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STATE AID AS AN INSTRUMENT FOR REINFORCING COMPETITIVENESS OF POLISH UNDERTAKINGS. NECESSITY FOR RETARGETING OF THE GRANTED AID?

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ABSTRACT

This paper is a part of project "*Changes in Industrial Competitiveness as a Factor of Integration: Identifying Challenges of the Enlarged Single European Market*". The main objective of this paper is participation in the critical discussion on the idea of re-targeting of state aid form sectoral to horizontal, what is foreseen in the consultation document prepared by the European Commission "*State Aid Action Plan*". The concept of changes of rules governing the granting state aid in the EU is significantly important from the new Member States' point of view in the context of the need and requirements of their undertakings, industry and economy. It will also effect the competitiveness of new Member State's industry and, in consequence, the whole EU economy as well.

Poland's equivalent document and an answer to European Commission's "*State Aid Action Plan*" is the „*Policy program in the scope of state aid for the years 2005-2010*", which was prepared with due consideration given to socio-economic objectives of Poland as a member of the European Union and conditions pertaining to the implementation of the Lisbon Strategy and the new EU financial perspective for the years 2007-2013. It seems that the main objective of state aid in Poland for the years 2005-2010 is to align state aid policy in Poland with standards and trends in place in the European Union. At the same time it was assumed that from the point of view of EU requirements Poland should:

- retarget state aid from sectoral to horizontal measures,
- reduce the scale of granted aid,

while taking into account specific features of the economic situation of Poland and adopting priorities reflecting the needs of the economy. It seems that those specific features are not addressed in the Action Plan of the European Commission.

Taking this into consideration one can ask one, but extremely very important question for the future analyses: about the effectiveness and efficiency of the horizontal instruments in the new Member States, what is proposed by the Commission in "State Aid Action Plan". There are no analyses on the results of horizontal state aid on the effectiveness of the restructuring process, which should be maintained and successfully finished in such countries as Poland.

INTRODUCTION

Reinforcement of competitiveness can be achieved mainly by ensuring innovativeness of undertakings. Many of them, particularly SMEs (not only in Poland), are unable to allocate significant funding for R&D, which substantially limits the potential for increase of their competitiveness. In such cases state support is necessary within the framework of state aid or, alternatively, EU structural funds.

At the EU summit in November 2004, the European Council stated that it is necessary to give a new impulse to the Lisbon Strategy. At the same time the Commission's Communication: „*Pro-active Competition Policy for a Competitive Europe*" indicated that a better control over state aid can contribute to attainment of the Lisbon Agenda goals by avoiding competition distortions accompanied by *retargeting of aid from sectoral to horizontal measures*. The European Commission states that the time has come to build momentum in partnership with Member States and stakeholders, so that state aid rules better contribute to sustainable growth, competitiveness, social and regional cohesion and environmental protection.

According to the Commission, the main reason underlying the need to reform the state aid rules, apart from the necessity to implement the Lisbon Strategy, is the 2004 EU enlargement. The Commission came to a conclusion that accession of new Member States resulted in a necessity to reinforce the instruments relating to economic case studies on state aid schemes as well as control over aid in 25 Member States.

On 7 June 2005 the European Commission adopted the „*State Aid Action Plan – Less and Better Targeted State Aid: a roadmap for state aid reform 2005-2009*". It contains rules, criteria and proposals for major changes concerning conditions for granting state aid to be in force for the following 5 years.

The European Commission tried to target quite precisely the goals of aid, designed as determining factors in the identification whether a given aid can be *justified*, and at the same time those factors should constitute a top priority within state aid hierarchy of individual Member States. Therefore the Action Plan contains 7 priorities, constituting the basis for selection by Member States of such state aid measures that should be compatible with single market rules. At the same time it would be worthwhile to confront them with Polish proposals (mentioned below), which contain priority measures requiring support from state authorities in Poland. It is important to underline, that on one hand, Poland has to finish the restructuring process, but on the other, to increase competitiveness of undertakings through support for innovation (sectoral versus horizontal state aid).

Poland's equivalent document and an answer to European Commission's Action Plan is the „*Policy program in the scope of state aid for the years 2005-2010*" adopted on 29 March 2005 by the Council of Ministers. It was prepared with due consideration given to socio-economic objectives of Poland as a member of the European Union and conditions pertaining to the implementation of the Lisbon Strategy and the new EU financial perspective for the years 2007-2013. The Program's objectives were formulated with taking into account: assessment of the existing state aid policy, budgetary rigors as well as the necessity for effective correlation of national measures with practices and standards determining state aid policy in the EU and its Member States.

The 2004 Enlargement has been one of the most significant developments in the history of the European integration. In terms of substantive State aid law, however, the response to the event has largely been "business as usual".[1] Especially, no specific measures have been introduced, for example, to take into account the GDP imbalance between the new and old Member States. There is no special treatment for new Member States as well.

The majority of new Member States were required by their respective Europe Agreements (concluded between 1991 and 1996) to approximate their laws to those of the EU, including the application of Article 87 EC Treaty. It is worth to underline that Poland's accession to the EU was connected with substantial changes in the state aid control system. However, the changes did not concern the criteria of admissibility of state aid, which were adapted to the *acquis communautaire*.

The main objective of this paper is participation in the critical discussion on the idea of re-targeting of state aid form sectoral to horizontal, what is foreseen in the consultation document prepared by the European Commission "State Aid Action Plan". The concept of changes of rules governing the granting state aid in the EU is significantly important from the new Member States' point of view in the context of the need and requirements of their undertakings, industry and economy. It will also effect the competitiveness of new Member State's industry and, in consequence, the whole EU economy as well.

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[1] *K. Kuik:* State Aid and the 2004 Accession - Overview of Recent Developments, European State Aid Law, quarterly, 3/2004.

1 A Need for a Reform of State Aid and The European Commission Action Plan

Competition policy is an instrument for fostering the achievement of the Community's basic objectives, i.a.: establishment of the internal market with no barriers to trade between Member states, the development of a co-ordination strategy for public interest goals, such as employment or regional policy and the enhancement of industry competitiveness. Competition policy should promote consumer welfare, encourage the optimal allocation of resources and grants to economic agents incentives to pursue productive and innovation efficiency. It is true that an open market economy, which is the EU market, can only be effectively maintained by abolishing those unjustified state subsidies that distort competition by artificially keeping non-viable firms in business.[2]

The legal basis for the control of state aids in the EU was incorporated into the EC Treaty from the outset. It was recognised from the start that mechanisms to control subsidies were an essential component of the rules underpinning the establishment of the internal market. As other barriers to trade such as tariffs and quotas were being outlawed, the temptation for Member States to resort to other forms of protectionism was considered likely to increase. This meant not only that Member States were perceived to be more likely to use subsidies, but also that the effects of subsidies would be felt more keenly by competitors in other countries.[3]

1.1 „Pro-Lisbon" state aid

The Lisbon Strategy, agreed by leaders of EU Member States in 2000, did not account at that time for the forthcoming enlargement. Both, accession of new 10 CEECs, and a broad range of goals adopted at that time by politicians at the Lisbon Summit, as well as lack of consistency in the implementation thereof resulted in the necessity to renew the

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[2] *P. Nicolaides, M. Kekelekis, P. Buyskes*: State Aid Policy in the European Community. A Guide for Practitioner, International Competition Law Series, Volume 16, Kluwer Law International, European Institute of Public Administration, the Hague 2005, p. 1-2.

[3] *F. G. Wishlade*: Regional State Aid and Competition Policy in the European Union, Kluwer, European Monographs, the Hague, London, New York 2003, p. 10.

Lisbon Agenda, mainly through a decrease in the number of goals contained therein. As regards elements relating to state aid contained in the Lisbon Strategy, a real breakthrough took place at the Stockholm summit (spring 2001), when it was decided that Member States are obliged to submit by 2003 evidence that the share in GDP of state aid goes down and the aid itself is retargeted to horizontal objectives. Although no figures were specified in Stockholm, an important precedent was created, since for the first time in Union's history a goal of state aid reduction was formulated and an indicator of this reduction – aid's share in GDP – and the related timeframe were specified.[4]

At the EU summit in November 2004 the European Council clearly stated a need to give a new impulse to the Lisbon Strategy. At the same time in its Communication: „*A pro-active Competition Policy for a Competitive Europe*"[5] the Commission indicated that monitoring of state aid can contribute to implementation of Lisbon goals by elimination of competition distortion accompanied by retargeting of aid from sectoral to horizontal measures. It is worthwhile stressing that the Commission, while in principle rejecting aid in the form of sectoral industrial policy (except for aid granted in the frames of regional policy and residual restructuring programmes for some sectors), not only allows but even promotes involvement of governments and local authorities in financing of various types of economic ventures, as long as they meet the non-discrimination condition. The fundamental feature of this policy is that it is not targeted at any specific sector or enterprise and it aims at improvement of operations of all enterprises.[6]

The above postulates were addressed in March 2005 Communication from the European Commission to the Spring European Council: "Working together for growth and jobs – A new start for the Lisbon Strategy in March 2005"[7], which stated that an efficient state aid control will play an important role in the attainment of the adopted goals. During that

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[4] *P. Jasiński*: Priorytety polityki pomocy publicznej w Polsce (Priorities of state aid policy in Poland) [in:] Priorytety pomocy publicznej (Priorities of the state aid), Polskie Forum Strategii Lizbońskiej, Nr 3, Niebieskie Księgi 2004.

[5] *A pro-active Competition Policy for a Competitive Europe, Communication from the Commission*, COM (2004) 293 final, Brussels, 27.04.2004.

[6] See: *A. Lubbe*: Pomoc publiczna to nie tylko rozdawanie pieniędzy (State aid - not only granting money) [in:] Priorytety pomocy publicznej...*op.cit*., s. 73.

[7] *Communication to the Spring European Council: Working together for growth and jobs – A new start for the Lisbon Strategy*, Communication from President Barroso in agreement with Vice-President Verheugen, COM (2005) 24 final, Brussels, 2.2.2005, SEC(2005) 192, SEC (2005) 193,

summit the European Council adopted conclusions[8], calling on the Member States to limit the general level of state aid. It is worth noting that both the European Council and the Council of Ministers have urged Member States to grant aid only for the purpose of remedying market failures, to assess the effectiveness of their aid schemes and to avoid undue distortion to competition.[9] **This trend should be supported by retargeting of aid towards horizontal goals, such as research and development and better use of human skills.**

It is worthwhile studying closely, however, the process of shaping the structure of state aid granted in the EU, in order to be able to decide whether there is really a need to retarget aid. When analyzing figures concerning the share of horizontal aid in aggregate aid granted in a specific country[10] one can notice that taking into account the average index from the period 2000-2003 (see: Chart 1.), relatively largest volume of horizontal aid, i.e. one consistent with standard Lisbon goals, was granted in the most developed countries: Denmark (95.2%), Sweden (90.6%), Finland (83.9%) and the Netherlands (82.0%). Among states of the old EU-15 particularly interesting are cohesion countries, where sectoral aid still prevails, and horizontal one constitutes a much lower percentage in relation to aggregate aid: Ireland (23.0%), Portugal (18.0%) or Greece (5.8%). It is worthwhile pointing to the example of Spain, where the share of horizontal aid is twofold greater than in its Iberian neighbour country and amounts up to 40% of the total aid value – this rate is still over twice lower in comparison with one recorded in very well developed economies. When analyzing situation in new Member States one can state that in some cases the situation is similar to the one in place in Portugal or Ireland: Cyprus (19.5%), Poland (18%), Hungary (17.6%), while in others the situation resembles Greece: Latvia (5.6%), Malta (5.6%), Lithuania (2.5%). Two countries of EU-10 are worthy of mention because their share of horizontal aid exceeded 2/3 of the general volume of aid granted in those countries: Estonia (66.6%) and i Slovenia (67.8%).

On this basis one can state that from a quantitative point of view most EU-25 Member States really grant mostly other aid than horizontal one. It certainly remains disputable whether sectoral aid is genuinely always inconsistent with the idea of Lisbon

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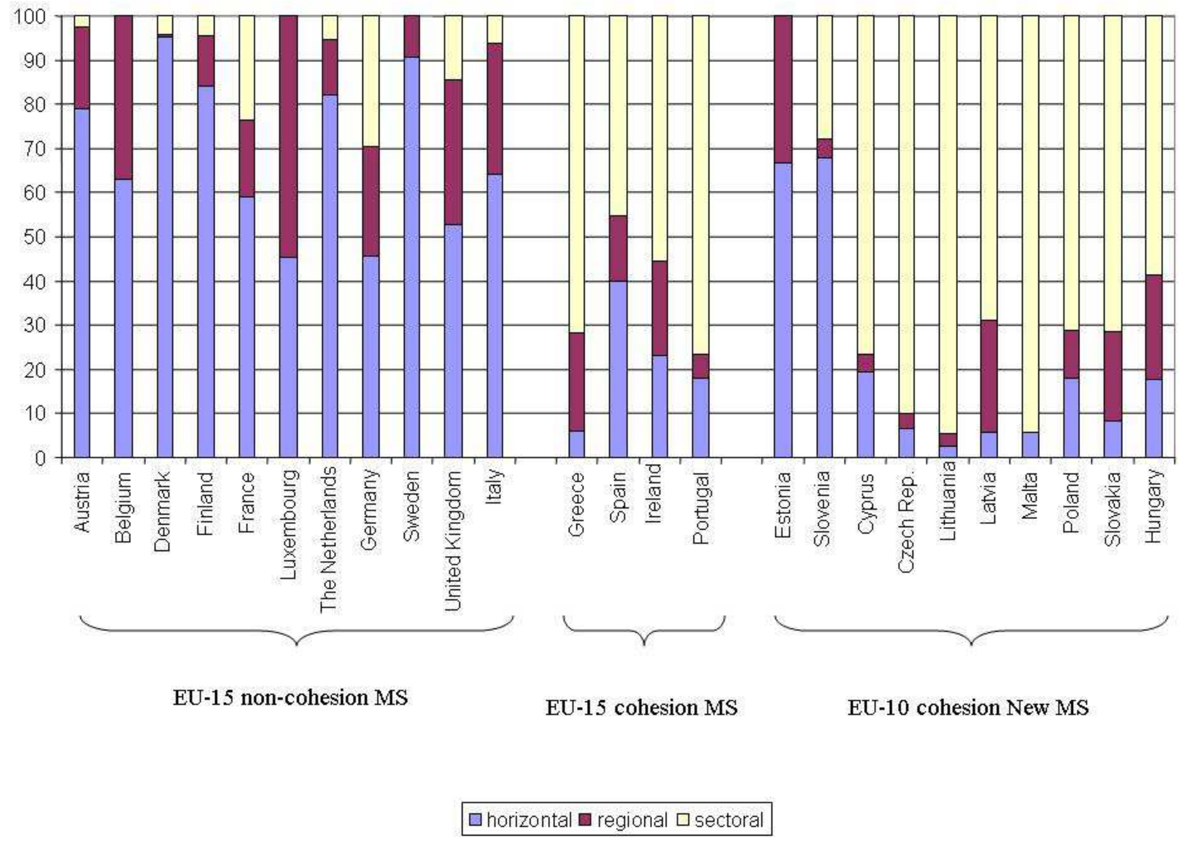
[8] European Council Brussels - 22-23 March 2005 - Presidency Conclusions - 23/3/2005 (English) No: 7619/1/05 REV1.

[9] *P. Nicolaides, M. Kekelekis, P. Buyskes*: State Aid Policy in the European Community. A Guide for Practitioner, International Competition Law Series, Volume 16, Kluwer Law International, European Institute of Public Administration, the Hague 2005, p. 6.

[10] When analyzing official statistical data concerning state aid one needs to stress that they are sometimes incomparable. This ensues particularly from the fact that in the new Member States the process of establishing state aid control systems has only begun in the recent years. It is sometimes incomplete, not all cases of aid are taken into account or properly labeled.

Strategy. One should also bear in mind that effective and one-off support to businesses, e.g. in the frames of sectoral restructuring, should enable them to operate in market economy and compete on international markets.

Chart 1. State aid structure in EU states (average for the period 2000-2003)



Source: Developed by the author on the basis of data from: *Commission of the European Communities, Report. State Aid Scoreboard, spring 2005 – update*, COM (2005) 147 final, Brussels 20.04.2005.

It is worthwhile mentioning, however, that the issue of interpreting state aid policy in individual Member States depends on how given support is labelled. According to a classic breakdown one can identify: horizontal, sectoral and regional aid. In its reports, however, the European Commission[11], differentiates only between sectoral aid, inconsistent with Lisbon goals, and horizontal aid, supporting competitiveness of Europe. The Commission included regional aid into the scope of horizontal support. Such classification system is justified insofar as, on the one hand, legal provisions concerning horizontal aid usually provided for an

[11] *Commission of the European Communities, Report. State Aid Scoreboard, spring 2005 – update*, COM (2005) 147 final, Brussels 20.04.2005

increase in admissible ceilings for granting state aid for undertakings operating in less developed regions (in the understanding of Article 87(3)(a) and 87(3)(c) of the EC Treaty). On the other hand it is worthwhile mentioning that the authors of the renewed Lisbon Strategy listed securing of socio-economic cohesion as one of the objectives thereof. Certainly those measures might prove ineffective without a support from structural funds or Cohesion Fund under supervision from the European Commission. However the very enabling of support to less developed regions in Member States mainly through pro-investment instruments might also contribute to improvement of the competitiveness of the European economy.

When analysing the aggregated shares of horizontal and sectoral aid in EU states (see: Table 1. and Chart 2.), it appears that in the majority of EU-15 states this rate exceeds 90%: Sweden (100%), Belgium (99.9%), Luxembourg (99.9%), Austria (97.5%), Denmark (95.7%), Finland (95.6%), the Netherlands (94.6%), Italy (93.8%). In the case of Spain and Ireland, the cumulated horizontal and regional aid was responsible for half of the total state aid (shares of, respectively, 54.7% and 44.4%), which signifies that sectoral aid constituted the rest.

Table 1. State aid in the European Union in the period 1990-2003

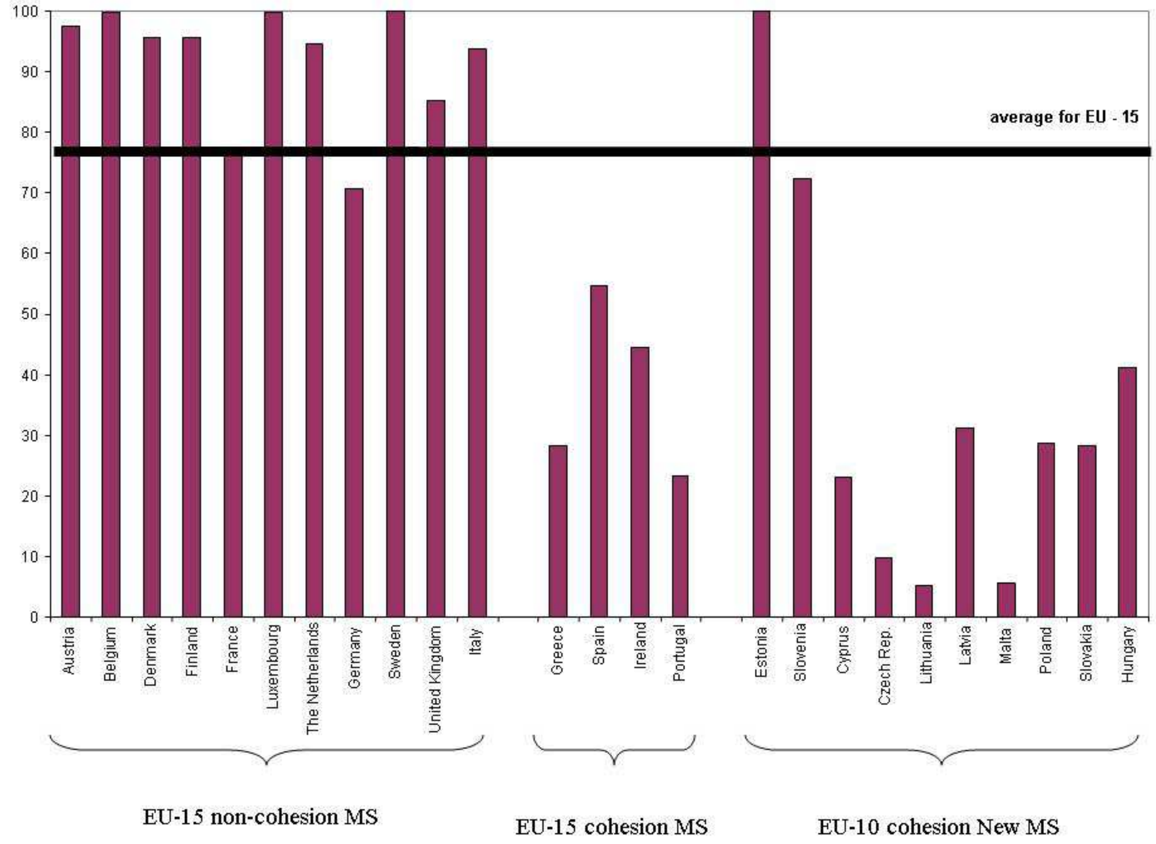
Year	*Value [bln EUR]*	*Share in GDP*	*Share of horizontal aid in total state aid*	*Share of sectoral in total state aid*
1990	55,1	0,95%	56%	44%
1991	50,2	0,84%	57%	43%
1992	57,9	0,84%	62%	38%
1993	64,1	0,94%	62%	38%
1994	59,0	0,84%	62%	38%
1995	56,4	0,74%	64%	36%
1996	55,4	0,71%	63%	37%
1997	74,9	0,91%	64%	36%
1998	47,6	0,56%	62%	38%
1999	39,0	0,45%	69%	31%
2000	39,8	0,43%	69%	31%
2001	40,2	0,43%	71%	29%
2002	40,9	0,44%	73%	27%
2003	37,3	0,40%	79%	21%

Sources: *Commission of the European Communities, Report. State Aid Scoreboard, spring 2005 – update*, COM (2005) 147 final, Brussels 20.04.2005, *Commission of the European Communities, State Aid Scoreboard*, COM (2001) 412 final, Brussels 18.07.2001,

It is worthwhile to pay attention to the situation in some new Member States, where as a result of aggregation of data on horizontal and regional aid, the share of the discussed

„pro-Lisbon" aid rose much in such countries as: Latvia (31.2%), Poland (28.6%), Slovakia (28.3%), Cyprus (23.2%). A completely separate category among new EU Member States is constituted by countries with very high rates of cumulated horizontal and sectoral aid: Estonia (100%) and Slovenia (72.3%).

Chart 2. Share of cumulated horizontal and regional aid in the total aid in EU states (average for the period 2000-2003)



Source: Developed by the author on the basis of data from: *Commission of the European Communities, Report. State Aid Scoreboard, Spring 2005 – update*, COM (2005) 147 final, Brussels 20.04.2005.

When analysing the data on new Member States one should pay particular attention to the fact that the above rates are a weighted average for the period 2000-2003. That was a time when those states were completing negotiations and undergoing process of harmonisation of both their legislation and the real sphere with requirements of membership in the EU. In many cases the governments of those states were aware, on one hand, of the necessity to carry out restructuring, so that domestic businesses can compete within the EU internal market, and of the existence within the EU of more restrictive regulations concerning subsidies to industry on the other. In this connection they decided to grant significant sectoral aid (mainly for restructuring in heavy industry) to domestic enterprises just prior to the accession. As an example in Poland the share of accumulated "pro-Lisbon" aid decreased from 66% in 2000 to 15% in 2003, despite the fact that taking into account the value of horizontal aid, it went down from 1137.4 million EUR to 840.6 million EUR (i.e. by mere 26%).

Having as a base the above mentioned analyses, one can state that there are no direct premises for a necessity of a radical retargeting of state aid. This derives from the fact that in order to support competitiveness of the European economy, the weaker – usually new – Member States require a slightly different support than highly developed EU-15 states. Moreover, retargeting of aid to horizontal support may lead to a situation where all restructuring processes carried out in new Member States could be hampered, which might adversely affect the entire European economy.

1.2 Granting of horizontal state aid in Poland

The total value of aid granted to undertakings in Poland in the years 2001-2004 amounted to 73,757 million PLN (See Table 2.). In comparison to EU-15, where the value of granted state aid systematically goes down and is targeted at such horizontal aims as environment protection, research and development, employment, state aid granted in Poland still differs much both by volume and by structure.

In 2003 the volume of state aid in relation to GDP of EU-15 altogether amounted to 0.40%; this figure amounted to 1.3% for Poland.

In the mid-90's when state aid levels were much higher, the share of total aid granted for horizontal objectives was around 50%. In line with the commitments undertaken at the various European Councils, Member States have however continued to redirect aid towards such horizontal objectives. Recently, the share of total aid for horizontal objectives increased by 5 percentage points over the period 1999-2001 to 2001-2003 from 71% to 76% of total aid). In Poland the horizontal state aid amounted to 33.6% of the total granted aid in 2002, 10% in 2003 and 32.2% in 2004.

Table 2. State aid granted to undertakings in the years 2001-2004

Year	*Value of granted aid (in million PLN)*	*Share in GDP*
2000	7,712	1.1%
2001	11,195	1.5%
2002	10,277	1.3%
2003	28,627	3.5%
2004	15,946	1.8%

Source: Reports on state aid in Poland granted to undertakings in 2001, 2002, 2003, 2004, The Office for Competition and Consumers Protection, Warsaw 2002, Warsaw 2003, Warsaw 2004 (only Polish versions).

Given the structure and value of horizontal aid granted in EU-15 states in the period 2000-2004, there is a large degree of its differentiation but aid for R&D, SMEs and environment protection ranks high in the general amount of funds. In the case of Poland the largest portion of aid was allocated to restructuring.

The largest differences in the structure of state aid granted in Poland in comparison to EU-15 structure concerned horizontal aid, where share of this type of support in Poland is significantly lower than in EU-15. This concern such aid targets as: for R&D – 3.7% in 2003 and 2.2% in 2004 (EU-15 average - 15%) and development of SMSs – 4.7% in 2003 and 2.0% in 2004 (EU-15 average - 14%). In 2003 and 2004 the largest portion of horizontal aid was allocated to restructuring, which constituted respectively 61% and 80% of the value of granted horizontal aid.

1.3 State aid and the enlargement

Accession to the European Union of ten new states resulted in an increase in the number of undertakings in the EU by about 20%. Before the enlargement business activity was pursued in EU-15 states by approx. 13.4 million undertakings, while in EU-10 states – 2.5 million, including 1.4 million in Poland alone (9% of all undertakings in the EU-25).

Undertakings operating in EU-15 and in EU-10 created in 2001 an added value of 4.5 billion EUR; Poland's share amounted to mere 3.2%. This rate is almost threefold lower than Poland's share in the number of business entities in EU-25 and twofold lower than Poland's share in the total employment in EU-25. This testifies to much lower productivity and huge technological gap separating undertakings operating in Poland from those operating in EU-15.

The draft Polish Operational Programme "Innovations - Investments – Open Economy 2007-2013", developed in the frames of programming the utilisation of structural funds in the years of the new financial perspective, stated that undertakings operating in Poland require additional capital outlays and upgrading to a larger extent than EU undertakings. At the same time it is beyond any doubt that Poland's accession to the EU provides an opportunity for intensification of those processes and narrowing of the development gap. It is certain that new opportunities of acquisition of Community funding to finance capital outlays as well as a better coordinated policy for granting state aid in Poland with EU requirements, will lead to upgrading of Polish undertakings sector and to a more rational use of production factors.

It needs to be stated, however, that the proposed radical retargeting of state aid <u>exclusively</u> to horizontal purposes in principle is contradictory to the interests of new Member States. This ensues from the fact that the legislation currently in force, regulating conditions for granting of state aid, enables completion of restructuring processes in those states that still suffer from adverse outcomes of the processes of socio-economic transformation. This is so because very frequently undertakings in new Member States need to be supported by actions of public authorities (the state government and local governments), since market itself is unable to cope efficiently, from social viewpoint, with restructuring problems.

2 A CRITICAL ANALYSIS OF THE ASSUMPTIONS OF THE EUROPEAN COMMISSION STATE AID ACTION PLAN

On 7 June 2005 the European Commission adopted „*State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009*"[12]. It contains rules, criteria and main proposals for changes in the regulations for granting of state aid, to be in force for the next 5 years. The Commission plans to use the fundamental rules for state aid granting as set forth already in the Treaty establishing the European Community, with a view to encouraging Member States to support the renewed Lisbon Strategy. The Competition Commissioner, Neelie Kroes pointed out that „*the state aid reforms outlined in the Action Plan aim to ensure that Member States have a clear, comprehensive and predictable framework, so that they can provide state aid which contribute to cohesion, competitiveness and high quality public service*"[13]. In the opinion of the European Commission[14], this goal is to be carried into effect through:

- Less and better targeted state aid – this concerns:
  - A change in the rules for granting of state aid so that it becomes an instrument of the renewed Lisbon Strategy and thus gain a broader political approval;
  - Targeting more funding at scientific research and development, innovation and risk capital for small enterprises;
  - Adoption of an economic approach when analysing admissible aid from the point of view of its compatibility with the common market; the Commission should also balance the positive impact of the aid measure against its potentially negative side

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[12] State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009 – COM (2005) 107 final. This document is of consultative character since Commission services gathered opinions from the Member States and other stakeholders (undertakings, associations, local and regional authorities) on this plan by 15 September 2005. At the same time an Annex is attached to this document, which assesses the impact of the new regulations proposed in the Action Plan – Annex to the State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009 – Impact Assessment – 10083/05 ADD 1, SEC (2005) 795.

[13] State Aid: Commission outlines comprehensive five year reform of state aid policy to promote growth, jobs and cohesion, Press release, Brussels, 7 June 2005, IP/05/680.

[14] *Koen Van De Casteele*, Unit "Strategic support and Decision Scrutiny", DG Competition, European Commission, Brussels: Presentation "The State Aid Action Plan. Enlargement and impetus to the Lisbon strategy", Documents and presentations prepared for the 9th Forum on European State Aid Law, organised by the Academy of European Law, ERA, Trier, Germany, 10-11 November 2005.

effects in the scope of distortion to trade and competition, and not solely in the scope of compatibility with EU legislation.

- Rationalization and improvement in the efficiency of procedures so that:
  - The rules become more comprehensible for aid providers and beneficiaries,
  - Fewer cases of aid need to be notified to the European Commission,
  - The decision-making process of the European Commission can be accelerated in the scope of state aid cases it is to be notified of;
  - The Commission and the Member States are to a larger extent responsible for improvement of rules and procedures and quality of notifications.

2.1 The issue of providing consumers with products at lowest possible prices

Regulations concerning state aid constitute an element of the *acquis* in the scope of competition policy. The European Commission assumes that **competition policy is based on the rule that market economy constitutes the best guarantee for improvement in living conditions of EU citizens**. Moreover the Commission defines that **well functioning markets are the key element ensuring provision of products to consumers <u>at the lowest prices</u>**. Subordination to this rule of measures undertaken at the Community level makes sense insofar as it does really guarantee unbiased approach of Community institutions to the attainment of this goal. This can be carried into effect, however, under assumption that **economies of the EU Member States are homogenous and there are no significant differences in economic development among individual states**. Assuming that this hypothesis is true, one can deem that the European Commission is right in stating that ensuring undistorted competition is a prerequisite for improved competitiveness of the European economy.

Taking into account, however, the results of the Third Progress report on cohesion in the EU[15], one needs to stress significant discrepancies in economic development among individual Member States. This signifies, first of all, diversified level of development of individual undertakings, their competitiveness and needs, ensuing from enhanced competitiveness on the EU market, as well as external competition from third countries. The aforementioned disproportions derives not only from current conditions for pursuance of business activity, which – due to harmonization of most and standardization of some regulations, should be convergent if not the same.

A much lower development level and, in most cases, completely different needs and preferences in comparison to EU-15 businesses, can be noticed among undertakings from CEECs. In their case the main reason behind such situation is the economic policy applied since late eighties and a relatively short period of functioning in market economy conditions. It should be stressed, moreover, that due to powerful position of trade unions, many restructuring measures were much delayed or even not carried into effect at all, which signifies that the gap in development level and needs between undertakings from new and old Member States remains significant.

Therefore one should point out in this context that subordination of markets operations to possibly lowest goods prices for consumers can mean that those considerations took into account only the classical theory of international trade. It is founded on specialisation based on existence between two countries of absolute differences in manufacturing costs. Adoption of this free-trade concept of the existence of an invisible hand of the market would signify that in many cases new Member States should end production of various goods, not invest in new technologies in those sectors, and solely focus on competition in the manufacturing of those goods, where they have the advantage of absolute costs – e.g. where cheap labour force with low qualifications is needed. Carrying such measures into effect would broaden, already relatively wide, gaps between new and old EU states, and at the same time would restrict the possibilities for enhancing competitiveness of the entire European economy in relation to the world economy.

On the other hand the rule of relative costs indicates the potential for beneficial international specialisation even when differences in absolute production costs between countries are maintained. This theory guarantees benefits parties involved in the trade exchange, as well as the availability of goods to consumers – and this should be pointed out in the context of the assumptions adopted by the European Commission – so it is not limited to lowering of prices for consumers.

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[15] Communication from Commission. Third Progress report on cohesion: Towards a New partnership for growth, jobs and cohesion, COM (2005) 192, 17 May 2005.

Therefore it seems that the criterion of having goods at the lowest prices as put forward by the European Commission is a condition of importance from consumers' point of view, but not the most important one and definitely not the only one from the viewpoint of an active economic policy of the state.

2.2 Maintaining level playing field on the market

The European Commission is of an opinion that **control of state results from the need to maintain a level playing field for all undertakings active in the Single European Market, no matter in which Member State they are established**. This assumption is correct if – when determining the „playing field" – one at the same time takes into account significant development gaps existing between Member States, resulting from economic policy of the past. If, on the other hand, understanding of the wording "level playing field" were limited solely to legal regulations concerning conditions for granting of state aid, then one would lose any reference to the existing development gaps between EU Member States, which does not conduce to the improvement of the competitiveness of European economy.

It is true that individual market economies have many features in common and thus they suffer due to the same or similar market failures. However each of those economies has unique features and thus its specifics need to be taken into account, e.g. in the case of Poland such features include uncompleted transformation, lower level of economic development and weakness of the law application.[16]

It seems, therefore, that in its considerations on competition policy and on the ban for introduction of any means that might – in its opinion - distort free market conditions, the European Commission should take into account differences in development of the economies of individual states and the situation of undertakings established therein.

The consequence of such reasoning should be a precise specification of admissible instruments of state aid and goals, depending on the supported undertaking, region and state. It seems that as a result of such analysis a genuine retargeting of state aid to horizontal measures might take place in highly developed countries. This ensues from the fact that in

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[16] *P. Jasiński*: Priorytety polityki pomocy publicznej w Polsce ... *op.cit., p. 42*.

well developed countries, which have already completed structural changes in production, employment and management in undertakings in individual sectors, it is necessary to undertake measures in the scope of innovation, research and development or deployment of new technologies. High costs and potential risk of failure in this regard do result in a necessity for the state to support such initiatives.

The situation is slightly different in weaker countries, which in principle include all cohesion countries of the enlarged Union. Due to the fact that they follow up with restructuring processes, elimination of the facility for granting state aid for the benefit of such type of measures accompanied by severe restriction of regional aid may result in serious consequences of social and economic nature. Economic instability in those countries would adversely affect competitiveness of the entire European Union and will lead to a contradiction of the Treaty idea of ensuring socio-economic cohesion of Europe.

It is worthwhile stressing, however, that the above considerations do not mean that new Member States, although presently weaker in economic terms, should not enjoy the facility of supporting their undertakings through horizontal aid. What we need is not maintenance of a technological gap between the old and new Member States of the Union, but such support to undertakings of new Member States that would enable them to gain competitive advantage on the global market standing side by side with undertakings of the „old" EU.

2.3 Conditions for granting of state aid and justified aid

The Commission is of an opinion that there is a particular need to deal with those **state aid measures that give unjustified, selective benefits to some undertakings**, which precludes or delays attainment of benefits from functioning of market forces by the most competitive businesses, and as a consequence lowers the competitiveness of the entire European economy. This is certainly in direct reference to the Treaty concept of a ban on granting such state aid that distorts or threatens with distortion of competitiveness and might have impact on trade between the Member States (Article 87 of the Treaty establishing the European Community).

It is worthwhile pointing out, however, that virtually any support by the state or local authorities to any undertaking changes competition conditions on a given market and – in connection with the functioning of the internal market and absence of physical barriers - can affect trade within the EU. From this point of view, one could assume that no state aid should be granted (as set forth in the Treaty). It is worthwhile to pay attention to the issue raised by the **Commission of a ban on such state aid that brings *unjustified* benefits only to some undertakings**. Hence one can assume that the European Commission might be ready to approve of aid that brings *justified* benefits (in other words, aid *justified* by benefits to undertakings and the market).

An analysis of the provisions of the Action Plan suggests that **the European Commission, in principle, opposes granting of state aid when it distorts competition, which restricts competitiveness of the European economy. At the same time the Commission admits *justified* aid**. Hence it is up to the Member States, undertakings or their association, who are consulted on the discussed document, to identify cases of *justified* and *unjustified* state aid.

A separate issue addressed by the European Commission is the necessity to realise that **state aid does not come for free** and that **it is not a miracle instant cure for all socio-economic problems**. The Commission recalled that aid is financed from taxpayers' money, who would like their contribution into the budget to be spent on other purposes, e.g. ones benefiting the public at large, like educational system, the health system, national security etc.

Summing this thread up, the Commission indicated that **it is necessary for Member States to make transparent choices and prioritise their aid measures**. The Commission gives certain leeway to the Member States, by indicating the issue of prioritising their measures. This may mean that in case of each Member State there might be different needs regarding support to undertakings and different priorities regarding state aid. Given those conclusions and admissibility of only *justified* aid, the authorities of the Member States are responsible for selection of areas requiring *justified* support.

2.4 Conditions for state aid granting and benefits for the market

In its State Aid Action Plan the European Commission made a reference to the Treaty provisions admitting derogations from the ban on state aid granting in cases where the proposed programmes can benefit the general development of the EU. On this basis the Commission may conclude that a given instance of state aid might be considered as compatible with the Treaty, provided that it is consistent with clearly defined **objectives of common interest**. The Commission defined the scope of common interest, and included the following: provision of public services of general interest, **regional and social cohesion**, employment, research and development, environmental protection and promotion of cultural heritage. State aid targeted at those objectives may, in the Commission's opinion, constitute support to the renewed Lisbon Strategy.

The Commission also pointed out that state aid measures can be sometimes an effective tools for achieving objectives of common interest, since they can:

- ***correct market failures*** (... when the market does not provide a good or service even though economic benefits outweigh economic costs. This happens when the private benefits (or costs) are not equal to the public benefits (or costs))[17], thereby improving the functioning of markets and enhancing European competitiveness,
- **help promote e.g. social and regional cohesion**, sustainable development and cultural diversity, irrespective of the correction of market failures.

From the above list, the most important objective for Poland is ensuring regional and social cohesion. It seems that many actions undertaken in new Member States, particularly those concerning restructuring of individual sectors, might qualify as measures ensuring regional cohesion of the EU.

When evaluating whether the notified aid is compatible with common market rules, the European Commission should take into account, basing on the Action Plan, positive

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[17] *Koen Van De Casteele*, Unit "Strategic support and Decision Scrutiny", DG Competition, European Commission, Brussels: Presentation: The State Aid Action Plan...*op.cit.*

impact of an aid measure[18] and potential negative side effects in the scope of distortion of trade and competition[19]. In the frames of the discussed reform, the Commission is to expand application of this method since **making use of a refined economic approach is a means to a proper and more transparent evaluation of the distortions to competition and trade associated with state aid measures**. The Commission intends to apply this method when investigating why the market itself is unable to achieve the desired objectives of general interest (correction of the aforementioned market failures). This is of particular interest to new Member States.

This means, therefore, that the Commission plans to restrict the facility to grant aid exclusively to those cases when the market is unable to achieve specified objectives, particularly economic ones by itself. Identification of the relevant market failure shall help, in the Commission's opinion, in drawing up a better justification of the proposed aid, adequacy of the applied solution and the modality for its implementation, so as to achieve the desired effect without distorting competition and trade to a degree inconsistent with general interest.

Box 1. Origins of market failures

According to the European Commission market failures have different origins, and notably:

- *Externalities*, which exist where actors do not take full account of the consequences of their actions on other actors in society. Market players may not have to pay for the full social cost of their actions (negative externalities) like in the case of pollution through industrial activity and they may also be unable to reap the full benefits of their actions (positive externalities) like in the fields of research and innovation.
- *Public goods*, which are goods which are beneficial for society but which are not normally provided by the market given that it is difficult or impossible to exclude anyone from using the goods.
- *Imperfect information*, which may lead to transaction costs, agency costs, moral hazard or antiselection, which in turn lead to inefficient market outcomes like in the financial market, where start-up firms usually face problems in finding adequate funding.
- *Coordination problems*, which appear when markets may not function efficiently when there is a coordination problem between market actors.
- *Market power*, which is a reason, why the market may not lead to an efficient outcome is the existence of market power, for instance in a situation of monopoly.

Source: State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009 – COM (2005) 107 final.

[18] The positive impact of an aid depends on: i) how accurately the accepted objective of common interest has been identified, ii) whether state aid is an appropriate instrument for dealing with the problem as opposed to other policy instruments and iii) whether the aid creates the needed incentives and is proportionate.

[19] The level of distortion created by an aid generally depends on: i) the procedure for selecting beneficiaries and the conditions attached to the aid, ii) characteristics of the market and of the beneficiary and iii) the amount and type of aid.

The European Commission stated that when markets do not function properly, the Member States may intervene with a view to correcting market failures. According to the Commission, **existence of market failures can be one of the most significant justifications for granting state aid to undertakings**. At the same time aid providers should always try to use instruments less harmful to competition and state aid should always be second best option.

Hence one can state that market failures existing in a specific economy can be interpreted as a proof for the need to grant state aid, although in most cases it certainly is just one of the possible remedies. As a consequence, there is a great temptation – and an equally great threat that governments will succumb to it – to replace the market failure analysis (which to certain degree has certainly already been done in other countries) with an attempt to satisfy various needs.[20]

Making a preliminary analysis of the term of market failures and of the interpretation adopted by the European Commission, one can state that the drafted changes will significantly limit the facility to grant state aid in new EU Member States, including Poland. It is much more alarming that the problems of undertakings and level of Poland's economic development do not meet the premises required for market failures to be recognised as a reason for granting state aid. As a consequence this can signify a large limitation of the facility for the state to influence economic processes, particularly in difficult situations, e.g. restructuring of industry or development of least developed regions.

Moreover it is worthwhile stressing that prevalence of economic approach in determination of aid eligibility makes the entire process of admissibility assessment less objective than it is the case in a an exclusively legal analysis. If results of economic research are admitted as the condition for admissibility of aid, this would also signify it should function as a separate and universal aid admissibility criterion, apart from the currently existing detailed criteria. Hence it is not clear whether failure to meet this criterion, while detailed criteria are met, would make given aid inadmissible. And finally there is also a threat that prevalence of economic analyses and application of the market failure criterion gives to the European Commission even more freedom and discretionary power in aid assessment.

At the same time it is worthwhile stressing that in its Action Plan the Commission quotes the European Council, which has invited Member States to pay attention to market

[20] *P. Jasiński*: Priorytety polityki pomocy publicznej w Polsce ... *op.cit., p. 42-43*.

failures and **the necessity to ensure social and economic cohesion when granting state aid.** Only this last objective might be effectively used in new Member States, including Poland. This is so, because such reference can constitute a premise justifying the necessity to grant state aid in those areas, which are not necessarily directly related to the renewed Lisbon Strategy.

3 PRIORITIES FOR GRANTING STATE AID IN ACCORDANCE WITH THE ACTION PLAN AND POLISH PROGRAMME

The European Commission tried to target precisely aid objectives that might determine whether aid is *justified*, and at the same time constitute a priority in hierarchy of state aid of individual Member States. In this connection the Action Plan contains 7 priorities constituting the basis for selection by the Member States of state aid measures that might be deemed compliant with common market rules. It is worthwhile to confront them against Polish proposals, which contain priority actions requiring support from public authorities.

A kind of equivalent of the Action Plan of the European Commission is the „*Policy program in the scope of state aid for the years 2005-2010*" developed and adopted in Poland on 29 March 2005. It was developed with due account taken of the social and economic objectives of Poland as a European Union Member State and conditions relating to implementation of the Lisbon Strategy and new financial perspective of the EU for the years 2007-2013. The Programme's objectives were formulated with due consideration of such elements as: assessment of the existing policy in the scope of state aid, budgetary rigours and a need for effective correlation of national measures with practice and standards determining state aid policy in the EU and its Member States (see: Table 3.).

Table 3. Priorities of the Action of the European Commission and Polish Programme of state aid policy

State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009 – COM (2005) 107 final. ***Priorities***	***„Policy program in the scope of state aid for the years 2005-2010"*** ***Priorities***
1. Targeting Innovation and R&D to strengthen the knowledge society	**Priority 1. Support to horizontal measures** in the area of support to research and development through

State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009 – COM (2005) 107 final. *Priorities*	*„Policy program in the scope of state aid for the years 2005-2010”* *Priorities*
	co-financing to: - Industrial research - And pre-competition research Carried out by undertakings or groups of undertakings in cooperation with R&D institutions.
2. Creating a better business climate and stimulating entrepreneurship - reducing the total administrative burden, - improving the quality of legislation, - facilitating the rapid start-up of new enterprises, - creating an environment more supportive to business, - stimulation of investment in the form of risk capital,	**Priority 1. Support to horizontal measures** in the area of SMEs development through co-financing of: - access to expert advisory assistance, - ensuring access to money capital to business entities, - support to implementation of new models of corporate governance
3. Investing in Human Capital - high level of employment, - the right incentives for employers to engage more workers, particularly those who have difficulties to access and remain on the labour market, - training for workers,	**Priority 1. Support to horizontal measures** in the area of SMEs development through co-financing of: - training, - and co-financing of job creation.
4. High quality Services of General Economic Interest	
5. A focused regional aid policy	**Priority 2. Support to economic development of regions** through: - co-financing of new investments creating new jobs, - support to development of regions, - support to investments deployed in Special Economic Zones.
6. Encouraging an environmentally sustainable future	**Priority 1. Support to horizontal measures** in the area of co-financing investments for pro-environmental infrastructure
7. Setting up modern transport, energy and information and communication technology infrastructure	**Priority 1. Support to horizontal measures** in the area of co-financing investments in technical infrastructure (motorways, indermodal transport, telecommunication networks, energy networks and infrastructure necessary for functioning of competitive fuel and energy markets)
	Priority 3. Extinguishing restructuring processes by targeting restructuring state aid to undertakings.

Source: Developed by the author on the basis of: State Aid Action Plan – Less and better targeted state aid: a roadmap for state aid reform 2005-2009 – COM (2005) 107 final. and the „*Policy program in the scope of state aid for the years 2005-2010*”

3.1 Targeting state aid at innovation and research and development

The European Commission reminded in the Action Plan that future development of Europe depends on its capacity to create innovative solutions and to use results of scientific research in industrial applications. With a view to supporting this task, the Commission is planning to adopt in 2005 a Communication on state aid and innovativeness, which will analyse needs and the potential in the scope of adjusting the existing rules to new challenges to create proper framework conditions for support to innovativeness in the EU.

In this context the Commission stressed that the **process of connecting knowledge and technology with the exploitation of market opportunities for new and improved products and services compared to those already available on the common market may be hampered by market failures** (mostly externalities, public goods and imperfect information). In the connection with the above mentioned the Commission is going to attach particular attention in the new rules to the specific situation of small and medium-sized enterprises and to the role of intermediaries between business and highly-skilled researchers working in the area of innovation. The objective is to make state aid regulations in this scope correspondent to challenges pertaining to implementation of the Lisbon Strategy.

Moreover the Commission declared that it will modify the Community framework for research and development[21], in the light of the Lisbon and Barcelona objectives[22]. **State aid in this area is to enable Member States to target market failures and provide the right incentives for greater investments in R&D**.

Measures proposed by the Commission in this area are grouped as the basic priority and strictly related to implementation of the renewed Lisbon Strategy. The Polish Programme also provides for measures in this respect, particularly by including a system of investment incentives for undertakings in the scope of exploiting new technologies, support to undertakings implementing EU programmes (e.g. 7th Framework Programme), and through implementation of pro-development tasks co-financed from structural funds in the frames of the present and future financial perspective. **From this point of view one can state that this Community priority is fully in line with Polish priority, as expressed in the Programme of state aid policy.**

This is important insofar that in Poland only 23.5% of investments in R&D are coming from private sectors undertakings, while in developed countries financing by business constitutes a majority of capital outlays to this end. This ensues from the fact that they no

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[21] Community framework for State aid for Research and Development *(Official Journal C 45, 17.02.1996, pages 5-16)* and Commission communication amending the Community framework for State aid for research and development *(Official Journal C 48, 13.02.1998, p. 2)*

[22] Presidency Conclusions. Barcelona European Council. 15 and 16 March 2002 (English) No: 100/1/02 REV1

longer have to incur expenditure for adjustments to requirements of the internal market and investments relating to willingness to attain the scale effect, and they only fight for market share with new technology products. In the case of Polish undertakings the gross majority of expenditures is still allocated to measures aimed at coping with competition within the internal market (sometimes merely at surviving at the marketplace), while investments in R&D are not a priority for those undertakings. Thus Poland needs a well targeted state aid supporting measures taken by Polish undertakings.

This is important insofar that the level of innovativeness of industrial undertakings sector in Poland[23] is assessed as relatively low, which is evidenced by one of the lowest indicators in the EU.[24] This is evidenced by low share on outlays on R&D at the level of 0.57% GDP, while it amounted to almost 2% in EU-15 states, 2.8% in the United States and 3.1% in Japan.

3.2 State aid targeted at creating conducive conditions for development of entrepreneurship

From the point of view of stimulating entrepreneurship, the European Commission in its Action Plan listed also reducing the total administrative burden, simplifying and improving the quality of legislation and facilitating the rapid start-up of new enterprises. Those measures, undertaken in the Competitiveness Council, are implemented in the frames of the initiative for better legislation and its simplification. Previously the existing legislation concerning the conditions for granting state aid was not taken into account in the development of lists of legal acts to be simplified. These initiatives are fully consistent with measures undertaken in Poland in relation to regulatory environment of the undertakings sector. Unfortunately the regulatory system in Poland, constituting an important factor affecting the situation and development capacities of the undertakings sector, is very unstable.

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[23] Innovativeness indicator specifies share in a studied population of industrial undertakings that introduced innovations in a 3-year period.

[24] See: Projekt Programu Operacyjnego "Innowacje - Inwestycje - Otwarta gospodarka, 2007-2013, Projekt Narodowego Planu Rozwoju 2007-2013, Ministerstwo Gospodarki i Pracy (Ministry of Economy and Labour), Warszawa, 29.08.2005,

From the point of view of legislation concerning state aid **the Commission pointed out to the necessity to review regulations on support to risk capital**[25]. This is a necessary and right step because most frequently SMEs or innovative undertakings of high risk struggle with gaining capital for start-up.

The Polish programme also provides for support to SMEs by ensuring access to money capital to business entities. It needs to be stressed, however, that after a more detailed analysis of the planned measures one can conclude that measures to be covered by state aid in Poland concern almost exclusively support to R&D. **It seems that Polish strategy of support to entrepreneurship and carrying out state aid policy lacks a concept to support risk capital, the shortage of which is experienced by SMEs, not only those operating in innovative sectors.**

It seems, however, that the Commission should deal not only with possible adjustment of risk capital legislation to SMEs' needs, but also with regulations concerning other types of financial instruments stimulating entrepreneurship, such as loans or guarantees to micro, small and medium-sized enterprises. It seems that those are traditional and universally applied instruments, better developed in new Member States and more accessible to undertakings. It is also worthwhile stressing that the aforementioned instruments, which may also assume the character of state aid, allow to a greater extent than risk capital to support also undertakings in non-innovative sectors. In view of the above, the Commission should deal also with Communication on state aid in the form of guarantees, which provide for instruments more frequently used in new Member States.

Additionally it is worthwhile pointing out that in the frames of systemic measures in support to entrepreneurship in Poland (this concerns SMEs in particular), in 2001 the Polish Agency for Enterprise Development (PAED) was established. It implements measures financed both with funds from state budget in the frames of state aid and from EU budget as structural funds.

[25] Commission Communication on State aid and risk capital *(Official* Journal C 235, 21.08.2001, pages 3-11)

3.3 State aid for investments into human capital

As regards support to investments in human capital, the European Commission pointed attention to the need to achieve one of the objectives of the Lisbon Strategy: high level of employment, sustainable growth and economic and social cohesion. In connection with the above, the Commission intends to justify state aid to employers in the form of incentives to engage more workers, particularly those who have difficulties to access to and remain on the labour market, and to provide appropriate training for workers. At the same time the Commission will consider as compatible with common market rules aid to quality training and education, constituting a response to challenges facing European economy and a foundation for improvement of its competitiveness.

The Commission intends to consolidate the block exemption regulation (concerning employment[26] and training[27] aids), exempting from ban on aid granting and its notification, currently in force, into a general block exemption regulation, while simplifying the existing criteria. Such step would simultaneously implement assumptions providing for better regulatory environment of the European Community.

Priority 1. of the Polish Programme stipulates support to development of SMEs with horizontal measures through co-financing e.g. of training and co-financing of job creation. It seems, therefore, that **this measure fits in with the thinking of the European Commission and deserves support from Poland.** Facilitation in obtaining state aid for training and employment should at the same time activate university communities and encourage them to come up with a more attractive educational offer targeted at stimulation of entrepreneurship.

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[26] Commission Regulation (EC) No 2204/2002 of 5 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment *(Official Journal L 337, 13.12.2002, pages 3-14)*.

[27] Commission Regulation (EC) No 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid *(Official Journal L 10, 13.01.2001, pages 20-29) and* Commission Regulation (EC) No 363/2004 of 25 February 2004 amending Regulation (EC) No 68/2001 on the application of Articles 87 and 88 of the EC Treaty to training aid *(Official Journal L 63, 28.02.2004, pages 20-21)*

3.4 State aid to ensure high quality services of general economic interest

The European Commission did not address in detail the issue of granting state aid to services of general economic interest. This ensues from the fact that adoption of relevant legislative texts has been envisaged on the basis of the already published White Book on the provision of such type of services. Moreover the Commission will adopt a Decision on the basis of Article 86.3 of the Treaty, and guidelines to specify, under which conditions public service compensations which constitute state aid, are compatible with the Treaty.

The Commission indicated that Member States enjoy a wide margin of discretion when deciding to finance services of general economic interest. However, to avoid distortion of competition the compensations granted should secure uninterrupted provision of the aforementioned services without leading to overcompensation of the incurred costs.

In the case of the Polish Programme, the priority concerning state aid to services of general economic interest was not developed, most probably in the understanding that such support is not an additional measure to be implemented by the state but rather a standard support from the state to provision of specified services of general interest. Hence this is not any new solution but rather a follow up and ensuring transparency of the existing responsibilities of the state.

3.5 A focused regional aid policy

The issue of social and economic cohesion might be not the most important element in the implementation of the Lisbon Strategy for EU-15, but for new Member States it certainly is one of the major instruments diminishing backwardness in economic development.[28] According to the European Commission, regional cohesion is a factor guaranteeing stability and feasibility of economic growth. Thus the Commission made a reference to previous enlargements, which proved that development of poorer and richer regions based on mutual benefits is feasible. This is a positive message from the **Commission proving that it considers the facility for granting regional aid**.

[28] See more about regional state aid: *F. G. Wishlade*: Regional State Aid and Competition Policy in the European Union, Kluwer, European Monographs, the Hague, London, New York 2003.

One can be alarmed, however, by the proposal for fundamental changes concerning rules for granting regional aid. The Commission is of an opinion[29] that regional aid policy needs to be updated to take account of developments in the seven years since the last guidelines were adopted in 1998[30], in particular the enlargement of the EU that took place. This concerns mainly proposals for changing the criteria for regions' eligibility as the least developed ones, which in combination with the future accession of poorer countries (and emergence of the so-called statistical effect), can result in exclusion of some areas of Poland from the facility to receive this type of aid or at least in significant limitation of such aid.

Moreover in the frames of the reform of those guidelines[31] the Commission plans **to lower the maximum level for aid granting, which can result, particularly in Poland, in a decline of the attractiveness of the applied investment incentives**, e.g. in the form of tax reductions. It seems that **this is an attempt to limit delocalisation, by lowering attractiveness of pro-investment instrument in relatively poorly developed regions, particularly of new Member States.**

The Commission declares that it has the intention to introduce into state aid rules the recommendations from the Third Cohesion Report[32], concerning: convergence, regional competitiveness, employment and European territorial co-operation. As regards regions that do not qualify as the least-developed ones, the Commission will determine the maximum aid level for undertakings, while giving Member States sufficient flexibility in development of policies at national level.

In the draft new guidelines, the European Commission indicated that the scope of regions covered by regional aid should be much smaller than those not eligible for aid. Taking into account recommendations from the European Council on depleting aid volume and on limiting adverse aid outcome for large undertakings, the Commission envisages lowering the

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[29] *R. Hankin*, Head of Unit "Regional State Aid", DG Competition, European Commission, Brussels: Presentation "Regional state Aid. Review of the regional aid gudlines 2007-2013", Documents and presentations prepared for the 9th Forum on European State Aid Law, organised by the Academy of European Law, ERA, Trier, Germany, 10-11 November 2005.

[30] Guidelines on national regional aid (*Official Journal C 74, 10.03.1998, pages 9-31)* and Amendments to the Guidelines on national regional aid *(Official Journal C 258,* 09.09.2000, p. 5)

[31] See: *A.A. Ambroziak*: Wpływ zmiany warunków udzielania regionalnej pomocy publicznej na wsparcie regionów w Polsce z uwzględnieniem specjalnych stref ekonomicznych, a paper under manuscript rights in preparation for publication in the frames of own study performed in *J. Monnet European Integration Chair, The Faculty of Word Economy, Warsaw School of Economics*

percentage of EU-25 population living in regions where regional aid can be granted to 42% of Union population.

When analysing the share of population of regions covered with regional aid, it is worthy of mention that in principle, pursuant to the planned guidelines, almost all new Member States will be fully covered with support under Article 87(3)(a) of the Treaty establishing the European Community, which constitutes a basic exemption of regional aid from general ban. It allows for the largest, in terms of the volume, state aid. As regards old Member States, only cohesion countries stand out as ones with significant share of areas where this type of regional aid will be admissible. This ensues from the fact that as a result of enlargement, 75% GDP *per capita* PPS indicator, i.e. the criterion for covering a region with aid in the understanding of Article 87(3)(a) of the EC Treaty, went down significantly. As a result GDP *per capita* PPS in individual regions went up much in relation to EU average.

As a result of the implementation of the Commission proposal concerning limitation of regions covered with this exemption, also the percentage of EU population inhabiting those areas will go down from 35% to 26.1% of the total population of EU-25. As regards old Member States, this reduction will be from 22.8% to 14.7%, while in the case of new Member States: from 96.7% to 83.9%.

In Commission's opinion, aid level should take into account the character and intensity of social and economic problems in a given region, which were the reason for aid granting. Hence the European Commission introduced *ex definitione* a differentiation between maximum levels of admissible aid in regions eligible for aid under exemptions set forth in Article 87(3)(a) of the Treaty and in regions eligible for aid pursuant to Article 87(3)(c) of the Treaty.

In the new guidelines, the Commission stresses that in connection with enlargement the disparities between regions increased while the average regional development rate went down in the entire EU-25. Hence the Commission grouped regions eligible for aid under Article 87(3)(a) of the Treaty, by the size of their GDP *per capita* PPS in relation to EU-25 average: under 45%, between 45% and 60% and between 60% and 75%. This enabled the Commission to differentiate aid intensity between regions. In general the Commission lowered maximum aid level for large undertakings, except for the least-developed areas, where maximum aid level remained unchanged.

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[32] Communication from Commission. Third Progress report on cohesion: Towards a New partnership for growth,

Worthy of mention is also the new system for raising the ceilings for SMEs. So far the regional aid level for this group of undertakings was uniform and amounted to 15% in regions eligible under Article 87(3)(a) of the Treaty. In the new guidelines the bonus for medium-sized enterprises was lowered to 10% while the one for small enterprises was raised to 20%. As a result the maximum level of admissible aid was generally lowered for medium-sized enterprises, while the maximum level of aid for small businesses was slightly raised or at least maintained at the existing level (or, possibly, slightly lowered in regions relatively well developed).

The drafted changes in the rules for national regional aid will also directly affect the facility for granting this support in Poland. Having analyzed Polish regions at NUTS II level, one can state that according to the draft new provisions, the entire Poland will be covered with the facility to grant national regional aid under Article 87(3)(a) of the Treaty. However, in comparison to the map of regional aid in force until the end of 2006, there will be a differentiation among regions depending on their relative economic development level.

Basing on the draft new guidelines on national regional aid one can assume that the greatest intensity of this type of aid will be admissible in the first group of 10 voivodships (regions) in Poland, where GDP *per capita* PPS is under 45% of EU-25 average. In this case it is envisaged that for large undertakings the maximum aid intensity should be set at a level not exceeding 50% of gross subsidy equivalent (at present it amounts to 50% of net subsidy equivalent). This means that there will be only a change in calculation from net to gross subsidy equivalent, which in fact depletes the aid volume (see: Map 1.).

A more radical drop in the admissible aid intensity will be felt by those regions where GDP *per capita* PSN is in the 45% to 60% bracket of EU-25 average (5 voivodships). In the case of large undertakings, located in those voivodships, the admissible aid ceiling was lowered in the Commission draft from 50% of net subsidy equivalent to mere 40% of gross subsidy equivalent. In the case of large undertakings located in the Mazovia region, the ceiling of admissible regional aid intensity will drop even from 50% of net subsidy equivalent to 30% of gross subsidy equivalent (by 20%).

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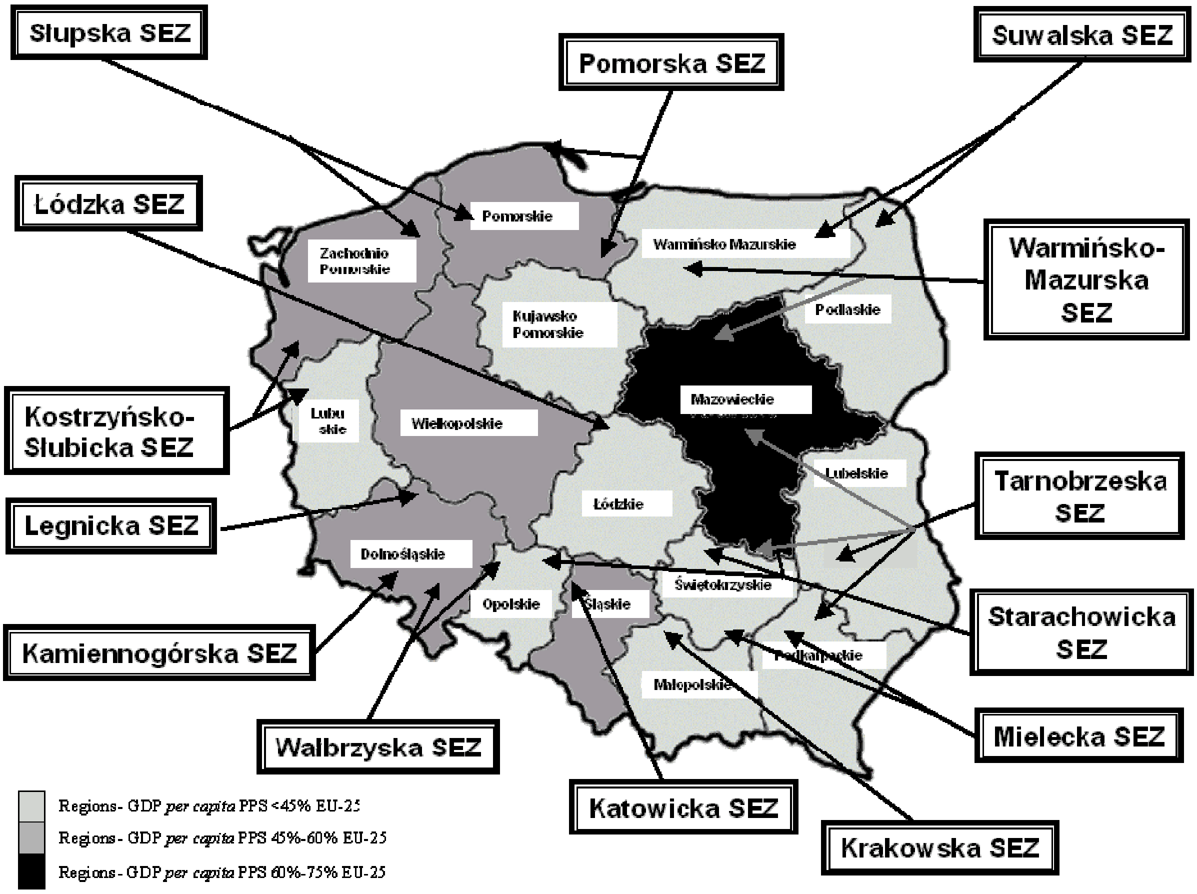
jobs and cohesion, COM (2005) 192, 17.05.2005.

Map 1. Special Economic Zones and regional state aid map in Poland basing on draft new guidelines on national regional aid for the years 2007-2013.



Source: Author's own development

As regards medium-sized enterprises, in general aid intensity for them will drop by 5% to 10%, and in the case of small enterprises it will slightly rise in a vast majority of voivodships to 70% of gross subsidy equivalent.

As demonstrated earlier, adoption of new guidelines on national regional aid will result in a general lowering of the intensity of state aid granted in areas eligible for support under Article 87.3 letter a) of the Treaty. This means that aid granted in Special Economic Zones (SEZs)[33] in Poland will be also limited (see: Map 1.). So far, the maximum aid intensity level was uniform across all zones and amounted to 50% of net subsidy equivalent

[33] Special Economic Zones in Poland function under the law on Special Economic Zones of 20 October 1994 (with later amendments). Running economic activities in SEZ requires a permit from Ministry of Economy who can entrust the managing company with granting, on his behalf, permits for executing control of economic activities and determine the scope of that control. The operation of SEZ is based on a system of incentives aimed at encouraging domestic and foreign entities to invest in the zones. The provisions of the law envisages that the incomes gained from economic activities run on the territory of a zone against permit are exempt from the income tax in an amount not exceeding the maximum level of the admissible aid in the region where the zone is located.

for large undertakings (except Krakowska SEZ within Kraków agglomeration – up to 40%). The entry into force of the new guidelines will result in significant diversification of aid intensity in individual zones and thus – in diversification of their attractiveness for investors.

In connection with the above, **the Polish Program also provided for support to economic development of regions, mainly through co-financing of job-creating investments, support to regions' development and investments deployed in Special Economic Zones.** Those priorities are to be carried into effect through measures envisaged under operational program for utilization of structural programs in Poland, and in the case of SEZs – through continuation of the existing support forms and gradual launching of the SEZs Fund[34] pursuant to the Act of 2 October 2003 amending the Act on Special Economic Zones[35]. Funding collected on such Fund could be used to support a new investment deployed by the entrepreneur - taxpayer or other companies related to it in terms of capital or organization operating on the territory of Poland[36].

3.6 Support to measures benefiting the environment and modern infrastructure

According to the European Commission, environmental protection can also be a source of competitive advantage for Europe, by providing opportunities for innovation, new markets and increased competitiveness through resource efficiency and investment. Although the Community guidelines on State aid for environmental protection[37] will be in force until 2007, the Commission plans to review them and adjust to the requirements of the Lisbon Strategy, in particular as regards eco-innovation and improvements in productivity through eco-efficiency in line with the Environmental Technologies Action Plan (ETAP). The Polish

[34] Due to inconsistencies in the law of 1994 on SEZ with the *acquis*, Poland had to implement some changes from the date of accession to the EU. It may cause that entrepreneurs would like to appeal to court with motions for obtaining compensation for the lost profits. In order to encourage investors to accept the changes, the new law of 2 October 2003 introduced a special incentives package, which consists of i.a.: SEZ Funds. Income taxes paid by the entrepreneurs who exceeded the admissible level of aid could be earmarked via SEZ Fund for financing their new investment projects, taking into account the conditions of admissibility of state aid for entrepreneurs.

[35] Ustawa z dnia 2 października 2003 r. o zmianie ustawy o specjalnych strefach ekonomicznych i niektórych ustaw (Dz. U. Nr 188, poz. 1840).

[36] Rozporządzenie Rady Ministrów z dnia 22 lutego 2005 r. w sprawie przekazywania i rozliczania wpływów z podatku dochodowego na rachunek Funduszu Strefowego (Dz. U. Nr 38, poz. 338).

[37] Community guidelines on State aid for environmental protection (Official Journal C 37, 03.02.2001, p. 3)

Program, on the other hand, envisages only support consisting in co-financing of pro-ecological investments.

In connection with the implementation of the Lisbon Strategy, the Commission invites Member States to fulfill their commitments in terms of **investments for Transport and Energy Networks**. One of the measures enabling carrying of this task into effect is to secure Public Private Partnerships to build infrastructures. In this connection the Commission plans to introduce state aid rules that are clear for the assessment of public resources involved in Public Private Partnerships. It seems, however, that the Commission should provide for a separate approach to cases of granting restructuring aid to entities from those sectors in new Member States, particularly in a situation where such aid is an element of implementation of restructuring and privatization programs.

CONCLUSIONS

There is currently a debate going on in the European Union on development of instruments that might accelerate and carry into effect the achievement of the Lisbon Strategy objectives. Beyond any doubt, it is in the best interest of Poland to actively support and join in the process of its implementation. However, the conditions and priorities of Polish economy need to be taken into account in those actions. The needs of Polish industry, sectors, regions or the entire state should not be concealed, since they may completely differ from the needs of highly developed EU Member States. In most cases the deep restructuring processes, which are currently in place in Poland or those that have to be still undertaken, were successfully implemented in the states of the „old" Union.

It is worthy of mention that significant limitations in respect of granting state aid, particularly sectoral but also regional one, took place as late as in early nineties. This was associated with re-launching of the single European market, which - while creating conditions for free competition - enforced introduction of legislation preventing Member States from excessive interventionism on domestic markets.

At that time Poland, similarly to other associated candidate countries aspiring for EU membership, just started that process. Radical restrictions on the facility to support restructuring processes and social and economic transformation in new Member States is incompatible both with their national and with Community interest, understood as the willingness to ensure social and economic cohesion of Europe. It is important to underline that the EU enlargement in 2004 resulted in an increased of inter-regional and inter-industry development disproportion in the EU. Reduction of the state aid for regional development and sectoral measures, targeted towards restructuring and improvement of competitiveness can make difficult to reduce development gap between old and new member states of the European Union.

With a view to enabling support from public resources to measures pertaining to implementation of the broadly understood Lisbon Strategy and enabling the granting of state aid, both related to transformation of economic system in Poland and desirable from the point of view of Lisbon objectives, Poland developed the „*Policy program in the scope of state aid for the years 2005-2010*". It is a framework document for measures conducive to changes in the directions of allocation and improvement of the effectiveness of state aid granted in Poland. At the same time it serves the purpose of correlating policy for state aid granted in Poland with standards and trends in place in the EU.

It is worthy mentioning that directions of actions set forth in the aforementioned Program also take into account the scope of the National Development Plan (NDP) for the years 2007-2013. In accordance with NDP assumptions, state support coming both from national resources and the Community ones under structural funds, will be targeted at pro-development and innovative ventures. The focus here is on development of knowledge-based economy, improvement in the functioning of the business environment and internationalization of undertakings, promotion of exports, improvement in the condition of the environment and job creation. Beyond any doubt, implementation of NDP in the years 2007-2013 in connection with the Program for the years 2005-2010, should lead to a decrease in the volume and a change in the structure of state aid granted in Poland, targeting the aid at horizontal objectives and creating conducive conditions for implementation of ventures with high added value.

When analyzing objectives and priorities contained in the Action Plan of the European Commission, as well as those assumed in the „*Policy program in the scope of state aid for the years 2005-2010*", one can conclude that the drafted measures provided for in both documents cover two areas of European Commission's interest:

- Enhancing implementation of the Lisbon Strategy by targeting aid at horizontal objectives, which enable improvement in the competitiveness of economies of individual Member States (including Poland) and as a consequence - of the European economy as a whole,
- Less, better targeted and more effectively monitored state aid.

It must be stressed, however, that Polish priorities lack measures pertaining to support high quality services of general economic interest. This ensues to a large extent from the absence of know-how on that issue and the fact that those are in fact preliminary actions of the European Commission in that area.

On the other hand, the State Aid Action Plan of the European Commission lacks priorities relating to the necessity to restructure certain economies, particularly of new Member States, including Poland. As already stated, this ensues from the assumption made by the Commission that the European Community is a homogenous economic organism in terms of economic development and financial needs. Hence the Polish Program included priority actions allowing for the situation of Poland: the necessity to allocate some aid to measures relating to implementation of economic transformation on one hand, and on the other – the necessity to decrease quotas and extinguish restructuring aid with a view to more effective expenditure of budget resources.

In summary one can state that the main objective of state aid in Poland for the years 2005-2010 is to **align state aid policy in Poland with standards and trends in place in the European Union**. At the same time it was assumed that from the point of view of EU requirements Poland should:

- retarget state aid from sectoral to horizontal measures,
- reduce the scale of granted aid,

while **taking into account specific features of the economic situation of Poland and adopting priorities reflecting the needs of the economy. It seems that those specific features are not addressed in the Action Plan of the European Commission.**

To conclude , it should be stressed that for the determination of Polish priorities it is important what are the priorities of other countries, particularly other EU Member States. Priorities of neighboring states and of economic partners are important insofar that on one hand they may result from an in-depth analysis of assessments, whose effects might be also applied in Poland. On the other hand, if state aid granted in those countries is effective and efficient, that might signify that in those areas Poland could either start lagging behind and allow for widening of the already existing gap in development and competitiveness of industry.

It is also worthy stressing, that compatibility of the rules for state aid with the *acquis* does not guarantee that thus allocated public resources will be spent wisely. It seems that the best framework document to look to for guidelines for Polish priorities of state aid is the properly interpreted and used Lisbon Strategy.

Finally it seems that the criteria that should determine selection of priorities for state aid policy in Poland should include in particular: permanence of expected effects of a supported measure, high assessment of effectiveness and efficiency of the planned aid, signifying lower social costs of resolving specific problems or achieving assumed objectives and a positive impact of the supported initiative on the economic and social environment.[38]

It is important to underline, that during the 9th Forum on European State Aid Law, organised by the Academy of European Law in Treir on 10-11 November 2005, the representatives of the European Commission underlined[39], that the "State Aid Action Plan" is not the answer to everything, but a kind of roadmap for future activities of the Commission.

Table 4. State aid in the EU in 1981-1990

Year	*Annual average Value [bln EUR]*	*Share in value added*	*Share of horizontal aid in the total state aid*	*Share of regional aid in the total state aid*	*Share of sectoral in the total state aid*
1981	35,373	4.8	47%	37%	16%
1982					
1983					
1984					
1985					
1986					
1987	35,807*	3.7	40%	21%	39%
1988	43,955**	4.1			
1989	33,583**	3.2			
1990	44,181**	4.2			

* annual value in constant prices (1989)
** annual value in constant prices (1991)
Sources: Commission of the European Communities, Forth Survey from the Commission on State Aid in the European Union in the manufacturing and certain other sectors, Brussels, 26.07.1995, COM(95) 365 final., Commission of the European Communities, Third Survey from the Commission on State Aid in the European Union in the manufacturing and certain other sectors, Brussels, 07.1992, SEC(92) 1384, Commission of the European Communities, Second Survey from the Commission on State Aid in the European Union in the manufacturing and certain other sectors, Brussels, 10.07.1990, SEC(90) 1165, Commission of the European Communities, First Survey from the Commission on State Aid in the European Union in the manufacturing and certain other sectors, Brussels, 13.12.1988, SEC(88) 1981.

Taking this into consideration one can ask one, but extremely very important question for the future analyses: about the effectiveness and efficiency of the horizontal instruments in the new Member States, what is proposed by the Commission in "State Aid Action Plan". There are no analyses on the results of horizontal state aid on the effectiveness of the restructuring process, which should be maintained and successfully finished in such

[38] *E. Modzelewska-Wąchal*: Pomoc publiczna w Polsce - perspektywa unijna [w:] Priorytety pomocy publicznej, Polskie Forum Strategii Lizbońskiej, Nr 3, Niebieskie Księgi 2004, s. 69.

[39] *Koen Van De Casteele*, Unit "Strategic support and Decision Scrutiny", DG Competition, European Commission, Brussels: Presentation "The State Aid Action Plan..*op.cit.*

countries as Poland. Taking into consideration the experiences of the EU-15 form the restructuring process, which were conducted in old Member States in 80's and 90's (see Table 4.), one can state, that the most useful instrument, which, on one hand, did not destroy the competition, but on the other, reduced the negative social consequences, was sectoral state aid.

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