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REPORT

State Aid Scoreboard

- autumn 2004 update –

(presented by the Commission)

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EXECUTIVE SUMMARY

The entry of eight central and eastern European countries together with Cyprus and Malta into the European Union has brought an additional 74 million citizens to form a single market of some 450 million people. The ten newcomers joined formally on 1 May 2004, the culmination of a long process of preparation and negotiation.

Part One: State aid in the new Member States

(1) Transition to market economies … strong economic growth but still lagging behind

During the 1990s, the eight Central and Eastern European countries underwent a difficult transition from centrally planned to market economies. Despite the considerable progress made in restructuring their economies - GDP growth in these countries has been consistently higher than for the EU-15 as a whole between 1995 and 2003 - the level of economic wealth remains, in general, much lower than in EU-15. In 2003, GDP per capita (PPS) in the eight Central and Eastern European countries[1] as a whole was less than 55% of that of EU-15 although there are significant differences among the new Member States.

(2) EU competition policy, including State aid control, was a key component of the enlargement process

As State aid control plays a key role in creating a well-functioning economy, effective application and enforcement of such a policy was therefore a crucial component of the enlargement process. In practice, before joining the Union, each of the new Member States had to establish a State aid monitoring authority which screened awards of State resources to determine whether or not they constituted State aid as defined under Article 87 of the Treaty and whether they were compatible with the common market. Where identified State aid measures were deemed to be incompatible with the EU acquis, countries had to either adapt them to Community standards, or abolish them or gradually phase them out. By mid-2002, the Commission was satisfied with the progress achieved in each Member State and consequently the accession negotiations were concluded in December 2002.

(3) Screening of measures proposed by the new Member States as "existing aid"

In order to prevent incompatible aid from being "imported" into the EU on the date of accession, a system was set up to examine measures which were put into effect in the Acceding Countries before 1 May 2004 and were still applicable after that date. This was known as the "existing aid" mechanism. The purpose of this mechanism was to provide Acceding Countries and economic operators with legal certainty as regards State aid measures that are applicable after the date of accession. The system applies to State aid in all sectors, except for the transport and agricultural sectors, for which different provisions apply.

During the first phase of the existing aid mechanism in 2002, some 222 measures were approved by the Commission and listed in the Treaty of Accession. During the second phase, the so-called interim procedure, by September 2004 the Commission had approved 278

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[1] In Cyprus and Malta the comparable figures in 2003 were 78% and 69% respectively

measures as existing aid. A significant number of measures were submitted right up to the day of accession. This is reflected in the 106 measures that the Commission is still assessing. In addition to existing aid, there are also ongoing payments after accession under a series of transitional arrangements laid down in the Treaty of Accession. These arrangements which aim to address specific problem areas of the new Member States are limited in scope and duration.

(4) Different provisions apply to existing aid in the agricultural and transport sectors

According to the Treaty of Accession, aid measures in the agriculture and transport sectors, put into effect in a new Member State before the date of accession and still applicable after that date, were regarded as 'existing aid' only if the measure was communicated to the Commission as 'existing aid' within four months of the date of accession, i.e. by 31 August 2004. These measures enjoy the protection of an 'existing aid' until the date of a so-called 'sunset clause'. In effect, the new Member States have until the end of April 2007 to ensure compatibility of those measures with the requirements of Community State aid rules.

(5) Annual average of €5.7 billion State aid awarded prior to accession in the new Member States

Total State aid[2] granted by the ten new Member States during the four-year period prior to accession was estimated on average at €5.7 billion per year. The comparable figure for EU-15 in 2002 was €34 billion. In absolute terms, the three biggest countries in terms of population, awarded the most aid: Poland (an annual average of €2.4 billion) the Czech Republic (€1.9 billion) and Hungary (€0.57 billion). Together they accounted for 86% of total aid in the ten new Member States.

During the period under review, the level of State aid increased each year from €4 billion in 2000 to €7.8 billion in 2003. The increase was caused by very large awards of aid in 2002 to the Czech banking sector (€2.4 billion) and in 2003 to the Polish coal sector (€3.9 billion).

(6) Prior to accession, the majority of new Member States tended to grant more aid as a percentage of their GDP than the EU-15 average …

For the ten new Member States as a whole, State aid amounted to 1.42% of GDP over the period 2000-2003. This is significantly higher than the EU-15 average of 0.4% in 2002. However, if certain measures which are in the process of being phased out are excluded, the average for the new Member states drops to 0.67% (see next paragraph).

(7) … though large disparities exist between the new Member States

Prior to accession, there were large disparities between the new Member States: Malta (3.86%), Cyprus (2.85%) and Czech Republic (2.80%) reported aid levels, as a percentage of GDP, well above the average. These relatively high proportions of State aid do not necessarily reflect a more lax attitude to State aid control in these countries. Instead, each appears to have had its own country-specific situation. Faced with a general banking crisis, the Czech Republic paid out €2.4 billion in 2002 in the form of guarantees in order to restructure and subsequently privatise several banks. In Cyprus, aid was mainly granted through tax relief under the International Business Enterprises Act (almost 60% of total aid over the period

[2] Total State aid less agriculture, fisheries and transport

2000-2003). In Malta, restructuring aid to shipbuilding and the ship repair sector accounted for around 50% of total aid. All of the above measures are either being phased out under transitional arrangements or limited in time. If the aid amounts given under these types of aid measures are excluded, a different picture emerges: the overall level of state aid drops to 0.67% of GDP for the ten new Member States and to 2.08% in Malta, 0.82% in Cyprus and 0.47% in the Czech Republic.

In contrast, the three Baltic States had by far the lowest shares: Estonia (0.11%), Lithuania (0.24%) and Latvia (0.26%). Moreover when aid is expressed in per capita terms, a slightly different picture emerges with the Slovak Republic joining the three Baltic states below the EU-15 average of 94 PPS per person. Furthermore, Slovenia and Hungary lie only slightly above the EU average.

(8) Support for the Lisbon objectives … though situations specific to the new Member States may lead to a decrease in aid levels for some and an increase for others

In the context of reducing and redirecting aid, it is somewhat premature to draw any conclusions due to the structural problems of the economies and the general macro economic environment in which the new Member States were operating prior to accession. Moreover, for a variety of reasons, an accurate forecast of future expenditure levels is not possible. Nevertheless, the available data do show that for some new Member States, a large part of the aid awarded in 2003 was through measures that did not continue after accession. For others, the data show that a significant proportion of total aid was awarded under a transitional arrangement. This implies that aid levels are likely to remain relatively high up to the end of the transitional period but will probably decrease in the long term. On the other hand, there is clearly no indication as to what extent the new Member States intend to introduce new aid measures in the coming years. Furthermore, given that the European Structural funds are subject to the so-called “additionality” principle, some new Member States have already indicated that overall State aid levels are likely to increase, at least in the short-term.

(9) Share of pre-accession aid to horizontal objectives was low but 95% of the existing aid measures are earmarked for horizontal objectives

In the context of redirecting aid, prior to accession, aid granted for horizontal objectives[3] accounted for around 22% of total aid in the new Member States. This share is rather low in comparison to 73% in the EU-15 Member States in 2002. The disparity can be explained in part by the relatively strong support of several industries (e.g., financial sector, coal and steel) before accession in the context of privatisation or to ensure viability. However, it is encouraging to note that 475 of the 500 aid measures qualifying as existing aid upon accession are earmarked for horizontal objectives although this figure overestimates the share of horizontal aid measures for a number of reasons. In particular, individual aids were less likely than schemes to be “applicable after” accession so they were less likely to come under the interim mechanism. In addition, the new Member States could not make use of the block exemption regulations, so that all such measures, which by their nature fall under horizontal objectives, came under the interim mechanism.

[3] Including aid for cohesion objectives (regional aid)

(10) Relatively high share of sectoral aid prior to accession though considerable variation among the new Member States

In the period 2000-2003, around 78% of State aid in the new Member States was earmarked for the potentially more distortive types of aid such as sectoral aid including aid to rescue and restructure firms in difficulty. There were large disparities between countries in the share of sectoral objectives ranging from around 50% or less of total aid in Latvia and Slovenia to 80% or more in Lithuania, the Czech Republic and Malta. In Estonia, no aid was earmarked for sectoral objectives.

The financial sector received the most support in these years (27%), due almost entirely to the legacy of a general banking crisis in the 1990s in the Czech Republic. A further 26% was directed towards the manufacturing sector[4], 24% for coal (mainly in Poland) and the remainder (1%) split between other non-manufacturing and service sectors.

(11) In contrast to the EU average, several new Member States tended to award aid through tax exemptions and guarantees rather than grants

For the new Member States as a whole, guarantees were the most frequently used form of aid instrument making up 41% of total aid over the period 2000-2003. This average, which dwarfs the EU-15 average of 3%, may be misleading as it is due almost entirely to the relatively large proportion of guarantees given to banks in the Czech Republic (78% of total aid). Elsewhere, Cyprus, the Slovak Republic and Hungary made widespread use of tax exemptions (60% or more of total aid) while Estonia, Slovenia and Lithuania tended to use grants (40% or more).

Part Two: Follow-up to Council conclusions (Lisbon process)

(12) EU-15 Member States responding positively to call for less and better aid

Starting with the Lisbon agenda in 2000 which launched the process of reducing the general level of State aids and shifting the emphasis from supporting individual companies or sectors towards tackling horizontal objectives of Community interest, the Council has adopted a series of Council conclusions on State aid. As a response to these conclusions, the Commission holds an annual meeting with State aid experts from the Member States to take stock of the Commission's and Member States efforts to follow-up the conclusions and to discuss future work in the area of reduction, reorientation, and measuring effectiveness of aid.

The latest meeting was held in July 2004 on the basis of written contributions received from over twenty Member States detailing recent steps taken to follow-up the conclusions. The vast majority of Member States attributed progress in reducing and redirecting aid to explicit policy efforts. For example, a number of Member States including Belgium, Denmark, Sweden and the United Kingdom reported that they have placed greater emphasis on improving the general business environment, streamlining and rationalising their business support schemes and directing support away from 'State aid' towards general measures. Others such as France and Germany have opted for budgetary restrictions as a way of meeting the commitment to reduce State aid.

[4] This figure excludes aid earmarked for the manufacturing sector which also had a horizontal objective

Several Member States also referred to steps taken to rationalise and improve the organisation of state aid at national level through a variety of institutional changes, legislation, improved coordination, better targeting of aid, greater emphasis on efficacy of aid, strengthening awareness and improving transparency. While many of these steps are aimed primarily at facilitating access to government by business and trying to ensure better value for public money, they may also assist in reducing and redirecting aid.

Part Three: Modernising State aid control

(13) In the context of a pro-active competition policy, the Commission intends to refocus State aid policy so as to eliminate the most distortive aid while allowing Member States more scope to support the Lisbon objectives

In April 2004, the Commission adopted a Communication entitled "A pro-active Competition Policy for a Competitive Europe". In the field of State aid, the reforms already undertaken and those on-going aim at refocusing State aid policy towards a more economic-based approach with the purpose of eliminating harmful State aid, while leaving the Member States with more flexibility to adopt horizontal measures to support, in particular, the Lisbon objectives. More specifically, in 2005-2006, a large number of the Commission's existing regulations, frameworks and guidelines come up for renewal including all the state aid exemption regulations, the regional aid guidelines, the framework for research and development aid and the risk capital communication. The environmental aid guidelines expire at the end of 2007. These factors, together with the beginning of a new programming period for the Community's structural funds in 2007, provide an unprecedented window of opportunity for a comprehensive review of the horizontal State aid rules to take account of the horizontal, and particularly Lisbon, objectives, and the new cohesion policy set out in the forthcoming Structural Funds regulations, as well as to consolidate, and wherever possible simplify the rules.

INTRODUCTION

This update of the State Aid Scoreboard attempts to present the state aid situation in the new Member States over a four-year period prior to accession. It draws on material provided by each of the new Member States in the context of a major inventory and data gathering exercise in 2004 as well as the annual reports on State aid transmitted by the then Candidate countries in accordance with the Europe Agreements.

A similar but more modest attempt to focus on the Candidate countries was made in the autumn 2002 edition of the Scoreboard. While caution should still be exercised in comparing the ten new Member States with one another and the EU-15 average, comparability has been greatly enhanced. For example, the Commission has now been monitoring the situation in the new Member States for several years. In the context of the Treaty of Accession and the interim mechanism procedure for existing aid, it has examined several hundred measures in the ten new Member States. Furthermore, the national authorities in each country have become much more familiar with the concepts of State aid control and transparency. By looking at the annual average amount of aid over a four year period prior to accession (2000-2003), the Scoreboard therefore gives an important and relatively accurate insight into the overall state aid situation in each of the new Member States upon accession.

Nevertheless, disparities between countries still exist and may be explained by the timing and extent to which each then Candidate country adapted to a competition discipline by adopting national legislation, based on the Community acquis, and set up State aid monitoring authorities charged with enforcing the rules. Moreover, given that the focus is on the period post-2000, it is important to bear in mind that State aid levels tended to fluctuate considerably around this time, e.g., a number of countries awarded much larger volumes of aid in 1998 and 1999, often in the context of restructuring or privatisation of national industries.

This autumn update of the Scoreboard has three main parts. Part One, which is split into several sections, focuses on the ten new Member States: the first section describes the enlargement process beginning with the transition from state-planned to market-oriented economies undertaken by the eight Central and Eastern European countries, through the negotiation process, and ending with the assessment of aid measures carried out initially by the national monitoring authorities and then by the Commission in the context of approving existing aid measures for the post-accession period. The second section then attempts, with all the necessary caveats, to compare the new Member States with one another and also vis-à-vis the EU-15 average. It looks at the overall level of aid, the sectors to which aid is directed and the use of various aid instruments. Finally, Annex II includes a country-specific profile outlining the state aid situation for each new Member State.

Part Two looks at the steps undertaken by both the Commission and Member States to follow up the various Council conclusions on State aid. Finally, part three summarises ongoing work to modernise State aid control including efforts to support aid for innovation.

The spring 2004 update of the Scoreboard[5] provided an overview of the State aid situation in the Union and examined the underlying trends based on the latest available data (2002). The

[5] COM(2004) 256 final of 20.04.2004

spring 2005 update will cover the year 2003 and include a section on the financing of public service broadcasters.

In addition to this paper edition, a permanent online Scoreboard (http://europa.eu.int/comm/competition/state_aid/scoreboard/) consisting of a series of key indicators and a range of statistical information for the EU-15 Member States was launched in 2002.

Conceptual remarks

Insofar as it was possible, the data in this Scoreboard have been harmonised by applying the same methodology as that used for the EU-15 Member States in previous Scoreboards. In principle, this Scoreboard covers State aid as defined under Article 87(1) EC Treaty[6] that was granted by the new Member States prior to accession in the period 2000-2003. All aid measures approved under the interim mechanism for existing aid were examined by the Commission. However, the data also include aid measures implemented prior to accession that were assessed only by the national State aid monitoring authorities to determine whether or not they constituted State aid as defined under Article 87(1). For some countries, the data include some measures that were incompatible. Furthermore, some categories of aid may not have been reported to the same extent by all countries. For example, certain types of restructuring aid which consist of postponing and, in some cases, the waiving of liabilities such as tax arrears, are particularly difficult to measure. It is also worth noting that while some countries include State aid granted by local government, others may include aid granted only by central government. As a result, the scope and quality of the data in this Scoreboard may vary from one country to another.

General measures and public subsidies that have no affect on trade and do not distort or threaten to distort competition are not included in the Scoreboard. The distinction between State aid measures and general economic support measures should be borne in mind when interpreting the data. For example, the share of State aid allocated to each horizontal objective such as employment or training may vary considerably from one Member State to another. This does not however mean that public expenditures on these activities are so different. Instead, some Member States may support these particular objectives through general economic support measures. Also excluded from the Scoreboard is Community funding provided to the new Member States prior to accession[7] as well as all aid compensating for the provision of services of general economic interest (SGEI)[8] and de minimis aid[9].

The new Member States were not required to report aid expenditure for the agricultural and fisheries sectors, which were covered by other chapters in the Europe Agreements. There are no comparable data either for the transport sector for the pre-accession period. These sectors are therefore dealt with in separate sections under 1.3.6.

Additional remarks of a more technical nature are included under methodological notes (Section 5).

The above text is without prejudice to the jurisprudence of the Court.

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[6] A measure constitutes state aid if it is granted by a Member State or through State resources, it distorts or threatens to distort competition, it favours certain undertakings or the production of certain goods, and it affects trade between Member States.

[7] The EU's financial planning for 2000 to 2006, adopted by the Berlin European Council in March 1999, included €22 billion devoted to 'pre-accession assistance' for infrastructure and institution-building (PHARE), environmental and transport infrastructure (ISPA) and rural development (SAPARD) in the applicant countries.

[8] See p8 of State aid Scoreboard spring 2004 update, COM (2004) 256 of 20.04.2004

[9] Under the de minimis rule, aid to an enterprise that does not exceed the threshold of €100 000 over any period of three years is not considered State aid within the meaning of Article 87(1) of the Treaty and is therefore not subject to the notification obligation as regards the EU Member States.

1. PART ONE: STATE AID IN THE TEN NEW MEMBER STATES

1.1. The economic context prior to accession

Any analysis of the State aid situation in the new Member States prior to accession needs to take account of the transition from centrally planned to market economies that took place in eight of the countries during the 1990s[10]. Below is a short description of that process as well as a brief overview of the economic situation in the ten new Member States.

1.1.1. The role of subsidies in centrally planned economies

Prior to transition, subsidies were widely used in Central and Eastern European countries (CEEC). In centrally planned economies, subsidies were an integral part of the system and were used to connect state budget and quantitative plans. Quantitative plans were made by governmental planning authorities, which determined what kind of goods and services, how much, when and where to produce. Planners also decided the 'socially desirable' prices of goods and services. Thus prices did not reflect the real cost of production of goods and services and led many enterprises to experience persistent losses or large profits which in turn were systematically corrected with budgetary subsidies or taxes. As the production cost varied from one enterprise to another, the subsidies and tax rates also varied and therefore contained enterprise-specific elements.

1.1.2. Transition from centrally planned to market economies

During the transition process from state-planned to market-oriented economies, the CEEC countries began to try to reduce their budgetary subsidies and move towards a liberalization of prices. Prices were permitted to reflect market-clearing levels in almost all manufacturing sectors. Only in some sectors, such as transport and housing, did prices remain under control. Almost all budgetary subsidies to enterprises in price-liberalized sectors were abolished. In addition, taxes on profit were harmonized, turnover taxes were rationalized and ad hoc exemptions largely eliminated.

Large-scale changes in the economic environment created disturbances in the economy. Most of the state-owned enterprises were faced with serious difficulties such as a decrease in domestic demand due to import liberalization, a decrease in exports due to the collapse of the Council for Mutual Economic Assistance[11], liquidity problems due to insolvency of trading partners in the former USSR, and rapidly rising interest rates. These problems caused a chain effect among enterprises and created high inter-enterprise debts. Furthermore, there was a risk of a significant rise in unemployment.[12]

Faced with these circumstances, the governments of transition countries were forced to help companies to survive. This resulted in financial support being awarded to state-owned companies although on a number of occasions this merely postponed a bankruptcy because a

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[10] This applies to the eight Central and Eastern European countries, not to Cyprus and Malta.

[11] The Council for Mutual Economic Assistance was organisation created in 1949 for co-ordination of economic planning in socialist states worldwide.

[12] In centrally planned economies, many companies enjoyed a monopoly or oligopoly position and any bankruptcy would create difficulties also for several suppliers which depended on the monopoly or oligopoly.

proper restructuring did not take place. While this inevitably caused some difficulties with the overall transition process, it should be noted that, before the Europe Agreements, subsidy levels were limited by the relatively low state budgets as most transition countries tried to rationalize taxes and public finances. In most cases, governments supported enterprises only to the extent needed to help them overcome difficulties or until privatization of state-owned enterprises.

With regard to privatisation, countries have tended to use a mix of different methods such as auctions or public tenders, management and employee buyouts, restitution to former owners, mass or voucher privatizations, etc. The problem in transition economies was that the stock of private savings was too small to purchase the industrial assets with fair prices. Thus the state also supported entrepreneurs by selling industrial assets with very low prices. In many cases, however, privatizations of state-owned enterprises were open also to foreign investors, who were able to pay higher prices for the industrial assets. Moreover, foreign investors brought new managerial knowledge and competences, potentially leading to improved efficiency. In cases where a privatization failed and where restructuring of the enterprise would not ensure its long-term viability, governments often opted for liquidation. This involved declaring the enterprise bankrupt and selling off the assets to new owners during the liquidation.

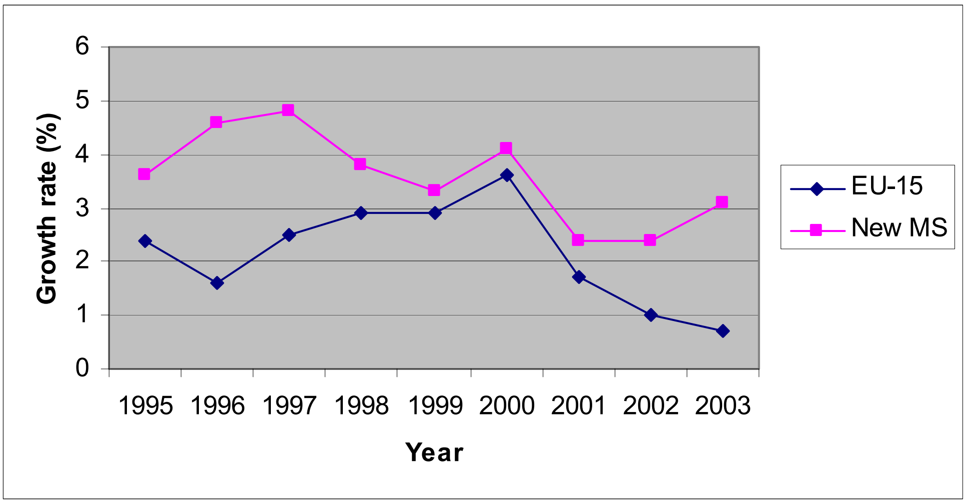
1.1.3. Economic indicators in the new Member States

Despite the fact that the Central and Eastern European accession countries have made considerable progress in restructuring their economies, the level of economic wealth remains, in general, much lower than in EU-15. In 2003, the GDP per capita (PPS) in the eight Central and Eastern European countries was less than 55% of that of EU-15. This average however masks significant differences among the new Member States ranging from 39% in Latvia to 70% in Slovenia[13].

Even though living standards in the new Member States remain lower, GDP growth in these countries has been consistently higher than for the EU-15 as a whole over the last nine years (Graph 1). In 2003, GDP growth rates were higher in every new Member State than the EU-15 average except in Malta. The highest GDP growth rates were in Lithuania (9%), Latvia (7.5%) and Estonia (5.1%) while the lowest rates were in Slovenia (2.5%), Cyprus (2%) and Malta (-0.1%).

[13] The corresponding figures for Cyprus and Malta in 2003 were 78% and 69% respectively.

Graph 1: GDP at constant prices, growth rate, new Member States and EU-15



Source: Eurostat, Statistics in focus, 17/2004

1.2. Enlargement process

Compared to EU-15 Member States, the governments of Central and Eastern European (CEEC) transition countries previously had more flexibility and freedom to grant aid to enterprises because they were not bound up by state aid rules. A new decade started in the mid-1990s[14]with the Europe Agreements[15], which provided a new framework for trade and related matters between the Union and each CEEC. Under the Agreements, the partner countries committed themselves to approximating their legislation to that of the EU, including the main substantive competition rules which applied in areas where trade between the EU and a CEEC was affected.

The Copenhagen European Council in 1993 defined the criteria which applicants had to meet before they could join the EU. Among the requirements were the existence of a functioning market economy and the capacity to cope with competitive pressures and market forces within the EU. As State aid control plays a key role in creating a well-functioning market economy, effective application and enforcement of such a policy was therefore a crucial component of the enlargement process. The accession negotiations, which opened in 1998, determined the conditions under which each applicant country joined the EU. The negotiations focused on the terms under which the applicants had adopted, implemented and enforced the *acquis*", i.e. the detailed laws and rules adopted on the basis of the EC Treaty, and the granting of transitional arrangements which had to be limited in scope and duration. In practice, each of the new Member States had to establish a State aid monitoring authority which screened awards of State resources to determine whether or not they constituted State aid as defined under Article 87 of the Treaty and whether they were compatible with the common market. Where identified State aid measures were deemed to be incompatible with the EU acquis, countries had to either adapt them to Community standards, or abolish them or gradually phase them out.

[14] The Europe Agreement came into force at different times throughout the course of the 1990s: 1994 – Hungary and Poland; 1995 – Bulgaria, Czech Republic, Romania, Slovak Republic; 1998 – Estonia, Latvia, Lithuania; 1999 – Slovenia. Association Agreements were also in force with the two other new Member States, Cyprus and Malta.

[15] The full text of the Europe Agreements with Central and Eastern European countries can be found on: http://www.europa.eu.int/comm/enlargement/pas/europe_agr.htm

Progress in the area of State aid tended to be much slower than in the antitrust field, and it was not until the years 2000 and 2001 that a real State aid discipline began to emerge. Companies (including public undertakings) needed to adjust to operating without distortive forms of State aid and public bodies involved in the granting of aid had to get used to State aid discipline, including *ex ante* notification procedures. The closure of the negotiations was a consequence of the satisfactory efforts undertaken to adopt appropriate legislation, to set up relevant authorities to ensure implementation as well as to demonstrate a credible enforcement record of the State aid rules. The negotiations with regard to all countries, except Bulgaria and Romania, were concluded at the European Council in Copenhagen in December 2002 and the Treaty of Accession was signed in Athens in April 2003. The autumn 2002 update of the State aid Scoreboard provides a more detailed overview of the enlargement process and negotiations. See also country profiles (Annex II).

1.2.1. Transitional arrangements

Requests for transitional periods were approached with the aim of preserving the integrity of the internal market after enlargement, while at the same time trying to constructively address specific problem areas in the new Member States. For instance, where identified State aid measures were deemed to be incompatible with the *acquis*, countries were at first instance required either to abolish these measures or align them. In some rare cases, special limited transitory arrangements were agreed.

Two types of aid measures proved particularly demanding. The first group consisted of fiscal aid regimes incompatible with Article 87 of the EC Treaty ranging from tax breaks, tax holidays and tax credits that are used to attract foreign investments, to off-shore arrangements. A second important issue concerned aid used to bail out ailing industries, consisting of, for example, tax arrears or loan guarantees.

The negotiations on transitional arrangements were conducted on the basis of the principle that they must be strictly limited in scope and duration. Estonia, Latvia, Lithuania and Slovenia did not request any transitional arrangements. Annex I presents the other six countries' transitional arrangements in some detail.

1.2.2. The role of the national monitoring authorities pre- and post accession

As stated under section 1.2, the Europe Agreements obliged the Acceding States to ensure the effective functioning and enforcement of a state aid monitoring system in their jurisdiction. The Acceding States were however free to choose the appropriate body to carry out the various tasks associated with such a system. By 2000[16], each country had set up its own state aid monitoring authority, often operating within the Ministry of Finance (see country profiles in Annex II for details). It is worth noting that the requirement to set up such an authority has no precedent and indeed not all EU-15 Member States have one.

From the date of accession, the competence to monitor state aid was transferred from these national monitoring authorities to the European Commission. New Member States are thus required to notify new aid measures to the Commission. As with the current Member States,

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[16] In some countries, some form of monitoring was carried out as far back as 1997 although the authority was not legally established until later. The exact date setting up each national authority varies somewhat from country to country and indeed is not always very significant as it merely formalised existing powers.

the Commission will control the granting of aid by means of a formal and transparent procedure.[17]

In spite of this handing over of their decision-making role, the national monitoring authorities continue to exist in some form or other in all new Member States. Although the precise role varies, each Member State has some type of coordination function in state aid matters and also provide annual reports to the Commission. Thanks to the considerable knowledge and expertise acquired in State aid issues over the years, these authorities are able to advise national state aid grantors on Community state aid rules and facilitate the notification process. In addition, all now assess and monitor measures under the block exemption regulations for SMEs, training and employment aid.

1.2.3. Existing aid and the "interim procedure"

In order to prevent incompatible aid from being "imported" into the EU on the date of accession, a new system for Acceding Countries was set up to examine measures which were put into effect before 1 May 2004 and are still applicable after that date. This is known as the existing aid mechanism. The purpose of this mechanism was to provide Acceding Countries and economic operators with legal certainty as regards State aid measures that are applicable after the date of accession. The system applies to State aids in all sectors, except for the agricultural and transport sectors, for which different provisions apply (see sections 1.3.6).

The Treaty of Accession (Annex IV) stipulated that aid schemes and individual aid put into effect in a new Member State before the date of accession and still applicable after accession should be regarded as existing aid within the meaning of Article 88(1) EC Treaty if one of the following conditions was met:

- aid measures put into effect before 10 December 1994 were automatically considered as existing aid from the date of accession;

- measures submitted by the Acceding Countries in 2002 were examined by the Commission in the light of the state aid acquis. Measures considered to be in line with the state aid rules qualified as existing aid and were included in the list annexed to the Treaty of Accession. This list was finalised in November 2002;

- for measures not accepted in the Treaty list and for those submitted after its finalisation and up to 30 April 2004, the so-called "interim procedure" for existing aid was introduced. Under this procedure, Acceding Countries submitted a series of measures to the Commission for assessment. The Commission approved all measures which were compatible with the state aid rules. When the Commission had serious doubts about the compatibility, it took a decision to initiate the formal investigation procedure which entered into effect on the date of accession. The notion of "applicable after accession" was a crucial factor in deciding whether or not the Commission should assess a particular measure as it did not have the power to oppose measures that were not "applicable after accession".

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[17] Council Regulation (EC) No 659/1999 of 22 March 1999 laying down detailed rules for the application of Article 93 of the EC Treaty, *Official Journal L 83, 27.03.1999, pages 1-9;*
Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, *Official Journal L 140, 30.04.2004, pages 1-134;*

Basically, the notion covered the following types:

– Aid schemes were considered to be "applicable after accession" if, from the date of accession, aid awards could still be made on the basis of these schemes and without further implementing measures being required;

– Aid that was not linked to a specific project and that was awarded before accession to one or several undertakings for an indefinite period of time and/or an indefinite amount[18];

– Individual aid measures for which the precise amount of State aid was not known at the time the aid was granted.

All measures still applicable after the date of accession, which constitute state aid but did not fulfil the conditions of existing aid set out above, have been considered as new aid upon accession. The qualification of a measure as existing aid as opposed to new aid has very important consequences: the Commission can immediately initiate the formal investigation procedure with regard to new aid not cleared under the interim procedure. If the aid is found to be incompatible with the Treaty, the Commission shall by decision order it to be recovered from the beneficiaries. In contrast to new aid, an existing aid measure is "protected" from actions of the Commission since it is subject to a co-operation procedure between the Commission and the Member State.

1.2.3.1. Some figures on the existing aid mechanism

During the first phase of the existing aid mechanism, i.e. establishment of the Treaty list in 2002, some 222 measures were approved by the Commission and listed in the Treaty of Accession. During the second phase, the so-called interim procedure, the ten Acceding Countries submitted a further 559 measures of which around 175 of them were withdrawn by the countries themselves. By September 2004, 278 measures had been approved by the Commission as existing aid measures. A significant number of measures were submitted just before accession on 1 May 2004. This is reflected in the 106 measures still under assessment. The number of measures varies considerably from one new Member State to another. While some opted to create aid schemes, such as Hungary, other countries such as the Czech Republic preferred to notify individual aid awards (Table 1).

Table 1: State aid measures approved as existing aid upon accession [19]

	CZ	EE	CY	LV	LT	HU	MT	PL	SI	SK	Total
Approved and listed in the Treaty	120	3	31	6	3	21	7	7	15	9	**222**
Approved under the interim mechanism	96	11	21	19	13	20	1	18	17	62	**278**
Under assessment as of September 2004	43	0	0	1	0	7	2	43	2	8	**106**

Source: DG Competition

1.2.4. Candidate countries

The European Union is currently engaged in accession negotiations with two other candidate countries: Bulgaria and Romania (see country profiles in Annex II). The competition chapter

18 These aids are also considered "aid schemes" under the Procedural Regulation No. 659/99.

19 The figures include state aid measures to the manufacturing, service and coal sectors as well as the fisheries sector.

for Bulgaria was provisionally closed in 2004, while negotiations are still on-going with Romania. They will join the Union in 2007, providing they meet the required standards of readiness in time. Two other candidate countries, Turkey and Croatia, are waiting to open their membership negotiations.

1.3. Overview of the State aid situation in the ten new Member States

This section provides a snapshot of State aid granted in the ten new Member States over the period prior to accession (2000-2003).

1.3.1. State aid in absolute and relative terms

The population of the ten new Member States stood at 74 million in the year 2003 compared with the EU total of 376 million. The largest countries were Poland (38 million), the Czech Republic (10 million) and Hungary (10 million), the smallest Malta (0.4 million) and Cyprus (0.7 million).

Total state aid[20] granted annually by the ten new Member States during the four-year period 2000-2003 was estimated at €5.7 billion. The comparable figure for the EU-15 Member States in 2002 was €34 billion[21]. In absolute terms, the three biggest countries in terms of population, awarded the most aid: Poland (an annual average of €2.4 billion) the Czech Republic (€1.9 billion) and Hungary (€0.57 billion). Together they accounted for 86% of total aid in the ten new Member States (Table 2).

During the period under review, the level of State aid increased each year from €4 billion in 2000 to €7.8 billion in 2003. The increase was caused by very large awards of aid in 2002 to the Czech banking sector (€2.4 billion) and in 2003 to the Polish coal sector (€3.9 billion).

Table 2: State aid in the new Member States, 2000 – 2003(1)

	EU 15	New MS	CZ	EE	CY	LV	LT	HU	MT	PL	SI	SK
Total State aid less agriculture, fisheries and transport in million €	34000	**5654**	1908	7	285	23	34	571	159	2409	139	118
State aid as percentage of GDP (%)	0.39	**1.42**	2.80	0.11	2.85	0.26	0.24	1.04	3.86	1.29	0.69	0.51
Population (million)	376.5	**74.1**	10.2	1.4	0.7	2.3	3.4	10.1	0.4	38.2	2.0	5.4
State aid per capita (PPS)	94	**150**	386	10	497	21	22	114	601	127	100	51

(1) Unless otherwise stated, the figures refer to the annual average over this period. For Malta, the period covered is 2000-2002. State aid data for EU-15 refer to 2002. Source: DG Competition and Eurostat.

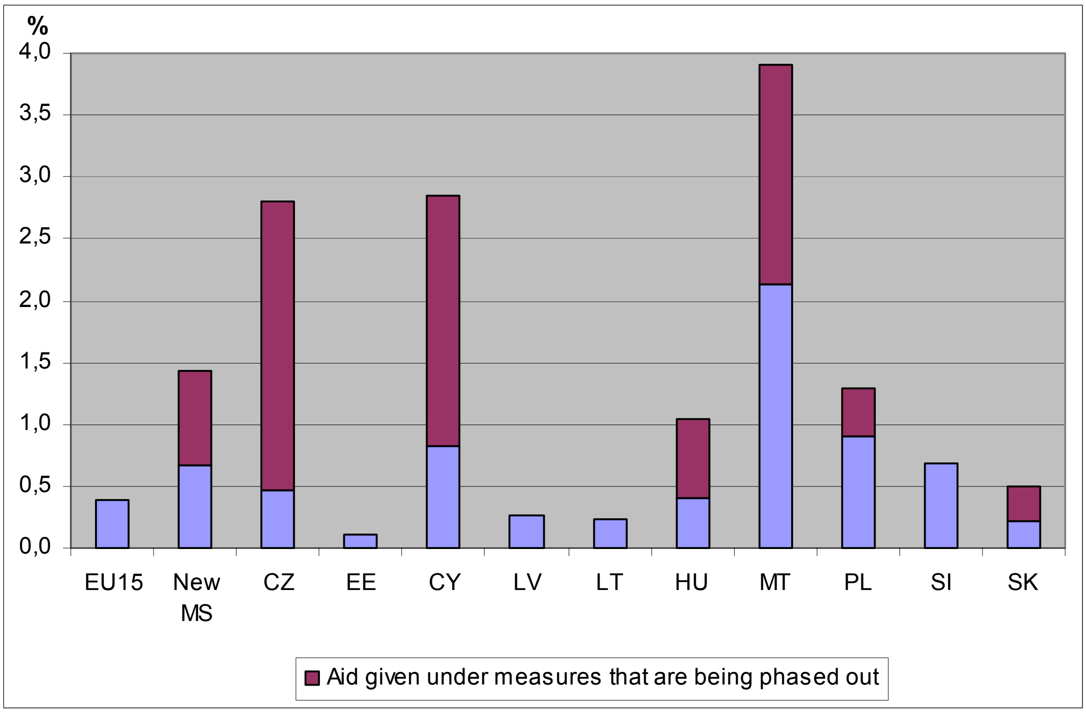
In relative terms, State aid may be expressed as a percentage of GDP or as a per capita measure. For the ten new Member States as a whole, State aid amounted to 1.42% of GDP over the period 2000 – 2003. This is significantly higher than the EU-15 average of 0.4 % in 2002. There were large disparities between the new Member States: Malta (3.86%), Cyprus (2.85%) and Czech Republic (2.8%) reported aid levels well above the average. In contrast, the three Baltic States had by far the lowest shares: Estonia (0.1%), Lithuania (0.24%) and

20 Total State aid less agriculture, fisheries and transport

21 As data for the EU-15 Member States are not yet available for 2003, the year 2002 is taken as the best proxy to compare with the annual average for the ten new Member States.

Latvia (0.26%). When aid is expressed in per capita terms (PPS)[22], a slightly different picture emerges with the Slovak Republic joining the three Baltic states below the EU-15 average of 94 PPS per person. Furthermore, Slovenia and Hungary lie only slightly above the EU average (Table 2 and Graph 2).

Graph 2: State aid as a percentage of GDP in the new Member States, 2000-2003



Note: Average 2000-2002 in mio € for Malta. EU-15 figures refer to 2002. Source: DG Competition

The above data present a very dispersed picture for the new Member States. However, the relatively high proportion of State aid in the Czech Republic, Cyprus and Malta does not necessarily reflect a more lax attitude to State aid control in these countries. Instead, each appears to have had its own country-specific situation. Faced with a general banking crisis, the Czech Republic paid out €2.4 billion in 2002 in the form of guarantees in order to restructure and subsequently privatise several banks. In Cyprus, the aid was mainly granted through tax relief under the International Business Enterprises Act (almost 60% of total aid over the period 2000-2003) and exemptions from import duties for raw materials in manufacturing sector (8% of total aid over the period 2000-2003 but 47% in 2003). In Malta, restructuring aid to shipbuilding and the ship repair sector accounted for around 50% of total aid. All of the above measures are either being phased out under transitional arrangements or limited in time. If the aid amounts given under these types of aid measures are excluded, a different picture emerges: the overall level of state aid drops to 0.67% of GDP for the ten new Member States and to 2.08% in Malta, 0.82% in Cyprus and 0.47% in the Czech Republic.

To what extent have the new Member States supported (or are likely to support in future) efforts the call to reduce the overall level of State aid, one of the principal objectives of the

[22] State aid per capita are expressed in terms of Purchasing Power Standards (PPS) and therefore the differences in price levels between countries are taken into account. In general, when PPS are used instead of exchange rates, the gap between high-income and low-income countries narrows as price levels in low-income countries tend to be low compared to richer countries.

Lisbon agenda? Notwithstanding the measurement difficulties set out below, the data presented for the year immediately prior to accession, 2003, can be broken down further so as to give some sort of indication as to likely future expenditure levels. The country profiles (Annex II) present, as a percentage of total aid awarded in 2003, the proportion of aid awarded under measures that did not continue after accession, i.e. in the case of a scheme which expired before 1 May 2004 or an ad hoc award of aid for the year 2003. The residual is therefore made up of aid qualifying as 'existing'[23] or aid awarded under a transitional arrangement for which there are likely to be ongoing payments after accession.

For some new Member States, this breakdown shows that a large part of the aid awarded in 2003 was under measures that did not continue after accession. For others, it shows that a significant proportion of total aid was awarded under a transitional arrangement. This implies that aid levels are likely to remain relatively high up to the end of the transitional period but will probably decrease in the long term.

Caution should however be exercised in attempting to use the data presented here, as a gauge for what may happen in the coming years. An accurate forecast of future expenditure levels is not possible due to a variety of reasons: first, there is clearly no indication as to what extent the new Member States intend to notify new aid measures in the coming years. Second, a significant number of new measures have been submitted under the interim mechanism during the first few months of 2004 and consequently are not covered in this exercise as there were no payments in 2003. Finally, given that the European Structural funds are subject to the so-called "additionality" principle[24], some new Member States have already indicated that overall State aid levels are likely to increase, at least in the short-term.

1.3.2. State aid by objective

State aid for horizontal objectives is usually considered as being targeted to recognised market failures and as being less distortive than sectoral and ad hoc aid. R&D, safeguarding the environment, energy saving, regional development and support to SMEs are the most prominent horizontal objectives pursued with State aid. In contrast, aid to support specific sectors is likely to distort competition more than aid for horizontal objectives and also tends to favour other objectives than identified market failures. Moreover, a significant part of such aid is granted to rescue or restructure companies in difficulty, one of the most potentially distortive types of State aid.

1.3.3. State aid for horizontal objectives

To what extent have the new Member States supported another key Lisbon objective, to redirect state aid towards horizontal objectives[25]? Between 2000 and 2003, aid granted for horizontal objectives accounted for around 22% of total aid in the new Member States. This share is rather low in comparison to 73% in the EU-15 Member States in 2002. The disparity

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23 The precise figures should be treated with caution due to the fact that some aid measures for which aid was granted during the period under review were subsequently modified and approved as existing aid.

24 The additionality principle states that Structural Funds spending should not replace, but be additional to the spending of national and other public authorities. It implies that the intervention of EU funding does not lead to the national planning authorities diverting resources from other schemes that they would have carried out normally, in the absence of Community funding, in order to co-finance the Structural Funds' programme.

25 Including aid for cohesion objectives (regional aid)

can be explained in part by the relatively strong support of several industries (e.g., financial sector, coal and steel) before accession in order to complete privatisation and reach viability (see also section 1.3.4).

As to likely future trends, given the structural problems of their economies and the general macro economic environment in which they were operating prior to accession (as outlined in section 1.1), it is somewhat premature to draw any conclusions. Nevertheless, in the context of redirecting aid, it is encouraging to note that 475 of the 500 aid measures qualifying as existing aid upon accession are earmarked for horizontal objectives although this figure overestimates the share of horizontal aid measures for a number of reasons. In particular, individual aids were less likely than schemes to be "applicable after" accession so they were less likely to come under the interim mechanism. In addition, the new Member States could not make use of the block exemption regulations, so that all such measures, which by their nature fall under horizontal objectives, came under the interim mechanism. In terms of expenditure, the share of horizontal objectives in total aid is likely to be much lower due to the large amounts of aid awarded for non-horizontal objectives, i.e. sectoral aid or ad hoc awards.[26]

During the period prior to accession, there were large disparities between the new Member States in the share of horizontal objectives ranging from around 10% or less of total aid in Malta, Lithuania and the Czech Republic to 50% or more in Slovenia and Latvia (Table 3). In Estonia, virtually all the aid awarded was earmarked for horizontal objectives.

In spite of some measurement difficulties (see methodological notes), the data do give a broad indication as to which horizontal objectives are favoured by each country. Over the period 2000-2003, around 20% of all aid in Slovenia was specifically granted for employment objectives. Estonia and Slovenia directed around 15% of its aid to environment compared with a new Member State average of just over 2%. The same two countries also granted around 15% of their total aid to research and development. Aid to conserve national heritage and support culture made up a prominent part (20%) of Estonia's total aid, while another Baltic state, Latvia, seems to have specifically favoured its SMEs (32% of total aid compared to 3% in the ten countries overall). Finally, Cyprus granted almost 10% for cultural purposes, theatrical and film productions and national broadcasting.

[26] A precise figure can not be given due to the fact that a significant number of these schemes were put into effect in 2004 and therefore expenditure data are not available for them.

Table 3: State aid for horizontal objectives and particular sectors in the new Member States, 2000-2003

														Annual averages
	EU-15		**New MS**		**CZ**	**EE**	**CY**	**LV**	**LT**	**HU**	**MT**	**PL**	**SI**	**SK**
	mio €	**%**	**mio €**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**	**%**
Horizontal Objectives	**24,711**	**73**	**1,229**	**22**	**10**	**100**	**23**	**55**	**4**	**42**	**5**	**24**	**73**	**24**
R&D	5,179	15	**102**	2	2	13	0	-	1	3	-	1	16	4
Environment	5,283	16	**133**	2	2	15	1	0	-	3	-	2	17	1
SME	4,857	14	**127**	2	2	10	4	2	-	7	1	1	9	1
Commerce	318	1	**13**	0	-	8	2	2	2	-	4	-	-	1
Employment aid	838	2	**218**	4	1	-	-	-	-	4	-	7	21	-
Training aid	562	2	**73**	1	0	-	2	-	-	1	0	2	2	-
Heritage conservation, cultural aid	510	1	**39**	1	0	20	11	-	-	1	0	-	1	1
Natural disasters	33	0	**3**	0	-	-	0	-	-	-	-	-	2	-
Risk capital	18	0	**1**	0	-	-	-	-	-	0	-	-	-	-
Regional aid	7,115	23	**520**	9	3	33	4	50	1	23	-	11	7	17
Sectoral aid (1) (2)	**9,294**	**27**	**4,425**	**78**	**90**	-	**77**	**45**	**96**	**58**	**95**	**76**	**27**	**76**
Manufacturing	1,138	3	**1,470**	26	10	-	n.a.	45	94	53	89	20	19	59
of which shipbuilding	485	1	**87**	2	-	-	n.a.	-	0	-	51	0	-	0
of which steel	9	0	**246**	4	4	-	n.a.	-	-	-	-	5	6	35
of which motor vehicles	18	0	**58**	1	1	-	n.a.	-	-	-	-	0	-	24
Coal	5,432	16	**1,373**	24	0	-	n.a.	-	-	4	-	56	7	3
Other Non-manufacturing	773	2	**32**	1	1	-	n.a.	-	2	-	1	0	-	8
Financial Services	1,836	5	**1,534**	27	80	-	n.a.	-	-	0	-	-	-	6
Other services	115	0	**15**	0	-	-	n.a.	-	-	0	5	-	0	0
Total aid less agriculture, fisheries and transport in million €	**34,005**	**100**	**5,654**	**100**	**1,908**	**7**	**285**	**23**	**34**	**571**	**159**	**2,409**	**139**	**118**

Note: Average 2000-2002 in mio € for Malta. EU-15 figures refer to 2002. For Cyprus, a breakdown of sectoral aid is not available (see country profile). The new MS figures for the sub-categories of sectoral aid are therefore slightly underestimated. (1) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring. Source: DG Competition.

1.3.3.1. State aid supporting regional development and cohesion

In terms of aid amounts, the largest horizontal objective was general regional economic development. Under Article 87(3) of the Treaty, certain areas (regions) may be given derogation from the incompatibility principle established by Article 87(1). Article 87(3)(a) provides that aid "to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment" may be considered compatible with the common market. In practice, a region qualifies for 'a' status if, being a NUTS[27] level II geographical unit, it has a per capita GDP of less than 75% of the EU average.

The Europe Agreements laid down that each country was to be regarded for five years from the entry into force of the Agreement as an area identical to those areas of the Community

27 NUTS is the Nomenclature of territorial units for statistics. http://europa.eu.int/comm/eurostat/ramon/nuts/home_regions_en.html

qualifying for regional aid under Article 87(3)a. Regional aid maps[28] were adopted for each country and have since been extended up to 31 December 2006[29]. In effect, virtually the entire territory of each new Member State is eligible for 'a' status, the only exceptions being the territory of Cyprus and the capital cities Prague and Bratislava.[30] This has implications for the classification of aid for regional objectives in that almost all the aid in the new Member States could be considered as regional aid in that it is directed towards assisted regions. For the purposes of comparability between Member States, however, all aid measures have as far as possible being classified under other horizontal objectives. Nevertheless, in the period under review, an annual average of €520 million (9% of total aid) was granted for regional and cohesion purposes, usually in the form of general economic development schemes. There were differences between countries in the share of regional aid to total aid ranging from less than 5% in Lithuania, the Czech Republic, Malta and Cyprus to more than 30% in Estonia and Latvia.

1.3.4. State aid for sectoral objectives

Aid to support specific sectors, including aid awarded to rescue or restructure companies, is likely to distort competition more than aid for horizontal objectives. In the period 2000-2003, around 78% of State aid in the new Member States was earmarked for these potentially more distortive types of aid. There were large disparities between countries in the share of sectoral objectives ranging from around 50% or less of total aid in Latvia and Slovenia to 90% or more in Lithuania, the Czech Republic and Malta (Table 3). In Estonia, no aid was earmarked for sectoral objectives.

The financial sector received the most support in these years (27%), due almost entirely to the legacy of a general banking crisis in the 1990s in the Czech Republic. A further 26% was directed towards the manufacturing sector[31], 24% for coal (mainly in Poland) and the remainder (1%) split between non-manufacturing not elsewhere classified and services other than financial.

There are significant differences between Member States in the sectors to which they directed aid (Table 3). Aid to the manufacturing sector accounted for less than 20% in Slovenia, the Czech Republic and Poland while in Malta and Lithuania the share was around 90%. The figure for Malta can be explained largely by the vast amount of aid given for restructuring the island's shipbuilding and ship repair sector. The high percentage in Lithuania can be explained by the relatively high amounts of rescue and restructuring aid to various manufacturing companies. Aid to coal mining accounted for a prominent part of total aid in Poland (56%) while aid to the financial sector made up 80% of total aid in the Czech Republic during the period under review.

1.3.4.1. State aid to the financial sector

From 1994 to 1998, the Czech Republic, Hungary and the Slovak Republic faced a general banking crisis that affected the whole banking sector, as a result of which governments

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28 The regional aid maps identify the eligibility of regions for regional aid as well as the maximum aid intensities allowed in each of these regions, taking account of regional disparities as reflected in per capita income. It sets eligible territories and allowable ceilings until a definite period.

29 The Czech regional aid map is still being assessed.

30 See more detailed information in the country profiles (Annex II).

31 This figure excludes aid earmarked for the manufacturing sector which also had a horizontal objective

intervened in order to restructure and subsequently privatise several banks. These measures included capital injections, transfers of assets, public guarantees, ring-fence agreements and litigation indemnities. The cost of these bailouts reached an annual average of €1.53 billion, accounting for 27% of the total aid over the period 2000-2003. The highest share was observed in the Czech Republic which paid out more than €2.4 billion in 2002 in the form of guarantees. Relatively smaller amounts were given in Hungary and the Slovak Republic where the restructuring mainly took place prior to 2000.

The countries in question notified a series of cases under the interim mechanism concerning aid to banks. To date, the Commission has adopted 18 decisions essentially declaring that the measures were (in technical terms) "not applicable after accession". In two cases the Commission has opened proceedings because it found that the measures were applicable after accession and had doubts as to its compatibility with the common market.

A "not applicable after accession" decision means that a measure was granted in its entirety before 1 May 2004, and thus the Commission was neither required nor empowered to assess such measures. An individual aid is considered as "applicable after accession" if it is likely to increase the liability of the state after the date of accession. This may be the case for example with a state guarantee, if the liability of the state is not clearly known. Nevertheless, a "not applicable after accession" decision does not mean that there would be no longer any further payments, within the predefined limits, for those aid measures after accession.

1.3.4.2. State aid to the coal sector

An annual average of €1.4 billion was granted to the coal sector between 2000 and 2003. In absolute terms, this amount is relatively low in comparison to the EU-15 average of €5.4 billion in 2002. In relative terms, while aid to the coal sector amounted to 16% of total aid in the EU-15 as a whole, in Poland it accounted for 56%. In the case of Poland, however, the annual average of €1.3 billion is rather misleading as €3.9 billion was awarded in 2003 alone.

Four other new Member States granted aid to this sector: Hungary (an annual average of €22 million), Slovenia (€10 million), the Slovak Republic (€3 million) and the Czech Republic (€1 million). In most cases, support to the coal industry took the form of closure aid, with the costs mainly related to exceptional expenditure on workers who lost their jobs and to the rehabilitation of former mining sites. In Poland, however, a large share of the aid (around 40%) awarded in 2003 was for earmarked for current production.

1.3.4.3. State aid to the steel sector

Steel is an important industrial sector in a number of new Member States, especially in the Czech Republic and Poland, a fact reflected by the level of employment in the sector and the value added generated by steel producers in both countries. Over the last decade, significant restructuring of the steel industry has been achieved, thereby strengthening the competitiveness of the sector. A large number of non-viable facilities have been permanently closed and existing plants modernised. Changes in management structures have also taken place in parallel with the ongoing privatisation and concentration process.

For many companies in these countries, viability could not have been achieved up to now without financial support of the governments. For this reason, transitional periods were negotiated with the Czech Republic and Poland to allow the granting of state aid to specific companies. The maximum amount of aid permitted corresponds to the financial projections made in the National Restructuring Programmes and the Individual Business Plans of the companies, which were adopted by the Czech and Polish governments and agreed by the Commission. For the Czech Republic, the maximum permissible amount of state aid was €413 million for the period 1997-2003 while for Poland it was €769 million. These exemptions from the EU rules on state aid are conditional on the fulfilment of certain obligations that are monitored and reported regularly. Over the period 2000-2003, an annual average of €246 million of aid to the steel sector was awarded in four new Member States: the highest amount in the Poland (€122 million), followed by the Czech Republic (€75 million). Smaller amounts were granted by the Slovak Republic (€41 million) and Slovenia (€9 million).

1.3.4.4. State aid to the shipbuilding sector

Of the new Member States, Poland, Malta and the three Baltic states have a shipbuilding industry, with regard to which State aid issues have arisen or may arise in future. The operations in the shipyards in these countries are to a large extent determined by the international context, and can be compared to the situation of any other European yard. The record world-wide order volumes in the past years have mainly benefited two countries - South Korea and China. The European shipbuilding industry is now searching for consolidation and reestablishment on the international market through specialisation and innovation. In this respect, the needs of shipyards in new Member States are similar to those of the EU-15 Member States. In the period under review, €87 million on average was allocated each year to the shipbuilding sector in the new Member States.

Unlike Malta, Poland, with its relatively large shipbuilding industry, did not negotiate any transitional arrangements for the application of State aid rules to this sector. Poland’s major shipbuilders in Gdynia and Szczecin are due to finalise in 2006 and 2004 their financial and material restructuring. A total of €24 million was paid out to these companies in the years 2000 and 2002. The sector, historically important in Poland, has been characterised by overcapacity, insufficient financing facilities, increased labour-costs and insufficient productivity levels. Maltese shipbuilding faces similar difficulties, but from the State aid perspective, a special transitional scheme closely monitored by the Commission was agreed upon in the Treaty of Accession. Under this scheme, an annual average of €81 million, representing around half the total aid in Malta, was allotted to the Maltese shipbuilding and ship repair companies.

1.3.4.5. State aid to the motor vehicle sector

The motor vehicle industry is another significant industrial sector in several of the new Member States. Over the period 2000-2003, an annual average of €58 million of aid was awarded to this sector in four countries. The highest amounts were awarded in the Czech Republic (€29 million per year) and the Slovak Republic (€28 million). Under its budgetary law, Poland granted almost €3 million state aid in 2002 while Cyprus exempted the import of raw materials used by the industry to the tune of almost €3 million in total over the period under review. These aids were used to bail out companies in difficulty and to exempt the sector from tax obligations.

In addition, smaller amounts were given in the Czech Republic and the Slovak Republic to support employment and training in the sector (€3 million per year), as well as to attract investments in underdeveloped regions (€5 million per year).

1.3.5. State aid instruments

All State aid represents a cost or a loss of revenue to the public authorities and a benefit to recipients. However, the aid element, i.e. the ultimate financial benefit contained in the nominal amount transferred depends to a large extent on the form in which the aid is provided.

For the new Member States as a whole, guarantees were the most frequently used form of aid instrument making up 41% of total aid over the period 2000-2003. This high percentage, compared to the EU-15 average of 3%, can be explained by the large proportion of guarantees in the Czech Republic (78% of total aid)[32]. Tax exemptions (29%) and grants (22%) were the two other instruments used predominantly in the new Member States (Table 4). The tendency of the new Member States to use instruments with a deferred impact on the budget, i.e. instruments other than grants, may be explained, in part, by budgetary constraints.

These averages conceal considerable differences between the new countries: while Cyprus, the Slovak Republic and Hungary made widespread use of tax exemptions (more than 60% of total aid) in the years 2000-2003, Estonia, Slovenia and Lithuania tended to use more grants (41% or more of total aid). Soft loans accounted for a significant share of total aid in Malta (33%) compared with a new Member State average of only 3%. Around 26% of aid in Latvia was awarded for the capitalisation of tax debts accrued before privatisation.

Table 4: State aid for manufacturing and services by type of aid instrument, 2000 – 2003

	FORM OF AID					in %
	Grants	**Tax exemptions**	**Equity participations**	**Soft loans**	**Tax deferrals**	**Guarantees**
EU-15*	58.6	24.0	5.6	6.0	2.6	3.2
New MS	**22.4**	**28.5**	**3.1**	**2.9**	**1.9**	**41.1**
CY	17.9	80.9	0.0	0.0	0.0	1.2
CZ	11.7	3.4	5.6	1.3	0.4	77.7
EE	68.6	14.4	0.0	0.2	0.0	16.7
HU	36.8	61.5	0.1	0.6	0.0	1.0
LT	41.1	15.6	9.6	5.2	0.7	27.8
LV	4.0	57.1	26.4	8.7	1.1	2.7
MA	19.1	36.6	0.0	33.4	1.4	9.6
PL*	32.1	34.5	0.5	3.9	6.3	22.8
SI	46.4	33.2	10.8	5.8	0.0	3.7
SK	10.0	72.4	0.0	0.0	0.0	17.6

Note: * EU-15 and Poland data only for 2000 – 2002. Source: DG Competition

1.3.6. State aid to other sectors

1.3.6.1. State aid to agriculture

State aid to agriculture was not covered by the pre-accession mechanism provided for under the Europe Agreements with the new Member States. Point 3 of Annex IV to the Treaty of

32 If the Czech Republic's guarantees for the banking sector are excluded, guarantees make up only 12% of total aid in the ten new Member States.

Accession on the interim mechanism procedure excluded *expressis verbis* its application to activities linked to the production, processing and marketing of agricultural products in Annex I of the EC Treaty. State aid granted in the agriculture sector is subject to a special regime under the Treaty of Accession as set out in Point 4 of Annex IV. The regime provides for the general rules applicable to all new Member States. In addition, several of the new Member States have obtained special temporary derogations from the State aid rules.

According to these provisions, aid schemes and individual aid granted in the agriculture sector, with the exception of fisheries products and products derived there from, put into effect in a new Member State before the date of accession and still applicable after that date, shall be regarded as existing aid within the meaning of Article 88(1) EC only if the measure is communicated to the Commission as existing aid within four months of the date of accession, i.e. by 31 August 2004.

These measures enjoy the protection of an existing aid until the date of a so-called 'sunset clause'. By 1 September 2004, all new Member State had submitted their existing aid measures which the Commission will publish in due course. The new Member States have until the end of the third year after the date of accession, i.e. end of April 2007, to ensure compatibility of those measures with the requirements of Community State aid rules. The new Member States shall, where necessary, amend these aid measures by the end of this three-year period. Ultimately, after 31 December 2007, any existing State aid that is incompatible with the *acquis* either has to be abolished or modified.

This provision concerning existing aid is without prejudice to the procedures concerning existing aid provided for in Article 88 EC. Therefore the Commission may, even before the end of the three years following accession, propose appropriate measures with regard to incompatible existing aid schemes. On this basis, it may recommend to a new Member State either to introduce amendments to such a scheme or abolish it. For such actions, the procedure set out in Articles 17 to 19 of Regulation (EC) No 659/1999 applies. Between April and the end of August 2004, all new Member States have submitted their 'existing aid' measures. The Commission will now proceed to their publication. Of course, the possibility to maintain an aid as existing aid does not authorise a new Member State to uphold measures that are in conflict with other parts of Community law, such as the rules on the free movement of goods or the common organisations for the markets for agricultural products.

1.3.6.2. State aid to fisheries

State aid to fisheries and aquaculture was not covered by the pre-accession mechanism provided for under the Europe Agreements with the new Member States. During the accession negotiations, the Commission stressed to the Acceding countries the importance of bringing their State aid measures into compliance with Community rules.

From April 2003, State aid in the fisheries sector was covered by the interim mechanism for existing aid provided for in the Treaty of Accession under which measures put into effect before 1 May 2004 and applicable after this date, could be notified. In respect to that procedure, the Commission services addressed a letter to all new Member States, encouraging their authorities to notify the existing measures to the Commission before 1 May 2004. During this period, the Commission services had on-going contacts with the authorities of the new Member States and participated in training meetings with them. In total, 13 measures were notified under this procedure (see table below).

Table 5: Existing aid measures for fisheries and aquaculture submitted under the interim mechanism procedure

Member State	Number of schemes	Duration	Annual budget (mio €/year)
Cyprus	1	In State Budget since 1995	€0.008
Czech Republic	6	Unlimited except for one scheme expiring in 2006 (1)	€23.2 of which €20.7 for scheme expiring in 2006
Hungary	2	2006	€1.5 in 2004
Latvia	1	2021	€2.24 for overall programme of which fisheries is a part
Lithuania	1	2002-2010	€0.8
Poland	1 (individual aid)	1996-unlimited	€0.5
Slovenia	1	2006	€0.058

(1)Aid scheme for renewal, dredging and reconstruction of fishponds and reservoirs. Source: DG Fisheries.

Based on the information available at present, State aid to fisheries and aquaculture in the new Member States does not appear to involve heavy funding. It is therefore likely that some of the measures which must now be notified under Article 88(3) EC Treaty will be excluded from this obligation after 1 November 2004, when the block exemption Regulation came into force (see section 3.8 for references and information on the recently adopted *de minimis* regulation for the fisheries sector). As of 1 September 2004, the Commission had received two notifications concerning State aid for fisheries and/or aquaculture, submitted since 1 May 2004.

1.3.6.3. State aid to transport

State aid to the transport sector was covered by the State aid provisions in the Europe Agreements.

Chapter 3, Article 4 of Annex IV to the Treaty of Accession provides for a particular interim mechanism with regard to State aid in the transport sector: "As regards aid to the transport sector aid schemes and individual aid to the transport sector put into effect in a new Member State before the date of accession, and still applicable after that date, shall be regarded as existing aid within the meaning of Article 88(1) of the EC Treaty until the end of the third year after the date of accession, provided they are communicated to the Commission within four months of the date of accession".

It follows from the interim mechanism that aid measures in force in the new Member States prior to 1 May 2004 that were communicated to the Commission before 1 September 2004, enjoy, until end April 2007, the protection of an 'existing aid'. As a consequence, the Commission, in co-operation with the new Member States, will review the existing measures during the transitional period in order to ensure compatibility with the common market in accordance with Article 88 (1) of the Treaty.

The new Member States have communicated to the Commission aid measures in force prior to accession and provided summary information with regard to those measures. The Commission services will now proceed with the examination of the measures and, where necessary, propose appropriate measures to ensure their compatibility with the common market.

Overall, approximately 150 measures relating to the transport sector have been submitted to the Commission by the new Member States under the interim mechanism. The number of aid measures in force varies considerably from one Member State to another, with two of the three largest countries, Poland and Hungary accounting for more than half the total number of measures submitted.

With regard to the different transport sectors, the information received shows clearly that the rail sector benefits from most measures while the remaining aid measures are rather evenly spread among the other transport sectors.

2. PART TWO: FOLLOW-UP TO THE COUNCIL CONCLUSIONS ON STATE AID

In the context of reducing overall levels of State aid, the conclusions of various European Councils have called for a shift in emphasis from supporting individual companies or sectors towards tackling horizontal objectives of common interest, including cohesion objectives. Furthermore, the Council invited Member States to "consider before granting State aid whether it is targeted on clearly identified market failures or directed at horizontal objectives … and whether an intervention in the form of State aid is the most appropriate and effective way to address these issues."[33]

2.1. Brief summary of the Council conclusions on State aid

The following is a summary of the key points emerging from the various Council conclusions on State aid since the Lisbon agenda was launched in 2000:[34]

- The Lisbon European Council of March 2000 set out to make the EU the most competitive and dynamic knowledge-based economy in the world, calling on the Council, Commission and Member States "to further their efforts to promote competition and reduce the general level of State aids, shifting the emphasis from supporting individual companies or sectors towards tackling horizontal objectives of Community interest, such as employment, regional development, environment and training or research."

- In March 2001 at the Stockholm European Council, Member States pledged to "demonstrate a downward trend in State aid in relation to GDP by 2003, taking into account the need to redirect aid toward horizontal objectives of common interest, including cohesion objectives."

- Further impetus was provided at the Barcelona and Brussels European Councils in 2002 and 2003 respectively.

- Outside of the European Council summits, more specific conclusions on State aid have also been adopted. In December 2001, under the Belgian Presidency, the Industry Council adopted a set of conclusions in which it invited Member States to continue their efforts to reduce aid levels, reorient aid towards horizontal objectives, further develop the use of "ex ante" and "ex post" evaluations of aid schemes, and improve the transparency and the quality of reporting to the Commission.

- In November 2002, under the Danish Presidency, the Competitiveness Council adopted conclusions on "an economic approach towards less and better State aid"[35]. The main aim of the conclusions was to develop a broader economic analysis of the effects of State aid by encouraging greater dialogue and exchange of information between the Member States. It reaffirmed the need to "closely evaluate State aid in order to identify and reduce the most distortive types of State aid, underlining that monitoring and follow-up of State aid

33 cf. Council conclusions adopted in November 2002 on "an economic approach towards less and better State aid". See Council document number 13799/02 http://register.consilium.eu.int/pdf/en/02/st13/13799en2.pdf

34 A full set of the conclusions was included in the autumn 2003 update of the State aid Scoreboard, COM (2003) 636 of 29.10.2003

35 Council document number 13799/02: http://register.consilium.eu.int/pdf/en/02/st13/13799en2.pdf

expenditures are essential components of State aid policies in Member States and Community State aid policy;" In this context, it invited Member States to "consider before granting State aid whether it is targeted on clearly identified market failures or directed at horizontal objectives of common interest, including economic and social cohesion objectives, and whether an intervention in the form of State aid is the most appropriate and effective way to address these issues" and to continue to "develop the use of "*ex-ante*" and "*ex-post*" evaluations of individual State aid and State aid schemes in order to monitor impact on competition and effectiveness of the aid".

2.2. Member States response to the Council conclusions

As a response to the Council conclusions, the Commission held a first meeting with State aid experts from the Member States in July 2003 to take stock of the Commission's and Member States efforts to follow-up the various Council conclusions on State aid and to discuss future work in the area of reduction, reorientation, and measuring the effectiveness of aid. The results of this meeting were reported in the autumn 2003 update of the Scoreboard.

On the basis of written contributions received from over twenty Member States on recent steps taken to follow up the various Council conclusions, a second meeting with Member States experts was held in July 2004. The following is a summary of the key points addressed at the meeting and/or in Member States contributions.

2.2.1. Specific efforts to reduce and redirect aid

As reported in the spring 2004 update of the Scoreboard, the latest underlying figures indicate that the majority of Member States appear to be responding positively to the call for less and better targeted state aid[36]. Although aid levels are falling less sharply than in the late 1990s, the smaller reduction is still in line with the Stockholm commitment. Moreover, virtually all the aid in several Member States (Belgium, Denmark, Greece, Italy, Netherlands, Austria and Finland) was earmarked for horizontal (including cohesion) objectives in 2002. It was agreed, however, that caution should be exercised in reading too much into aggregate indicators. For example, not all horizontal schemes are necessarily effective.

The vast majority of Member States attributed progress in reducing and redirecting aid to explicit policy efforts (see additional examples in Annex III):

A number of Member States have placed greater emphasis on improving the general business environment, streamlining and rationalising their business support schemes and directing support away from 'State aid' towards general measures. These include Belgium, Denmark, Sweden and the United Kingdom who reported that they have consistently taken a restrained line regarding the awarding of State aid. Denmark and Sweden contend that their industrial strategy concentrates on improving the general environment and growth conditions of firms, rather than on helping individual firms directly. Belgium refers to its strategy of devising alternatives to state aid as part of an overall business policy. The United Kingdom, too, claims that wherever possible, it "moves whatever support is necessary to provide to industry away from routes which constitute State aid." Similarly, Sweden has established an explicit principle of restraint whereby subsidies to companies should never be a first-hand solution for

[36] 2002 figures reported in the State aid Scoreboard spring 2004 update, COM (2004) 256 of 20.04.2004

achieving different aims. Instead, alternative policy instruments should first be analysed and tested regularly.

Sweden argues that if subsidies are chosen, neutral solutions as regards competition should be developed as far as possible; aid should be aimed inter alia at deficiencies in the market's operation (e.g., soft loans for SMEs or for facilitating innovation) or other efforts which may hasten development in socially desirable directions (e.g., improvement of the environment and more efficient use of energy in the economy). The current Finnish government programme states that "aid should be granted only where specially warranted and it should be temporary and transparent." Portugal also draws a distinction between different types of State aid, arguing for example, that operating aid, which by its nature is likely to cause greater distortion to competition, ceased many years ago to form part of panoply of new state aid measures in Portugal.

France has opted for budgetary restrictions as a way of meeting the commitment to reduce State aid. With the exception of aid for R&D and SMEs, a good many budget appropriations for operations have been either frozen or revised downwards. Germany continues to reduce subsidies through "greater transparency, tighter assessment and improved control arrangements". In future, financial aid will be granted only for a limited period laid down by law and will, as a matter of principle, be degressive. Aid levels for investment and job creation are being reduced in line with the Regional Aid Map 2000-2006 for Ireland. The proportion of aid going to investment and job creation projects is also declining, as there is an increased refocusing of aid to, e.g., the funding of R&D and training projects. The Netherlands contend that as they are managing with shrinking budgets, their commitment to reducing state aid is being met almost automatically.

2.2.1.1. Special situation in the new Member States

While the new Member States have also pledged their support for a reduction and redirection of State aid, it was accepted that their situation is not directly comparable with existing Member States. Given that the European Structural funds are subject to the so-called "additionality" principle[24], some of the new Member States indicated that overall State aid levels are likely to increase, at least in the short-term.

Section 1.3 describes in some detail the State aid situation in these Member States, including the underlying trends and the extent to which aid has been directed towards horizontal objectives prior to accession.

2.2.2. Improvements to national State aid set-up

Several Member States also referred to steps taken to rationalise and improve the organisation of state aid through a variety of institutional changes, legislation, better targeting of aid, greater emphasis on efficacy of aid, strengthening awareness and improving transparency. While many of these steps are aimed primarily at facilitating access to government by business and trying to ensure better value for public money, they may also assist in reducing and redirecting aid. See examples in Annex III.

2.2.3. Improving transparency and raising awareness of State aid

Denmark and Spain each reported on ongoing work aimed at making state aid more transparent. One of the tools currently being developed by Denmark, in cooperation with the

Norwegian authorities, is a database providing detailed information on all aid schemes, including budgets, aid actually paid out, objectives, etc. The database should provide policy-makers with a better basis for decision-making when aid schemes have to be reviewed or introduced. Greece, Italy and Slovenia also indicated that similar efforts were underway.

The United Kingdom described its proactive approach to raising awareness of and local expertise in State aid which, it argues, will assist in the reorientation/reduction in several ways: a greater awareness of the need to comply with the State aid rules should assist in reducing the number of cases where aid is granted without notification. This approach should also, particularly in combination with advice provided by the Department for Trade and Industry (DTI), result in more schemes being designed so that aid is avoided or, where it is necessary to include aid, targeted towards horizontal measures. See additional information in Annex III.

2.3. Improving the effectiveness of aid

2.3.1. Ongoing work in the Member States

Faced with constraints on national public finances, questions have been raised generally in most Member States about the direction of their national State aid policy and its effectiveness. Furthermore, in the context of a streamlining of aid policy ongoing in several Member States, there has been a need to build up a sufficiently firm knowledge base. There has therefore been a greater demand for monitoring and evaluation of existing aid.

2.3.1.1. Monitoring and evaluation

While all Member States carry out some form of monitoring and evaluation of their aid programmes, there is no common benchmark with which to assess a particular aid measure. Nevertheless some Member States appear to have adopted broadly similar approaches. Monitoring and evaluation of national State aid policy is carried out in different forms and by different actors in the public administrations. As Sweden points out, the authorities responsible for the aid measure are themselves naturally responsible for showing the results achieved. As well as this decentralised approach, the Swedish Government has also set up a special authority[37] at central level to evaluate Swedish growth policy from all angles. In the work on evaluating existing measures in growth policy, there have been *inter alia* reductions of certain state aid for companies.

In the United Kingdom, the appraisal of all Government spending (whether this constitutes State aid or not) is a fundamental part of the policy development process. Similarly, the Dutch authorities have been applying since 2001 a system covering the whole gamut from policy preparation to policy accountability whereby, if aid is to be granted, an opinion is given on the resources to be used and a statement of accountability is presented at the end. The accountability exercise takes place each year in parliament. See also Annex III for further examples.

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37 The Institute for Growth Policy Studies exercises responsibility for carrying out analyses and evaluations and disseminating knowledge. ITPS has developed a proposal for indicators which can be used both in an analysis of the conditions for growth policy efforts and for following the development of the effects of those efforts at first hand.

As the State Aid rules have been in force in the new Member States for a limited period of time, some countries such as Cyprus and Malta pointed out that the effects of many measures are not yet visible and it is therefore difficult to evaluate either the effectiveness of the State Aid measures introduced or their impact on competition. Most of the new Member States have however begun (or intend to shortly begin) to carry out evaluation exercises, some of which are outlined in Annex III.

2.3.1.2. Apparent trend towards 'repayable' State aid instruments

Partly as a consequence of the growing emphasis on evaluation of aid measures, there appears to be a trend in several Member States towards providing funding to firms on a repayable basis rather than in the form of non-repayable grants. Portugal and Ireland each reported that an increasing proportion of funding is being provided to indigenous firms in this way. As part of an overhaul of Swedish regional aid policy[38], there is an explicit intention to move from grants to loans. In Finland, the current government programme[39] is rather explicit in its support for loans and guarantees. In Estonia, research into the impact of four different aid measures on job creation revealed that the most successful was a loan guarantee scheme targeted at SMEs. In response to a request for examples of particularly successful aid measures, the Netherlands cited a long-standing scheme that, "at minimum cost, effectively promotes entrepreneurial activities" by providing state guarantees for loans to a large number of SMEs. Latvia also quoted a measure in which the Latvian Bank issues a large number of credits to SME's leading to significant job creation.

In contrast, Germany appears to take the opposite stance arguing that in order to prevent subsidies from becoming permanent, the general rule is that only financial aid, i.e. aid granted directly from the Federal budget; and, solely in justified exceptional cases, tax subsidies, will be granted. Steps are also to be taken to examine to what extent tax relief can be converted into direct grants.

2.3.2. Ongoing work by the Commission

The Industry Council of December 2001 invited the Commission to "develop, together with the Member States, statistical tools enabling these Conclusions to be followed up and devise indicators of effectiveness and efficiency". In response, the Commission has launched a number of studies in this field.

2.3.2.1. Improving understanding of the competition effects of state aid

In virtually all the examples of successful aid measures provided by Member States (see above), success was measured solely in terms of the effectiveness of the aid as opposed to its impact on competition. A full evaluation of the welfare effects of a State aid, however, needs to take account of the impact on competition in the affected markets, which may include not only the economic activity directly targeted by the aid but also neighbouring markets. The analysis of the competition effects of state aids is therefore important both for the Commission, in controlling state aid, and for policy-makers in the aid-giving bodies in the Member States.

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[38] A Policy for Growth and Vitality throughout the Country 2001/02:4

[39] "Business support policy shall continue to give priority to repayable aid. Aid should be granted primarily in the form of loans or guarantees and should require the company's owners and other finance providers to contribute with financial inputs that ensure adequate commitment." 24 June 2003

Recognising the need to improve the knowledge base and better understand the competition effects of state aid, the Commission intends to launch a study in the coming months. The main aim of the study will be to improve the economic basis for analysing the impact on competition of state aid. The study will construct an analytical framework for evaluating competition effects in terms of the impact on rivals (rent-stealing, foreclosure) and on consumer welfare, distinguishing between domestic effects and cross-border spillovers.

On this basis, it will define a set of criteria and indicators that can be used (a) to assess the importance of the impact of individual aid awards on competition, (b) as a starting point for developing some general rules that can be applied to aid schemes, where the identity of the beneficiaries is not known in advance, in order to limit the potential harm to competition and (c) to contribute to the development of a method for identifying state aids that are unlikely to have a significant impact.

Results of the study are expected by the end of 2005.

2.3.2.2. Assessing the impact of R&D state aid

The Spring European Council[40] in 2004 raised concerns over the relative weakness of European private sector investment in R&D and stressed the importance of increasing R&D within the Union. The Commission recognises that in this area market failures may exist which inhibit private investment in R&D and innovation giving rise to slowdown in productivity and competitiveness. The Commission has launched a study to prepare the review of the R&D aid guidelines[41] which has been in force since 1996 and will expire at the end of 2005.

In essence, this study is focussing on the role of State aid as an instrument to facilitate the achievement of the Barcelona objective to devote 3% of the EU's GDP to R&D spending. More specifically, it will focus on what types of activities should be considered eligible for support, and on appropriate levels of State aid.

The study has the following five main objectives:

- to ascertain the role R&D aid plays in the overall public R&D support context such as universities and public research institutes in the last decade
- to describe and analyse functional changes of public research establishments
- to describe and analyse public support for R&D activities used by the Community's major trading partners
- to describe and analyse the categorisation of research activities
- to analyse the leverage effect of R&D aid, i.e. the potential of aid to stimulate additional private R&D investment

Results of the study are expected in the spring 2005.

Also in the context of R&D State aid, the Scientific and Technical Research Committee (CREST) has recommended to the Council and Commission to draw up a track record of

[40] Presidency Conclusions of the European Council 25-26 March 2004.
[41] OJ C 45, 17.02.1996

success on how State Aid has been redirected towards R&D programmes in some Member States, with a view to preparing a guide for other Member States.

2.3.2.3. Measuring the effectiveness of State aid to SMEs

Successive European Councils have recognised the role played by SMEs in stimulating growth and creating employment in the Union. Aid to SMEs clearly falls within the category of horizontal objectives, and is justified by well-recognised market failures, typically occurring in capital markets (difficult access to finance especially in the creation/start up phase, asymmetric information, etc). There is therefore a need to improve understanding of the effectiveness of various types of state aid measures which Member States use to support SMEs.

In theory, one way of looking at the effectiveness of state aid would be to measure the extent to which it redresses the identified market failure. In practice, this approach has proved problematic due to the difficulties associated with quantifying market failures. An alternative method is to measure the extent to which the aid in question has met its specific policy objective. For SMEs, this could include enterprise creation, SME growth, SME innovation, SME turnover, SME employment, etc. This second approach would seem to be more useful for policy-makers and more feasible to implement. However, in order to make it operational, Member States could find it useful to know more about the pros and cons of possible methodologies and about the data requirements.

The Commission therefore recently launched a study with a view to identifying if and how Member States evaluate the effectiveness of state aid to SMEs, and to make recommendations as to the best methodology (or methodologies). Results of the study should be available by the end of 2004.

3. PART THREE: MODERNISING STATE AID CONTROL

3.1. Adoption of a pro-active competition policy

In April 2004, the Commission adopted a Communication entitled "A pro-active Competition Policy for a Competitive Europe"[42]. This document sets out why and how competition policy brings about productivity gains and innovation, therefore increasing Europe's competitiveness on the world stage to the benefit of long term economic growth in the Union's single market.

The document also describes how the instruments of EU Competition policy have undergone a review in recent years and sets out the challenges that lie ahead. In the field of State aid, the reforms already undertaken and those on-going aim at refocusing State aid policy towards a more economic approach with the purpose of eliminating harmful State aid, while leaving the Member States with more flexibility to adopt horizontal measures to support, in particular, the Lisbon objectives.

In 2005-2006, a large number of the Commission's existing regulations, frameworks and guidelines come up for renewal including all the state aid exemption regulations, the regional aid guidelines, the framework for research and development aid and the risk capital communication. The environmental aid guidelines expire at the end of 2007. These factors, together with the beginning of a new programming period for the Community's structural funds in 2007, provide an unprecedented window of opportunity for a comprehensive review of the horizontal State aid rules to take account of the horizontal, and particularly Lisbon, objectives, and the new cohesion policy set out in the forthcoming Structural Funds regulations, as well as to consolidate, and wherever possible simplify the rules.

3.2. Review of the regional aid guidelines

One of the biggest challenges in the ongoing reform is to redefine regional aid policy in an enlarged Union, reconciling the overall reduction of state aid volumes with the Community objective of economic and social cohesion within the framework of enlargement.

A first Working Paper which outlines the approach that the Commission services are proposing to follow for the review of the regional aid guidelines was sent to Member States on 30 April 2004. The main policy objectives of the review, which fits within the general move towards a more economic approach to State aid policy and takes full account of the conclusions of the Third Cohesion Report, are threefold: achieving concentration of regional aid to investment in the least favoured regions, ensuring an adequate margin of flexibility for Member States and regions to pursue local regional policy, and enhancing the long-term competitiveness and growth potential of all European regions.

This first Working Paper proposes that the assisted areas, laid down in regional aid maps, would consist, as at present, of regions eligible to Article 87(3)(a) and Article 87(3)(c). On the one hand, the criteria for the designation of Article 87(3)(a) regions would basically remain unchanged, meaning that all NUTS II regions that have a per capita GDP (measured in purchasing power standards) of less than 75% of the Union average would qualify. On the other hand, with regard to the derogation under Article 87(3)(c), it is proposed to limit its use to a

[42] COM(2004) 293 final of 20.04.2004

number of predefined ('earmarked') regions. Article 87(3)(c) regions might therefore only include former 87(3)(a) regions (although a different treatment would apply according to whether those regions lose their previous status due to the statistical effects entailed by enlargement, or as a result of an increase in regional wealth), as well as outermost regions and low population density areas, regardless of their current levels of GDP.

Outside the assisted areas, only SMEs would be able to benefit from State aid to general investment. As far as large companies are concerned, the present horizontal rules (many of which will be reviewed before 1.1.2007) should provide Member States with sufficient room for manoeuvre to tackle any relevant problems and, incidentally, also to differentiate between regions where this is considered necessary. Reliance on such a thematic approach in State aid should also contribute to "less and better-targeted State aid" by playing a role in shifting from subsidies that temporarily compensate for regional disadvantages to the provision of public goods and incentives permanently increasing the potential of all regions to growth.

Although the Commission services requested comments on the proposals laid down in the working paper by 30 June 2004, very few Member States were able to meet the deadline, and most comments were received in July and August (including from regions and regional organisations). With a view to continuing consultation with Member States and the EFTA Surveillance Authority on all major steps of the review, a first draft of the new regional aid guidelines may be discussed at one or two multilateral meetings of national State aid experts in early 2005. A final version of the guidelines should in principle be adopted by the end of 2005, in order to leave ample time for Member States and the Commission to ensure a smooth transition by the end of 2006.

3.3. Services of General Economic Interest (SGEI)

On 18 February 2004, the Commission adopted draft instruments designed to increase legal certainty as regards the financing of services of general economic interest. The first is a draft Commission Decision on the application of Article 86 of the Treaty to state aid in the form of public service compensation. The purpose of the Decision is to set out the conditions under which state aid granted to small-scale services of general economic interest is compatible with the Treaty and to exempt such aid from the prior notification requirement. The second instrument is a draft Directive on the transparency of financial relations between Member States and public undertakings. The Commission services have also drawn up a draft "Community framework for state aid in the form of public service compensation" which sets out the conditions under which compensation granted to large-scale services of general economic interest (i.e. those not covered by the above-mentioned Decision) constitutes compatible aid. See spring 2004 update of the Scoreboard for further details.

The draft instruments have been presented to the Member States, the European Parliament, the Economic and Social Committee and the Committee of the Regions for their opinions. Not all of these institutions have yet taken a final position[43]. The drafts are available on the Competition DG's website[44], and all interested third parties can make known their views on them. The drafts will be finalised by the Commission in the light of the comments received.

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43 The Committee of the Regions adopted its opinion on 29 September 2004. The Economic and Social Committee is at an advanced stage of preparing its opinion. The European Parliament has appointed a 'rapporteur' and a first exchange of views took place in early October.

44 http://europa.eu.int/comm/competition/state_aid/others/

3.4. Review of the rescue and restructuring guidelines

New guidelines on rescue and restructuring aid for companies in difficulty entered into force on 10 October 2004. The guidelines clarify the approach the Commission intends to take in individual cases where the State financially supports a rescue and restructuring operation in favor of individual enterprises. In so doing, Commission decisions in individual cases should become more predictable for companies and the public at large.

The rules clarify the eligibility of the firm: a firm is regarded as newly created (and thus ineligible for rescue or restructuring aid) during 3 years from start of operation. The so-called "one time, last time" has been reinforced to exclude all kinds of repeated interventions with the exception of restructuring aid following rescue aid within the same operation. The new rules also strengthen the Commission's recovery policy through a prohibition of new rescue or restructuring aid for firms which do not reimburse aid previously declared incompatible.

Unlike the current rules, the new Guidelines allow for the undertaking of the first urgent structural measures during the rescue period. However, rescue aid can still only be granted in the form of reimbursable liquidity while other interventions, such as capital injections from public authorities which cannot be undone, remain prohibited as rescue aid. Moreover, the rescue period is clearly limited to 6 months including the reimbursement of the rescue aid.

In order to speed up procedures, Member States have the possibility to opt for a lighter procedure to approve rescue aids if the amount of the aid does not exceed the result of a standard formula and, in any event, €10 million. Furthermore, with the aim of concentrating resources on those cases that really pose a threat to competition, the Commission will no longer assess the viability of restructuring plans for SMEs.

To avoid undue distortions of competition, a principle has been introduced that compensatory measures are necessary except for small undertakings. Compensatory measures can take the form of divestment of assets, reduction in capacity or market presence, reduction of entry barriers, etc. It is also explicitly confirmed that activities which would have been abandoned anyway are not included in the assessment of compensatory measures.

The new Guidelines clarify that the contribution by the beneficiary should be real and free of aid. For small enterprises, it should in principle be at least 25% of the restructuring costs, for medium-sized enterprises at least 40%, and for large undertakings at least 50%. In exceptional circumstances and in case of particular hardship the thresholds can be reduced.

For agriculture, the rules have been considerably simplified. For processing and marketing of agricultural annex-I products, the normal rules will apply.

3.5. State aid for innovation

At the Lisbon European Council in 2000, the Union set itself a new strategic goal for the next decade: "to become the most competitive and dynamic knowledge-based economy in the world." The Council has subsequently emphasised the importance of innovation as the main source of competitiveness and economic growth, and its key role in the European Research Area.

While fostering competition and market opening is considered as the most efficient instrument to stimulate innovation, situations exist in which the market fails to deliver the incentives necessary to reach the desirable amount of innovation activities in view of the social returns it generates. In such cases government interventions may be appropriate to correct existing market failures, but the benefits of State intervention must always be assessed against its costs, particularly in terms of distortion of competition.

In its Communication on "A pro-active competition policy for a competitive Europe" of April 2004" (see section 3.1), the Commission announced that it would draw up a vade-mecum or 'Practitioner's guide' to provide guidance on measures in support of innovation which can be adopted within the existing State aid regulations and frameworks to State aid for innovation. The Commission also committed itself to producing in 2005 a Communication in which the need and potential to expand the possibilities to aid innovation will be explored.

Consequently, the Commission services are currently preparing a vade-mecum on Community rules on State aid for innovation. The document is based on an economic approach, identifying four key market failures[45] which impede innovation in the European economy. The vade-mecum then describes the different types of State aid measures which might be used to try to address those market failures, using key Commission decisions as illustrations.

On the basis of a questionnaire[46] that was sent by the Commission to Member States in April 2004, State aid for innovation was also discussed at the above-mentioned meeting with State aid experts from the Member States held in July 2004.

The Commission summarized the issues raised in Member States replies to the questionnaire after which there was a useful exchange of views. The Commission took note of a range of market failures cited by Member States, which largely confirmed the Commission's internal analysis (see vade-mecum). A number of Member States expressed the view that it might be difficult to reach a commonly-accepted definition of innovation generally applicable for State aid purposes. An alternative option could be to define innovation activities relating to identified market failures. It also emerged that market failures tend to be larger the smaller the company is. Some Member States floated the idea of allowing special treatment for small and micro-enterprises, whereas others warned that this could distort the incentive for enterprises to grow.

Although innovation does not generally develop according to a 'linear' model from basic research to commercial implementation, it remains true that, on the one hand, market mechanisms are less capable of correctly assessing and adequately funding fundamental research, while, on the other hand, public support bears greater risks of distorting competition the closer the activity is to its commercialisation phase.

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45 (1) the existence of public goods and externalities as a result of which the innovating firm cannot fully appropriate the returns on its investment and therefore may give up promising projects; (2) the inefficient dissemination of information leading to low take-up rates for innovation; (3) failures in the capital markets leading to insufficient funding for innovation; (4) labour market mis-matches, due to lack of skills or mobility of the workforce.

46 Member States were asked: (1) to describe the market failures giving rise to the need for innovation aid; (2) to explain how the existing rules prevent them from granting aid for innovation; (3) to provide a definition of what they consider to be innovation/innovatory activities/enterprises; (4) if higher aid intensities were to be introduced for innovation aid, to indicate how they could ensure that aid would be restricted to 'innovative' activities only.

Against this background, Member States broadly agreed about the need on one hand to adapt existing aid instruments to better cover innovative activities and, on the other hand, to develop instruments that address gaps in the current system. As indicated above, the Commission has announced that it will address these issues in a Communication on State aid and innovation to be presented in 2005. In addition, the majority of the instruments mentioned in the vade-mecum (e.g., R&D Framework, Regional aid guidelines, Risk capital communication) will undergo a detailed review in 2005-2006.

3.6. State aid to cinema

In accordance with Article 87(3)(d) of the EC Treaty, the Commission may authorise aid to promote culture, where such aid does not affect competition and trading conditions to an extent contrary to the common interest. A Communication from the Commission on certain legal aspects relating to cinematographic and other audiovisual works (Cinema Communication I), adopted in 2001, clarified the criteria used by the Commission when applying the exception of this Article to State aid to cinema.

The Cinema Communication II, adopted on 16.3.2004, extends the validity of these criteria until the end of 2007.[47] In addition, it announces an extensive economic study on the effects of the existing State aid systems. The study should examine in particular the economic effects of territorialization requirements imposed by certain Member States.

3.7. Improving current procedures and working methods

In March 2004, the Commission adopted implementing provisions[48] under Article 27 of Regulation (EC) n° 659/1999[49]. The overall objective is to accelerate, simplify and modernise procedures, in particular with a view to reducing the resources expended on routine cases and to enable the Commission to concentrate resources on more important cases which present real competition concerns at the Community level.

The new provisions concern the form, content and other details of notifications and annual reports to be submitted by Member States to the Commission. The aim is to streamline and simplify procedures as well as enhancing transparency and legal certainty. The provisions also include details of time-limits, the interest rate for the recovery of unlawful aid, as well as other suggestions to improve current procedures and working methods. For further details, see article in the summer edition of the Competition Newsletter.[50]

3.8. State aid to the agricultural sector

On 6 October 2004, the Commission adopted a new Regulation on the application of Articles 87 and 88 of the EC Treaty for "de minimis" aid in the agricultural and fisheries sectors.[51] It foresees that aid up to €3000 per farmer/fisherman can be granted over a period of three years without being notified to the Commission, provided that the global amount of such aid does

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47 COM(2004) 171 final. OJ C 43 on 16.2.2002

48 Reg. EC 794/2004, OJ L 140 of 30.4.2004, p. 1

49 Council Reg. (EC) No. 659/99 of 22 March 1999, OJ L 83 of 27.3.1999, p. 1

50 "Reform of procedural rules for state aid cases", Competition Policy Newsletter 2004 Nr 2 summer http://europa.eu.int/comm/competition/publications/cpn/cpn2004_2.pdf

51 Commission Regulation (EC) No 1860/2004 of 6 October 2004 on the application of Articles 87 and 88 of the EC Treaty to de minimis aid in the agriculture and fisheries sectors (OJ L 325 of 28.10.2004 p.4)- http://europa.eu.int/comm/agriculture/stateaid/leg_fr.htm

not exceed 0.3% of production in the agricultural or fisheries sector of the Member State concerned. From 1 January 2005, Member States will be able to grant aid that is in line with the Regulation without the Commission having to approve the aid in advance, but they will also have to provide information certifying that the two ceilings have been complied with.

3.9. State aid to the fisheries sector

On 30 June 2004, the Commission adopted a new set of rules on state aid to the fisheries sector. These rules bring state aid policy into line with the reformed Common Fisheries Policy, adopted in December 2002. The new rules provide for a 'block exemption'[52] for certain types of aid which will no longer have to be notified to and approved by the Commission before Member States can implement them. Aid not covered by this exemption will still have to be notified and assessed by the Commission under guidelines[53] also adopted on 30 June 2004. They will become applicable from 1 November 2004.

The measures covered by the block exemption relate to aid unlikely to threaten conservation or distort competition in a manner not in line with EU interest and which therefore has never given rise to investigation procedures by the Commission. The aid concerned has to comply strictly with the criteria set out in the block exemption regulation, which are identical to those governing the allocation of EU funds under the Financial Instrument for Fisheries Guidance (FIFG).

The block exemption will apply to aid granted to SMEs for amounts below €1 million or to aid designed to finance measures with a maximum eligible amount of €2 million. To ensure the proper allocation of such aid, monitoring will take place through a simplified procedure comprising ex-ante information of the Commission on the aid to be granted, published on the internet and the Official Journal, and ex post reporting obligations. Both the block exemption and de minimis aid regulations have a retroactive effect explicitly built in.

See also section 3.8 re de minimis aid in the agricultural and fisheries sectors.

3.10. State aid to the transport sector

State aid to the aviation sector

In the autumn of 2004 the Commission will be studying draft guidelines aimed at supplementing the guidelines on state aid in the aviation sector adopted in 1994; they will take account of the major developments that have occurred in recent years in the European air transport market. One such change is the emergence of several new Community-scale companies with promotional rates supported by a low-cost structure. Another concerns airports which in the last few years have been particularly active in seeking to attract new air routes and have created a real airport market with its own case law (Aéroports de Paris judgment in 2000). The guidelines cover both aspects.

As regards start-up aid, the draft guidelines suggest extending the Commission Decision of 12 February 2004 on the aid granted to Ryanair at Charleroi by codifying the practice thus

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52 Commission Regulation (EC) No 1595/2004 of 8 September 2004 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium-sized enterprises active in the production, processing and marketing of fisheries products (OJ L291/3 of 14.9.2004). http://europa.eu.int/comm/fisheries/doc_et_publ/factsheets/legal_texts/stateaids_en.htm

53 Guidelines for the examination of State aid to fisheries and aquaculture (OJ C229 of 14.09.2004)

established and allowing airports, especially regional airports, provided they comply scrupulously with the rules on transparency and proportionality, to contribute to the creation of new routes. The maximum period envisaged is 5 years and the maximum aid intensity 50% of the costs of starting up the routes.

As regards the financing of airports, the draft guidelines envisage to retain the principle that the building of airport infrastructure that is open to all users may come under the heading of the power of public authorities to provide public infrastructure and facilities. On the other hand, the financing must be limited to the installations that are specifically required for air transport itself and not its commercial adjuncts such as shops, hotels or car parks. Nor must it allow airport managers to gain an unfair advantage by imposing excessive charges which could place them in a predatory position in relation to other airports.

State aid to combined transport

The Commission is currently preparing a working document in relation to state aid for the combined transport sector. The absence of specific guidelines for this sector implies a lack of transparency and understanding by third parties of the rules and criteria applied by the Commission when assessing public financing in this sector. Nevertheless, the Commission has through a substantial number of decisions established a constant legal practice which could be converted into specific guidelines, therefore providing the necessary transparency and legal certainty that is required by interested parties.

3.11. De minimis aid to the coal sector

In March 2004, the Commission adopted a draft regulation which would explicitly exclude the coal sector from the scope of the de minimis regulation of January 2001. The coal sector has been covered by the EC Treaty only since 24 July 2002, following the expiry of the ECSC Treaty. Since then, the sector has been subject to specific rules which prevent the application of other exemption regimes.

4. ONLINE STATE AID SCOREBOARD AND REGISTER

The online Scoreboard contains electronic versions of this and previous Scoreboards as well as a set of key indicators, a wide array of statistical tables and internet-links to information on State aid policy issues of the Member States and the European Parliament.

http://europa.eu.int/comm/competition/state_aid/scoreboard/

Any queries or requests for data should be sent to the scoreboard mailbox at Stateaid-Scoreboard@cec.eu.int

State aid Register – a second transparency tool

The Commission's State aid Register has been online since 2001. The Register provides detailed information on all State aid cases which have been the object of a final Commission decision since 1st January 2000 as well as block exemption cases published in the Official Journal. It is updated daily and thus ensures that the public has timely access to the most recent State aid decisions. It is available on the homepage of the Competition Directorate General's Internet site:

http://europa.eu.int/comm/competition/state_aid/register/

5. METHODOLOGICAL NOTES

The data used in this Scoreboard were provided by the national administrations of each new Member State. Additional data on population, GDP and exchange rates were obtained from Eurostat. Data for 2004 are provisional. Annual average exchange rates were provided by Eurostat and may differ from those used by the national authorities. Furthermore, exchange rates for some of the currencies in question have been subject to considerable fluctuations, which clearly have an impact on the data.

Total aid excludes agriculture, fisheries and transport for which comparable data prior to accession are not available. See section 1.3.6 for details of the provisions that apply in these sectors for the existing aid mechanism.

State aid expenditure is attributed to the year it was made. In cases that result in expenditure over a number of years, the total amount is attributed to each of the years in which expenditure took place. All data are provided in million (or billion where appropriate) euro at constant 2000 prices so that the effects of inflation are removed. Some data for the year 2003 in Cyprus, Hungary, Latvia, Lithuania and Poland are provisional.

In relation to the autumn 2002 update of the Scoreboard[54], many of the figures have been subject to significant revisions.

State aid data collected for the Scoreboard are grouped according to primary objectives which may be either horizontal or sector-specific. Information on the objective of the aid, or, the sector to which the aid is directed, refers to the time the aid was approved and not to the final recipients of the aid. For example, the primary objective of a scheme which, at the time the aid was approved, was exclusively earmarked for small and medium-sized enterprises is classified as aid for ‘small and medium-sized enterprises’. In contrast, aid granted under, say, a regional development scheme may ultimately be awarded to small and medium-sized enterprises, but is not regarded as such if, at the time the aid was approved, the scheme was open to all enterprises.

The following symbols have been used in the Scoreboard:

n.a.	not available
-	real zero
0	less than half the unit used
NGE	net grant equivalent
New MS	new Member States
R&D	research and development
SMEs	small and medium-sized enterprises
GDP	Gross Domestic Product

See also Conceptual remarks (after Introduction). Further information on methodological issues may be found on the online Scoreboard:

http://europa.eu.int/comm/competition/state_aid/scoreboard/conceptual_remarks.html

54 COM(2002)638 of 27.11.2002

ANNEX I: TRANSITIONAL ARRANGEMENTS PROVIDED FOR IN THE TREATY OF ACCESSION

Cyprus

- Phase-out incompatible fiscal aid by the end of 2005

Czech Republic

- Restructuring of the steel industry to be completed by 31 December 2006.

Hungary

- Phase-out incompatible fiscal aid for SMEs by the end of 2011

- Conversion of incompatible fiscal aid for large companies into regional investment aid; the aid will be limited to a maximum of 75% or 50% of the eligible investment costs depending on the start date of the investment; in the motor vehicle industry the aid is further limited, and set at a level that corresponds to 30% or 20% of the eligible investment costs respectively.

- Phase-out incompatible fiscal aid for off-shore companies by the end of 2005

- Phase-out incompatible fiscal aid granted by local authorities by the end of 2007

Malta

- Phase-out incompatible fiscal aid for SMEs by the end of 2011

- Conversion of incompatible fiscal aid for large companies into regional investment aid; the aid will be limited to a maximum of 75% or 50% depending on the date of the attainment of tax exemption

- Aid for restructuring of the shipbuilding sector during a restructuring period lasting until the end of 2008

- Phase-out of operating aid under the Business Promotion Act by the end of 2008

Poland

- Phase-out of incompatible fiscal aid for small enterprises by the end of 2011

- Phase-out of incompatible fiscal aid for medium-sized enterprises by the end of 2010

- Conversion of incompatible fiscal aid for large companies into regional investment aid; the aid will be limited to a maximum of 75% or 50% of the eligible investment costs depending on the date of the attainment of the permit; in the motor vehicle industry the aid is further limited, and set at a level that corresponds to 30% of the eligible costs.

- With regard to state aid to environmental protection, transitional arrangement agreed for investments that relate to standards for which a transitional period has been granted under the Chapter Environment and for the duration of that transitional period, whereby the aid intensity is limited to the regional aid ceiling

- Restructuring of the steel industry to be completed by 31 December 2006.

Slovak Republic

- Conversion of incompatible fiscal aid to one beneficiary in the motor vehicle manufacturing sector into regional investment aid; the aid will be limited to a maximum of 30% of the eligible investment costs.

- Incompatible fiscal aid to one beneficiary in the steel sector to be discontinued at the end of 2009 or when aid reaches a pre-determined amount, whichever comes first.

ANNEX II: COUNTRY PROFILES

Cyprus

Year 2004	Annual average years 2000-2003
Population: 0.73 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 165 million CYP
GDP: € 12.0 billion	**Total State aid (euro)**: € 285 million
GDP per capita: €16 459 or 18 152 PPS	**State aid as a percentage of GDP**: 2.85 %
Exchange rate: 1€ = 0.582 CYP	**State aid per capita**: € 405 or 497 PPS

State aid legislative, administrative and enforcement framework

Following the entry into force of the Public Aid Control Law on 30th April 2001, the Office of the Commissioner for Public Aid, headed by an independent official, the Commissioner for State Aid Control, was established in order to create a proper framework for the effective control of State Aid (www.mof.gov.cy). The Commissioner took office on 1st June 2001. According to the Law and the secondary legislation, no state aid could be advanced without the prior approval of the Commissioner. Upon accession, Community state aid rules became directly applicable with the substantive control of State aid being shifted from the Commissioner to the European Commission. The legislative framework was amended accordingly. According to the State Aid Control Laws of 2001 to 2004, all competent authorities intending to grant any type of aid are obliged to notify all draft aid measures to the Commissioner before their implementation. If any draft aid measure is implemented without the prior approval or opinion of the Commissioner, the latter may take a decision requiring the recovery of the aid from the beneficiary. The Commissioner possesses powers and responsibilities in respect of issuing non-binding recommendations on all draft aid measures, notification of State aid measures to the Commission, assessment and monitoring of all measures under the block exemption regulations, the effective control of de minimis aid and the collection of data. Therefore, the Office of the Commissioner for State Aid Control now acts as the national focal point and coordinator for state aid matters in Cyprus.

State aid in the years 2000-2003

Cyprus granted annually €285 million of state aid in the years 2000 – 2003. This represented 2.85% of GDP or the equivalent of €405 per capita. The relatively high level of state aid can be attributed to two peculiarities in Cyprus, the impact of which will diminish in the coming years leading to an expected reduction in the overall level of State aid. A fall in the absolute amount of state aid can be observed in 2003 due to the beginning of the phasing out process of Cyprus's largest scheme that gives tax reductions to International Business Enterprises (see below).

On average 88% of total aid was given under schemes, while €36 million was awarded through ad hoc measures.

International Business Enterprises Act

In the medium term, Cyprus's transitional arrangement for its International Business Enterprises Act foresees the phasing out of a significant amount of tax relief by the end of 2005. This aid is made up largely of tax relief through a reduced tax rate of 4.25%, as opposed to the standard rate of 20-25%. Already in 2003, expenditure under this scheme dropped to around €68 million from €219 million in 2002 due to the new tax code that entered into force on 1 January 2003. It eliminated all incompatible fiscal aid with immediate effect and abolished the distinction between the onshore and offshore sector. For one provision of the tax code, a transitional period was requested by Cyprus until the end of 2005 for existing beneficiaries in the offshore sector. This arrangement accounted for almost 60% of total aid in the years 2000 to 2003.

Exemptions from import duty before accession

The other cause for the relatively high aid levels prior to accession should disappear in the short-term, leading to significant reductions in aid expenditure already in 2004. Prior to accession, a system of sectoral exemptions was in force exempting most manufacturing enterprises from payment of import duties for certain raw materials or inputs, provided that these raw materials were used for the manufacture of final products either for domestic consumption or for export. All these measures were abolished on the date of accession. In 2003, the imports of raw materials increased substantially (from €9 million in 2002 to €114 million, or 47% of total aid, in 2003) as a result of manufacturing companies stocking-up by importing large quantities of raw materials before the abolition of these measures.

Given the clear commitment of phasing-out both the above-mentioned cases, it is interesting to look at the figures excluding these two schemes: total state aid would have amounted to only €60 million in 2003, representing 0.6% of GDP.

State aid to horizontal objectives

Aid for horizontal objectives averaged €66 million per year or 23% of total aid in the observed period. Annually, €31 million (11% of total aid) was devoted to the preservation of heritage and national culture, mainly through the financing of national and multinational film and theatrical productions, including national broadcasting. Cypriot state aid policy aims also to enhance human resources development (2%) and to protect the environment (1%). Around 4% of total state aid was specifically earmarked to SMEs.

Regional aid in Cyprus

The smooth integration of Cyprus into the Union is constrained by a number of special characteristics, namely the large distance of Cyprus from EU markets, the scarcity of water and own energy resources, the small size of its domestic market and some weaknesses in the structure of production. These disparities are addressed by a few horizontal, regional aid measures totalling €11 million yearly (4% of total aid). According to the Guidelines on national regional aid, the total territory of Cyprus is regarded as an Article 87(3)(c) region providing for a uniform aid ceiling of 20% NGE and 10% for SMEs and covering 100% of the population. Cyprus is regarded as one region at each NUTS level. It should be noted that this applies only to the area of the Republic of Cyprus under the control of the Government of Cyprus.

Sectoral and Rescue & Restructuring aid

Sectoral aid constituted a substantial part of total state aid in Cyprus amounting to an average €219 million between 2000 and 2003 (77 % of total aid). This relatively high percentage can be attributed almost exclusively to the two measures detailed above. No rescue and restructuring was granted in the period under review. There are no so-called sensitive sectors in Cyprus.

Aid instruments

State aid took mostly the form of fiscal instruments. Tax exemptions, subsidized rent and other duty relief made up 81% of total aid in the period 2000-2003, followed by grants (18%). Guarantees and soft loans were scarcely used.

Existing aid in Cyprus

Cyprus has 51 existing state aid measures through which it can award aid in future without prior notification to the Commission. 31 of these measures were annexed to the Treaty of Accession while a further 20 were approved by the Commission as existing aid under the interim mechanism. These schemes are devoted to various horizontal objectives, especially to the support of the film industry and major cultural events.

Transitional arrangements with Cyprus

In course of the negotiations, Cyprus requested a transitional arrangement to allow the granting of a grandfather clause to International Business Enterprises. Thus the undertakings which were active on 31st December 2001 and had, by that date, acquired the benefit of section 28A of the Income Tax Law are allowed to maintain the benefit until 31st December 2005.

Looking to the future ...

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels. However, by looking at the situation in the last year before accession, 2003, it can be observed that around €154 million (64% of total aid) was awarded under measures that will not continue beyond accession. Aid given under existing schemes (32 out of a total of 158 in 2003), i.e. that are scheduled to continue after 1 May 2004, amounted to €20 million (8% of total aid) in 2003. Finally, a considerable amount of aid (€68 million or 28% of the total) was awarded under transitional arrangements foreseen in the Treaty of Accession.

State aid for horizontal objectives and particular sectors in Cyprus, 2000-2003

	Average 2000-2003		2000	2001	2002	2003
	mio €	% of total	mio €	mio €	mio €	mio €
Horizontal Objectives	**66.3**	**23%**	**56.7**	**65.8**	**89.3**	**53.3**
Research and Development	1.1	0%	0.9	1.2	1.5	0.7
Environment	1.7	1%	1.6	1.1	2.2	2.1
SME	11.9	4%	14.0	13.1	18.4	2.2
Commerce	4.6	2%	4.5	5.5	5.3	3.2
Training aid	5.3	2%	5.6	5.0	5.5	5.2
Heritage conservation, cultural aid	30.6	11%	21.6	30.6	33.3	36.7
Natural disasters	0.4	0%	-	-	-	1.5
Regional aid n.e.c. (1)	10.7	4%	8.7	9.3	23.2	1.5
Sectoral aid (2) (3)	**219.0**	**77%**	**198.5**	**242.1**	**247.0**	**188.5**
Total aid less agriculture, fisheries and transport in million €	**285.3**	**100%**	**255.2**	**307.8**	**336.5**	**241.8**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring. (3) The International Business Enterprises scheme benefits various sectors but the exact amounts are unknown for each sector. However, a breakdown of the main sectors in which the benefiting enterprises operate provides a useful indication: 53% services other than transport and communication, 25% transport, communication, 21% construction.

Czech Republic

Year 2004	Annual average years 2000-2003
Population: 10.2 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 62,137 million CZK
GDP: € 79.8 billion	**Total State aid (euro)**: € 1 908 million
GDP per capita: € 7,810 or 15,406 PPS	**State aid as a percentage of GDP**: 2.8 %
Exchange rate: 1€ = 32.059 CZK	**State aid per capita**: € 187 or 386 PPS

State aid legislative, administrative and enforcement framework

The Czech Act on State Aid that entered into force in May 2000 contained the main principles of Community State aid rules. The State Aid Department of the Office for the Protection of Economic Competition (http://www.compet.cz/) exercised ex ante control over all aid (also regional and municipal) granted in the Czech Republic from May 2000 up to accession. Before accession a new Act on the "modification of certain relations in the area of state aid" replaced the previous legal regulation. The decision-making functions of the State aid Section of the Office were wound up on 1 May 2004. The new functions of the Office as the national central coordination, advisory and monitoring unit are to facilitate and accelerate notification contents and procedures; advise Czech State aid providers on the EU State aid rules in individual cases; manage national obligations under the block exemption regulations; collect necessary data and draft regular or ad-hoc reports on State aid and to assume the role of a regular national contact point in working relations with the Commission.

State aid in the years 2000-2003

The Czech Republic granted annually €1 908 million of state aid in the years 2000 to 2003. This represented 2.8 % of GDP or the equivalent of €187 per capita. The relatively high amount of state aid in the Czech Republic can be attributed to the measures taken by the Czech government, mainly in the form of guarantees, to resolve the legacy of the banking crisis of the 1990s. The overall state aid level was highest in 2002 and 2003 due to the increased recourse of these state guarantees.

As a consequence of the rules of the Czech Act on Investment Incentives that foresaw an individual assessment of all fiscal aid awards, the Czech state aid system is based on a considerably large number of ad hoc cases, which made up around 90% of all aid measures prior to accession.

Czech banking crisis

Between 1994 and 1998, the Czech Republic faced a general banking crisis. The Government adopted a series of measures during and after the crisis to enable the creation of a viable, privatised banking sector, and in particular to ensure the rescue and restructuring of several banks and their successful privatisation. These measures included capital injections, transfers of assets, public guarantees, ring-fence agreements and litigation indemnities. The Czech Republic notified some cases under the interim mechanism procedure. To date, the Commission has adopted 15 decisions essentially declaring that the measures were (in technical terms) "not applicable after accession". This means that those measures were granted in their entirety before the accession date, and thus the Commission was neither required nor empowered to assess such measures. These aids cannot be challenged upon the Czech Republic's entry to the EU. Nevertheless, a "not applicable after accession" decision does not necessarily mean that there are no longer any further payments, within the predefined limits, for these aid measures after accession.

As a condition for the provisional closure of the Competition chapter during the accession negotiations, the Czech Republic undertook a commitment to create full transparency with regard to all State aid measures for the Czech banking sector taken in the process of its restructuring. It is worth noting that prior to accession around 15 banks that were granted restructuring aid now cease to exist. Payments from guarantees accumulated to €1 459 million yearly in the period 2000-2003, with the highest amount (nearly €2.4 billion) paid out in 2002. A further €185 million of aid was granted in 2000 in the form of grants and soft loans. Given the exceptional circumstances of the banking crisis inferring the necessary intervention of the state, it is interesting to look at the situation without these payments: state aid would have amounted to €388 million, representing only 0.55% of the GDP during the period under review.

Aid for horizontal objectives

Aid directed towards horizontal objectives amounted to €185 million or 10% of total aid in the observed period. Annually €40 million (2.1 %) was devoted specifically to Czech SMEs. State aid policy also aimed to strengthen R&D activities (2%) and support environmental protection and energy saving (2%).

Regional aid in the Czech Republic

A somewhat higher proportion of horizontal aid was granted under the Guidelines for national regional aid. The figures show €63 million of regional aid corresponding to 3% of total aid over the period under review. The Czech Republic consists of eight NUTS II regions that have a per capita GDP not exceeding 60% of the Community average except for Prague (almost 120%). According to the Community guidelines on national regional aid, the territory of the Czech Republic with the exception of Prague shall be regarded as an area identical to those areas of the Community described in Article 87(3)(a). Therefore the intensity of regional aid must in general not exceed the rate of 50% NGE. The maximum aid intensities vary slightly in the different regions of the country (between 46% in Southwest and 50% in Central Bohemia and Silesia). Prague is an area eligible for Art. 87(3)(c) status and the intensity of regional aid must not exceed the rate of 20% NGE. All ceilings may be raised by 15 percentage points in 87(3)(a) regions and by 10 points in 87(3)(c) regions in the case of aid granted to SMEs.

Sectoral, rescue and restructuring aid

Due to the reasons outlined above, rescue, restructuring and other sectoral aid outweighed all other types of aid. The aid given to these potentially more distortive objectives amounted to an average €1 723 million (almost 90% of total aid) over the period under review. The majority of the rescue and restructuring aid benefited the financial sector: an annual average of €1 520 million or 80% of total aid. Between 2000 and 2003, the steel sector also benefited from an annual average of €75 million of aid as part of a general restructuring plan (see below). Around 2% of total aid (€29 million per year) was granted to the motor vehicle industry while a relatively small amount of closure aid was given to its coal industry in 2002 and 2003.

Aid instruments

State aid in the Czech Republic took mostly the form of guarantees which made up 78% of total aid in the period 2000-2003, followed by grants (12%). Equity participation (6%), tax exemptions (3%) and soft loans (1%) given by the State were used much less frequently.

Existing aid in the Czech Republic

The Czech Republic has 214 existing state aid measures through which it can award aid in future without prior notification to the Commission. 120 of these measures were annexed to the Treaty of Accession while a further 94 were approved by the Commission as existing aid under the interim mechanism. These measures involve mostly regional investment aid in the form of tax exemptions to individual companies and schemes for co-financing the Structural Funds. Some of the measures accepted as existing aid under the interim mechanism were mere modifications to the already listed measures in the Treaty. Some 40 measures are still under assessment.

Transitional arrangements with the Czech Republic

Protocol 2 of the Treaty of Accession sets out detailed transitional arrangements for the restructuring of the Czech steel industry, with the aim of leading to its viability under normal market conditions by the end of 2006. Steel is an important industrial sector in the Czech Republic. Over the last decade, significant restructuring has been achieved, reinforcing the competitiveness of the sector. Despite these efforts, the restructuring process is not yet complete. For this reason, transitional arrangements were negotiated to allow the granting of state aid to specific companies. The maximum amount of state aid under these arrangements is €413 million for the period 1997-2003. An overall productivity comparable to that of other EU countries shall be achieved gradually by 2006 under close monitoring of the Commission. The amount of state aid granted up to the end of 2003 was lower than the maximum agreed ceiling. In the period 1997-2003, the Czech Republic granted a total amount of CZK 12 000 million (€371 million), which is approximately 85% of the Protocol ceiling.

Looking to the future…

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels. However, aid given under existing measures (54 out of a total of 100 measures in 2003), i.e., that are scheduled to continue after 1 May 2004, amounted to €147 million (7% of total aid) in 2003. Of the remaining 93%, 7% was awarded under measures that will not continue beyond accession and 8% was awarded to the steel sector under a transitional arrangement which was phased out in 2003. The future trend in the overall level of aid will depend greatly on the extent to which payments are made from existing guarantee and indemnity measures to the banking sector which accounted for 78% of total aid in 2003. In this context, the Commission would have the authority to assess such aid only if the Czech Republic were to exceed the limits of the already cleared measures under the interim mechanism or if they were to introduce new aid measures.

State aid for horizontal objectives and particular sectors in the Czech Republic, 2000-2003

	Average 2000-2003		2000	2001	2002	2003
	mio €	**% of total**	**mio €**	**mio €**	**mio €**	**mio €**
Horizontal Objectives	**185,0**	**10%**	**120,1**	**153,3**	**228,1**	**238,4**
Research and Development	33,4	2%	24,0	26,7	42,9	40,1
Environment	31,6	2%	39,5	25,1	23,3	38,6
SME	40,4	2%	31,6	34,3	56,8	39,0
Employment aid	9,8	1%	5,8	10,5	15,9	7,0
Training aid	7,0	0%	2,8	3,7	17,6	3,8
Heritage conservation, cultural aid	0,1	0%	0,6	-	-	-
Regional aid n.e.c. (1)	62,6	3%	15,9	53,1	71,5	109,9
Sectoral aid (2)	**1722,8**	**90%**	**1448,6**	**1030,1**	**2632,0**	**1780,3**
Manufacturing	190,9	10%	217,9	189,7	188,6	167,2
of which steel	*74,6*	*4%*	*117,6*	-	*16,7*	*164,1*
of which motor vehicles	*28,6*	*1%*	-	*114,4*	-	-
Coal	0,8	0%	-	-	3,2	0,2
Other Non-manufacturing Sectors	10,9	1%	-	-	3,2	40,6
Financial Services	1520,1	80%	1230,7	840,3	2437,0	1572,4
Total aid less agriculture, fisheries and transport in million €	**1907,7**	**100%**	**1568,7**	**1183,3**	**2860,1**	**2018,7**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring.

Estonia

Year 2004	Annual average years 2000-2003
Population: 1.4 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 113 million EEK
GDP: €8.8 billion	**Total State aid (euro)**: €7.2 million
GDP per capita: €6495 or 10798 PPS	**State aid as a percentage of GDP**: 0.11%
Exchange rate: 1€ = 15.6466 EEK	**State aid per capita**: €5 or 10 PPS

State aid legislative, administrative and enforcement framework

In Estonia, State aid prior to accession was monitored by the State aid and Public Procurement Division within the Ministry of Finance (www.fin.ee). It was regulated by a Competition Act and ten Regulations on special conditions for granting State aid. From 1 May 2004, the State aid chapter of the Competition Act was amended and the ten Government Regulations were repealed. The new provisions in the Competition Act determine the national procedures for co-ordination, preparation and submission of State aid notifications and State aid reports (including summary information on State aid granted under the block exemption regulations) to the European Commission. Since 1 May 2004, the State aid and Public Procurement Division has a co-ordination and advisory role in the field of State aid. Co-ordination of State aid issues in the field of agriculture and fisheries is carried out by the Ministry of Agriculture and in the field of transport by the Ministry of Economic Affairs and Communications.

State aid in the years 2000-2003

Estonia granted annually around €7.2 million of aid in the years 2000 - 2003. This represented 0.11% of GDP or the equivalent of €5 per capita. The aid was granted through 15 State aid measures, of which 11 were schemes and 4 ad hoc measures.

Aid given to horizontal objectives

In 2000-2003 all aid in Estonia was granted exclusively for horizontal objectives. The largest amounts were granted for regional objectives (33% of total aid), heritage conservation and cultural objectives (20%), environmental objectives (15%) and R&D purposes (13%). Aid for heritage conservation and culture totalled annually €1.5 million (20% of total aid) and consisted largely of grants to support the Estonian film industry and for publishing cultural magazines. Environmental aid decreased during the period under review, because the aid was mainly granted through Article 10 of the Pollution Charge Act, which expired on 1 January 2002. In contrast, the aid for R&D objectives increased year by year.

Regional aid in Estonia

Aid for regional objectives amounted annually to €2.4 million of aid in the years 2000-2003. Regional aid was mainly granted via two schemes: a Pollution Charge Substitution Scheme and an Investment support scheme for development and diversification of alternative economic activities in rural areas. Estonia has a per capita GDP that does not exceed 60% of the Community average. All regions are therefore totally eligible for Art. 87(3)(a) status. There are five groups of regions at NUTS III level. For the purposes of drawing up the regional map, the territory is divided into two parts: the NUTS III region of Northern-Estonia and the four remaining NUTS III regions, because the GDP figures in Northern-Estonia are considerably higher than in the other regions. The maximum aid intensity of the eligible costs is 40% in Northern Estonia and 50% in the other regions of Estonia.

Aid instruments

Grants were the most frequently used form of aid instrument making up 69% of total aid, followed by guarantees (17%) and tax exemptions (14%).

Existing aid in Estonia

Estonia has 13 existing state aid measures through which it can award aid in future without prior notification to the Commission. 3 of these measures were annexed to the Treaty of Accession while a further 10 were approved by the Commission as existing aid under the interim mechanism. These aid schemes are earmarked for horizontal objectives such as regional development, R&D, commerce and internationalisation and aid for SMEs.

Looking to the future…

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels. However, by looking at the situation in the last year before accession, 2003, it can observed that 0.7 million (8%) of total aid was awarded under measures that will not continue beyond accession. Aid given under existing schemes, i.e., that are scheduled to continue after 1 May 2004, amounted to €7.7 million (92% of total aid) in 2003.

State aid for horizontal objectives and particular sectors in Estonia, 2000-2003

	Average 2000-2003		2000	2001	2002	2003
	mio €	% of total	mio €	mio €	mio €	mio €
Horizontal Objectives	**7.2**	**100%**	**4.1**	**7.5**	**8.7**	**8.4**
Research and Development	1.0	13%	0.3	0.5	1.2	1.8
Environment	1.1	15%	1.8	2.4	0.0	0.1
SME	0.7	10%	0.0	0.6	1.4	0.8
Commerce	0.6	8%	0.4	0.5	0.3	1.1
Heritage conservation, cultural aid	1.5	20%	1.3	1.1	1.6	1.8
Regional aid n.e.c. (1)	2.4	33%	0.3	2.4	4.2	2.8
Sectoral aid (2)	-	-	-	-	-	-
Total aid less agriculture, fisheries and transport in million €	**7.2**	**100%**	**4.1**	**7.5**	**8.7**	**8.4**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified. (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring.

Hungary

Year 2004	Annual average years 2000-2003
Population: 10.12 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 144 561 million HUF
GDP: € 80.5 billion	**Total State aid (euro)**: € 571 million
GDP per capita: € 7 961 or 13 654 PPS	**State aid as a percentage of GDP**: 1.04 %
Exchange rate: 1€ = 253 HUF	**State aid per capita**: € 56 or 114 PPS

State aid legislative, administrative and enforcement framework

State aid in Hungary has been monitored and controlled by the State Aid Monitoring Office and its predecessor within the Ministry of Finance since 1996 (www.p-m.hu). Due to constitutional concerns against direct applicability of the acquis and the absence of a transposition of Community rules in Hungarian law, the Office was able to base its opinions directly on the substantive State aid rules and give binding opinions only from 1 January 2002, when a bill amending the Act on Public Finance and an implementing decree containing the substantive rules were adopted. From 1 May 2004, the national state aid rules have been modified and the state aid rules of the acquis became directly applicable in Hungary. The Article of the Act on Public Finance defining the notion of state aid was replaced by a reference to Art. 87 of the EC Treaty. A new procedural decree entered into force that aims to maintain the previous notification procedure vis à vis the State Aid Monitoring Office as a national (pre-) control and co-ordination function. The Ministry of Finance where necessary notifies aid measures to the Commission.

State aid in the years 2000-2003

Hungary granted annually €571 million of state aid in the years 2000-2003.[55] This represented 1.04 % of GDP or the equivalent of €56 per capita. This amount was stable during the observed four years, except for a slight increase in 2002 mostly due to a higher appropriation for environmental protection purposes.

State aid system in Hungary

The Hungarian system differs from those of other Member States in that almost all aid is granted through a few so-called earmarked schemes within which aid grantors publish call for applications (sub-schemes). These contain the more detailed rules for granting aid for a specific objective each year. While the number of schemes was between ten and twenty, the number of sub-schemes was over one hundred. Both the major framework schemes taking the form of acts, ministerial or governmental decrees and the sub-schemes are subject to prior notification to the State Aid Monitoring Office. Meanwhile the budgets of the earmarked schemes are established in the Act on the Annual Budget; those of the sub-schemes are determined by the aid granting bodies within the limits of the general scheme. Generally, major schemes remain in force for an indefinite period of time, in contrast to sub-schemes that are renewed every 6 or 12 months with changing objectives and criteria. Ad hoc aid in Hungary can be granted only as a government decision. Aid at local level is granted on the basis of a local decree (scheme) or local decision (ad hoc aid). Previously, fiscal aid was obtained automatically if the criteria of the law were fulfilled. These particularities of the Hungarian system are reflected in the share of ad hoc aid to total state aid which was 6% on average.

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55 The expenditure figure for tax exemptions granted under the Investment tax benefits scheme was estimated for 2003 to be €254 million in 2000 constant prices, due to lack of precise data.

Aid to horizontal objectives

Most of the above-mentioned earmarked schemes were directed towards horizontal objectives amounting to €241 million or 42% of total aid in the observed period. Annually €40 million (7%) was devoted specifically to Hungarian SMEs. State aid policy also aims to foster employment (4%), support environmental protection and energy saving (3%) and strengthen R&D activities (3%).

Regional aid in Hungary

A large proportion of horizontal aid was granted through general economic development schemes. Thus the figures show an annual average of €134 million of regional aid, equivalent to 23% of total aid. Yearly €44 million (8% of total aid) of regional funding came from local governments in the form of tax exemptions.

The whole Hungarian territory is regarded as a region described in Art. 87(3)(a) of the Treaty. The country is made up of three NUTS I level regions, in which 7 NUTS II regions are represented. In five NUTS II level regions large enterprises may be granted aid up to 50% of the eligible costs of initial investment or job creation. There are significant disparities within some regions, notably in Central Hungary and Western Transdanubia. In Budapest, the GDP per capita figure is considerably higher than that of the County of Pest making up the rest of Central Hungary. Accordingly, the aid intensity ceiling for the County of Pest is 40% while in Budapest it is 35%.

Sectoral and Rescue and Restructuring aid

Despite the growing number of schemes directing aid to horizontal objectives, in expenditure terms, sectoral aid still outweighed horizontal aid in the period prior to accession. Aid given to this potentially more distortive objective amounted to an average of €331 million between 2000 and 2003 (58% of total aid). Much of the sectoral aid is made up of tax exemptions allowed under a transitional arrangement that is being phased out (see below). These investment tax benefits accounted for €305 million (53% of total aid) per year, benefiting mainly the manufacturing sector. In 2001, the financial sector also benefited from around €10 million. No rescue and restructuring aid was granted in the period under review.

Sensitive sectors

Some 4% of total aid, i.e. around €22 million per year was granted to the coal mines to moderate the impacts caused by their necessary gradual closure. Hungary also has a fairly small steel industry. In the course of its privatisation, the sector received restructuring aid in the mid-1990s. Following this, no incompatible restructuring aid was granted. Before 2000, uncapped corporate tax exemptions were granted to the motor vehicle industry, which may not have been in line with the Community's Motor Vehicle Regulations. Under the transitional arrangements negotiated by Hungary, the sector may continue to benefit from tax exemptions that are limited to 30% or 20%, depending on the start date of the investment, of the eligible investment costs allowed for large enterprises under the same arrangement.

Aid instruments

Prior to accession, State aid in Hungary took mostly the form of a fiscal instrument. Tax exemptions and other duty relief made up 62% of total aid, followed by grants (37%). Guarantees and soft loans were rarely used.

Fiscal aid

The issue of fiscal aid was discussed at length prior to closure of the Competition Chapter during the accession negotiations with Hungary. Until 1 January 2003, fiscal aid was outside the control of the State Aid Monitoring

Office insofar as it was granted automatically on the basis of provisions included in the Hungarian Act on Corporate Taxes and Dividends. The Act foresaw a number of different fiscal aid schemes (tax breaks) e.g., for so-called high priority regions and entrepreneurial zones. Most of these schemes provided incompatible investment aid (i.e. not limited as a percentage of eligible initial investment costs).

Transitional arrangements with Hungary

The modification of the Act, bringing these schemes into compliance with the *acquis* and the Europe Agreement (i.e. ensuring that no further incompatible benefit was granted) by 1 January 2003, was a pre-condition for the EU agreeing to any transitional arrangements. Consequently, the EU accepted transitional arrangements (1) for the HUF 3 billion and HUF 10 billion investment schemes up to the limit of 75% or 50% of eligible investment cost from 1 January 2003; (2) SMEs, which were granted benefits by 31 December 2002 can retain them up to 31 December 2011; (3) under the off-shore scheme, all individual benefits granted under the scheme by 31 December 2002 have to be fully phased out by 31 December 2005; and (4) for tax exemptions granted by local authorities up to 2% of the net receipts of an undertaking, which is unlikely to surpass the de minimis threshold, until 31 December 2007. The value of these tax exemptions before accession was €350 million yearly (61% of total state aid).

Existing aid in Hungary

Hungary has 39 existing state aid measures through which it can award aid in future without prior notification to the Commission. 21 of these measures were annexed to the Treaty of Accession while a further 18 were approved by the Commission as existing aid under the interim mechanism. These were mostly the 'general earmarked schemes' described above.

Looking to the future…

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels. However, by looking at the situation in the last year before accession, 2003, it can be observed that €67 million (13%) of total aid was awarded under measures that will not continue beyond accession. Aid given under existing schemes (16 out of a total of 22 measures in 2003), i.e., that are scheduled to continue after 1 May 2004, amounted to 28% of total aid in 2003. Finally, a considerable amount of aid (€293 million or 59% of the total) was awarded as investment tax benefits which are set to continue under the transitional arrangements foreseen in the Treaty of Accession. The latter figure implies that aid levels are likely to remain relatively high up to the end of the transitional period but may decrease thereafter.

State aid for horizontal objectives and particular sectors in Hungary, 2000-2003

	Average 2000-2003		2000	2001	2002	2003
	mio €	**% of total**	**mio €**	**mio €**	**mio €**	**mio €**
Horizontal Objectives	**240.6**	**42%**	**164.0**	**242.9**	**332.2**	**223.2**
Research and Development	14.8	3%	7.2	28.0	20.0	3.9
Environment	19.7	3%	17.5	9.7	48.0	3.7
SME	40.0	7%	16.5	41.3	73.6	28.4
Employment aid	22.0	4%	13.3	24.2	26.0	24.4
Training aid	3.9	1%	0.0	0.8	0.6	14.0
Heritage conservation, cultural aid	5.6	1%	-	0.2	7.1	15.3
Risk capital	0.6	0%	-	-	-	2.5
Regional aid n.e.c. (1)	134.0	23%	109.5	138.7	156.9	131.0
Sectoral aid (2)	**330.7**	**58%**	**418.5**	**327.9**	**303.3**	**273.1**
Manufacturing	304.8	53%	393.2	287.5	284.7	253.7
Coal	22.3	4%	25.3	29.8	18.6	15.5
Financial Services	2.4	0%	-	9.8	-	-
Other services	1.2	0%	-	0.9	-	4.0
Total aid less agriculture, fisheries and transport in million €	**571.3**	**100%**	**582.5**	**570.9**	**635.5**	**496.3**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified. (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring.

Latvia

Year 2004	Annual average years 2000-2003
Population: 2.3 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 13 million LVL
GDP: €10.3 billion	**Total State aid (euro)**: €23 million
GDP per capita: €4479 or 9790 PPS	**State aid as a percentage of GDP**: 0.26%
Exchange rate: 1€ = 0,6597LVL	**State aid per capita**: €10 or 21 PPS

State aid legislative, administrative and enforcement framework

Prior to accession, State aid in Latvia was controlled by the State Aid Surveillance Commission, which was set up in 1997. A State aid law on "Control of the State and local government aid to entrepreneurial activity" was adopted in February 1998. As of 1 May 2004, the State Aid Surveillance Commission ceased its decision-making power on State aid cases due to the transfer of competences to the European Commission. However, the State Aid Control Department within the Ministry of Finance (www.fm.gov.lv) continues to work as a contact-point between national aid granting authorities and the Commission. The Department advises national institutions and acts as a filter before notifications on planned state aid measures are sent to the Commission. The Department covers State aid issues regarding the manufacturing sector (including aid to non-Annex I agricultural products) and the transport sector. Due to accession, the Latvian State aid control law was amended in order to be compatible with Community State aid rules. The amended law determines the permissible aid objectives, costs to be supported and maximum aid intensities, as well as national procedures on control of State aid.

State aid in the years 2000 – 2003

Latvia granted annually around €23 million of aid in the period 2000 - 2003. This represented 0.26% of GDP or the equivalent of €10 per capita. The aid was granted through 32 State aid measures, of which 17 were schemes and 15 ad hoc measures.

Aid for horizontal objectives

Aid for horizontal objectives amounted annually to €13 million or 55% of total aid in the period 2000-2003. Around 2% of total aid was granted to SMEs mainly through 9 State aid schemes which had various purposes such as the development of non-agricultural entrepreneurial activities, helping Latvian enterprises to participate in international fairs and exhibitions, consultations for the start-up of entrepreneurial activity, etc.

Regional aid in Latvia

The largest share of horizontal aid (50% of total aid) was awarded to regional objectives, amounting to an average of €12 million per year. Regional aid was to a large extent granted under the law on foreign investments, and via Special Economic Zones and a Free Ports scheme under which manufacturing companies in free zones received tax relief from the immovable property tax and enterprise income tax.

Latvia has a per capita GDP that does not exceed 60% of the Community average (35% in 2002). Latvia is therefore regarded as an area identical to those areas of the Community described in Article 87(3)(a) of the Treaty. There are five regions at NUTS III level for which the maximum aid intensity is 50% NGE. This ceiling can be raised by 15 percentage points in the case of aid granted to SMEs.

Sectoral and Rescue and Restructuring aid

In Latvia sectoral aid accounted for 45% of total aid. It was mainly granted in the form of rescue and restructuring aid to firms in difficulties. The bulk of the €7 million was awarded for the capitalisation of tax debts accrued before privatisation as well as deferred tax provisions for pre-privatisation tax debts that could not be capitalised.

Aid instruments

In the period 2000-2003, grants were the most frequently used form of aid instrument making up 35% of total aid. They were followed by equity participation (25%) and tax exemptions (20%).

Existing aid in Latvia

Latvia has 25 existing state aid measures, through which it can award aid in future without prior notification to the Commission. 6 measures were approved by the Commission as existing aid in the Treaty of Accession and 19 under the interim mechanism. These measures are earmarked for horizontal objectives.

Looking to the future…

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels. However, by looking at the situation in the last year before accession, 2003, it can be observed that €4 million (43%) of total aid was awarded under measures that will not continue beyond accession. Aid given under existing schemes, i.e., that are scheduled to continue after 1 May 2004, amounted to €5 million (57 % of total aid) in 2003. Data for 2003 are provisional.

State aid for horizontal objectives and particular sectors in Latvia, 2000-2003

	Average 2000-2003		2000	2001	2002	2003 (3)
	mio €	% of total	mio €	mio €	mio €	mio €
Horizontal Objectives	**12.9**	**55%**	**14.6**	**18.1**	**10.7**	**8.3**
Environment	0.1	0%	0.4	0.0	0.0	0.0
SME	0.5	2%	0.5	0.5	0.3	0.8
Commerce	0.5	2%	0.5	0.4	1.0	0.1
Regional aid n.e.c. (1)	11.8	50%	13.3	17.2	9.4	7.3
Sectoral aid (2)	**10.5**	**45%**	**31.0**	**9.6**	**0.6**	**0.7**
Manufacturing	10.5	45%	31.0	9.6	0.6	0.7
Total aid less agriculture, fisheries and transport in million €	**23.4**	**100%**	**45.6**	**27.7**	**11.3**	**9.0**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified. (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring. (3) Figures for the year 2003 are provisional.

Lithuania

Year 2004	Annual average years 2000-2003
Population: 3.4 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 121 million LTL
GDP: €17.5 billion	**Total State aid (euro)**: €34 million
GDP per capita: €5079 or 10653 PPS	**State aid as a percentage of GDP**: 0.24%
Exchange rate: 1€ = 3.4518 LTL	**State aid per capita**: €10 or 22 PPS

State aid legislative, administrative and enforcement framework

Prior to accession, State aid in Lithuania was controlled by the Competition Council which was set up in March 1999. The Competition Council did not form part of any Ministry and was therefore operationally independent from all State aid granting authorities. A Law on Monitoring of State Aid to Undertakings was passed on 18 May 2000. On the basis of this law, the Competition Council carried out functions which are now held by the European Commission. The above Law was amended on 15 April 2004 and changed the role of the Competition Council (www.konkuren.lt/english/index.htm) to a co-ordination activity for state aid matters. In compliance with the procedures approved by the Government, it now provides advice to state aid providers and gathers information on state aid for submission to the Commission.

State aid in the years 2000 – 2003

Lithuania granted annually €34 million of aid in the years 2000-2003. This represented 0.24% of GDP or the equivalent of €10 per capita.

Aid for horizontal objectives

Aid for horizontal objectives totalled annually €1.4 million in the period 2000-2003, which represented 4% of total aid. The largest amount (€0.7 million) was granted for commerce and internationalization objectives (2% of total aid) through a scheme: “Partial payment of insurance premiums in export credit”. The purpose of the scheme is to subsidise partially the premiums paid by undertakings for the insurance of export credit (only non-commercial, non-marketable risks are subsidised). A further €0.4 million was granted for R&D activities.

Regional aid in Lithuania

Regional aid amounted to an annual average of €0.3 million in the period 2000-2003. This represented around 1% of total state aid and was mainly granted on an ad hoc basis. There was only one regional aid scheme, which provides tax exemptions for investments in the Klaipeda free economic zone.

Lithuania has a per capita GDP that does not exceed 60% of the Community average and is therefore regarded as an area identical to those areas of the Community described in Article 87(3)(a) of the Treaty. There are 10 regions at NUTS III level in which the maximum aid intensity for granting regional aid is 50% NGE. These ceilings can be raised by 15 percentage points in the case of aid granted to SMEs.

Sectoral and Rescue and Restructuring aid

Aid directed at specific sectors went mostly to the manufacturing sector and amounted annually to €33 million in the period 2000-2003. This accounted for 96% of total aid. Most of the aid went for the rescue and restructuring of ailing firms.

Aid instruments

Grants were the most frequently used form of aid instrument making up 41% of total aid in the period 2000-2003. Guarantees accounted for 28% of total aid, tax exemptions 17% and equity participation 10%.

Existing aid in Lithuania

Lithuania has 16 existing state aid measures, through which it can award aid in future without prior notification to the Commission. 3 of these measures were annexed to the Treaty of Accession while a further 13 were approved by the Commission as existing aid under the interim mechanism. These aid measures are to a large extent earmarked for horizontal objectives.

State aid for horizontal objectives and particular sectors in Lithuania, 2000-2003

	Average 2000-2003		2000	2001	2002	2003 (3)
	mio €	% of total	mio €	mio €	mio €	mio €
Horizontal Objectives	**1.4**	**4%**	**1.2**	**1.5**	**1.3**	**1.5**
Research and Development	0.4	1%	0.2	0.6	0.4	0.3
Commerce	0.7	2%	1.0	0.8	0.5	0.3
Regional aid n.e.c. (1)	0.3	1%	0.0	0.0	0.5	0.9
Sectoral aid (2)	**32.6**	**96%**	**40.0**	**13.0**	**57.4**	**20.2**
Manufacturing	32.1	94%	40.0	13.0	57.4	18.2
Other Non-manufacturing Sectors	0.5	2%	0	0	0	2
Total aid less agriculture, fisheries and transport in million €	**34.0**	**100%**	**41.2**	**14.5**	**58.7**	**21.8**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified. (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring. (3) Figures for the year 2003 are provisional.

Malta

Year 2004	Annual average years 2000-2002
Population: 0.39 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 64.4 million MTL
GDP: € 4.3 billion	**Total State aid (euro)**: € 158.7 million
GDP per capita: € 10,997 or 16,194 PPS	**State aid as a percentage of GDP**: 3.86 %
Exchange rate: 1€ = 0.426 MTL	**State aid per capita**: € 404 or 601 PPS

State aid legislative, administrative and enforcement framework

The concept of State aid was adequately transposed in Regulation 3 of the Maltese State Aid Monitoring Regulation. State aid procedural rules were laid down in the Business Promotion Act[56] and in other secondary legislation. The State Aid Monitoring Board was set up on 30 June 2000 as an independent body within the Ministry for Economic Services and reached full capacity by the second quarter of 2001 (www.mfin.gov.mt). State aid in Malta is granted by virtue of legislation, administrative policy measures and agreements between the beneficiaries and the central Government and its agencies. The main aid grantor is the Malta Enterprise Corporation, whereas no State aid is granted by local governments. State aid legislation was amended in 2004 to reflect Malta's accession. The State aid Board has maintained its monitoring function and is now the point of reference on State aid issues in Malta ensuring that compliance with State aid rules and principles, regarding for example notifications, is maintained in Malta without impinging on matters which are the Commission's competence.

State aid in the years 2000-2002

Malta granted annually €159 million of state aid through around 10 aid measures in the years 2000-2002[57]. This represented 3.86% of GDP or the equivalent of €404 per capita. The Maltese state aid system does not favour either aid schemes or ad hoc measures with each category accounting for around half of total aid. The relatively high level of state aid in comparison to other Member States can be explained by two aid schemes.

Business Promotion Act

Firstly, the manufacturing sector is assisted by means of a scheme of incentives under the Business Promotion Act (BPA), which are mainly of a fiscal nature. The BPA is a framework scheme, containing a number of sub-schemes, most of them aiming to encourage growth in 'promising' manufacturing sectors. Another pursued objective is to provide incentives to encourage the establishment of new manufacturing companies, especially those with the potential to be the catalysts for the introduction of new technologies and know-how in Malta. A part of the scheme grants fiscal incentives to companies licensed to operate in the Freeport (previously Malta Free Ports Act). Most of the Regulations under the BPA were amended before accession and are now mainly in line with the acquis. As part of Malta's transitional arrangements, a few other Regulations of the Act that allow for reduced rates of income tax and operating aid will be kept in force until the end of the period set in the Treaty of Accession even though they don't fully comply with Community state aid rules. Between 2000 and 2002 on average 39% of total state aid was granted under the regulations of the BPA in various forms (reduced rate of income tax, investment tax credits,

56 By Act VI/2001, the former Industrial Development Act and the Malta Freeport Act were renamed and merged into the Business Promotion Act.

57 The observation period in case of Malta was reduced to the years 2000 to 2002 due to late reporting obligations of aid grantors.

soft loans, etc.).

Restructuring of shipbuilding and ship repair sector

Secondly, the acceptance of Malta's request for another transitional arrangement concerning its shipbuilding and repair sector is and will be reflected for the coming years in Malta's relatively high state aid level. Shipbuilding and repair is the biggest individual industrial sector on the island characterised by overcapacity, insufficient financing facilities, increased labour-costs and insufficient productivity levels. In order to restructure the two Maltese facilities that are state-owned and are loss making, a special transitional regime closely monitored by the Commission was agreed upon in the Treaty of Accession. Within the scope of this scheme, Malta is allowed to grant aid up to a maximum overall amount of 419 million Maltese lira (around €984 million) in restructuring aid during the period from 2002 until the end of 2008. Between 2000 and 2002, aid to this sector averaged €81 million per year, representing around half the total aid.

Aid for horizontal objectives

Aid for horizontal objectives amounted to a relatively low €8 million per year or 5% of total aid in the period under review. The objectives aimed by these aid schemes were backing export activities (4%), training of employees (0.5%) and patronizing SMEs (1%). With the amendment of the Business Promotion Act, incentives linked to exports are no longer provided. Moreover, enlarging the types of horizontal objectives, a new scheme supporting the Maltese film industry was introduced from 2003.

Regional aid in Malta

No support was given purely under the Community Guidelines for national regional aid in the period 2000-2002, although Malta qualifies for regional aid in terms of Article 87(3)(a) of the EC Treaty with regional aid intensities for investment aid of 40 % for large companies and 55 % for SMEs as its GDP per capita was 69% of the EU average in 2002. The country has been designated as one region at NUTS Levels I and II and two regions at NUTS Level III consisting of Malta and Gozo-Comino.

Sectoral, rescue and restructuring aid

In contrast to horizontal objectives, sectoral and rescue, restructuring and closure aid constituted a vast 95% of total state aid in Malta between 2000 and 2002 (€151 million per year). This relatively high percentage has to be attributed to the above-mentioned sectoral weaknesses of the shipbuilding industry and fiscal benefits to manufacturing companies. Apart from the shipbuilding and ship repair sectors, Malta does not grant aid to those sectors considered as 'sensitive' in the Union namely coal, steel, synthetic fibres and motor vehicles.

Tourism sector

The tourism sector was another beneficiary of state aid measures in Malta (5% or €9 million per year) in the observation period. The Tour operator support scheme that has been in place since 1986, was phased out during the second quarter of 2004. Its main aim was to provide incentives related to package tours sold by United Kingdom and Irish operators.

Aid instruments

State aid took the form of various fiscal and non-fiscal instruments. Tax exemptions were the most frequently used aid instrument making up 37% of total aid in the period 2000-2002, followed by favourable loans (33%). Grants accounted for 19% of total aid, while guarantees (10%) and tax credits (1%) given by the state were lesser used aid instruments.

Existing aid in Malta

Malta has 11 existing state aid measures through which it can award aid in future without prior notification to the Commission. 6 sub-schemes of the

Business Promotion Act and a cultural aid scheme were annexed to the Treaty of Accession while a further 4 measures were submitted to the Commission as existing aid under the interim mechanism. The latter are still under assessment.

Transitional arrangements with Malta

Malta submitted three transitional requests which after successful negotiations were included in the Treaty of Accession. During a transitional period, SMEs, which were eligible for tax exemptions granted by virtue of the Business Promotion Act, will be allowed to continue to benefit from this aid until the end of 2011, in light of the legitimate expectations created in this respect. For other undertakings, state aid for regional investments can be given up to 75% or 50% of the eligible investment costs. Secondly, operating aid under the provisions of the same Act may be given until the end of 2008 within predefined limits. For the arrangements concerning the ship repair and shipbuilding sector see above.

Looking to the future ...

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels, especially as the latest data refer to 2002. However, by looking at the situation in 2002, it can be observed that €84 million (48%) of total aid was awarded under measures that will not continue beyond accession. Aid given under existing schemes (4 out of a total of 16 measures in 2002), i.e. that were scheduled to continue after 1 May 2004, amounted to only €6 million (3% of total aid) in 2002. A further 4 schemes submitted in 2004, for approval as existing aid, are still being assessed and are therefore not included in the figures. Finally, a relatively high amount of aid (€86 million or 49% of the total) was awarded under the transitional arrangements foreseen in the Treaty of Accession. The latter figure implies that aid levels are likely to remain relatively high up to the end of the transitional period but may well decrease thereafter.

State aid for horizontal objectives and particular sectors in Malta, 2000-2002

	Average 2000-2002		2000	2001	2002
	mio €	**% of total**	**mio €**	**mio €**	**mio €**
Horizontal Objectives	**8.2**	**5%**	**9.4**	**7.5**	**7.6**
SME	1.3	1%	-	1.4	2.5
Commerce	6.1	4%	8.7	5.2	4.3
Training aid	0.8	0%	0.7	0.9	0.7
Sectoral aid (1)	**150.5**	**95%**	**126.7**	**156.8**	**168.2**
Manufacturing	140.7	89%	118.0	146.2	157.9
of which shipbuilding	*81.3*	*51%*	*79.9*	*75.3*	*88.5*
Other Non-manufacturing Sectors	1.2	1%	1.2	1.2	1.1
Other services	8.7	5%	7.4	9.4	9.2
Total aid less agriculture, fisheries and transport in million €	**158.7**	**100%**	**136.1**	**164.3**	**175.7**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring.

Poland

Year 2004	Annual average years 2000-2003
Population: 38.2 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 9937 million PLN
GDP: €189 billion	**Total State aid (euro)**: € 2409 million
GDP per capita: €4 965 or 10 421 PPS	**State aid as a percentage of GDP**: 1.3%
Exchange rate: 1€ = 4,5861PLN	**State aid per capita:** €63 or 127 PPS

State aid legislative, administrative and enforcement framework

The Law on the conditions for admissibility and supervising of state aid for entrepreneurs came into force on 1 January 2001. Prior to accession, State aid in Poland was controlled by the Office for Competition and Consumer Protection (OCCP) (www.uokik.gov.pl/). The OCCP is not linked to any ministry and therefore operationally independent from all aid granting bodies.

As from 1 May 2004 the competence of monitoring state aid shifted from national to Community level. Poland introduced a new Act of 30 April 2004 on the procedural issues concerning State aid[58], which provides guidance on drafting state aid notifications for submission to the Commission. The objective of the Act is to ensure that notifications are prepared in accordance with the Community State aid rules. Co-ordination of the work prior to submitting an aid scheme to the Commission lies with the OCCP President. The Act refers to the procedures to be followed for new aid, existing aid, unlawful aid, recovery of aid, misuse of aid, as well as cases concerning State aid before the Courts. The Act also regulates the issue of reporting on State aid granted to enterprises in Poland. The entities granting aid and their beneficiaries have an obligation to report regularly to the President of the OCCP on all cases of awarded State aid. The President of the Office must then inform the Commission of the aid.

State aid in the years 2000 – 2003

Poland granted annually around €2.4 billion of aid in the years 2000 - 2003. This represented 1.29% of GDP or the equivalent of €63 per capita.

Aid to horizontal objectives

Aid for horizontal objectives totalled annually €577 million and accounted for 24% of total aid. It was made up largely of aid for regional objectives (11% of total aid) and employment objectives (7%).

Employment aid amounted annually to €158 million in the period 2000 – 2003. A significant proportion of employment aid was earmarked for the rehabilitation of working persons with disabilities. In most Member States, employment measures fall under the category of 'general measures'. However, in this case, the measure qualifies as State aid due to the discretionary power enjoyed by the aid awarding authorities.[59]

During the period under review, relatively lower amounts of state aid were granted for other horizontal objectives such as environment (annually around €54 million), training (€54 million), R&D (€24 million), and SMEs (€18 million). It is expected in the coming years that environmental aid will increase, because Poland is allowed to grant investment aid to achieve standards for which a transitional period has been agreed. This transitional

[58] Journal of Laws No 123, item 1291

[59] See Chapter 2.4 of the Scoreboard Spring 2004 update on the difference between general measures and state aid measures for employment purposes

arrangement was approved on the grounds that private companies have considerable investment costs in order to achieve EU environmental standards. The duration of the aid is limited to the transition period while the aid intensity is limited to the regional aid ceiling (30-50%) with a 15% supplement for SMEs.

Regional aid in Poland

Almost half the regional aid, totalling on average €269 million per year, consisted of tax exemptions awarded to undertakings, mainly under the law on special economic zones. Under the Special Economic Zones Act of 1994, companies located in the zones could be granted tax exemptions, which constituted operating aid. On 1 January 2001, the Act was modified and brought into line with the EU acquis regarding regional investment aid so that the tax exemptions are limited to a percentage of the initial investment costs. However, Poland requested a transitional period for those companies, which had acquired rights under the old incompatible scheme up to 2017. After successful negotiations, these tax exemptions were allowed until the end of 2011 in the case of small enterprises and until the end of 2010 in the case of medium-sized enterprises. As for large companies, the aid is limited to a maximum of 75% or 50% of the eligible investment costs depending on the date when the company obtained its zone permit.

The entire territory of Poland is regarded as an area identical to those areas of the Community described in Article 87(3)(a) of the Treaty. None of the 16 regions at NUTS II level in Poland exceeds 60% of GDP per capita. Accordingly the aid intensities (NGE) are as follows:
50% for 40 regions at NUTS III level,
40% for the regions of Wroclaw, Cracow, Gdansk-Gdynia-Sopot,
30% for the regions of Poznan and Warsaw.

These ceilings can be raised by 15 percentage points in the case of aid granted to SMEs.

Sectoral, rescue and restructuring aid

Around 76% of total aid was aimed at specific sectors or awards of ad hoc aid. The coal sector received annually €1.34 billion of State aid in the period 2000 - 2003, which accounted for 56% of total aid in Poland. It is worth noting however that by far the largest amount was granted in 2003 (provisional figure of €3.88 billion). A large proportion of this aid (€1.65 billion) in 2003 was granted to current production while the remainder was directed to general restructuring of the whole sector.

Over the period 2000-2003, Poland granted on average €122 million to its steel sector, which made up 5% of total aid. However, the annual average of € 122 million is rather misleading as the largest amount was granted in 2003 alone (provisional figure of €458 million). Aid for rescue and restructuring companies in difficulty accounted for more than 13% of total state aid.

Aid instruments

The most frequently used state aid instruments in Poland during the years 2000-2003 were tax exemptions (34% of total State aid) followed by grants (32%) and guarantees (23%).

Existing aid in Poland

Poland has currently 25 existing state aid measures, through which it can award aid in future without prior notification to the Commission. 7 of these measures were annexed to the Treaty of Accession while a further 18 were approved by the Commission as existing aid under the interim mechanism. In addition, some measures proposed under the interim mechanism are still being assessed.

Transitional arrangements

According to the Treaty of Accession, Poland has transitional arrangements in three areas: state aid for restructuring of the steel industry, fiscal aid in special economic zones and state aid for environmental protection (see description above and Annex I).

State aid for horizontal objectives and particular sectors in Poland, 2000-2003

	Average 2000-2003		2000	2001	2002	2003 (3)
	mio €	% of total	mio €	mio €	mio €	mio €
Horizontal Objectives	**576.8**	**24%**	**1186.8**	**392.2**	**344.3**	**383.8**
Research and Development	24.4	1%	23.5	22.6	30.9	20.7
Environment	53.8	2%	83.3	22.6	35.6	73.8
SME	18.4	1%	1.5	12.7	27.7	31.5
Employment aid	157.7	7%	452.2	68.5	46.0	64.0
Training aid	53.7	2%	-	117.1	84.1	13.8
Regional aid (1)	268.8	11%	626.3	148.7	120.0	180.1
Sectoral aid (2)	**1832.5**	**76%**	**578.0**	**1285.7**	**1022.4**	**4443.7**
Manufacturing	487.9	20%	197.5	589.8	604.4	559.9
of which steel	*121.6*	*5%*	*21.0*	*7.0*	-	*458.4*
Coal	1337.2	56%	351.2	695.9	417.9	3883.8
Other non-manufacturing sectors	7.3	0%	29.3	-	-	-
Total aid less agriculture, fisheries and transport in million €	**2409.2**	**100%**	**1764.8**	**1677.9**	**1366.7**	**4827.5**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified. (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring. (3) State aid figures for 2003 are provisional.

Slovenia

Year 2004	Annual average years 2000-2003
Population: 1.99 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 30 432 million SIT
GDP: € 25.5 billion	**Total State aid (euro)**: € 139 million
GDP per capita: €12 795 or 17 240 PPS	**State aid as a percentage of GDP**: 0.69%
Exchange rate: 1€ = 239 SIT	**State aid per capita**: € 70 or 100 PPS

State aid legislative, administrative and enforcement framework

In Slovenia, systematic monitoring and controlling of the allocation of state aid has been in place since 1997. In 2000, the State Aid Control Act was adopted together with its implementing regulations. Since February 2000, the control of state aid has been carried out by the Commission for the Monitoring of State aid (www.gov.si/mf/), an independent body whose members were appointed by the government. Expert, technical and administrative tasks were carried out for the Commission by the Sector for Monitoring of State Aid at the Ministry of Finance. Moreover, the system to control state aid granted by local authorities in Slovenia by means of reporting or preliminary control was set up in 2002.

After accession

This legislation ceased to exist upon accession when the Community state aid rules became directly applicable. The national state aid regulation was replaced by a corresponding legal act entering into force. On the date of accession the responsibility for the control of state aid was transferred from the national State Aid Control Commission to the European Commission. Accordingly, the national State Aid Control Commission was dissolved. In order not to lose the considerable knowledge built up in previous years, the State Aid Control sector continues to play a role in state aid issues and to represent the control, information and coordination point for the Slovenian administration. The staff continues to give support to different Ministries and grantors of state aid in preparing notifications as well as giving opinions on block exemption matters and collecting state aid data.

State aid in the years 2000 – 2003

Slovenia granted annually around €139 million of aid in the years 2000-2003. This represents 0.69% of GDP or the equivalent of €70 per capita. Significantly higher amounts in the years 2000 and 2001 can be partly explained by a state aid scheme for restructuring the steel sector. Around €35 million of aid, primarily in the form of guarantees, was granted in these years to the steel industry for restructuring the sector which was completed in 2001. In 2003 aid grew slightly, particularly within horizontal objectives. On average 90% of the aid was given under schemes, while €14 million was awarded under ad hoc measures.

State aid to horizontal objectives

Aid for horizontal objectives amounted to €102 million or 73% of total aid in the period 2000-2003. Environmental aid, largely in the form of tax exemptions, accounted for 17% of total aid. R&D measures made up 16% of total aid and employment and training activities 23%.[60]

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[60] As the rules for the Slovenian Active employment policy scheme and the measures for co-financing education in form of general and special training offer higher benefits to specific sectors or groups of employees, they partially constitute state aid, which is fairly exceptional within aid measures for these objectives. See Chapter 2.4 of the Scoreboard Spring 2004 update on the difference between general measures and state aid measures for employment purposes.

Regional aid

Aid for regional objectives amounted to €9 million or 7% of total aid in the period under review. Slovenia as one single region reaches 70% GDP per capita of the Community average. This means that the whole area of Slovenia can be treated as one NUTS II level region eligible under Article 87(3)(a) whose per capita GDP is higher than 60% but lower than 75% of the Community average where regional aid may be granted up to 40% NGE. The exception is Central Slovenia (the Ljubljana region), for which the proposed ceiling is limited to 35% NGE as the GDP per capita reaches 96% of the Community average.

Sectoral and Rescue & Restructuring aid

In the years 2000-2003 sectoral and rescue, restructuring and closure aid constituted 27% of total state aid (€37 million). This relatively high percentage can largely be explained by the above-mentioned restructuring program within the steel sector as well as closure aid for the coal mining sector which represented 7% of total aid. All state aid was allocated to the re-employment of miners within the scope of the program of gradual closure of coal mines.

Aid instruments

Grants were the most frequently used aid instrument making up 46 % of total aid in the period 2000-2003, followed by tax exemptions and relief from the payment of social security contributions (33%). Capital investments and conversions of debt into equity participation accounted for 11% of total aid, while favourable loans (6%) and guarantees (4%) given by the state were the least frequently used aid instruments.

Existing aid in Slovenia

Slovenia has 36 existing state aid measures through which it can award aid in future without prior notification to the Commission. 15 of these were annexed to the Treaty of Accession. These aid measures were generally schemes earmarked for horizontal objectives, particularly for environmental protection and investments, stimulation of development of certain regions (Zasavje and Posocje) and promotion of audiovisual media productions. A significant number of schemes were designed to restructure or gradually close mining activities (see above) and boost employment. A further 21 measures were approved by the Commission as existing aid under the interim mechanism. They mostly covered adjustments to the schemes already listed in the Treaty of Accession as existing aid. One example is a scheme designed for financing programs and measures for stimulating entrepreneurship and competition for the years 2002-2006, boosting SMEs, R&D activities and specific regions. This scheme alone amounted to around €20 million in 2003, representing 17% of total aid.

Looking to the future…

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels. However, by looking at the situation in the last year before accession, 2003, it can be observed that €36 million (31%) of total aid was awarded under measures that will not continue beyond accession. Aid given under existing schemes (23 schemes out of a total of 43 measures), i.e., that are scheduled to continue after 1 May 2004, amounted to 69% in 2003.

State aid for horizontal objectives and particular sectors in Slovenia, 2000-2003

	Average 2000-2003		2000	2001	2002	2003
	mio €	% of total	mio €	mio €	mio €	mio €
Horizontal Objectives	**101.7**	**73%**	**128.8**	**102.2**	**82.1**	**93.6**
Research and Development	22.2	16%	19.8	21.0	22.1	25.7
Environment	23.1	17%	13.2	25.2	22.9	31.2
SME	12.4	9%	22.9	11.6	6.8	8.5
Employment aid	28.9	21%	64.2	20.1	16.5	14.6
Training aid	2.5	2%	2.1	3.1	2.6	2.0
Heritage conservation, cultural aid	0.7	1%	-	-	0.4	2.4
Natural disasters	2.5	2%	2.0	4.8	3.3	-
Regional aid n.e.c. (1)	9.4	7%	4.5	16.3	7.4	9.2
Sectoral aid (2)	**37.2**	**27%**	**42.2**	**69.8**	**15.0**	**21.7**
Manufacturing	26.9	19%	30.8	69.6	0.5	6.5
of which steel	*8.8*	*6%*	*3.8*	*31.4*	-	-
Coal	9.7	7%	11.4	0.2	14.4	12.9
Other services	0.6	0%	-	-	0.0	2.2
Total aid less agriculture, fisheries and transport in million €	**138.8**	**100%**	**171.0**	**172.1**	**97.1**	**115.3**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring.

Slovak Republic

Year 2004	Annual average years 2000-2003
Population: 5.4 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 5022 million SKK
GDP: €25 billion	**Total State aid (euro)**: €118 million
GDP per capita: €6052 or 11370 PPS	**State aid as a percentage of GDP**: 0.47%
Exchange rate: 1€ = 40.296 SKK	**State aid per capita**: €22 or 51 PPS

State aid legislative, administrative and enforcement framework

Prior to accession, State aid in Slovakia was controlled by the State Aid Office (SAO), a body set up under the State Aid Act in the year 2000. The drafting of State aid legislation belonged under the competence of the Ministry of Finance. The State Aid Act regulated the granting of State aid for a wide range of horizontal and sectoral objectives. Upon accession, Slovakia amended this Act. State aid is now directly regulated by the relevant Community State aid rules. The Office of State aid Assistance was dissolved upon accession though the competences and some employees were transferred to the Ministry of Finance. The current State Aid Act defines the position and competences of the state administration in the State aid area and sets out the responsibilities for State aid (including de minimis aid) providers.

State aid in the years 2000 – 2003

The Slovak Republic granted annually around €118 million of aid in the period 2000-2003. This represented 0.47% of GDP or the equivalent of €22 per capita.

Aid for horizontal objectives

Aid for horizontal objectives totalled €29 million, which accounted for 24% of total aid. The largest proportion of horizontal aid was granted for regional objectives which amounted to an annual average of €20 million during the period under review. Around €4.4 million was granted for R&D with a further €1.6 million for environmental and energy saving objectives.

Regional aid in Slovakia

The Slovak Republic consists of three regions, in which GDP per capita does not exceed 75 % of the Community average (Western Slovakia 45%, Central Slovakia 42% and Eastern Slovakia 39%) and of one region, in which GDP per capita in PPS is 98% of the Community average (the region of Bratislava). According to the guidelines on regional national aid, the first three regions are regarded as areas identical to those areas of the Community described in Article 87(3)(a) of the Treaty. Therefore the maximum aid intensity is 50% NGE in there regions. The region of Bratislava is regarded as an area identical to those areas of the Community described in Article 87(3)(c) of the Treaty and the maximum regional aid intensity is 20% NGE. These ceilings can be raised by 15 percentage points in the case of aid granted to SMEs.

Sectoral, rescue and restructuring aid

Aid for sectoral objectives totalled annually €89 million and accounted for 76% of all aid. Aid for the steel sector, which made up 46% of total aid, is likely to continue in the coming years, because the Slovak Republic requested a transitional period to protect fiscal aid granted for ten years under the Act No 366/1999 on Income Tax to foreign investors in the steel sector. The aid can be granted only until the end of 2009 or when the aid reaches a pre-determined amount. A further 31% of sectoral aid was granted to the motor vehicles sector. This sector, too, is likely to receive state aid in the coming years due to a similar 10-year transitional period to protect tax exemptions granted under the Act No 192/1998 to beneficiaries in the motor-vehicle manufacturing sector. This fiscal aid can be granted only until the end of 2008 and the aid is limited to a maximum of 30% of the eligible investment costs.

Aid instruments

Tax exemptions were the most frequently used form of aid instrument making up 72% of total aid in the period 2000–2003. Guarantees accounted for 17 % and grants 10% of total aid.

Existing aid in the Slovak Republic

Slovak Republic has currently 71 existing state aid measures, through which it can award aid in future without prior notification to the Commission. 9 of these measures were annexed to the Treaty of Accession while a further 62 were approved by the Commission as existing aid under the interim mechanism. In addition, some measures proposed under the interim mechanism are still being assessed.

Transitional arrangements

Two transitional arrangements were included in the Treaty of Accession, one for the steel sector, the other for the motor vehicle sector (see description above and Annex I).

Looking to the future ...

Due to a number of measurement difficulties set out in section 1.3.1, it is not possible to provide an accurate forecast of future aid expenditure levels. However, by looking at the situation in the last year before accession, 2003, it can be observed that €9 million (8%) of total aid was awarded under measures that will not continue beyond accession. Aid given under existing schemes, i.e., that are scheduled to continue after 1 May 2004, amounted to €12 million (11 % of total aid) in 2003. Finally, a considerable amount of aid (€95 million or 81% of the total) was awarded under fiscal measures for the steel sector and motor vehicle manufacturing and which are continuing under the transitional arrangements foreseen in the Treaty of Accession. This implies that aid levels are likely to remain relatively high up to the end of the transitional period but may well decrease thereafter.

State aid for horizontal objectives and particular sectors in the Slovak Republic, 2000-2003

	Average 2000-2003		2000	2001	2002	2003
	mio €	%	mio €	mio €	mio €	mio €
Horizontal Objectives	**28.7**	**24%**	**66.4**	**12.0**	**14.7**	**21.5**
Research and Development	4.4	4%	8.1	4.9	4.0	0.7
Environment	1.6	1%	6.5	0.0	0.0	0.0
SME	1.4	1%	4.9	0.7	0.0	0.0
Commerce	0.8	1%	0.0	0.0	0.3	3.0
Heritage conservation, cultural aid	0.6	1%	0.7	0.0	1.8	0.0
Regional aid (1)	19.7	17%	46.2	6.4	8.6	17.8
Sectoral aid (2)	**89.3**	**76%**	73.5	119.2	69.8	94.9
Manufacturing	69.8	59%	49.2	70.7	64.3	94.9
of which steel	41.1	35%	18.2	46.3	37.1	62.8
Coal	3.1	3%	4.3	4.9	3.4	0.0
Other non-manufacturing sectors	9.2	8%	20.0	14.7	2.1	0.0
Financial Services	7.2	6%	0.0	28.9	0.0	0.0
Total aid less agriculture, fisheries and transport in million €	**118.0**	**100%**	**140.0**	**131.1**	**84.5**	**116.5**

Note: All figures are expressed in euros at 2000 constant prices so that the effects of inflation are removed. (1) Aid for general regional development not elsewhere classified (2) Aid for specific sectors awarded under measures for which there was no horizontal objective as well as aid for rescue and restructuring.

Bulgaria

Year 2004	Annual average 2000 - 2003
Population: 7.8 million	**Total State aid less agriculture, fisheries and transport (national currency):** 187 million BGN
GDP: € 19.6 billion	**Total State aid (euro):** € 89 million
GDP per capita: € 2,515 or 6,975 PPS	**State aid as a percentage of GDP:** 0.6%
Exchange rate: 1€ = 1.9593 BGN	**State aid per capita:** € 11 or 37 PPS

Source: Bulgarian Annual Reports on State aid 2000-2003

Over the period 2000-2003, total State aid (less agriculture, fisheries and transport) in Bulgaria amounted on average to €89 million, the equivalent of 0.6% of GDP or €11 per capita. Around 76% of the aid was earmarked for sectoral objectives. The relatively large share of aid granted to seven companies in the coal and ore mining sector (32% of total aid) has aimed at the restructuring, privatisation and closure of ineffective production in the Bulgarian coal mining industry. Aid to the manufacturing sector also constitutes a significant share of total aid. A large proportion of this aid covers the difference between the cost and retail prices fixed by the Government and was mainly granted to 17 district central heating companies.

Romania

Year 2004	Annual average 2000 – 2002
Population: 21.7 million	**Total State aid less agriculture, fisheries and transport (national currency)**: 36.377 billion ROL
GDP: € 55.9 billion	**Total State aid (euro):** € 1,111 million
GDP per capita: € 2,576 or 6,850 PPS	**State aid as a percentage of GDP:** 3,3%
Exchange rate: 1€=41,071 ROL	**State aid per capita:** € 50 or 181 PPS

Source: Romanian Annual Reports on State aid 2000-2002

Over the period 2000-2002, total State aid (less agriculture, fisheries and transport) in Romania amounted on average to €1.1 billion, the equivalent of 3.3% of GDP or €50 per capita. Sectoral aid, including rescue and restructuring, represented on average 67% of overall aid. Around 30% was allocated to the restructuring and privatisation of the Romanian steel sector, which itself accounted for the exceptionally high level of aid granted in 2001. A further 25% was granted for other rescue and restructuring purposes. On average, horizontal objectives, including regional aid, accounted for 33% of overall aid. Almost all horizontal aid was granted under general schemes to enhance privatisation, modernisation, investment and production.

ANNEX III: FOLLOW-UP TO COUNCIL CONCLUSIONS ON STATE AID

The following summaries of national contributions are provided in addition to the material provided in Section 2.2.

Specific efforts to reduce and redirect aid

Denmark contends that its industrial strategy concentrates on improving the general environment and growth conditions of firms, rather than on helping individual firms directly. For example, in food, agriculture and fisheries the annual appropriations for R&D projects (under the Innovation Act) have been falling steadily. Up to 2003, a subsidy was given to a number of associations providing specialised agricultural advice. In 2004 the subsidy was cut back, in line with the Government's policy of reducing direct subsidies to trade and industry and placing the emphasis instead on improving the general business environment. In this case, the saving of €13 million made in 2004 was reflected in a corresponding reduction in land taxes for all farmers.

Portugal also draws a distinction between different types of State aid, arguing for example, that operating aid, which by its nature is likely to cause greater distortion to competition, ceased many years ago to form part of panoply of new state aid measures in Portugal. At the same time, economic and social cohesion is a central objective of state aid policy. This is reflected in the fact that the large majority of existing aid schemes include a regional objective.

France has opted for budgetary restrictions as a way of meeting the commitment to reduce State aid. With the exception of aid for R&D and SMEs, a good many budget appropriations for operations have been either frozen or revised downwards. Instead, France is pursuing a policy broadly based on the development of research and on support for SMEs. More specifically, support for enterprises today has two strategic focal points: First, the stepping-up of aid for research and innovation will take the form of increased public involvement in the emergence and development of "competitiveness poles". The aim is to provide back-up, through better coordination and a concentration of funds on innovation and training, for cooperative and multidisciplinary projects which will have the biggest positive impact on the industrial and scientific base. The increase in the number of industrial accidents is inducing the French authorities to consider redirecting aid towards the employment zones hardest hit by industrial change, an approach justified on grounds of national solidarity and social and territorial cohesion.

In Spain, most of the programmes currently under way in, for example, the Madrid Autonomous Region have a horizontal content, with innovation being a key factor when evaluating projects. To qualify for aid, SMEs must carry out projects that do not fall within their normal activities, and there must be a lower component of investment aid relative to aid for activities not funded by companies' current expenses. Specifically in relation to innovation aid, re-targeting is being achieved through restrictive criteria which are being tightened each year in order to phase out aid for projects in which the element of "innovation" may start to become obsolete or has already substantially penetrated the market. For example, aid for implementation of ISO 9000 quality standards has not been granted in the last two years since implementation of these standards is now regarded merely as a market requirement rather than an innovative initiative.

Improvements to national State aid set-up

In Spain, the recently adopted "General Law on Subsidies"[61] establishes a single legal framework for state aid as well as making several significant improvements to the current legislative framework. For example, it introduces general improvements in the procedures for managing and controlling state aid,

[61] Law 38/2003 of 17 November 2003. Official State Gazette No 276, 18.11.2003.

clearly defines fraudulent practices and establishes a system of sanctions for such practices; it also aims to improve the instruments for evaluating the effectiveness of the aid. One intention is to draw up strategic plans in the medium term to ascertain the effects of the aid policy and thus determine the priorities for optimising use of the resources, which will make it easier to evaluate the effect of state aid on the budget. The Law also defines the basic principles of the aid policy stipulating that "when the objectives that have been set affect the market, their aim must be to correct clearly identified faults and their distortionary effects must be kept to a minimum".

The DTI (Department for Trade and Industry) in the United Kingdom has carried out a recent review of Business Services. The aim of the Review was to restructure the manner in which DTI business support services were organised, to rationalise the current business support schemes and close those which were unnecessary or not achieving their desired results.[62] The new business support structure consists of a small number of horizontal products organised in themes that reflect the DTI's strategic priorities, which are aimed at addressing demonstrable market failures and which should also create a more transparent, accessible and understandable system for the Department's end customers. This approach should also lead to an increase in the proportion of aid given for horizontal objectives. In a similar vein, the Netherlands reports that attempts are being made to streamline as many schemes as possible in order that the panoply of aid instruments is more easily accessible for users and more transparent.

Belgium has recently introduced a series of legislative changes and economic policy changes which support policies of reduction and redirection as well as ensuring greater effectiveness and better coherence among various policies. For example, the reform of the Economic Expansion Acts for the Walloon Region was finalised in 2004[63]. Among the decrees adopted were stricter requirements for aid to large firms, increased incentives for SMEs making it easier for them to obtain aid, incentives to promote environmental protection and more lasting use of energy. The Act also foresees improved infrastructure for hosting economic activities, with provision being made in particular for the demarcation of special use areas such as science parks, the establishment of telecommunications infrastructures, incubators, etc. The reform therefore has the twofold aim of reducing the overall level of aid – mainly to large firms – and of shifting the focus to horizontal aid (SMEs, the environment, etc.), as well as being designed to ensure greater effectiveness on the part of aid and better dovetailing between Walloon business policies. The Flemish region has also reviewed its economic aid policy concluding that "the roles of, and the division of responsibility between, government and the other economic actors is changing considerably. In today's society, government has mainly an activating and framework-setting role, which stimulates stakeholders to implement community interests." This requires government action that uses new types of policy instrument such as measures to support life-long learning in firms and other forms of aid to improve entrepreneurship.

In France, the Government intends to develop tools making it possible both to increase familiarity with, and hence keep under control, aid measures implemented by local and regional authorities and to delegate responsibilities to those authorities. A new law on local freedoms and responsibilities[64] provides that the regions should draw up each year both a quantitative and a qualitative review of aid granted in their territory by all local and regional authorities. These censuses are designed to enable local and regional authorities and the State to better assess the effectiveness of the economic intervention tools used and hence to refocus them in a more coordinated and more strategic direction, the aim being, not to grant aid, but to act in a targeted manner in support of actions which shape the economic development of France.

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62 By 2002, there were around 180 separate schemes and projects operating in support of business in the UK.

63 New legislation on economic growth has also been adopted by both the Flemish Government and the Brussels Region.

64 Number 2004-809, adopted 13 August 2004 and published in the Official Journal in France n°190 of 17 August 2004, p.14545 (c.f. Article 1).

The Slovak Republic reported on how it has set the implementation and development of the objectives of the Lisbon strategy as one of its priority tasks. It has defined the following instruments, including among the objectives the continuation of a state aid policy aimed at reducing the volume of state aid granted in Slovakia: reform of public finances and of the public sector; a fiscal policy based on three pillars, transparency (i.e. timely, accurate and complete information on ongoing public finance processes), responsibility and increased efficiency.

Poland has included a programme to re-target State aid towards horizontal objectives in its National Development Plan for the years 2004-2006. In this respect, State aid shall be directed at the strengthening of competitiveness of enterprises through the support of research and investments serving the innovativeness and improvement of products and services. The aid, hitherto concentrated on large state-owned enterprises, shall primarily be granted to SMEs which conduct innovatory activities. Such efforts will continue in the National Development Plan for 2007-2013, during which aid directed to individual sectors of the economy is expected to decrease.

The Ministry of Economy in Lithuania contends that one of the main reasons for the success of state aid given so far is “the thorough and appropriate evaluation of projects that have been considered for funding, as well as careful monitoring during the course of the project.” This can be illustrated by the success of many firms which have participated in the Eureka[65] projects.

The Estonian Competition Act imposes an obligation on all State aid grantors to ensure transparency and monitor the effectiveness of State aid. The Ministry of Finance as the co-ordinating body on State aid issues in Estonia has planned to deal with this matter in the near future.

Slovenia has set up a system to monitor and allocate state aids, to ensure transparency and to measure the effectiveness and efficiency of State aids. In this context, the Slovenia Government has recently introduced a set of “instructions” to help in the assessment of each aid measure. These include defining the precise aims of the aid and a series of indicators as well as carrying out an annual evaluation. The first results of this evaluation exercise are expected by mid-2005.

As pointed out in particular by Cyprus, the competent authorities when drafting new measures “have been largely guided by the experience gained from the implementation of previous measures and the feedback from the beneficiaries of such measures.” They have also been willing to take into consideration the views and suggestions of organisations representing the interests of beneficiaries and other interested parties such as the Employers and Industrialists Federation, the Cyprus Chamber of Commerce and Industry, etc.

Improving transparency and raising awareness

Spain has also taken concrete steps to improve transparency and now obliges aid grantors to make this aid public. The new General Law on Subsidies (see above) provides for the State Public Accounts Department to create a national database in order to make aid more effective, prevent the cumulation or concurrent granting of different aid schemes and facilitate planning, monitoring and follow-up measures. This will provide the economic players with more information on aid and enhance aid control and effectiveness by making it easier to eliminate the aid schemes with the most adverse effects on free market conditions. Among the new Member States, Slovenia reports on recent work to build up a detailed database of all State aid measures and of the obligation on aid grantors to ensure transparency.

The United Kingdom described its proactive approach to raising awareness of and local expertise in State aid. The aim of these activities has been “to increase wider knowledge of the State aid rules, help them to build consideration of the State aid rules into the design of their schemes at the earliest

65 EUREKA (European research, development and cooperation programme)

possible stage and to encourage/assist aid administrators to find approaches to their projects which are in harmony with the Government's policy on reorientation and reduction of State aid". In practice, this entails providing advice to officials in various departments and offices to assist them in designing aid schemes so that, wherever possible, they either do not contain State aid or may be incorporated within the State aid block exemptions. Where this is not possible assistance is provided in the notification of aids. In addition, the Government operates training and awareness raising activities.

Improving the effectiveness of aid

Work in Finland has focussed primarily on developing a qualitative evaluation of aid. In Finland evaluating aid programmes is a statutory duty. This means that the authorities have an obligation to monitor the conduct of aid programmes and to have evaluations carried out to report on the objectives of the aid and its effectiveness. A long-term objective is to standardise evaluation practices and, as far as possible, introduce a common monitoring system for the different authorities. One related project is the project launched by the Government Institute for Economic Research entitled "Taxation, State Aid and Business Conditions". The research focuses on the real competitiveness of the Finnish economy and the key factors influencing it. The purpose is to map changes in the structure of business and production as well as the processes of privatisation. The focus is on using what powers the public authorities have to improve real competitiveness through economic and industrial policy and business taxation. The aim is also to analyse the trend in business aid granted by the State and its effectiveness.

Greece is in the process of developing a methodology for assessing the effectiveness of aid and its contribution to the improvement of the competitiveness of the Greek economy. The Ministry of Economic Affairs and Finance, which is responsible for monitoring state aid, is at the stage of commissioning a study of the subject.

In the United Kingdom, the appraisal of all Government spending (whether this constitutes State aid or not) is a fundamental part of the policy development process. This is written into both Departmental funding systems and HM Treasury's advice to Departments and wider Government ("The Green Book: Appraisal and Evaluation in Central Government[66]. These formal appraisal processes ensure that, before resources are granted, the rationale, objectives and proposed methodologies of all support measures have been scrutinised. This helps ensure that the design of the instrument is such that both the likelihood of success of the instrument and value for public money are maximised. The appraisal protocols also require ongoing monitoring and evaluation of the support instruments so that, should they be seen not to be achieving their expected results, the reasons for this can be examined and any necessary changes made.

[66] http://www.hm-treasury.gov.uk/Economic_Data_and_Tools/greenbook/data_greenbook_index.cfm