Public economic support in the EU
State aid and special economic zones

SUMMARY
State aid can be defined as an advantage given by a government that may provide a company with an unfair competitive edge over its commercial rivals. State aid can take several forms, such as public subsidies, tax relief, or the purchasing of goods and services on preferential terms. While the European Union (EU) competition rules consider State aid to be incompatible with the internal market, they allow such aid when it promotes general economic development, for example, when tackling the challenges of global competition, the ongoing financial crisis, the digital revolution, and demographic change. To this end, all EU Member States provide some public economic support, for instance, to the coal mining sector, banks, or the digital economy. To contribute to regional development and to increase competitiveness, some Member States have created special economic zones (SEZs), which offer an attractive combination of tax-and-tariff incentives, streamlined customs procedures, less laws, provision of infrastructure, and creation of business clusters.

The European Commission is currently evaluating the State aid modernisation (SAM) package and some of its related laws, as these will expire by the end of 2020. The European Parliament takes a two-fold stance towards public economic support in the EU. On the one hand, Parliament stresses that State aid should support ecological transformation and foster the development of services, knowledge, and infrastructure rather than providing support to specific companies. On the other hand, it calls on the Commission to ensure that State aid is reduced in the long term, given its distortive effects on the internal market. While the temporary State aid offered to the financial sector to stabilise the EU financial system might have been necessary, Parliament calls on the Commission to scrutinise and eventually remove this aid. Parliament, inter alia, also calls on the Member States to abandon unfair competition practices based on unjustified tax incentives and to adopt appropriate rules in the Council.
Background – the rationale of public economic support

The classical economic theory of Adam Smith’s ‘invisible hand’ postulates that a self-regulatory market force would automatically bring markets to equilibrium through the mechanism of free demand and supply. However, many arguments have been made that the conditions required for this mechanism to work are not fulfilled in practice, necessitating corrective measures, such as public subsidies, to reach the desired equilibrium.

Many EU Member States are reluctant to take a genuine laissez-faire economic philosophy. Fostered by challenges derived from global competition, the ongoing financial crisis, the digital revolution, and demographic change, the discussion of the political, economic, and social relevance of public subsidies – such as State aid – has gained importance in the EU. Today, all Member States use State aid to support their economies, albeit to varying degrees and with differing scopes (see Figure 1).

Figure 1 – Total State aid expenditure as a percentage of GDP in 2017, excluding railways

The European Commission defines State aid as an ‘advantage given by a government that may provide a company with an unfair competitive edge over its commercial rivals. Such State aid can be delivered in a variety of ways, such as through the allocation of grant subsidies, the provision of interest and tax relief, or the purchasing of goods and services on preferential terms’. In principle, EU competition rules consider State aid incompatible with the internal market, and therefore forbid State aid altogether. However, State aid can nevertheless be justified under certain circumstances related to general economic development. The European Commission currently uses a ‘fitness check’ to evaluate its State aid modernisation (SAM) package ahead of the expiration of a number of rules by the end of 2020. To provide predictability and legal certainty, the Commission intends to extend these rules by two years (2020–2022). The SAM package aims to foster economic growth, and job creation, allowing the Commission to focus on cases most likely to distort competition.

Another form of public economic support is the creation of special economic zones (SEZs), which are intended to offer a combination of tax-and-tariff incentives, streamline customs procedures (e.g. one-stop shops for investors), reduce regulation, provide infrastructure, and create business clusters. Some business associations and politicians have called for the creation of new SEZs in certain Member States in order to increase or sustain international competitiveness. In July 2019, the European Commission presented a proposal for a Council decision to meet the Organisation for Economic Co-operation and Development (OECD) recommendation on enhancing transparency in SEZs and free zones.

This briefing aims to provide an overview of the rules, application, benefits, and challenges arising from public economic support in the European Union.
Public economic support in the EU

State aid – legal framework, scope, procedures, exemptions

Public economic support and subsidies can take several forms. The relevant legislation in the Member States depends on their individual economic and social needs and differs depending on whether it deals with regional, horizontal, or sectoral aid. There is, however, one overall EU rule that Member States must respect, established in Articles 107 and 108 of the Treaty on the Functioning of the European Union (TFEU).

Article 107(1) TFEU forbids State aid granted by Member States, stating it is ‘incompatible with the internal market’ if it ‘distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods … in so far as it affects trade between Member States’.

The European Commission is charged with ensuring that State aid rules are applied and observed equally across all the Member States in order to prevent fragmentation of the single market. To this end, Article 108 TFEU defines the terms for granting State aid. Paragraph 1 empowers the Commission to ‘keep under constant review all systems of aid existing’ in Member States. Paragraph 2 states that if the Commission finds the aid granted by a State incompatible with the internal market according to Article 107 (see below), or that such aid is being misused, ‘it shall decide that the State concerned shall abolish or alter such aid’. If the Member State concerned does not comply with this decision, the Commission or any other interested State may refer the matter to the EU Court of Justice.

As outlined in Article 109 TFEU, the Council plays an important role in issues of national State aid: ‘The Council, on a proposal from the Commission and after consulting the European Parliament, may make any appropriate regulations for the application of Articles 107 and 108 and may in particular determine the conditions in which Article 108(3) shall apply and the categories of aid exempted from this procedure’.

Member States must notify the European Commission of any plans to grant new aid. The procedure obliges the Commission to immediately inform the EU country concerned of the receipt of a notification and to decide within two months whether the aid is lawful or an investigation is needed. During the investigation, the Commission may request any Member State and company concerned to provide all the market information necessary to decide whether or not the aid is compatible with EU rules. In the event that a company provides false or misleading information, fines may be imposed. The Commission must try to reach a decision within 18 months of the opening of the investigation procedure. In addition, the Commission may, on its own initiative, examine any information it receives regarding any allegedly unlawful aid. It may also conduct an investigation whenever it suspects that the State aid awarded to a particular economic sector distorts, or may distort, competition. In this context, the 2013 revision of the State aid procedural regulation introduced the possibility of conducting State aid

General Block Exemption Regulation

The General Block Exemption Regulation (GBER) streamlines State aid rules by encouraging aid that stimulates economic growth, job creation, and other objectives of common interest. It allows Member States to grant more aid measures and higher amounts without having to notify the Commission for prior authorisation, as they are less likely to lead to undue distortions of competition in the single market.

In June 2017, the GBER was amended by Commission Regulation (EU) 2017/1084, which aims at simplifying the procedure for public investment in ports, airports, culture, multi-purpose sports arenas, and the EU’s outermost regions. The amended regulation intends to make it easier to implement crucial infrastructure investments more quickly and with full legal certainty for project developers and aid-granting authorities. The amended GBER now covers the following areas:

- regional aid,
- aid for small and medium-sized enterprises (SMEs), including finance,
- aid for research, development, and innovation,
- training aid,
- aid for disadvantaged workers and for workers with disabilities,
- aid for environmental protection,
- aid to make good the damage caused by certain natural disasters,
- social aid for transport of residents of remote regions,
- aid for broadband infrastructures,
- aid for culture and heritage conservation,
- aid for sport as well as multifunctional recreational and local infrastructures,
- aid for regional airports and ports.
inquiries, which was previously only possible as part of antitrust and merger control. While, under the Juncker Commission, the control of State aid was carried out by several Directorates-General (DGs), the new European Commission under President Ursula von der Leyen has merged most of these units and responsibilities into one DG: DG Competition.

State aid is considered compatible with the internal market when the following criteria, set out in Article 107(2) and (3), are met:

- aid with a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
- aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;
- aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State;
- aid to facilitate the development of certain economic activities or of certain economic areas;
- other categories of aid, specified by a decision of the Council on a proposal from the Commission.

In this regard, the Commission can adopt regulations to declare specific categories of State aid as compatible with the EU Treaties if they fulfil certain conditions, thus exempting these categories from the requirement of prior notification and Commission approval. These regulations are known as block exemption regulations and are set out in Council Regulation (EU) 2015/1588 and Council Regulation (EU) 2015/1589. Further exemptions are listed in Regulation (EU) No 651/2014, known as the General Block Exemption Regulation (GBER), part of a broader reform effort launched under the EU State Aid Modernisation agenda (see Box). Other categories of State aid – such as the 'Important projects of common European interest' (IPCEI) and the de minimis aid (see Box) – are also exempted from the requirement of prior notification and Commission approval. State aid to firms in difficulty and State aid to railway companies are other areas of possible exemption according to European Union rules.

### Important projects of common European interest (IPCEI) and de minimis aid

**IPCEI:** In its June 2014 communication, the European Commission specified rules on IPCEI that are usually large-scale projects considered to generate economic growth, jobs, and competitiveness in the EU. Such projects are often hard to finance because of the technological or financial risks they entail and their need for transnational cooperation. IPCEI are, in general, exempted from EU State aid rules. To prevent market distortions, the Commission has put eligibility and comparability criteria in place to ensure that the project is large enough and of truly common European interest, meeting one or more EU objectives (e.g. European Research Area, Trans-European Energy or Transport Networks, Innovation Union, Digital Agenda for Europe, etc.). IPCEI must create value across the EU, involve more than one Member State, and have clearly identifiable positive spill-over effects. One example of an IPCEI is the microelectronics project, jointly notified by France, Germany, Italy, and the United Kingdom and considered to be a key enabling technology. Another is the battery consortium.

**De minimis aid:** This rule refers to small amounts of State aid to undertakings that are also exempted from the obligation to notify the European Commission. The maximum amount for de minimis aid is €200,000 for each undertaking over a three-year period (€100,000 in the road transport sector). Such small State aid amounts are exempted from State aid control, as they are deemed to have no impact on competition and trade in the EU’s internal market. The current EU regulation on de minimis aid was adopted in 2013 and is applicable until 2020. The regulation simplified previous regulations in the treatment of small aid measures. In particular, companies experiencing financial difficulties are no longer excluded from the scope of the law and will therefore be allowed to receive de minimis aid. Furthermore, subsidised loans of up to €1 million may also benefit from the de minimis regulation, if certain conditions are met.

Regardless of these exemption cases, problems regarding infringement and misuse of State aid still remain. In a 2016 report, for instance, the European Court of Auditors (ECA) found a significant level of non-compliance with State aid rules in the field of cohesion policy. The ECA and the Commission have detected far more cases of infringement of State aid rules than did the national level competition authorities national level. This points to the need for the European Commission’s continued support.
The 2018 State aid scoreboard

The 2018 State aid scoreboard lists aid expenditure by Member States before 31 December 2017, which falls under the scope of Article 107 (1) TFEU. The data is based on annual reporting by Member States. Expenditure refers to all active aid measures awarded to industries, services, agriculture, and fisheries, on which the Commission adopted a formal decision or received an information sheet. The 2018 State aid scoreboard reports the following main findings:

- In 2017, State aid increased in both absolute and relative (percentage of GDP) terms. Member States spent a combined total of €116.2 billion on more than 3,300 active measures. This amount equals about 0.76% of their combined GDP – an increase of about 0.04 percentage points between 2016 and 2017 (see Figure 2).

Figure 2 – Total State aid expenditure, excluding aid to railways, as a percentage of GDP

Source: European Commission, Directorate-General for Competition.

- About 53% of total State aid went to initiatives aimed at protecting the environment and saving energy (largely due to the approval of numerous renewable energy initiatives in many Member States) – an increase of €4.4 billion between 2016 and 2017 (see Figure 3). The most noticeable increases occurred in Germany (+€1.4 billion), France (+€1 billion), Italy (+€853 million), Poland (+€359 million), and Hungary (+€211 million).

Figure 3 – Overall change in State aid expenditure by objective between 2016 and 2017 in the European Union (in € million)

Source: European Commission, Directorate-General for Competition.

- Total expenditure on measures under the General Block Exemption Regulation represented about €41.7 billion in 2017, an increase of about €7.8 billion since 2016. For the first time,
spending under the GBER increased for all objectives and particularly for: local multi-recreational broadband infrastructures (+129 %), SMEs and risk finance (+81 %), social support for individual consumers (+56 %), research, development, and innovation (+30 %), culture and heritage conservation (+28 %), and employment (+21 %).

Looking at expenditure by aid instrument, grants – including interest subsidies – remain the most popular (64 % of total expenditure), followed by tax exemptions (29 %).

Examples of State aid in the European Union

Public economic support and the coal mining sector

The EU’s commitment to cut carbon dioxide emissions, as well as competition from cheaper and lower-emitting natural gas, threatens the commercial viability of coal mines in many Member States. According to European Commission figures, coal currently provides 16 % of EU energy consumption and about 24 % of power generation. Coal is mined in 12 Member States, and coal-fired power plants operate in 21 Member States.

The European coal sector employs 238 000 people (an estimated 100 000 in Poland alone) in directly linked activities, such as coal mines and power plants. A switch to cleaner fuel supplies means an estimated 160 000 jobs could disappear by 2030. Some Member States delay the closure of coal mines to avoid economic, regional, or social impacts. On the other hand, as part of the government’s transition towards renewable energy, Germany’s hard coal mines have lost valuable public economic support since 2018. Portugal, for instance, aims to close down its last coal plant by 2020, and the United Kingdom and Austria by 2025.

Until 2010, Council Regulation (EC) No 1407/2002 was the reference framework regarding State aid and subsidies to the coal industry. Since 2011, the general State aid rules have applied to the sector. In this context, the Council adopted Decision 2010/787 to facilitate the closure of uncompetitive coal mines by the end of 2018, through covering production losses and exceptional costs.

If a Member State wants to grant State aid to coal mines during the process of their closure, it has to notify the Commission. Such closure aid can cover operational losses up to certain limits and must be based on an agreed closure plan. Aid to cover exceptional costs resulting from closure activities can be paid out even after the closure and until the end of December 2027, when Decision 2010/87 expires. It must also be based on an agreed closure plan. The following are some examples of State aid granted in accordance with Decision 2010/787.

In November 2016, the European Commission approved Romania’s decision to close two uncompetitive coal mining units and to provide public funding of RON447.8 million (approximately €94 million), to ensure their orderly closure. The aid aimed at easing the closure process by providing financial support for workers who found themselves unemployed. In particular, this public support funded compensation salaries for the personnel laid-off, programmes to retrain former employees for alternative jobs, and other social security benefits. Furthermore, the aid aimed to undertake necessary underground safety measures related to the closure, to rehabilitate the mining sites, and re-cultivate land after closure.

In May 2016, the Commission agreed to Spain’s plans to grant €2.13 billion for the orderly closure of 26 uncompetitive coal mines. The aid aimed to alleviate the social and environmental impact of the mine closures without unduly distorting competition in the single market.

In January 2013, the European Commission authorised HUF42.24 billion (some €128 million) of public funding for the closure of the uncompetitive Márkushegy coal mine in Hungary. The Commission found the measure to be in line with EU State aid rules, because production aid would decrease over time and Hungary committed to carrying out measures to mitigate the social and environmental impact of the closure.
Public economic support and the banking sector

In the wake of the 2008 financial crisis, many Member States injected massive amounts of public money into their banking systems to rescue distressed banks. Between October 2008 and October 2011, the Commission approved some €4.5 trillion (equivalent to 37% of the EU's GDP) of State aid measures to rescue financial institutions. More than 100 EU banks – accounting for around 25% of the total assets of the EU banking system – received State aid and 22 Member States provided aid in support of the financial sector.

State aid measures granted to the financial sector were based on temporary special rules, adopted after the financial crisis broke in 2008. These rules provided guidance on how to bail-out financial institutions without infringing EU State aid control rules and built on the derogation to the prohibition of State aid in cases of 'serious disturbance in the economy of a Member State' set out in Article 107(3)(b) TFEU.

Table 1 – Total amounts of approved State aid to banks in the EU, 2008–2017 (in € billion)

<table>
<thead>
<tr>
<th>Aid instrument</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>Total (1, 2) or maximum (3, 4), 2008–2017 (in € billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Recapitalisations</td>
<td>269.9</td>
<td>110.0</td>
<td>184.0</td>
<td>37.5</td>
<td>150.8</td>
<td>25.6</td>
<td>20.3</td>
<td>18.8</td>
<td>8.5</td>
<td>25.7</td>
<td>855.1</td>
</tr>
<tr>
<td>2. Impaired asset measures</td>
<td>4.8</td>
<td>305.5</td>
<td>78.0</td>
<td>6.3</td>
<td>177.5</td>
<td>14.7</td>
<td>3.5</td>
<td>1.0</td>
<td>0.0</td>
<td>0.0</td>
<td>404.3</td>
</tr>
<tr>
<td>Total of capital-like aid instruments (1+2)</td>
<td>274.7</td>
<td>448.5</td>
<td>262.0</td>
<td>43.8</td>
<td>308.3</td>
<td>44.3</td>
<td>23.9</td>
<td>19.8</td>
<td>8.5</td>
<td>25.7</td>
<td>1,459.4</td>
</tr>
<tr>
<td>3. Guarantees</td>
<td>3.097.3</td>
<td>87.6</td>
<td>54.8</td>
<td>179.7</td>
<td>275.8</td>
<td>76.0</td>
<td>38.7</td>
<td>165.4</td>
<td>310.7</td>
<td>328.5</td>
<td>3,415.7</td>
</tr>
<tr>
<td>4. Other liquidity measures</td>
<td>82.5</td>
<td>5.5</td>
<td>66.8</td>
<td>50.2</td>
<td>37.5</td>
<td>9.7</td>
<td>1.7</td>
<td>0.0</td>
<td>0.0</td>
<td>14.2</td>
<td>243.0</td>
</tr>
<tr>
<td>Total of liquidity aid instruments (3+4)</td>
<td>3,182.8</td>
<td>98.1</td>
<td>122.6</td>
<td>229.9</td>
<td>313.2</td>
<td>85.7</td>
<td>40.4</td>
<td>165.4</td>
<td>310.7</td>
<td>342.7</td>
<td>3,658.4</td>
</tr>
</tbody>
</table>

Source: European Commission, Directorate-General for Competition.

The banking sector plays a key role in financing the economy and is highly interconnected with other players in the financial system. The financial support granted by many Member States to rescue their credit institutions was therefore necessary to prevent widespread disruption in the financial markets and the real economy. However, this support had a negative impact on the finances of these Member States and reinforced the 'vicious circle' between banks and sovereigns, which might have endangered financial stability, especially within the euro area. For these reasons, the idea emerged to put an end to the paradigm of bank bail-outs.

First of all, the temporary framework on State aid to financial institutions was amended in 2013, by the Commission's Revised Banking Communication that introduced the 'burden-sharing principle', according to which, stakeholders and subordinated creditors must contribute to bearing the costs of a bank’s restructuring before resorting to public financial support, while depositors and senior creditors are not involved.

As a further step in the same direction, the Bank Recovery and Resolution Directive (BRRD) was adopted in 2014, setting out common tools for the prevention and resolution of EU bank crises, including the bail-in mechanism that entered into force in January 2016. This mechanism can be imposed by a resolution authority on a distressed bank undergoing a resolution procedure. It entails a form of burden-sharing consisting of writing down a minimum amount of the bank’s equity and liabilities, or converting liabilities into equity, before activating other resolution tools or tapping other resources, including resolution funds and possible public support. Bailed-in instruments are written down or converted according to a predefined hierarchy. As opposed to under the burden-sharing mechanism outlined in the Revised Banking Communication, certain deposits can also be bailed-in under the BRRD.
The adoption of the BRRD has not completely replaced the temporary framework on State aid to the financial sector. In fact, Article 32(4) BRRD envisages that if a bank is not in resolution but needs precautionary recapitalisation 'to address capital shortfalls established in the national, EU-wide or SSM-wide stress tests, asset quality reviews or equivalent exercises', such banks may receive a temporary capital injection from the Member State concerned. This public support is subject to the EU State aid control rules, which include the application of appropriate burden-sharing measures to shareholders and subordinated debt holders. Nevertheless, point 45 of the Revised Banking Communication states that the application of burden-sharing measures to subordinated creditors can be derogated 'where implementing such measures would endanger financial stability or lead to disproportionate results'.

In its July 2016 decision on the Kotnik case, the European Court of Justice (ECJ) declared that the burden-sharing principle set out in the Revised Banking Communication is compatible with EU law, although the ECJ pointed out that measures following that principle must comply with the general principle of proportionality, especially with regard to subordinated creditors. Specifically, the ECJ stated that 'an obligation to effect the conversion, or write-down, of subordinate rights in their entirety before the granting of State aid cannot be imposed on a bank if, inter alia, the conversion, or write-down, of a part of the subordinate rights would have been sufficient to overcome the capital shortfall of the bank concerned' (p. 101). According to the ECJ decision, therefore, in a case of precautionary recapitalisation, Member States are allowed to apply burden-sharing measures to subordinated creditors ex-post, and only to the extent strictly necessary to cover the capital shortfall ascertained by stress tests or asset quality reviews.

It has been argued that the Kotnik case judgment does not represent a revolutionary change to the framework of State aid to banks. However, the ECJ decision establishes that – as opposed to the provisions in the Revised Banking Communication – the burden-sharing measures do not necessarily apply to subordinated creditors before the granting of public aid and that the proportionality principle is safeguarded, especially with regard to the protection of retail investors. The judgment confirms the difficulties of concrete application of the burden-sharing principle and reinforces the need for further clarification in the relevant regulatory framework, also taking account of the critical issues identified by various commentators in the bail-in mechanism.

Public economic support and the digital economy

The examples of State aid in the mining and banking sectors given above focus on the provision of public support to companies in need. However, there are also cases of indirect public economic support addressed not to companies in need but rather to those aiming to attract investment, especially from large multinational enterprises. In recent years, this has been the case with large tech giants, to whom some Member States have provided incentives through special tax arrangements, which have been argued to amount to unjustified State aid.

The European Commission has been actively investigating this particular category of tax arrangements, also known as tax rulings, since 2013. Not all tax rulings violate competition rules, however. Indeed, the Commission recognises the importance of tax rulings as a tool to provide legal certainty for taxpayers. An issue nevertheless arises when rulings use a taxation methodology that provides a selective advantage resulting in corporate tax avoidance – for example, tax rulings for companies that are actually financing entities within a multinational group and whose only activity is to transfer funds or intellectual property rights between different companies of that same group. Rulings in such cases can result in tax deductions that offer unfair advantages, and therefore constitute State aid. To ascertain if particular tax rulings are legal or abusive, the Commission launches specialised factual case-by-case analyses.

In a much debated 2016 decision on State aid to Apple, the European Commission concluded that Ireland had granted undue tax benefits of up to €13 billion to Apple. This decision was the result of a State aid investigation launched in 2014, over two tax rulings granted by Ireland in 1991 and 2007, which endorsed a way to establish taxable profits for two Irish incorporated companies of the Apple
The tax rulings allowed for the internal (within company) allocation of most of these profits to a head office, which was not based in any country, existed only on paper and could not have generated such profits. Moreover the profits allocated to the ‘head offices’ were not subject to tax in any country under specific provisions of the Irish tax law, which are no longer in force. The European Commission’s assessment showed that Apple paid an effective corporate tax rate on the profits recorded by ASI that declined from 1% in 2003 to 0.005% in 2014. The practice was therefore found to be in breach of EU State aid rules, and Ireland was notified to recover the illegal aid. For many commentators, the ASI case was the first to connect national tax affairs and competition policy, prompting a rethinking of how countries can attract multinational companies without violating competition agreements.

The 2017 decision on State aid to Amazon addressed the combined challenges posed by tax rulings, multinational corporations, and the digital economy in unprecedented ways. In 2017, the European Commission concluded a long-standing investigation over a tax ruling issued by Luxembourg in 2003 and prolonged in 2011. This ruling granted undue tax benefits to Amazon, enabling the company to avoid taxation on three quarters of the profits it made from its entire sales in the EU. According to the Commission, the ruling enabled Amazon to artificially shift profits from Amazon’s operating company for retail business in Europe (Amazon EU) to a holding company (Amazon Europe Holding Technologies). The holding company had no employees, no offices, and no business activities other than holding certain intellectual property rights, which were made available to Amazon EU under an exclusive licence based on royalty payments.

The Commission investigation showed that the Luxembourg ruling endorsed an inflated level of royalty payments and did not reflect the economic reality of the company. Based on this tax ruling, Amazon was able to pay less tax than other companies that were subject to the same national tax rules. In May 2018, Luxembourg completed the recovery of more than €260 million from Amazon, in addition to €21 million in recovery interest.

Notwithstanding the above, the Commission’s approach to State aid needs to account for other cases where the transition to the digital era needs to be facilitated on account of its contribution to economic growth, job creation, and EU competitiveness. To this end, the Commission adopted its June 2014 communication on important projects of common European interest (IPCEI), mentioned above, which allows support for innovative projects, whilst ensuring that competition distortions are limited. It seems that IPCEI are gaining increasing importance in the context of European industrial strategy, as emphasised in the mission letters to Executive Vice-President Margrethe Vestager, responsible for digitalisation, and Thierry Breton, Commissioner for the Internal Market.

Special economic zones and free zones – rules and application

Special economic zones (SEZs), free trade zones (FTZs), free zones (FZs), industrial parks/zones (IZs), and other similar terms are used to describe geographically limited and specially administered areas within a country that are established to attract local and foreign direct investment to enhance trade, employment, and industrial development. The incentives used to attract investment can vary considerably from country to country and from zone to zone. In addition, these economic zones may be administered by national, regional, or local governments, by the public sector alone, or by public-private partnerships. The legal basis for setting up geographical areas, in which a public authority provides incentives to private firms is defined by the national law of each Member State.
As a result, different legal frameworks, administrative procedures, taxation rules, and instruments exist.

In the European Union, the terminology of special economic zones and free zones is also often used interchangeably, which can create some confusion, as FZs are subject to the Union Custom Code. According to the European Commission, FZs are ‘enclosed areas within the customs territory of the Union where non-Union goods can be introduced free of import duty, other charges (i.e. taxes) and commercial policy measures’. According to December 2019 figures, there are more than 70 free zones in the EU, with Croatia having the most FZs (11).

The setting up of a new SEZ, or a major modification to an existing SEZ system, requires compliance with the General Block Exemption Regulation (GBER) rules or Commission State aid approval. The Commission’s assessment is based on the Guidelines on regional State aid for 2014–2020 (RAG). Regional aid rules apply to the whole territory of the EU. Specific incentives for business can be qualified as State aid and have to be assessed under State aid rules. In most cases, the aid schemes, under which regional aid can be provided for investment, are based on the GBER. A core requirement of both the RAG and the regional aid provisions of the GBER is that the area to be covered is an ‘assisted area’. In other words, it needs to be on the regional aid map of a Member State, and the maximum aid intensities have to be respected.

The establishment of SEZs has to be in line with the State aid rules outlined in Council Regulation (EU) 2015/1588, Council Regulation (EU) 2015/1589, and the GBER. In order to avoid a tax break ‘competition’ between Member States, Article 13 of Regulation (EU) No 651/2014 stipulates that the regional aid rules do not apply to beneficiaries that have closed down the same or a similar activity in the European Economic Area in the two years preceding their application for regional investment aid. Article 13(d) of the Regulation applies to situations where an enterprise closes down its business in one Member State and opens it in another, where it wishes to apply for State aid. According to some experts, however, closing an establishment and opening another in the same Member State does not disqualify an enterprise from regional aid.

The forms, implementation methods, and practices of SEZs and FZs in the EU show a mixed picture. For instance, Poland has established SEZs in 14 different regions (Kamienna Góra, Katowice, Kostrzyn-Słubice, Kraków, Legnica, Łódź, Mielec, Pomeranian, Słupsk, Starachowice, Suwałki, Tarnobrzeg, Wałbrzych, and Warmia-Mazury). These SEZs will operate until 31 December 2026. The main benefit granted to them is the exemption from property tax and income tax on income earned from business activities carried out within the areas. According to a 2015 study, the total value of capital invested in these 14 SEZs over the previous 20 years was upwards of PLN100 billion (about €23.2 billion), with more than 300,000 jobs created.

In Croatia, there are 11 free zones (Krapina-Zagorje, Vukovar, Kukuljanovo, Luka Rijeka-Škriljevo, Osijek, Split-Dalmatia, Zagreb, Ploče, Pula, Rijeka port, and the Split Harbour Area). Measures to attract investment include profit tax incentives and aid to cover the costs of job creation and training. Goods in FZs can be used, for example, to manufacture and refine goods, for wholesale trade (whereas retail trade is not allowed in FZs) or innovation centres. If the goods from the FZs are destined for a third country, they are exempt from value-added tax.

In Italy, the government recently entitled eight less-developed and transition regions (Abruzzo, Basilicata, Calabria, Campania, Molise, Apulia, Sardinia, and Sicily) to establish special economic zones around strategically important port areas. The SEZs receive ad hoc tax credits and benefits from simplified bureaucratic procedures.

Some Member States have made the promotion of SEZs and FZs central to their economic policy. Several trade unions, however, have questioned the contribution of SEZs and FZs to sustainable economic development. They argue that these zones create unfair competition and lower environmental and social standards, for example, by imposing forced overtime, short-term contracts, and lower wages. In some cases, FZs have been accused of receiving illegal tax exemptions, which has forced the Commission to open in-depth investigations.
Public economic support in the EU

Outlook and European Parliament position

Since May 2012, the European Commission has implemented a major reform of EU State aid rules in the framework of the State aid modernisation (SAM) package. Today, more than 97 % of all State aid measures are implemented by Member States without the need for prior approval by the Commission. As part of SAM, the Commission has revised numerous State aid rules since 2013. Some rules, however, are due to expire by the end of 2020. Consequently, to provide predictability and legal certainty, whilst preparing for a possible future update of the State aid rules adopted as part of SAM, the Commission plans to take the following two steps.

First, it intends to prolong for two years (until the end of 2022) the validity of those State aid rules, which would otherwise expire by end 2020. These are the following:

- General Block Exemption Regulation (GBER),
- De minimis Regulation,
- guidelines on regional State aid,
- guidelines on State aid to promote risk finance investments,
- guidelines on State aid for environmental protection and energy,
- guidelines on State aid for rescuing and restructuring,
- communication on important projects of common European interest (IPCEI).

Second, in line with the Commission's Better regulation guidelines, an evaluation of the rules was launched in January 2019. The evaluation will not only cover the seven above-mentioned State aid rules, but also the guidelines on State aid to airports and airlines, the framework for State aid for research, development, and innovation, the railways guidelines, and the short-term export credit communication. To this end, in spring 2019, the Commission has conducted public stakeholder consultations. It is expected that the outcome of these consultations on how to reform the existing State aid rules will be published in early 2020.

Regarding special economic zones and the free zones, the Commission presented a proposal in July 2019 for a Council Decision to meet the OECD Council recommendation on enhancing transparency in free trade zones and tackling illicit trade, which undermines good economic governance and the rule of law. In the European Parliament, the International Trade Committee (INTA) is responsible for the file.

The European Parliament takes a two-fold stance regarding State aid. In its January 2013 resolution on State aid modernisation, Parliament underlines the need for less but better-targeted State aid. It also stresses that State aid should support ecological transformation and foster the development of services, knowledge, and infrastructure, as opposed to providing support to specific companies. Parliament also calls on the Commission to ensure that State aid will be reduced in the long term.

In its January 2019 resolution on EU competition policy, Parliament underlines 'the distortive effect' that State aid can have on the internal market. Since most decisions concerning antitrust issues and State aid are taken at the national level, Parliament believes that the Commission 'should take measures to ensure consistent policy within the internal market'. Parliament also notes the relevance of temporary State aid to the financial sector; however, it regrets the 'insufficient nature' of the current scrutiny regime and asks the Commission to examine whether banking institutions have benefited from implicit subsidies and State aid through the provision of liquidity support from central banks. Furthermore, Parliament calls on the Member States to abandon unfair competition practices based on unjustified tax incentives. It calls on the Council to adopt the proposed common consolidated corporate tax base (CCCTB). Parliament regrets that, under the current State aid rules, unpaid taxes recovered from beneficiaries of illegal tax aid are returned to the country that granted the aid. In this context, it calls on the Commission to work on a solution to this problem.

In December 2019, the draft annual report on competition policy for 2019 (rapporteur: Stéphanie Yon-Courtin, Renew Europe, France) was presented in the Parliament's Committee for
Economic and Monetary Affairs. It focuses on the role of competition policy in globalisation and on the need for an EU economy fit for the digital age (e.g. better enforcement of EU competition rules and protection of citizens’ interests). The draft report also includes recommendations to expand the role of the European Parliament in defining the general framework for competition policy at EU level.

FURTHER READING

Szczepański M., EU competition policy – Key to a fair single market, EPRS, European Parliament, October 2019.

ENDNOTES

1 The State Aid Register lists all cases that have been the object of a Commission decision since 1 January 2000, including information on general block exemption cases. A database allows searches for individual competition cases.
2 For more information on unlawful State aid and its recovery, please take a look at the overview (an Excel table sorted by date, Member State, etc.) provided by the European Commission Directorate-General for Competition.
3 The exemption rules were first established by Council Regulation No 994/98 of 7 May 1998, and amended by Council Regulation No 733/2013 of 22 July 2013.
4 In this context, a ‘Just Transition Fund’ was announced by the new Commission President von der Leyen as part of the ‘European Green Deal’. This proposal may contain some provisions on compatibility with State aid.
5 There are four categories of subsidies for the energy sector: consumer subsidies (to make fossil fuel affordable for consumers), producer subsidies (to make fossil fuel extraction and production cheaper for businesses), pre-tax subsidies (encompassing all kinds of financial subsidies to producers and consumers to make fossil fuels cheaper), and post-tax subsidies (to the non-inclusion of external costs in the costs for fossil fuels).
6 According to the BRRD, credit institutions and investment firms are required to pay contributions towards resolution funds that resolution authorities may use for the financing of resolution measures. For Member States participating in banking union, the Single Resolution Mechanism Regulation established a Single Resolution Fund (SRF), to be gradually built up in a transitional period of eight years (2016–2023). At the moment, in case of an SRF shortfall in financing a resolution measure, Member States can provide a national individual credit line to back their national compartment in the SRF. However, the 2015 Five Presidents’ report highlighted that a credible common fiscal backstop for the SRF should be set up both during the transition period and in steady state. It also suggested that a direct credit line from the European Stability Mechanism (ESM) to the SRF could be a solution, noting that the backstop should be fiscally neutral in the medium term. The Euro Summit of 29 June 2018 agreed that the ESM will provide the common backstop to the SRF while the details were to be arranged at a later stage. Further discussions took place both at Euro Summit and at Eurogroup level. On 13 December 2019, the euro-area leaders took stock of progress made on the implementation of the June 2019 political agreement and tasked the Eurogroup with continuing to work on the ESM package of reforms.
7 Apple appealed this decision and the appeal case is still ongoing.

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