AGENDA ITEM No. 3 (a)

NORTH LANARKSHIRE COUNCIL

REPORT

To: ECONOMIC DEVELOPMENT COMMITTEE		Subject: STATE AIDS SEMINAR SCOTTISH OFFICE, THURSDAY 11TH JANUARY
From: DIRECTOR OF PLANNING & DEVELOPMENT		
Date: 1 MARCH 1996	Ref: GS/JM/REPORT.009	

Introduction

This report seeks to advise members on the rules of state aid notification and the outcome of a seminar on this subject hosted by the Scottish Office on January 11th, 1996.

The purpose of this seminar was to provide information on the State Aid rules to those people working in economic development within local authorities in Scotland. The seminar sought to provide clarity to the State Aid rules and to overcome any doubts officers may have had about the relevance of these rules to the work that is being done in the local authorities. It was stressed that virtually everything that is done to support industry is governed by Community rules and these rules are legally binding on all practitioners.

Definition

The European Commissions "State Aids" are the legal obligations and rules determining what any part of government in the Community can and cannot do in support of businesses. The Commission has considerable powers to monitor, control and restrict the forms and levels of aid given by all member states to their industries. Over recent years DT6IV which is primarily responsible for enforcing State Aid rules, has given increasing priority to applying these rules more rigorously. The starting point for understanding the basic principles underlying State Aids is articles 92 and 93 of the Treaty of Rome. Article 92 establishes the principle that State Aid granted by or through the state resources of a member state which distorts competition by favouring certain undertakings or the production of certain goods is incompatible with the common market in so far as it affects trade within member states. It lists the derogations to the usual rules, for example article 92 (3C) allows member states to promote R & D, provide aid for regional development in assisted areas and encourage growth in SMEs. Article 93 establishes the Commissions powers to act on the principles established in Article 92 and in particular to issue guidelines and frameworks on the application of the State Aids rule; to require member states to abolish or change aid if judged by the commission to be incompatible with the Common Market (93(2)); to require Member States to notify proposed aid in advance for clearance (93(3)).

There is no clear definition of what does and does not constitute state aid. Instead there is a clear statement of principle that any form of aid - whether provided directly by the state or indirectly through "state resources" is incompatible with the Treaty if it distorts or threatens to distort competition.

Examples of Aid as seen by the Commission

The following were listed as being examples of aid. Some are obvious, some are not so obvious and some are quite surprising.

- Grant to firms for investment research and development training
- Cash injections to public enterprises
- Loans and guarantees
- Consultancy advice
- Creation of Enterprise Zones and agencies of urban renewal
- Aid to help companies invest in environmental projects
- Deferral of tax, social security or other payments to the state
- Writing off operating losses to public enterprises
- Provisions to help prepare a public enterprise for privatisation
- The sale of land/property at discounted rates

- The legislation to protect or guarantee market share
- Free advertising on state owned television
- Statutory or state administered levies
- Infrastructural projects benefitting identifiable end users
- Guaranteed workload or business from publicly owned customers

Counselling or Consultancy

A considerable amount of time was spent debating a definition of consultancy advice as a State Aid. A clearly defined definition was sought of when advice in advising a company "through a process" becomes consultancy, which the EC would expect a client to be charged for. The Scottish Office has produced guidance notes on this matter which are attached at Appendix 1. State Aid also includes any assistance that is given to firms using surpluses resulting from the provision of services on behalf of government departments/agencies. It will also include any public funds used to co-finance EC structural funds.

Aid is generally regarded favourably by the Commission if: there is a limited effect of competition within the community; there is little conflict with the poorer or specially assisted regions in the community; capacity is reduced or linked to restructuring plans in sectors suffering over capacity; SMEs are the primary beneficiaries; EC competitiveness is likely to be enhanced by, for example, assisting the introduction of genuinely innovative or state of the art technologies. It was stressed that it was the Commission who decide what is and is not a compatible aid.

There are serious risks and penalties when a local authority or agency provides aid to a company which is not compatible. These may include: injunctions and repayment by the company, interest charges of an illegal loan; challenge on the loan in the UK courts. Officers were advised that the rules were continuously evolving and it is the responsibility of local authorities and agencies to adapt to the evolving rules but they can play apart in influencing the rules for the future.

Framework

Using the powers in Article 93(1) the Commission develop appropriate measures for particular sectors or types of aid by issuing frameworks or codes. The general principals regarding aid have been unchanged since 1978 and are as follows:

- Aid must meet clearly established social and economic needs and enhance EC policies.
- Aid should solve long term problems, not preserve the status quo or put off inevitable changes.
- Aid must not transfer unduly problems to another member state.
- Aid should be digressive, limited in time and clearly linked to the structuring plans.
- There should be minimum disturbance to competition.
- For industries in crises no aid to increase capacity should be given.

The Commission has issued sectoral restrictions which take precedence over all other frameworks, even if dealing with very low levels of aid or support for R & D, the development of SME's or environmental purposes all of which are generally regarded very favourably by the Commission. In some sectors aid is either banned or subject to severe restrictions. These sectors are:

- Textiles and clothing
- Synthetic fibres
- Motor vehicles
- Ship building
- Steel/Coal
- Agricultural and fisheries

Officers are advised that before aid is given to a company in any of these sectors sectoral codes should be considered and there is a responsibility to fully consult with the appropriate DTI Division and/or sponsor department to consider if the codes may be at odds with the aid that is to be given. Aid to businesses can be summarised into 4 frameworks:

- Research and development
- Small and medium sized enterprises
- Environment
- Regional aid

It is important to note the cumulation rules which states that the value of aid for a given project across any of the frameworks should be cumulated and that the total must not exceed the appropriate EC ceiling.

Notifying Schemes for Projects

The seminar identified 3 methods of notification to the Commission that can be adopted:

- DeMinimis
- The accelerated procedure
- Standard notification

The United Kingdom has accepted to adopt standard notification as a means of informing the Commission of the total value of state aid and this is co-ordinated through the DTI in London. The responsibility for collating the Scottish information rests with the Scottish Office who will issue a notification document which will be required to be returned to them for submission to the Commission before the end of March.

The information which is required to be notified for March is the total number of companies assisted and the total amount of aid received between September 1995 - March 1996.

This information is now being collated by the respective local authorities and will be submitted to the Scottish Office before March 31st as requested.

Recommendation

That members note the contents of this report.

S. Cook
Director of Planning and Development

For further information contact G Smith, Head of Business Development and Property.

EUROPEAN COMMISSION
STATE AID RULES

GUIDANCE FOR LOCAL AUTHORITIES

February 1996

THE SCOTTISH OFFICE

EC STATE AID RULES: GUIDANCE FOR LOCAL AUTHORITIES

Purpose

1. The purpose of this guide is to assist local authority staff to understand how the EC state aid rules affect their day to day work.

General

2. All support for industry from any public source, whether from a Government department, Local Enterprise Company (LEC) or local authority has to comply with European Community rules under Articles 92 and section 93 of the Treaty of Rome. These rules are designed to ensure that aid granted by one Member State does not distort trade or affect competitiveness throughout the rest of the Community.

3. The European Commission established the following general principles governing state aids in 1978:

- aid must meet clearly established social and economic needs and enhance EC policy;
- aid should solve long-term problems, not preserve the status quo or put off inevitable changes;
- aid must not transfer unduly problems to another Member State;
- aid should be reducing, limited in time and clearly linked to restructuring plans;
- there should be minimum disturbance to competition; and
- for industries in crisis, no aid to increase capacity.

4. The consequences of failing to apply the state aid rules correctly are serious:

- any aid can be halted if it is judged not to have been properly notified in advance
- aid which is illegal must be repaid, with interest from the date it was received
- aggrieved competitors can bring action in the national court challenging aid which has not been notified, which may result in a recovery order.

Sectoral restrictions

5. In some sectors, assistance is either banned or subject to severe restrictions in order to avoid subsidy races between Member States for investment in sectors already facing severe over-capacity. These sectors are: textiles and clothing; synthetic fibres; motor vehicles; shipbuilding, steel/coal; and agriculture and fisheries. In certain circumstances aid to firms in

these sectors may need to be separately notified to the Commission. In the case of textiles and clothing only, schemes targeted specifically at this sector are prohibited but firms in Assisted Areas can still benefit from regional and other general aid schemes. **The DTI State Aid Policy Unit (0171-215 4401/4428) can give advice on the application of sectoral restrictions.**

GUIDANCE

6. For the purposes of this guidance, aid is divided into 2 categories:

- aid given to small and medium-sized enterprises (SMEs); and

- other aid.

AID GIVEN TO SMEs: BLOCK APPROVAL

7. All assistance given by local authorities in the United Kingdom to Small and Medium-sized Enterprises (SMEs) within certain criteria is now covered by a "block approval", ie the European Commission has given a general clearance for such assistance and no further prior notification or approval is required. EID Circular No 11/1995 informed local authorities about this block approval which was granted with effect from 6 September 1995 and will run for 5 years. The first part of this guide summarises what the commitment to keep within the SME guidelines means in practice and, in particular, seeks to clarify the Commission's approach to what it terms "soft aids", eg advisory and information support.

What is covered

8. In their letter of approval the Commission specified that approval was limited to aid within the terms of the framework for aid to SMEs provided that it respects the limits set out in the Commission's Guidelines on State Aid for SMEs (a copy of which can be obtained from the DTI (0171-215 4428)) and, as appropriate, regional aid ceilings. Examples of state aids as seen by the Commission include grants and loans (eg for business start-ups or expansion), investment aid, training, consultancy and advisory services, statutory or state administered levies. Annex 1 gives further examples.

What is an SME?

9. The Commission defines an SME as a company with:

- 250 or fewer employees;

- either an annual turnover of less than ECU 20 million (approximately £16 million);

- or a balance sheet total of less than ECU 10 million (approximately £8 million); and

- less than 25% owned by one or more companies not falling within this definition (except public investment corporations or venture capital companies).

What limits apply?

Programmes involving state aid to SMEs (see Annex 1) are subject to the following maximum aid ceilings.

Capital Expenditure (investment aid)

10. Local authorities can give capital assistance to SMEs subject to the following ceilings and the rules on cumulation of aid (see paragraph 19):

Within UK Assisted Areas (**both Development and Intermediate Areas**): capital aid towards expenditure on, for example, land, buildings, plant and machinery, is subject to a maximum ceiling of **up to 30% of eligible costs.**

Outside UK Assisted Areas: investment support is restricted to **15%** of **eligible costs** for firms with under 50 employees or **7.5%** for others.

Aid for environmental investment

11. A higher level of aid is allowed to SMEs for environmental investment (eg pollution control, adaptation of production methods in order to protect the environment). In each case the eligible costs must be strictly confined to the additional investment cost necessary to meet environmental objectives.

Within UK Assisted Areas **(both Development and Intermediate Areas)**

Investment to comply with environmental mandatory standards: 35-40%

Investment which improves on mandatory standards: 40%

Where there are no mandatory standards: 40%.

Outside UK Assisted Areas

Investment to comply with mandatory standards: 25%

Investment which improves upon mandatory standards: 40%

Where there are no mandatory standards: 40%

The Community's Guidelines on State Aid for Environmental Protection are available from the DTI State Aid Policy Unit.

Soft aid

12. The Commission has not yet published its further guidance on what can and cannot be done under the heading of "soft aid" for SMEs but it is the Department's understanding that the following reflects the Commission's general approach to the kinds of services local authorities provide. Local authorities will of course be notified if there are any changes to this.

General information services

13. The provision of general information, such as the provision of "shared" information from computer databases, eg, lists of local suppliers, or a signposting service made available to all companies regardless of sector is **not** an aid and can be made freely available.

Counselling/Consultancy

14. Initial counselling, for example to identify a client's need, is **not** an aid and can be given without contribution from the company. However, in-depth reviews and consultancy advice, eg a one-off holistic analysis of a business are subject to state aid rules and assistance is restricted to 50% of the cost of the consultancy. There is a clear distinction between giving advice, on whether, for example, a company needs a new computer system and providing assistance towards the design of a suitable system. In the first case 100% support can be provided but in the second case assistance is restricted to 50% of the cost. Similarly, advice on the need for a business plan can be freely given but help in writing a plan is restricted to 50% of the costs.

Routine advice

15. Routine/regular services such as accountancy or taxation services which are commercially available cannot be supported from public funds since the Commission regard this as being part of the normal running costs of the company. Local authorities can only offer such assistance if it is charged at the full commercial rate for the service.

Training

16. Training targeted at disadvantaged groups, such as the long-term unemployed, to improve their prospects of finding a job and assistance given to an individual to help them obtain a qualification, eg SVQs, is not regarded by the Commission as being a state aid. However, measures which reduce a company's overheads by, for example, training employees in the use of new machinery or management/business practices, are subject to the state aid rules and assistance is restricted to 50% of the external training costs. Assistance towards the cost of running internal training courses, which is the responsibility of the employer, is regarded as being an operating aid and cannot be supported under any circumstances.

Reclamation of Derelict, Vacant or Under-used Land or Buildings

17. For aid not to be involved, local authority support must not result in any aid accruing to the end-user of regenerated sites, and land and buildings must be sold at the full market value. This will probably involve seeking an independent valuation from the Assessor. Care must also be taken to ensure owner/developers do not receive a gratuitous profit as a result of local authority assistance. In particular, funding to encourage owners/developers to bring derelict or under-used land and run-down buildings back into productive use, must only compensate for the <u>additional</u> costs involved.

Sale of Public Land

18. The disposal of land at less than market value is **not** covered by the block notification and individual Commission approval will be required. Again, it may be advisable to seek independent valuation from the Assessor to ensure public land is not inadvertently sold at less than best price.

Cumulation of different aids

19. Local Authority assistance for a particular project may be provided under a number of instruments, but in all cases the assistance will be cumulative and must not exceed the EC ceilings described above. Local authorities may also provide assistance in association with support from other public bodies (eg Central Government, SE, HIE, LECs etc). In such cases the total assistance given to a project (ie local authority plus all other assistance) must not exceed the appropriate EC ceilings.

Co-financing with EC Structural Funds

20. Local authority finance is often used to co-finance EC structural fund projects. Where assistance is provided in this way, it must **not** exceed the levels described in paragraphs 10 and 11 without the specific approval of the Commission.

De minimis

21. De minimis rules (see paragraph 30 below) do **not** apply to assistance provided under the block approval.

Calculation of aid

22. State Aid ceilings are normally expressed in terms of a cash grant equivalent. Where assistance is provided in a form other than a grant (eg a loan), it must be converted into a cash grant equivalent value. The cash grant equivalent value of the loan in an any year is the difference between the interest due at the reference interest rate (broadly commercial rate) and that actually paid.

Sectoral restrictions

23. The sectoral restrictions outlined in paragraph 5 above apply to aid given to SMEs as well as to larger companies.

Annual Reports

24. A condition of the block approval is that the UK Government must submit an annual report to the Commission showing:

a. The number of companies aided.

b. The value of all aid by local authorities to SMEs in their area.

Local authorities will be asked by The Scottish Office Education and Industry Department to submit an annual return (for the financial year) to enable an all-Scotland return to be sent to the Department of Trade and Industry.

OTHER AID

General

25. **All aid which falls outwith the block approval, which is typically larger amounts of aid to larger companies, will need to be individually notified in advance, through DTI, to the Commission. This includes aid to SMEs in the (so-called) restricted sectors.** The exception is aid which falls under the de minimis rules explained in paragraph 30.

Limits to aid

26. Capital aid to larger companies is restricted to those firms situated in Assisted Areas. Maximum levels of assistance are:

- **Development Areas** - 30% of eligible project costs.
- **Intermediate Areas** - 20% of eligible project costs.
- **Non-Assisted Areas** - no support can be given.

As with SMEs, rules on the calculation of aid ceilings and on cumulation of different kinds of aid apply. There may also be restrictions on aid to certain sectors of industry, agriculture and fisheries and to agricultural enterprises run on industrial lines.

27. Higher levels of aid are allowed for environmental investment (see paragraph 11 above) and are allowed for non-Assisted Areas. For larger companies, the limits are:

Within UK Assisted Areas

Investment to comply with mandatory standards: 30% in Development Areas; 20% in Intermediate Areas.

Investment which improves on mandatory standards: 30% (in <u>both</u> Development and Intermediate areas).

Where there are now mandatory standards: 30% (in <u>both</u> Development and Intermediate areas).

Outside UK Assisted Areas

Investment to comply with mandatory standards: 15%

Investment which improves upon mandatory standards: 30%

Where there are no mandatory standards: 30%.

Other Frameworks

28. There are a number of Horizontal Aid Frameworks or Guidelines ie research and development, environment and regional aid. **The DTI's State Aid Policy Unit can give more detailed advice on the application of these frameworks/guidelines.**

Notifying schemes or projects

29. It is important to consider the EC rules from the start of a project and seek advice from DTI on any potential difficulties. Preparation for the formal notification should begin at an early stage. There are two routes for notifying schemes or projects:

- De minimis

- Standard notification.

An individual project funded under an approved aid scheme will in most cases not require individual notification and local authorities may wish to seek advice from DTI on establishing general aid schemes.

De Minimis Rules

30. Any aid scheme which provides aid awards of less than ECU 100,000 (about £84,000) over three years need not be notified. This rule applies regardless of the size of firm (although the de minimis rules do not apply to any aid under the block approval). However, any further aid the beneficiary receives from the local authority or any other source must not take the total aid received over the ECU 100,000 limit. The de minimis rules do not apply to export aid or to aid to firms in the following sectors: Coal, Steel, Shipbuilding, Transport, Fisheries and Agriculture.

Standard Notification

31. The "standard" notification procedure will apply to all aid which falls outwith the de minimis rules (only applicable to aid to large firms) and/or the block approval. Annex 2 provides an outline of the steps to be followed in notifying and obtaining Commission approval for a new scheme or individual award of aid, the most important of which is early contact with DTI's State Aid Policy Unit. The maximum time allowed for the Commission to reach a decision is two months (plus any additional time required for providing supplementary information) .

Additional information and sources of advice

32. This is a brief guide to those parts of the EC State Aids rules which most concern local authorities in their economic development activities. Any questions about them or further advice is available from the State Aids Policy Unit of the DTI (0171-215 4401 or 0171-215 4428; fax: 0171-215 4468).

ANNEX 1

Examples of Aid as seen by the Commission

The Obvious	The not-so obvious	The Surprising
• Grants to firms for: ★ Investment ★ R&D ★ training • cash injections to public enterprises	• loans and guarantees • consultancy advice • creation of Enterprise Zones and Agencies of Urban Renewal • aid to help companies invest in environmental projects • deferral of tax, social security or other payments to the state • writing-off operating losses of public enterprises • provisions to help prepare a public enterprise for privatisation • sale of land/property at discounted rates • legislation to protect or guarantee market share	• free advertising on state owned television • statutory or state administered levies • infrastructural projects benefiting identifiable end-users • guarantee workload or business from publicly owned customers

Notification & Clearance Procedure

Step 1	-	Idea for new scheme or changes to an existing scheme.
Step 2	-	Early contact with DTI (ECTR Division) who will advise on need to notify.
Step 3	-	ECTR/UKREP contact Commission to establish any potential difficulties.
Step 4	-	Prepare formal notification
Step 5	-	Notification submitted to Commission by ECTR.
Step 6	-	Commission consider and possibly seek additional information.
Step 7	-	Hopefully scheme is approved (may be with conditions).