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REGIONAL DEVELOPMENT

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DIRECTORATE-GENERAL FOR INTERNAL POLICIES

Policy Department for Structural and Cohesion Policies

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STUDY

Abstract

European Union funding co-managed by Member State authorities is considered to be a state resource that may only be granted in conformity with the rules on state aid. Compliance with both state aid and Structural Funds' rules appears to be problematic, hence this study identifies the relevant issues in the interface between these two sets of rules and makes proposals to facilitate compliance.

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CONTENTS

LIST OF ABBREVIATIONS

ABER	Agriculture Block Exemption Regulation
CPR	Common Provisions Regulation
EIB	European Investment Bank
EIF	European Investment Fund
ESIF	European Structural and Investment Funds
FI	Financial Instruments
GBER	General Block Exemption Regulation
MEIP	Market Economy Investor Principal
RDI	Research, Development and Innovation
SGEI	Services of General Economic Interest
SME	Small and Medium Sized Enterprise
TFEU	Treaty on the Functioning of the European Union

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EXECUTIVE SUMMARY

Background

This study explains how the concept of state aid applies to operations co-financed by European Structural and Investment Funds (ESIF), considers how state aid rules interact with the ESIF rules which are laid down in the Common Provisions Regulation (CPR) and proposes adjustments to facilitate the implementation of ESIF-supported projects in compliance with state aid rules. In addition, the study examines the differences and the related challenges and difficulties in the application of state aid and ESIF rules to projects for research, development and innovation (RDI) and financial instruments.

State aid is not normally allowed in the European Union because it distorts competition in the internal market. State aid is only exceptionally allowed when it supports well-defined public policy objectives.

A public measure constitutes state aid when it uses state resources to confer a selective advantage to enterprises in a manner that affects cross-border trade. Resources from ESIF are considered to be state resources when they are managed by a Member State public authority. ESIF rules require compliance with EU state aid law.

When support from ESIF contains state aid, managing authorities have only two options: grant it in conformity with the provisions of a "block exemption regulation", or grant it after they notify it to the Commission and obtain its authorisation. Managing authorities also have the possibility of granting small amounts of aid – the so-called "de minimis" aid – which, legally, does not constitute state aid in the meaning of Article 107(1) TFEU.

Among others, ESIF provide support to RDI and risk finance for SMEs. Member State measures co-financed by ESIF can be designed to be free of state aid:

- Public funding of RDI is free of state aid when it supports universities in their normal educational and research missions which do not constitute economic activities.
- Public funding of financial instruments is free of state aid when investments are made on market terms.

However, public funding that supports RDI which is economic in nature or supports investment in SMEs in order to remedy market failure must be provided in conformity with state aid rules and procedures. Managing authorities need to distinguish between funding that may or may not constitute state aid.

Although the Common Provisions Regulation explicitly requires compliance with state aid law, it is not always easy for managing authorities to determine whether ESIF operations contain state aid and, if they do, how compliance may be achieved. For this reason, it is proposed that the future Common Provisions Regulation establishes a rebuttable presumption that direct or indirect ESIF support for enterprises constitutes state aid that must, in principle, conform to the "General Block Exemption Regulation". The effect of such changes would be to make managing authorities and other implementing bodies more aware of the need to establish whether state aid is present in their operations and how to deal with it.
In addition, this study makes a number of proposals to facilitate the granting of state aid to projects supported by ESIF and/or to ensure compliance with what is required or prohibited by state aid rules. In particular, the study proposes that the revision of the Common Provisions Regulation in the future should consider the following:

- The definition of undertakings in difficulty (undertakings in difficulty are undertakings that have lost a significant amount of their capital and are likely to go out of business in the absence of state intervention). It would be easier for managing authorities to understand the concept of “undertakings in difficulty, if the definition currently used by the state aid rules was inserted in the revised CPR or a reference to the Commission Guidelines on Rescue & Restructuring Aid was cited.
- The definition of beneficiaries. A distinction should be made between beneficiaries which are public authorities or implementing bodies and beneficiaries which are undertakings that are the final recipients of aid. However, it is understood that this issue will be addressed in the forthcoming “omnibus” regulation.
- The lumping together of de minimis aid and state aid (Member States are asked to consider that de minimis aid is state aid for the purposes of the CPR). De minimis aid is legally not state aid and a clear distinction should be made to that effect. If managing authorities must report all aid they grant with public money, including de minimis aid, the revised regulation should make it explicit.
- The definition of economic operators. It should be made more explicit that an economic operator is an undertaking or any entity that carries out economic activities. A revised CPR may define “economic operator” as “any natural or legal person who receives assistance from the ESI Funds that constitutes state aid”.
- The categories of enterprises which may be supported by financial instruments. This categorisation is obsolete and should be deleted. It unnecessarily constrains managing authorities and bodies implementing financial instruments.
- The direct granting by managing authorities of loans and guarantees. State aid rules require that financial instruments which contain state aid must be implemented via financial intermediaries. If in the future ESI Funds are to be allowed to be used for loans and guarantees granted directly by managing authorities, the revised regulation should require that they are free of state aid.
- The use of state aid methods for the calculation of the maximum ESIF and Member State support. It should be made explicit that when ESIF support contains state aid, the ceilings imposed by state aid rules may not be exceeded. This restriction concerns in particularly revenue generating projects where special methods can be used only if public funding does not constitute state aid.
- Simplified cost options for state aid granted on the basis of block exemption regulations. Reference may be made to the recent adoption of corresponding simplified options in revisions of the block exemption regulations for state aid.
- The 10-year rule. It should be explicitly mentioned that documents concerning projects that have benefited from state aid must be kept for a minimum period of 10 years and that the period for recovery of incompatible state extends beyond that for financial corrections. Incompatible aid is recovered up to 10 years after the moment it was granted. Interest must always be charged on recovered state aid.

Although compliance with state aid rules is occasionally perceived as an obstacle to achieving the objectives of territorial and social cohesion, applying state aid principles to projects supported by ESIF can strengthen the assessment of the need for state intervention, minimise market distortions, prevent waste of public resources and, therefore, make cohesion policy more effective.

1. INTRODUCTION

This study explains how the concept of state aid applies to operations co-financed by European Structural and Investment Funds (ESIF), considers how state aid rules interact with the ESIF rules which are laid down in the Common Provisions Regulation[1] (CPR) and proposes adjustments that facilitate the implementation of ESIF-supported projects in compliance with state aid rules.

Recent debates in the European Parliament have addressed concerns about the need for further harmonisation of state aid rules with EU policy instruments under direct and shared management. There is concern that the absorption of EU funds is hampered by the need to comply with multiple rules that apply differently in apparently similar situations. This perceived inconsistency increases administrative costs and the likelihood of errors.

In addition to the analysis of the concept of state aid and the link between state aid and ESIF, the study examines the differences and the related challenges and difficulties in the application of state aid and ESIF rules to projects for research, development and innovation (RDI) and financial instruments.

Section 2 outlines the concept of state aid and the main obligations of Member States that stem from the Treaty on the Functioning of the European Union (TFEU), the case law of the Court of Justice, secondary legislation and guidelines of the European Commission. Section 3 explains how the compatibility of state aid with the internal market is determined. Section 4 applies the criteria that make up the concept of state aid to ESIF-supported operations and identifies issues that need particular attention by managing authorities. Section 5 summarises the state aid rules that apply to research, development and innovation. Section 6 summarises the relevant state aid rules for risk finance measures. Section 7 identifies the difficulties and ambiguities in the interface between ESIF and state aid rules and suggests possible revisions to improve clarity. Lastly, section 8 summarises the main findings and recommendations of the study.

[1] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJEU L 347, p. 320.

2. CONCEPT OF STATE AID AND MEMBER STATE OBLIGATIONS

KEY FINDINGS

Any public measure regardless of its objectives, constitutes state aid when:

- State resources are transferred to an undertaking (enterprise or economic operator),
- the state resources confer a selective advantage to certain undertakings that lowers their costs (operating expenses, investment, RDI, training, etc.),
- cross-border trade can be affected and competition is distorted.

A public authority that supports projects of economic nature has the following options:

- the public support can be designed to be free of state aid or the aid is kept below the de minimis threshold, or
- if it contains state aid, it must be granted in compliance with a block exemption regulation, or notified to the European Commission for prior authorisation.

One of the objectives of the European Union is to establish a single market in which competition is not distorted. Public subsidies or "state aid" can distort competition. For this reason, Article 107(1) TFEU declares "any" state aid, in "any form", to be incompatible with the internal market. This means that state aid is, in principle, prohibited.

The text of Article 107(1) is as follows:

"Save as otherwise provided in the Treaties, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market."

Since Article 107(1) starts with the words "save as otherwise provided …", the prohibition of state aid is not absolute. State aid may be allowed when it fulfils the conditions for exemption which are laid down in Article 107(2) & (3), Article 43 concerning agriculture, Article 93 concerning coordination of transport and compensation for public service obligations in the area of land transport and Article 106(2) of the Treaty concerning services of general economic interest. The reason that, under certain conditions, state aid is allowed is that markets do not always function smoothly or that they do not always lead to socially equitable outcomes. Governments may have a legitimate cause to intervene to correct market failure or to achieve a more even geographic distribution of economic activity and more equitable distribution of income.

Not all the means by which governments intervene in the economy can be classified as state aid. For example, regulation of professional qualifications or health and safety standards at the workplace are not state aid, even when they favour certain activities or type of enterprises. For a public measure to constitute state aid, it must satisfy all four of the criteria that are laid down in Article 107(1). These criteria are:

1. state resources are transferred to an undertaking,

2. the recipient undertaking obtains an advantage in the form of reduction of its normal costs,
3. the advantage is selective because it is offered only to certain or some instead of all undertakings,
4. the recipient undertaking operates in a sector open to cross-border trade and the aid distorts competition by placing that undertaking in a more advantageous position than its competitors.

A public measure, regardless of its objectives or form, that satisfies all of the four criteria is necessarily classified as state aid. Since the form of aid is not relevant, public authorities can provide state aid using a variety of different instruments such as grants, low-interest loans, injections of equity, guarantees, tax reductions, transfer of public land, etc.

Article 107(1) TFEU applies only to aid granted to “undertakings”. An undertaking is any natural or legal person who is involved in an economic activity, regardless of its status, objective and the way it is financed. Therefore, the classification of an entity as an undertaking depends on its activities, not on its legal status. An activity is economic in nature when, in principle, a market exists for it.

Further clarification of the four criteria of Article 107(1) with examples from Structural Fund operations is provided in section 4.[2]

Article 108(3) TFEU imposes an obligation on Member States to notify to the European Commission for prior authorisation all new measures that contain state aid, regardless of form or objective. Notified aid measures may not be implemented before the Commission approves them.

However, Member States are relieved from the obligation to notify new aid when their measures fall within a “block exemption” regulation or when the aid remains below the “de minimis” threshold of EUR 200 000 per undertaking over a three fiscal-year period. If the amount of aid exceeds the de minimis threshold or if the aid measures do not fall within a block exemption regulation, Member States must notify the measures to the Commission. According to the latest statistics, Member States use the General Block Exemption Regulation (GBER) for more than 95% of all their new aid measures.[3]

Member States are not obliged to notify measures that do not constitute state aid. However, if a Member State is not certain whether state aid is present in or absent from a public measure, it may still notify the measure to the Commission for purposes of legal certainty.
It is up to Member States to decide whether to grant state aid. However, if they do decide to grant aid, they must ensure that it remains below the de minimis amount, or, if it exceeds that amount, that it is either compliant with a block exemption regulation or it is notified to the Commission. There is no other legally possible option.

If a Member State implements a measure in the mistaken belief that it is free of state aid, but later the Commission, EU courts or national courts conclude that it did contain state aid, then legally such a Member State is in breach of its notification obligation under the Treaty. Non-notified aid is deemed to be automatically illegal and actionable before national courts.

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2 The European Commission has published useful guidance on the concept of state aid. See European Commission, Notice on the notion of State aid as referred to in Article 107(1) TFEU, OJ C262, 19 July 2016.

3 Commission Regulation 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty, OJ L187, 26/6/2014.

National courts are obliged to suspend an illegal aid measure and may order recovery of any aid amount already granted.

The Commission, however, may not order recovery of illegal aid before examining its compatibility with the internal market. If the Commission finds that the aid is incompatible, it must order its recovery. Recovery means that all aid is paid back to the state with interest as of the date that it was granted. EU courts have never accepted as a legitimate defence that incompatible aid was granted in "good faith" or that the Member State concerned made an "honest" mistake or that it "genuinely" thought that the measure in question did not contain state aid. Competitors of the beneficiary who receives incompatible aid may also initiate proceedings against the aid-granting authority before national courts to obtain compensation for damage they may have suffered.

It follows that if a Member State is uncertain about the existence of state aid in a public measure, it has four possible options:

1. It may proceed to implement the measure and ignore the risk that it may contain state aid and the legal consequences that stem from the granting of such aid.
2. It may notify the measure to the Commission in order to obtain confirmation that indeed it is free of state aid.
3. It may adjust the measure in such a way so that any public funding remains below the threshold of de minimis aid.
4. It may design the measure to be compliant with state aid rules.

If it chooses the last option, then it will have to decide whether to conform with the requirements of a block exemption regulation, such as the GBER, which obviates notification, or to notify the measure according to the requirements of the relevant state aid guidelines of the Commission.

Member States remain responsible for all the state aid they grant. They need to ensure that the aided project does not start before the aid is granted (please see below the principles of compatibility of state aid) and that the aid supports eligible costs only up to the allowable aid intensity. The obligations of the aid recipient have to be written down in a funding agreement. The existence of such an agreement facilitates the recovery of aid in case irregularities are detected later on.

After the project is completed Member States also need to verify that the project has been executed according to the terms of the funding agreement. It is a general principle of good administration that Member States should establish transparent procedures for publicising aid measures, receiving aid applications, approving aid applications, dispersing aid and carrying out ex post verification checks on aided projects. At minimum, the current state aid regime requires Member States to publish their state aid measures, individual grants and the names of beneficiaries whenever the amount of a grant aid exceeds EUR 500 000 (these transparency requirements are different and extra to the obligation of Member States laid down in Article 115 of the CPR to publicise ESIF-supported projects).

Aided projects are subject to "ex post monitoring" (i.e. checks) by the Commission's Directorate-General for Competition to verify compliance with the relevant state aid rules. Ex post monitoring also covers measures that are implemented on the basis of a block exemption regulation and which were not subject to prior notification to and assessment by the Commission. State aid measures that include Structural Funds are, in addition, subject to the internal and external audit procedures that apply to EU resources.

3. ASSESSMENT OF THE COMPATIBILITY OF STATE AID WITH THE INTERNAL MARKET

KEY FINDINGS

State aid is compatible with the internal market when:

- it supports an objective of common interest and addresses a market failure or equity concern,
- it is appropriate, necessary and proportional, and
- it does not cause undue distortion of competition.

The European Commission enjoys exclusive competence in determining the compatibility of state aid with the internal market. Not even EU courts can substitute their view for that of the Commission. This is because, as recognised by EU courts, the assessment of the compatibility of state aid requires complex economic and legal analysis. Unavoidably, there is an element of subjectivity in this analysis. However, like all decisions of EU institutions, the Commission's assessment is subject to judicial control. On appeal, EU courts verify that Commission decisions are free of factual errors, that they are sufficiently motivated and explained, that they have abided by procedural rules that protect the rights of Member States, aid recipients and competitors and that they are based on the correct interpretation of relevant EU law.

Although EU courts have confirmed that the Commission enjoys wide discretion in determining what aid may be considered compatible with the internal market, the Commission is still bound by EU law to approve only aid which falls within one of the categories of exception listed in the Treaty and which is capable of facilitating the achievement of well-defined public policy objectives. Those objectives are:

- the achievement of social policy (Article 107(2)(a)),
- the remedying of damage caused by natural disasters of exceptional occurrences (Article 107(2)(b)),
- regional development (Article 107(3)(a) & (c)),
- support for important projects of common European interest (Article 107(3)(b)),
- remedying the effects of a serious economic disturbance in the economy of a Member State (Article 107(3)(b)),
- the development of certain economic activities such as research, entrepreneurship, energy efficiency, etc. (Article 107(3)(c)),
- support for culture and heritage conservation (Article 107(3)(d)),
- coordination of transport or compensation for public service obligations (Article 93),
- support for services of general economic interest (Article 106(2)).

At the same time as promoting the achievement of common objectives, aid may not infringe other provisions of the Treaty such as the principle of non-discrimination. For example, aid may not be granted on condition that domestic products are used or that it is limited only to nationally-owned companies.

In order to help Member States to design measures that are compatible with the internal market, the Commission has issued many sets of guidelines over the years. These guidelines, as their name indicates, "guide" Member States to notify measures that the Commission is in a position to approve. In this way, guidelines prevent waste of scarce administrative resources at European and national level in examining or designing measures that are incompatible with the internal market.

The current Commission guidelines for the period 2014-20 are all based on the so-called "common assessment principles". These principles emanate from the case law. The Commission, in an effort to make the assessment of state aid more transparent and predictable, has collected and elaborated them in a cohesive framework. Their purpose is to ensure that the benefits from aid, in terms of the market correction and more equitable distribution of economic activity, outweigh the costs of aid, in terms of distortion of competition. They are now to be found in all of the various Commission guidelines.

The common assessment principles are the following:

1. The aid contributes to the achievement of a well-defined objective of common interest. Member States need to identify precise policy targets and relevant performance indicators that can show whether the targets have been achieved. For example, recently, the Commission found that aid was not in the common interest when it supported duplication of airport infrastructure (Gdynia airport in Poland and Zweibrücken airport in Germany) and when it supported infrastructure for which there was no market demand (testing tracks and facilities for very high speed trains in Spain).
2. There must be a need for state intervention. Member States must demonstrate the existence of market failure or a legitimate equity concern. For example, the Commission prohibited aid for broadband networks in areas that were extensively served by the market because the involvement of market players showed that there was no need for state intervention (broadband network of the city of Appingedam in the Netherlands).
3. The aid must be an appropriate policy instrument. It must be shown through impact assessment that there is no other more effective and less distortionary policy instrument. For example, the Commission did not authorise aid for the conversion of analogue to digital broadcasting because the alleged market failure could be resolved by regulation (switch to digital broadcasting in Germany and Italy).
4. Aid must have an incentive effect. The aid must be capable of changing the behaviour of beneficiaries. Alternatively, the aided project should not be possible without the aid. For this reason operating aid is not normally allowed. Such a kind of aid merely covers day-to-day expenses without the beneficiaries doing anything extra that is in the common interest. The Commission never allows aid for a project that has already started because the aid lacks an incentive effect. (Please note that the state aid assessment of a project that is subject to "phased implementation" such as those under Article 103 of the CPR is carried out before the start of the first phase and takes into account all subsequent phases. The possibly long time period needed for the completion of a phased project does not necessitate assessment of each individual phase. Please also note that feasibility studies do not indicate the start of a project.)
5. The aid must be proportional. This means that aid must be kept to the minimum necessary amount. The Commission does not normally permit aid above the ceilings laid down in block exemption regulations and guidelines.
6. Undue or excessive negative effects must be avoided. The aid measures should not crowd out private initiative, they should not strengthen market power, they should not support

unviable firms in stagnant markets and they should not be limited only to a few favoured beneficiaries. For example, the Commission prohibited aid that was not technologically neutral because it would lead to excessive distortion (subsidies for the purchase of decoders for digital broadcasting in Italy).

7. Aid must be transparent. Member States are obliged to publish all individual awards of aid exceeding EUR 500 000 and the names of recipient companies.

3.1 Case study: Regional state aid

Regional development provides a good example of how state aid rules apply to a public policy. State aid for regional development can promote the achievement of an objective of common interest. Article 107(3)(a) TFEU allows "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment, and of the regions referred to in Article 349, in view of their structural, economic and social situation". These areas are considered to suffer from a regional disadvantage that is defined in relation to the average EU income per person.

In addition, Article 107(3)(c) TFEU allows "aid to facilitate the development of … certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest". The regional disadvantage of these areas is defined in relation to the average national income per person and other economic conditions such as the regional rate of unemployment.

Regional disadvantages are the result of multiple factors such as remoteness, antiquated infrastructure or lack of skilled labour. For these reasons, undertakings are reluctant to invest in less prosperous regions. The purpose of state intervention is to incentivise companies to locate their operations in those regions and, in the process, create new sources of income and jobs for the local population.

Under the current state aid rules, about 47 % of the EU28 population lives in "assisted areas", i.e. areas eligible to receive state aid. The latest EU statistics on state aid indicate that in 2016, Member States granted EUR 7.3 billion for regional development.[4] Of that amount, EUR 5.7 billion was granted by measures that had been adopted on the basis of the GBER. This suggests that close to 80% of all regional aid is granted through GBER-compatible measures.

Articles 13-16 of the GBER lay down the conditions that apply to regional aid. Article 14 allows aid for investment and job creation linked to investment. Article 15 exceptionally permits operating aid for outermost regions, least developed areas under Article 107(3)(a) and sparsely populated areas. Article 16 concerns aid for urban development projects which are implemented via urban development funds and are co-financed by ESIF.

All Member States have drawn "regional aid maps" which had to be notified to the Commission for its approval. These regional aid maps indicate the maximum allowable aid intensity per region. In general, the aid intensity is higher for investments and jobs in areas under Article 107(3)(a) than under Article 107(3)(c). Investment aid may be granted to SMEs located in all eligible areas, while investment aid for large enterprises may be granted only in Article 107(3)(a) areas.

[4] See European Commission, State Aid Scoreboard 2017, DG Competition. It can be accessed at:http://ec.europa.eu/competition/state_aid/scoreboard/index_en.html.

When aid measures satisfy the requirements laid down in the GBER they are considered to generate sufficient benefits without causing excessive distortion of competition. Since the benefits outweigh the costs, they are compatible with the internal market.

4. APPLICATION OF THE CONCEPT OF STATE AID TO ESIF

KEY FINDINGS

Support from ESIF should be presumed to constitute state aid, unless:

- The final beneficiaries are not undertakings (economic operators), or
- The funding supports freely accessible public infrastructure, or
- The funding provides general support to all undertakings in the economy, or
- The granting authority acts as a private investor and the funding conforms with the "market economy investor principle", or
- The funding is so small as not to be able to affect trade

  - either because it remains below the "de minimis" threshold, or

  - because the supported project is purely local.

Article 6 of the CPR, requires that operations supported by ESIF must comply with EU law, including state aid law. A recent special report of the European Court of Auditors (ECA) stated: "We recall that non-compliance with EU and national rules in public procurement and state aid are two of the main sources of irregularities in Cohesion policy."[5] Because of the requirement laid down by Article 6 of the CPR, infringement of state aid rules automatically results in infringement of ESIF rules.

The CPR refers specifically to state aid rules in Articles 37, 38 and 44 on financial instruments, Article 61 on revenue generating operations, Article 62 on public private partnerships (PPPs), Article 65 on eligible expenditure, Article 71 on durability of operations, Article 131 on payment applications, Article 137 on preparation of accounts, Article 140 on availability of documents, and Article 146 on the obligations of Member States concerning corrections and recovery. In addition, Annex XI lays down ex ante conditionalities for the effective application of state aid law.

This section examines the conditions under which co-managed funding from the EU creates a state aid situation which necessitates compliance with state aid law. As mentioned earlier, a public measure constitutes state aid only when it satisfies all of the criteria of Article 107(1). Therefore, funding from the EU also becomes state aid when it satisfies those criteria. It is explained in more detail immediately below that the European origin of the funds cannot by itself exclude ESIF funds from the scope of Article 107(1).

4.1 State resources

Aid must be granted "by a Member State or through state resources." The term "Member State" includes any public authority such as the central government and its ministries or departments, regional and local governments or councils, municipalities and any other agency of the state that exercises powers reserved for the state such as, for example, a broadcasting regulator, a transport regulator, or a financial regulator. An authority assigned by the state the task of managing cohesion funds is an arm of the state.

[5] European Court of Auditors, Special Report 15, *Ex Ante Conditionalities and Performance Reserve in Cohesion*, November 2017. Problems with state aid compliance were also noted by Special Report 24, *More efforts needed to enforce compliance with and raise awareness of state aid rules in Cohesion policy*, October 2016.

The term “state resources” refers to resources that are collected and distributed by public or private bodies which are owned, supervised, otherwise controlled or designated by the state for the purpose of collecting and distributing resources to beneficiaries determined by the state. However, the mere fact that such bodies are owned or controlled by the state is not sufficient to create a presumption that they act in line with public policy. For example, state-owned banks may be pursuing purely commercial objectives. Therefore, it becomes necessary to consider whether the decisions of state-owned or state-controlled bodies which are not public authorities are taken independently or whether they are dictated by the state. If the decisions of those bodies are not taken autonomously but are imposed or influenced to such an extent so that they can be “attributed” or “imputed” to the state, then their resources are deemed to be “state resources”.

Three implications follow from the above. First, regulatory or administrative measures which do not result in transfer of funds owned or controlled by the state are not considered to be state aid even if they confer a commercial advantage to undertakings.

Second, subsidies given by entities which are not controlled by the state or which can decide autonomously without state interference (e.g. privately-owned companies, or independent research organisations) are not considered to be state aid and, thus, fall outside the scope of Article 107(1).

Third, the concept of “state resources” covers funds which do not normally enter the budget of a public authority but whose use is determined by the state. For example, surcharges levied on electricity users by private electricity distributors for the purpose of generating revenue to fund the production of green electricity are normally considered to be state resources whenever the surcharges are imposed by law, the task of collecting and distributing the revenue is assigned by law and the final beneficiaries are defined by law.

It follows that EU resources received by a managing authority and which are disbursed according to criteria defined by that authority come under the control of the authority and their spending is attributed to a decision of the authority. ESIF Funds managed by national authorities become state resources.

It also follows that EU resources which are disbursed through programmes centrally managed by EU institutions according to criteria defined by those institutions [e.g. COSME, Horizon 2020, European Fund for Strategic Investments (EFSI), TEN-T] do not normally come under the control of national public authorities. Since such resources are normally paid directly to beneficiary undertakings they are not considered to be “state resources” and, consequently, they do not fall within the scope of state aid rules. In practice, money paid directly to an enterprise by the Commission, the EIB/EIF or an EU joint undertaking is unlikely to constitute a state resource. If on the other hand, the money is paid by a national authority it is likely to constitute a state resource regardless of its origin.

4.2 Undertakings and Economic Activity

EU state aid rules apply only to aid granted to “undertakings”. The concept of undertaking is loosely equivalent to that of an enterprise but legally it is much wider. According to the Court of Justice of the European Union, it covers any natural or legal person, irrespective of legal status and means of finance, which engages in an economic activity. An undertaking for the purposes of Article 107(1) TFEU can be a self-employed person (such as a lawyer, accountant, car mechanic or carpenter), a professional partnership, a private company, a company quoted on a stock exchange, a group of companies, a public company wholly or partially owned or controlled by the state or even an agency of the state.

An economic activity is the provision of goods or services on a market with a certain regularity and duration for the purpose of remuneration. It is irrelevant that the provision of goods or services is for profit or not. What matters is whether in principle there is a market for such goods or services in the sense that their suppliers assume risk in order to receive adequate remuneration and that the interaction between suppliers and consumers is voluntary. Remuneration constitutes “consideration normally agreed upon between the provider and the recipient”.

This definition of undertakings and economic activity has the following implications. First, for some activities there cannot be a market because they belong to the sphere of exclusive competence of the state, such as the issuing of passports or birth certificates, irrespective of the fact that normally one has to pay a fee to obtain such documents. The fee in such cases is not “consideration” but a charge intended to cover administrative costs.

Second, some activities are not economic in nature because they are not based on voluntary transactions, as for example, compulsory social insurance or compulsory pensions. Some other activities such as public health services and public education are also not economic because it is the duty of the state to provide them to its citizens and because they are financed on the basis of social solidarity by taxpayers regardless of whether they “consume” such services. Hence, the operation of public schools and public hospitals is not subject to state aid rules.

Third, a yet another group of activities are not economic because they are not carried out for the purpose of generating adequate remuneration such as, for example, research whose results are widely disseminated, the provision of shelter to homeless people or the construction of public roads and public parks.

Fourth, economic and non-economic activities which appear to be rather similar may co-exist such as, for example, compulsory pensions (provided by the state) and voluntary pensions (provided by private funds), public schooling which is open to all and private mathematics or music lessons, academic research for the advancement of human knowledge and contract research for the benefit of the sponsor. The activities which are economic in nature are normally undertaken for profit or for revenue that can cover costs with payments by users or consumers.

Fifth, an entity is classified as an undertaking solely on the basis of the activities it carries out, not according to its legal status or public mission. Even a public authority can become an undertaking in relation to those of its activities which are economic such as the management of a port or airport, the provision of parking space or the sale of wood from public forests.

Because public funding of non-economic activities is not state aid, public authorities may be tempted to consider projects they support as not being economic on the grounds that their funding pursues a certain public policy objective. However, as stressed above, the concept of economic activity does not depend on policy objectives or missions but simply on whether a market for such an activity can in principle exist.

ESIF funding can support both economic activities [e.g. investment by enterprises] and non-economic activities [e.g. public roads]. Broadly, direct or indirect funding of undertakings by

ESIF should be considered to fall within the scope of Article 107(1). Funding of public authorities for their own needs and tasks and funding of infrastructure projects open to the public, public hospitals, schools and universities normally falls outside the scope of Article 107(1). The table below provides examples of economic and non-economic projects for all 11 of the thematic objectives listed in Article 9 of the CPR.

Table 1: Examples of economic and non-economic activities

ESIF thematic objectives	Examples of economic activity	Examples of non-economic activity
(1) Strengthening research, technological development and innovation	R&D project of an enterprise whose results are kept private	R&D project of a university whose results are disseminated
(2) Enhancing access to, and use and quality of, ICT	Investment in ICT equipment by an enterprise	Investment in ICT equipment by a public school
(3) Enhancing the competitiveness of SMEs, of the agricultural sector and of the fishery and aquaculture sector	Investment in new technologies or processes	Research on the determinants of competitiveness & dissemination of results
(4) Supporting the shift towards a low-carbon economy in all sectors	Investment in energy efficiency	Research on how to reduce carbon emissions & dissemination of results
(5) Promoting climate change adaptation, risk prevention and management	Investment in renewable energy sources	Research to identify sectors or areas at risk from climate change & dissemination of results
(6) Preserving and protecting the environment and promoting resource efficiency	Investment in recycling technology or more durable products	Establishment of new nature reserves
(7) Promoting sustainable transport and removing bottlenecks in key network infrastructures	Investment in systems for managing truck fleets	Installing traffic management systems
(8) Promoting sustainable and quality employment and supporting labour mobility	Incentives for posting or secondment of personnel	Advice to job seekers on how to improve their communication skills or to present themselves
(9) Promoting social inclusion, combating poverty and any discrimination	Incentives for employment of persons from minorities	Public information campaign on the costs and consequences of discrimination
(10) Investing in education, training and vocational training for skills and lifelong learning	Training of persons already in employment	Advice on how to accumulate a portfolio of career-advancing skills
(11) Enhancing institutional capacity of public authorities and stakeholders and efficient public administration	Incentives to the private sector to second staff to ministries	Training of civil servants or restructuring of public administration

Source: Author's compilation based on ESIF thematic objectives.

4.3 Advantage

State aid exists when the transfer of state resources favours one or more undertakings, resulting in an “advantage” that could not have been obtained under normal market conditions. Normal market conditions indicate the situation that prevails without public intervention. They do not signify a hypothetical situation of the market under perfect competition or without market failure. Intervention by the state to correct market failure or to achieve an equity objective can still confer an advantage to undertakings that receive subsidies, for example, to carry out more research, protect the environment, hire handicapped persons or invest in backward regions.

Article 107(1) applies to aid in any form and bans aid according to its effects (actual or potential), rather than the declared intentions of the granting authority. Therefore, the concept of aid includes any advantage of monetary nature conferred by the state, which would not have been otherwise enjoyed by the recipient undertaking. Advantage is a reduction, even a small one, of the expenses which are normally included in the budget of undertakings, such as investment or operating costs, or a relief from charges which are normally borne by undertakings, such as corporate taxes or employers’ social insurance contributions. Advantage in the meaning of Article 107(1) encompasses not only grants actually given by the state for free, but also anything owed to the state, which the latter fails to collect or receive, such as taxes, interest on loans, premiums on guarantees and dividends on invested public capital, as well as potential revenue that the state gives up without objective reason such as when it sells products, services or land at prices below market rates. Undertakings also obtain an advantage when the state incurs higher costs without objective reason such as when it purchases products and services from suppliers at prices above market rates.

It follows that the notion of state aid includes a large variety of instruments some of which may also be mobilised or co-financed by ESIF, such as:

- grants;
- reimbursable advances;
- loans at preferential rates of interest;
- free public guarantees;
- tax advantages: tax base or tax rate reductions, tax deferment, tax cancellation, tax exemptions;
- reduction of social security contributions;
- provision of goods and services at prices below market rates;
- sale or renting of public land at prices below market rates;
- purchase of goods and services by the state at above market rates;
- capital injections which are not in conformity with the market economy or private investor principle (this is the case when the expected return is lower than the rate demanded by a private investor in similar market conditions and risk);
- free use of public assets such as buildings or equipment;
- provision of free advice to undertakings.

The implication of this wide definition of advantage is that there are only four possible cases where payments or other monetary contributions by a public authority do not confer an advantage to the recipient undertaking. The first and most general case is when the public authority procures goods and services for its own needs at market prices, normally by following a public procurement procedure. Here the public authority behaves just like any other consumer. ESIF funding to support public administrations does not constitute state aid. The second case is when a public authority acts as an investor who seeks to maximise return on investment. Section 6 explains in more detail the concept of the "market economy investor principle" (MEIP) and how it may apply to risk finance measures. In general, financial instruments co-financed by ESIF and which conform with the MEIP do not constitute state aid.

Thirdly, a public authority may compensate an undertaking for the extra costs of public service obligations that that authority imposes on it. Such compensation does not confer an advantage when it satisfies the conditions identified by the Court of Justice in its "Altmark" judgment.[6] Accordingly, there must be an act of entrustment of a public service obligation, the parameters of compensation must be determined in advance, the amount of compensation may not exceed the net extra costs of the service and the provider must be selected on the basis of a competitive procedure or it must be shown to be efficient. It is rare for compensation to satisfy these conditions. The "Altmark" conditions are cumulative. If one or more of them are not satisfied, compensation granted to providers of services of general economic interest (SGEI) counts as state aid, regardless of the social importance of those services. The economic or social significance of the subsidised activity is not sufficient to remove it from the scope of Article 107(1). ESIF funding to support investment by an SGEI provider and which is "Altmark" compliant does not constitute state aid. Normally, however, ESIF funding cannot be used to support the operating expenses of an SGEI provider.

Lastly, payments to remedy damage suffered by an undertaking because of negligence of a public authority only provide relief from an abnormal financial burden, so they are not state aid.

4.4 Selectivity

"General" measures of economic policy are not selective and therefore do not constitute state aid. Article 107(1) refers to advantages favouring "certain" undertakings or the production of "certain" goods. The term "certain" has been interpreted by the Court of Justice to mean that aid must be "selective" or "specific" in the sense that it targets undertakings in certain regions or of certain size, sector, activity or type.

The fact that a measure may apply to many, perhaps thousands, of undertakings does not make it general. For example, a measure that limits eligible beneficiaries to those with SME status is selective despite the fact that more than 95% of all enterprises in Europe are SMEs. Incentives for investment in renewable energy generation would also be selective as they target a particular sector, regardless of the fact that there may be numerous potential beneficiaries.

By contrast, reduction of the rate of corporate taxation across the board is a general measure because it applies to any company, of any size, in any sector or region. A measure which is not general is necessarily selective and falls within the scope of Article 107(1).

In order to understand whether a measure is selective it is sufficient to establish that it distinguishes between undertakings which are in the same factual or legal situation. For example, a measure that exempts from corporate tax those undertakings that carry out

[6] Judgment of the Court of Justice of 24 July 2003, *Altmark Trans*, C-280/00, ECLI:EU:C:2003:415, paragraphs 87 to 95.

investments in a particular region is selective on two counts. First, a certain region benefits to the exclusion of other regions. Second, companies providing non-tradable services in other regions do not benefit, even though they too are subject to the same tax.

Measures which appear to be general may in their application still favour certain undertakings or certain products. For example, a measure that supports participation in trade fairs abroad may be in principle open to all companies from all regions of a Member State. However, in its implementation it would effectively exclude all those companies offering non-tradable services.

Most thematic objectives listed in Article 9 of the CPR are selective in their explicit intention and practical application. However, some of them may include truly general actions such as free advice funded by ESIF for the benefit of any company that wants to reduce its carbon footprint or increase its energy efficiency or strengthen its innovative capacity. (Please note that the provider of such advice may be a company which has to be selected through a competitive procedure to prevent it from obtaining an undue advantage.) In addition, funding for infrastructure projects may also lack selectivity when access to such infrastructure is open to all companies.

4.5 Effect on Trade

Article 107(1) does not cover situations which are purely domestic or completely outside the EU and do not have any noticeable indirect impact on the internal market. For example, subsidies granted to hairdressers would not be considered to be state aid because individuals do not normally buy hairdressing services from other Member States and hairdressers do not normally operate salons outside their locality, let alone region or country.

The conditions under which trade between Member States is affected and competition is distorted for the purposes of Article 107(1) are, as a general rule, inextricably linked. If aid is found to have a foreseeable effect on trade, it is almost always considered to distort or threaten to distort competition. This is because the Court of Justice has taken the view that when state aid affects trade it necessarily strengthens the position of the beneficiary undertakings in relation to their competitors in other Member States.

There is no quantitative threshold below which aid is not capable of affecting trade. Even small amounts of aid may affect trade. The exception here is when the amount of aid is considered to be “de minimis” (see below).

The effect on trade does not have to be significant. Nor, does it have to be actual or direct. What is necessary is that it can be predicted with reasonable degree of certainty that the “pattern” of trade may be affected. This means that trade can be affected both directly as, for example, when aid stimulates exports, or indirectly as, for example, when aid makes products cheaper and consumers from other countries travel to the place of supply (e.g. subsidies to ski lifts at international ski resorts). Aid to a purely local service such as municipal transportation can still have an indirect effect on trade if the provider is selected through an open procedure in which companies from other Member States can participate. Similarly, even if aid is received by an undertaking which sells its products solely within the domestic market of a Member State, intra-EU trade may still be indirectly affected, if it becomes more difficult for similar products from other Member States to enter that particular market.

Trade is normally not affected when:

- the amount of aid remains below the “de minimis” ceiling, or

- the market for the aided product is proven to be only local with no cross-border transactions or movement of users/consumers, and the supplier of that product has no other operations outside the local market, or
- the situation is wholly outside the EU, provided that there is no indirect impact on the internal EU market.

Small amounts of aid that are presumed not to affect trade are classified as “de minimis” aid. Commission Regulation 1407/2013[7] defines de minimis amounts to be less than EUR 200 000 over a three fiscal-year period per recipient undertaking. Commission Regulation 360/2012[8] establishes a higher de minimis threshold of EUR 500 000 exclusively for providers of services of general economic interest. However, for primary agricultural products and for fisheries the lower thresholds of EUR 15 000 and EUR 30 000 apply, respectively [see Regulation 1408/2013[9] and Regulation 717/2014[10]]. It is important to note that for aid to be qualified as de minimis it is necessary that it conforms with all of the requirements of Regulations 360/2012, 1407/2013, 1408/2013 and 717/2014, respectively.

Operations supported by ESIF may very well affect intra-EU trade. Some operations explicitly incentivise cooperation between undertakings from different regions or Member States [e.g. Interreg]. Most operations are intentionally open to any undertaking from any economic sector. In these situations, trade must be considered to be affected, since it cannot be excluded that some aid recipients may compete with undertakings from other Member States or may engage in cross-border transactions themselves.

Whenever ESIF-supported operations are thought not to affect intra-EU trade, the presumed absence of impact on trade has to be actually established in each individual case on the basis of credible data that show no or marginal cross-border movement of products or consumers and no or marginal cross-border establishment by companies that can supply the same product. For example, ESIF support for evening classes for adults or cultural centres in rural areas or training of public officials is unlikely to affect trade.

4.6 Distortion of Competition

For aid to fall within the scope of Article 107(1), it must also be capable of distorting competition. As mentioned above, the conditions under which trade between Member States is affected and competition is distorted are as a general rule inextricably linked. The distortion does not have to be significant, nor is it necessary that the aid beneficiary acquires a distinct competitive advantage over its rivals. Small effects on trade are sufficient to generate a distortion. Similarly, any aid, except de minimis aid, that actually disturbs or threatens to disturb the conditions of competition between undertakings within a Member State or between undertakings from different Member States is sufficient for Article 107(1) to apply.

It is often argued that aid is granted for the purpose of correcting distortions of competition caused by the policies of other Member States or to offset the granting of unfair advantages

[7] Commission Regulation (EU) No 1407/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid Text with EEA relevance, OJ L 352, 24.12.2013, p. 1–8.

[8] Commission Regulation (EU) No 360/2012 of 25 April 2012 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid granted to undertakings providing services of general economic interest Text with EEA relevance, OJ L 114, 26.4.2012, p. 8–13.

9 Commission Regulation (EU) No 1408/2013 of 18 December 2013 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid in the agriculture sector, OJ L 352, 24.12.2013, p. 9–17.

10 Commission Regulation (EU) No 717/2014 of 27 June 2014 on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid in the fishery and aquaculture sector, OJ L 190, 28.6.2014, p. 45–54.

by those Member States. Such arguments have never been accepted by EU courts or the Commission. The only decisive element is whether the aid recipient obtains an advantage which is not available to its competitors. It is irrelevant that the competitors may, in fact, enjoy many other advantages.

The implication of this wide definition of distortion of competition is that an attempt by a Member State to approximate, by unilateral measures, conditions of competition in a particular sector of the economy to those prevailing in other Member States cannot remove those measures from the scope of Article 107(1). It follows that an aid measure does not escape from the scope of Article 107(1) either because more favourable conditions for undertakings exist in other Member States or because competition from those undertakings is deemed to be excessively strong or unfair.

In order to establish whether state intervention distorts competition in a sector or region it is sufficient to consider the situation before and after state intervention, not between the actual and desirable situation of a sector or region. State intervention distorts competition even when the change it seeks to bring about benefits society as a whole by, for example, stimulating investment, protecting the environment, reducing energy consumption, increasing research output or offsetting economic disadvantages and handicaps such as inadequate infrastructure.

Since ESIF-supported operations seek explicitly to change economic conditions in particular sectors or regions, they do have an impact on competition. It is important to note that the beneficial effects of such changes are taken into account at the stage where the compatibility of the aid with the internal market is considered. It is at that stage that the benefits and costs of the aid are compared. At the stage of determining the existence of aid, such potential benefits or actual handicaps must be ignored.

In conclusion, ESIF funding should be considered to constitute state aid unless it can be shown that one or more of the criteria of Article 107(1) does not hold. ESIF funding is normally state aid because i) it is managed by a national public authority, ii) it intends to confer an advantage to its recipients, iii) it targets particular sectors, regions or types of economic activity, iii) it affects or encourages cross-border transactions and iv) it seeks to alter the conditions of competition in the internal market.

5. STATE AID FOR RDI

KEY FINDINGS

ESIF support to RDI

- does not constitute state aid when it funds universities and research organisations which do not act as economic operators. Their non-economic character is normally indicated by the wide dissemination of the results of their research and the reinvestment of any incidental income into their primary activities of education and research;
- constitutes state aid when it funds undertakings such as SMEs or economic activities such as joint research projects between universities and SMEs when the results of the research are exploited commercially. State aid for RDI needs to

  - conform with the GBER, or

  - be notified to the European Commission.

State aid rules apply to any economic activity including research, product development and innovation (RDI). State aid to promote RDI is normally regarded to be compatible with the internal market because RDI generates knowledge that benefits society at large and also because research and innovation are prone to market failure. The private sector is unwilling to invest in research when competitors cannot be excluded from using the results of one's own research efforts. Moreover, capital markets are unwilling to provide finance to start-up companies of inventors who do not have a proven track record or to projects with high risk and long pay-back periods. For these reasons, the support of RDI is an important EU objective (laid down in Article 179 of the Treaty). EU funding for RDI is provided through different instruments, to different recipients and it is disbursed both at European level (e.g. Horizon 2020, COSME) and national level (e.g. ERDF).

Not all public funding of RDI constitutes state aid. The recipients may not be undertakings (e.g. universities), the amounts may be de minimis, or the resources used may not be classified as state resources (e.g. private funding or funding from centrally managed programmes at EU level such as COSME). It may also happen that the funding authority is acting as a private investor who wants to obtain a return on its investment in line with the market economy investor principle. In this case too, no state aid is granted.

The implementation of state aid measures for RDI has to comply either with the relevant provisions of the General Block Exemption Regulation (i.e. Regulation 651/2014) or with the requirements of the Commission Framework on State Aid for RDI.[11] Measures implemented on the basis of the GBER need not be notified to the European Commission. By contrast, measures outside the provisions of the GBER must be notified to the Commission before they are put into force. The Commission examines their conformity with the common assessment principles as they are elaborated in detail in the RDI Framework.

Member States may use the GBER for measures that support research projects (Article 25 of the GBER), investment in research infrastructures (Article 26), investment in or operation of innovation clusters (Article 27), innovation by SMEs (Article 28), process and organisational innovation (Article 29) and R&D in fisheries and aquaculture (Article 30).

[11] The RDI Framework can be accessed at: COMMUNICATION FROM THE COMMISSION Framework for State aid for research and development and innovation (2014/C 198/01).

According to the questions submitted by Member States to DG Competition, it appears that the most difficult issues are those concerning eligible costs and the funding of entities that may not be undertakings (e.g. universities).[12] With respect to costs, ESIF-supported projects that may involve state aid must conform with the requirements of state aid rules such as those laid down in the GBER. To this effect, a proposal is made in section 7.1. With respect to the notion of non-undertakings, it is necessary that all public authorities comply with it as the concept of economic activity stems from the case law of the Court of Justice.

The maximum aid intensities allowed by the GBER in terms of percentage of eligible costs are shown in the table below.

Table 2: Aid intensities for RDI

	Aid intensity (%)	Bonus for small enterprise / medium enterprise
Fundamental research	100	100
Industrial research	50 [+15]*	+ 20/10 [+15]*
Experimental development	25 [+15]*	+ 20/10 [+15]*
Feasibility studies	50	+ 20/10
Research infrastructure	50	50
Innovation clusters Investment aid Operating aid	50 [+15 for "a" +5 for "c" areas]** 50	50 [+15 for "a" +5 for "c" areas]** 50
Innovation for SMEs	--	50/50
Process & Organisational Innovation	15	50/50
* Effective collaboration or wide dissemination (up to maximum of 80%) ** "a" area = Article 107(3)(a) area; "c" area = Article 107(3)(c) area		

Source: Author's compilation based on the GBER.

Member States now use the GBER extensively. More than 95% of all new aid measures have been adopted on the basis of the GBER. The very high rate of utilisation of the GBER explains why so far the Commission has approved only four aid measures on the basis of the RDI Framework after individual notification.

[12] See DG Competition, GBER: Frequently Asked Questions.

6. STATE AID FOR RISK FINANCE

KEY FINDINGS

ESIF support for financial instruments

- does not constitute state aid when it conforms with the "market economy investor principle" or when investors or financial intermediaries receive no advantage and all the benefits are passed on to the SME final recipients in the form of de minimis aid;
- constitutes state aid when
  - it incentivises participation of private investors or financial intermediaries, or
  - it supports SMEs which do not have access to market finance with amounts that exceed the de minimis ceiling.

SMEs often have difficulty to access funding from capital markets despite the fact that SMEs as a group tend to be as innovative as large enterprises. SMEs have difficulty to obtain market finance because they have little or no collateral, they do not have a long-enough track record or credit rating, it is not possible for outside investors to monitor closely the performance of the managers of SMEs and because the administrative costs of small amounts finance are disproportionately high. Banks and institutional investors generate proportionately higher return from funding large, multi-million projects. All these reasons justify, in principle, government intervention to incentivise investors to provide finance to SMEs.

Incentives such as tax deductions for investors, acceptance of first loss or lower return by the public investor in co-investments between public and private investors or public guarantees that protect the capital of private investors or ensure a fair return for private investors normally constitute state aid.

Even when the investment incentives are limited to private individuals who invest their own money and not on behalf of clients (i.e. they are not acting as undertakings) and even when investment decisions are commercially motivated, it is considered that the amount of available risk finance increases and therefore the final SME recipients also obtain an advantage even if it is difficult to quantify it. Therefore, if there is state aid at the level of the investors or at the level of the fund managers, it is presumed that there is state aid also at the level of the final recipients.

Risk finance measures are free of state aid in any of the following three situations:

1. The investment decisions of both the public and private investors are based on purely commercial criteria and comply with the "market economy investor principle" (MEIP) (i.e. there is no advantage for the recipients in the meaning of Article 107(1)).
2. The amount of aid falls below the de minimis threshold (i.e. not all criteria of Article 107(1) are fulfilled).
3. The money that is invested comes directly from a private source or from a fund centrally managed at European level by an EU institution such as the EIB or the EIF (i.e. there are no state resources in the meaning of Article 107(1)).

On the basis of Implementing Regulation 964/2014, the European Commission has designed three so-called "off-the-shelf" financial instruments which are free of state aid because all aid is kept below the de minimis ceiling of EUR 200 000 and it is fully passed on to the final

SME recipients. However, a recent study for the European Parliament indicated that “off-the-shelf” financial instruments had not been used for support of energy efficiency and the production of energy from renewable sources because they were introduced relatively late and because they did not meet specific needs in that field. Perhaps the reason was the fact that the aid has to be de minimis.[13]

The Commission has designed additionally two financial instruments which contain compatible state aid. Managing authorities can use any of the five financial instruments with assurance that they conform with state aid law.[14]

A public authority acts like a private investor when it seeks to make a return on its investment that is commensurate to the risk it assumes. If a public investment is MEIP-conform, then it is free of state aid because the recipient of the public money enjoys no advantage. There is no advantage for the recipient because it could have obtained the same amount of funds on the same terms from the market. Therefore, to demonstrate that a public investment is MEIP-conform it must be benchmarked against private investment of similar size for similar purposes.

As acknowledged in the 7th Cohesion Report, “the [financial instrument] landscape at EU level is complicated, with various players, instruments and areas of intervention.”[15] Indeed, this complexity may cause confusion to public authorities as to whether they need to comply with state aid rules. However, as already indicated above, the fact that resources originate from the EU is not sufficient to remove them from the scope of state aid rules. In general, ESIF support does have to comply with state aid law. Article 107(1) and state aid rules do not apply only the resources which are managed directly by EU institutions.

The implementation of state aid measures for risk finance has to comply either with the relevant provisions of the GBER or with the requirements of the Commission Guidelines on State Aid for Risk Finance.[16] Measures implemented on the basis of the GBER need not be notified to the European Commission. By contrast, measures outside the provisions of the GBER have to be notified to the Commission prior to their implementation. The Commission examines their conformity with the common assessment principles as they are elaborated in the Risk Finance Guidelines.

Member States may use the GBER for measures that facilitate access to finance for SMEs (Article 21 of the GBER), support of start-ups (Article 22), establishment of alternative trading platforms for SMEs (Article 23) and offsetting of scouting costs (Article 24). The GBER sets the following limits for the aid amounts or intensity of risk finance measures:

- Finance for SMEs (Article 21): EUR 15 million per undertaking.
- Start-ups (Article 22): EUR 1-2 million for loans, EUR 1.5-3 million for guarantees, EUR 0.4-0.8 million for grants or equity per undertaking.

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13 European Parliament, *Research for REGI Committee – Financial instruments for energy efficiency and renewable energy*, Directorate-General for Internal Policies, August 2017. It can be accessed at: http://www.europarl.europa.eu/RegData/etudes/STUD/2017/601992/IPOL_STU(2017)601992_EN.pdf.

14 Commission Implementing Regulation (EU) No 964/2014 of 11 September 2014 laying down rules for the application of Regulation (EU) No 1303/2013 of the European Parliament and of the Council as regards standard terms and conditions for financial instruments, OJ L 271, 12.9.2014, p. 16–44. See the Commission press release IP/16/2448 of 11 July 2016 concerning the launch of the two new financial instruments. “FI-Compass” also provides information and guidance on financial instruments. See: https://www.fi-compass.eu/.

15 European Commission, *7th Report on Economic, Social and Territorial Cohesion*, September 2017, p. 182.

16 Communication from the Commission, Guidelines on State aid to promote risk finance investments, (2014/C 19/04).

- Trading platforms (Article 23): Same as for start-ups under Article 22.
- Scouting costs (Article 24): 50% of eligible costs.

According to the questions submitted by Member States to DG Competition, it appears that the most difficult issues are those concerning the selection of and incentives to private investors, the assignment of tasks to entrusted entities and the direct funding by public authorities. With respect to direct funding by public authorities a proposal for clarification is made in section 7.[17]

[17] See DG Competition, GBER: Frequently Asked Questions.

7. CHALLENGES FOR MEMBER STATES IN COMPLYING BOTH WITH ESIF AND STATE AID RULES AND PROPOSALS FOR IMPROVING COMPLIANCE

KEY FINDINGS

Revision of ESIF regulations for the purpose of streamlining them with state aid rules should consider different and/or more elaborate phrasing for the following concepts:

- The definition of undertakings in difficulty.
- The definition of beneficiaries.
- The exclusion of de minimis aid from compliance with state aid rules.
- The definition of economic operators.
- The categories of enterprises that may be supported by financial instruments.
- The direct granting by managing authorities of loans and guarantees.
- The use of state aid methods for calculation of the maximum allowable aid.
- Simplified cost options for state aid granted on the basis of GBER and ABER.
- Explicit mention of the 10-year rule for availability of documents and recovery of incompatible state aid whenever ESIF-supported projects involve state aid.

Revised ESIF regulations may also introduce:

- A rebuttable presumption that Structural Fund operations in favour of undertakings constitute state aid.
- A standard option for compatibility of state aid on the basis of the GBER.

When EU institutions and Member States implement projects supported by ESIF, they must also comply with EU law. This is required by Article 6 of the CPR. All secondary legislation such as the CPR must conform with the fundamental principles laid down in EU treaties such as the conditional prohibition of state aid. Section 4 explained how the concept of state aid applies to ESIF operations. The purpose of this section is, first, to identify briefly the references to state aid obligations in ESIF regulations and, second, to consider in detail how certain provisions of the CPR may be difficult for Member States to interpret or implement according to the requirements of state aid law.

Before turning to the CPR here is a summary of the main provisions of cohesion regulations with relevance to state aid:

- Regulation 1300/2013 on Cohesion Fund: Article 2 excludes undertakings in difficulty, as defined under state aid rules.
- Regulation 1301/2013 on ERDF: Article 3(3) also excludes undertakings in difficulty, as defined under state aid rules.
- [Regulation 1302/2013 refers to European groupings of territorial cooperation. It has no state aid significance.]
- Regulation 1304/2013 on ESF: Article 14 exempts from the simplified cost options operations receiving state aid.

- Regulation 1305/2013 on EAFRD: Article 60 on the contribution of the Fund stipulates that support to enterprises must remain below the state aid ceilings. Article 81 requires support for rural development to conform with the substantive and procedural state aid rules, except where payments by Member States fall within the actions defined in the Regulation.
- Regulation 508/2014 on EMFF: Article 8 applies substantive and procedural state aid rules to support for fisheries, except where payments by Member States conform with the Regulation.

With the exception of Regulation 1304/2013, the references to state aid above do not appear to create any particular difficulty for managing authorities in simultaneously complying with structural fund and state aid rules. However, it will be easier for managing authorities to understand the concept of "undertakings in difficulty" if, in addition to referring to the state aid rules for the precise definition, the regulations explained that undertakings in difficulty are undertakings that have lost a significant amount of their capital and are likely to go out of business in the absence of state intervention.

The issue concerning simplified cost options is examined in more detailed below. The situation with the CPR is rather different, as some of its provisions appear to diverge from typical state aid practice. The CPR refers to state aid at the following points:

Article 2(10): Definition of beneficiaries

"'Beneficiary' means a public or private body ... responsible for initiating or both initiating and implementing operations; and in the context of State aid schemes, as defined in point 13 of this Article, the body which receives the aid; and in the context of financial instruments under Title IV of Part Two of this Regulation, it means the body that implements the financial instrument or the fund of funds as appropriate".

Under state aid law, the beneficiary is always the recipient of the aid and the recipient is always an undertaking. As defined by the CPR the beneficiary can be a public authority that manages EU funds or a special legal person that dispenses funds. Although the definition in Article 2(10) indicates that the term can refer to bodies other than undertakings, the reference to both state aid and the implementation of financial instruments can be confusing because the fund of funds itself is in many cases not an undertaking. It is often a legal person whose only purpose is the release of funding without being allowed to have any other activity of economic nature. Such legal persons have been found by the Commission not to be undertakings.

A similar complication arises in Article 2(27) of the CPR which defines a fund of funds as "a fund set up with the objective of contributing support from a programme or programmes to several financial instruments. Where financial instruments are implemented through a fund of funds, the body implementing the fund of funds shall be considered to be the only beneficiary within the meaning of point 10 of this Article". Again, under state aid law, there can be multiple beneficiaries of state aid (e.g. the investors in the funds, the managers of the funds, the financial intermediaries which may be co-investors or the SMEs which are the final recipients of the finance).

A way of avoiding confusion in the definition of "beneficiaries" is, perhaps, to designate as beneficiaries the entities that implement operations and "beneficiary undertakings" as the entities that receive funding that constitutes state aid. Please note, however, that this issue is also expected to be addressed under the forthcoming "omnibus" regulation.

Article 2(13): Definition of state aid

"'State aid' means aid falling under Article 107(1) TFEU which shall be deemed for the purposes of this Regulation also to include de minimis aid within the meaning of Commission Regulation (EC) No 1998/2006, Commission Regulation (EC) No 1535/2007 and Commission Regulation (EC) No 875/2007".

De minimis aid is not state aid in the meaning of Article 107(1) TFEU. Article 3 of the de minimis aid Regulation 1407/2013 stipulates that "aid measures shall be deemed not to meet all the criteria in Article 107(1) of the Treaty, …, if they fulfil the conditions laid down in this Regulation". Moreover, the de minimis regulations specifically refer to the possibility that de minimis aid can be financed by EU resources too.

Member States are asked to consider that de minimis aid is state aid for the purposes of the CPR, but it is far from obvious what kind of obligation in practice is imposed on Member States. The reason of lumping together state aid and de minimis aid is not clear. If the purpose is to get Member States to report all support they grant, then this can be accomplished by requesting Member States to report both the amounts of state aid and de minimis aid used in ESIF operations.

Furthermore, the usefulness of lumping together state aid and de minimis aid in the context of the CPR is also questionable given that de minimis aid is explicitly mentioned only once in the rest of the CPR in Article 61(8) on revenue generating operations. The provision of Article 61(8) can be understood without having to lump de minimis aid with state aid.

In order to achieve consistency with state aid law, the revision of the CPR in the future should treat de minimis aid as not state aid and should be explicit about how Member States should report the use of EU resources to finance de minimis aid.

Article 2(37): Definition of economic operator

"'Economic operator' means any natural or legal person or other entity taking part in the implementation of assistance from the ESI Funds, with the exception of a Member State exercising its prerogatives as a public authority".

Under state aid law, an undertaking is any natural or legal person who is involved in an economic activity. It may be inferred that an operator is "economic" when its activities are economic in nature. However, as already explained above, legal persons whose only purpose is to disburse funding and have no other activity are not considered under state aid law to be undertakings and therefore they are not economic operators. To avoid confusion, a revised CPR may define "economic operator" as "any natural or legal person who receives assistance from the ESI Funds that constitutes state aid".

Article 19 and Annex XI(part II(5)): Ex ante conditionalities on state aid

Member States have to fulfil the ex ante conditionalities in order to ensure effective implementation and application of EU state aid law through:

"Arrangements for the effective application of EU state aid rules."

"Arrangements for training and dissemination of information for staff involved in the implementation of the ESI funds."

"Arrangements to ensure administrative capacity for implementation and application of Union State aid rules."

The Commission has elaborated the principles in Annex XI as follows:[18]

- Effective application of state aid rules: Knowledge of state aid, capacity to enforce recovery order, procedure for checking eligibility, procedure for complying with reporting obligations.
- Training and dissemination of information: Training strategy in place, procedure for dissemination and exchange of information.
- Administrative capacity: Existence of a central body to give advice and technical assistance.

In addition, the Commission has organised a number of seminars for Member States. Despite the Commission's guidance and training and its willingness to offer advice, apparently certain Member States have found it difficult to assess by themselves how to determine in practice whether they fulfilled the ex ante conditionalities and how to demonstrate, for example, sufficient knowledge of EU law or adequate capacity to give advice. The importance of the ex ante conditionalities for the correct and effective implementation of state aid rules is also highlighted in the EU's 7th cohesion report.[19]

However, the European Court of Auditors in its Special Report 24 noted that, somehow paradoxically, "several Member States had a higher frequency of problems in the design and implementation of aid measures than the ones which concluded that they did not fulfil the State aid ex ante conditionalities".[20] Perhaps this is because those who admitted they had administrative weaknesses actively sought to remedy them through training and procedural reform.

Article 37: Financial instruments

Article 37(4) refers to the various categories of enterprises that should be targeted by financial instruments such as "early stage", "seed", "expansion", etc. These categories are no longer used in the GBER (Article 21) and the Risk Finance Guidelines in order not to constrain unnecessarily Member States. Since risk finance is also subject to state aid rules, the reference to these categories in the CPR is probably superfluous.

Article 38: Implementation of financial instruments

Article 38(4) allows managing authorities to implement directly loans and guarantees without having to go through financial intermediaries. However, Article 21(13)(a) of the GBER explicitly requires implementation via financial intermediaries. These two provisions appear to be contradictory. An interpretation that ensures consistency between the CPR and the GBER is that direct implementation necessarily entails that the financial instrument is free of state aid either because the managing authority is acting as a private investor or the amount of aid is kept below the de minimis threshold.

[18] European Commission, *Guidance on Ex ante Conditionalities for the European Structural and Investment Funds*, 13 February 2014.

[19] See European Commission, *7th Report on Economic, Social and Territorial Cohesion*, September 2017.

[20] European Court of Auditors, Special Report 24, *More efforts needed to enforce compliance with and raise awareness of state aid rules in Cohesion policy*, October 2016.

A revised CPR should either require that direct implementation of loans and guarantees is free of state aid (e.g. because of the use of off-the-shelf financial instruments or conformity with the MEIP) or explicitly define the direct implementation by managing authorities of loans and guarantees as an exception to the GBER.

Article 38(5) refers to financial intermediaries and requires that they are selected on "the basis of open, transparent, proportionate and non-discriminatory procedures, avoiding conflicts of interest." In addition, Articles 37(1) and 38(4) impose on Member States a general obligation to comply with public procurement law. Article 21(13)(b) of the GBER lays down a similar obligation, also referring to "open, transparent, and non-discriminatory" selection of intermediaries. In this connection, managing authorities have raised the question whether the management of financial instruments can be directly assigned to "in-house operators" in the meaning of public procurement rules. Under public procurement rules, it is allowed to make direct awards to in-house operators. Direct award does not appear to conform with the obligation of open selection. However, a managing authority may appoint an "entrusted" entity to act on its behalf and that entrusted entity may be an in-house operator.

Article 61: Revenue-generating operations

Article 61 requires deduction of expected future revenue, calculated according to certain flat rates, from the eligible costs of ESIF-supported projects. Its intention is to prevent unnecessary subsidisation of projects. However, Article 61(8) also declares the first six paragraphs of Article 61 inapplicable whenever ESIF support constitutes de minimis aid or compatible state aid. This may create confusion because revenue-generating operations can be economic in nature and therefore ESIF support can be state aid. The reason for their inapplicability is that whenever state aid rules apply to an operation, the calculation of the amount of public support and the definition of eligible costs has to be carried out according to those rules, whereas the intention of Article 61 is to prevent excessive subsidies. The same task is performed by the ceilings and maximum aid intensities defined by state aid rules. The purpose of the eighth paragraph of Article 61 can be made clearer by stipulating instead that whenever state aid is granted, the amount of aid and eligible costs have to be calculated according to the methods and ceilings laid down in the applicable state aid rules. Please note, however, that this issue is also expected to be addressed under the forthcoming "omnibus" regulation.

Article 65: Eligibility of expenditure

Article 65(8) states that "This paragraph shall apply to operations which generate net revenue during their implementation and to which paragraphs 1 to 6 of Article 61 do not apply.

This paragraph shall not apply to:

(e) operations subject to State aid rules".

Same as in Article 61, a revised CPR may add that "(e) operations subject to State aid rules whose eligibility is determined according to those rules".

Article 67: Forms of grants and repayable assistance

Article 67 provides for the calculation of assistance to be carried out on the basis of simplified options. Although Article 67 does not refer explicitly to state aid, recently, Regulation 2017/1084 introduced the simplified cost option in the GBER and in Regulation 702/2014, which is the corresponding block exemption regulation in the area of agriculture and forestry (ABER), whenever a project is co-financed by an EU fund. This revision of the GBER and ABER should make it easier for managing authorities to conform with both ESIF and state aid rules.[21]

Article 140: Availability of documents

This Article requires that "without prejudice to the rules governing State aid, the managing authority shall ensure that all supporting documents regarding expenditure supported by the Funds …, are made available to the Commission and the European Court of Auditors upon request for a period of three years". Under state aid rules documents have to be kept for at least 10 years from the moment of each payment or the moment the Commission asked for information. The phrase "without prejudice" is too vague, whereas a simple reference to the 10-year rule is much clearer.

Article 146: Obligations of Member States for financial corrections

According to this Article "a financial correction by the Commission shall not prejudice the Member State's obligation to … recover State aid within the meaning of Article 107(1) TFEU". Again the phrase "shall not prejudice" is not clear enough. The recovery period for incompatible state aid can extend back 10 years starting from the date on which it was decided to grant the aid. This period, however, can be interrupted if the Commission asks for information. A reference to the 10-year rule, subject to interruption by the Commission, would be clearer.

In addition, recovery of Structural Funds in case of irregularities merely results in the return of the nominal amount that was granted. Interest is levied only when the return of the nominal amount is delayed. By contrast, recovery of incompatible state aid always carries interest as of the date the aid was granted. The interest is charged on the full amount of the aid and the rate of interest is equal to the base rate for the country concerned plus 1%.[22]

7.1 What Else?

Before managing authorities grant any ESI Funds to enterprises they need to answer two questions: whether the ESI Funds constitute state aid and whether the aid needs to be notified to the European Commission. Given the complexity of the concept of state aid and the diversity of public measures across the Member States, a revised CPR can only lay down an obligation for compliance with Article 107(1) TFEU without attempting to identify in detail the structural operations that may fall within the scope of Article 107(1). However, a revised CPR can also provide clearer guidance to managing authorities on how to comply with state aid rules.

In 2015-17, DG Regional Policy, in collaboration with DG Competition, carried out a series of meetings with Member States for the purpose of explaining how state aid could be granted legally in policy areas such as RDI, transport, energy, regional development, infrastructure, etc.[23] It became apparent from the questions posed by representatives of managing authorities that the most perplexing issue was to determine the existence of state aid in ESIF support. Once, it is understood that funding constitutes state aid, it is possible to decide

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21 Commission Regulation (EU) 2017/1084 of 14 June 2017 amending Regulation (EU) No 651/2014 as regards aid for port and airport infrastructure, notification thresholds for aid for culture and heritage conservation and for aid for sport and multifunctional recreational infrastructures, and regional operating aid schemes for outermost regions and amending Regulation (EU) No 702/2014 as regards the calculation of eligible costs, OJ L156, 20/6/2017, p.1.

22 Discount rates are fixed according to the methodology in the Commission Communication on the Revision of the Method for Setting the Reference and Discount Rates, OJ C14, 19/1/2008, p.6. Recovery rates are fixed according to the Commission Regulation 271/2008 amending Regulation (EC) No 794/2004 Implementing Council Regulation (EC) No 659/1999 laying down Detailed Rules for the Application of Article 93 of the EC Treaty, OJ L82, 25/3/2008, p.1.

23 The author was an invited speaker to most of the events.

without much effort how to achieve its compatibility with the internal market and whether it should be notified to the Commission. However, for someone who is not well acquainted with state aid rules, it is easier to conclude, mistakenly, that an activity is not economic or that funding does not confer a selective advantage or that it does not affect trade. If the funding is not considered to be state aid, then it is unlikely to be designed in a way that is compatible with the internal market. Grave legal consequences follow from failing to notify aid or from granting incompatible aid.

Therefore, by establishing a rebuttable presumption that Structural Fund operations which support directly or indirectly enterprises constitute state aid, unless proven otherwise, a revised CPR will in effect strengthen compliance with state aid rules because it will force managing authorities to consider and justify the inapplicability of those rules or ensure compliance with the rules.

In addition, managing authorities should be required to design their measures in conformity with the GBER, unless they decide otherwise. In the process they will either grant compatible aid or they will decide that their measure needs to be notified to the Commission for prior authorisation. Either option is legally correct.

Consequently, a revised CPR should explicitly provide, say, in a new Article 4 defining "general principles" that structural operations that directly or indirectly support enterprises are presumed to constitute state aid which if implemented in conformity with the GEBR in force at the time is considered to be compatible with the internal market. Legally such a clarification will not affect state aid rules or the obligation to comply with state aid law but it will make it clearer that compliance with state aid law means that managing authorities must have a view as to whether their operations involve state aid and, if they do, that the aid must be compatible with the internal market.

8. CONCLUSIONS

Support from the European Structural and Investment Funds can constitute state aid when all of the criteria of Article 107(1) TFEU are satisfied. Normally these criteria are satisfied when national authorities mobilise European funds to partially cover the costs of economic projects even when such projects are not normally financed by the market because the commercial risk may be too high or the commercial return may be too low.

However, market failure as signified by the unwillingness of the market to undertake projects that may generate substantial benefits for society may justify intervention by the state in the form of well-designed subsidies. Precisely because markets do not always function smoothly, the TFEU permits the granting of state aid to achieve certain objectives of common interest. Such objectives of common interest can be as diverse as the remedying of the effects of natural disasters, regional development, support for RDI, protection of the environment, heritage conservation or adequate supply of services of general economic interest.

Article 108(3) TFEU imposes an obligation on Member States and their public authorities to notify to the European Commission all their measures that contain state aid. The TFEU confers on the Commission the exclusive right to assess the compatibility of state aid with the internal market. In order to reduce administrative costs and delays, the Commission has issued block exemption regulations which relieve Member States from the obligation to notify their state aid measures. Indeed, Member States have been using extensively these block exemption regulations. As a result, the regulations have become the main legal basis for the granting of state aid and such aid has to comply fully with all of the relevant provisions of the regulations.

A Member State that wants to use ESIF funds to support a project of economic nature has the following options:

i) It may design the measure to be free of state aid.

ii) It may limit the amount of aid so that it does not exceed the "de minimis" threshold.

iii) It may use a block exemption regulation.

iv) Or, it may notify the aid measure to the Commission if it falls outside the parameters laid down in a block exemption regulation.

When Member States use ESIF Funds they must comply both with ESIF regulations and with other EU law such as the rules on state aid or public procurement. In general, ESIF and state aid rules co-exist seamlessly. However, a few provisions in ESIF regulations create problems of interpretation and compliance with state aid rules. This study has indicated how these problems may be resolved.

This study has proposed that a revision of the CPR in the future should include a rebuttable presumption that ESIF-supported operations in favour of undertakings or economic activities should be considered to constitute state aid, unless it can be explicitly shown that aid is absent. In addition, the study proposes that, if ESIF-supported operations include state aid, the revised CPR should require compliance with the General Block Exemption Regulation, unless a different method of compliance is explicitly chosen. Both of these proposals aim to make managing authorities and other responsible bodies more aware of the need to know when state aid is present and how to deal with it.

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The primary guide on the concept of state aid is the Commission's notice on the notion of state aid:

European Commission, Notice on the Notion of State Aid as Referred to in Article 107(1) TFEU, OJ C262, 19 July 2016.

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Up to date commentary and analysis of recent developments in the field of state aid is provided on the Lexxion state aid hub and the blog "state aid uncovered": http://stateaidhub.eu/blogs/stateaiduncovered

There are numerous academic papers on the impact of Structural Funds on the European economy or the impact of state aid in various sectors of national economics. However, much less attention has been given to the interaction between Structural Funds and state aid. The few papers that have recently been published are cited below:

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