PERSPECTIVES OF ISLANDS COMMISSION ACTION ON STATE AID

The aim of this paper is to set the scene for the work of the Islands Commission on State Aid policy in view of the revision of the State Aid Regulations (for regional aid, aid for environmental protection and energy, aid to airports and airlines, de minimis regulation) for the post-2020 period. For doing so, it recalls the past positions of the Islands Commission with regards to State Aid policy.

Secondly, it recalls the contribution of the Islands Commission to the recent two-step (May and December 2016) consultation on the General Block Exemption Regulation (GBER) that took place in 2016. At a second stage, when the Commission publishes the amended GBER, this document will be revised to regroup which of the suggestions of the Islands Commission were introduced and which the Islands Commission will continue to pursue.

INTRODUCTION AND BACKGROUND

In 2012, the Commission initiated a comprehensive reform programme of the State aid system in order to strengthen the single market, increase the efficiency of public expenditure but also to curb the anti-competitive reactions of States facing the need for economic recovery linked to the crisis. This was part of the negotiation period of the multi-annual financial framework (MFF) 2014-2020 and the strengthening of economic and budgetary monitoring within the scope of the European Semester. The main objectives of this reform were:

- To promote smart, sustainable and inclusive growth in a competitive internal market.
- To focus the commission's ex ante examination on cases with the biggest impact on the internal market while strengthening cooperation between Member States in the application of regulations on state aid.
- To simplify the regulations and speed up the decision-making process. [1]

The modernisation programme resulted in the revision, simplification and the adoption of new guidelines: regional state aid, aid for research, development and innovation, environmental aid, aid for private equity, aid for high-speed broadband networks, as well as de minimis and general block exemption regulations. The main components of the reform were adopted in 2014, and was completed in May 2016 with the Notice on the Notion of State Aid.

[1] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, May 2012. http://eur-lex.europa.eu/legal-content/FR/TXT/?uri=CELEX:52012DC0209

1 THE NOTION OF STATE AID

A major component of the modernisation plan of state aid that started in 2014 was the clarification of the notion of state aid itself and its components, which was only published in May 2016. It provides precision and clarification on the notion of state aid, as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) with a view to contributing to an easier, more transparent and more consistent application of this notion across the Union

For instance, clarifications include the following:

- Public investment for the construction or upgrade of infrastructure is free of State aid, if it does not directly compete with other infrastructure of the same kind. This is typically the case for roads, railway infrastructure, inland waterways and water supply and waste water networks. In contrast, infrastructure in fields such as energy, broadband, airports or ports is often in competition with similar infrastructure. In these sectors, if one project is financed with public money while competing projects have to operate without public support, this can give the subsidised project a selective economic advantage over its rivals. Therefore, such financing is subject to prior Commission scrutiny under EU State aid rules.
- Even if infrastructure is built with the help of State aid and in line with the EU rules, its operator and users should pay a market price to use the infrastructure in question, for instance as a result of a competitive, transparent, non-discriminatory and unconditional tender.
- EU state aid control focuses on public investments that have effect cross-border. Funding provided to local infrastructures or local services which are unlikely to attract customers from other Member States, and which only has a marginal effect on cross-border investment, does not fall under EU State aid rules.
- Public financing of certain cultural activities which are not commercial but provided for free or against a minimal fee, will not be covered by State aid rules.

Qualification for state aid in remote islands and outermost regions raises questions about the real consequences that aid granted in these territories could have on trade and competition on the European market. The effect of such aid remains very localised and marginal when it comes to exports in EU countries. The measures are primarily intended to maintain business activity and the local economy, which in addition is increasingly faced with competition from non-EU countries located nearby and that are not subject to the same regulations for aid or salary-related, social or environmental practices.

2 A REMINDER OF THE ISLANDS COMMISSION'S POSITIONS

2.1 REGIONAL STATE AID

Regional state aid is state aid that may be considered compatible with the internal market and with the objective of promoting the economic development of certain disadvantaged zones. Within the scope of regional State Aid, the Islands Commission has defended in the past the following elements:

- **Coverage of "a" and "c" assisted zones:**

Many island territories are already covered by the provisions (and therefore the limit and intensity of aid) laid down in various legislation: Article 349 of the Treaty (Outermost Regions), Article 170(3)(a) ("Less Developed Regions"), or for those covered by the provisions set out in Article 170(3)(c), under which automatically included are only islands with a population of less than 5,000.

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The Islands Commission has asked for **automatic eligibility of all the islands under Article 107.3.c** and for the revision of the population quota for the concerned Member States, as is already the case for low population density zones[2], which along with islands are also covered by Article 174 of the TFEU.

In this regard, in 2012 the Islands Commission conducted a study[3] assessing the impact of such a measure both for island regions not affected by the provisions of articles 107.3.a and 107.3.c and for the entire EU. It showed that **statistical indicators used for eligibility under Article 107.3.c do not adequately reflect the territorial constraints of islands**, and, more particularly, the case of the smaller islands that suffer the most from a lack of economies of scale and a reduced market size. The inclusion scenarios presented in that study show that only a very small proportion of the EU population would be affected and that the impact on the domestic market would thus be negligible.

The CPMR had also requested that, in order to be consistent with Cohesion Policy, the scope of the "predefined" regions under Article 107.3.c should be extended to all areas that were covered by Article 107.3.a during the previous programming period.

- **The coverage ceiling for "a" and "c" assisted zones:**

The global coverage ceiling (zones "a" and "c") should generally be at least maintained, as it was the case for the current programming period (even a slight increase from took place).

- **Aid to large companies:**

In terms of the aid, the Islands Commission stresses that the positive effects that are brought about by large companies on the economic network of the most vulnerable territories should be considered in the regulation and therefore such aid should be maintained for territories under **Article 107.3.c.**

Currently the aid is maintained solely for initial investment creating new economic activities or for the diversification of existing establishments in new products or for new process innovations. The Islands Commission had asked that aid for large companies is authorised in the regions covered by Article 107.3.c also when they contribute to the strategic objectives set by the EU, or when these areas are faced with a particular element of vulnerability, as acknowledged in Article 174 of the Treaty, or when such companies contribute to the "blue growth" objective, especially the maritime industry and maritime clusters.

The Islands Commission had also raised the issue of the definition of large company (more than 250 employees), as a firm with 251 employees is then put on a par with a multinational. The CPMR had argued for a **creation of an intermediate category[4]**. This would make it possible to distinguish companies that have a systemic interconnection with the regional economic fabric from those that are dependent on multinationals. Although this is not ultimately the case with Regional State Aid, an intermediate category appears in the Guidelines on financial risks, defined by "small businesses with average capitalisation" where the number of employees does not exceed 499 people[5].

Failing to achieve an exemption or expansion of the criteria that allow aid to large companies, the CPMR had argued that the creation of such an intermediate category would, to some extent, help to differentiate those that are historically rooted in the regional economy from those belonging to a multinational and which therefore have unrivalled capacity in terms of access to capital or choice of location.

[2] Article 157, guidelines for RSAs. *"The Commission also considers that each Member State affected must have 'c' coverage that is sufficient for being able to designate regions with low population density as 'c' zones."*
[3] Including island territories under Article 107.3.c, in April 2012, the Islands Commission CPMR
[4] The CPMR's Policy Position, approved by the Political Bureau in Alexandroupolis, March 2013. http://www.crpm.org/pub/docs/392_ppp-aides_detat.pdf
[5] See the definition of applicable field of the guidelines.
http://eur-lex.europa.eu/legal-content/FR/TXT/?uri=CELEX:52014XC0122(04)

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- **Additional transport costs:**

The Islands Commission had proposed a relaxation of the rules on state aid for the island territories so that all island regions are entitled to receive operating aid to cover the additional transportation costs in the same way as the outermost regions and low population density zones.

2.2 STATE AID FOR THE PROTECTION OF THE ENVIRONMENT AND ENERGY

As part of the Europe 2020 strategy and the EU objectives for 2030[6], the Commission has adopted new rules favouring a gradual evolution toward support mechanisms for market based renewable energy. Guidelines relating to state aid for the protection of the environment and energy for the period 2014-2020, define the conditions through which the aid granted can be compatible with the internal market under the terms of Article 107.3.a and c.

The CPMR in a policy position had suggested the following[7]:

- **Inclusion of regions suffering from severe and permanent geographical and demographic handicaps as set out in Articles 174 and 170 of the Treaty:**

  Although the specific handicaps of the assisted zones are taken into account in the guidelines, these zones are exclusively defined as those subject to articles 107.3.a and c, as defined in the regional state aid maps. However, not all island regions are included under these articles and the provisions of Articles 174 and 170[8] of the Treaty recognising the particular situation of regions with severe and permanent geographical and demographic handicaps are not considered to be a factor for specific treatment. **The CPMR had asked that any other region with severe and permanent geographical or demographic handicaps under the terms of Articles 174 and 170 be included within the scope of the guidelines**.

  In the framework of the mid-term review of the MFF, the Commission revised the maps of assisted zones, as most recent statistical data for regional GDP were taken into account. This revision affected the NUTS 2 regions that were not currently listed as "a" zones in Appendix 1 of the RSA guidelines and whose average GDP over the last three years is less than 75% of the EU28 average. Concretely, the revision had an impact on 11 regions, among them 3 island regions, namely, by country: **Crete** and **Ionia Nissia** for Greece and **Sardinia** in Italy. Re-qualification of these regions as eligible for regional aid under the terms of Article 107.3.a though does not appear to be automatic under the guidelines for Regional State Aid. The eligibility of the relevant regions seems to be subject to the Commission's decision which "will establish at that point whether such regions may be eligible for regional aid under the terms of Article 107.3.a (...)"[9].

- **Differentiation of aid intensity:**

  Maximum aid intensity is determined depending on the size of the market failure and the level of distortion of competition and trade. Therefore, the intensity of aid for investment varies depending on the market targeted (e.g. research, energy efficiency, waste management, etc.). Assisted zones may benefit from an increase of the aid intensity up to 100% of eligible costs, equal to 15 percentage points

[6] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - "A policy framework for climate and energy for the period between 2020 and 2030", COM/2014/015 final of 01/22/2014.
[7] http://www.crpm.org/pub/docs/416_fr-rponse_crpm-consultation_aides_etat_energie.pdf
[8] Article 170 of the Treaty on trans-European networks "takes particular account of the need to link island regions, landlocked and peripheral to the central regions of the Union."
[9] Article 183, of RSA guidelines.

for zones covered by Article 107.3.a and 5 points for those covered by article 107.3.c. However, not all islands are included in the assisted zones. The Islands Commission would have liked **"territories with severe and permanent geographical and demographic handicaps" to be mentioned** (such as islands, mountains, sparsely populated areas) where isolation, significant additional costs or restrictions due to the size of the market lead to market failure, and cannot ensure the participation of a sufficient number of companies in the tender process.

- **Exclusion relating to aid for projects in isolated small and micro-networks and outermost regions**

  The outermost regions and small islands cannot for the most part be connected to the European network and operate in a virtually isolated way. **During the consultation, the CPMR rightly requested that the relevant small isolated networks as defined in Directive 2009/72[10] be subject to a specific evaluation or an exclusion from the application of the guidelines.**

2.3 STATE AID FOR AIRPORTS AND AIRLINES

The Islands Commission welcome that recent guidelines for state aid for aviation and airports define "all EU islands, including small island states, such as remote areas, as well as the outermost regions and very low population density zones", demonstrating that it is possible to implement a differentiated policy for islands. Islands have therefore been granted more flexible arrangements for start-up aid for new air routes, improved aid intensities for investment in airports in those territories or authorisation for operating aid with no time limit for airports operating a Service of General Economic Interest (SGEI).

2.4 DE MINIMIS AID

De minimis regulations concern low amounts of aid which are outside the control of state aid since their impact on the operation of the common market is considered to be non-existent. Since the aid defined by the de minimis regulations is not regarded as state aid by EU rules, it is exempt from notification to the Commission.

- **Ceilings**

De minimis aid is essential for regional development policies, actually targeting territories whose economic fabric relies on small and medium sized companies. It seems to be one of the instruments best suited to meeting the needs of the islands, especially since the amount of funding required by island SMEs is generally proportional to their small size. The current ceiling is €200,000 and the Commission has argued that in reality this is only rarely reached and increasing it "would entail significant risks for competition and trade in the single market"[11].

- ***De minimis* de facto reduced by inflation**

However, in reality the ceiling is even significantly lower since between 2006, the year in which the ceiling of €200,000 came into force and 2013, the year in which the new regulations came into force, the EU experienced inflation of almost 16%.

- **Differentiated ceilings according to territories**

De minimis regulations do not take into account the specific nature of territories such as islands and low population density zones whose handicaps are recognised by Article 174 of the Treaty, nor of the outermost

[10] Under the terms of Directive 2009/72/EC "... any network with consumption of less than 2500 GWh an hour in 1996, and that can be interconnected with other networks for an amount lower than 5% of its annual consumption." http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0055:0093:fr:PDF

[11] http://europa.eu/rapid/press-release_IP-13-1293_fr.htm

regions where the lack of economies of scale and the small size of the local market do not allow for genuine market distortion. Within this scope, the CPMR proposed an establishment of differentiated ceilings depending on the nature of the territories. Therefore, higher ceilings could be granted in territories suffering from severe and permanent handicaps, without the operation of the EU's internal market being disrupted as a result[12]. The application of a differential like this would help to create more equal opportunities between those industries having to cope with specific territorial constraints and others.

3 General Block Exemptions Regulation (GBER)

The regulation adopted in 2014 exempts from notification for certain types of aid that are compatible with the market and pursues an objective to simplify and reduce the Commission's administrative and control procedures. The aids exempted are not notified to the Commission by Member States and are subject to a simple memo in order to significantly accelerate their implementation.

The Commission opened a consultation concerning a proposal to amend the General Block Exemption Regulation (GBER) and integrate two new sections into the GBER: Aid for regional airports and Aid for ports. The aim is to simplify the implementation of unproblematic state aid for ports and airports.

A two-step consultation took place in May and December 2016, following which the revision is being prepared. Some changes are also made to the terms of control of the aid exempted from notification and regional operating aid in the outermost regions.

3.1 ELEMENTS RELATED TO ISLAND AND OUTERMOST REGIONS

Past Islands Commission's positions were already touching upon aid related to airports. Some of them were included in the current Commission's proposal for the revision of the GBER.

In the following section, the elements of interest to island and outermost regions which the Commission proposes to be included in the revision of GBER, as well as those proposed by the Island's Commission in the recent consultation and which were adopted are listed. In addition, for each topic the relevant Islands' Commission proposals that have not been considered so far are also listed.

- **Regional operating aid implemented in the outermost regions and sparsely populated areas**

In terms of compensation for additional operating costs relating to the ORs, the Commission has merged the former two categories of additional transport costs and other additional costs arising from a region's remoteness to one.

The annual amounts of aid per beneficiary granted under all operating aid schemes are increased by between 5 and 10 percentage points compared to the amounts indicated in the current regulation.

- **Other relevant proposals by the Islands Commission:**

The flexibility rule proposed by the Commission for companies with a maximum annual turnover of €300 000 allowing an annual amount of aid increased by 10 percentage points should be extended to micro enterprises, i.e. a turnover of €2 million as defined in the GBER.

The Commission should better consider the additional costs linked to transport for all island regions, on the basis of the provisions of Article 174 of the TFEU. The aid granted to maritime and air carriers within the scope of public service missions is not enough to put island industries on a level playing field with those on the mainland. To overcome this problem, an operating aid scheme for island companies should be set up to

[12] "A policy aiming to substantially increase the de minimis in island regions would only affect 15 million people in the EU, equal to 3% of the EU population (2.22% if we exclude ORs)". August 2011, *How to take into account the specific situation of islands in the State aid system?* CPMR, Islands Commission. http://www.islandscommission.org/pub/news/119_fr_2011_note_aides_detat.pdf

compensate for additional transport costs. As part of the guidelines on regional aid and the GBER such aid should be authorised and exempt in the same way as for the outermost regions and sparsely populated areas.

- **Aid for regional airports**

Concerning the category of investment aid for regional airports, the proposal for a Regulation maintains the criteria of non-compatibility of aid for airports located at distance of 100 kilometres or travelling time of 60 minutes by car, bus, train or high-speed train from an existing airport from which scheduled air services are operated.

The conditions defining the very small airports, which are excluded from the application of the above criteria, has been increased from annual passenger traffic of 50,000 to annual passenger traffic of up to 150,000 passengers.

The draft Regulation includes **investment aid only** and still **does not include certain kinds of operating aid or start-up aid for new routes**.

- ***Other relevant proposals by the Islands Commission:***

The criteria of distance and travelling time defining an airport's catchment area should be revised downwards. Concretely, the distance separating two airports, defining the non-compatibility of aid, should be reduced from a distance of 100 kilometres to 50 kilometres, and travelling time should be reduced from 60 minutes to 30 minutes by car, bus, train or high-speed train. These distances and travelling times should refer to cases where **alternative transport is realistically available**.

This is because this criterion could penalise an airport located on an island at a distance of less than 100 kilometres from another airport located on another island, or on the mainland, in which case **access by road would be impossible**. These exclusion criteria based on distance should therefore **not apply** in cases where there is a **territorial discontinuity** and where the absence of transport alternatives (car, bus, train or high-speed train) prevents access to an airport located on another island or on the mainland.

Investment aid for airports with an annual volume of traffic of **between three and five million passengers** should also be included in the GBER, as this is the case in the guidelines on aid to airports and airlines. In the case of airports situated in peripheral regions as defined in the guidelines, there is no real alternative in terms of access to other airports located in the European area.

Investment aid for regional airports is the only category of aid included in the GBER. **Operating aid** granted to airports and start-up aid granted to airlines are not covered by the Commission's proposal and certain types should be allowed. These are essential to maintaining the connectivity of peripheral and island regions and as such should be included in the GBER in the same way as investment aid.

- **Aid for ports**

The draft Regulation includes as eligible costs the costs of investment for the replacement of maritime port infrastructure and access infrastructure within the area of the port, and also mobile equipment. However, maintenance dredging costs remain excluded from eligible costs.

- ***Other relevant proposals by the Islands Commission:***

Maintenance dredging is vital to the proper functioning of the infrastructure and to increase the port's intake capacity. For this reason, **maintenance dredging should not be excluded from eligible investment costs**.

The discrimination between ports in the core network and ports in the comprehensive network should end, as this goes against the principles of accessibility, particularly since ports in the comprehensive network also contribute to the completion of the trans-European transport network. The ports in the comprehensive network drive distortion of competition even less than the ports in the core network. Eligible costs up to EUR 120 million should be extended to cover the whole of the TEN-T network.

The specific provision made for the assisted areas as defined under Articles 107(3) (a) and 107(3) (c) should be extended to all peripheral regions as defined in the GBER, since not all the territories suffering from geographical handicaps and facing problems linked to the development and maintenance of their transport activities are covered.

Appendix 1 - What is state aid?

State aid is a competitive advantage selectively granted to a company by a public body. Article 107.1 of the Treaty relating to the operation of the European Union defines state aid as an aid that fulfils all of the following criteria: it is granted by a State or through State resources, it favours certain companies or certain production types, it distorts or threatens to distort competition and affects trade between Member States. State aid is not authorised and can only be granted if it falls within the scope of state aid compatible with the internal market.

State aid can be compatible if it is part of an exemption to the regulations relating to state aid or if there is an aid scheme approved by the Commission or if the aid was notified and approved by the Commission. Otherwise, ***de minimis*** **regulations** allow the compatibility of a proportion of low amounts of aid.

The General Block Exemption Regulation (GBER) provides a set of block exemptions and is used to define the compatibility of aid by public agencies.

Aid may be defined as compatible by the GBER. It must then meet all of the general criteria and fulfil specific conditions for exemption from the relevant category. The general conditions of application of the GBER stipulate that aid must:

- fall within the scope of the block exemption
- comply with the applicable threshold for the relevant block exemption
- be granted in a transparent manner, be deemed to have an incentivizing effect
- comply with the specific terms of aid intensity and eligible costs
- comply with the rules on the accumulation of aid.

Appendix 2 - Regional state aid

The specific characteristic of the regional state aid system is the territorial nature of its application.

Member States must inform the Commission of this aid, except when it falls under the general block exemption regulation. There are therefore three types of aid: **investment, operating and urban development**. These types of aid must meet specific conditions for regional state aid.

- **Investment aid** must: not exceed the relevant notification threshold, be positioned within the specific framework of exemptions for regional aid, be intended for an assisted zone, concern an initial investment and not exceed the aid ceiling and cover only the eligible costs. Also, the investment must be maintained across the zone for a certain period of time. With regard to aid for the development of a high-speed broadband network, additional conditions are set out in Article 14.10[13].

- Regional **operating aid** is granted exclusively in the Outermost Regions (ORs) and in low population density zones, as defined by Member States in the maps of assisted zones. They are used to compensate for additional costs linked to the transportation of the goods produced and/or processed in these territories, and linked to the direct consequences of one or more permanent handicaps referred to in Article 349 of the Treaty (Article 15).

- **Regional state aid for urban development** is closely related to the implementation strategy of sustainable urban development integrated into the urban environment and fulfilling the specific criteria set out in Article16.

It should be noted that some **business sectors are excluded** from regional aid block exemptions.

Coverage of "a" and "c" assisted zones:

One of the criteria for the compatibility of aid measures with the Treaty is the need for state intervention when faced with a problem of equity or cohesion for which the market does not itself provide significant improvements. In this sense the aid granted in assisted zones, under the terms of articles 107.3.a and c, are considered compatible with the market.

- Type "a" assisted zones are covered by Article 107.3.a, and these are regions where the standard of living is abnormally low or where there is serious underemployment, as well as the regions referred to in Article 349, namely the ORs. They are defined in these regulations as the NUTS2 whose GDP per capita in PPS is less than 75% of the average of the EU 27 based on the last three available years (2008-2010) and ORs.
- Type "c" assisted zones are covered by Article 107.3.c, and are defined as disadvantaged areas compared to the national average within their Member State and for which aid enables development "without being limited by the economic conditions set out in 107.3.c". These type "c" zones are made up of:

  - predefined "c" zones made up of former "a" zones during the 2011-2013 period and low population density zones (NUTS2 <8 inhabitants per km² or NUTS3 <12.5 inhabitants per km²).
  - non-predefined "c" zones which may be made up of territories defined by 5 territorial criteria, including islands of less than 5,000 inhabitants with a GDP per capita below or equal to the EU27 average or an unemployment rate higher than or equal to 115% of the national average[14].

[13] Namely; the aid is only intended for areas that do not have the same category of network and where such a network will not be developed in the following three years on a commercial basis, the operator offers active and passive wholesale access and aid is awarded through a competitive process.
[14] See details in Article 168, guidelines for RSAs.