

EAST AYRSHIRE COUNCIL

DEVELOPMENT SERVICES COMMITTEE – 4 MAY 2004

THE FUTURE OF EUROPEAN UNION REGIONAL AND STATE AIDS

Report by Executive Director of Development and Property Services

1. PURPOSE OF REPORT

1.1 The purposes of this report are:-

- (a) To inform the Committee of the current position and to highlight issues regarding the proposals to reform European Union Regional Aid and State Aids post 2006.
- (b) To inform the Committee of the discussions and outcome of a major lobbying exercise that was held in Brussels 15-18 March 2004; and
- (c) To obtain approval from the Committee for officers and elected members of the Council to participate fully in the continued lobbying of the Scottish Executive, UK Government and European Institutions through the Alliance for Regional Aid (ARA) and other organisations including the West of Scotland European Consortium (WoSEC) and the Coalfield Communities Campaign (CCC) with a view to securing appropriate Regional and State Aid support post 2006 to areas of need in the UK such as East Ayrshire.

2. BACKGROUND

1.1 On 26 August 2003 the Development Services Committee considered and approved a report by the Director of Development Services that informed them of the UK Governments consultation exercise on “A Modern Regional Policy for the United Kingdom”

2.2 On 28 January, 2004 the Members Services and Civic Ceremonial Sub Committee considered a report informing them of a major lobby of the European Institutions on the future of Regional Aid and State Aids proposed by the Alliance for Regional Aid to be held in Brussels 15 -18 March 2004. The Sub-Committee agreed that Councillor James Kelly should represent the Council.

3. A SUMMARY OF THE PROPOSALS FOR THE REFORM OF EU REGIONAL AID POST 2006

3.1 *Regional Aid – The Current Position*

In very general terms the European Union gives aid to less developed regions of Europe in the form of European Structural Funds. The funds are targeted on specific problems or areas of economic need. The funds are delivered through 3 “Objectives”. Objective 1 is for the regions in the

European Union that need most help. Objective 2 is for regions with urban problems, declining traditional industries, rural problems or declining fishing industries. Objective 3 is linked to national programmes to improve people's skills.

Western Scotland is an Objective 2 Area. The Western Scotland Objective 2 Programme 2000-2006 (Single Programme Document) lays out the aims and objectives of the funds for the West of Scotland, establishes priorities under which projects are to be funded and indicates the types and amounts of financial support that are available.

East Ayrshire is within the Objective 2 area and a number of projects in the area have benefited from the current 2000-2006 and earlier Programmes. Recent projects include the East Ayrshire Woodlands initiative, the Ayrshire Electronic Community and Moorfield Industrial Estate. Over £5M of support for projects in East Ayrshire has been approved to date through the current Programme.

Objective 3 is delivered through a separate Programme Document that covers the whole of Scotland. In broad terms this provides revenue support for eligible skills training and employment related projects. To date some £1M of support to projects in East Ayrshire has been approved through this Objective.

Under the present (2000-2006) arrangements the UK Regions receive about £1050M a year from the regionally based Structural Fund Programmes. Objective 1 Areas receive in total around £600M a year and Objective 2 Areas around £450M a year.

- 1.1 *The European Commission's Proposals 2007-2013*** – On 18 February 2004 the European Commission published the "Third Report on Economic and Social Cohesion". This includes the Commission's assessment of progress and problems in narrowing the difference in prosperity between the EU Regions. Most importantly it includes the Commission's proposals for post 2006 EU Regional Policy.

The report outlines a new architecture for cohesion policy for the enlarged Union post 2006. It proposes that support in the future should be focused on actions and investment in line with 3 general priorities namely Convergence, Regional Competitiveness and Employment and Territorial Co-operation.

Convergence - This heading corresponds generally to the current Objective 1 category maintaining the eligibility grounds of the region concerned having a GDP under 75% of the EU average.

It is proposed that 78% of the Cohesion Policy budget would be dedicated to this priority.

Most of the fund would go to support the less developed regions in the new member states of the new EU. As a result, should the proposal prevail, within the United Kingdom only Cornwall and the Scilly Isles would be eligible for support.

The proposal does recognise that a number of other areas within the UK would have also qualified for this level of support had enlargement not occurred and in recognition of this “statistical effect” a special transitional package of assistance (Objective 1a) would be available. The areas that at present appear likely to qualify for this assistance are the Highlands and Islands, Merseyside and West Wales and the Valleys.

Regional Competitiveness and Employment – This priority brings together the current Objectives 2 and 3 and would account for 18% of the budget for the next programme.

It would support some similar activities to those under Objectives 2 and 3 of the current Structural Funds Programme. However the new programmes would not be tied to maps. Funds would be allocated to regions based on the criteria of GDP per inhabitant, employment and population density.

It is proposed that the funds would be split 50/50 between:-

1. National programmes focussed on employment in line with the European Employment Strategy. These would be supported by the European Social Fund (ESF).
2. Regional programmes concentrated around three thematic priorities in line with the Lisbon strategy namely
 - (A) Innovation and the knowledge economy,
 - (B) Accessibility and services of general economic interest,
 - (C) Environment and risk prevention

These would be supported by the European Regional Development Fund (ERDF).

In addition it is proposed that there would be a guaranteed urban dimension within the main stream of regional policy with an allocation of this second priority to a new URBAN+ Focus. Eligible areas would be agreed by Member States in consultation with the regions.

Territorial Co-operation – This would build on the experience of the present INTERREG Initiative accounting for 4% of overall funding support (2 times the current level of support). Essentially this is support for co-operation between regions at cross border and inter-regional level.

Possible Budget - The best estimate is that the UK regions might receive around £800M a year should this proposal prevail. The Convergence regions (the new Objective 1 and 1A areas) might receive around £300M a year. Around £500M a year might support the ERDF element of the Regional Competitiveness and Employment priority. The ESF element of this priority would be around £500M a year (much as at present)

3.3 **The UK Government's Proposals 2007- 2013** - The UK Government has a fundamentally different view about the future of EU Regional Policy.

In March 2003 the UK Government published proposals for an EU Regional Policy in which EU money would be spent exclusively in the poorest countries – the new Member States plus Portugal and Greece of the existing members.

In the rest of the EU, including the UK, spending on regional policy would be re-nationalised. This means it would be up to member state governments themselves to look after the spending needs of their own regions – within a broad framework of priorities agreed at EU level.

It is argued that the UK proposals would mean a much cheaper regional policy. Each member state would contribute less to the EU budget leaving more cash to look after their own regions or to spend on other things.

The UK Government is of the view that the UK has benefited from Regional Funds for over 20 years, has well developed mechanisms for working in Partnership and has strong Regional Institutions. It would like flexibility to allow it to support its own areas of most need in the most appropriate ways.

The UK Government is guaranteeing to make good the loss of funds from Europe by offering the regions what they would have received from Europe if the spending rules that were applied from the current round were re applied to up to date figures and an EU of 25 member states.

Possible Budget - It is estimated that the UK Government's guarantee would be worth some £600M-£650M a year in extra UK Aid to the regions.

3.4 **The Issues**

The European Commission's Regional Aid Proposals – The above budget estimates would suggest that the UK Regions might receive more if the Commission's proposals were to prevail.

However the Commission's figure is derived from budgetary proposals based on the Member States agreeing a contribution to the EU Budget of 1.24 % of their respective GNI.

It is understood that the UK, Germany, The Netherlands and Sweden have expressed the view that the EU Budget should be reduced to 1% of GNI. France and Austria are also suggesting a smaller budget contribution to that proposed.

Any reduction in the EU budget would almost certainly have a negative impact on Regional Policy budgets. This is because spending on the other major budget heading-the CAP-has already been set and cannot be changed.

The Commissions proposals, in budgetary terms, should therefore be considered as being optimistic. Even if they prevailed, a full on regional policy of the sort proposed by the Commission would require either higher Taxes or reduced public expenditure to pay for the higher contribution to Brussels.

Some of this would fall on taxpayers, or public services, in the regions assisted by Brussels. In any case whilst the budget for the Regional Competitiveness and Employment priority may seem comparable to the current Objective 2 budget it will have to cover a much greater population.

These proposals have highlighted a number of concerns particularly within the less prosperous regions. Within the UK disparities between the well off and poor areas continue to expand and there is concern that:-

- The proposals are likely to result in less Structural Funding overall being available within the UK.
- The funds would be made available to the Scottish Executive, Welsh Assembly and the RDA's in England with each having responsibility for dispersing the funds in accordance with general rules.
- The funds would support themes across the regions with a focus on urban areas and with no focus on poorer areas, some of which are rural.
- Unless pressure is exerted on the Scottish Executive a consequence of the above would be that there may be a tendency to support "winning" projects. This might result in the already prosperous areas benefiting most and the prosperity gap between the wealthy and poorer areas (such as East Ayrshire) widening. Less prosperous areas need to be able to offer additional incentives to make project development in their areas both practicable and attractive.

The UK Government's Proposals- These give rise to similar concerns to those outlined above. Whilst the UK Government has indicated a desire for assistance to be made available to poorer areas that desire is not enshrined in the proposals. Poorer areas would therefore need to lobby their respective regions (e.g. The Scottish Executive) to ensure that there is a focus of attention on their areas.

There is an additional doubt as to whether the UK Government can in fact guarantee the level of support indicated beyond the current Parliamentary period.

4 A SUMMARY OF THE PROPOSALS TO REFORM STATE AIDS POST 2006

- ### **4.1 State Aids – The Current Position** – In general terms State Aid is public money used to support private sector business activities and covers a wide range of subsidies and incentives ranging from Government bail out of airlines through to Investment grants for the coal industry and local authority support for Small and Medium sized Enterprises (SME's). Unless they are exempted or approved by the European Commission all state aids are illegal.

The financial incentives offered to companies as part of UK regional policy are a form of State Aid and therefore need approval from the Commission.

EU State Aid rules matter for local authorities in the UK's less prosperous areas as they set the framework for what the UK Government, development agencies and local authorities are allowed to provide in the way of business support.

Examples include Regional Selective Assistance, Enterprise Zones (that are the subject of a separate but related lobbying exercise led by the Alliance for Regional Aid) and Equity Finance schemes.

Different levels of State Aid support are available in different areas. In general, what are known as Tier 1 areas are geographically the same as the current Objective 1 Regional Aid areas and in those areas the maximum levels of financial assistance are available.

Tier 2 areas cover a further 12 million people mostly in the other older industrial parts of Britain and in these areas lesser, but never the less significant, levels of assistance are available.

A substantial part of East Ayrshire is an Assisted Area and the ability to provide State Aid assistance has been crucial in the past either to secure new inward investment or the development of existing business. In 2003, 3 East Ayrshire based firms accepted RSA grant offers totalling £950,000.

4.2 The European Commission's Proposals - The current round of State Aid rules will also finish in 2006 and the Commission has begun to consult on its proposals for a new regime post 2006.

In general terms the Commission proposes that:-

- Small amounts of aid for certain purposes would be subject to blanket exemptions and may therefore be available throughout the UK.
- Tier 1 regional incentives would be restricted to only the post 2006 Objective 1 Areas i.e. Cornwall and the Scilly Isles.
- Highlands and Islands, Merseyside and West Wales and the Valleys (the "statistical effect areas" referred to earlier in this report) may be eligible for transitional assistance.
- There would be no direct replacement for Tier 2 assisted areas.

This would mean that the whole of Central Scotland and the North East and the North West of England (except Merseyside) would lose their current eligibility for regional State Aids after 2006.

- It is proposed that out with the Tier 1 areas State Aids would be delivered horizontally supporting themes that are regarded by the Commission as being those most important to modern businesses i.e.: - Training, Employment, Research and Development, Restructuring and Environmental Aid

4.3 The Issues

The proposals for State Aid post 2006, especially for those areas with currently Tier 2 status where there is no successor proposed, will result in many areas being hit twice as a result of the current Regional Aid and State Aid review proposals. This would have serious consequences on the ability of areas such as East Ayrshire to attract new economic investment opportunities.

5 THE BRUSSELS LOBBY

5.1 As the entire frame work for EU Regional Policy and State Aids post 2006 is under review the Alliance for Regional Aid (ARA) recognised that there was a key window of opportunity for the UK local authorities to make their voice heard by lobbying the European Institutions in Brussels.

5.2 The lobby was held in Brussels on 15 – 18 March and was attended by representatives of some 58 UK local authorities and organisations.

Because of the uncertainties regarding the budget implications of the respective Commission and UK Government proposals re Regional Aid the ARA's position was not to endorse either proposal at this stage.

The primary objectives of the lobby were therefore to:-

- Receive updates on the respective positions of the EU Institutions in Brussels on the above issues.
- Debate and make known to the Institutions the Local Authorities' views and concerns regarding the respective proposals - in particular emphasising the fact that within the UK there remain areas that need assistance and that regional disparities are widening.
- Secure the best deal for the poorer UK areas
- Thereafter agree a framework and timetable for continued lobbying.

5.3 **The Programme for the Lobby** - This included the following:-

- **The UK Government's View** – Presentation by Tim Figures, First Secretary UK REP
- **The European Parliament's View** – Presentations by and discussions with UK Regional Affairs MEPs and Senior Regional Affairs MEPs
- **View from other Industrial Regions in Europe** – Presentations from representatives of regions in Sweden and Germany and also from the European Industrial Regions Association (EIRA)
- **The Commission's Proposals** – Presentation by Graham Meadows, Acting Director General DG Regional Policy

- **State Aid Policy and the Regions** – Presentation by Claude Chene, Depute Director General, DG Competition

5.4 Conclusions from the Discussions – The presentations and the discussions that followed confirmed many of the concerns outlined above and highlighted the following:-

- In relation to Regional Aid neither the Commission's nor the UK Government's positions are fixed at this stage. Similarly the Commission's position regarding State Aids is not fixed.

There is room for manoeuvre and it is vital that areas of need lobby extensively to secure the best deal for their areas.

- The European Commission's proposals for Regional Aid anticipate a contribution to the European Budget that is higher than some Member States, including the UK, believe is appropriate.
- If the EU Budget were to be reduced, in terms of Regional Aid, then there would likely be a focus of attention on support for the new Accession States with a detrimental knock on effect on the budgets for Regional Competitiveness and Employment and Territorial Competition
- Whilst the size of the potential budget for the regions under either the Commission's or UK Government's proposals for Regional Aid is an important consideration, the terms regarding the disbursement of the budget within the regions is equally important.

The Commission's proposals are clear in that funds, other than through the Convergence priority, should be dispersed horizontally. This is potentially to the disadvantage of areas of need such as East Ayrshire that might find it difficult to compete for funds against larger authorities or city authorities that have dedicated European Sections, substantial funds for match purposes, experience with inter regional and cross border partnership programmes and close officer links with the Brussels Institutions.

- Different regions have different views of the Commission's proposals. This is to be expected. Some regions still have significant challenges regarding restructuring of their economies and believe that an element of geographically focused Regional Aid should be retained. Other regions, including some that currently benefit from Objective 2 status, believe that their positions have improved to an extent that they are well placed to compete in wider markets and therefore support the broad thrust of the Commission's proposals.

At the conclusion of its visit the delegation of more than 100 representatives of member authorities of the Alliance for Regional Aid agreed that:-

- 1 There remains enormous uncertainty about whether the basic framework for post 2006 regional policy will reflect the proposals put forward by the

European Commission or the alternative framework advocated by the UK Government, and agrees that the Alliance should seek the best deal for its member authorities within which ever framework eventually prevails.

- 2 Whatever framework for post 2006 regional aid is adopted, the method of allocation of funding in the UK must primarily reflect economic need and should fully involve local authorities. Targeting “quick win” and “easy spend” areas where results flatter the performance of regional development agencies offers no substitute for genuine economic recovery.
- 3 It is absolutely essential that EU State Aid rules continue to provide the flexibility for member states like the UK to offer substantial support to companies in the regions, including in areas where EU regional aid may be reduced or withdrawn.
- 4 The lead officers of the four Alliance associations should be asked to meet as soon as possible to draw up a detailed plan of action to pursue the Alliance’s objectives regarding post 2006 regional policy, including the possible roles of individual member authorities, MEPs, Members of the Welsh Assembly, MSPs and MPs in any proposed lobbying, and that following political approval, the plan of action should be circulated to all member authorities for information and implementation.

6 FINANCIAL IMPLICATIONS

- 6.1** There are no financial implications directly resulting from this report

7 LEGAL/POLICY IMPLICATIONS

- 7.1** There are no legal or policy implications

8 RECOMMENDATIONS

- 8.1** It is recommended that the Committee:-

- (i) Notes the current position regarding proposals to reform European Union Regional and State Aids post 2006
- (ii) Notes and supports the outcome of the Alliance for Regional Aid Lobby held in Brussels 15-18 March 2004
- (iii) Authorises Elected Members and Officers of the Council to participate fully in the continued lobbying of the Scottish Executive, UK Government, and European Institutions through the Alliance for Regional Aid and other organisations including the West of Scotland European Consortium and the Coalfield Communities Campaign with a view to securing appropriate Regional and State Aid support to areas of need in the UK such as East Ayrshire.

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DAH/AM
29 March 2004

BACKGROUND PAPERS

- 1 “A modern regional policy for the United Kingdom” March 2003 HMSO**
- 2 “The Third Report on Economic and Social Cohesion” February 2004
European Commission**

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