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### Enlargement and State Aid in CEECs

#### Introduction

The Accession Act follows the Europe Agreements in requiring the Central and East European Countries (CEECs) to adopt the *acquis communautaire* concerning state aid control.

For example, Article 64(1)(iii) of the Europe Agreement with the Czech Republic concerned any public aid<sup>1</sup> which distorted or threatened to distort competition by favouring certain undertakings or the production of certain goods. Any such aid was incompatible with the proper functioning of the Agreement, in so far as it might affect trade between the Community and the Czech Republic. Article 64(2) of the Agreement stipulated that any practices contrary to this provision should be assessed on the basis of 'criteria' arising from the application of Article 87 EC.<sup>2</sup> At the same time, there was an express requirement of approximation of 'rules on competition' in Article 70 of the Europe Agreement.<sup>3</sup>

The underlying plan was that 'free competition should be based on those [principles] applying within the Community: associated countries might initially benefit from certain exemptions in respect of state aid.'<sup>4</sup> In the event, this plan did not preclude certain variations in the wording of the relevant provisions in the Europe Agreements.<sup>5</sup> For example, Article 64(3) of the Europe Agreement with the Czech Republic provided that, until implementing rules were adopted by the Czech-EU Association Council, practices

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<sup>1</sup> Public aid is defined as state aid in the preambles to the Implementing Rules. See, eg, the 3<sup>rd</sup> recital in the preamble to Decision 1/98 of the EC-Czech Association Council (OJ, 1998, L195/21) adopting the implementing rules for the application of the provisions on state aid referred to in Art 64(1)(iii) and 64(2) EA.

<sup>2</sup> Art 70(2) of the Stabilisation and Association Agreement with Croatia (OJ, 2001, C332/2) also refers to 'interpretative instruments adopted by the Community institutions'.

<sup>3</sup> See, generally, A Evans, 'Voluntary Harmonization in Integration between the European Community and Eastern Europe' (1997) ELR 201.

<sup>4</sup> Association Agreements with the CEECs: a General Outline, COM (90) 390, Annex, 5.

<sup>5</sup> See, regarding the differences, A-M Van den Bossche, 'Competition Provisions in the Europe Agreements', in M Maresceau (ed), *Enlarging the European Union: Relations Between the EU and Central and Eastern Europe* (Longman, London, 1997) 84.

incompatible with Article 64(1) should be dealt with by the Contracting Parties on their respective territories, according to their respective legislations.<sup>6</sup> In contrast, Article 63(3) of the Europe Agreement with Poland<sup>7</sup> provided that, until implementing rules were adopted, the provisions of the Agreement on interpretation and application of Articles VI, XVI and XXIII GATT were to be applied as the rules for the implementation of Article 63(1)(iii) and (2).<sup>8</sup> The practical significance of such differences in wording might be expected to be reduced by the implementing rules adopted by the Association Councils.<sup>9</sup>

Implementing rules were to be adopted by the relevant Association Council within three years of the entry into force of each Europe Agreement.<sup>10</sup> In June 1998 the Association Council adopted implementing rules in the case of the Czech Republic.<sup>11</sup> These rules were treated as a model for the rules adopted by the EU-Bulgaria,<sup>12</sup> EU-Estonia,<sup>13</sup> EU-Latvia,<sup>14</sup> EU-Lithuania,<sup>15</sup> EU-Poland,<sup>16</sup> EU-Romania,<sup>17</sup> EU-Slovakia,<sup>18</sup> and EU-Slovenia<sup>19</sup> Association Councils, but 'constitutional problems' made their adoption problematic in Hungary.<sup>20</sup> The

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<sup>6</sup> The same wording was used in Art 64(3) of the Europe Agreement with Slovakia and Art 65(3) of the Europe Agreement with Slovenia.

<sup>7</sup> The equivalent of Art 64 of the Europe Agreement with the Czech Republic.

<sup>8</sup> The same approach was adopted in the Europe Agreements with Estonia, Latvia, and Lithuania.

<sup>9</sup> But see heading below, regarding 'transition aid' under these rules.

<sup>10</sup> See, eg, Art 64(3) of the Europe Agreement with the Czech Republic. The rules were 'apart from wider policy considerations, also seen as an important step towards reducing any possible trade friction between the Community and the third country in question, because [they might], if properly implemented, eliminate the need for either party to have recourse to action under the WTO Agreement on Subsidies and Countervailing Measures.' See *Twenty-ninth Report on Competition Policy* (EC Commission, Brussels, 2000), 111-112.

<sup>11</sup> Decision 1/98 of the EC-Czech Association Council (OJ, 1998, L195/21) adopting the implementing rules for the application of the provisions on state aid referred to in Art 64(1)(iii) and 64(2) EA.

<sup>12</sup> Decision 2/2001 (OJ, 2000, L216/20).

<sup>13</sup> Decision 1/2002 (OJ, 2002, L299/43). They had apparently been agreed more than 2 years before their publication. See the Joint Press Release of the Third Meeting of the EU-Estonia Association Council, 14 Feb 2000.

<sup>14</sup> Decision 4/2001 (OJ, 2000, L163/16). In some CEECs national legislation provided for assessment of the compatibility of state aid by way of direct application of the Europe Agreement. See, regarding the Law on State Aid 1998 in Latvia, Progress Report 2000, 47.

<sup>15</sup> Decision 2/2001 (OJ, 2001, L98/19).

<sup>16</sup> Decision 3/2001 (OJ, 2001, L215/39).

<sup>17</sup> Decision 4/2000 (OJ, 2001, L138/16).

<sup>18</sup> Decision 6/2001 (OJ, 2002, L48/11).

<sup>19</sup> Decision 2/2001 (OJ, 2001, L163/20).

<sup>20</sup> NPAA, 177. Arts 1 and 6 of the implementing rules relating to the restrictive practices of undertakings (Decision 2/96 of the EU-Hungary Association Council, OJ, 1996, L295/29) were declared unconstitutional by the Hungarian Constitutional Court, because they required the Hungarian Office of Economic Competition to apply Union law criteria directly. See J Volkai, 'The Application of the Europe Agreement and European Law in Hungary: the Judgment of an Activist Constitutional Court on Activist Notions', *Harvard Jean Monnet Paper* 8/99. A German translation of the judgment is available at <http://www.mkab.hu/Dec/deu/30-1998.htm>. See also H. Küpper, 'Integration mit Hindernissen – Die "Europa-Entscheidung" des ungarischen Verfassungsgerichts', ROW (1998) 333. The implementing rules had to be re-adopted by Decision 1/2002 (OJ, 2002, L145/16). Cf, regarding the Czech Constitutional Court and, more generally, problems of 'closed constitutions', HG Krenzler and M Everson, 'Preparing for the Acquis Communautaire', *RSC Policy Paper* 98/6, 15.

rules included procedures for the settlement of disputes concerning state aid, though the preference was to deal with any such disputes in the context of accession negotiations.<sup>21</sup>

Adoption of the *acquis* in the context of accession negotiations has proved problematic in all the CEECs. The problems are documented in successive Commission reports on the individual applicant countries.<sup>22</sup> They will be examined in the following sections of the present article.

The emphasis in the reports, as in the accession negotiations, is on critical assessment of the adoption performance by the CEECs rather than on self-criticism by the EU. The lack of self-criticism may be unjustified. For example, observers argue that both the EU and the CEECs need to distinguish between aid that creates identifiable cross-border distortions to competition and aid that is merely irritating to competitors or a waste of taxpayers' money. This distinction is far from being implemented either inside or outside the Union. Yet, state aid control is presented as playing 'a key role in creating a well-functioning economy'<sup>23</sup> and as necessary 'to ensure that the economic actors in the Candidate countries are able to withstand the competitive pressures of the internal market'.<sup>24</sup>

There are more particular problems with the *acquis*. There has been no coherent application of the principle of subsidiarity in this field. The EU hesitates between considering the control of state aid as important to prevent Member States from inflicting damage on each other, and treating it as a kind of medicine that should be taken for Member States' own good. Sometimes governments choose to use state aid in a way that is foolish, but causes little damage outside their own borders. The waste of taxpayers' funds is a matter of concern, but there are domestic political mechanisms for the expression of such concern.<sup>25</sup>

Moreover, the Commission has a large and growing caseload of state aid notifications to assess. But its ability to control the aid being granted is very limited. The proportion of cases that culminate in a negative decision has fallen from between 2% and 5% in the late 1980s to under 1.5% since 1991. Because of the overload on the Commission's staff it is questionable whether the aids found objectionable are necessarily the ones that are most damaging, either to Member States or to the common market as a whole.

Again, the lack of clear principles underlying the Commission's control of state aid is an invitation to lobbying and to the use of the judicial process as a strategic tool against competitors. A resulting risk is that the state aid rules may be invoked by EU firms (as anti-dumping procedures may have been used)<sup>26</sup> merely to stifle competition from firms in CEECs. Both CEECs and the EU need to distinguish much more carefully aid that creates identifiable cross-border distortions to competition from aid that is merely irritating to competitors or a waste of taxpayers' money. A policy that could make this distinction is a long way from being implemented, either inside or outside the EU.<sup>27</sup>

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<sup>21</sup> P Schütterle, 'State Aid Control - an Accession Criterion' (2002) 39 CMLRev 577, 581.

<sup>22</sup> The reports on competition policy tend to be even more critical. See, eg, *Twenty-ninth Report on Competition Policy* (EC Commission, Brussels, 2000), 111-112.

<sup>23</sup> State Aid Scoreboard – Special Edition on the Candidate Countries, COM (2002)638, 6.

<sup>24</sup> *Ibid*, 9.

<sup>25</sup> FG Wislade, *Regional State Aid and Competition Policy in the European Union* (Kluwer International, The Hague, 2003), 247-8.

<sup>26</sup> See, eg, A Evans, 'Zastosowanie przepisow antidumpingowych do Krajow o "gospodarce nierynkowej"' in *Europa 1992: A Mozliwosci Polskiego Eksportu do EWG* (University of Gdansk, 1989).

<sup>27</sup> P Seabright, 'Controlling State Aids: Implications for the Accession Countries' (Centre for Economic Policy Research, London, 2003).

Such criticism takes as its premise the need to ensure that the *acquis* concerning state aid control maximizes efficiency in trade between states. It pays less attention to the problems of adapting this *acquis* to other goals, such as regional development, of significance for CEECs. Such problems with the *acquis* seem to have been largely disregarded in implementation of the Europe Agreements<sup>28</sup> and in accession negotiations. The focus has been on problems in legislative and administrative adoption of the *acquis* in the CEECs, which will be examined in the following sections of the present article.

The Union may dismiss the problems as ‘largely technical.’<sup>29</sup> However, observers may be led to claim that the ‘EU is trying to impose the whole *acquis* on the candidate countries in a totally inflexible and anti-economic way.’<sup>30</sup> At least, differences in economic conditions, as between, for example, Slovenia on the one hand and Romania on the other, may make it unrealistic to expect all the CEECs to accept the state aid *acquis* without substantial modification.<sup>31</sup> Prospects for more ‘flexible’ solutions will be explored in final sections of the present article.

### Legislative Problems in Adoption of the *Acquis*

The EU has insisted that national legislation in the CEECs should give effect to Union rules on state aid, including rules contained in Commission guidelines,<sup>32</sup> which are of disputed legal status within the EU.<sup>33</sup> The legislation adopted by the CEECs has been critically examined by the Commission and has often had to be extended in scope, made more precise, or tailored to the dynamism of EU law. In many cases further legislative reform is still demanded by the Commission.<sup>34</sup>

#### *Scope*

In Estonia the Competition Act 1998 dealt with state aid in Chapter 6.<sup>35</sup> The Commission considered that this legislation did not go far enough. According to the Commission, in order to make the aid control framework fully operational, regulations covering EU legislation and other relevant instruments needed to be adopted.<sup>36</sup> The Competition Act 2001 and implementing legislation relating to aid to the shipbuilding/repair sector go some way to meeting this criticism. The new Act contains the main principles of state aid control, although implementing legislation in three sectors regarded as sensitive (steel, cars, and synthetic fibres) has not been completed.<sup>37</sup>

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<sup>28</sup> See, generally, A Evans, ‘Contextual Problems of EU Law: State Aid Control under the Europe Agreements’, (1996) ELRev 263.

<sup>29</sup> Cf HG Krenzler and M Everson, op cit, 2.

<sup>30</sup> A Mayhew, ‘Enlargement of the European Union: an Analysis of the Negotiations with the Central and Eastern European Candidate Countries’, *Sussex European Institute Working Paper* 39 (2000), 43.

<sup>31</sup> See, eg, T Tóth, ‘Competition Law in Hungary: Harmonisation Towards EU Membership’, [1998] ECLR 358, 361. Cf, the argument that ‘a variegated *acquis* would not be a sign of Union weakness, but rather an indication of its maturity and ability legally to structure intensified integration within a highly diversified European continent’ (HG Krenzler and M Everson, op cit, 19).

<sup>32</sup> See, eg, Art 2(1) of the Czech Implementing Rules (OJ, 1998, L195/21).

<sup>33</sup> A Evans, *EC Law of State Aid* (Oxford University Press, 1997).

<sup>34</sup> The need for secondary legislation might be obviated where national law allows for direct reference to the *acquis* (Czech Progress Report 2001, 54).

<sup>35</sup> <http://www.legaltext.ee/en/andmebaas/ava.asp?m=022>

<sup>36</sup> Progress Report 2000, 42-44.

<sup>37</sup> Progress Report 2002, 59.

In Poland the Act on the Conditions of Admissibility and Monitoring of State Aid to Entrepreneurs 2001 was criticized, because it did not always require examination of aid to large-scale restructuring projects by the Office for Competition and Consumer Protection.<sup>38</sup>

In Hungary the Act on Public Finance 2001 includes a general prohibition of state aid. A Government Decree on exemptions from the prohibition of state aid contains the basic principles of state aid control. However, important fiscal aid schemes are excluded, and regional aid ceilings are considered too high by the Commission.<sup>39</sup>

The Lithuanian Act on State Aid 1998, which entered into force in 2000, contains the basic principles of EC state aid control. More of the *acquis* has been implemented through resolutions, notably on *de minimis* aid. However, the Act does not apparently cover aid proposed directly by the Government under legislative acts and decisions.<sup>40</sup>

Romanian legislation on state aid control was adopted in July 1999. Implementing regulations, concerning regional aid, aid to small and medium-sized enterprises, aid to rescue and restructure firms in difficulty, research and development aid, training aid, and environmental protection aid, came into force in January 2003. However, further transposition of the substantive state aid rules is still necessary. It is also unclear whether legislation on state aid control takes precedence over legislation on businesses and legislation under which state aid is provided.<sup>41</sup>

### *Precision*

In July 2002 Poland adopted a new Act on the Conditions of Admissibility and Supervision of State Aid for Entrepreneurs. The aim of the new Act is to define more accurately and extend the statutory definitions of state aid, to strengthen the responsibility of the organs that grant the aid, and to create the institutions for aid schemes. Furthermore, regulations on regional, horizontal, and sectoral aid as well as on procedures have been adopted. However, the transposition of the Commission guidelines on restructuring and environmental aid into Polish regulations is considered insufficiently precise.<sup>42</sup>

### *Dynamism*

In Slovakia the State Aid Act 1999 was not in line with the *acquis*, particularly as regards aid to employment and aid to sensitive sectors, such as automobiles and steel.<sup>43</sup> A revised State Aid Act 2001 is broadly in line with the *acquis*. In particular, the Act updates Slovakia's rules on regional aid and on aid to the sensitive sectors, and also incorporates the key provisions of the 'block exemptions' on aid to small and medium-sized enterprises, on training aid, and on *de minimis* aid. Even so, the Commission insists that Slovakia continues to update its legislation in line with recent developments in the *acquis*, such as the guidelines for aid to rescue and restructuring and on environmental aid.<sup>44</sup> The CEECs may thus be said to face the problem of 'moving targets'.<sup>45</sup>

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<sup>38</sup> Progress Report 2000, 45.

<sup>39</sup> Progress Report 2002, 63.

<sup>40</sup> Progress Report 2000, 46.

<sup>41</sup> Progress Report 2002, 66-67.

<sup>42</sup> Progress Report 2002, 64.

<sup>43</sup> Progress Report 2000, 43-44.

<sup>44</sup> Progress Report 2002, 63. See, similarly, regarding Slovenia, Progress Report 2002, 59. Cf, regarding Latvia, Progress Report 2002, 63.

<sup>45</sup> HG Krenzler and M Everson, *id op*, 4. See also T Tóth, *id op*, 365.

## Administrative Problems in Adoption of the *Acquis*

As the Commission puts it, 'rule changes [must] result in new conditions on the ground as well as in the statute books'.<sup>46</sup> The Commission once suggested, as a future possibility, that a 'competition authority' be created along the lines of the EFTA Surveillance Authority by several or all of the CEECs.<sup>47</sup> However, this suggestion was not pursued. Attention has turned to administrative problems, particularly those arising from institutional and procedural arrangements for the control of state aid, in individual CEECs. According to the Commission, each CEEC must establish 'an adequate administrative capacity (in particular a well-functioning competition authority)' as well as 'a credible enforcement record of the *acquis*'.<sup>48</sup>

### *Institutions*

Bodies responsible for state aid control have been established in each CEEC,<sup>49</sup> as envisaged in the Implementing Rules.<sup>50</sup>

In the Czech Republic the Act on State Aid 2000 provided for state aid control by the Office for the Protection of Competition (OPEC). OPEC is a fully independent authority. It is responsible for the analysis of existing and future individual aid awards and programmes in the Czech Republic and gave opinions about their compatibility with Article 64(1)(iii) and (2) of the Europe Agreement.<sup>51</sup>

In Poland the Office for Competition and Consumer Protection (OCCP) is responsible for the control of state aid. The Office is not classified as a ministry, which results in lower levels of remuneration and may make staff retention difficult.<sup>52</sup>

Often, state aid control bodies are within the ministry of finance in the CEEC concerned. For example, in Hungary the State Aid Monitoring Office (SAMO) is within the Ministry of Finance.<sup>53</sup> In Estonia the Ministry of Finance contains the Competition and State Aid Division (CSAD).<sup>54</sup>

In Latvia the State Aid Surveillance Commission (SASC) is an independent collegiate institution made up of officials representing different state institutions within the Ministry of Finance. However, 'budgetary restraints' may prevent decisions of this Commission from

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<sup>46</sup> *European Report* 2169 (26 Oct. 1996).

<sup>47</sup> Follow Up to 'The Europe Agreements and Beyond: a Strategy to Prepare the CEECs for Accession', COM (94)361, 7.

<sup>48</sup> *Ibid*, 10.

<sup>49</sup> The Commission will, under the relevant Union programmes, assist the bodies responsible for state aid control in the CEECs by providing for documentation, training, study tours and other relevant technical assistance. Such assistance may be provided under the Phare Programme. However, it has been questioned whether the human and financial resources of the Commission are sufficient to enable adequate and effective assistance to be given to all the CEECs (ESC Opinion of 25 Jan 1995 (OJ, 1995, C102/40), para 3.38). This problem, as well as the limited absorption capacity of the CEECs, has also been observed in the context of twinning arrangements with officials from the CEECs and the Member States. See *Twinning: final assessment report*, July 2000 4, [http://europa.eu.int/comm/enlargement/twinning/assesm\\_july.pdf](http://europa.eu.int/comm/enlargement/twinning/assesm_july.pdf).

<sup>50</sup> See, eg, the 4<sup>th</sup> and 5<sup>th</sup> recitals to the Preamble to the Czech Implementing Rules (OJ, 1998, L195/21).

<sup>51</sup> Progress Report 2000, 51-52.

<sup>52</sup> Progress Report 2000, 51-52.

<sup>53</sup> Progress Report 2002, 63; [http://www.meh.hu/PM/TVI/feladat\\_en.htm](http://www.meh.hu/PM/TVI/feladat_en.htm).

<sup>54</sup> Progress Report 2002, 58.

being implemented.<sup>55</sup> In January 2002 a new division, the State Aid Control Division, was created within the Ministry of Finance. This division takes over the role of Secretariat to SASC.<sup>56</sup>

It may seem problematic that aid control bodies in the CEECs lack independence from their national government.<sup>57</sup> True, aid monitoring has been assigned to ministries in existing Member States. For example, in Germany the Ministry of Economic Development monitors state aid; in France the Ministry of Economy together with the sectoral ministries do so; in Austria a unit within the Federal Chancellery, which works in close contact with the respective ministries, does so.<sup>58</sup> However, the state aid provisions of the EC Treaty are applied *vis-à-vis* Member States by the Commission as a supranational authority. The Member States themselves need not set up special independent authorities to decide whether or not state aid is permissible.<sup>59</sup>

Apart from doubts about their independence, the work of bodies responsible for state aid control in CEECs may be impeded by lack of training, as in the Czech Republic,<sup>60</sup> Poland,<sup>61</sup> and Lithuania.<sup>62</sup>

There may also be demarcation problems, as in the case of Bulgaria, Romania,<sup>63</sup> and Slovenia.<sup>64</sup> In Bulgaria the State Aid Department within the Ministry of Finance is responsible for *ex post* state aid monitoring (annual report and inventory). The State Aid Directorate within the Commission for Protection of Competition (CPC) - a fully independent authority - is in charge of *ex ante* state aid control (authorizing or prohibiting aid projects after compulsory notification). A memorandum of understanding on co-operation between these two bodies was signed in September 1999, but practical difficulties seem to persist. According to the European Commission, clarification of institutional responsibilities, to ensure effective monitoring and control of direct and indirect state aids at national and regional level, is necessary.<sup>65</sup>

Such problems may reflect the role of the CEECs as 'downloaders' rather than 'uploaders' of EU policy.<sup>66</sup> In other words, CEECs adopt rather than influence the development of the *acquis*. In these circumstances, they may seek to minimize the impact of such adoption on

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<sup>55</sup> Progress Report 2000, 46-47.

<sup>56</sup> Progress Report 2002, 63.

<sup>57</sup> But cf, regarding the possibility that independence may imply isolation, T Tóth, *id op*, 366.

<sup>58</sup> <http://www.csd.bg/publications.inst-infrastructure-en/5.html>.

<sup>59</sup> In contrast, Art 70(4) of the SAA with Croatia requires the establishment of 'an operationally independent authority'.

<sup>60</sup> Progress Report 2002, 51-52. PHARE assistance may be used in the training of personnel within 'twinning' arrangements (Czech Position Paper, chapter 6).

<sup>61</sup> Council Decision 2002/91 (OJ, 2002, L44/72) on the principles, priorities, intermediate objectives and conditions contained in the Accession Partnership with Poland.

<sup>62</sup> Progress Report 2002, 62.

<sup>63</sup> In Romania there are two competition authorities: the Competition Council and the Competition Office, the former being responsible for authorizing or prohibiting aid and the latter being responsible for monitoring and reporting aid.

<sup>64</sup> In Slovenia there are a Commission for Monitoring of State Aid and a Commission for State Aid Control.

<sup>65</sup> Progress Report 2002, 61-62.

<sup>66</sup> TA Börzel, 'Shaping and Taking EU Policies: Member State Responses to Europeanization', *Queen's Papers on Europeanization* 2/2003.

their domestic institutional arrangements. Hence, the impact be 'shallow' and may be 'insulated' from their general institutional systems.

### *Procedures*

Various procedures for state aid control have been established in the CEECs.

However, the scope of these procedures may be limited. For example, Bulgaria,<sup>67</sup> the Czech Republic,<sup>68</sup> and Slovakia<sup>69</sup> have been criticized for not having a comprehensive notification system in operation.

In Romania numerous state aid measures are not notified to the competition authorities. According to the European Commission, the Romanian Competition Council should take a firmer and more pro-active approach to ensure the effective application and enforcement of the state aid rules, including non-notified aid, and the alignment of existing aid schemes and legislation under which authorities at various levels grant aid.<sup>70</sup> Despite such criticism from the Commission, the Competition Council has not yet taken any decision on non-notified or existing aid.<sup>71</sup>

In Hungary the procedure for prior notification of state aid covers most aid, including aid to sensitive sectors, large investment projects, and the Hungarian Privatization and State Holding Agency. At present, however, the imposition of a prior notification obligation on local authorities is for constitutional reasons not legally possible. According to Government Decree 254/2000<sup>72</sup> amending Government Decree 217/1998,<sup>73</sup> local authorities are only obliged to provide *ex post* information – in aggregate form - on state aid, listed separately in their annual report.<sup>74</sup>

In Latvia the relatively small number of aid cases decided upon by the State Aid Surveillance Commission (SASC) has led the European Commission to express doubt whether all aids are, in fact, being notified.<sup>75</sup>

The European Commission does not consider that solutions to such problems depend solely on the work of bodies established to control state aid. Accordingly, the CEECs have all been called upon to increase awareness of the rules amongst market participants and aid granters and to intensify the training of the judiciary in the field of state aid.<sup>76</sup>

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<sup>67</sup> Progress Report 2003, 55.

<sup>68</sup> Progress Report 2000, 51-52.

<sup>69</sup> Progress Report 2000, 43.

<sup>70</sup> Progress Report 2002, 67.

<sup>71</sup> Progress Report 2003, 60.

<sup>72</sup> XII.25.

<sup>73</sup> XII.30.

<sup>74</sup> Hungarian NPAA.

<sup>75</sup> Progress Report 2000, 46-47.

<sup>76</sup> See, eg, Council Decision 2002/85 (OJ, 2000, L44/20) on the principles, priorities, intermediate objectives and conditions contained in the Accession Partnership with the Czech Republic. In Latvia it was planned that by 2002 most judges would have been trained in EU law (Statement of the Latvian Foreign Minister at the Second Meeting of the EU-Latvia Association Council, 22 February 1999). It is said that the legislation in the CEECs rarely allows for proceedings to be taken against the national aid monitoring authority. See P Schütterle, *id op*, 579. However, an SAO decision was appealed against and upheld by the Slovak Supreme Court (Progress Report 2002, 63). In Bulgaria decisions of the Commission for Protection of Competition may be challenged before the Supreme Administrative Court, but this body works slowly and does not seem to the Commission to be well equipped to handle competition cases. In 1999 the Court ruled on only 11



The work of bodies established to control state aid may also be heavily dependent on legislative transposition of the *acquis*. In the Czech Republic, for example, an amendment to the Investment Incentives Act, which came into force in January 2002, creates a direct connection between the Act and the State Aid Act. OPEC is faced with the necessity to assess every individual aid award under the Investment Incentives Act. A heavy workload, which could be avoided by establishing a fully compatible investment scheme, is entailed.<sup>77</sup>

Again, in areas where the transposition of the *acquis* has been less than satisfactory, for example restructuring aid arising from the cancellation or rescheduling of public liabilities, and environmental aid, the enforcement record of the Polish OCCP has not impressed the European Commission.<sup>78</sup>

### Solutions to Adoption Problems

Solutions to adoption problems may not depend simply on legislative and administrative reforms in the CEECs. They may also depend on evolution of the *acquis* itself.

#### *Authorization of Regional Aid*

Provision was made in the Europe Agreements for the CEECs to be treated as areas identical to those areas of the Union described in Article 87(3)(a) EC.

For example, according to Article 64(4)(a) of the Czech Agreement, for the purposes of applying Article 64(1)(iii), the Parties recognized that during the first five years<sup>79</sup> after the entry into force of the Agreement, any public aid granted by the Czech Republic should be assessed taking into account the fact that the Czech Republic should be regarded as an area identical to those areas of the Union described in Article 87(3)(a) EC.

Under all the Europe Agreements the relevant Association Council should, taking into account the economic situation of the CEEC concerned, decide whether to extend the initial period. The implementing rules laid down the procedure for taking such decisions. According to the Czech rules, the monitoring authorities should jointly evaluate the maximum aid intensities and specific regional coverage of areas in the Czech Republic eligible for regional aid. They should submit a joint proposal to the Association Committee, which should take a decision on the proposal on behalf of the Association Council.<sup>80</sup>

In the case of the Czech Republic, the Commission examined the figures and information available for this country. The data showed that gross domestic product (GDP) *per capita* there measured in purchasing power standards (PPS) reached 63% of the Union average<sup>81</sup> in 1997. Accordingly, there were sufficient grounds for granting the Czech Republic an extension. However, regular information had to be provided on the economic situation of the Czech Republic, particularly regarding regional *per capita* GDP figures.<sup>82</sup>

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of the 50 such cases before it. See Progress Report 2000, 43-44. In Lithuania aid recipients and third parties may challenge decisions of the Competition Council before the Higher Administrative Tribunal. In Romania state aid law is enforced through the Competition Council and national courts with the possibility of appeal to the Supreme Court.

<sup>77</sup> Progress Report 2002, 66.

<sup>78</sup> Progress Report 2002, 64.

<sup>79</sup> In later Europe Agreements the periods were 4 years.

<sup>80</sup> Art 4(2) of the implementing rules (OJ, 1998, L195/21).

<sup>81</sup> Since the analogue regions were those covered by Art 87(3)(a) EC, modification of this average, to take account of GDP in the CEECs, was unnecessary.

<sup>82</sup> EU-Czech Association Council Decision 3/2001 (OJ, 2001, L100/16).

Extensions, sometimes with retrospective effect,<sup>83</sup> were agreed within other Association Councils, though the Councils did not apparently have available the data necessary to determine the appropriateness of such extensions throughout the territory of each CEEC.

Very limited regional data existed concerning structural business statistics in Hungary<sup>84</sup> and Poland.<sup>85</sup> No data existed concerning social indicators and structural business statistics in regions of the Czech Republic<sup>86</sup> or Slovakia.<sup>87</sup> In Bulgaria regional statistical data were poor, and the creation of a database for regional data storage would require significant investment of financial resources.<sup>88</sup> In Romania very limited data existed concerning investment, social indicators, and structural business statistics.<sup>89</sup> No regional data were available for GDP, social indicators, or structural business statistics in Slovenia,<sup>90</sup> Latvia,<sup>91</sup> or Estonia.<sup>92</sup>

More particularly, decisions on extensions, such as that for the Czech Republic, sought to take due account of the differing levels of economic development and envisaged modulation of the maximum aid intensities within the different regions of the Czech Republic. To this end, differentiation of aid intensities was agreed jointly by the Commission and the Czech monitoring authority and stipulated in the decision. However, the Czech Government had merely 'created an inter-ministerial committee to consider [the] issue' of a regional aid map.<sup>93</sup> Regional aid maps were intended to differentiate aid intensity levels according to the severity of the regional problems, as reflected in *per capita* income, being addressed. In the absence of such a map, it is uncertain on what data the modulation of maximum aid intensities envisaged in the decision was to be based.<sup>94</sup>

Similarly, in the case of Poland, the procedure for extending the initial transitional period was 'well under way,'<sup>95</sup> even before the preparation of a regional aid map had commenced.<sup>96</sup>

Later decisions on extension required the CEEC concerned within six months of the decision to submit *per capita* GDP figures at NUTS Level II, that is the whole of the country, so that a regional aid map could be adopted.<sup>97</sup> The maximum level of aid intensity for Slovenia generally was set at 40%, though 50% was permissible in EU regions which, like

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<sup>83</sup> See, eg, COM (2002)638, 17.

<sup>84</sup> NPAA, 50.

<sup>85</sup> Progress Report 2000, 67-68.

<sup>86</sup> Progress Report 2000, 82.

<sup>87</sup> Progress Report 2000, 63-65.

<sup>88</sup> Progress Report 2000, 69-70.

<sup>89</sup> Progress Report 2000, 69-70.

<sup>90</sup> Progress Report 2000, 63-64.

<sup>91</sup> Progress Report 2000, 74-75.

<sup>92</sup> Progress Report 2000, 68.

<sup>93</sup> Progress Report 2000, 51.

<sup>94</sup> The Czech Republic subsequently proposed a regional aid map, which was in line with the *acquis*, for joint adoption by the Association Committee (Progress Report 2002, 66). The SAA with Croatia makes express reference to a regional aid map (Art 70(7)(b)).

<sup>95</sup> Joint Press Release of the Seventh Meeting of the EU-Poland Association Council, 10 October 2000.

<sup>96</sup> Progress Report 2000, 43. Poland subsequently proposed a regional aid map for adoption under the Europe Agreement (Progress Report 2002, 63).

<sup>97</sup> See, eg, EU-Slovenia Association Council Decision 4/2001 (OJ, 2002, L37/9), Art 2.

Slovenia, had a *per capita* GDP less than 60% of the Union average. The maximum level of aid intensity was set at 35% for Central Slovenia, 'in view of the relative situation of each NUTS level III region'.<sup>98</sup> Possibly, lower maxima than within the existing Union were set because 'the seriousness and intensity of the regional problems addresses must be assessed within the broader context of all the countries which have concluded Europe Agreements'.<sup>99</sup>

The lack of such data may conceal underlying problems of the *acquis*. Improved data and accession may sharpen the focus on such problems.

Article 87(3)(a) EC provides that aid may be authorized 'to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment.' According to Commission practice, the main criterion for considering an area eligible for regional aid pursuant to Article 87(3)(a) EC is that GDP *per capita* should be less than 75% of the Union average, measured in PPS.<sup>100</sup> This practice, if unreformed, means that enlargement will create 'victims of shifting statistical averages'.<sup>101</sup> In other words, a few regions of CEECs will cease to meet the 75% criterion, simply because enlargement leads to a reduction of the determining average.<sup>102</sup>

Again, Commission practice within the Union has been based on the principle of concentration – that aid should be concentrated in the most 'needy' regions.<sup>103</sup> It is unclear whether such practice is capable of taking into account the structural problems of the CEECs.<sup>104</sup> In the case of Poland, for example, it has been argued that if 'structural mega-adjustment' is to succeed, the regions with the greatest economic potential, such as Gdansk, Poznan, and Warsaw, should receive priority for state support, particularly as regards infrastructure.<sup>105</sup> In other words, comparative strength rather than comparative weakness should be a criterion for the grant of aid. This criterion would contradict the concentration principle in Commission practice. The contradiction might be reflected in concrete problems. For example, as the above regions of Poland develop, they might cease to meet the 75% criterion.

Even where the 75% criterion is met, certain aid, particularly 'operating aid', may be prohibited in Commission practice. Operating aid has been defined by the Court of First Instance as aid intended to relieve an undertaking of the expenses it would itself normally have had to bear in its day-to-day management or its usual activities.<sup>106</sup> It has been defined

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<sup>98</sup> Proposal for a decision adopting a regional aid map on the basis of which public aid granted by Slovenia will be assessed, COM (2002)39, 11<sup>th</sup> recital in the Preamble.

<sup>99</sup> *Ibid*, 9<sup>th</sup> recital in the Preamble.

<sup>100</sup> Commission Communication on the method for the application of Art 92(3)(a) and (c) EEC to regional aid (OJ, 1988, C212/3) para 1.1; Guidelines on national regional aid (OJ, 1998, C74/2).

<sup>101</sup> FG Wishlade, *Regional State Aid and Competition Policy in the European Union* (Kluwer Law International, The Hague, 2003), 241.

<sup>102</sup> Cf, regarding their ineligibility for Objective 1 assistance, M Hallet, *National and Regional Development in Central and Eastern Europe: Implications for EU Structural Assistance* (EC Commission, DG for Economic and Financial Affairs, Brussels, 1997), 14.

<sup>103</sup> See, eg, Commission Decision 85/18 (OJ, 1985, L11/25) on the French regional planning grant scheme ('*Prime d'aménagement du territoire*').

<sup>104</sup> Cf M Cremona, 'State Aid Control: Substance and Procedure in the Europe Agreements and the Stabilisation and Association Agreements' (2003) 9 ELJ 265-287, 278 and 285, regarding 'emerging economies'.

<sup>105</sup> Centre for Co-operation with European Economies in Transition, *Regional Development Problems and Policies in Poland* (OECD, Paris, 1992), 44.

<sup>106</sup> Case T-459/93 *Siemens SA v EC Commission* [1995] ECR II-1675, II-1696.

by the Commission as aid having a direct effect on production costs and selling prices of recipients.<sup>107</sup> Such aid includes, for example, aid for transportation and storage,<sup>108</sup> aid for financing shipyard stocks of semi-finished products and finished products, as opposed to raw materials,<sup>109</sup> a ten-year tax exemption on returns from approved investments,<sup>110</sup> and aid for the renovation of a float line at a flat-glass factory, which had to be carried out every six to nine years.<sup>111</sup>

It is feared that such aid may discourage firms from undertaking the restructuring necessary for them to solve their problems.<sup>112</sup> Instead of enabling recipient undertakings to overcome their difficulties, it may simply offset them and thus hamper structural adoption. As a result, such undertakings may be encouraged to continue uncompetitive activities.<sup>113</sup> If they are not likely to be rendered viable without permanent aid, no contribution is made to the development of a region as required under Article 87(3)(a) EC. Thus such aid may be prohibited.

However, various regions of CEECs, such as Katowice in Poland, may require aid simply to cushion the social consequences of restructuring.<sup>114</sup> If such aid has operating character, it may not necessarily be compatible with Union practice under Article 87(3)(a) EC.<sup>115</sup> For example, according to the Commission, the legislation on the Special Economic Zones in Poland included operating aid, particularly tax relief for investors until 2017 and the reduction of social security contributions. The Commission objected to such aid in accession negotiations.<sup>116</sup>

Again, in Latvia the Commission objected to certain aid schemes, particularly export aids, in the Special Economic Zones.<sup>117</sup> Amendments aimed at aligning the legislation on these Zones and on free ports with the *acquis* entered into force in January 2002.<sup>118</sup> Similarly,

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<sup>107</sup> Commission Decision 82/744 (OJ, 1982, L315/23) concerning Italian Law No 423/81 of 1 Aug. 1981 on measures for agriculture.

<sup>108</sup> Commission Communication C25/91 (OJ, 1991, C189/5) concerning aids by means of which the Netherlands intend to stimulate an environmentally acceptable disposal of surplus manure.

<sup>109</sup> Commission Decision 88/281 (OJ, 1988, L119/33) on aid for shipbuilding and ship repair in Italy – Art 10 of Law No 111 of 22 March 1985.

<sup>110</sup> Commission Decision 70/304 (JO, 1970, L128/33) relative au projet de loi italien visant la restructuration, la réorganisation et la conversion de l'industrie textile.

<sup>111</sup> Commission Decision 87/195 (OJ, 1987, L77/47) on a proposal by the Belgian Government to grant aid for investments by a flat-glass producer at Moustier.

<sup>112</sup> Commission Decision 73/274 1973 (OJ, 1973, L254/14) on Art 20 of Italian Law No 1101 of 1 Dec 1971 on the restructuring, reorganisation and conversion of the textile industry.

<sup>113</sup> Commission Decision 79/496 (OJ, 1979, L127/50) on the UK scheme of assistance in the form of interest relief grants in favour of the offshore supplies industry.

<sup>114</sup> Centre for Co-operation with European Economies in Transition, op cit, 44.

<sup>115</sup> Though in certain sectors some operating aid may be permissible. See, eg, regarding 'current production aid', Art 5(3) of Council Regulation 1407/2002 (OJ, 2002, L205/1) on state aid to the coal industry.

<sup>116</sup> Progress Report 2000, 42-43. Poland has responded to Commission objections by abolishing the possibility of granting tax relief to exporting companies (A Mayhew, op cit, 26). It may be questioned whether the elimination of such aid would undermine the domestic popularity of the Polish Government or enable it to improve public finances, using accession requirements as an excuse. Cf, L Friis and A Jarosz, 'When the Going Gets Tough. The EU's Enlargement Negotiations with Poland' (2001) *Journal of European Integration* 29-62.

<sup>117</sup> Progress Report 1998, COM (98)704.

<sup>118</sup> Progress Report 2002, 63.

Slovenia had to repeal the export-based criterion for tax reductions under the Act on Economic Zones.<sup>119</sup>

In Romania an Act on Industrial Parks was adopted in August 2000. The criteria established by this Act for the creation of industrial parks and the financial incentives, such as soft loans and interest rebates, given to companies in these parks did not appear to the Commission to be in line with the Romanian legislation on state aid or with the *acquis*.<sup>120</sup> Accordingly, such aid was challenged by the Commission.

In short, therefore, only limited attempts seem to have been made in practice based on Article 87(3)(a) to investigate conditions in the CEECs, let alone to adapt this practice in the light of such conditions.

#### *Authorization of 'Transition Aid' or Transitional Aid?*

Authorization of 'transition aid' was envisaged in the implementing rules adopted under the Europe Agreements.<sup>121</sup> According to the rules for the Czech Republic, the Commission and the monitoring authority of the Czech Republic should work out, and modify if necessary, in addition to the types of aid allowed in the Union, special guidance on the compatibility of transition aid. Such aid was that designed to combat the specific problems of the Czech Republic as it completed transition to a market economy.<sup>122</sup>

The approach seemed somewhat stricter in the later rules. For example, according to the rules adopted by the EU-Lithuania Association Council, the monitoring authorities might, if necessary and at the request of Lithuania, jointly evaluate problems raised by the implementation of the *acquis* in the field of Lithuanian state aid, as it completed transition to a market economy. The evaluation of such problems should not relate to the agricultural sector, fisheries, coal and steel, or to sensitive sectors (automobiles, man-made fibres, or shipbuilding) for which specific Union arrangements existed. Where appropriate, the monitoring authorities should submit a joint proposal to the Association Council, which might adopt a decision.<sup>123</sup>

Questions raised by such arrangements had already been faced at the time of German unification, when the former GDR became part of the Union.<sup>124</sup> It was questioned whether Article 87 EC, having been devised for a 'normal situation,' would prove sufficiently flexible to cope with the economic problems of the former GDR and to facilitate the transition towards a market economy.<sup>125</sup> The questions, as in the case of the CEECs, focussed on operating aid, horizontal aid, and sectoral aid.

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<sup>119</sup> Council Decision 2002/94 (OJ, 2002, L44/101) on the principles, priorities, intermediate objectives and conditions contained in the Accession Partnership with Slovenia.

<sup>120</sup> Progress Report 2000, 45. See, similarly, in the case of Slovakia, Progress Report 2000, 43.

<sup>121</sup> Cf Art 29 of the WTO Agreement on Subsidies and Countervailing Measures, which makes special allowance for aid necessary for the 'transformation from a centrally-planned into a market, free-enterprise economy'.

<sup>122</sup> Art 4(3) of the implementing rules (OJ, 1998, L195/21).

<sup>123</sup> Art 4(3) of Decision 2/2001 of the EU-Lithuania Association Council (OJ, 2001, L98/19) adopting the implementing rules for the application of the provisions on state aid referred to in Art. 64(1)(iii) and (2) EA.

<sup>124</sup> The European Community and German Unification, Bull EC, Supp 4/90, 74-75; M Schütte and J-P Hix, 'The Application of State Aid Rules to Privatizations: the East German Example' (1995) 32 CMLRev 215.

<sup>125</sup> K Hailbronner, 'Legal Aspects of the Unification of the Two German States' (1991) EJIL 18, 40. Cf, regarding 'abnormalities' in Poland, OECD, *Industry in Poland: Structural Adjustment Issues and Policy Options* (Paris, 1992).

## Operating Aid

To take account of transition problems in the former GDR, some flexibility was introduced into Commission practice regarding operating aid. For example, 'with a view to the unprecedented transformation of a planned economy into a market economy inside the Community,' the Commission accepted that operating aid might be granted to eastern German companies to enable them to maintain production which might become viable after restructuring.<sup>126</sup>

A controversial matter was whether a satisfactory balance was struck between transition needs and competition policy requirements. For example, it was argued that state aid in eastern Germany favoured large-scale and capital-intensive investment mainly by companies which often already had a dominant position in the western German market. As a result, the structure of competition in Germany as a whole might be adversely affected.<sup>127</sup>

Nevertheless, the CEECs argued in accession negotiations that account should be taken of transition problems. In particular, Poland requested a protocol providing that state aid to environmental, regional, and restructuring projects would be judged in the light of transition problems.<sup>128</sup> There was, in fact, a Commission draft of a special aid regime for countries in transition, but the draft was withdrawn.<sup>129</sup>

The EU may have been reluctant to use the expression 'transition' in accession negotiations, because completion of transition to a market economy is a condition for Union membership stipulated at the Copenhagen Council in 1993.<sup>130</sup> At the same time, the EU may have sought to limit disruption of the *acquis*. Accordingly, the EU emphasis in accession negotiations was on limiting the authorization of operating aid in CEECs to transitional periods.

According to the Accession Act, Poland may apply corporate tax exemptions granted before 1 January 2001 in the Special Economic Zones for transitional periods. They may be granted to small enterprises, as defined in accordance with the Union law definition of such enterprises<sup>131</sup> and in conformity with Commission practice, until 31 December 2011. They may be granted to medium-sized enterprises, as defined in accordance with the Union law definition of such enterprises<sup>132</sup> and in conformity with Commission practice, until 31

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<sup>126</sup> Notice C 14/93 (ex N 36/93) (OJ, 1994, C162/4) concerning aid which Germany plans to grant to Leuna AG for the production and sale of caprolactam. However, the likelihood of future viability must be established. See Communication C 4/94 (ex NN 103/93) (OJ, 1994, C206/10) concerning aid decided by the German Government in favour of Leuna AG, Land Sachsen-Anhalt. More particularly, aid to facilitate adaptation of an undertaking to the market and thus to make its privatisation possible might be permissible in the former GDR. See, eg, Notice C 62/94 (N 376/94) (OJ, 1995, C113/13) concerning aid the German Government intends to grant to Sächsische Olefinwerke GmbH, Bohlen.

<sup>127</sup> 'German Unification: Consequences and Prospects for East Germany', *European Economy* (1991) 163.

<sup>128</sup> National Strategy for Integration II, para 2.74. See, similarly, in the case of the Czech Republic, the Czech Position Paper, chapter 6.

<sup>129</sup> A Mayhew, *op cit*, 26.

<sup>130</sup> Bull EU 6-1993, pt I.13.

<sup>131</sup> Commission Recommendation 96/280 (OJ, 1996, L107/4) concerning the definition of small and medium-sized enterprises.

<sup>132</sup> *Ibid*.

December 2010.<sup>133</sup> In the event of a merger, acquisition, or any similar event which involves the beneficiary of such a tax exemption, the exemption shall be discontinued.

In the case of large undertakings, corporate tax exemptions may only be continued until 31 December 2006, and may only be granted for regional investment or for training, research and development, or environmental investment.

Regional investment aid for large undertakings shall not exceed a maximum of 75% of the eligible investment costs if the undertaking obtained its Special Economic Zone (SEZ) permit before 1 January 2000. If the undertaking obtained its SEZ permit during the year 2000, the total aid shall not exceed a maximum of 50% of the eligible investment costs. Eligible costs shall be defined on the basis of the Guidelines on national regional aid.<sup>134</sup> If the undertaking is active in the motor vehicle sector,<sup>135</sup> the total aid shall not exceed a maximum of 30% of the eligible investment costs. The period for calculating the aid to be included under these ceilings shall start on 1 January 2001; all aid claimed and received on the basis of profits that precede this date shall be excluded from the calculation.

Aid to large undertakings for training, research and development, or environmental investment must not exceed the relevant aid intensity ceilings applicable to such aid objectives pursuant to Article 87 EC or as otherwise provided for in the Accession Act.<sup>136</sup> The period for calculating the aid to be included under the applicable ceilings shall start on 1 January 2001; all aid claimed and received on the basis of profits that precede this date shall be excluded from the calculation. For the purpose of calculating the total aid, account shall be taken of all aid granted to the beneficiary in relation to eligible costs, including aid granted under other schemes and irrespective of whether the aid is granted by local, regional, national, or Union sources. Eligible costs shall be defined on the basis of the Union rules applicable to the aid objective concerned.<sup>137</sup>

Similarly, Hungary may apply corporate tax benefits granted prior to 1 January 2003.<sup>138</sup> They may be granted to small and medium-sized enterprises, as defined in accordance with the Union definition<sup>139</sup> of such enterprises and in conformity with Commission practice, up to 31 December 2011. In the event of a merger, acquisition or any similar event which involves the beneficiary of a tax benefit, the benefit shall be discontinued.

In the case of large undertakings, corporate tax benefits may only be continued until 31 December 2005, and may only be granted for regional investment aid or for training, research and development, or environmental investment.

Regional investment aid for large undertakings shall not exceed a maximum of 75% of the eligible investment costs if the undertaking started its investment under the scheme prior to 1 January 2000. If the undertaking started its investment under the scheme during the years 2000-2002, the total investment aid shall not exceed a maximum of 50% of the eligible

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<sup>133</sup> Poland had sought a transition period lasting until 2017. See National Strategy for Integration II, para 2.74.

<sup>134</sup> OJ, 1998, C74/ 9.

<sup>135</sup> Within the meaning of Annex C of the Community Multisectoral framework on regional aid for large investment projects (OJ, 2002, C70/8).

<sup>136</sup> See below, regarding Section 5.2 of Annex XII to the Accession Act.

<sup>137</sup> Section 5.1 of Annex XII to the Accession Act.

<sup>138</sup> Under Arts 21(7), (10) and (11) of Act LXXXI of 1996 on Corporate Tax and Dividend Tax and Art. 93 of Act CXXV of 1999 on the Budget of 2000.

<sup>139</sup> Commission Recommendation 96/280 (OJ, 1996, L107/4) concerning the definition of small and medium-sized enterprises.

investment costs. If the undertaking is active in the motor vehicle sector,<sup>140</sup> the total investment aid shall not exceed a maximum of 30% of the eligible investment costs if the undertaking started its investment under the scheme prior to 1 January 2000. If the undertaking started its investment under the scheme during the years 2000-2002, the total investment aid shall not exceed a maximum of 20% of the eligible investment costs.

Aid to large undertakings for training, research and development, or environmental investment must not exceed the relevant aid intensity ceilings applicable to such aid objectives pursuant to Article 87 EC. The period for calculation of aid to be included under the applicable ceilings shall start on 1 January 2003; all aid claimed and received on the basis of profits that precede this date shall be excluded from the calculation. Eligible costs shall be defined on the basis of the criteria arising from the Union rules applicable on 1 January 2003 to the aid objective concerned. In the case of investment by the beneficiary in relation to public infrastructure, the aid shall be limited to 100% of the costs incurred up to and including 31 December 2002.<sup>141</sup>

Moreover, Hungary may apply corporate tax reductions in favour of offshore companies granted prior to 1 January 2003<sup>142</sup> up to 31 December 2005. In the event of a merger, acquisition, or any similar event which involves the beneficiary of a tax reduction, the reduction shall be discontinued.<sup>143</sup>

Finally, Hungary may apply, up to 31 December 2007, local business tax reductions of up to 2% of the net receipts of undertakings, granted by local government for a limited period of time.<sup>144</sup> Such reductions are not available to undertakings in receipt of corporate tax reductions or aid incompatible with Article 87 EC.<sup>145</sup>

Apparently, in practice, such aid mainly benefits transnational corporations (TNCs). The aid means that the Hungarian Government incurs considerable tax losses and undermines its national SMEs, even though the aid is not the main factor attracting foreign direct investment. However, the interests of aid recipients have become internalized in state policy. There may be close contacts between TNCs, business organizations, and the Hungarian Government and the pressure of possible exit and legal challenges by TNCs. At the same time, the Government may depend on investors for information and arguments. The result is a convergence of interests between the Hungarian Government and its major foreign investors. Thus in accession negotiations the Hungarian Government might merely mediate between its TNCs and the Commission on behalf of the TNCs.<sup>146</sup>

#### 'Horizontal Aid'

Commission practice regarding research and development aid<sup>147</sup> reflects the requirement in Article 163(1) EC that the Union should seek to strengthen the scientific and technological bases of Union industry and encourage it to become more competitive at international level.

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<sup>140</sup> Within the meaning of Annex C of the Community Multisectoral framework on regional aid for large investment projects framework for state aid to the motor vehicle industry (OJ, 2002, C70/8).

<sup>141</sup> Section 4.1 of Annex X to the Accession Act.

<sup>142</sup> Under Arts 4.28 and 19(2) of Act LXXXI of 1996 on Corporate Tax and Dividend Tax.

<sup>143</sup> Section 4.2 of Annex X to the Accession Act.

<sup>144</sup> Under Arts 6 and 7 of Act C of 1990 on Local Taxes, as amended by Art 79(1) and (2) of Act L of 2001 on the Amendment to Financial Laws, as amended by Art 158 of Act XLII of 2002 on Amendment of Acts on Taxes, Contributions, and Other Budgetary Payments.

<sup>145</sup> Section 4.3 of Annex X to the Accession Act.

<sup>146</sup> A Bieler, 'European integration and Eastward Enlargement: the widening and deepening of neo-liberal restructuring in Europe' *Queen's Papers on Europeanization* (forthcoming).

<sup>147</sup> Community Framework for State Aids to Research and Development (OJ, 1996, C45/2).



This practice relies on the distinction between aid to ‘modernization’ and aid to ‘genuine innovation’ at Union level. A project may be regarded as insufficiently innovatory for aid to be permissible where it concerns processes already in use in other Member States.<sup>148</sup> However, the fact that innovation by Union standards may not be the intended result of such aid does not necessarily preclude the possibility that technological development of considerable importance for CEECs could result.<sup>149</sup> Certainly, the Commission might authorize ‘technical rationalization’ aid in the former GDR, given ‘the omissions of the former system to invest in necessary equipment, neglected maintenance and repair and outdated equipment.’<sup>150</sup> However, the Accession Act makes no exception from general EU rules regarding costs eligible for aid to research and development.

Again, Article 174(2) EC establishes as one of the principles of Union environmental policy that the polluter should pay. This principle is embodied in the Commission guidelines regarding environmental aid.<sup>151</sup> However, the Economic and Social Committee considers that application of the principle should be withheld in respect of the least-developed regions or acknowledged problem areas within the Union.<sup>152</sup> More particularly, the Commission might accept aid in the former GDR to enable undertakings to meet environmental standards, given ‘former omissions to respect these standards.’<sup>153</sup> It has also been suggested by the Committee on External Economic Relations of the European Parliament that aid granted to the coal and steel industries by the CEECs for the purpose of environmental protection should be exempted from prohibition.<sup>154</sup>

However, the EU preference is to rely on transitional periods for authorization of environmental aid taking account of conditions in CEECs. In the case of investments in Poland that relate to standards for which a transitional period has been granted under the Environment Chapter and for the duration of that transitional period, the aid intensity is limited to the regional aid ceiling with a 15% supplement for SMEs. For existing integrated pollution prevention and control (IPPC) installations covered by a transitional period under the Environment Chapter, the level of 30% aid intensity is accepted until the end of 2010. For the IPPC-related investment not covered by a transitional period under the Environment Chapter, the level of 30% aid intensity is accepted until 31 October 2007. For large combustion plants, an investment aid intensity of 50% is authorized during a transitional period granted under the Environment Chapter.<sup>155</sup>

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<sup>148</sup> Commission Decision 87/16 (OJ, 1987, L12/27) on a proposal by the Italian Government to grant aid to a firm in the chemical industry (producing industrial auxiliaries, intermediates and pesticides).

<sup>149</sup> Cf. the argument regarding the promotion of technology transfer to less developed regions of the Community in the ESC Opinion of 25 Sept 1991 (OJ, 1991, C339/6) on the Regions in the 1990s – Fourth Periodic Report on the Social and Economic Situation and Development of the Regions of the Community para 4.11.

<sup>150</sup> Notice C 61/94 (N 375/94) (OJ, 1995, C113/5) concerning aid which the German Government intends to grant to Buna GmbH.

<sup>151</sup> Community Guidelines for State Aid to Environmental Protection (OJ, 2001, C37/3).

<sup>152</sup> ESC Opinion of 19 Sept 1990 (CES (90) 1052) on Environmental policy and the single European market (additional own-initiative opinion on environmental policy, a fundamental aspect of economic and social development), 14. See now Arts 174(2) and 175(5) EC.

<sup>153</sup> Notice C 61/94 (N 375/94) (OJ, 1995, C113/5) concerning aid which the German Government intends to grant to Buna GmbH.

<sup>154</sup> Report on the draft implementing rules for state aid control to be adopted by the EU-Czech Association Council, EP Doc A 4-0394/97, 12.

<sup>155</sup> Section 5.2 of Annex XII to the Accession Act.

## Sectoral Aid

Particular difficulties may arise in connection with the very strict approach adopted in Union practice towards aid to sectors which may be dominant in declining industrial areas. The difficulties of extending this approach to CEECs are suggested by the relaxation of restrictions on aid to shipbuilding and the steel industry in eastern Germany.<sup>156</sup> In the Accession Act the difficulties are supposed to be resolved by resort to transitional periods.

In Poland alignment with Union rules governing state aid to the steel industry was demanded by the Commission.<sup>157</sup> According to the Accession Act, Poland may only grant such aid, if the national and individual restructuring programmes of the recipient companies include necessary measures for reaching viability and necessary cuts in production capacity, in line with the requirements set out in Protocol 2 of the Europe Agreement. Productivity 'comparable with the one attained by the EU steel industry shall be achieved gradually by 31 December 2006.'<sup>158</sup>

Again, Slovakia may apply until the end of the fiscal year 2009 a corporate income tax exemption<sup>159</sup> to one beneficiary in the steel industry.<sup>160</sup> The aid beneficiary must cap its production of flat products and its sales of flat products (hot-rolled, cold-rolled and coated) in the enlarged EU. The cap shall be established on the basis of the figures concerned for the year 2001. As from 2002, the aid beneficiary may make annual increases of 3% in the cap for production and 2% in the cap for sales. The cap for sales shall take effect as from the date of accession. Output of specific product types may vary on condition that combined output does not exceed the established caps. The beneficiary must not extend its range of groups of finished products existing on 13 December 2002. The total aid granted to the beneficiary must not exceed a total of US \$500 million. This aid can only be granted once and may not be extended or renewed under any circumstances.

The beneficiary must meet the terms of the privatization contract regarding the maintenance of employment levels. If the beneficiary fails to meet these terms, the aid shall be discontinued with immediate effect and the penalties provided for in the privatization contract shall apply. The objective of the aid is to facilitate the ordered rationalization of excess staffing levels, the resulting total cost being comparable to the aid.

Moreover, Slovakia may apply until the end of the fiscal year 2008 a corporate income tax exemption<sup>161</sup> to one beneficiary in the motor vehicle industry. The total aid under this tax exemption must not exceed 30% of the eligible investment costs of the relevant project incurred since 1998. Eligible costs shall be defined on the basis of the Guidelines on national regional aid.<sup>162</sup>

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<sup>156</sup> A Evans, *EC Law of State Aid* (Clarendon Press, Oxford, 1997).

<sup>157</sup> Council Decision 2002/91 (OJ, 2002, L44/72) on the principles, priorities, intermediate objectives and conditions contained in the Accession Partnership with Poland.

<sup>158</sup> Annex III to Prot 8, on the Restructuring of the Polish Steel Industry, to the Accession Act. In the Czech Republic aid for restructuring of the steel industry is also permissible until 31 December 2006 (Para 1 of Protocol 2 on the Restructuring of the Czech Steel Industry).

<sup>159</sup> Under Act No 366/1999 Coll. On Income Tax.

<sup>160</sup> State aid granted to the steel industry in Slovakia was incompatible with Protocol 2 of the Europe Agreement (Progress Report 2002, 63).

<sup>161</sup> Under Government Regulation No 192/1998 Coll.

<sup>162</sup> OJ, 1998, C74/9.

## Conclusion

Within the EU evolution of the *acquis* regarding state aid control is a consequence of application of Article 87 EC by the Commission. Under the Europe Agreements adoption of this *acquis* by the CEECs might take a different course. As Article 64(2) and (6) of the Europe Agreement with the Czech Republic implied, such adoption might be a precondition for operation of Article 64(1)(iii) as anything more than a basis for resort to safeguard measures under Article 64(6) of the Agreement.<sup>163</sup> In practice, any arrangements which might have justified resort to such measures were either tackled informally or referred to accession negotiations.<sup>164</sup>

The Accession Agreement treats the issues raised within the limited context of determining the acceptability or otherwise of transitional periods for aid in the CEECs.

The treatment of the acceptability of aid within the existing Union may be more flexible. The flexibility has been reflected not only in the relaxation of state aid rules in the case of the former GDR but, more generally, in a willingness to take account of the 'burden of the past'<sup>165</sup>

Accession may not only highlight, rather than resolve, problems of extending the *acquis* to countries for which it has not been designed. Accession may also reflect problems of implementing the *acquis* in the existing Union.

Union practice suggests that state aid control may be adapted to changing conditions within the Union. According to this practice, account may be taken of the 'burden of the past.' For example, aid was approved for the Portuguese chemical firm, EPSI, because it partially covered an unfavourable financial structure from which the company had suffered since its formation prior to Portuguese accession to the Union.<sup>166</sup>

Ultimately, therefore, development of state aid control which takes account of the needs of CEECs may depend more on 'internal' developments within the Union, notably the continuing adaptation of such control to the diversity of regional problems within the Union, than on transitional periods fixed in the Accession Act. In fact, reliance on transitional periods may merely have postponed consideration of the real problems of such adaptation within an enlarged Union rather than adoption by CEECs.

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<sup>163</sup> Art 64(6) provides: If the Community or Poland considers that a particular practice is incompatible with the terms of paragraph 1, and:

- is not adequately dealt with under the implementing rules referred to in paragraph 3, or
- in the absence of such rules, and if such practice causes or threatens to cause serious prejudice to the interest of the other Party or material injury to its domestic industry, including its services industry,

it may take appropriate measures after consultation within the Association Council or after 30 working days following referral for such consultation.

In the case of practices incompatible with paragraph 1 (iii) of this Article, such appropriate measures may, where the General Agreement on Tariffs and Trade applies thereto, only be adopted in accordance with the procedures and under the conditions laid down by the General Agreement on Tariffs and Trade and any other relevant instrument negotiated under its auspices which are applicable between the Parties.

<sup>164</sup> P Schütterle, id op, 578.

<sup>165</sup> Eg, where the person responsible for the pollution is not identified or cannot be made to bear the cost, the person responsible for the work may receive aid. See Community Guidelines for State Aid to Environmental Protection (OJ, 2001, C37/3), para 38.

<sup>166</sup> Bull EC 10-1991, 1.2.32.