessary objectives. This is not only inequitable and arguably a breach of article 295 of the treaty, it ties up large amounts of public finance in land ownership and development, an activity where private companies might be able to perform more efficiently and certainly with

less commitment of public resources. There is no difference in terms of the impact on competition between the two methods as long as the payment in either case is the minimum necessary to secure the desired outcome.

74. The answer in our view is to treat the speculative development of land (where no specific end-user is foreseen or foreseeable) as analogous to the supply of infrastructure. Member States could allow public authorities to develop the land themselves or encourage them to pay private owners the minimum necessary to secure the development which is required and then sell it or rent it on the open market.[1]

75. Similarly, some Member States finance the provision of basic services to small businesses, including incubation services and financial advisory services for example, through State agencies. In other Member States there is a belief that such services should be supplied nearer to the market, but if the market will not supply the services in full or at an acceptable price by itself, there is a need for an element of state resource to nudge the market in the right direction. The latter solution should distort competition far less than the market replacement model of state intervention, but is typically treated more harshly by the Commission when it comes to State aid issues.

76. The UK approach would be to allow the minimum necessary to be paid, whether to the private or the public provider of property or services, to overcome the market failure and achieve the market outcome which is desired. As long as the intermediary is paid the minimum necessary, to achieve that which the market, left to itself, would not deliver, all residual aid (if there is any) will flow to the end user and the aid to the end user is the same in both private and public models. Where it can be shown that the end user pays a full market price, the State finance can be shown to have simply met the market failure

77. The UK has prepared a paper explaining these arguments in the context of land and property redevelopment and setting out why we believe a new approach is needed towards aid for improving the physical infrastructure of deprived communities, whether inside or outside Assisted areas. This is attached as Annex 2.

VII. Modernising Practices and Procedures

78. The UK welcomes the Commission's recognition of shortcomings in the practices and procedures of state aid administration. However, the Action Plan limits itself largely to proposals to combine and simplify the various State aid Guidelines, Frameworks and Block Exemptions. More ambition is required in due course, because the current procedures do not work well.

[1] If the end user **is** identified in advance, and especially if a price is agreed in advance with the developer, there is a much greater risk of State aid either to the developer or the end user or both. Any such aid would have to be considered as investment aid. However, it should be open for Member States even in these cases to prove that the intermediary is only compensated for market failure and that the end user has paid a market price. If so there could be little if any aid and the payments should be approvable.

79. In particular, it is important that decisions should be taken faster. Delays can mean that by the time clearance is given, the recipient has already had to take decisions, so the aid has reduced impact and less "additionality".

80. The UK believes that many payers of what is potentially State aid currently prefer to take the risk of non-notification, especially if they perceive the risk of distortion of competition to be low and/or the likelihood of a complaint to be low, rather than seeing their projects delayed, perhaps by up to 2 years. The figures for notified cases vary substantially by Member State, indicating inconsistency of application of the notification obligation.

81. This undermines respect for European law and damages the EU's reputation. But the Commission could not possibly cope with the massive increase in its workload, which would occur if all Member States rigorously notified everything which might be a State aid, regardless of its real impact on competition or cross-border trade.

82. A way must be found for more potential State aid cases to be taken outside the notification obligation, where risk of serious distortion of competition is low. This would allow increased legal certainty for those cases currently not notified at all and, if done properly, a greater likelihood that genuinely distortive aid would come to the Commission's attention. This means first extending the Block Exemptions.

- **Block Exemptions**

83. The UK welcomes the Commission's proposals to broaden and expand the various Block Exemptions. The Commission's State aid resources must be focused on the most distortive aids and the notification bureaucracy and delay must be proportionate to the risk of serious distortion of competition arising from the aid in question.

84. The UK would favour the development of more Block Exemptions under the various horizontal Guidelines, such that the smallest cases of each type of aid no longer need to be notified. This would include some environmental aid, for example and small-scale support for venture capital investments. Small-scale culture and heritage payments could also usefully be covered by a new Block Exemption.

85. The UK also supports the integration of the different Block Exemptions as long as this does not lead to over-generalisations such that different approaches and tests for different types of aid are lost in the need to come up with common text. Where the tests for approvability and susceptibility to Block Exemption treatment make sense to be harmonised across different types of horizontal aid, then integration of Block Exemptions and guidelines makes sense. But integration is less important than getting the policy right for each type of aid on its own.

86. The UK supports a raising of the *De Minimis* threshhold. If the cumulation issue (see below) is not addressed, we would probably favour a limit of Euro 250,000 –

300,000.

87. Better still, however, would be for the Commission to address the cumulation problem in relation to *De Minimis* aid. We believe that no Member State, certainly no large Member State, possesses the administrative resources to be certain of avoiding cumulation of aid between different Ministries and agencies of Government and different levels of Government. Attempts to keep track of De Minimis aid over 3 years and apply the cumulation rules are bureaucratic, time-consuming, usually ineffective and totally disproportionate to the risk of distortion of competition if the cumulation rule were broken.

88. The UK would prefer to focus the De Minimis limit on a project basis. Restricting the cumulation rules to the individual project and relying on the low level of the De Minimis ceiling would offer a lighter mechanism. Alternatively a one year cumulation period would be better than the impractical 3 year period we currently face. Deliberate sub-division of aid to manipulate the De Minimis limit could still be outlawed.

89. No system of state aid control can be absolutely perfect and these options would not be water-tight if Member States were determined to abuse them. But the UK believes that the current mechanism is not enforced properly and is therefore also open to abuse in practice and this is an area where administrative efficiency gains would more than compensate for the slight increase in risk of distortion of competition.

90. If progress could be made on reducing or eliminating the burden of cumulation control, a lower limit for De Minimis aid would be more appropriate – say, Euro 150,000.

- **Notifications**

91. Where cases still need to be notified, a way must be found to quickly identify which cases raise serious competition concerns and to rapidly approve those which do not raise such concerns. This means improving the quality of notifications.

92. The UK accepts that Member States have an obligation to supply detailed and comprehensive notifications, but our experience is that the more we supply, often the more questions and demands for further documentation we face in the next stage. However diligently we attempt to prepare notifications, it does not seem to appreciably reduce the timeframe for Commission decision-making at present.

93. More clarity is needed in advance of what information is required in a notification. The required information will vary according to the type of aid measure, so under each new Guideline the Commission should set out how proposed aid will be assessed under that Guideline and what information the Commission will need.

94. The UK would like to see much more focus in notification documents and in Commission assessments on the market impact of the measures. The content of

each notification should depend on the framework or guideline under which it is notified, but for most of the horizontal aid measures the following structure would, we think, be appropriate:

- What is the desired outcome that the payment(s) are designed to procure?
- Where is the evidence of market failure?
- How else might the market failure be removed and why is state funding the only or the best option?
- What is the nature of the aid and who is the intended recipient?
- What steps have been taken to assess the relevant market and the impact on that market of the proposed payment?
- How has the Member State ensured that the minimum necessary is being paid?
- How has the Member State avoided upstream or downstream consequences of aid measures?

95. The first three of these questions need not be answered in cases which fall within Guidelines where the relevant market failures are already recognised at EU level and the Commission accepts the validity of State aid to remedy these failures.

96. These questions are often much more pertinent than the financial minutiae of the proposed payment, which have traditionally occupied the centre ground, but which we accept are more important when considering a proposed payment under the regional aid Guidelines or other guidelines where aid intensity levels are the key criterion for approvability. The Commission's Action Plan gives little indication of how the Commission proposes to make greater use of market assessments. This is a major gap in our view.

97. In cases which fall outside any guidelines, Member States should have to prove in particular that such measures are clearly aimed at tackling a market failure and are unlikely to cause significant competition distortions. Member States wishing to propose such measures should prepare a competition impact assessment. If the competition assessment shows there will not be any significant distortions, approval should be able to be given for the aid without an 88(2) investigation being needed. This would give Member States greater flexibility to introduce relatively small, targeted state aids.

98. At present the Commission sometimes seems to work on the assumption that any aid which is not covered by the guidelines is likely to be incompatible with the Treaty and at least requires a full 88(2) investigation before it can be approved, regardless of its likely impact on competition. This ignores the fact that Commission guidelines do not comprehensively cover all market failures which Member States might wish to tackle with state aid in the Community interest.

- **Speeding up Assessments of Notified Aid**

99. To take account of those cases where, despite improved guidance on the required content of notifications, Member States still might not submit the information the Commission needs, there must remain scope for the Commission to ask for more information. But there should only be one such opportunity and the Commission

should make such request within six weeks of the date of notification, giving the Member State one month to supply it, perhaps six weeks if there is uncertainty over what is needed and both sides agree to the extension.

100. The Commission should then take a decision within a maximum of six weeks of the Member State reply, based on the information available. This may, of course, mean rejecting some proposed aids because the Commission lacks the information to be able to make a proper assessment. These cases would then have to be re-notified or dropped. If the Commission fails to take a decision within the six weeks, the aid should be deemed to be approved.

101. No preliminary case should therefore last more than 18 weeks from the date of notification and this should be a formal maximum, unless an article 88(2) investigation is launched. If complex merger control decisions can be taken within a tighter time frame, there is no reason why preliminary state aid investigations should not be subject to a timetable at least as strict as this.

102. The UK would like to see cases falling within "safe harbour" limits as set out in revised guidelines being addressed even faster[2]. If a case falls outside a relevant Block Exemption, but squarely within Guidelines and if the Member State can supply convincing evidence from a market impact assessment on why the proposed aid will not appreciably distort competition, the Commission should be able to take a Decision within weeks, not months. We would propose a 6 week limit, unless further information is genuinely required from the Member State before making a decision.

103. If an 88(2) investigation is launched, it must also be conducted much more rapidly. Six months should be the maximum from publication of the notice in the OJ to adoption of the final decision. This would still leave Member States time to comment on third party responses and space for the Commission to ask for one further round of more information after that.

104. The Commission must also sort out the delays in publishing 88(2) notices – in one recent case a delay of 2 months was noted and in another case it took 4 months simply to publish the notice of the investigation. This is obviously unacceptable.

105. 10 months should be the maximum total length of a State aid investigation.

- **Non-notified Aid**

106. Investigations into non-notified aid should also not be allowed to drag on for years. This can have a serious effect on the credit rating or stock market value of a company alleged to have received illegal State aid, even if the final decision is that there was no State aid.

[2] Revised Guidelines would set out criteria for a second level of cases above Block Exemption levels but where serious distortions of competition are unlikely to occur, ("safe harbour limits"). These could be based on economic criteria, size of aid, size of aid recipient, relevant market share of aid recipient, proof of minimum necessary, degree of selectivity/competition for the aid, etc.

107. The UK would like to see these cases dealt with by requiring Member States to notify within 2 months any *prima facie* case of non-notified aid. The normal notification deadlines would then apply. If Member States failed to notify, the Commission could proceed to open an 88(2) investigation directly, subject to the normal 6 month deadline.

- **Role of Independent Competition Authorities in the Member States in Case Assessment**

108. One option for speeding up assessments could be to offer Member States the option of securing an independent review of the distortion of competition that might result from the proposed payment. Such a paper, if authoritative, could perhaps obviate the need for detailed investigation by the Commission itself in some cases. This could become a role for independent competition authorities (ICAs) in relation to State aid, at least in some Member States. If so, it would hopefully ensure effective, independent economic review and reduce the burden on the Commission, provided that the Commission paid appropriate regard to the assessments made by the ICAs.

109. A more radical alternative would be, over time, to remove the notification obligation for a second tier of cases within Guidelines/block exemptions, that fall outside the conditions for direct block exemption but are nevertheless within broader "safe harbour" limits and therefore unlikely to distort competition seriously on a European scale. These could avoid notification if Member States obtained an opinion from an ICA that the measure was unlikely to distort competition to any significant extent. This could be done gradually and only when the Commission were satisfied that particular ICAs had the necessary expertise and independence. This might even incentivise Member States to ensure that their ICAs were sufficiently robust.

110. The ICA would apply largely economic tests as to be set out in the revised guidelines to check whether cases genuinely fell within the safe harbour limits and to assess whether any serious risk of distortion of competition were present. In case of a serious risk of distortion or an exceeding of safe harbour limits, the ICA would have to refer the case to the Commission. Cases before ICAs would have to be published in the OJEC and could be subject also to a four month time limit, or perhaps less. Decisions would be subject to appeal to the national Competition Appeals Tribunal. The Commission might retain the right to request that any specific case be referred directly to it, even if within the safe harbour limits.

111. The UK can see advantages to such an option, but also disadvantages. Most serious would be the risk of uneven application of the rules, especially given the varying structures and levels of experience and expertise of ICAs. It would be difficult to ask ICAs to take decisions about the Community interest in cases of doubt, so their role might have to be confined to competition and market assessment, so the Guidelines setting out their role would have to be clear and prescriptive subject only to the competition assessment point. Also some ICAs might prove unable to take decisions any faster than the Commission, and if ICA

decisions were subject to Commission review or appeal, procedures might even be lengthened, with aid givers facing, in effect, "double jeopardy".

- **Improving Third-party Input**

112. Another option would be to insist on the publication of a short notice in the OJ every time a proposed aid is notified. Third parties would then have, say, 10 days to request a non-confidential copy of the relevant notification and, say, a further 10 or 15 working days to offer comments or express concerns. The Commission (or eventually ICA)could then consider any comments received when asking Member States for further information. If no concerns were expressed, the Commission could have somewhat greater confidence that the proposed aid would not seriously distort competition.

113. More radical than this would be to have a category of aid again outside the normal block exemption limits but unlikely to distort competition significantly. A short description of such aid could be published and notification made conditional on whether any competing business expressed concern. If no concerns were expressed, the aid could be deemed approved under the relevant Block Exemption.

- **Enforcing State aid Discipline**

114. The UK is not sure that independent competition authorities could have a useful role, in practice, in enforcing state aid discipline, unless they had the delegated authority to approve cases described above. They would not be aware of all the cases under discussions by the national authorities and are not equipped to monitor such activity. They would also have no authority to challenge an action of a Government Department and would be left, at best, having to apply to national Government, a national Court or to the Commission for action to be taken. They would, in the end, be reduced to acting in this area as the Commission's agents in the Member States, which might detract from their independence in other areas.

115. The UK supports the Commission's idea of examining how judicial enforcement of state aid rules in the Member States could be reinforced. This may or may not be a problem in other Member States, but we believe our own Courts take a robust approach already.

116. Another angle for removing the benefit of illegal receipt of State aid would be to give greater publicity to cases of non-notified aid and especially non-recovered illegal aid. Naming and shaming will lead to firms suffering credit concerns and lower stock market value. Perhaps the Commission could officially notify the company's auditors in cases of clear illegality.

117. The role of national audit offices in raising awareness of state aid risk and examining state aid compliance is important. The UK would support encouragement from the Commission to audit institutions to strengthen their arrangements for raising awareness of the State aid rules. However, any decisions over the means by which audit institutions should monitor and report on State aid

compliance should remain matters of audit judgement.

118. In the UK, the NAO already has three strands of work where State aid rules are considered.

- Financial audit addresses the matter of State aid in that there are EU legal requirements encompassed within regulatory coverage and audits assess the controls put in place by Government departments to ensure regulatory compliance.
- Secondly, State aid issues may also be considered in relation to investigations of major financial support offered by the Government.
- Finally, compliance with or knowledge of State aid rules in specific circumstances may be considered in value for money work. Some recent reports such as: *"Progress on the Channel Tunnel Rail Link"* HC 77 Session 2005-06, *"Emissions Trading Scheme"*, HC 517 Session 2003-04 and *"Regional Grants in England"*, HC 1028 Session 2002-03 dealt with aspects of State aid.

119. The NAO is planning to issue new guidance for its auditors on State aid rules in financial audit, outlining the rules, the risks for Government bodies and the implications for audit work. It will include examples of the high-level controls which may be used by a state body seeking to ensure compliance and guidance on matters to be considered when examining individual aid measures.

120. The UK also supports ideas for forming a closer network of Member State State aid authorities.

121. One focus of such a network could be to improve State aid training across borders and including the involvement of Commission officials. The UK already organises advanced training events involving case studies for experts on State aid within Government departments and regional and devolved authorities. These could be extended to a limited number of other Member State officials or Commission officials capable of operating in English. UK officials would be happy to attend events in other Member States if the languages were appropriate for their abilities. Our events are mainly designed to improve understanding of State aid law and policy around the UK, but they also serve to improve the awareness of DTI advisers and policy leads of the practical obstacles faced by officials trying to deliver economic development "at the coal face".

122. The network could also look at the use of benchmarking, exchanging best practice and especially improved evaluation of the effectiveness of aid, including techniques for *ex ante* assessments.

123. Faster recovery of illegal and incompatible aid is certainly desirable. There are often practical, legal barriers, however, especially if the recipient has since gone bankrupt. It would be a complex exercise to examine how to remove such barriers even in one Member State, let alone all 25. One option to study might be to devise a "Remedies" Directive similar to that for Public Procurement remedies adopted some years ago. The UK would need to study any proposed text very carefully, however, before committing its support to such an instrument.

124. Provisional recovery of aid which has not been notified but may or may not be approvable, presents further problems. We can see the reason for such an approach but would be concerned about the practical implications. There remains significant legal uncertainty about what constitutes a State aid – the recent cases involving SGEI and fiscal aid are testament to that. There are also many areas, such as aid for the supply of health and education services and for the activities of universities, where Member States know that the Commission is sympathetic to their aims and can be confident that any aid arising would be approvable, but cannot be absolutely certain that all of their complex financial interventions would not be found to be State aid by a Court.

125. The introduction of provisional recovery orders could lead to malicious complaints combined with legal uncertainties leading to administrative paralysis and a flood of new notifications to the Commission ("just to be on the safe side") even when the risk of distortion of competition is minor. Until the Commission can make the State aid rules far less intrusive and provide effective legal certainty, it should not lightly impose automatic provisional recovery for non-notified aid.

126. The alternative would be to only impose recovery where it is clear and unambiguous that an illegal aid has been paid and that it is seriously distorting competition. The UK would probably support this line, but it would not be a major change, as we understand it, from current practice.

- **Commission Procedure**

127. The UK welcomes the Commission's proposal to correspond electronically, to look again at translation issues and to gather sectoral and market data with which to assess aid applications. Again, this latter area could be one where national competition authorities could have a role.

VIII. Remaining Issues

128. The UK looks forward to a review of the Rescue and Restructuring aid guidelines. Aid for restructuring is amongst the most distortive types of aid. The UK would like to see stricter rules and stricter enforcement of existing rules in this area. Member States should not prop up failing firms unless there are overwhelming practical reasons why they must, which are independent of industrial policy. Restructuring should normally take place in administration or through acquisition. State intervention should be restricted to dealing with the social consequences of restructuring (retraining, protection of pension rights for workers, etc.) If restructuring aid is allowed, compensatory measures should more clearly be pro-competitive.

129. The UK would like the Commission to issue guidelines, including a block exemption on aid for culture and the scope of Article 87(3) (d). The three decisions on heritage aid from 2003 have removed some uncertainties and there are regular discussions on aid for public sector broadcasting and for films, but State aid for sport and for other cultural pursuits often remains problematic.

130. In our view it is only in the context of an 88(2) investigation that the issue of needing to equip EU "champions" to compete with non-EU rivals can be considered. In our view this is a proper consideration for the Commission to look at only in those cases where an EU company is primarily competing against non-EU competition and the implications for market distortion within the EU are minor. In any event, this factor should not be taken into account unless it is raised as a potential argument in an article 88(2) notice, allowing therefore EU competitors to make their voice heard on the issue.

131. Member States need to do more to assess the value for money of State aid expenditure and evaluate the effectiveness of this spending. The UK believes this is important and should be a focus of Commission interest alongside looking at judicial enforcement and the role of national audit offices. It is also an area where the UK would hope to make use of the network of Member State aid experts to exchange best practice and ideas.

132. The UK would also like the Commission to reflect on how it can monitor the effectiveness of the State aid rules on an ongoing basis. There should be a mechanism for seeing, with hindsight, whether aid that has been allowed has actually proved very damaging to competition or whether aid has been blocked that would have proved innocuous. Just as Member States should do more to evaluate the effectiveness of their use of public funding, so the Commission should evaluate the effectiveness of its regulatory controls.

133. Transparency of payments to business could be another area of focus. If Member States had to publish all payments to businesses over a certain threshold and an explanation of the nature of the payment and its State aid justification, this would concentrate the mind and help the Commission, other member States and competitors to see which companies are benefitting from funding under approved State aid schemes and programmes with multiple recipients.

134. Finally, the UK would like to see some reflection on how the Commission investigates complaints. It is not currently transparent, for example, how much of a *prima facie* case a complainant has to make before the Commission launches an investigation. The UK does not want to discourage genuine complaints, but the procedure may be open to abuse from malicious complainants simply seeking to delay implementation of Government policy which they happen not to like. The Commission may need to prioritise which complaints it decides to follow-up and perhaps the initial investigation of complaints concerning smaller aids could be delegated to expert consultants or even Independent Competition Authorities in the Member States.

REFORM OF THE ENVIRONMENTAL GUIDELINES

This note explains briefly why the EU's Guidelines on State Aid for Environmental Protection ("the Environmental Guidelines") need to be reformed and makes some suggestions as to the changes that are required. First, a few preliminary remarks:

(i) We support tight control of distortive state aid: the suggestions here are entirely consistent with the Commission's stated policy of focusing resources on such distortive aid and of taking a more flexible approach to state aid that is generally considered not to have a significant impact on competition. We also support the Commission's attempt to inject more economic and market impact analysis into the assessment of which aids should be approvable. This paper suggests how this might be done in the context of environmental aid.

(ii) There is a fundamental economic difference between a "pure" subsidy to a company on the one hand and a payment to achieve an environmental objective, **which would not otherwise be achieved** on the other. The Guidelines should recognise that:

- where companies are not obliged to improve environmental performance and such improvement involves a net cost to the company, state payment of the minimum necessary to secure the improvement will not provide a material advantage to the company receiving the payment and will therefore not significantly distort competition. It will merely offset the non-economic cost to the company of the environmental gain. Such payments are not aid at all if they provide no advantage whatsoever to the recipient. In cases where marginal advantage to the recipient cannot be entirely excluded, the aid should always be approvable, regardless of the location of the investment, as long as the environmental gain is legitimate and the procedures for ensuring that the minimum necessary is paid are sufficiently robust;

- where companies are subject to environmental regulations (or taxes) which impose costs upon them, this will distort competition unless such regulations/taxes are imposed equally on all their competitors. In practice this is often not the case, so to avoid Member States and the EU as a whole being deterred from introducing such regulations/taxes, the Commission must allow some flexibility for Member States to respond to the additional costs of achieving environmental gains with compensation, especially if that Member State has in practice imposed higher environmental standards than other EU Member States. Such compensation may be pro-competitive, rather than distortive as well as enabling a greater degree of pro-activity by Member States for achieving environmental gain.

(iii) at all times, no more aid should be permitted than is <u>strictly necessary</u> and this should be in proportion to the objectives sought;

(iv) the purpose of environmental aid must be solely to achieve European and Member State <u>environmental goals</u> – not to achieve industrial goals. This means that environmental aid should either be offered to all companies subject to a particular environmental challenge or in a position to achieve the particular environmental gain or be offered through competitive process to those undertakings which can best achieve the environmental gain at the lowest cost.; and

(v) we recognise that this area is complex and that there may be more than one way of achieving these objectives. What follows are ideas to assist the reform process and the UK would be very happy to discuss them with the Commission.

Against this background, some of the main reasons for reform are summarised below and, secondly, some suggestions for change are made.

A REASONS FOR REFORM

These can be grouped under the following broad headings:

1 Achieving Environmental Objectives

The fundamental reason why the Environmental Guidelines need to be reformed as soon as possible is to ensure that environmental support can be given more effectively and to support more global and strategic measures which are vital in the interests of environmental protection and sustainable development. This should not be seen as a radical development as the current Environmental Guidelines state clearly that they are concerned with support for:

- "environmental protection";
- action to "remedy or prevent damage to our physical surroundings or natural resources";
- "sustainable development"; and
- "environmental objectives"; and recognise
- the need to "encourage the efficient use of these natural resources".

However, while these objectives are set out clearly at the beginning of the current Environmental Guidelines, later passages, and the Commission's interpretation of them, have meant that a number of important environmental initiatives cannot be supported under them. We would particularly refer to three aspects:

(a) Environmental Harms

"Emissions and pollution" are only one of many sorts of environmental harm: it is vital that Member States should be able to take steps to achieve the above environmental objectives and to tackle other forms of environmental harm by all available means (including state aid where the other pre-conditions for granting aid are met);

(b) Pump Priming

The current application of the Environmental Guidelines focuses on support to help a company "improve its own environmental record" or "to reduce its own pollution". This is not always the most efficient way of dealing with an environmental problem – either from a state aid or an environmental policy perspective. It is often more effective to support investments which act as a catalyst and deliver environmental benefits well beyond the point at which the intervention is made in the production cycle. This would allow Member States to determine the point in the supply/production/services chain where intervention will most effectively be able to incentivise environmental gains along the entire chain: this enables the maximum environmental benefit to be derived from the

minimum state intervention and ensuring that no more aid is given than is "strictly necessary" to achieve the objective in question.[1]

(c) Environmental Benefits

The Commission's current interpretation of the Environmental Guidelines ignores many direct and indirect environmental benefits, not just to the recipient of the aid, but to the wider Community (and, indeed, the Member State and the EU as a whole) in terms of a better use of natural resources, reduced emissions of greenhouse gases and other pollutants, increased recycling of waste, reduction and remediation of pollution, reduced landfill etc. etc.

2 Minimising Distortions of Competition

As stated above: "the purpose of environmental aid must be solely to achieve European and Member State environmental goals – not to achieve industrial goals. This means that environmental aid should either be offered to all companies subject to a particular environmental challenge or in a position to achieve the particular environmental gain or be offered through competitive process to those undertakings which can best achieve the environmental gain at the lowest cost."

The current guidelines allow selective assistance of 30 or 40% (or more for small businesses and/or in certain regions) of the net cost of certain environmental enhancements. This is allowed regardless of whether this level of aid is the minimum necessary or not and even if such aid is only given to a sub-set of companies. This may allow Member States to distort competition by making grants available to some firms but not others. It also threatens to distort competition by allowing higher aid in some regions than in others, regardless of whether the firms in those regions require higher aid to achieve the same result.

Arbitrary investment aid limits, especially those which are allowed to vary in this way, are an inappropriate basis for assessing which aids will distort competition contrary to the Community interest and which will not. The Commission should instead focus on ensuring the following:

- That the environmental purpose is valid
- That the environmental purpose would not be delivered by the market by itself (i.e. that there is a market failure)
- That the payment is the minimum necessary to achieve the desired environmental policy objective
- That the aid is offered equally to all companies in the same position

Any extra support for firms in assisted areas or for SMEs should have to be treated as regional/SME aid and approved separately on this basis.

[1] This is consistent with the EU's Sixth Environmental Action Programme: "Subsidies can be used in a beneficial way when they are used to pump prime the development of environmentally-friendly processes and products provided they respect the Community state aid rules".

3 Financial Aspects

Excluding innovative and cost-effective schemes from the scope of the Environmental Guidelines could have serious implications from a financing and environmental policy perspective. If Member States cannot support private companies which are prepared to help Member States achieve environmental objectives (often themselves set by the EU or under international obligations), then Member States will have to:

- support only companies which are, in a narrow sense, reducing their own pollution rather than making a wider contribution to achieving environmental goals (as mentioned above, this latter approach will often be more efficient and require less state aid to achieve a given environmental objective – "more bang for your buck");
- do all the work, and incur all the expenditure itself: i.e. carry out its own R&D, build its own infrastructure etc. This is likely to put unnecessary pressure on state budgets and may, in many cases, be less effective and more distortive of competition;
- amend or dilute their plans so that they fall within other state aid regimes which were not designed for environmental purposes (e.g. regional aid or support for SMEs); or
- fail to meet environmental objectives.

In particular, permitting support for wider environmental objectives would promote "public-private" initiatives (or, put another way, better cooperation between social partners). The Commission has recognised that a public-private partnership approach to environmental issues can be the most efficient from both an environmental and state aid policy perspective.[2]

4 Subsidiarity

The Commission has, in many cases, underlined that it is the right of Member States to determine their own public policy. The UK considers that, as noted above, the State aid rules should facilitate that process to the extent that it does not cause unacceptable distortion of the common market. In providing guidance on whether a proposed Member State measure provides an acceptable level of distortion the guidelines should allow the Commission to consider the effects beyond the direct recipient in order to weigh its wider effects and to allow Member States to put in place the most efficient solutions to environmental problems. In this context, we note that:

- environmental policy is a shared responsibility of the EU and Member States and Member States should be free to pursue their own environmental objectives as best suits their own circumstances (as long as this does not conflict with EU law – including state aid law); and
- in many cases where the EU has agreed environmental objectives to be achieved, it is for the Member State to determine the precise manner and the appropriate policy instruments to achieve those environmental objectives[3] (except of course where Member States agree to do this at Community level).

---

[2] See, for example, paragraph 3.1.5 of the UK Support for Land Remediation Decision.

[3] For example, the EC Landfill and EC Packaging directives only set "general targets" for Member Sates to fulfil (not specific targets binding on individual companies).

Because environmental policy in the different Member States is varied and because it is also constantly evolving, the environmental aid guidelines need to be capable of accommodating a variety of policy responses across a range of areas and of reacting to innovative policy changes. The current rules are too complex, prescriptive and limitative. The guidelines need to set out the principles according to which aid will be assessed, but leave room for innovative approaches, as long as these do not distort competition contrary to the common interest.[4]

5 Support for the Environment

The UK strongly supports the drive to reduce the total amount of state aid given by Member States. However, it is important that Member States have the possibility to provide state aid in appropriate cases and there may be circumstances, at least in the medium term, where more state aid may need to be given for environmental initiatives given the scale of the environmental problem faced by the Community and the relatively low level of support currently provided.

Reform of the Environmental Guidelines will not, as such, increase the amount of aid given but would simply mean that, where providing targeted support for environmental initiatives was the best method for achieving an environmental objective, this would be classed as Environmental aid. Reform should also assist in reducing the level of aid necessary to achieve a particular environmental effect by facilitating more effective and efficient uses of aid.

Furthermore, it should improve transparency as some aid currently given for environmental reasons is being approved under different measures (e.g. regional guidelines) because of the limitations on the current use of the Environmental Guidelines.

B POSSIBLE AMENDMENTS TO THE ENVIRONMENTAL GUIDELINES

There is much in the existing Environmental Guidelines to support a less restrictive view of them. However, the Commission has clearly felt compelled to take a restrictive view of them. It is therefore important to amend those features of the current Guidelines that have led the Commission to take this approach. The UK believes that the Commission should take a fundamentally different line with the Environmental Guidelines allowing Member States more flexibility of response and assessing proposed measures according to simple economic criteria designed to avoid serious distortions of competition.

The UK believes that where a company is under no obligation to undertake environmental improvement, which is in the broader public interest, and such improvement involves a net cost to the company, the relevant permitted aid intensity should be "the minimum necessary".

Where companies are subject to a regulatory obligation or environmental tax, helping some of them to meet the cost may at times be necessary to maintain fair competition, depending on the situation of their competitors. The Commission should allow state aid to counterbalance higher environmental standards in order to encourage such higher standards to exist.

---

4 While approval of certain aid directly under Article 87(3)(c) in cases such as the UK's WRAP Scheme or Support for Land Remediation is possible, it is clearly preferable that, going forward, aid given for environmental reasons is generally only supported under the Environmental Guidelines. The Commission should ensure that the drafting of any revised guidelines is sufficiently flexible to allow them to accommodate developments within the environmental sector.

In both the above cases the application of arbitrary maximum aid intensities, especially those which vary by region, is inappropriate. Such an approach risks leading to far more aid than is necessary being paid in some circumstances and too little aid being available to meet the environmental challenge in others. It permits selectivity and therefore distortion of competition and the EU does not want to see environmental gain only in its assisted areas.

The Commission should instead focus on ensuring the following:

- That the proposed aid addresses an environmental purpose rather than purely an economic or industrial policy /purpose;
- That the environmental purpose would not be delivered by the market by itself (i.e. that there is a market failure);
- That the payment is the minimum necessary to achieve the objective;
- That the payment is offered equally or competitively to all companies in the same position.

In the UK's response to the Commission's "Action Plan" or "roadmap" for State aid reform, we put forward the idea that market impact assessments be conducted for certain types of proposed aid and that decisions on approving notified aids be taken subject to fixed timeframes and on the basis of reviewing whether the proposed measure was likely to seriously distort competition. We suggest that independent competition authorities in the Member States might have a role in advising whether State aid is likely to materially distort competition and/or that third parties be invited to register concern at an early stage to offer further insight over whether distortions of competition were likely. . All this would work particularly well if the Guidelines consisted of largely economic tests such as the above. The UK also considers that there should be scope for some environmental aid to be approved through a block exemption regulation. It should be feasible for the Commission to set out types of aid which have a sufficiently limited distortionary effect that, so long as they meet the criteria in the block exemption regulation, they should not require full prior approval by the Commission. This block exemption approach should be possible whether the Commission adopts the proposals set out in this paper or retains its current approach to aid for environmental protection.

We would also like to suggest some further amendments and clarifications to the Guidelines if they are to continue in anything like their current form. The following suggestions are illustrative of some of our areas of concern.

1 Environmental Protection / Sustainable Development.

It should be stated unequivocally that (if the other pre-conditions of the Guidelines are met) support can be provided for <u>any</u> measure or project which is designed to improve "environmental protection" or performance and contribute to "sustainable development" (i.e. not just reduce "emissions and pollution").

It might also be helpful to set out some (non-exhaustive and purely illustrative) examples of the sort of initiatives which could be potentially supported in the interests of environmental protection/performance and sustainable development but where the market was not sufficiently well developed to allow them to proceed without support. For example:

- making more efficient use of scarce resources (including reduction of energy usage and increasing use of renewables);
- reducing emissions and pollution to air, land and water (including reduction of landfill)
- encouraging the collection and use of recycling materials;
- remediating contaminated or derelict land such that it can be reused;
- preventing and minimising waste, improving waste management; and
- encouraging the development and take-up of new environmental technologies.

2 Wider Benefits

Equally, it could be made clear that it is immaterial whether the support improves the environmental record of the recipient or that of a third party or provides environmental benefits for the wider public.[5] As noted above the most effective manner to address an environmental problem may be to support investments which act as a catalyst and deliver environmental benefits beyond the point at which the intervention is made. This would allow Member States to target aid at the point intervention will most effectively create environmental gains along a supply/service chain – enabling maximum environmental benefit to be derived from the minimum state intervention and ensuring that no more aid is given than is "strictly necessary" to achieve the objective in question

3 Incentive Effect

It should be made clear that just as support can be provided to help companies meet national environmental standards that are higher than those applicable elsewhere in the EU, if there is no relevant (Community or national) law with which a recipient firm must comply, then support for that company to take environmentally beneficial steps should be allowable (provided it has a clear incentive effect).[6] It should be clear that a company should not be precluded from receiving state aid under the Environmental Guidelines merely because, in doing so, this helps a Member State, or the Community as a whole, achieve some environmental objective. [7] This is immaterial to the company receiving the payment and therefore not a relevant consideration when assessing to what extent a payment distorts competition. Because Member State compliance with environmental laws must be in the Community interest, such a factor should make any aid more, rather than less likely to be approved.

---

5 The Commission recognised this clearly in paragraph 73 of the WRAP Scheme decision where it stated that it was proposing to amend the Guidelines to include "environmental benefits at the global level of the Member State or the Community, and not [just] at the individual level of the beneficiary".

6 It is clear that aid should only be granted to assist the implementation of environmental improvements which would not occur spontaneously (or even for some period of time) through existing market forces – otherwise there is no incentive effect.

7 This seems consistent with paragraph 21 of the existing Environmental Guidelines, which explains that it is not necessary to provide aid to firms merely to "encourage them to obey the law". However, there is clearly room for different views here as the Commission has used paragraph 29 of the Environmental Guidelines as the basis for not applying the Environmental Guidelines even where the only obligation was at the Member State level (cf paragraphs 37 and 56 – 58 of the WRAP Scheme decision). In these circumstances, it is appropriate to clarify paragraphs 20, 21, 29 and 40 of the Environmental Guidelines (all of which touch on this subject and which are internally inconsistent).

4 Polluter Pays

We strongly support the "polluter pays" principle but the Environmental Guidelines need to recognise that there are limits to the concept of cost internalisation in the context of environmental issues, especially where a more environmentally-beneficial approach is not mandatory. For example, it is not clear that a producer should be required "to internalise" the environmental costs of his current choice of, for example, virgin raw materials, rather than recycled raw materials.[8] There are also situations where, even though costs may be internalised, it may still be appropriate to permit state aid under the guidelines – for example, to stimulate new technology.

5 State of the Art

It should be clear that support for environmental objectives should not be precluded where the process/approach/technology being supported is not yet the state of the art: i.e. its use is not yet the norm and is unlikely to be so in the medium term (e.g. within two or three years) without some form of intervention – e.g. by the use of state aid.

It should also be clear that support can be given to help environmental technologies move forward from niche applications towards mainstream and/or state of the art (e.g. cleaner production, the use of more energy-efficient goods, use of renewable technologies, or the production of goods with higher recycled contents). This would include support for demonstration equipment and demonstration facilities.

6 Investment Aid / Operating Aid

The rules governing investment aid for the environment (and for waste management and energy saving in particular) should be at least as favourable as those governing operating aid for these purposes. In the WRAP Scheme decision, the Commission noted that paragraphs 42 to 46 of the existing Environmental Guidelines, dealing with aid to promote waste management and energy saving, deal only with "operating" aid, and could not be used to justify "investment" aid. In a narrow sense, this may be legally correct but, from an environmental and state aid policy perspective, it would seem to be the wrong way round: generally, state aid policy is (quite rightly) more restrictive in relation to operating aid than investment aid.

7 Eligible Costs

Some clarification of point 37 of the Environmental Guidelines would be helpful. In particular, this point tends to lead to an approach which looks to compare the costs of an environmentally friendly investment, with the cost of an environmentally "unfriendly" project. While, in some cases, this would be appropriate, in many cases it will not (because there is no "unfriendly" comparator). As the Commission has recognised in a number of cases,[9] this approach is not required by paragraph 37 and refocusing the paragraph would therefore be welcome. We would make three comments/suggestions on this:

---

[8] The producer should not be seen as the "polluter" in these circumstances. Furthermore, there is no need to view the producer as a polluter once it is accepted that the Environmental Guidelines can permit support for measures designed to achieve global objectives, rather than simply reducing on-site pollution (cf point B.2 above).

[9] E.g. in the *WRAP Scheme* decision or in the *Photovoltaic* decision.

- the "minimalist" approach to such a clarification might simply entail deleting the word "extra" in the first paragraph of paragraph 37;
- the Guidelines should allow support for investments which compensate for environmental "externalities". For example, the rules on operating aid for renewable energy in section E.3.3 (Option 3, para 63) of the Environmental Guidelines allow aid to be calculated on the basis of the avoided external costs (in effect, the real environmental benefits of the investment or the cost of the market failure). There is no reason, in principle, why this approach should only be confined to renewable energy – it could equally well apply to other environmental technologies, including resource efficiency investments such as those designed to establish recycling capacity; and
- the costs would be eligible up to the lesser of the cost of the extra cost of the environmentally "friendly" technology or the cost of the avoided external costs.

8 Aid Intensity

The Commission should reconsider the effective allowable percentages at which interventions can be made under the guidelines in the light of changes in markets and technologies. The UK would prefer the maximum permitted aid intensity for environmental aid to be "the minimum necessary", as explained above, but even if the Commission does not accept this, the current system still needs reform.

While the maximum aid intensities provided under the guidelines of around 30-40% may seem appropriate and in line with the intensities allowed in other horizontal frameworks, this gives a misleading view of the actual aid intensities which are allowable. The restriction to aiding purely marginal environmental costs of a project actually leads to aid intensities which are significantly lower than the nominal figures. In many cases the effective maximum level of aid allowed under the Environmental Guidelines may simply be insufficient to allow a project to go ahead.

In particular, where the aim of a measure is to address a market or financing failure in an environmental market (rather than "greening" an existing market's activities) the model described above and in section 7 breaks down. The amount of aid needed depends on the scale of the market failure and because these are multiple and varied across the entire environmental field, fixed percentages cannot hope to be flexible enough for purpose. This has been demonstrated in the difficulty which the Commission has had in approving entirely reasonable and proportionate Member State schemes within the scope of the guidelines.

There should be scope for wider environmental effects to be taken into account in the consideration of a proposed aid: in particular, schemes which support activities which will have a wider effect across a market to produce an environmental benefit (or a number of environmental benefits).[10] If aid is particularly beneficial, some small distortions of competition may be an acceptable price to pay.

---

10 For example, an investment in a recycling facility will have a direct benefit that recycling of a particular product will increase. However, the project may also be configured to achieve other important environmental effects as second or third-order effects – for example, an increase in use of waste feedstock will remove material from landfill, increase efficient usage of existing natural resources and the arrangements for collection of the waste feedstock may create sufficient critical mass to incentivise the collection and recycling of other materials etc

If, despite this paper, the Commission retains regional aid-style maximum aid intensities, at the very least, it should be possible for the Commission to re-consider the way in which the eligible costs to which the aid intensities apply are calculated. For example, as noted above, no account is taken in the current guidelines of environmental effects beyond the direct recipient of the aid. This should be included within any future guidelines. Furthermore, as noted above, the model on which the calculation of marginal environmental costs is based is no longer sufficient to cover the range of projects for which approval is sought under the guidelines. Many current aid schemes, particularly those which are designed to remedy market failure to achieve the desirable environmental outcome and offer the minimum necessary to achieve that objective can be argued to contain little or no ”non-environmental" element and, therefore, all their eligible costs should be able to be considered for funding. The revised guidelines should deal with such a possibility.

If the Commission considers that this is not possible then there may be other ways to ensure that there is sufficient scope to provide levels of aid sufficient to incentivise improved environmental performance. For example, an approach along the following lines could be adopted. It may be possible to increase the aid intensity which may be applied to the marginal environmental costs of a project to a higher level – say 50-60% - while retaining a provision that no aid may be granted above 30% of the total eligible costs of the project. This would provide for higher levels of aid where necessary while retaining discipline on overall levels of aid. It should be emphasised again, here, that the UK believes that even under such arrangements, no more aid should ever be permitted that that strictly necessary to achieve the objective in question and additionality should be demonstrated in all cases.

9 Tax Issues

It would also be helpful to clarify two tax issues:

(i) the rules on tax reductions or exemptions should be more flexible to allow Member States to adapt reductions or exemptions already granted, in the light of new information on their effect on the market, competition and the environment;.[11] and

(ii) provided all other conditions are met (necessity, proportionality etc), it should be possible to permit temporary tax reductions from environmental taxes (e.g. the climate change levy) because of a temporary loss of industrial competitiveness in sectors exposed to international competition. An example of this would be new discounts for energy-intensive sectors under the climate change levy where new information has revealed competitiveness problems which had not originally been anticipated.

10 Tradeable Permits

The Guidelines should make it clear when tradeable permits may amount to state aid and the circumstances in which this may be approved. In particular, it could be stated that trading permits allocated on a “grandfathered” basis will not amount to state aid where this is done on an objective and non-discriminatory basis and the level of tradeable permits

[11] The Environmental Guidelines currently only allow derogations in the light of “significant changes in economic conditions that placed the firm in a particularly difficult competitive situation” (para 51(2)(b)).

allowed is proportionate to the level of effort required by the recipient to meet the environmental standard in question.

11 Further Safeguards

In amending the Environmental Guidelines, the Commission (and some Member States) will, quite rightly, be concerned not to open the floodgates to excessive or inappropriate aid. This is not the intention of the proposed reforms and, to allay concerns, it may be helpful to build in some further safeguards and/or to re-affirm or clarify some existing principles. The following are some examples/suggestions:

(a) Polluter pays

With an appropriate qualification (see point B.4 above) re-affirm the "polluter pays" principle.

(b) Legal obligations

It could be re-emphasised that state aid should not generally be available merely to help the recipient meet a legal obligation applicable to that recipient, unless its competitors are not subject to similar obligations. If a Member State proposes to offer aid to help companies meet EU-wide obligations, the presumption would be that such aid was unwarranted, but there could be exceptions if a Member State hosting a major competitor had manifestly failed to apply the EU rules correctly, for example, or if a company primarily faced non-EU competition and all other Member States hosting competitors were not opposed to such aid being granted.

(c) Necessity

It could be confirmed that state aid should only be permissible under the Guidelines where this is "necessary" from an environmental perspective. This could include showing, at the time of granting the aid, that the market will not support activities leading to environmental benefits and, as a result, the project being supported is not currently economically viable; For example, this might be the case where a project involves:

(a) supporting innovation and new process and technology developments (establishing new technologies, e.g. pilot plants, demonstration activities and, where appropriate, full production facilities);

(b) supporting existing technology which has not yet been proven for use in novel applications or for new markets or new material;

(c) encouraging the development of new end-uses or markets for existing materials;

(d) supporting technology transfer where technology has been proven elsewhere in the world but for which market failure is preventing its development here; and

(e) facilitating the development of new recycling capacity where the principal purpose of the project is environmental (and not industrial).

Further relevant factors to help demonstrate the aid is necessary to achieve environmental objectives could include showing that:

the body giving the aid is a bona fide environmental body with environmental objectives;[12]

* examples of the scheme or measure in question show that they are directed to environmental, and not solely industrial, objectives;

* the objectives of the proposed investments are in line with EU policy on the environment;[13]

* no more aid is given than is necessary to meet that environmental purpose. Again, this can be demonstrated in a variety of ways but relevant factors could include showing that the criteria for selecting companies/projects were open, transparent and non-discriminatory.

(d) Proportionality

Confirm that the principle of proportionality must, in all cases, be respected. For example, show that every effort has been made to off-set and reduce any potential adverse effects on competition.

[12] Although it should not be limited to this as, obviously, public bodies with a wider mandate may give support wholly, or primarily, for environmental purposes.

[13] This should not be the only way in which the environmental objectives can be demonstrated as Member States are entitled to pursue environmental objectives different, or going beyond, Community environmental objectives (as long as they do not conflict with Community law).

STATE AID SUPPORT FOR LAND AND PROPERTY REDEVELOPMENT IN SUSTAINABLE COMMUNITIES UK PROPOSALS FOR REFORM

Introduction

1. Many parts of the UK, and of other Member States, currently suffer from physical, economic and social deprivation. These areas are usually characterised by communities with a weakened economic base, with large concentrations of under-skilled, unemployed and socially disadvantaged residents who are surrounded by a poor physical environment. They are typically areas of high crime and high levels of social exclusion. These deprived communities can be small and localised, often found within relatively prosperous as well as disadvantaged regions and often outside the Assisted Areas designated in the EU Regional Aid Guidelines.

2. Overcoming deprivation involves creating a built and natural environment in which people want to live and work by providing amenities, tackling degradation and safeguarding natural and built heritage. It should also assist in meeting economic objectives – in achieving self sustaining economic growth which leads to job creation and sustainable improvements in economic performance in all areas – and social objectives – in meeting peoples' social needs by promoting social inclusion, neighbourhood renewal, building social capital, promoting stronger communities, better health and access to services and recreation.

3. The UK's Sustainable Communities agenda, which is committed to delivering "thriving, vibrant, sustainable communities", together with other policy initiatives, is designed to tackle these issues. The key principles of this policy include encouraging the economic development of urban and rural areas suffering from severe (and often multiple) local difficulties, making affordable and decent housing the norm throughout the country, improving the local environment at all levels including at community level, empowering and strengthening the communities themselves and also the protection of the environment.

4. Improving the physical appearance and infrastructure of these areas – tackling **physical deprivation** – is a high priority. Good quality, well–designed and affordable housing and other buildings, as well as other improvements to the environment and the development of high quality public space, can make a huge difference in combating deprivation. Poor quality, ugly or derelict neighbourhoods, by contrast, reinforce despondency and breed crime and disaffection.

5. Communities in these areas often need assistance to mobilise themselves to create organisations for mutual support, including charitable activity and voluntary sports and recreational facilities – tackling **social deprivation**. Small-scale, community-based economic activity often has a valuable social function as well as developing entrepreneurial skill-sets and contributing to economic development within the area .

6. A major contribution can also be made by encouraging entrepreneurship and small-scale business activity and by combating the market failures which lead to **economic underperformance** in these areas. This does not mean large-scale investment aid for large or even for small and medium sized companies. Rather it

involves providing a business service "infrastructure" – financial advisory services, business incubation facilities, suitable business premises, which the market might not deliver by itself. Very low intensity tax incentives may also play a part in encouraging business to invest in a deprived area, rather than elsewhere, yet without distorting competition to any significant extent.

7. Many of the UK's most deprived areas lie within otherwise relatively prosperous regions. General regional development may not be the problem so regional investment aid is not the solution. What is needed is precise targeting of joined-up investment in physical, social and economic infrastructure to combat market failures in these pockets of deprivation. Business investment will then take care of itself.

8. This paper focuses on the changes needed in the rules and frameworks affecting investment to tackle physical deprivation.

Background: Existing Approvals

9. The Commission has already approved what forms a suite of measures underpinning the physical redevelopment of sustainable communities in the UK. This has enabled the United Kingdom to support a range of measures, which have facilitated individual redevelopment schemes in compliance with the State aid rules.

10. In particular, the Commission's positive decision on the UK's Support for Land Remediation scheme was very helpful. Directorate General Competition themselves considered their approval of the scheme to be a landmark case with Europe-wide significance. The approval has provided the UK with the flexibility to support the remediation of derelict and contaminated land, within certain parameters but wherever the UK sees the need to do so, without the risk that such support might be challenged and considered an unallowable state aid.

11. Also, the Commission has approved schemes which allow the limited funding of property developments on the basis of the Regional Aid Guidelines, the remediation work on heritage buildings and sites, and provision of social housing. These approvals, although not as broad as that for land remediation, still went some way towards providing the UK with clear guidance and discretion as to what could be supported in regeneration projects inside and outside the designated Assisted Areas.

12. Other approvals have helped, for example the Community Development Venture Fund, the Coalfield Enterprise Fund, the GRO and Credit Unions projects in Scotland and the Stamp Duty Exemption Scheme. Background on some of these schemes is set out at **Annex A**.

13. The UK has used these approvals to support a number of programmes and the benefits of these are already being felt. However, it is timely to take stock given that both the current approvals and the regional aid guidelines will expire at end December 2006. The rest of the paper looks in more detail at the need to continue or change the existing rules, and what more might be needed.

Issues: Using State Aid to Tackle Market Failures

14. Deprived areas can be subject to a range of market failures. The Commission has acknowledged the existence of problem areas where incidences of market failure are high[1]. As a result of these market failures, areas remain socially distressed, land is derelict or under-used, and economic activity is much less than would otherwise be the case.

15. Market failures can arise from a complex web of inter relating factors. Policy interventions need to take account of this complexity and address individual facets of it in a way that will contribute to an overall solution. The Commission has endorsed the view that the public sector should be able to support a package of measures combining the rehabilitation of obsolete infrastructure with economic and labour-market actions to combat social exclusion and to upgrade the quality of the environment[2]. There is a major role for the private sector to play, as it offers significant additional resources that are otherwise unavailable, and can bring in project design and management expertise to specific schemes. Interventions must be in compliance with the principles of fair competition, but there is real potential to improve prosperity in all areas if horizontal measures are used to target specific communities in need and to complement measures for large geographical areas. Targeted interventions will include a range of measures that are not affected by state aid rules, but many desirable interventions are caught, because of the very wide definition of state aid which has been developed by the European Courts.

16. Socially deprived communities can be of any size and occur in any area, including otherwise prosperous ones. Within a region which performs well overall, there may be specific local pockets (e.g. at NUTs 4 or 5 levels) where there are serious problems of dereliction and deprivation. The UK has identified its 2000 most deprived "wards"[3], a number of which are located in otherwise well performing regions.

17. Member States need the flexibility to target support in such areas so as to be able to develop specific schemes to remedy the problems. Otherwise, investment would be focused away from these areas and they would suffer further decline. The market failures are not in regional development, they are rather in very local physical, social and environmental conditions. Remedying these will not distort competition as long as end users pay market rates for use of facilities created, the intermediaries needed to deliver the improvements are chosen competitively where possible and they are paid the minimum necessary for their work

18. The UK accepts that large-scale investment aid in pockets of deprivation within otherwise affluent regions cannot be accommodated under the Regional Aid

[1] In "The programming of the Structural Funds 2000-2006: an initial assessment of the Urban Initiative", Brussels, 14 June 2002, COM(2002) 308 final.
[2] Communication from the Commission to the Member States of 28 April 2000 laying down guidelines for a Community initiative concerning economic and social regeneration of cities and of neighbourhoods in crisis in order to promote sustainable urban development (URBAN II): OJ C 141,19.5.2000, p8.
[3] NUTS 5 level areas, roughly equivalent to the size of an urban "commune" or a small town

Guidelines. Instead, horizontal aid frameworks should be designed to permit the targeting of the market failures in specific pockets of deprivation.

19. The horizontal state aid rules covering aid for employment, training, venture capital, aid to SMEs, aid for SGEIs and aid for environmental protection, allow for important interventions in under-performing areas which can tackle failures in labour and capital markets and achieve social and environmental policy objectives. The UK's response to the Commission's road map sets out the UK's views on how these rules might be improved.

20. However, there is still a gap when it comes to tackling market failures affecting land and property. Bringing back long-term vacant or derelict property into use may yield environmental and health benefits, reduce crime and vandalism as well as reducing 'visual blight' – externalities which are not captured by the developer. It will also reduce pressure on greenfield sites. Data shows that market prices do not adjust downwards to take account of the additional costs of renovating long-term derelict properties, and that once properties have been vacant for a year or more, they are more likely to remain vacant

21. The Deprived Urban Areas Guidelines were withdrawn in 2002. A number of Member States have written to the commission in support of the initiative led by the Netherlands about better targeting state aid in urban pockets of deprivation. Whilst noting that needy pockets of deprivation are not restricted to urban areas, the UK agrees with the importance of this initiative as part of the modernised state aid regime needed to support the EU's Lisbon agenda.

Drawbacks and gaps in existing approvals

22. As described above, the UK has secured a number of approvals relevant to tackling these issues. But there are problems. This section sets out issues with the schemes as a whole. **Annex B** gives examples of cases where the present rules have prevented or hindered appropriate public sector intervention.

23. The Land Remediation Scheme has enabled the redevelopment of a large number of brownfield sites containing derelict buildings and contaminated land. But a site may also lie idle because the high cost of development in relation to the potential end value means that the land has a negative value. The barrier to developing the land may lie not in its dereliction or contamination, but rather in its location and possibly in restrictions placed upon its use under the land use planning system of (e.g. town centre site cannot be used for warehousing or parking because of transport issues). In such cases, the current landowners will frequently decide to leave the site vacant rather than paying for its development or accepting an inevitably very low price for someone to take it away from them. The present scheme does not enable the payment of grant to stimulate physically, socially or environmentally desirable development in such cases.

24. This means that public authorities frequently resort to buying plots of land in deprived areas and developing it themselves as so-called "direct development". This is often an inefficient use of public funds – more could be achieved by leveraging in private finance. It is also hard to understand why support payments for private-sector

led land regeneration is unacceptable, whilst the same activity by the public sector is permitted, especially in view of Article 295 of the EC Treaty and the wide definition of "undertaking" given by the European Courts.

25. The housing gap funding approval, restricts support to up to 60% of eligible costs. Not only was this a very arbitrary and uncertain limit – it is far from clear what in every case constitute eligible costs - the UK's experience suggests that it is over-bureaucratic and unnecessary.

26. The important point in both the above cases is that the payment must be the minimum necessary to overcome the market failure. If it is, there will be no advantage outside the normal course of trade to the developer. The imposition of an arbitrary cap and/or restriction to Assisted Areas only makes sense if the payment offers some gratuitous subsidy and distorts competition. But these payments should not distort competition because they merely offset the specific market failure. The amount needed to enable a social housing project to go ahead may be 25% of development costs in one case and 75% in another. To pay 50% in both cases would in one case create a massive distortion of competition and in the other be inadequate for the project to go ahead.

27. The UK believes that the Commission should focus in cases like this on ensuring that Member States have transparent and robust procedures for ensuring that the market would not deliver the desirable outcome by itself (proving the market failure) and ensuring that the minimum necessary is paid. The principle which governs aid for SGEIs is also valid in these scenarios. In both cases Government is engaging undertakings as intermediaries to deliver a socially advantageous outcome which the market would not otherwise supply. In both cases there is only an advantage to the undertaking involved if it is paid beyond the normal course of trade.

28. The UK government's proposed Business Premises Renovation Allowance, which is currently before the Commission for approval, represents another potential instrument for triggering economic regeneration through physical redevelopment. It would provide a 100% first year capital allowance for the renovation of any business premises in the 2,000 Enterprise Areas which have been vacant for more than one year.

29. The UK accepts that a state-wide tax incentive such as this inevitably fails to calibrate exactly the minimum necessary to overcome the relevant market failure in each case. However, this measure's administrative efficiency and very low aid intensity allow it the potential to have a substantial impact at low cost to the Government and with very little risk of significant distortion of competition. Where there is a clear public interest in seeing land development take place and there is demonstrable market failure in achieving this purpose, very low intensity aids will result in minimal distortion of competition and trade. Small tax incentives for development of vacant, brownfield land should be allowed where the aid intensities fall below a fixed maximum intensity (such as 5%).

30. For regeneration to be really effective, more certainty, coherence and co-ordination is needed. Simply relying on those approvals already gained, important as they are, is not enough. In any case, the validity of those approvals expires at end

2006. This is too short a time horizon for most developers even to design a scheme, especially if land has to be purchased and/or reclaimed, let alone see it to completion. So certainty needs to be given that aids for such land and property development schemes, if allowable up to 2006, remain allowable at least until 2013 and the commission needs to allow new schemes as long as they do not threaten to distort competition seriously and they pursue a valid regeneration agenda.

Way Forward: General Approach

31. The UK believes that horizontal measures are the way to tackle the issues set out above. The Commission road map has set out a philosophy for horizontal measures based on tackling market failures. The Commission's recent decision on Services of General Economic Interest, which the UK welcomes, is based on a similar philosophy.

32. In the context of enabling land and property redevelopment to promote physical regeneration, the UK would suggest that this general philosophy can be applied on the basis of the following principles:

- Physical redevelopment can bring wider social, economic and environmental benefits, which should be recognised in considering whether public support is necessary and appropriate. Support should be provided only where there are wider benefits to be gained.
- Where the market will not develop the land, for public support and incentives to private development are appropriate where there are clear wider benefits resulting.
- Such support should, of course, be limited to the minimum necessary to overcome the market failure.
- After land has been developed, then use of that land should be subject to market mechanisms (users should pay the market price)..

33. This general approach sets out an economic rationale to underpin policy and inform the assessment of specific proposals.

34. In terms of specific future policy development, the UK would wish the Commission to address the following areas.

Clarification of existing approvals

35. The UK will be seeking the extension of current approvals which, as noted above, are critical to the UK's policy. As well as this, however, it would be helpful to have guidance on how aids based on different guidelines and approvals may be combined. Tackling deprivation cuts across existing guidelines and block exemptions as well as specific approvals, and would benefit from consolidated guidance. Whilst it is sometimes possible to develop schemes that maximise the use of different guidelines and approvals covering different eligible costs, it is a very cumbersome approach, and it is always uncertain whether the Commission will agree that the rules have been correctly applied. More clarity could be obtained through publication of a Vade Mecum explaining how all the existing rules may be joined together to facilitate regeneration.

Aids not significantly affecting competition

36. The UK believes there is scope for increasing Member States' discretionary use of support which does not significantly affect competition. This issue has wide application, but can be particularly significant for regeneration schemes. The UK welcomed the proposal put forward by DG Competition concerning Lesser Amounts of State Aid (LASA), which would have allowed Member States such increased discretion to a clearly defined extent. The UK is disappointed that the measure was not approved by the Commission, and considers that there is a growing need for Member States to be able to allocate State aid that, whilst of significance to the recipient, demonstrably does not have a significant impact on competition within the EU.

37. This could be achieved to a certain extent through expansion of the Block Exemptions, including raising the "De Minimis" threshold and by adopting some of the LASA principles within the horizontal guidelines. The UK's response to the Commission's State Aid Action Plan or "Road Map" offers some ideas on this. Revised guidelines should be much more economic data-based, as the Commission has itself now proposed; and their enforcement in relation to relatively minor payments to undertakings could be speeded up (especially where there has been effective market impact assessment). Some assessment could even be left to Member States and the market itself, so that the Commission need only consider larger aids which threaten to distort competition seriously.

Review/renewal of guidelines and approvals

38. We would like to build on, and extend, the existing approvals and guidelines to enable Member States to take a more holistic approach to regeneration. There are four strands to this:

- Renewing existing approvals and, where necessary, extending their scope to tackle specific gaps, such as those described in paragraphs 22-30 above.

- Ensuring that existing horizontal guidelines enable the holistic approach to be achieved, and to make any changes which maybe needed to enhance their effectiveness in tackling regeneration problems. The UK will comment in detail as the specific reviews are undertaken.

- Developing a clear policy rationale to inform future decisions, either on future guidelines, or specific approvals, relating to physical redevelopment. This should be based on a clear recognition that market failures occur in the context of physical redevelopment. The principles set out at paragraph 32 above could form the basis for an approach, or criteria, for applying this philosophy in practice which could be set out in new strategic guidance for tackling land and property market failures.

- Pursuing procedural reform so that small-scale aids are covered by Block Exemptions and decisions on proposed aids which offer little prospect of serious

distortion of competition can be taken faster. The UK's response to the Sate Aid Action Plan sets out our approach towards these issues.

CONCLUSIONS

39. The need to regenerate the most deprived areas of the European Union in order to provide the benefits of economic growth for all its citizens equally is undisputed. The guidance on State aids rightly aims to ensure that government intervention does not jeopardise that aim by unfairly distorting competition. However, there is also a clear need to give greater certainty and extension of scope, subject to suitable constraints, to Member States' governments to allow them to tackle market failures wherever these occur, in order to assist the redevelopment of deprived areas within the EU.

40. At present, investment aid is quite properly restricted by the Commission's regional aid guidance to the designated Assisted Areas.. Market failures in land and property development and in social, community and enterprise development exist, however, outside as well as inside Assisted areas.

41. The existing guidance and approvals on state aid have gone some way towards helping clarify at least what may be done within and outside the assisted areas. Yet the Commission has on occasion treated payments to offset market failures as if they were subsidies, even where clear evidence can be and has been provided of the scale of the market failure concerned. And even existing levels of certainty will be lost post 2006, unless the current guidance and approvals are formally extended.

42. The UK would therefore recommend that:

(1) The Commission consider the approvals it has to date given to the UK and other Member States to facilitate regeneration activities (such as land and property development, land remediation social and environmental development etc) with a view to producing guidance for Member States in the form of, for example, a vade-mecum, guidance notes or guidelines. The UK will be looking, in addition, to extend their current suite of approvals to at least 2013;
(2) The Commission consider the need for extending their policy and interpretation with relation to aids in support of regeneration activities beyond the scope of the existing UK and other Member State approvals. This should be carried out in the light of a clear policy rationale, which could be expressed in further strategic guidance on horizontal state aids for tackling land and property market failures.

43. It is important to consolidate the advances made in previous years with state aid rules that avoid distortions to trade and competition, but that will allow Member States' actions to combat market failures where they arise in land and property as well as in community and environmental development. If deprived areas can be given a decent physical environment, improved social cohesion and encouragement of indigenous entrepreneurial potential, they should have the basic infrastructure to attract market-based business investment, without the need for investment aid.

Annex A

CURRENT UK APPROVALS

1. In 2001-02, the UK put forward a number of individual schemes for approval following the Commission's decision that the Partnership Investment Programme (PIP) did not comply with state aid rules.

(i) Support for Land Remediation

2. The land remediation scheme enables the payment of grant to developers to meet up to 100% of their costs incurred in bringing derelict land back into use. A further 15% of costs is permitted where the land has been polluted and the original polluter cannot be found. The land may be anywhere within the UK: the Regional Development Agencies are responsible for administering the scheme in their areas, and grant aiding developers direct.

(ii) Supporting Heritage Related Sites

3. The UK's Historic Regeneration scheme enables funding bodies to support all the heritage-related costs associated with the repair, restoration and rehabilitation of designated historic buildings, conservation areas, ancient monuments, and historic parks and gardens where this would not happen through market forces alone. This is clearly of benefit in areas where the development value of the land on which a heritage building is located may be considerably greater than the value of the land net of the maintenance cost of the buildings on it.

4. Being able to support the extra costs associated with a building's designation as a heritage asset is most helpful when combined with other forms of state support. The Commission's approval restricted the use of the grant towards meeting the maintenance cost of the heritage building; it did not allow the costs of redevelopment of the building into e.g. office space. Nonetheless, the scheme has enabled a number of heritage sites to be at least maintained, since the landowners receive the grant support towards such costs even if the building does not generate other income. Moreover, support for a heritage building's maintenance may be combined with support for other aspects of a redevelopment scheme, if for instance it includes social housing, or business units for SMEs.

(iii) Support for Housing Developments

5. The UK's "Partnership Support for Regeneration" scheme aims to increase the stock of housing available for owner occupation. Owner-occupation occupation helps prevent the exodus of those whose situation and prospects have improved and tends to stimulate a demand for improvements in local public services and the local environment, thereby contributing to the overall regeneration of the area.

6. The costs of providing owner-occupier housing in deprived areas can be greater than the value of housing, particularly if the land is contaminated or derelict, however. This scheme provides the minimum grant necessary for private developers to be able to meet the difference between the cost of building and the open market

value. There has been significant take-up of the scheme; but the UK still has a significant shortfall in good quality housing stock.

7. The UK welcomes the Commission's recent Decision on State aid support of Services of General Economic Interest (SGEI), and the specific inclusion of social housing within its scope. This will enable much more specific and targeted support for social housing without the need for separate notification to the Commission.

(iv) Stimulating business establishment and property development

8. Two approvals for bespoke and speculative property development allowed the UK to support the redevelopment of land and property for commercial purposes, where the costs of the redevelopment or refurbishment would exceed the value of the redeveloped or refurbished land or property. These were key approvals to trigger the necessary physical conditions for economic regeneration (even though support for large development companies was not permitted outside the Assisted Areas).

9. In addition, the stamp duty exemption for disadvantaged areas removed the requirement for businesses to pay stamp duty (4% for most transactions) for commercial property transactions in the UK's 2,000 most disadvantaged areas (called Enterprise Areas). The aim of the scheme was to encourage business establishment and property development in disadvantaged areas by tackling market failures which lead to dereliction and abandonment, lack of local services and community dislocation as residents commute to find work. The rate of transactions for commercial property is around six times lower than the rate for wards in the rest of the UK. Hence there is inefficient price formation in the market which this measure aims to overcome. The stamp duty exemption scheme has since been wound up and is to be replaced by the "Business Premises Renovation Allowance" scheme, currently being considered by the Commission.

10. In addition, the Commission has approved two further regeneration-based schemes, the "Support for environmental regeneration" scheme and the "Community / voluntary (neighbourhood) regeneration" scheme. These schemes allow government support of environmental work linked with regeneration and small, locally based schemes put forward by voluntary groups and operated on a not-for-profit basis.

ANNEX B

EXAMPLES OF PHYSICAL LAND REGENERATION PROJECTS CURRENTLY PUT AT RISK BY THE STATE AID RULES

Northampton Brownfield Joint Initiative, Northampton, Central England

The area proposed for development is unassisted. It is made up of three sites, located in or adjacent to the flood plain of the River Nene, and they make up a total area of approximately 97ha to the west and south east of Northampton town centre.

The three areas are ideally located for the town's growth, being both close to the town centre and to several main roads. The redevelopment of the sites would provide much needed housing and green spaces to the local population. However, this has been prevented by the high costs associated with redevelopment. All of the areas are former landfill sites and partly because of this contain derelict, vacant and underused land and have an unattractive appearance. Land ownership is currently shared by various public and private landowners.

The proposed approach is to develop the three sites together, as this will generate benefits which the sites can not individually do. The high cost of remediating the land and then subsequently transforming its use means that it would be unprofitable for any one land owner to develop their own site, without further development on related sites and provision of the necessary transport infrastructure. In order to address this market failure, and for redevelopment to take place, state resources would need to be used to make redevelopment worthwhile to the private landowners.

The rationale for government intervention is therefore based on generating positive external benefits to society that would not otherwise be realised. The need is as great as any pocket within the designated UK Assisted Areas, but because it is outside those areas the permitted intervention rates are low and the necessary private sector investment may not be levered in.

Bickershaw Colliery, Wigan, NW England

This 18ha site is located on the western edge of Leigh, two miles from Leigh Town Centre and five miles from Wigan Town Centre, and is currently in a Tier 2 Assisted Area. The former colliery site comprises two distinct areas:

- Plot 1, to the north is 11.8ha of despoiled land and was previously used for operational colliery buildings and storage. The site is now cleared of previous structures. To the north of Plot 1 is a significant colliery spoil area and partly reclaimed land known as Bickershaw North, owned by Wigan Council and the NCP.
- Plot 2 is 5.5ha and was the former pithead area, with five capped shafts located in the central area. Two of these are fenced and vented to allow gas monitoring by the Coal Authority. Roughly triangular, the western boundary lies close to a group of disused buildings in private ownership, formerly used for commercial purposes associated with the colliery.

Private sector development of the site has been hindered because of the uneconomic costs of the necessary land remediation and the difficulty of securing all the land from its various owners.

The proposed project involves reclamation of the 18ha site; making available some 15ha of residential land, 1,000 sq m of retail space and a 4,000 sq m marina. The marina is crucial because the Leeds-Liverpool canal is an increasingly important link to the wider inland water network.
State aid was therefore needed to:

- deliver benefits to the local population and wider sub-region through reclamation of the site;
- provide local communities with access to enhanced open space provision and recreational opportunities;
- improve access to a wider choice and diversity of housing and local employment opportunities, particularly for residents in the adjoining estates, which are characterised by deep seated socio-economic problems[4].

Current approvals allow public sector bodies to give developers grants of up to 100% of the costs associated with land remediation and the creation of a public open space; and up to 60% to gap fund the cost of housing provision and its value on completion. Although the needs of this area are great, the limited amounts of aid which may be given towards the costs of developing the marina and retail space are insufficient to attract the necessary private investment to get the project started. However, granting the level of aid needed to initiate the project is unlikely to distort competition to any significant extent in any relevant market.

Snowdown Colliery, Aylesham, Kent, SE England

This 50 hectares site is situated in a 87 3(c) area in South East England. It borders two villages which together have a population of 4,700 and neighbours several other, more prosperous towns and villages. Since the closure of the colliery in the mid 1980's the area has declined, and the land is now derelict through disuse and subsistence from the mine workings.

While many former colliery workers have been able to find new employment, long term unemployment is high among the middle aged workforce (largely as a result of the closure of the mines) and the local infrastructure is weak: road access to the site is poor and the train station is difficult to reach on foot. Bus services are infrequent and there is a significant lack of other village facilities.

[4] Within England information relating to income, employment, education, health, skills and training, barriers to housing and services and crime are combined into an overall measure of deprivation known as "The Indices of Multiple Deprivation." A score is calculated for each area; a low score indicates greater deprivation – the most deprived Lower Layer Super Output Area of Local Authority [NUTS 4 level] is indicated by a rank of 1. Wigan has an overall rank of 53 out of 354 Local Authorities - Indices of Deprivation 2004. In April 2001, 41.50% of households in Wigan had more than one person with a limiting long-term illness compared to 34.05% in England in Wales. Source: www.neighbourhood.statistics.gov.uk.

The long term plan would be to provide a good quality business park at Snowdown that would provide employment opportunities for an up skilled local community, along with a heritage park. Connection to the main road, the A2 which runs from Dover to London, is also envisaged. Public intervention would allow this land to be brought into a liveable, green, and sustainable condition for people to live and work in.

The major barrier to the regeneration of Snowdown is that the site is currently owned by a private undertaking; the Coal Authority is committed to pay the site owner a lease until 2042. This makes the site particularly difficult to address; the cost of remediating the land and providing the necessary infrastructure are too high to attract investment from the private sector but the public intervention needed to improve the site and the local economy surpasses the limits permitted under even the current approvals.

Chatterley Whitfield Colliery

This derelict coal colliery is regarded as a heritage site of national importance and the most complete example of a Victorian colliery in the UK. It is an 80 ha site located on the north-eastern edge of Stoke-on-Trent, a Tier 2 assisted area in the West of England.

The area surrounding the colliery has been in steady decline since its closure in 1976. Housing stock within the area is of very poor quality and the citizens of Stoke-on-Trent are among the most disadvantaged in the UK in terms of: unemployment ([5]employment rates for 03-04 were 68% compared to an average of 75% for the English Local Authorities); health ([6]in April 2001 42.53% of households had one or more person with a limiting long-term illness compared to 34.05% in England and Wales) and education ([7]in 03-04, 43.6 per cent of pupils in Stoke-on-Trent achieved 5 or more GCSEs graded A* to C, compared to 53.7% nationally). [8]According to the 2004 English Indices of Deprivation, Stoke-on-Trent has an overall rank of 18 out of 354 Local Authorities.

Stoke-on-Trent's need is therefore comparable to a site within the Art 87(3)(a) area of West Wales and the Valleys, but because it is in the relatively more prosperous region of Shropshire and Staffordshire, [the relevant NUTS 2 region] only limited State aid support can be given.

It is the aim of the local community and several regeneration bodies to preserve the colliery as a heritage site and to convert the 34 existing buildings into viable

[5] Source: Office of the Deputy Prime Minister, Local Area Data Base.
[6] Source: 2001 UK Census www.neighbourhood.statistics.gov.uk
[7] Source: www.neighbourhood.statistics.gov.uk
[8] Within England information relating to income, employment, education, health, skills and training, barriers to housing and services and crime are combined into an overall measure of deprivation known as "The Indices of Multiple Deprivation." A score is calculated for each area; a low score indicates greater deprivation – the most deprived Lower Layer Super Output Area or Local Authority [NUTS 4 Level] is indicated by a rank of 1. Source: www.neighbourhood.statistics.gov.uk

commercial office space and house training courses and events for local people. It must first overcome several obstacles, such as the need to reclaim much of the land (which is currently dangerous and at various stages of decline) and the necessity to find private sector investment.

Although current State aid approvals allow assistance of up to 100% to cover remediation and restoration costs, the amount of support which may be granted to a beneficiary to support the cost of building the office space is limited by the aid intensity ceilings. In the case of this site, the amount of assistance available to a potential developer, expressed as a percentage of eligible costs, is insufficient to lever in the necessary private sector investment.

Manningham Mills, Bradford , West Yorkshire, England

This 700,000 sq ft site is located in a part of the former industrial heartland of the North of England. Once a world centre for the production of silks and 'plushed velvet', the mill is an important heritage site is of industrial archaeological interest. Abandoned in the 1990s, its condition gradually deteriorated into a state of dereliction. Like the former colliery sites, the costs of bringing the site back into use were greater than the potential redeveloped value and this hindered private sector development.

The local population is largely Pakistani with a mixture of other ethnic minorities and an indigenous white population[9]. The local area has many socio-economic[10] problems, and was one of the scenes of the riots which occurred in Bradford in the summer of 2001.

The project involves extensive restoration and land remediation work followed by conversion of the former mill into a mixed development of apartments, commercial offices and studios, community space and leisure activities. Transformation of this site into a range of new uses will play a key role in tackling the wider socio-economic problems of the local community: creating much needed jobs[11], housing[12] and

[9] In the 2001 Census, 60.1% of the population in the Manningham ward described themselves as being of Pakistani ethnic origin, 21% of the population described themselves as White, 7.5% as Bangladeshi and 4.6% as Indian. There are also significant numbers from other ethnic groups. Source: http://www.bradfordinfo.com/census/WardProfiles.cfm

[10] Within England information relating to income, employment, education, health, skills and training, barriers to housing and services and crime are combined into an overall measure of deprivation known as "The Indices of Multiple Deprivation." A score is calculated for each area; a low score indicates greater deprivation – the most deprived Lower Layer Super Output Area of Local Authority [NUTS 4 level] is indicated by a rank of 1. Bradford has an overall rank of 30 out of 354 Local Authorities - Indices of Deprivation 2004. Source: www.neighbourhood.statistics.gov.uk.

[11] In 2003-2004, the employment rate for the Bradford Metropolitan District Council was 71.1%. The average overall employment rate in English Local Authorities for 03-04 was 75%. Source: Annual Local Area Labour Force Survey, 2003-2004.

[12] The 2001 Census found that over a ¼ of all households in the Mannigham ward were overcrowded, 42.9% did not have central heating or the sole use of a bath and inside toilet, and 49.5% had one or more persons with a long-term illness. Source: http://www.bradfordinfo.com/census/WardProfiles.cfm

investment. However, being outside the designated Article (87)(3) (a) areas, it was extremely difficult to package the levels of investment required within the permitted State aid limits.

At present the Historic Regeneration and Land Remediation schemes enable both the maintenance and remediation costs to be met. However, conversion of the mill into a range of new uses – office space, for example - might be simplified if allowed as a part of a single scheme to regenerate the building and immediate area, rather than the building alone.

Manningham Mills is an example of a scheme which would benefit from the clarification of the State aid rules, and additional guidance on how they may be applied together.

Electric Wharf, Coventry, West Midlands

This project involved the conversion of a derelict former electricity generation facility in a Tier 2 Assisted Area into modern space for living and working (with an element of social housing). The development was designed to demonstrate advanced standards of social and environmental engineering and attract relatively enterprising and prosperous new residents (especially from the artistic and high-technology communities) and businesses to an area that was previously run-down, whilst also benefiting existing residents. This physical redevelopment project is thus designed to contribute to community and economic regeneration of the wider area over time.

The project was only ever viable with public financial support., particularly to secure the public benefits of the extra social, environmental and cultural features. The selected developer happened to be an SME, despite the size of the project (£18m). Even so the work involving the footbridge and the restoration of the towpath had to be separately identified and funded as a public works project (at great cost in terms of administration) in order for the aid intensity for the remaining project to come below the permitted maximum in State aid terms.

Various environmental features had to be dropped to fit within the maximum aid intensity levels under the SME Block Exemption, including the installation of photovoltaic cells, a combined heat and power facility, “grey” water recycling and storage and a system for reclaiming heat from ventilation and recycling it. Some of the environmental and heritage elements might have been or could now be financed under specific UK approved schemes or Commission Guidelines; but this would have been very complex to administer, with associated delay and cost.

Eliot Park Innovation Centre – Nuneaton, West Midlands

The land for this site was originally used for waste disposal but was remediated at public expense before this project began. Remediation costs were therefore not an issue this time.

Nuneaton is an area of the West Midlands suffering from the decline of the manufacturing sector and associated social problems. Areas of the town contain brownfield, post-industrial land which is under-utilised at present and inhibits positive

development of new activity in the town moving forward. The area is currently a UK Objective 2 area for ERDF support, but not an Assisted Area.

There had been no substantial private sector speculative development of office space for small businesses in Nuneaton for over 20 years. Local and regional authorities identified potential demand for such facilities but the market was unwilling to take the risk of such supply, preferring to offer land developed for retail and distribution (and manufacturing) use, as had been traditional in this part of the West Midlands.

Faced with this market failure a decision was taken to offer public support for the development of such space, in the form of a managed workspace innovation centre, primarily designed for technology focused SMEs, with flexible letting terms. The public authorities also wanted to demonstrate that such buildings could incorporate latest technology for energy efficiency, in terms of solar heating panels and advanced insulation and lighting.

Consideration was given to supporting a proposed private sector development elsewhere in Nuneaton, but because the area is non-assisted, there were serious doubts that any such support would be State aid compatible. The cost of remedying the market failure to supply office space in Nuneaton combined with the cost of incorporating advanced environmental design would have necessitated a substantial aid package. Whilst meeting the cost of some of the specific environmental enhancements might have been approvable aid (but would have required notification and delay) the aid for remedying the broader market failure would have been notifiable on a separate basis and quite possibly not approvable, even after long delay.

The decision was therefore taken to develop such a facility directly in the public sector and at a cost of £7.2 million to the public purse, the project went ahead. The availability of ERDF support (£2.9m) was a critical factor in the necessary funds being assembled. The Centre is managed on behalf of the relevant local and regional authorities by Coventry University Enterprises, which rapidly secured high rates of occupancy at market rates for the area.

Since then several private sector developers have seen that market-led office developments in Nuneaton can be achieved at a profit and have developed further office space in the town. The project therefore has had the desired catalytic and demonstration effect.

This case shows how State aid concerns can determine whether projects are public or private-led, though EU rules are supposed to be neutral on forms of ownership. The market impact of pursuing the private route would have been the same as that resulting from public direct development, as long as procedures had been robust enough to ensure that the subsidy only met the market failure and the extra cost of the environmental enhancements.

Moreover, far from distorting competition, the project shows how regeneration efforts targeted at remedying market failures can actually be pro-competitive. The result of the project has been to open up a market, which had previously been inhibited. It is impossible to identify an undertaking whose business has been damaged as a result of this public support for land development. Yet had there been no ERDF funds

available, the project might have been prevented from taking place in the name of "competition policy" by fears over the application of the State aid rules.