BRIEFING NOTE ON HOW THE COMMITTEE CAN INFLUENCE ANY DECISION ON WHETHER TO ALLOW NORTHERN IRELAND AN EXTENSION OF REGIONAL AID FOLLOWING 2013

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BACKGROUND

Briefing Note on how the Committee can influence any decision on whether to allow NI to retain Assisted Area status within the Regional Aid Guidelines issued following the end of December 2013. This should include information on how decisions are made and by whom, whether any other exceptions are being considered, how and through whom the Committee may influence any decision.

SUMMARY

Changes to the rules around Regional Aid for the post-2013 period will have significant implications for the scale and nature of support that government can offer businesses in Northern Ireland (NI). Regional Aid is currently the dominant mechanism for providing financial assistance with 72% of assistance to undertakings in NI being delivered within its parameters.

NI continued to benefit from Regional State Aid for the period of 2007-2013 due to a special dispensation granted on the basis of its 'particular circumstances'. These included the high level of aid received in the preceding period and the EU Commission's broad agenda not to derail economic progress by removing funding too soon. This process followed 'extensive lobbying, including representations from the Secretary of State Peter Hain… both in the UK and in Brussels.'[1] By the time the new Regional Aid funding period starts in 2014 however, NI will have been in receipt of progressively lower levels of funding, so this mode of leverage will be less effective.

The Commission is only involved in two stages of the process. It determines the level of coverage allocated to the UK in relation to the rest of the EU, and it drafts the guidelines which determine general regional eligibility. Final determinations remain with the national governments in respect of those areas which retain Assisted Area status.

Currently the UK position regarding Regional Aid post-2013 has not been determined. Furthermore, the Commission has not yet started *formal* consultations with Member States to establish the changes which will take place. However, informal consultations are ongoing at the European level. It is difficult to ascertain precisely how much influence could be brought to bear in Brussels, but the main

[1] Department of Enterprise, Trade and Investment, News Release, 15th February 2006. http://archive.nics.gov.uk/eti/060215i-eti.htm

focus could be on gaining a sense of the direction the Commission is taking in this policy from DG Competition officials. Critically however, in the area of Regional Aid, London remains the best venue for NI lobbying efforts.

INTRODUCTION

The EU's overarching position is that any undertaking[2] which receives government support and obtains an advantage over its competitors has the potential to distort competition between Member States; contrary to the workings of the internal market. From this absolute position exemptions occur when justified by general economic development. To ensure that this prohibition is respected and exemptions are applied equally across the EU, the Directorate General (DG) for Competition within the European Commission is in charge of monitoring compliance with State Aid rules.

The determination as to whether a company has received State Aid is established if the support meets the all following criteria:

- there has been an intervention by the State or through State resources
- competition has been or may be distorted;
- the intervention confers an advantage to the recipient on a selective basis, for example to specific companies or sectors of the industry, or to companies located in specific regions;
- the intervention is likely to affect trade between Member States.

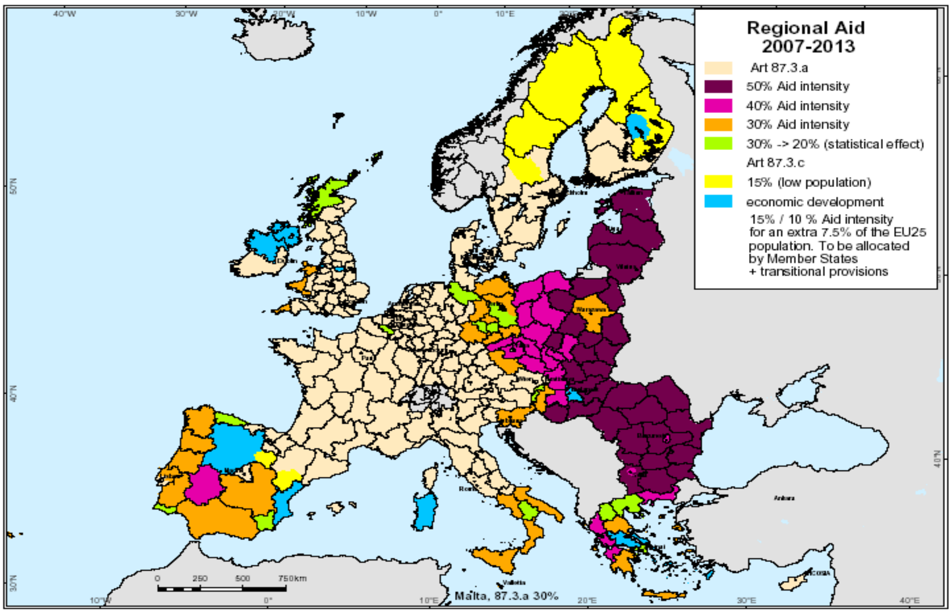
State Aid can relate to either sectoral or horizontal objectives. While sectoral State Aid regulations relate to specific areas, horizontal State Aid engages objectives which apply across the economy and are aimed at solving problems that may arise in any industry or any country. A full list of the various types of State Aid can be found in Annex A. Trends appear to be moving away from sectoral State Aid to its horizontal counterpart.

Article 87(3)a and Article 87(3)c of the Treaty of Amsterdam, 1997[3] enunciate the bases upon which Regional Aid may be granted by Member States to promote the economic development of certain disadvantaged areas. Regional Aid consists of aid for investment granted to companies and is targeted at specific regions to redress inter-regional disparities.[4] It can be used as assistance for 'investment in the setting up of a new business, the expansion of an existing business or business diversification of new products.[5]

One of the main benefits of Regional Aid for NI is 'the increased scope for financial assistance to industry'[6] due to higher maximum aid intensities compared to other forms of State Aid covering Research and Development and Innovation (R&D&I) and Training. This is valuable in attracting both foreign direct investment and capital

[2] Undertakings are defined by the Commission as private and public organisations that are involved in economic activities
[3] Now known as Articles 107(3)(a) & 107(3)(c) of the Treaty on the Functioning of the European Union (TFEU)
[4] Guidelines on National Regional Aid for 2007-2013 (2006/C54/08) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:054:0013:0044:EN:PDF
[5] Independent Review of Economic Policy (DETI and Invest NI) 'Independent Review of Economic Policy. September 2009. p.44
http://www.irep.org.uk/Docs/report.pdf
[6] Ibid, footnote No.20

investment for expanding indigenous companies. Currently within NI Regional Aid accounts for 72% of the total State Aid assistance, compared to 10% for R&D&I, 9% for Training and 3% for SME. The low figure for SME aid reflects the reality that SME tends to be approved under Regional Aid Rules because of the potential for higher aid intensities.



Based on EUROSTAT statistics of 7.4.2005 (GDP in PPS per Capita 2000-2002 Avg) / Cartography: DG COMP - G1 12/2005 / © EuroGeographics for the administrative boundaries

REGIONAL AID RULES

Regional Aid through the derogation in 87(3)(a) is granted to promote the economic development of regions where the standard of living is considered to be 'abnormally low'[7] or there is serious underemployment 'in relation to the Community as a whole'[8]. The Commission recognises these conditions as being fulfilled if a region has a per capita gross domestic product (GDP) of less than 75% of the Community average. As seen in the above map, East Germany and the new accession states to the east primarily benefit from this form of Regional Aid.

The derogation in 87(3)(c) is wider in scope and allows the Commission to authorise aid intended to further the economic developments of areas which are disadvantaged in relation to the national averages, without being restricted by the economic conditions laid down in 87(3)(a)[9]. **Selection of eligible regions for this derogation is normally undertaken through a two-step process which consists of, first, the determination, by the Commission, of the maximum population coverage to qualify for aid in each member state, and, secondly, the selection of eligible regions through a variety of criteria.**

The Commission allowed a degree of flexibility in the determination of which regions could become Assisted Areas through measures for 'statistical effect regions'.[10] These measures represent recognition that some areas may fall outside the statistical parameters of 87(3)(a) because of EU enlargement, rather than any

[7] Guidelines on National Regional Aid for 2007-2013 (2006/C 54/08) para. 15,
[8] Case 248/84, *Germany v Commission* [1987 ECR 4013, para 19]
[9] Ibid
[10] Guidelines for National Regional Aid, Section 3.3

economic progress in real terms. The figures from the time show that 75% of the average EU-15 GDP per capita corresponded to 82.2% of the average EU-25 GDP per capita.[11] This meant that regions so affected would be eligible for Regional Aid on a transitional basis to ensure past progress was not undermined by too rapid change.

Northern Ireland qualified for Regional Aid for 2007-2013 as it had benefited, within the period of 2000-2006, from Regional Aid intensities similar to that of regions which qualified for the Article 87(3)(a) derogation. As such, Northern Ireland was considered an economic development region and would receive continued assistance, albeit at a lower basic level of 30%. The average will decrease further to 15% on 1/1/2011, with Belfast dropping to 10%.

This was an extremely favourable outcome for NI. For example this scheme meant that Belfast, as a Nomenclature of Units for Territorial Statistics (NUTS) III region, was eligible for aid despite failing to meet the eligibility criteria, with a GDP above the EU-25 average and an unemployment rate below the recommended 115% of EU-25 average.

Table 1: NI NUTS III Regions' unemployment against the EU average in 2007.

Name	GDP Average. EU 25 = 100	Unemployment EU 25 = 100
Belfast	161.4	86.5
Outer Belfast	76.0	55.8
East of NI	87.2	45.7
North of NI	74.3	96.3
West and South of NI	71.4	72.3

Source: European Commission United Kingdom Regional aid map 2007-2013

In accordance with paragraph 49 of the Regional Aid Guidelines, general aid ceilings for large enterprises can be increased by 10% for medium sized enterprises, those with fewer than 250 employees, and 20% for small enterprises, those with fewer than 50 employees.[12] This affords considerable potential for Government intervention but will be subject to lower limits from next year.

Table 2: Aid Intensity Breakdown by NUTS III Area and Enterprise Size

Regional Aid Intensity Ceiling (%)						
	Jan 2007 to Dec 2010			Jan 2011 to Dec 2013		
	Large	Med	Small	Large	Med	Small
Belfast	30%	40%	50%	10%	20%	30%
Outer Belfast East of NI North of NI West and South of NI	30%	40%	50%	15%	25%	35%

Source: European Commission, Regional Aid Guidelines 2007-2013

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[11] Ibid. footnote 23

[12] European Commission, State aid N 673/2006 – United Kingdom Regional aid map 2007-2013 http://ec.europa.eu/competition/state_aid/regional_aid/2007_2013/n673_06_united_kingdom_en.pdf

RULES GOVERNING INTERACTIONS BETWEEN TIERS OF GOVERNMENT REGARDING STATE AID

The 'Concordat between the Department of Enterprise, Trade and Investment and The Department Of Trade And Industry'[13] (renamed the Department of Business, Innovation and Skills, BIS) provides a framework for the working arrangements between our devolved assembly, central government and the European Union, on State Aid matters.

This document states that relations with the EU remain the responsibility of the UK Parliament and Government. Specifically, BIS coordinates UK policy input to the Commission on State Aid, provides advice on the application of the State Aid rules, and assists Regional Development Agencies (RDAs) and devolved administrations with all State Aid notifications to the Commission.'[14] Within the context of State Aid this means that BIS 'considers the needs of those parts of the UK/GB which will be affected'[15] and DETI is informed and consulted about the proposals before they are made public. DETI then has an opportunity to respond to BIS so that its views may be' taken into account when formulating UK policy.'[16]

These rules extend further still and articulate the rules governing communications between the DETI and the European Commission stating:

> *'DETI will channel communications with the European Commission on State aid issues through [BIS]'s State Aid Policy Unit, which in turn is responsible for onward transmission to UKREP in Brussels (UKREP is responsible for onward transmission to the EC). Such communications may, for example, concern … **developments in Commission policy towards particular types of aid**… Informal contacts between DETI and the Commission are of course not excluded but they should be discussed and agreed with [BIS]'s State Aid Policy Unit and UKRep beforehand to ensure that there is **consistency of approach, in the best interests of the aid concerned**.'* [17]

It should be noted however that the Concordat is a voluntary arrangement between the DETI and BIS, and does not create legal obligations or restrictions on either party.[18]

WHERE TO INFLUENCE?

When embarking on the first of its responsibilities within the Regional Aid decision-making process the Commission determined the eligible national population coverage for aid so that total aid levels remained within the determined limits agreed by Member States and the European Council. 'Lesser and better' aid was the Commission's guiding principle in the last process which also represented the UK's

[13] Concordat between the Department of Enterprise, Trade and Investment and the Department of Trade and Industry; http://www.bis.gov.uk/files/file33009.doc
[14] Ibid p.4
[15] Ibid
[16] Ibid
[17] Ibid p.5
[18] Ibid p.2

position. A target was set that less than 42% of the overall EU population living within regions should be receiving aid.

The Commission has previously issued *Guidelines on National Regional Aid* as a guiding document after a period of consultation and would be expected to do so for the decision in 2014. This document sought to frame the criteria for selection of eligible regions and enunciate the budgetary ceilings for the national decision-making process. This document, in 2007-2013, offered comparative flexibility as to which regions could be nominated for Regional Aid funding under Article 87(3)(c).

NI was uniquely identified at an early stage as a region which should qualify for funding following extensive lobbying in the years running up to 2007, in both London and in Brussels, by NI Department officials and the NI Secretary of State. Extended Assisted Area status was given, but strictly due to NI's previous levels of aid, and despite its relative prosperity. The Department of Trade and Industry, as it was then, justified this decision on the basis of the particular circumstances of NI including;

- The unique difficulty in terms of spatial targeting;
- The boundary with Borders Midland and Western region of the Republic of Ireland. These areas qualified for continuing coverage on the economic criteria and NI's settlement was very similar to their's. This was due to the potentially distortive effect of disparities upon competition in the border areas ; and
- The fact that Northern Ireland is 'currently eligible for an aid intensity of 40%, higher than any other region of the UK.'[19]

In the end, provided they respect the conditions set out in the Commission's guidelines, it is ultimately the responsibility of national level government to decide whether they wish to grant Regional Aid, and up to what level, as part of a well-defined regional policy.[20] Subsequently, NI was defined an economic development region, which is an area of a Member State that is 'disadvantaged in relation to the national average.'[21] It is therefore useful to examine how the UK government regarded other economic development regions in the previous determination of assisted areas under Article 87(3)(c) in preparation for the 2007-2013 period with a view to how they may approach the next period.

National government undertook its own consultation process in the build up to its final decision on the extent to which economic development areas would be eligible. Respondents outside of South Yorkshire and Merseyside, the areas affected, were 'overwhelmingly'[22] against full funding. They preferred instead 'to use discretionary coverage in a way that would have the strongest impact in promoting our domestic objectives on growth, productivity, skills and jobs.'[23] As a result, Regional Aid was allocated to those areas with the greatest need and opportunity. The UK government proposed specific wards within these regions to receive aid, based upon the 'same objective assessment as the rest of the country.'[24] This restricts the ability to government to target the funds autonomously, and the ability of companies to direct

[19] The Department of Trade and Investment, Review Of The Assisted Areas Stage 2 – The Government's Response and Draft Assisted Areas Map, July 2006 http://www.berr.gov.uk/files/file32025.pdf
[20] Ibid para 22.
[21] Case 248/84, *Germany v Commission* [1987] ECR 4013, paragraph 19.
[22] Review of Assisted Areas, Stage 2, p.12
[23] Ibid
[24] Ibid, p.13

resources anywhere in the region. Importantly, merely falling within the definition of an economic development region has been insufficient for Assisted Area status alone, rather further objective criteria had to be met.

The indicators which determined those regions which were eligible were also subject to the national consultation. Four indicators were established.

- Employment Rate
- Adult Skills – level 2 or above
- Incapacity Benefit claimants
- Manufacturing share of employment – as an indicator of the opportunity to use the flexibility.

Eligibility was determined when a region was either one standard deviation worse than the UK average on any one of these indicators, or half a standard deviation worse than the UK average on any two of these indicators.

This highlights an avenue that could be potentially pursued with the UK Government. Previous audits have shown that the greater Belfast area is substantially more prosperous than the rest of NI, with a GDP per capita twice as high as any other NUTS III area in Northern Ireland.[25] Smaller regional units within the North, West and South of NI could still be considered as falling within the indicators of the objective economic criteria. Critically, the determination as to whether smaller units would receive funding lies with the national government and as such; the best opportunity to influence the debate is through continuing to work closely with the UK government in the development of this policy area. Gaining concessions for NI may prove to be a significant challenge as the official UK position towards regional funding from Europe is that funding should go to 'less prosperous Member States'[26] rather than poorer regions within more affluent States.

One area which could potentially be pursued by the Committee in its engagement in Brussels regarding Regional Aid is that of working groups. These groups are populated by civil servants from Member States who determine the broad framework of particular policies areas. Such a working group will be established for the determinations over Regional Aid in the run up to 2014. Typically, the UK representatives are from the national level, but given that Regional Aid primarily impacts devolved regions, the Committee may wish to seek further involvement of regional representatives with first hand knowledge of policy implementation.

OTHER FORMS OF HORIZONTAL STATE AID

R&D&I: This includes all measures and programmes providing aid for R&D and Innovation by, or on behalf of, companies. The financing of non-commercial R&D or Innovation activity is not normally considered to be a State Aid, and allowable costs include salaries, equipment and costs of services. Under the State Aid rules for 2007-13, a wide range of aid intensities are allowed, depending on the nature of the research, the size of firm and the degree of collaboration.

[25] Further information on the NUTS hierarchy is in Annex B
[26] HM Treasure, 'Global Europe: vision for 21st centure Europe.' June 2008 http://ec.europa.eu/budget/reform/library/contributions/pgs/20080619_PGS_89.pdf

Table 3: Aid Intensities for R&D Project Aid (% of costs)

	Through to December 2013
Large firms	25-50
Medium firms	35-60
Small firms	45-70

Source: Independent Review of Economic Policy, 2009

The potential problem posed by R&D&I aid is that large multinationals have a tendency to prefer their Research operations to take place in close proximity to their central operations. Therefore, this mechanism may not be particularly useful in promoting foreign direct investment to NI.

Training: This accounted for just under 9% of State Aid in NI in 2007. Aid is permitted to reduce training costs borne by the firm and, in terms of general training, the maximum aid intensities range from 60-80% of costs – depending on the size of firm. With regard to firm-specific training, the range is much lower at 25-45%. Again however, it operates as a relatively weak incentive for inward investment due to its specificity.

The Independent Review Panel were firmly of the view that changing Regional Aid rules will have significant implications for the scale and nature of support that government can offer businesses in NI. Regional Aid is currently the dominant mechanism for providing financial assistance and is likely to be severely restricted over the next few years. The Review identified the limits in place for R&D&I as 'much more generous, and less likely to be reduced in reforms to state aids, given the objectives of the Lisbon strategy to promote R&D throughout the member states.'[27] The prospect that funds are more likely to be available for R&D&I than for other investment projects after 2013 is consistent with its broader objectives to realign economic development policy around Innovation and R&D.

However, it also recommended that DETI and other relevant departments commence work on a case for retaining Regional Aid limits 'highlighting the special cases for the retention'[28], but that such investment, up until, and potentially beyond 2013 should be focused in support of Innovation and R&D in light of its broader recommendations for the NI economy.

WHO TO SPEAK TO?

Commissioner Johannes Hahn has the political responsibility for regional policy and Mr Dirk Ahner is the Director General of DG Regio. The DG Competition is in charge of the State Aid arm of the EU. The Commissioner is Joaquin Almunia, and the Director General is Alexander Italianer.

Another useful contact from a NI point of view is Ronnie Hall within DG Regio. Mr Hall is from NI but now works for the Commission permanently. He will be a useful conduit in trying to establish current Commission thinking on the future of Regional Aid more generally for 2014+.

[27] Independent Review of Economic Policy, September 2009, p.47
[28] Ibid p.135

ANNEX A: THE VARIOUS FORMS OF STATE AID[29]

Exemptions to the Prohibition on State Aid

Sectoral-Specific State Aids

- Audiovisual production
- Broadband
- Broadcasting
- Coal industry
- Electricity (stranded costs)
- Fisheries
- Postal Services
- Shipbuilding
- Steel Synthetic fibres - Motor vehicles industry
- Transport

Horizontal State Aids

- Aid to disadvantaged and disabled workers
- Training aid
- Regional aid
- Research and Development and Innovation
- Environmental aid
- Risk capital
- Rescue and restructuring aid
- SMEs

Interventions which would be classified as a State Aid

State aid within the scope of Article 87(1) examples:

- State grants;
- interest rate relief;
- tax relief;
- tax credits;
- State guarantees or holdings;
- State provision of goods or services on preferential terms;
- direct subsidies;
- tax exemptions;
- preferential interest rates;
- guarantees of loans on especially favourable terms;
- acquisition of land or buildings either gratuitously or on favourable terms;
- provision of goods and services on preferential terms;

[29] Department of Business, Enterprise and Regulatory Reform, The State Aid Guide: Guidance for state aid practitioners. October 2007 http://www.bis.gov.uk/files/file42032.pdf

- indemnities against operating losses;
- reimbursement of costs in the event of success;
- State guarantees, whether direct or indirect, to credit operations preferential re-discount rates;
- dividend guarantees;
- preferential public ordering;
- reduction of, or exemption from, charges or taxes, including accelerated depreciation and the reduction of social contributions;
- deferred collection of fiscal or social contributions;
- assistance financed by special levies;
- capital transfers;
- certain State holdings in the capital of undertakings.

Less obvious examples where State aid might arise include:

- consultancy advice;
- advantages resulting from the activities of agencies for urban renewal;
- assistance to help companies invest in environmental projects;
- assistance to help a public enterprise prepare for privatisation;
- legislation to protect or guarantee market share;
- public private partnerships and contracts not open to competitive tendering;
- Receipt of landfill tax credit funding.

Surprising examples of State aid:

- free advertising on State owned television;
- infrastructure projects benefiting specific users.

ANNEX B: THE UK'S NUTS HIERARCHY[30]

NUTS (Nomenclature of Units for Territorial Statistics) areas are used by Eurostat, the European Commission's Statistical Office, for presenting regional and local statistics. In the UK, there are five hierarchical levels, built up from local government administrative units as follows:

UK NUTS hierarchy

Level	Northern Ireland	England	Scotland	Wales
Nuts 1	Northern Ireland	Government Office Regions	Scotland	Wales
Nuts 2	Northern Ireland	Counties or groups of counties	Combinations of council areas, LECs and parts thereof	Groups of unitary authorities
Nuts 3	Groups of district council areas	Counties or groups of unitary authorities	Combinations of council areas, LECs and parts thereof	Groups of unitary authorities
LAU 1 (formerly NUTS 4) Districts or unitary	District council areas	authorities	Combinations of council areas, LECs and parts thereof	Unitary authorities
LAU 2 (formerly NUTS 5)	Electoral wards	Electoral wards or divisions	Electoral wards or, rarely, parts thereof	Electoral divisions

MAY 2010

[30] Guide to Regional and Local Labour Market Statistics
http://www.statistics.gov.uk/downloads/theme_labour/Guide_regional_local_lms.pdf