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State aid control in the context of other community policies

EXECUTIVE SUMMARY

This supplement discusses the Commission's policy in relation to state aids. It shows clearly that the Community's competition policy is profoundly influenced by other policy objectives in such diverse fields as protection of the environment, industrial policy and regional development. In every aid case, the Commission is obliged to assess : (a) whether the aid addresses a Community objective laid down in Article 92, (b) whether the aid is an appropriate means for contributing to the achievement of that objective, and (c) whether the beneficial effects of the aid outweigh the damage which may be caused by distortion of competition.

For the sake of consistency and transparency, the Commission has adopted a number of guidelines and frameworks which specify the criteria to be applied in carrying out such assessments and impose certain limits on the level of aid which may be granted according to the objective of the aid, the region concerned and other relevant circumstances. These frameworks or guidelines therefore have to address a matrix of problems. For example, the Community objectives of promoting SMEs, reducing regional disparities and restoring the balance between demand and supply in "sensitive" sectors are common threads which run through almost all of the state aid rules.

However, the relationship between competition policy and other Community policies is reciprocal. In order to maintain economic efficiency, the other policies have to be implemented in such a way as not to give rise to excessive distortions of competition. The Community recognises, for example, that the goals of industrial policy cannot be achieved without an effective competition policy. The new Article 130 of the EC Treaty, which introduces explicit industrial policy goals into the Treaty, stipulates that Community action in this field must be *"in accordance with a system of open and competitive markets"* and that *"This Title shall not provide a basis for the introduction by the Community of any measure which could lead to a distortion of competition"*.

During the period 1980–1990, covered by the Commission's three surveys of state aids, there was a declining tendency in the total volume of aid. However, the economic climate has changed since the beginning of the 1990s, with the accession of the new German Länder, the recession and tougher international competition. In this context the pressure on Member States and on the governments of non-member countries to adopt more interventionist policies is increasing. For these reasons, it is very important for the Commission to remain vigilant in order to counter the danger of a relapse, both at home and abroad, into covert protectionism by means of state aids.

INTRODUCTION

The use of subsidies as a policy instrument may hurt economic welfare by introducing distortions between enterprises within one sector, between sectors, regions or countries. However modern industrial economics has stressed the point that in the presence of market failures subsidies can, in theory, restore efficiency. Decisions on subsidies therefore require both theoretical and empirical evaluation.

Surveillance and control of State aids have from the beginning of the Communities been transferred to the Community level. The concept of state aid in the Treaty of Rome is very broad and covers not only direct grants, but also low rates of interest, deferment of tax liabilities, and in general any gratuitous advantage. In principle, State aids which distort trade between Member States, are forbidden unless a derogation is accorded specifically. To allow effective control, the Member States have to notify the Commission of measures which could constitute State aid. However, the application of these principles has required a large body of derived legislation, in particular Commission guidelines. These guidelines can be divided into two main categories: horizontal and sectoral.

For those subsidies which are subject to Community rules, the Commission has by means of surveys on State aids published in 1988, 1990 and 1992 established a degree of transparency.

I. THE HARMFUL EFFECTS OF STATE AIDS

Subsidies are an instrument by which public authorities influence behaviour by changing the relative prices which producers, consumers and suppliers of factors of production face. The effects of subsidies can be classified in the following main groups : changes brought about in the conditions of competition within a given product market, shifts in the allocation of resources between products or factors of production, competition between regions, the impact on public finances and the reactions of trading partners.

1. Changes in the conditions of competition

It is obvious that, by artificially improving the competitive position of certain enterprises, a subsidy can enable them to increase or maintain their market shares at the expense of other enterprises which do not benefit from aid. The conditions of competition are altered even if the subsidy is not reflected in the price of the product; the competitive position of a firm is also strengthened, for example, if an aid enables it to pursue a more aggressive strategy or reduce its indebtedness. As a consequence, more efficient firms can be forced to limit their output to sub-optimal levels or, in extreme cases, even to withdraw from the market. The competition effects of subsidies can therefore have important macroeconomic implications by reducing economic efficiency and hence total output (GDP).

At this point it is interesting to note that an analogy can be drawn between state aids and anti-competitive behaviour by firms. If, as a result either of inadequate anti-trust mechanisms or of deliberate government policy, firms are able to indulge in anti-competitive practices in their home markets (e.g. forming cartels or abusing dominant market positions), the effects are in many ways similar to those of an aid, with the difference that the costs are borne by the firms' customers rather than the taxpayers. Imports into the home market may be restricted and the firms' ability to penetrate other markets will be strengthened. Hence, there is a clear need for Community control not only over aid under Articles 92 to 94 EEC but also over anti-competitive practices by firms under Articles 85 to 87 and over mergers under the Merger Regulation.

In carrying out its duties under Articles 92 to 94 of the EEC Treaty, the Commission is concerned only with the aids which create or threaten to create distortions of trade between Member States. Trade distortion is primarily cross-border competition distortion, although it may also result from a shift in resource allocation, e.g. when a subsidy increases the consumption of a domestically-produced product at the expense of an imported substitute.

The restriction of the scope of the Commission's authority to state aids which create trade distortions is unlikely in practice to exclude any major aids, since economic integration in the Community has already reached an advanced level and is still progressing. A much more significant restriction on the Commission's powers is the stipulation in Article 92(1) that the state aid rules apply only to aids which favour "**certain** undertakings or the production of **certain** goods", i.e. that measures which apply equally to all firms in all sectors and regions are not subject to control. Such measures would include, for example, generally applicable national rules on corporate taxation or employers' social security contributions[1].

2. Shifts in resource allocation

Under Articles 92–94 EC the Commission therefore has to focus on aids which favour individual firms or firms in specific sectors or regions and which distort intra-Community competition or threaten to do so. If we focus too narrowly on the competition issues, however, we may overlook the implications of state aids for **resource allocation** and thus, perhaps, underestimate the dangers which subsidies present for economic efficiency. Resource allocation is affected when a subsidy results in over-production and over-consumption of a given product as compared to an ideally efficient economy. For example, if we subsidise coal, this has repercussions on the levels of production, consumption, employment and investment in all other parts of the energy sector. It may be argued that a coal subsidy is needed to compensate for distortions in other parts of the energy market which give an unfair advantage to other energy sources. However, to use the subsidy instrument rather than to deal directly with the original distortions is to introduce a new distortion which artificially increases the consumption of energy in general.

Subsidies can also distort the allocation of factors of production. For example, many aids are granted for fixed investment rather than labour. Capital-intensive firms will tend to receive a large share of such aids, which may also encourage more labour-intensive firms to increase their capital/labour ratios to sub-optimal levels.

[1] If the Commission considers that these measures cause important distortions, it may make proposals for harmonisation under Articles 100–102 EC.

3. Impact on public finance and income redistribution

From the macro-economic point of view, the control of state aids also has a place in the efforts to achieve economic and monetary union. State aids represent a small but not insignificant proportion of public spending in Member States (averaging 4.3% in the period 1988–1990). Member States therefore have an interest in limiting aid expenditure as part of the general effort to restrain budget deficits and public debt in order to meet the convergence targets which are a precondition for monetary union under the Maastricht Treaty.

Another aspect which should not be neglected, although it is primarily the concern of the Member States rather than the Commission, is the question of equity. The granting of state aids is a form of income redistribution (from the taxpayers to the beneficiaries of the aid). Ideally, therefore, Member States should scrutinise each of their aids carefully to determine whether the aid and the additional tax needed to finance it bring the economy closer to or further away from the politically desirable distribution.

4. Uncontrolled competition between regions

Community control of state aids is also important in the context of the Community's objective of achieving economic and social cohesion. In uncontrolled competition between regions of the Community to influence enterprises' choice of location, there would be a tendency towards a general "bidding up" of levels of regional aid as public authorities come under pressure to match or surpass the aid granted in other areas. In such a contest, the more prosperous Member States would always be able to outbid the less developed Member States. The priority objective of economic and social cohesion requires therefore a strict control of State aid in the most prosperous areas. The impact of aid approved for the development of the less favoured regions has not to be offset by large amounts of aid distributed in richer areas.

5. The reaction of trading partners

In the context of the Community's relations with its trading partners, it is an important task of the Commission to keep a close watch on the subsidies being granted to enterprises by non-Community countries. However, it is also necessary to give careful consideration to the danger that certain aid measures within the Community may provoke retaliatory action and to take account of the Community's obligations under international agreements. Several such agreements, to which the Community is a party, contain provisions on the granting of state aids. These include the General Agreement on Tariffs and Trade, the OECD Understanding on export credits, the Europe Agreements with Eastern European countries and the agreement on the European Economic Area.

Articles 61–63 of the latter agreement transpose the main state aid rules of the Community to the EEA level, so that the Commission is now obliged to consider the impact of aids on competition throughout the Area. In the EFTA countries which are parties to the agreement, the competition rules are enforced by the new EFTA Surveillance Authority, which also has to consider the interests of the whole Area.

II. JUSTIFICATIONS FOR AID AND INDUSTRIAL POLICY

The foregoing discussion has concentrated on the disadvantages of state aids. However, since perfect competition is a theoretical construct rather than a reality, there are cases where strong arguments can be put forward in support of government intervention. Many of the arguments in support of State aid are precisely the same as those which are advanced more generally in favour of government intervention under the heading of "industrial policy". Indeed, throughout the Community state aids are a significant instrument for achieving the goals of industrial policy, especially in the following fields : support for "infant industries", research and development, vocational training, small and medium-sized enterprises, industrial restructuring. These arguments can be classified under the general heading of market imperfections.

The most commonly mentioned type of market imperfection occurs in the presence of externalities. Externalities are said to exist when an activity undertaken by an individual or firm has a spill-over effect on others which is not properly reflected in the market prices. There is therefore a difference between the private costs and benefits, which determine the individual activities, and the costs and benefits from the point of view of society as a whole. These external effects may be negative or positive.

An obvious example of a **negative externality** is air or water pollution. In the absence of an effective system for applying the "polluter-pays" principle, e.g. through regulation, taxation or tradable emission licences, the only feasible way to reduce pollution may be to offer subsidies for less-polluting products or production methods.

As examples of **positive externalities** we can take research and development or vocational training. Unless a firm undertaking R&D can completely protect all the results of its work, there are likely to be some spill-over benefits for other firms. When assessing the costs and benefits of a research proposal, however, the firm will not take these spill-overs into account. Consequently, the total R&D effort is likely to be less than the social optimum. Similarly, the vocational training efforts of an individual firm increase the total pool of skilled labour available to other firms. At the limit, some firms can be total "free riders" in this respect, relying on attracting skilled labour from other employers while spending nothing on training. Other firms, finding that the benefits which they derive from training their personnel do not correspond to the costs, may reduce the resources allocated to training. In such cases, therefore, there may again be a justification for subsidies, perhaps financed by para-fiscal levies.

Market imperfections also exist because of uncertainty. **Perfect information** is never available about the present and future prices of all goods and factors of production. Uncertainty means risk and risk-averse financial markets will be biased against new activities ("infant industries") where the degree of uncertainty is high. They will also be reluctant to invest in an activity if the projected pay-back period is long, because uncertainty increases with time. As a result, it can be argued that such activities would not be sufficiently undertaken without government intervention, particularly in the form of subsidies. However, the effective use of subsidies in such situations requires that government should possess better information and greater foresight than private lenders and investors, in other words, that government should be good at "picking winners". In the words of Paul Krugman : "It is in fact easy to offer a justification for industrial policy... The difficult questions are how to implement such a policy in practice, and how to manage the political economy of such a policy in such a way us to avoid the usual mistakes".

This problem of imperfect information and risk-averse financial markets has also been identified as one of the major problems besetting **small and medium-sized enterprises**. SMEs often have difficulty in raising finance because they can offer less security to lenders than big firms and because reliable information about their past performance and future prospects is less readily available. Consequently, for example, banks may consider that the cost of carrying out a thorough appraisal of an SME's loan application is simply not justified by the amount of new business involved. Because of their limited administrative resources, SMEs may also suffer from a lack of information about their existing and potential markets, or the possibilities for linking up with other firms. Assistance to SMEs has therefore become an important element in the industrial policies of the Community and the Member States.

Finally, we should mention the market imperfections which can be classified under the general heading of **imperfect mobility of factors of production.** The geographic mobility of labour, for example, is limited and it is not certain that the results would be entirely desirable if there were perfect mobility (depopulation of peripheral areas and excessive concentration in the central areas). It is also important to bear in mind that the geographic distribution of economic activities does not necessarily correspond to the present pattern of comparative advantages but is a product of history. Consequently, there are strong arguments in favour of a regional policy including a judicious use of subsidies. The need for action to rectify regional imbalances is recognised in the Community's "cohesion" objective and the associated measures undertaken by the Community's financial instruments, such as the Regional Fund and the EIB.

Another aspect of imperfect mobility of production factors is revealed in **the frictional problems** which arise when a firm is no longer viable or when a sector needs to be restructured. The factors of production "liberated" by factory closures cannot be transferred overnight to some new activity and serious unemployment problems can arise. In such cases also there can be a justification for state aid in order to ease the transition to a new structure of economic activity.

III. PRESENTATION OF SURVEYS ON STATE AID (Commission of the European Communities, 1988, 1990, 1992)

General patterns of State aid

In three surveys published in 1989, 1990 and 1992, the Commission presented elements of quantification of state aid by Member States. These surveys cover only measures which constitute state aids subject to Community rules.

The third survey found that in 1988–1990, state aids to all sectors amounted to ECU 89 billion per year, which represents 2.0% of the Community's GDP. However, in certain Member States, state aids are over 2.8% of national GDP, 40% more than the EC average: Belgium (2.8%), Greece (3.1%), Italy (2.9%), Luxembourg (4%). In other Member States they represent less than 1.6% of national GDP (Denmark, Netherlands and United Kingdom). The importance of state aids can also be seen from the fact that they are 4.3% of total general government expenditure which is more than the revenue generated from direct taxation of enterprises. In some Member States, state aid represents over 5.0% of public spending (Belgium, Germany, Greece, Italy, Luxembourg and Portugal) while the proportion is less than 3.7% in others (Denmark, France, Netherlands, United Kingdom).

TABLE 1 : **Total state aid by Member State** (average 1988–1990)

	In % of GDP	In ECU per employed person	In % of total public spending
B	2.8	1040	5.4
DK	1.1	409	1.9
D	2.4	971	5.2
GR	3.1	387	6.0
E	1.8	480	4.2
F	1.8	735	3.7
IRL	2.0	564	4.5
I	2.9	982	5.6
L	4.0	1389	7.6
NL	1.3	528	2.2
P	2.2	245	5.0
UK	1.1	312	2.9
EUR-12	2.0	687	4.3

Source : Third Survey on State Aids in the European Community, Commission, 1992.

It is interesting to note that the countries where there is a high level of state aid (Italy, Belgium, Greece) are also countries where the public deficit is very high. In Italy, the financing of state aid corresponds to 28% of the public deficit, in Belgium to 44% of this deficit, and 45% for Portugal; a stricter control of state aids could therefore contribute to the reduction of public deficits and enhance the prospects for these countries to fulfil the convergence criteria for Economic and Monetary Union.

The significance of aids can also be highlighted in terms of ECU per employee. Luxembourg (1389 ECU) has an expenditure much higher than the other large aid givers: Belgium(1040), Italy (982) and Germany (971). On the other side, Denmark (409), Greece (387), Portugal (245) and the United Kingdom (312) appear to be relatively small aid givers. These small aid givers include two countries with low GDP per head compared to the Community average, which means that even if State aid in terms of percentage of GDP is high, the volume in ECU per head is low. In the case of Denmark and the United Kingdom, state intervention is weak both in % of GDP and in monetary terms.

Manufacturing industry

In the period 1988–90 covered by the third survey, aids to manufacturing amounted to 40% of total state aid compare to 29% for transport, 18% for coal and 13% for agriculture and fisheries. Manufacturing is therefore the first recipient of state aid except in the United Kingdom and Germany where coal played a major role (32% of total state aid in Germany and

42% in United Kingdom) and in Luxembourg where transport is first. On the other hand, state aid to manufacturing represents 73% of total aid in Greece, 60% in Ireland and 68% in Portugal. The less developed countries of the Community in terms of GDP per head are also countries where state aid to manufacturing is very important. In conclusion, isolating the manufacturing sector shows that aid is in fact very important to this sector, and represents a greater percentage of value added than in the economy in general, more than 3.2% of value added in the recent period.

TABLE 2 : **Total state aid by Member State 1988-1990**
(broken down into main sectors)

	Agriculture & fisheries	Manufacuring	Transport	Coal	Total
B	6	32	35	28	100
DK	27	31	42	0	100
D	11	31	26	32	100
GR	14	73	13	0	100
E	4	42	35	19	100
F	14	38	31	17	100
IRL	20	60	20	0	100
I	15	49	36	0	100
L	7	19	74	0	100
NL	21	48	31	0	100
P	20	68	11	1	100
UK	10	38	10	42	100
EUR-12	13	40	29	18	100

Source : Third Survey on State Aids in the European Community, Commission, 1992.

Table 3 compares the average yearly amounts given as state aid to manufacturing in the period 1986–1990. It can be seen that the volume of aid in EUR-12 has declined in real term by 17% between 1986 and 1990. The lowest point was reached in 1989 but the following year saw an increase of 5%. At the end of the 80's, the level was still below that of 1981–1982, but it is not clear if this trend could not be reversed in 1992 and 1993 with the recession and the pressure from sectors with overcapacity[1].

Trade in manufacturing products accounts for the bulk of activities engaged in intra-Community trade, which explains why special attention is needed in this sector, where the distortive effects of subsidies could have a strong cross-border impact. In figures 1 and 2, State aid to the manufacturing sector has been expressed both in terms of percentage of value added in the sector and in Ecu per employee.

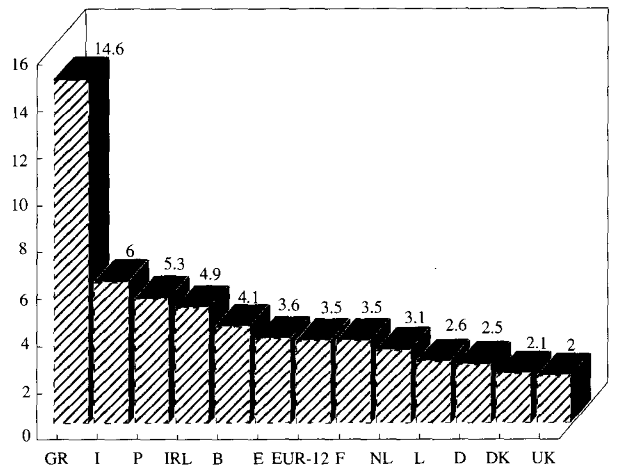
TABLE 3 : **Aid to the manufacturing sector in the Community**
(annual amounts from 1986 to 1990)

EUR-12	1986	1987	1988	1989	1990
In % of value added	4.2	3.7	4.0	3.2	3.3
In Ecu[1] per person employed	1383	1225	1360	1100	1152

[1] At constant 1989 prices.
Source : Third Survey on State Aid in the European Community, Commission, 1992.

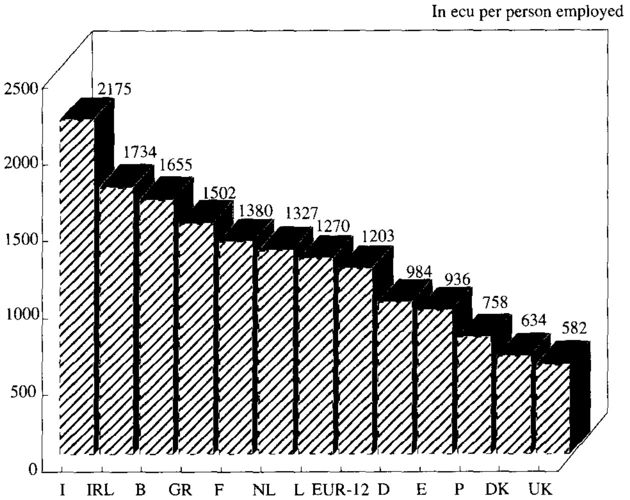
The results obtained here are quite comparable to those observed for the total economy. Whilst it is dangerous to impute distortions of competition from global aid figures, the differences among countries are so marked that it is necessary to have a strict control in order to establish if such huge differences in aid can be objectively justified, having regard to their distortive effects on competition. In nearly all Member States certain sectors have in general been very highly aided : steel, shipbuilding, the hard coal industry.

GRAPH 1 : **State aid to the manufacturing sector**
(annual averages 1988–1990)



Source : Third Survey on State Aids in the European Community, Commission, 1992.

GRAPH 2 : **State aid to the manufacturing sector**
(annual averages 1988–1990)



Source : Third Survey on State Aids in the European Community, Commission, 1992.

Table 4 shows for instance aids to shipbuilding as a percentage of gross value added in 1981–1985 and 1988–1990. In this sector, aids are significant, and represent more than one third of value added. Moreover this share has increased substantially between 1981–1985 and 1988–1990 in Germany (from 12.3% to 25.1%) in Italy (from 34.2% to 84.8%) in Netherlands (from 10.7% to 23.4%).

Type of interventions

Grants have formed the bulk of interventions in many Member States: Spain (78%), United Kingdom (78%), Luxembourg (75%), Netherlands (66%), Denmark (59%). Tax reductions were important in Germany (61%), notably

[1] The Commission's fourth survey, covering the period up to 1992, should be published this year.

for regional development purposes (Berlin), in Ireland (44%) and in Italy (40%). On average, grants or tax relief (group A) are predominant in all Member states with the exception of Portugal (64% for other types of aids), France (56%) and to some extent Greece (40%) and Denmark (37%).

TABLE 4 : **Aid to shipbuilding 1988–1990 and 1986–1988** (in % of value added in the sector[1])

	1981–1985	1988–1990
B	27.7	14.5
DK	33.8	33.4
D	12.3	25.1
GR	n.a.	13.0
E	n.a.	34.1
F	56.6	55.0
I	34.2	84.8
NL	10.7	23.4
P	n.a.	78.6
UK	21.6	10.8

[1] As value added figures were not always available for recent years, some estimates had to be made. The figures should therefore be regarded as estimates.
Source : Third Survey on State Aid in the European Community, Commission, 1992.

Capital injections involve aids when the historic performance of the companies concerned and their level of indebtedness would have deterred a private investor from making the investment. Equity participation has formed a significant form of aid in Portugal (59%), in Greece (18%), in France (11%) and in Spain (10%). Equity participations were very often in these countries intended to cover the losses of state-owned companies. With the privatisation process, there may be a tendency in the long run for equity participation to diminish as an instrument of aid in comparison of other forms of interventions. However, in the short term, there may actually be an increase in such interventions as governments may be tempted to re-capitalise heavily indebted public enterprises in order to make them more attractive to potential buyers.

The aid element of soft loans or tax deferrals is an important part of aid in Denmark (37%) and is also of some significance in France (17%) and Luxembourg (16%). The aid element of guarantees is a significant part of aid only in France and to a lesser extent Greece (11%). These guarantees are often associated with trade/export.

TABLE 5 : **State aid to the manufacturing sector 1988–1990** (breakdown by type of aid in %)

	Group A		Group B	Group C		Group D	Total
	Grants	Tax relief	Equity (participation)	Soft loans	Tax Deferrals	Guarantees	
B	55	27	5	5	0	8	100
DK	59	3	0	37	0	0	100
D	28	61	0	7	3	1	100
GR	44	17	18	11	0	11	100
E	78	0	10	11	0	1	100
F	28	16	11	14	3	28	100
IRL	50	44	2	0	0	3	100
I	53	40	5	2	0	0	100
L	75	5	2	16	0	1	100
NL	66	27	0	4	0	3	100
P	34	3	59	4	0	1	100
UK	78	4	8	3	6	1	100
EUR-12	47	32	7	7	2	6	100

Source : Third Survey on State Aid in the European Community, Commission, 1992.

Objectives of aid

The proportion of the total aid element in each Member State according to the various objectives is presented in table 6. The most immediate conclusion is that regional objectives and horizontal objectives predominate.

Horizontal aids include schemes such as support for research and development, small and medium enterprises, export subsidies, and general investment aid not formally targeted on specific sectors. Sectoral aids include schemes targeted on particular industries and ad hoc aids for individual firms. Rescue and restructuring aids constitute a large part of this category. Among the horizontal aid schemes, the most important subcategories in term of expenditure are : trade subsidies, SMEs, innovation and R&D (around 10% each for EC). However there are large differences among the different countries : R&D is very important in Denmark and the Netherlands, SMEs in Belgium, Luxembourg and the Netherlands, export subsidies in Greece, France and Ireland.

Sectoral aids accounts for very high proportions of the total in Denmark, Greece, Spain and Portugal. As previously remarked, sectoral aids go mainly to steel and shipbuilding.

TABLE 6 : **State aid to the manufacturing sector 1988–1990** (breakdown by sector and function)

Sectors/function	B	DK	D	GR	E	F	IRL	I	L	NL	P	UK	EUR-12
Horizontal objectives	76	59	29	81	28	66	50	30	39	77	17	45	42
Innovation R&D	13	35	12	1	9	17	4	4	8	35	1	8	10
S.M.E.	25	1	7	10	5	11	8	10	21	31	0	12	10
Export subsidies	14	8	2	22	1	36	38	8	2	1	0	15	11
General investment	12	0	0	10	5	1	0	2	8	4	1	9	3
Other objectives	8	0	2	37	6	0	0	7	0	0	14	0	5
Sectoral aids	4	38	11	56	67	25	9	15	0	11	78	20	20
Shipbuilding	1	32	3	3	10	4	0	4	0	7	27	7	5
Regional objectives	21	3	61	15	5	9	42	55	61	12	5	34	38
Total	100	100	100	100	100	100	100	100	100	100	100	100	100

Source : Third Survey on State Aid in the European Community, Commission, 1992.

IV. COMMUNITY GUIDELINES

The general principles of state aid control are laid down in the EEC and ECSC Treaties and in the EEA agreement, but the practical application of these principles in many cases requires much more detailed rules, sometimes in the form of derived legislation. These rules serve, firstly, to ensure that the Commission has adequate information for the assessment of the aids, secondly, to define the circumstances in which the Commission may consider that aid is compatible with the common market, and, thirdly, to establish limits to the amount of aid that may be granted.

In the agricultural, fisheries and transport sectors, some aids are exempted from the provisions of Articles 92–94 EC. In agriculture and fisheries, the exemption applies only to aids covered by specific Council regulations under Article 42 EC. Such regulations usually contain very precise rules concerning the amounts of aid and the circumstances in which it may be granted. In the transport sector, aids are exempted from the normal competition rules if they "meet the needs of coordination of transport" or if they compensate for "public service obligations" (Article 77 EC). Secondary legislation[1] was needed to define these concepts. In the coal and steel sectors, on the other hand, the secondary legislation in effect substitutes new rules for the very strict prohibition of aid contained in Article 4 of the ECSC Treaty.

In other areas of state aid policy, which present special problems or where an exceptionally favourable attitude to aids is adopted, the Commission has felt the need for a formal systematisation of its approach by means of published guidelines, taking account of the relevant case law. In drawing up its legislative proposals and guidelines, the Commission has to take into account not only the impact of state aids on the conditions of competition but also Community objectives in other fields, such as regional, social and industrial policy.

The secondary legislation and Commission guidelines can be divided into three main groups : horizontal, regional and sectoral. In cases where more than one set of rules apply, the more restrictive rules are generally decisive. A feature common to many of these rules, whether horizontal, regional or sectoral, is a negative attitude towards operating aids which are deemed to be conservative in their effects and not likely to lead to a lasting solution to the problems that they address.

Horizontal guidelines

The horizontal guidelines set out rules which apply generally to all sectors of the economy covered by Articles 92 to 94 EEC (i.e. excluding ECSC sectors, much of agriculture and fisheries and part of the transport sector). These guidelines concern aids for particular purposes, such as environmental protection, R&D, the promotion of SMEs etc., and also particular forms of aid, such as state guarantees and public authorities' equity holdings. Only guidelines of the first type will be discussed here.

Aid for environmental purposes

The Commission published its first, rudimentary framework for environmental aids in 1974. However, as the political importance of environmental protection grew so did the size and complexity of the aid schemes implemented by the Member States. The Commission gradually developed a policy for controlling these schemes but this was not fully codified until 1993, when the Commission adopted its "Community guidelines on state aid for environmental protection"[2].

The Commission's long-term objective is to extend considerably the application of the "polluter pays" principle, i.e. the principle that those who cause environmental damage should be forced, through taxation or other means, to bear the costs which they would otherwise impose on the rest of society. However, in the words of the guidelines, "Both positive financial incentives, i.e. subsidies, and disincentives, namely taxes and levies, have their place". However, subsidies are regarded as "a second-best solution in situations where the polluter pays principle... is not yet fully applied".

The guidelines cover all types of aids which are commonly used as instruments of environmental policy, including notably aid for investment in equipment to reduce or eliminate pollution and incentives for the purchase of environmentally friendly products. Aid for investments in energy-saving technology and the use of renewable energy sources is also covered by the guidelines.

The most detailed rules in the guidelines relate to investment aids. These rules distinguish between, on one hand, investments which are made to comply with legally obligatory norms and, on the other hand, investments which go beyond these norms or which are made entirely voluntarily in the absence of any legal norm. In principle, the eligible investment costs must be strictly confined to the extra costs incurred in meeting environmental objectives. In practice, however, this rule may be difficult to apply in some cases.

Where the investment merely enables the firm to adapt to legal requirements, aid is limited to 15% of the eligible investment cost (25% in the case of small and medium-sized enterprises). Such aid may only be granted for adapting plant which has been in operation for at least two years at the time when new legal requirements enter into force. Where the investment exceeds legal requirements, or where no legally enforceable norms are applicable, the aid intensity may be up to 30% (40% for SMEs). In assisted areas where the Commission has authorised higher rates of regional aid, the higher regional limits apply.

The purchase of environmentally friendly products by final consumers may be subsidised provided that there is no discrimination as to the origin of the products and that the subsidy does not exceed the extra cost of meeting the environmental objective.

Research and development

In the field of research and development, the Commission issued in 1986 a "Community framework for state aids for research and development"[3]. In Article 130f of the EEC Treaty, the Community set itself the objective of improving its international competitiveness by strengthening the scientific and technological basis of its industry. Furthermore, as we have argued in the introduction, there are important positive externalities involved in R&D. Consequently, this Community framework is generally favourable towards aid in this field.

The framework distinguishes between basic and applied research, basic research being theoretical and experimental work not leading directly to new products or production processes. For basic research, aid up to 50% of the total cost is normally allowed. For applied R&D or pilot projects, the permitted rate of aid depends on the distance from the market but

[1] Notably, Council Regulations (EEC) N^{os}. 1191/69, 1192/69 (O.J. n° L156 of 28.6.69) and 1107/70 (O.J. n° L130 of 15.6.1970) as amended by Regulation 1473/75 (O.J. n° L152 of 12.6.75).

[2] O.J. n° C 72 of 10.3.94, page 3.

[3] O.J. n° C 83 of 11 April 1986.

is typically limited to a maximum of 25%. SMEs, firms in the least favoured regions and projects of special importance for the Community may receive additional aid of up to 10 percentage points. Although the Commission is normally prepared to give a general authorisation for schemes which comply with these rules without requiring notification of each individual case of application, aid for very large projects (costing more than 20 MECU) must receive individual prior approval from the Commission.

SMEs

Support for SMEs is the subject of very detailed guidelines published in 1992[1]. This document acknowledges the importance of SMEs for employment creation, for the flexibility of the economy and for innovation but notes that they are in some respects at a disadvantage by comparison with larger firms, e.g. difficulties in raising finance, high costs of compliance with government regulations. The guidelines therefore outline a fairly favourable approach to aid for SMEs. In particular, aid may be given to support investment by SMEs throughout the Community, whereas larger firms may only receive investment aid for projects undertaken in the assisted regions of the Community. Small firms, which are defined as those with up to 50 employees[2], may receive up to 15% of their investment costs anywhere in the Community, while firms with between 50 and 250 employees[3] may receive up to 7.5%. In assisted regions, the normal aid ceilings are raised by up to 15 percentage points, depending on the region concerned.

Rescue and restructuring

When firms run into difficulties and are threatened with closure, governments often come under intense pressure to grant aid to enable them to survive. In the Commission's terminology such aid is referred to as rescue aid when its purpose is merely to keep the firm in business and as restructuring aid when the objective is to reorganise and rationalise the firm so as to restore its viability. Such aids can have harmful effects in delaying necessary adaptations to changed market conditions and may result in transferring industrial and social problems from one Member State to another, particularly in sectors with serious problems of over-capacity.

Consequently, in guidelines published in 1979[4], the Commission stressed the need for strict control of such aids. However, the Commission has to take account of the industrial and social impact of factory closures. It may therefore be willing to authorise rescue aid provided that it is granted only during the time necessary to draw up a recovery plan (normally six months are allowed). Furthermore, the aid should be strictly limited to the amount needed to keep the firm in business during that period. The Commission may approve restructuring aid if the restructuring plan offers good prospects of a return to viability within a reasonable time and the aid is no more than is needed to support the firm until the plan bears fruit. To alleviate the adverse effects on competitors who do not receive any aid, the Commission normally requires that the beneficiary firm should reduce its production capacity, particularly when there is chronic over-capacity in the sector concerned.

Public enterprises

In the context of rescue and restructuring aids it is worth mentioning that financial transactions between Member States and public enterprises can be extremely complex and difficult to control in accordance with the state aid rules. A Commission Directive of 1980[5] therefore requires Member States to make adequate information on such transactions available to the Commission, so that it can judge whether or not state aid is involved. Problems arise in particular when a public enterprise which is in financial difficulties benefits from a state guarantee of its debts or from a capital injection from public resources. In such cases, the Commission applies the so-called "commercial investor principle". According to this principle, the provision of finance from public resources to an enterprise constitutes a state aid if that firm would not, in the given circumstances, be able to obtain finance on the private capital markets, or if it could do so only on terms less favourable to itself. In many cases when a firm is in difficulties, there are good reasons to doubt whether a private investor would subscribe to a capital increase or a private banker would be willing to grant a guarantee. In these cases the Commission is faced with the difficult task of deciding whether the state aid rules apply.

Regional aid rules

Community policy explicitly recognises the need for public intervention in favour of disadvantaged regions. Article 130a of the EU Treaty states that "the Community shall aim at reducing disparities between the various regions and the backwardness of the least-favoured regions", while Article 92(3) (and Article 61(3) of the EEA agreement) allows the Commission to grant derogations from the general prohibition of state aids in the following cases :

- "aid to promote the development of areas where the standard of living is abnormally low or where there is serious underemployment" (Article 92(3)(a)),
- "aid to facilitate the development of .... certain economic areas" (Article 92(3)(c)).

Thus, it can be argued that the Treaty implicitly accepts the view put forward in section II of this paper that regional disparities are instances of market failure that can in some circumstances justify the use of state aid. Some economists, however, contend that regional problems are not evidence of market failure and would argue that the derogations in favour of regional aids are purely an expression of a political preference.

The tasks of the Commission in relation to regional aid are, first, to regulate such aid so as to limit the resulting distortions of competition to an acceptable level and, second, to prevent the competition between regions to attract investment from degenerating into a self-defeating process of bidding-up of subsidies. Community policy deals with these problems in

[1] Community guidelines on state aid for small and medium-sized enterprises (SMEs), O.J. nº C213 of 19 August 1992.

[2] And either a maximum annual turnover of 5 Mecu or a balance-sheet total not exceeding 2 Mecu.

[3] And either a maximum annual turnover of 20 Mecu or a balance-sheet total of not more than 10 Mecu.

[4] "Eighth Report on Competition Policy", point 228.

[5] Commission Directive no.80/723/EEC of 25 June 1980 (O.J. nº L 195 of 29.7.1980) as last amended by Commission Directive nº 93/83/EEC of 30 September 1993 (O.J. nº L254 of 12.10.93).

two ways : firstly, by restricting the geographical scope of regional aids to those areas which are genuinely disadvantaged and, secondly, by setting limits to the intensity of the aid according to the degree of disadvantage suffered by the region.

The Commission has established criteria for determining which regions can benefit from these derogations[1]. The analysis of the regions' economic situation is normally carried out on the basis of the standard NUTS geographical units (*Nomenclature of statistical territorial units*).

Regions eligible under sub-paragraph (a) of Article 92(3) — the least-favoured regions — are defined as NUTS II regions with a *per capita* GDP, averaged over the last three years, of 75% of the Community average or less. There are, however, two exceptions to this rule[2]. In total, the Article 92(3)(a) derogation applies to regions containing about 86 million inhabitants, about one quarter of the total Community population, including the whole of Greece, Ireland and Portugal and the new *Länder* of Germany.

By contrast with sub-paragraph (a), sub-paragraph (c) of Article 92(3) is extremely vague about the type of area which may benefit from aid. However, the Commission has developed a method for defining the areas which may benefit from this derogation. This method takes account of a region's socio-economic situation in relation to the overall situation in the Member State concerned but also takes account of the wider Community context. The method is in two stages. In the first stage, only the regional *per capita* GDP and unemployment rate are considered. To qualify at this stage, a region must have **either** a *per capita* GDP at least 15% below the national average **or** an unemployment rate at least 10% higher than the national average[3]. To take account of the Community context, the required differentials are widened if the Member State concerned is more prosperous or has a lower unemployment rate than the Community average.

If an area does not satisfy the conditions of the first stage, a second stage of analysis is undertaken. This takes other socio-economic indicators into account, such as net migration, dependence on declining sectors, forecasts of impending job losses etc. Especially when an area is very close to the threshold values required in the first stage, this further analysis may reveal sufficient justification for authorising regional aid.

If it decides to authorise regional aid under either sub-paragraph (a) or sub-paragraph (c), the Commission fixes the investment aid ceiling for each region individually, according to the degree of disadvantage suffered by the region. The aid ceiling may be as high as 75% NGE[4] in the least-favoured regions. **However, mainly because of shortage of budgetary resources, the actual rate of aid is usually much lower than this**. In areas covered by sub-paragraph (c), the aid ceiling set by the Commission is not normally higher than 30% (and often lower than 20%). Operating aids, i.e. aid for recurrent running costs, are permitted only in the least-favoured regions and only in exceptional circumstances, since the Commission considers that such aids do not usually contribute towards a permanent improvement of the regional economic situation but rather tend to freeze the existing pattern of economic activity.

1 "Commission communication on the method for the application of Articles 92(3)(a) and (c) to regional aid", O.J. C212, 12.8.88, and "Commission communication on the method of application of Article 92(3)(a) to regional aid", O.J. C163, 4.7.90.

2 One is the Spanish province of Teruel, which is a NUTS level III area within a NUTS II region (Aragon) that does not qualify as a whole under this rule. The other is Northern Ireland, because of its special problems.

3 Since regional policy is concerned with long-term problems, the indices used are five-year averages.

4 Net Grant Equivalent, which takes into account the effect of taxation.

Sectoral guidelines

Special rules apply to the so-called "sensitive sectors", which for the most part are mature or declining industries with chronic over-capacity, such as steel, shipbuilding and the motor vehicle industry. These rules reflect the dual preoccupation with the maintenance of competition in the internal market and the need for industrial restructuring. A common feature of these rules is a severely restrictive attitude towards aid which could lead to increases in production capacity. In some sectors such aid is completely forbidden.

However, the problems of the disadvantaged regions are given special consideration and a more favourable attitude is generally adopted towards aid given for research and development, workers' training, and environmental protection measures. Aid for restructuring is scrutinised with particular care and is normally only permitted when there are substantial permanent reductions in capacity.

The Steel Industry

As 75% of steel consumption is accounted for by two sectors (construction/civil engineering, automobiles), the industry is highly dependent on the economic situation in these sectors.

In 1991, the EC accounted for 18.7% of total world production, compared with 10.8% for the USA and 14.9% for Japan. Since 1980, the EC, Japan and the USA have all slightly lost world market share to newly industrialised countries (NICs) and Eastern European countries, which have often entered the EC market at dumping prices. Central and Eastern European countries now hold an estimated 2–5% of the EC market. The ratio of exports to production has declined steadily since 1986 and has been more or less stable around 8% over recent years. Thus, the reduction in internal demand was not compensated by increased exports.

The average capacity utilisation in the entire steel sector in 1992 amounted to 69%. Although national restructuring plans for crude steel production, which accounts for most of the employment in the sector and has the highest fixed costs, have led to a 19% capacity reduction between 1980 and 1986, the sub-sector is still marked by 16–23% overcapacity. Increased capital intensity in the sector has led to higher productivity and a decline in employment in the last 20 years.

The steel sector in the EC is highly concentrated : in 1990, almost half of Community production of crude steel was produced by 5 companies and the first 15 firms accounted for 73%. As the industry has heavy fixed costs, entry barriers are high. Moreover a recent tendency to merge activities in response to increased competition from cheaper imports has exacerbated the competition situation.

It is clear, therefore, that the steel industry presents special problems for both competition and industrial policy. In an effort to deal with these problems as far as state aids are concerned, the Commission has since 1980 enacted a series of decisions commonly known as the "steel aids codes".

TABLE 7 : **Summary of Article 95 decisions**

Company	Aid (MECU)[1]	Main conditions	Aid per t[2] (ECUs)
CSI (Spain)	2773	2.3 mio t reduction in hot-rolled capacity (–36 %)[3]. 1.4 mio t reduction in liquid steel capacity. New hot strip mill at Sestao to be delinked from CSI. Early closure of hot strip mill at Ansio. Level of financial charges not to be reduced below the average level of competitors.	1225
Sidenor (Spain)	507	379 000 t reduction in hot-rolled capacity (–27 %). 505 000 t reduction in liquid steel capacity.	1338
SEW Freital (Germany)	142	160 000 t reduction in hot-rolled capacity (–47 %). 100 000 t reduction in crude steel capacity.	887
EKO–Stahl (Germany)	420	462 000 t reduction in hot-rolled capacity[4]. Aid must not result in financial charges less than 3.5 % of turnover.	909
ILVA (italy)	2537	1.7 mio t reduction in hot-rolled capacity (–14 %). If proceeds from privatisation are greater than foreseen, the extra receipts must be used to reduce the amount of aid. The financial charges of the (privatised) successor companies must not be reduced below the level of competitors	1492
Siderurgia Nacional (Portugal)	305	140 000 t reduction in hot-rolled capacity (–16 %).	2179

[1] Amounts covered by the Article 95 decision. Varying amounts of other aid, notably for social costs, can be authorised under the Steel Aid Code and do not require a special decision.
[2] Aid per tonne of reduction in capacity to produce **hot-rolled** products.
[3] New capacity of 1 mio t to be built at Sestao is not taken into account.
[4] Part of the aid is for construction of a new mill with a capacity of 0.9 mio t. However, the Commission decided that in Eastern Germany the global net capacity reduction can be taken into account.

The code currently in force[1] makes no concessions to the pressure to allow aid in order to counter suspected dumping by Eastern European and Asian producers. This problem is dealt with under the Community's trade policy and anti-dumping regulations. Operating aid is strictly forbidden by the code. However, the code does allow aid to be granted for R&D in accordance with the normal rules and it also contains special provisions permitting limited aid for environmental protection and plant closures. Investment aid may be granted only in Greece, Portugal and the new Länder of Germany and then only if the aided investment does not lead to an increase in capacity. In Portugal, eligibility for investment aid is restricted to SMEs, while in Eastern Germany approval for aid is conditional on substantial cuts in total capacity.

The combined effect of strict aids codes and extensive rationalisation has been a substantial fall in the amount of aid granted to the industry in most Member States. Between 1988 and 1990 average annual subsidies to the national steel industries have varied in the Member States from zero (B, DK, IRL, L) to 727 million ECU in the case of Italy. Compared with the annual average for the period 1986–1988, this meant a decline of 80% in the case of Britain, 35% in Germany and 15% in Spain. Only Portugal, taking advantage of the special status which it enjoyed until the end of 1991, and Italy had significantly increased their aid to the steel industry, while France's average remained roughly unchanged.

In 1992 the Commission was notified of six major restructuring plans for publicly owned steel companies, involving large amounts of state aid. These cases concerned two companies in Spain (CSI and Sidenor), two in Germany (SEW Freital and EKO–Stahl), ILVA in Italy and Siderurgia Nacional in Portugal[2]. None of these cases could be approved under the Steel Aids Code, which sets very narrow limits to the possibilities for granting aid.

However, in each case, after negotiating appropriate adjustments to the plans with the Member States concerned, the Commission considered that the plans could make a sufficient contribution to Community objectives to justify the granting of state aid to ease the restructuring process. In particular, the revised plans provided for substantial reductions in capacity for producing hot-rolled products, which account for 70% of the Community's total finished steel products (by weight). The Community-wide over-capacity in this sub–sector was estimated in 1992 as about 26 million tonnes/year (15% of capacity). Consequently,in April 1994, after long negotiations to obtain the Council's unanimous assent as required by the ECSC Treaty, the Commission adopted special decisions approving aid under Article 95 ECSC.

Planned or completed reductions in hot-rolled production capacity by private sector firms amount to about 15 million tonnes/year and the additional reductions linked to the six cases now under consideration amount to 5.5 million tonnes/year. The amounts of aid and the main conditions attached thereto are summarised in Table 7. The Commission attempted to strike a balance between the amounts of aid authorised and the size of the capacity reduction. However, as the last column of the table shows, after allowance was made for special circumstances, there was a wide variation in the amount of aid per tonne of capacity reduction.

The aid per tonne for the Portuguese company (SN) is by far the highest. The reasons for this are that SN is the only Portuguese steel firm and that it has only two plants. The present capacity is quite small and any reduction in excess of that foreseen in the restructuring plan would necessitate closing one of the plants entirely. Both plants are situated in areas of high unemployment.

A special feature of the EKO–Stahl case is that the proposed aid is partly intended to help finance the construction of a new hot strip mill with a capacity of 900000 tonnes/year. The Commission allows this only because total capacity in eastern Germany as a whole is to be reduced by a net amount of 462000 tonnes/year in addition to capacity reductions already taken into account for the authorisation of aid to other firms.

[1] Commission Decision nº 3855/91/ECSC of 27 November 1991 (O.J. nº L 362 of 31.12.1991).

[2] SEW Freital, EKO–Stahl, ILVA and Siderurgia Nacional are to be privatised. A buyer has already been found for one of the two German firms.

In the case of the Spanish firm CSI, the Commission has agreed to consider that the reduction in capacity will be 2.3 million tonnes/year, even though CSI will be a minority shareholder in a firm which is to build a new hot strip mill at Sestao with a capacity of 1 million t/y.

In the Commission's view, the decisions achieve a satisfactory balance between the amounts of aid to be authorised and the capacity reductions to be achieved. However, the decisions have met with a hostile reception from the private sector, which has demanded as a condition for agreeing to additional capacity reductions on its part that there should be no further authorisations of similar aids.

The Car Industry

The European car industry is undergoing restructuring in the face of three major challenges : a slump in demand, competition from more efficient Japanese producers and substantial over-capacity resulting from new investments.

Between 1986 and 1991 new car registrations in the EC rose annually by 2.4% on average. Over the last two years, they fell by 25% while production continued to expand. The Community manufacturers' share of the home market, which stood at about 90% in 1991, will in the long term come under pressure as a result of the planned complete liberalisation of trade with Japan by the year 2000.

For the near future, a substantial increase in over-capacity is possible, not only because of increased market penetration by Japanese firms but also because some EC manufacturers are pushing ahead with investment plans in the EC conceived in the booming 1980s. Furthermore, production is being relocated outside the Community, attracted by low labour costs and growing markets, particularly in Eastern Europe.

The declining competitiveness of European carmakers has significant effects on employment. For example, Volkswagen, the market leader, is planning to shed 33.000 jobs worldwide over the next two years, and Mercedes–Benz cut 13.000 jobs in Germany alone last year. Other industries are also affected because the car industry is an important factor of demand for upstream and downstream industries and services : it is estimated that 10% of Community employment depends thus on the car industry. As new production techniques such as just-in-time-delivery are introduced, plants abroad are increasingly served by local components manufacturers, thus reducing orders for EC component suppliers. These developments may also have a negative impact on the EC's trade balance.

Because Japanese carmakers are producing more efficiently than their EC counterparts, their entrance into the European market will force EC carmakers to increase productivity and product quality. Thus, the entrance of Japanese carmakers will eventually contribute to greater efficiency if European carmakers face up to the challenge. In the Commission's view, excessive reliance on subsidies to solve the industry's problems could undermine these healthy effects of foreign competition.

The Commission's sectoral guidelines[1] reflect these concerns. All cases of aid to this sector must be individually approved by the Commission. Investment aid may be permitted in assisted regions if the Commission considers that the regional benefits outweigh any possible adverse effects on the sector as a whole (resulting, for example, from an increase in total production capacity). Outside the assisted regions, the Commission will approve investment aid only in very exceptional circumstances and on condition that the aided project does not lead to an increase in production capacity.

As far as restructuring aid to this sector is concerned, the Commission follows its usual practice of requiring the irreversible reduction of production capacity as a condition for its approval. In 1988, for example, the Commission allowed the French government, sole owner of Renault, to write off FF 12 billion of Renault's debts in return for several commitments regarding the production capacity and legal status of Renault. When the agreed cuts in the firm's production capacity were delayed, the Commission ordered the carmaker to repay over two thirds of the aid, a proportion which was finally reduced to one half after lengthy negotiations.

The Shipbuilding Industry

The capacity extensions of the 1970s and the subsequent oversupply of ships in the recession of the early 1980s have led to the loss of 2/3 of the jobs in the Community industry since 1975.

The world market in shipbuilding is dominated by Japan (38%), followed by the European Community (23%) and Korea (15%). European producers face severe competition from lower-priced ships built in Asia. Between 1986 and 1989 the EC steadily increased its share in world production from 19.7% to 23.7%. However, in 1991, Community production declined faster than world production so that the EC's share in the world market was down to 23%. New orders have also declined faster in the Community (31%) than internationally (16.7%).

However, prices have been rising since 1986 despite the overcapacity. A stable equilibrium seems possible if prices continue to rise and there are no additions to capacity. The Community is leading internationally in some market segments with high value-added where modern production technologies and R&D are of crucial importance.

National aids to the shipbuilding industry in the Community amounted to about 1.8 billion ECU per year in the period 1988–1990, or 5% of all state aid granted to manufacturing during that period. As a proportion of value added in the industry, the level of aid in the Community as a whole has remained stable at about 33% since 1986. However, aid levels were much higher in Italy (85%), Portugal (79%) and France (55%). The lowest levels were observed in the U.K. (11%), Greece (13%) and Belgium (14%).

An argument that has sometimes been put forward in favour of aid to shipbuilding yards is that a decline in demand maybe particularly devastating to yards which have invested most heavily in recent years in new equipment. When the market is in equilibrium these yards are the most cost-efficient and

[1] "Community framework on state aid to the motor vehicle industry", O.J. n° C 123 of 18.5.1989.

best able to compete successfully in the world market. However, such firms have higher fixed costs and, if unable to exploit economies of scale in a depressed market, will suffer greater losses than their competitors using old–fashioned techniques. Consequently, a long period of depressed demand could result in the closure of modern, technologically advanced shipyards, weakening the Community's ability to take advantage of an upturn in the market.

There is a wide-spread suspicion that the low prices of Asian competitors are not entirely due to indigenous production advantages but may be partly the result of production subsidies. The structure of the shipping sector is such that normal trade policy measures, such as anti-dumping procedures, are ineffective for dealing with this problem. Consequently, Community policy towards operating (production) aids has been much more lenient in this sector than in other sectors.

Since 1969 state aid to shipbuilding has been the subject of a series of Council directives. It is now governed by the Seventh Directive[1], which expires at the end of this year. The Commission is allowed to authorise operating aid subject to a common upper limit that is established annually by the Commission as percentage of the contract value of the ships before the aid and is to be reduced progressively. The ceiling takes account of the cost difference between the Community's most competitive yards and their main international rivals. Since 1987 this ceiling has been reduced progressively for most ships from 28% to 9% and for small vessels from 20% to 4.5%. No operating aid is allowed for ship repairing. The East German shipyards benefit from a special derogation from these provisions on condition that their total capacity be reduced by 40% by the end of 1995.

As in other industries, Community policy has to address the problem of over-capacity in the shipbuilding sector: any kind of investment aid must therefore be linked to a restructuring plan which does not involve any increase in the shipbuilding capacity of a yard, unless there is a corresponding reduction in the capacity of other yards in the same Member State.

Aid towards costs arising from the partial or complete closure of a yard may also be authorised if the capacity reduction is "genuine and irreversible". The eligible costs include redundancy compensation, early retirement pensions and investment in converting shipyards to other uses.

[1] Council Directive nº 90/684 EEC of 21 December 1990, O.J. nº L 380 of 31.12.1990, as amended by Council Directive nº 92/68/EEC of 20 July 1992, O.J. nº L 219 of 4.8.1992.

Principal economic policy measures – March 1994

Community (EUR–12)

21.3. ECOFIN Council examines and gives a favourable reaction to Denmark's convergence programme.

23.3 European Commission approves the Annual Economic Report for 1994.

Belgium (B)

1.3. The central bank reduces its central rate from 6.40% to 6.25% and cuts the rate on advances within the ceiling from 7.90% to 7.75%.

9.3. The central bank reduces its central rate from 6.25% to 6.15% and cuts its rate on advances within the ceiling from 7.75% to 7.65%.

25.3. The government concludes the budgetary review for 1994 without having to take new austerity measures. It corrects the BFR 17 billion overrun by increasing the amount obtained from realizing assets from BFR 40 billion to BFR 57 billion.

30.3. The central bank lowers its central rate from 6.15% to 6.05% and its rate on advances within the ceiling from 7.65% to 7.55%.

Denmark (DK)

None.

Germany (D)

None.

Greece (GR)

4.3. The government takes measures to implement the 1994 budget that involve raising budget revenues of DR 400 billion from tax arrears.

8.3. The government takes over DR 500 billion in debt from the Agricultural Bank of Greece, increasing public sector debt by the same amount.

15.3. Interest rates on one-year Treasury bills are reduced by 25 basis points to 18.75%.

31.3. Interest rates on one-year Treasury bills are reduced by 25 basis points to 18.50%.

Spain (E)

3.3. Bank of Spain cuts the minimum intervention rate by 50 basis points to 8% (5 percentage points lower than a year earlier).

France (F)

14.3. The government adopts plans to increase military expenditure by 0.5% per year in volume terms over the period 1995 – 2000. Under the five-year law on public finance consolidation, primary budgetary outlays should decrease by 0.6% per year in volume terms.

24.3. The Monetary Policy Council of the Banque de France cuts its intervention rate from 6.1% to 6%.

Ireland (IRL)

None.

Italy (I)

None.

Luxembourg (L)

8.3. The Tripartite (the government and the two sides of industry) concludes an intersectoral social agreement aimed at stemming the rise of unemployment, the growth of inflation and the loss of business competitiveness. The trade union organizations undertake to moderate their wage demands and to take account of the need to boost productivity. In return, the employers undertake to maintain, or even to increase, the level of employment. Another measure is designed to restore business competitiveness, namely the scrapping of the special contribution equal to 1.7% of a firm's wage bill, which helped to strengthen the finances of the social security system. A special tax on motor fuels (petrol and diesel) is introduced to make up for this revenue shortfall, but the higher prices will not be reflected in the consumer price index and will not therefore affect the growth of wages, which will continue to be adjusted on the basis of the sliding-scale system (automatic wage indexation).

Netherlands (NL)

None.

Portugal (P)

None.

United Kingdom (UK)

None.

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