



Regional Development. EU Regional aid Policy and Regional Development in Central and Eastern European Countries (CEECs)

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Introduction

EU regional aid policy is rapidly becoming a factor of increasing importance in the regional development of the Central and Eastern European countries (CEECs). The short-term implications of EU regional policy relate to regional aid arrangements in the state aid framework of the Association Agreements concluded between the EU and associated countries. The tendency to progressively adapt CEE regional state aid policies to the EU regional aid framework is expected to accelerate as accession activities progress. In the long run, this means that CEECs will have to adopt EU criteria that have been developed under different resources, rules of law etc. The objective of this paper is to analyze the implications of these harmonization policies in both the short and long term.

EU control of regional and state aid has been of direct importance in achieving a system of undistorted competition as stipulated in Article 3 (3) of the EEC Treaty. It has been extended to the reforming countries of Central and Eastern Europe by virtue of the *Association Agreements*. The European Union's policy towards the countries of Central and Eastern Europe is, in many ways, an ongoing attempt to find an appropriate legal and institutional framework for integrating them.

The association policy has evolved from the Europe Agreements signed by Hungary, Poland, the Czech Republic, the Slovak Republic, Romania, Bulgaria, Slovenia and the Baltic countries, through the declarations of the European Council in Copenhagen (June 1993) and Essen (1995), the *White Paper on Enlargement* (1995) and the Accession Partnerships adopted by the European Commission (1998).

This discussion paper surveys the impact of European Union regional aid policy on the national and regional aid policies of the CEECs. It also analyses the extent to which the legal framework for regional and state aid in the *Association Agreements* can facilitate the progressive adaptation of CEE regional aid policies to EU regional development policies. Though based on an effort to assess the legal framework of regional and state aid in the *Association Agreements*, this is a policy paper that attempts to raise awareness about regional development policy issues in CEECs in light of their desired accession to the EU and the progressive adaptation of their legal rules to the framework of regional and state aid controlled within the EU.

Particular attention is paid to recent, controversial constitutional law developments in Hungary and the Czech Republic that shed an interesting light on the process of adapting CEE laws to suit EU rules. They have initiated a constitutional discussion concerning the direction of the policy of harmonization of laws. This survey suggests that regional aid policy demands from CEE and EU policymakers is a novel interplay of economic and political rationales different from that found in the original EC integration model; it advocates that the EU take a specific and realistic approach to the peculiarities of the regions.

This paper focuses on and addresses regional aid policies within the EU, regional aid arrangements in the *Association Agreements* and policy concerns about the application of EU

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regional development policies based on advanced economic and political models in CEECs.

Regional Aid Policies within the EU

EU regional aid policies for exemptions from the general ban on state aid by making aid available to promote economic development in areas where there is serious undevelopment and an extremely low standard of living. Because they are so directly and interdependently related, regional aid provisions need to be interpreted on the basis of state aid provisions. The objectives for granting regional aid to regions and groups most in need of assistance have been spelled by the Commission as follows¹:

- to promote the development and structural adjustment of regions whose development is lagging behind (Objective 1);
- to convert the regions, frontier regions or parts of regions (including employment areas and urban communities) seriously affected by industrial decline (Objective 2);
- to combat long-term unemployment and facilitate the integration of young people and of persons exposed to exclusion from the labor market into working life (objective 3);
- to facilitate the adaptation of workers of either sex to industrial changes and to changes in production systems (Objective 4);
- to promote rural development by:
 - speeding up the adjustment of agricultural and fisheries structures in the framework of the reform of the common agricultural policy and of the review of the common fisheries policy (Objective 5a);
 - facilitating the development and structural adjustment of rural areas (Objective 5b).

Because regional aid provisions form exemptions from the general ban on state aid, they must be interpreted according to their stated objectives. The legal framework for assessing regional aid policies is laid down in Article 92 (3) (a) of the EEC Treaty, which addresses aid for regions that are particularly disadvantaged compared to the EU as a whole (with their GNP amounting to less than 75 percent of the Community average). Article 92 (3) (c) is wider in scope and allows aid to be given to regions that are only disadvantaged compared to other regions in the same member state (regions with a GNP no higher than 80 % of the national average and an unemployment rate at least 10 percent above the national average). Thus, Article 92 (3) (c) gives member states more leeway² in granting aid and serves the objective of reducing economic disparities between regions by not requiring that beneficiary regions display substantial economic underdevelopment. The criteria applied by the Commission when examining the compatibility of national regional aid with the common market under Articles 92 (3) (a) and 92 (3) (c) of the *EC Treaty* have been set out in a number of documents of various sorts. The criteria for accessing the admissibility of regional aid reflects the willingness of the Commission to intervene to reduce interregional disparities and to facilitate “a favorable environment for competitiveness”³ provided that “the responsibility and initiative for economic activity must lie in the first instance with firms themselves”⁴. The priority here is to create conditions for attracting private investment in disadvantaged regions based on the assumption that “public capital inflows are necessary to promote attractive conditions to private capital... while a steady flow of private investment is vital to ensure an overall efficient allocation of resources and for public investment to bear its fruits”⁵.

The criteria for accessing the admissibility of regional aid have been subject to extensive elaboration by the European Court of Justice. Thus, in a case of involving *Philip Morris*,⁶ the court took the position that state aid might be justified under Article 92 (3) only if this aid, through the activities of the supported enterprise, is likely to achieve one of the objectives

¹ See OJ 1988 No. C 212/2ff.

² See Carl Baudenbacher, *A Brief Guide to European State Aid Law*, European Business, Law and Practice Series, 1997, p. 40. Also Cf. ECR (1987) pp. 4013ff. / *Germany v. Commission*.

³ COM (93) 67.

⁴ COM (92) 2000.

⁵ COM (92) 84.

⁶ Case 730/79, *Philip Morris Holland BV v. EC Commission* (1980) E.C.R. 2671; (1981) 2 C.M.L.R 321.

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specified by the Community objectives preferred by the Article, and where those objectives would not otherwise be attained within a reasonable period of time through the instrument of the market. However, in the case of underdevelopment (which occurs over a substantial period of time and which presupposes market failures), granting aid could well be justified on a regional basis. Moreover, the Commission believes that the authorization of regional aid can play an important role in achieving the desired cohesion of different regions within the EU. The concrete amount of aid has been made contingent on both the type and extent of problems encountered in each particular case and is to be affected within a particular geographical region⁷. Comprehensive criteria for accessing the compatibility of certain regional aid with the common market is present in the 1998 notification on regional aid⁸. Thus, aid pursuant to Article 9 (3) (c) should be regionally specific, promote the development of specified problem areas and have a regional objective. In short, the aid should be specifically designed to solve explicitly defined regional problems⁹.

A standard has been developed to limit operating aid (aid with a direct effect on production costs and selling prices¹⁰) and to determine whether it is objectionable¹¹. In light of existing practice, aid deemed inappropriate includes, for example, aid for transportation and storage that has to be carried out on a regular basis. The major concern is that a lack of such aid may discourage firms from restructuring to solve their problems and therefore hamper their structural adaptation to the market. Approval of operating aid depends on whether it is likely to render the beneficiary viable without permanent help (see *Belgium v. EC Commission*¹²), or whether it contributes to the development of the region (in *Executive Regional Walloon and Glaverbel v. EC Commission* it was ruled that aid to support periodic renovation involved no such development¹³).

Aid cannot be justified in cases where companies are considered incapable of becoming competitive in the short or medium term¹⁴. Case practice has acknowledged justification for operating aid when there is sufficient threat to the “social fabric”. Furthermore, with the accession of Greece, and later, Spain and Portugal, Commission policy was reconsidered¹⁵. In most cases, the underdeveloped character of a region could, in fact, serve as an argument for granting operating aid. However, placing limits on such aid remained a sensitive issue. The viability of a given company is a major factor for considering whether aid is admissible. Thus, in *Italy v. EC Commission*¹⁶ the Court refused to justify aid to a company because it was held to be “without a perspective of viability” and unable to promote durable development according to Article 92 (3) (a). Similarly, continued public investment in loss-making companies without restructuring plans and in sectors suffering from overcapacity has been denied on grounds that such aid does not favor regional economic development¹⁷. Limitations to granting regional help concern individual undertakings that have no particular influence on the development of the region or the national territories as a whole. Exceptions include Ireland and Luxembourg both of which might be considered regions in themselves¹⁸.

More recently, the transformation of the former East German economy led the Commission to state that it will apply state aid rules constructively to facilitate the development and full integration of the former GDR economy. However, this was only to be done while

⁷ See the 21st Commission *Report on Competition Policy*, 1991, mrg. nos. 277ff.

⁸ Commission communication of 10 August 1988 on applying Article 92 (3) (a) and (c) to regional aid, OJ 1988 No. C212/2ff (amended by OJ 1993 No. C 119/7).

⁹ See Commission decision of 18 May 1979, 79/519/EEC, OJ 1979 No. L 138/30ff.

¹⁰ Decision 82/ 744 of 11 October 1982 (OJ 1982 L315/23) concerning Italian Law No. 423/81 of 1 August 1981 on measures for agriculture.

¹¹ See Article 6 of Commission Decision 2064/86 of 30 June 1986 (OJ 1986 L177/1) which establishes Community rules for state aid to the coal industry.

¹² Case C-142/ 87 *Belgium v. EC Commission* (1990) ECR I-959.

¹³ Joined Cases 62 and 72/87 (1988) ECR 1573.

¹⁴ See Tim Frazer, *Competition Policy, the Regions and the Central and Eastern European Countries*, conference paper, 1996.

¹⁵ Sixteenth *Report on Competition Policy* (EC Commission, Brussels 1987), p. 178.

¹⁶ Case C – 305/89 *Italy v. EC Commission* (1991) ECR I/1603, 1644.

¹⁷ Case C – 303/88 *Italy v. EC Commission* (1991) ECR I-1433, 1481.

¹⁸ Commissions communication on regional aid of 21 December 1978, Cons. 9, OJ 1979 No. C 31/9 ff.

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maintaining a level playing field in the common market and avoiding unjustified advantages for East German companies¹⁹. The concern was to ensure that such aid was disproportionate neither to its subjective nor to aid provided to other disadvantaged areas in the EU. There were efforts to minimize the risk of inefficient aid use given the existing law level of discipline in this respect. In general, if applied in an appropriate and reasonable manner, regional aid is regarded by the Commission as an indispensable instrument in regional development²⁰. The Commission has, however, stresses the need for coordination and consistency in economic policies pursued by member states at the national, regional and local level. The review and transparency of regional aid – as well as a partnership between the Commission, national governments, local and regional authorities, and economic and social partners in the negotiation and implementation of plans, programs and projects – is considered essential. The application of the principle of additionality has been invoked: it requires that EU resources supplement rather than replace resources already allocated on a national level.

These considerations attempt to limit the dangers inherent in assessing the effects of regional aid in advance²¹. They are also designed to limit the risk of mutual outbidding between member states trying to attract investment at the expense of less developed regions in other member countries. Such preferential policies can lead to serious trade obstructions²². In this respect, the cost of aid policies could outweigh the desired benefits of reducing economic disparities and rendering the standard of living as homogeneous as possible. This shows the need for the intensive review and coordination of aid policies.

Implications of EU Regional Development Policies and the Approximation Strategies for CEECs

Policy considerations concerning the implications of EU policies – in respect of state and regional aid and the related relevant clauses of the *Association Agreements* and the obligation of the Association Countries to approximate in detail their domestic competition rules with the respective EU standards – lie in different fields. These implications should be considered in both the short and long run.

Among the most important concerns is whether EU standards are flexible enough and appropriate for CEECs. The CEECs, notwithstanding their different success during the transition, still exhibit significant economic and political differences from Member States. Within Associated Countries – where the notion of controlling state and regional aid still confuses the traditional administrative approach towards subsidizing particular sectors and regions – it is important to develop criteria for assessing state aid. In the absence of adequate tradition and practice, the *Association Agreements* use criteria developed by the EU in this field. This issue is whether stringent EU policy is flexible enough to cope with the problems found in CEECs as they make the transition to a market economy²³, and to what extent EU standards help facilitate this transition. Market failures are almost inevitable when financial institutions in Central and Eastern Europe find it difficult to correctly assess the long-term prospects of credit applicants and when such assessments are subjected to real hazards in political, economic and social life. Public efforts to compensate failures in the market are likely to be heavily influenced by various political pressures. The possible difficulties arising from the interaction and interdependence of various policy considerations embodied in EU state aid competition policy requirements deserve careful consideration. The author advocates a careful adjustment of EU criteria concerning regional aid in the CEECs. The process of adjustment requires special attention before implementation. It is a step-by-step process that should be performed accordingly. Maintaining the coordination and consistency of economic policies at the national, regional and local level – and ensuring transparency, flexibility and simplicity – are among the major goals of state and regional aid in the CEECs. Though these countries are considered equivalent in clause Article

¹⁹ The European Community and German Unification, Bull, EC 1990, Supp. 4, pp. 74-75.

²⁰ Cf. Commission Decision of 2277/1982, 82/740/EEC, OJ 1982 No. L 312/18 ff.

²¹ See Commission notification regarding regional aid of 21/12/1978, mrg. No. 10 OJ 1979 No. C31/9ff.

²² See Cf. Commission decision of 15/7/1987, 87/573/EEC, of 1987 No. L 347/64ff.

²³ K. Hailbronner, "Legal Aspects of the Unification of the Two German States" (1991) EJIL 18-41, p. 40.

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92(3)(a) concerning regions within the transitional five-year period, there is a major difference between the aid budgets of the CEECs and core Member States. Thus, the reallocation of existing resources in CEECs seems to be a radically different matter from the perspective of supporting particular industries, or even countries, lagging behind within the European Union, which has the resources, expertise and mechanisms to do so. The political lexicon of EU aid has lost its meaning; hollow policy without the promised effectiveness should be curtailed. The immediate implementation of standards to better determine the size, location and likelihood of improving the actual situation would, in turn, maximize policy effectiveness. In the future, Associated Countries as a whole are to be considered areas equivalent to 92(3)(a) regions during the initial period of the *Association Agreements*. Particular regional aid arrangements should be seen not only in light of recent, often chaotic efforts to revive national economies, but also in their capacity to cause serious problems after the accession of the CEECs. The problems currently experienced in the CEECs will certainly be enhanced through prospective new membership in the EU, where the burden and dispersal of EU funds is uneven and benefits peripheral states as they make the necessary structural and economic improvements. The regional development of CEECs still very much depends on state aid arrangements and the reallocation of public money. Accession indeed means adjustment. In the particular field of regional policy, such adjustment for the EU implies the need to carefully formulate the EU that potential future accession presupposes remains outside the scope of the present paper. The author would like to point out that it remains highly unlikely that the EU would adopt an unconditional additionality principle towards CEECs. Experience with Greece, Portugal and, more recently, East Germany, suggests that one of the conditions of accession for CEECs will be a no increase of output in most industries. Further criteria as to potential authorization of a general regional aid program envisage, for example, the capacity in the relevant market, aid for capital intensive plants and aid exceeding a certain threshold. For reasons of legal certainty the procedures should be clear and decisions should be made within a given time. Of extreme importance, however, is the steps the CEECs will take on their own. The intention and desire to join the EU, which involves meeting numerous requirements, will certainly enhance administrative reform, the decentralization of funds and the regional policies of CEECs. Supporting the transfer of CEE local governments in preparation for joining the EU requires large-scale institutional, operational and legislative changes. In the field of regional policy and cohesion – provided that the CEECs create the necessary administrative and budgetary framework and work toward building adequate structures of financial control – CEECs should, in the medium term, be able to use regional and structural funds to support their development effectively. The shift in regional aid policy required by future accession demands deep changes in the system of public administration and finance reform. Regional aid policies as an integral part or subsystem and the ideas on its change or improvement are interrelated and interdependent with the whole system of public finance. The current pattern, where most decisions are taken by a central government that subsequently transfers funds to local budgets, implies a considerable degree of dependence on local authorities and leaves open the possibility for subjective partisan judgments. A new system of coordination is needed to replace the traditional socialist model of taking decisions on the governmental level and implementing them on the local level. Only after adopting new laws concerning local public administration, local public finance and local public assets and implementing a comprehensive program that makes steps toward greater local autonomy and the decentralization of local governance can real reform in the system of state aid begin. Investigating concrete needs and interests on the local level should be connected with reviewing interests on the regional level, which, in turn, has to be coordinated with interests on the national level. The reform will only succeed when the needs, capacities and prospects for viability are taken into consideration at the same time at each level. To create a more efficient state aid administration, especially during the transition to market economies and democratic states, it is essential to strictly establish the responsibilities of public authorities and specific tax instruments among the different levels of government. The process of fiscal decentralization is inevitably connected to the transfer of political power to local authorities. The main objective is to minimize the level of subjectivity as much as possible and to provide the regions with further incentives to compete. The decision should be based on factors such as regional and local financial capacity, spending needs, available sources, development potential or any combination of the above. Spending can be made more efficient

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by making a more comprehensive analysis of existing needs compared to potential sources of funding and development prospects.

Transparency is essential to enable the public dissemination of information and announce administrative decisions that involve the spending of public money. There should be a dialogue between authorities and citizens through public meetings, surveys and other form of participation. A different area of concern relates to whether the system of administrative supervision and control of state and regional aid designed by the EU is indeed the framework best suited to assessing regional policies in the CEECs. The *White Paper* requires Associated Countries to design forms of control that parallel those found in member states and to introduce a national agency authorized to decide on aid after notification²⁴. Furthermore, commentators emphasize the “implicit expectation” of the EU that national authorities will refer to the Community to ensure that no aid is further contested. What seems problematic here is that such control over the CEEC trading partners appears much more far-reaching than the discretion of the European Union vis-à-vis other GATT/WTO partners.

Given the asymmetrical disposition of the obligations under the *Association Agreements*, the EU could easily challenge aid that has been given within the CEE state on grounds that it discriminates against EU-based firms. Within the EU, such policy has the clear purpose of counteracting inefficiencies that have been created by intervening in the market and providing different treatment to economic agents. In the context of CEECs, however, applying EU standards to a system of limited resources, investment choices, capital feedback, etc., could be problematic. Given the economic framework of limited actors, resources, potential investors, the often unbalanced political influence on the development of particular industries and other subjective factors, unrealistic. Commentators argue that such national surveillance authority, which will assume control of the state and regional aid, needs years of experience to be efficiently incorporated in the existing state apparatus and the system of public administration in CEECs (including local government decision-making bodies).

Moreover, the state in most CEE countries is still a major shareholder, notwithstanding the facts that privatization is in process and capital markets are being developed. The whole unique set of diverse political and economic interests makes it highly unlikely that the CEE states would allow far-reaching external control of national policies that provide preferential treatment to particular industries or economic actors of strategic importance. This is especially true as the *Association Agreements* contain promises, but no real guarantees, for future accession to the European Union. The points that have been made are not arguments against the introduction of an EU-based system of supervision of regional and state aid. These are arguments for moving carefully. A topic of concern in this respect in the relevant Bulgarian experience. The new Bulgarian act on the protection of competition provides the only example among CEE competition laws for following the requirements of the *White Paper* and incorporating provisions on state aid that actually reproduce the scope of Article 92. The real success of the law in this respect, notwithstanding its victory in the Bulgarian Parliament, is still in question as a struggle over its implementation continues to rage between the competition agency and executive power.

Conclusions

Any discussion about the future of the regions in the CEECs before and after their accession to the EU inevitably involves questions that only the future can answer. How far the accession process will go and how wide and deep the changes will be remains in the realm of speculation. What is important at this stage is not to try to look into the future, but to deal with present problems and their developments. Finding concrete solutions to concrete problems in the ongoing process of administrative, fiscal and social reform in CEE is the only way to invite a more prosperous and fair future. In the words of a Hungarian proverb, “If you don’t help yourself, God cannot help you either”.

²⁴ See Peter Holmes, *supra* note 32, at. 9.

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