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Romania, between the “magnetism” of Structural Funds and the “corrective” tools of EU state aid regulations

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*Abstract: This paper raises the question of the relevance of the *acquis communautaire* on state aid in the context of Romanian regional policy-making. EU state aid regulations impose a number of restrictions on regional aid spending, which in their combination are intended to concentrate and modulate overall spending within priority areas. The paper reviews the Romanian legal, institutional and procedural frameworks on state aids and briefly analyses the main financial support schemes designed by the Romanian authorities to support regional development.*

Keywords: state aid, regional development, regional-policy making

Introduction

The primary objective of this paper¹ was to explain the relevance of the *acquis communautaire* on state aid in the context of Romanian regional policy. With a GDP per capita (in PPS) amounting to only 24% of the EU average in 2000,² and an average unemployment rate of 7% and projected on the rise,³ Romania is currently one of the poorest candidates to EU membership. While Romania's population is equivalent to 6.0% of the EU-15 population, Romania only produces 1.4% of the European Union's GDP. In 2001,

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¹ Some main parts of this paper are based on a more exhaustive research project, which I coordinated in 2002/2003. For more information, see Gabriela Dragan (coordinator), Isabela Atanasiu, *Compatibility between the Romanian frameworks for regional policy-making and EU state aid regulations*, Study no.8, Phare Project RO 9907-02-01, European Institute of Romania, 2003, available at www.ier.ro/studiiimpact.html

² Eurostat, Statistics in Focus, Economy and Finance, No. 28/2001: *GDP of Candidate Countries - annual GDP, growth rate and main aggregates*.

³ European Commission, DG ECFIN: *Autumn 2001 Economic Forecasts for the Candidate Countries*, EUROPEAN ECONOMY, Supplement C - Economic Reform Monitor, No. 4/2001, Luxembourg.

Romania's per capita GDP (in current prices) was Euro 1,868 - 12 times lower than the EU-15. In terms of purchasing power parity, the GDP in Romania in 2000 was only 4.3 times lower⁴.

In the context of accession to the EU, the regional policy frameworks set up by the Romanian authorities should not only meet the specific development needs of the Romanian regions, but also be compatible with EU structural assistance frameworks. The latter is a necessary pre-condition for obtaining pre-accession financial support from the EU (*via* instruments such as ISPA, SAPARD and PHARE 2000-2006), and a preparatory step for the receipt of EU structural assistance (*via* the Structural Funds and the Cohesion Fund) following accession. In short, Romania should adopt regional policy frameworks that are both targeted on its specific regional problems *and* compatible with the patterns of EU structural assistance. For a country lacking tradition in regional policy-making, and furthermore, one so short of resources to devote to structural interventions, the design of regional policy frameworks that satisfy both sets of criteria mentioned above is not without difficulty.

In order to explain the relevance of the *acquis communautaire* on state aid in the context of Romanian regional policy-making, the paper was structured in two main sections, the first summarizing the status-quo and recent trends in the field of public aid used in the context of regional development policy in Romania and the second describing regional aid schemes currently in place in our country and analyzing the compatibility of the Romanian regional aid schemes with the *acquis communautaire* on state aid. The final part of this paper summarizes the main findings and includes the main conclusions.

SECTION 1.

1.1. Explaining the link between regional policy and state aid control in the EU

Regional policy-making could be defined as the use by public authorities of a combination of economic policy instruments in order to stimulate investment, create employment, and

⁴ According to the *Romanian National Development Plan for 2004 - 2006*, comparing to some of the economies in the EU-15, Romania's GDP per inhabitant for 2000 amounted to only 3.5% of Luxembourg's GDP per inhabitant, 4.8% of Denmark's level per inhabitant, 6.1% of Austria's, 13.3% of Greece's GDP and 13.7% of Portugal's, respectively.

thereby improve living conditions in a specific territory/region.⁵ Such economic policy instruments range from the more general - e.g. legal frameworks destined to support development, or economic regulation - to the more specific support instruments - e.g. public aid to companies, which are destined to attract/stimulate investment or support restructuring/re-conversion projects.

Public aid instruments traditionally played an important role in the “*intervention tool-kit*” of policy-makers worldwide, including those of the EU Member States. One of the Commission’s most recent State Aid Survey⁶ shows that, over the years 1995 to 1999, *regional aid* (that is, public aid granted to companies for regional policy considerations) accounted for about 56% of the overall state aid expenditure in the EU. Certainly, public expenditure of this kind would vary in terms of total amount or form from one Member State to another, in function of the latter’s specific regional problems, views on regional policy-making, and not in the least, availability of public resources to be committed to such end.

According to the last Commission’s State Aid Scoreboard (April 2004)⁷, in the EU-15 aid earmarked for horizontal objectives, including cohesion objectives, accounted for 79% of total aid less agriculture, fisheries and transport in 2003. The four main horizontal objectives were environment and energy saving (23% of total aid), regional economic development (21%), R&D (14%) and SMEs (13%). The remaining 21% was aid directed at specific sectors (mainly coal) including aid to rescue and restructure ailing firms.

Each Member State targets part of its State aid towards the least developed regions, the so-called ‘*assisted regions*’. For the Union as a whole, an estimated €7.6 billion of aid was earmarked exclusively for assisted ‘a’ regions (under the Art.87 (3) (a) provision) in 2003, of which some €3.1 billion was approved under the *Guidelines for national regional aid*. The €7.6 billion represented around one fifth of total aid (less agriculture, fisheries and transport for which a regional breakdown is not available). The comparable figure for the EU-15

⁵ For detailed and easily-accessible reviews of the economic literature in favor or against public intervention in support of regional development objectives, as well as of the justifications for regional policy-making at EU level, see e.g.: Reiner Martin (1998): *Regional Policy in the European Union*, Centre for European Policy Studies, Brussels, pp. 18-32; Yves Hervé and Robert Holzmann (1998): *Fiscal Transfers and Economic Convergence in the EU: An Analysis of Absorption Problems and an Evaluation of Literature*, Nomos Verlagsgesellschaft, Baden-Baden; Loukas Tsoukalis (1999): *The New European Economy Revisited*, Oxford, Oxford University Press, pp. 187-222.

⁶ See European Commission (2001): *Ninth Survey on State Aid in the European Union*, COM (2001) 403(01), pp. 40-47.

⁷ See European Commission (2005), State Aid Scoreboard, Spring 2005 update, COM(2005) 147 final, Brussels

Member States in 2002 was €34 billion⁸. In absolute terms, the three biggest countries in terms of population awarded the most aid: Poland, the Czech Republic, and Hungary accounted for 86% of total aid in the ten new Member States. During the period under review, the level of State aid increased from €5 billion in 2000 to €9.2 billion in 2003 (the very large awards of aid was caused by the increase of aid allocated in 2002 to the Czech-banking sector (€2.6 billion) and in 2003 to the Polish coal sector (almost €4 billion)⁹).

Disparities between the Member States in the levels of aid reserved for assisted ‘a’ regions reflect not only differences in regional policy but also the size of each country’s eligible population as well as the extent to which each Member State grants aid at a sub central level. Aid to the assisted ‘a’ regions fell dramatically from a peak of €28 billion in 1993 to €9 billion in 2000, due largely to the phasing out of the restructuring programme in the new German Bundesländer. Aid to the assisted ‘a’ regions in Germany stood at €1 billion in 2003.

Public aid to companies also plays an important role in **the Community’s own structural interventions**. During *the second programming period* of the Structural Funds (1994-1999), for example, the EU committed 40% of the overall Structural Funds budget (170 billion Euro) to “supporting investment projects” in the European regions assisted under Objectives 1 and 2. It must be said, however, that starting with the third programming period of the Structural Funds (2000-2006) the Community sought to reduce its public aid expenditure in favor of other forms of structural intervention (i.e. financial support for human capital formation and the building of infrastructure) “as a result of stricter EU regulation on state aid and in recognition of the significant deadweight losses resulting from such forms of support”.¹⁰ Public aid to companies also plays an important role in the Community’s own structural interventions. During the second programming period of the Structural Funds (1994-1999), for example, the EU committed 40% of the overall Structural Funds budget (170 billion Euro) to “supporting investment projects” in the European regions assisted under Objectives 1 and 2. It must be said, however, that starting with *the third programming period* of the Structural Funds (2000-2006) the Community sought to reduce its public aid expenditure in favor of other forms of structural intervention (i.e. financial support for human capital formation and

⁸ See European Commission (2004), State Aid Scoreboard, COM(2004)750 final, 16.11.2004, Brussels, p.17

⁹ Ibidem

¹⁰ See European Commission (2001): *Second Report on Economic and Social Cohesion*, and in particular “Part III: The EU Budget and the contribution of structural policies to economic and social cohesion”, available at http://www.europa.eu.int/comm/regional_policy/sources/docoffic/official/reports/p323_en.htm.

the building of infrastructure) “as a result of stricter EU regulation on state aid and in recognition of the significant deadweight losses resulting from such forms of support”.¹¹

According to the Third Report on Economic and Social Cohesion¹², *the forth-programming period of Structural Funds* (2007-2013) will have to meet four challenges, namely:

- to increase cohesion in a enlarged Union (where social-disparities will double and the average GDP of the Union will decrease by 12.5%);
- to strengthen the Union’s priorities (cohesion policy needs to incorporate the Lisbon and Gothenburg objectives and to become a key vehicle for their development via the national and regional development programmes);
- to strengthen regional competitiveness through well-targeted investment throughout Union and promote sustainable and more balanced development (regional policy will reduce the pressures of over-concentration, congestion and bottlenecks);
- to create a new partnership for cohesion (the need to reinforce institutional capacities at all levels of government in order to bring greater efficiency, transparency and political accountability).

The link between regional policies and EC state aid control

So far we established that public aid to companies is an instrument of regional policy-making commonly used both at the level of the EU and of the Member States. What is then the relevance of EU state aid control in this context?

In the multi-level governance system of the European Union, Community structural interventions co-exist with the regional policies of the Member States. Yet, while the Community concentrates its interventions on the regions that are most disadvantaged *from a European-wide perspective*, the Member States have as primary objective to reduce their own internal regional disparities (therefore from an *internal perspective*). To the extent that the parallel pursuit of such different priorities can reduce the effectiveness of the Community’s own regional interventions, the Community seeks to influence the patterns of regional spending in the Member States so as to render them more consistent with its own. To this end,

¹¹ Ibidem

¹² See European Commission (2004): *Third Report on Economic and Social Cohesion* “A new partnership for cohesion. Convergence, competitiveness, cooperation”, February 2004, available at http://www.europa.eu.int/comm/regional_policy/sources/docoffic/official/reports/hm.

the Community relies, on the one hand, on the **“magnetism” of the Structural Funds** (the co-financing pre-requisite for obtaining assistance from the Structural Funds induces the Member States to orient at least part of their resources on supporting development in the regions assisted by the EU itself). On the other hand, the Community seeks to **“calibrate” the patterns of regional spending in the Member States** according to its own priorities *via* state aid regulation (i.e. by limiting the overall regional aid expenditure in the better-off Member States). This is possible in so far as public aid instruments used in the context of regional development programs fall under the scope of application of EU competition rules.

Indeed, public aid measures benefiting directly to the economic agents (companies) have the potential to distort competition in the internal market by favoring certain companies to the disadvantage of their competitors. As such, the public aid measures in question would be qualified as involving “state aid”, and thereby will fall under the scope of EU competition rules applicable to state aid. (It is important to observe that EU state aid rules apply not only to public support measures that are financed/supported exclusively out of national sources, but also to those co-financed by the EU itself *via* the Structural Funds.)

Art. 87(1) of the EC Treaty contains a general ban on state aid distorting or having the potential to distort competition on the internal market. Nevertheless, Art. 87(3) EC lists a number of exceptions from this general ban, the most significant of which are conceived on the basis of regional development/economic-and-social-cohesion considerations. Thus, Art. 87(3)(a) EC empowers the Commission to approve state aid measures destined “to promote the economic development of *areas where the standard of living is abnormally low or where there is serious underemployment*”. In turn, Art. 87(3) (c) EC empowers the Commission to approve state aid measures destined to “facilitate the development of certain economic activities or *of certain economic areas*, where such aid does not adversely affect trading conditions to an extent contrary to the common interest”.

EU state aid regulation sets out a detailed methodology for the selection of the European regions entitled to benefit from the above-mentioned exceptions. In addition, it establishes a set of precise criteria for the approval and use of state aid in such regions, all of which are destined to bring under EC control the amount of regional aid spending in the Member States.¹³ For the purposes of this sub-section, it is relevant to note that the current methodology for selecting regions qualifying for the “assisted area” status under Art. 87(3)(a)

¹³ See European Commission (1998): *Guidelines on National Regional Aid*, OJ C 74, 10.03.1998, pages 9-31.

EC is identical with that for selecting the regions assisted by the EU itself under Objective 1 of the Structural Funds (i.e. European regions at NUTS II territorial administrative level where GDP per capita in PPS is below 75% of the EU average). In this case, the direct link with the objectives of EU regional policy is quite straightforward: EU state aid regulation will allow the use of public aid instruments on more generous terms in the “assisted regions” that are supported by the EU itself under Objective 1 of the Structural Funds (and where, indeed, Art. 87(3) (a) EC allows that the EU itself co-finances investment projects). By contrast, Art. 87(3) (c) EC is applied in such a way so as to allow the Member States some flexibility in the pursuit of their internal cohesion priorities. Thus, the state aids exceptions foreseen by Art. 87(3)(c) EC apply in “assisted regions” selected at NUTS III administrative level that sometimes, but not necessarily always, coincide with those assisted by the EU itself under Objective 2 of the Structural Funds. (As a general rule, such regions are selected among those facing industrial reconversion problems - where state aid is allowed to support the process of industrial restructuring/re-conversion and/or to cushion the social consequences of massive job losses.)

The Commission’s approach to regional state aid will be updated for the period 2007-2013, to take account of developments in the seven years since the last guidelines were adopted in 1998, in particular enlargement. The Commission will accordingly review the **Community guidelines on regional aid (or ‘RAG’)** and integrate the **Multisectoral Framework on regional aid for large investment** projects into the guidelines. A final version of the guidelines should be adopted in principle by the end of 2005, in order to leave ample time for Member States and the Commission to ensure a smooth transition by the end of 2006.

Having said this, it must also be noted that there is an inherent tension between the objectives pursued by regional policy-makers and those of EC state aid regulation. A certain degree of tension is inevitable, as long as the two sets of economic policies evaluate the role and effects of public aid instruments according to different economic criteria and objectives. For the regional policy-maker, the effectiveness of public aid instruments is measured in terms of its contribution to (macro-economic) regional convergence and its social cohesion effects. For the competition law enforcer, instead, public aid is justified in so far as remedying determinate market failures and as long as the benefits of aid do not exceed the inevitably negative effects of distorting competition. Nonetheless, in so far as Art. 87(3)(a) and (c) EC

allow a number of exceptions from the state aid discipline that are justified on cohesion grounds, EC state aid regulation can indeed contribute to achieving more consistency between EU and Member State regional interventions.

It is interesting to note that the concern to ensure more consistency between EU and Member State regional interventions, and as a matter of consequence, to ensure more consistency between the objectives pursued by EU regional and state aid policies, is of relatively recent date only. In its *First Cohesion Report* (1996),¹⁴ the Commission examined for the first time the consequences of the lack of geographical consistency between the regions assisted by the EU and those assisted by the Member States under the criteria established by EC state aid regulation. It turned out that during the programming period 1994-1999 6,6% of the EU population lived in areas assisted by the Structural Funds, but not by the Member States. In such cases the problem was that, according to EU state aid rules, the Structural Funds could co-finance in such regions only public aid for R&D projects and SMEs, but not for large investment projects (we remind that state aid to investment projects is allowed only in regions that enjoy the “assisted area” status under Art. 87(3) (a) or (c) EC).¹⁵ Moreover, it was found that the regional aid expenditures of the better-off Member States exceeded by far those of the cohesion countries - a situation that could not be counter-balanced even considering the preferential allocation of Structural Funds to the latter. The Report concluded that for the future EU state aid regulation should address such inconsistencies by, *inter alia*, reducing the overall state aid expenditures of the Member States, and making eligibility for EU assistance one of the criteria for allowing assistance under the Member States’ own regional policies.

As a result of this analysis, in Spring 1998 the Commission tightened the general rules applicable to regional aid, adopted special rules allowing a case-by-case screening of regional

¹⁴ Available at http://www.europa.eu.int/comm/regional_policy/sources/docoffic/official/reports/repco_en.htm.

¹⁵ Douglas Yuill, John Bachtler and Fiona Wishlade of the ECRP, University of Strathclyde, in *European Regional Incentives*, 14th edition (Bowker-Saur, London), report of disputes in the early 1990s between DG Competition (then DG IV) and DG Regio (then DG XVI) on area designation issues.

aid to large investment projects,¹⁶ and published a *Communication on the links between regional and competition policies*.¹⁷

In short, the interplay between EU state aid regulations and regional policy-making could be described as a sort of **“stick and carrot” strategy** deployed by the Community in the pursuit of its economic and social cohesion objectives. Thus, the Community uses on the one hand **the “carrot” of the Structural Funds** to induce the Member States to concentrate their resources on supporting the development of the most disadvantaged European regions, and on the other hand it uses **the “stick” of state aid regulation** in order to “calibrate” the Member States’ regional aid expenditure in agreement with Community cohesion priorities.

1.2 Regional policy in Romania: overview of the current situation

Before 1989 (and more exactly, starting with 1976), all economic planning activities in Romania were carried out on the basis of a so-called *“National State Plan”* (hereafter NSP), elaborated at central government level and according to the principles of a centrally planned economic development model. The main objective of the NSP was to bridge the development gap between the existent territorial administrative units (the so-called “judets”, which were territorial administrative units similar in size to the NUTS III regions inside the EU). Development gaps were identified on the basis of a sole criterion - in an initial stage, the level of industrial endowment. The consequences of carrying out this plan were a forced industrialization of all the “judets” and an apparent diminishing of development disparities, whereas in reality all economic efficiency and location advantage criteria were totally disregarded. The process of forced industrialization resulted in a contradictory picture: an over-diversified industrial base established in all “judets”, complemented by the emergence of many counties heavily dependent on a single (small or large) industrial company, usually operating in the heavy machinery, chemical or engineering sectors.

¹⁶ European Commission (1998): *Multisectoral framework on regional aid for large investment projects*, OJ C 107, 07.04.1998, pages 7-18, recently amended by the *Communications from the Commission: Multisectoral Framework on regional aid for large investment projects - rescue and restructuring aid and closure aid for the steel sector*, C(2002) 315 final.

¹⁷ *Communication from the Commission to the Member States on the links between regional and competition policy – Reinforcing concentration and mutual consistency*, OJ C 90, 26.03.1998, pages 3-8.

As a consequence, Romania ended up with a unique economic situation as compared to the other Central and Eastern European countries. The negative outcomes of the economic policy promoted by the communist party were felt as early as the 1970s, worsened over the 1980s, and were exacerbated after 1990. These consequences are felt to this day, when all the country's “judets” are facing economic and particularly industrial restructuring problems.

After 1989, the law 151/1998 on regional development was the first coherent attempt to deal with these problems after the fall of the communist regime. The law establishes fundamental objectives of regional policy-making, an institutional framework for achieving them, delimits the competencies of the different institutions involved in the planning and carrying out of development programs, and lists the specific instruments to be used for the purposes of regional development policy in Romania.

In order to achieve the main objectives of regional development policy, Law No.151/1998 authorized the creation of **eight development regions** - corresponding with NUTS II level, through the voluntary association of counties (judete). These regions are not administrative units, and do not have legal personality. Romania's territorial-administrative structure comprises 266 towns (of which 96 municipalities) and 2,686 communes. All these represent the basic administrative level and correspond to the NUTS V statistical level. They are organized in 41 counties (*judete*), which, alongside Bucharest, the capital of the country, correspond to the NUTS III statistical level.

As a consequence of the massive economic decline recorded in Romania after 1990, the national regional development policy could no longer be thought out exclusively in terms of diminishing regional discrepancies. Thus, to this objective was added a broader one, targeted towards supporting the restructuring of the regional economies.

The National Development Plan currently in force (for 2004-2006) aims at both reducing the existing regional disparities and preventing the emergence of new imbalances, particularly by stimulating a balanced development and accelerating the recovery of those areas lagging behind due to historical, geographic, economic and political circumstances. Therefore, the main objective of the *National Development Plan 2004-2006* is to create the conditions for the development of an innovative capacity at territorial level and enable regions to undertake new activities. These new activities should replace progressively the old ones, which no longer meet the requirements of the market and are not income yielding, given that, in the present context of economic globalization, initiative and entrepreneurship are the chief

premises of regional development. In this regard, the objective of the national regional development policy is to support regions, “judets”, various areas, and localities with the necessary means for enabling them to develop an economic, social and cultural structure of a quality that will make them more attractive.

1.3 State aid control in Romania: overview of the current situation

In the context of accession negotiations Romania concerning *Chapter 6* (Competition), Romania declared to accept in full the *acquis* on state aid (the Romanian negotiations were opened in 2000 and closed in 2004). Moreover, Romania has committed itself to apply the *acquis communautaire* on state aid even before accession, this time in the context of the Association agreement concluded with the EU (in force from February 1995). The so-called “*Europe Agreement*” concluded with the EU contains provisions on state aid closely following the model of the EC Treaty, provisions that engage the Romanian authorities to eliminate state aid measures distorting trade with the EU and its Member States and to render state aid expenditures transparent.

In particular, the Europe Agreement contains a general ban on state aid measures distorting trade between the associated parties similar to the one contained in Art. 87(1) EC Treaty. The criteria for evaluating the effects of state aid are those arising from the application of the same - including EU secondary legislation, Commission policy guidelines and decisions, and the jurisprudence of the EC courts in the area of state aid. The enforcement of the state aid provisions contained in the Agreement relies on cooperation between the state aid authorities of the associated parties. This two-pillar enforcement structure *de facto* obliges Romania to *incorporate the acquis communautaire on state aid* into its own legal system, as well as to *establish an institutional framework* for the screening and monitoring of state aid granted on Romanian territory in a similar manner as done on the EU side by the Commission.

From this perspective, it could be said that the obligations assumed by Romania (and the other candidate countries) in the area of state aid control are even stricter than those of the EU Member States themselves. The latter are not obliged to incorporate the *acquis* on state aid into their legal systems, but only to apply it. Furthermore, the state aid authorities of the Member States need not perform a fully-fledged *ex ante* control and *ex post* monitoring, since

the European Commission performs these functions. Indeed, the establishment of functional state aid control mechanism EU-style at national level poses numerous legislative, technical and institutional difficulties.

At the same time, Romania is allowed some flexibility with respect to the use of state aid instruments in the context of regional policy and the industrial restructuring process. Thus, for the first five years of implementation of the Agreement, Romania qualified with its whole territory for the generous exceptions from the EU state aid discipline that are reserved to the most disadvantaged European regions under Art. 87(3) (a) EC. This preferential treatment was recently prolonged for another five years.¹⁸ In addition to these facilities, Protocol 2 on ECSC products annexed to the Agreement allowed to Romania a five-year dispensation on restructuring aid to ECSC steel producers – dispensation that was made conditional upon the reduction of redundant production capacities. It is interesting to note that, apart from ECSC steel, Romania (and for that matter all other candidate countries) were not allowed any other special dispensations, e.g. with respect to state aid given in the context of privatization and industrial restructuring, as applied in the German new Länder during the period 1990-1995.¹⁹

The core legislative basis for the control and monitoring of state aid in Romania is Law No. 143/1999 amended by Law no. 603/2003, hereafter referred to as “*the State Aid Law*”.²⁰ Point I of the State Aid Law (Arts. 1-4) relays the main substantive law concepts developed in EU state aid regulation, e.g. the definition of *state aid* - including a distinction between new, existent and unlawful aid fully corresponding to the equivalent EU definitions. Art. 14 of the Romanian State Aid Law lists examples of state aid measures (categorized according to their objectives) that may be eligible for approval (including state aid measures aimed at regional development and industrial restructuring objectives), as well as examples of state aid measures that may be prohibited (i.e., state aid granted without the authorization of the Competition Council).

Under Romanian law, **state aid** is defined as any support, regardless of its form, from state funds, granted by public authorities or by other institutions that administer public funds. The

¹⁸ See Decision No. 2/2000 of the EU-Romania Association Council, OJ L 230/2000.

¹⁹ For a discussion of the special derogations that applied in the German new Länder over the mentioned period, see e.g. M. Schütte and J.-P. Hix (1995): “The application of EC state aid rules to privatisations: the East German example”, *Common Market Law Review*, Vol. 25, pp. 251-248, and S. Depypere (1998): “State aid policy enforcement in the new Länder of Germany – Status in 1997”, *EC Competition Policy Newsletter* No. 2, pp. 45-47.

²⁰ English text available at http://www.officialconcurrentei.ro/legal_english.htm.

Competition Council must expressly authorize any state aid, regardless of the beneficiary, with certain exceptions stipulated by law. State aid may be granted in the form of a transfer of public funds to a private company, or in the form of the state’s giving up of future income from a company thereby conferring on the company a benefit that it would otherwise not have received. The means by which the government can grant state aid include, but are not limited to, state subsidies, debt cancellation, the undertaking of a company’s losses by the state, exemptions, discounts or extensions on taxes, and preferential interest loans. State aid can be awarded in a number of areas such as research and development, small and medium businesses, environment protection, labor, regional development, promotion of exports, promotion of culture, conservation of national patrimony, and promotion of health and education.

According to the latest update on the “*State Aid Scoreboard*” *Report*, Romanian state aid comprised 2.82% of the GDP in 2002, greatly exceeding the 0.4% EU average and the 1.42% average of the new EU member states. Nevertheless, in the last three years, the percentage of state aid out of the GDP has continuously decreased in Romania, reflecting Romania’s desire to achieve EU standards in this domain as well as its own goal of eliminating the distortion that state aid can produce on competition and in the market.

The current European Commissioner on Competition, Nelli Kroes, in a speech delivered at the European Institute of Romania in Bucharest on May 12²¹, has stated that Romania must implement more extensive measures for controlling state aid before it can be admitted into the EU. To this effect, Commissioner Kroes has clarified what shall be understood as *existing aid*, defined as state aid awarded prior to the accession of Romania to the European Union. She has emphasized that not all pre-accession aid will be automatically considered “existing” and therefore irrevocable, but will have to not only be authorized by Romania’s Competition Council, but also submitted to the European Commission for further approval. Moreover, no state aid will be given “existing aid” status until Romania’s enforcement record improves to the EU’s satisfaction. If this enforcement record is not satisfactory, all aid will be considered “*new aid*” and will have to be reviewed by the European Commission upon accession. Whether European Commission should considered state aid inappropriate, it may be revoked and even recovered after accession.

²¹ See the complete text of the speech at: [http:// www.euractiv.ro](http://www.euractiv.ro)

SECTION 2

2.1. Regional aid schemes currently in place in Romania

The purpose of the first part of this section is to describe in more detail the content and current *status quo* of the four regional aid schemes currently in place in Romania.

“D-Zones”

Legal basis: Government Emergency Ordinance (GEO) No. 75/2000, approved by Law No. 621/2001 (modifying GEO No. 24/1998, which was approved by Law No. 20/1999).

Short description of the scheme: The scheme introduces a series of custom and taxation (fiscal) facilities for companies investing in the so-called “disadvantaged zones” (hereafter “D-zones”). D-zones are defined as strictly delimited geographical areas where:

- the unemployment rate is three times higher than the national average over the three months preceding the declaration of the “D-zone” status; and/or
- local infrastructure and communication endowments are weak.

Facilities made available:

- 1) waiver of the obligation to pay customs duties and VAT for machinery imported in relation to the execution of an investment project in the area (respectively, waiver of obligation to pay VAT for machinery of Romanian fabrication);
- 2) waiver from the obligation to pay custom duties on imported raw materials and components used for own production in the area;
- 3) waiver of tax applicable to changing destination of land, or its withdrawal from agricultural use;
- 4) exemption from tax on profit for the whole duration of the “D-zone”;
- 5) access to direct investment grants, funded from the Special National Development Fund (which was established according to the Emergency Ordinance No 59/1997, concerning the destination of the funds collected by the State Ownership Fund within the process of privatizing the commercial companies where the state is a shareholder) or from other central government sources, yearly allocated, in relation to the finance of special programs approved by the Government.

Beneficiaries of the scheme: In principle, the above-mentioned facilities should be available only to companies undertaking *new investment projects* on the territory of the D-zones (Art. 5 of GEO 75/2000). The scheme will benefit to newcomers as well as to companies already

functioning on the territory of D-zones that undertake an investment/modernization and/or create new jobs in the zone. (The D-zone regime does not apply to companies that already benefited from other facilities under schemes implemented before the adoption of GEO No. 24/1998).

Duration of the scheme: D-Zones are established for periods of 3 to 10 years.

Current status: At the moment, 38 D-Zones are operational on the Romanian territory with different periods of existence.

Industrial Parks

Legal basis: Government Ordinance (GO) No. 65/2001, replacing Law No. 134/2000 on industrial parks.

Short description of the scheme: The scheme provides for a series of fiscal facilities benefiting to companies specialized exclusively in providing infrastructure services for industrial operators, otherwise known as “industrial parks”.

Facilities made available:

- 1) waiver of the tax applicable to changes of land destination, or to exclusions of land from the agricultural circuit;
- 2) the deduction of 20% of the value of the investments made in utilities (electricity, gas, water, etc.) from the tax on profit;
- 3) postponed payment of VAT on equipment and materials used at the construction of the park utilities and infrastructure until the entry in function of the park.

Beneficiaries: Companies engaged in the construction and administration of the so-called “industrial parks”.

Duration: Variable – to be determined on an individual basis for each company administering an industrial park, through decision of the Ministry of Development and Prognosis.

Current status: The original scheme (Law No. 134/2000 on industrial parks) did not get to be put into practice, *inter alia* because the EU Commission questioned the conformity of some of the fiscal facilities therein offered with the *acquis communautaire* on state aid. The Ministry of Development and Prognosis (MDP) later amended the scheme through Government

Ordinance (GO) No. 65/2001. When consulted on the content of this amendment, the Competition Council suggested some further changes so as to render the scheme fully compatible with the *aquis* on state aid.

Free Zones

Legal basis: Law No. 84/1992 establishing the regime for “free zones” (an amendment of this law is currently drafted at the Romanian Ministry of Transport). See also Government Decision No. 682/1994, approving the methodology for the concession of land and constructions within the free zones, and individual Government Decisions establishing each of the free zones (Table 1 below).

Short description of the scheme: The scheme provides for a series of custom duty and taxation facilities for companies established and operating within the territory of the free zones (which, as a general rule, will be located along the Romanian borderlines, particularly in harbors along the Danube River and on the maritime coast of Romania).

Facilities made available:

- 1) concession of land and buildings on the basis of time-limited contracts, awarded on the basis of open auction, for a maximum length of 50 years;
- 2) exemption from custom duties and VAT on imported goods, including those transiting the Romanian territory;
- 3) exemption from tax on the circulation of goods, excise tax and tax on profit for companies established and operating within the free zones;
- 4) exemption from custom duties on raw materials, accessories and components of Romanian origin;
- 5) exemption from custom duties on goods of Romanian origin used for the construction and maintenance of facilities within the territory of the free zones.

Beneficiaries: Companies licensed by the administration of the free zones to carry out productive, commercial and servicing activities on their territory.

Duration of the scheme: The free zones *per se* are established for an indeterminate period of time. Companies established and operating on the territory of the free zones will benefit from the customs and taxation facilities made available under this scheme for an indeterminate

period of time, whereas contracts for the concession of land and buildings must be of maximum 50 years.

Current status: The Romanian Ministry of Transport (MT) established so far six free zones, as presented in Table 1 (below).

Table 1: Free Zones currently operational on the Romanian territory

Title	Legal Basis	Generalities
<i>Braila</i>	Government Decision No. 330/1994, completed by Government Decision No. 478/1999	Consists of three distinct platforms: - a light industry activity site; - an industrial (“export processing”) area; - a dock & warehouse area.
<i>Curtici-Arad</i>	Government Decision No. 449/1999	Consists of 2 sites: - a surface of 75 hectares in Curtici town; - a surface of 15 hectares in the Arad international airport.
<i>Constantza South</i>	Government Decision No. 410/1993	Extended in 1997 to comprise the neighboring area of Basarabi, on the basis of Government Decisions Nos. 191/1997 and 788/1997.
<i>Galati</i>	Government Decision No. 190/1994	According to an Agreement signed in June 1997 between Romania, Moldavia and Ukraine, this Free Zone should become part of a future extended Special Economic Zone, functioning in the area Galati-Giurgulesti-Reni.
<i>Giurgiu</i>	Government Decision No. 788/1996, modified and completed by Government Decision No. 336/1998	NB: several <i>shipbuilding companies</i> operate in the zone. According to the Ministry of Transport, after the liquidation in 1999 of SC “Santierul Naval” SA Giurgiu (judgment of the Giurgiu Court of 18 January 1999), the shipbuilding companies that are currently operational in the zone are: SC “Giurgiu NAV” SA, SC “ICMUG” SA, SNP “Petroil” SA – PECO, Santierul Naval Giurgiu, and “Granitul” SA.
<i>Sulina</i>	Government Decision No. 156/1993	-

Source: Compiled from various Government Decisions, as listed above.

Law No. 84/1992 on the Free Zones entered into force before the adoption of Law No. 143/1999 on State Aid. Consequently, the Competition Council examined the free zones scheme under the procedure applicable to “existing aid”. (Art. 3 of the State Aid Law qualifies aid measures that were adopted prior to the Romanian state aid legislation as “existing aid”. The distinction between “existing”, “unlawful” and “new” aid measures is important in both the EU state aid control system and the Romanian one which mirrors it, in so far as it leads to a different treatment of the support measure. Most importantly, the state aid authorities cannot order the recovery of aid already disbursed under an “existing aid” scheme, but only propose the modification or elimination of the scheme for the future.)

2.2. Compatibility of the Romanian regional aid schemes with the *acquis communautaire* on state aid

All three aid schemes described in the previous section (D-Zones, Industrial Parks and Free Zones) are designed to stimulate the economic development of certain Romanian areas/regions and rely on the use of taxation (fiscal) incentives to investment. While it is important to distinguish between *fiscal aid instruments* and *direct subsidies*, it must nevertheless be said that the *acquis communautaire* applicable to fiscal aid measures in regional development contexts is by and large identical to the one relevant for budgetary subsidies utilized for the same purposes²². This is why in what follows we focus on the *acquis* relevant to the three Romanian regional aid schemes relying mainly on use of fiscal incentives.

We find useful to make a few remarks on the context of the Commission’s change of policy on fiscal aid schemes after 1998. For the readers that are less familiar with this subject, it may indeed be difficult to understand why the Commission changed so radically its view with respect to, and took legal action against, fiscal aid schemes which for many years were considered to either not involve any state aid at all, or to involve state aid that nevertheless qualified for approval under Art. 87(3) (a) EC. The most notorious examples for this abrupt change of policy are the two Irish cases of 1998 - Irish Corporate Tax scheme, IFS and the Shannon customs-free airport zone, as commented above, as well as the Madeira and Trieste schemes. The explanation of this abrupt change of policy lies in the relationship between the adoption of the *Code of Conduct on Direct Business Taxation* (as commented at the beginning of this section) and the introduction of the *Fiscal Aid Guidelines*. We find it worthwhile to make a few remarks on the link between these two EC policy instruments, as this will help the reader to anticipate the position of the European Commission in other borderline (and therefore controversial) cases of fiscal aid schemes in the candidate countries, including Romania.

In our opinion, however, this description of the DG Competition’s mode of acting with respect to fiscal aid schemes is not totally fair. To be more precise, it is not entirely true that

²² For more about EU state aid legislation, see:
http://www.europa.eu.int/comm/competition/state_aid/others/vademecum/vademecum_en.htm.

DG Competition decides whether to open or not formal investigations with respect to certain fiscal aid measures in function of the progress achieved during the negotiations carried out between the Member States in the application of the *Code of Conduct*. In reality, the DG Competition will always seek to negotiate with the Member State a mutually acceptable solution on state aid schemes that need to be amended before opening formal proceedings against them. In many cases, such negotiations result in a settlement, therefore there is no need to reach formal negative decisions (as it happened in the case of the two Irish tax schemes, etc.). At the same time, it is true all fiscal aid schemes challenged by DG Competition following the publication of the *Fiscal Aid Notice* were previously identified as “harmful tax measures” by the Primarolo Group, which is in charge of the application of the *Code of Conduct*.²³

In the original impact study²⁴, the authors were addressed the main changes that should face the schemes currently in place in order to ensure the compatibility with the EU provisions, respectively:

- **D-Zones:** Although the geographical coverage of this scheme is much more reduced than that of the eight “development regions” established at NUTS II administrative level (in fact, the 33 D-Zones established so far cover territories corresponding to NUTS IV, even V, administrative level units), the concentration of the assistance on smaller geographical areas can nevertheless be considered acceptable under EU state aid regulation, as long as justified and feasible in terms of future regional development prospective. As to aid volume limitations, the D-Zone scheme should be amended so as to contain guarantees in the sense that the total amount of aid derived by each beneficiary (expressed in NGE) is in compliance with the aid intensity ceilings approved for the eight Romanian “regional development regions” (i.e. 50% of the total cost of the investment project, respectively 65 % in the case of SMEs). In addition, some guarantees must be introduced in the Romanian legislation (both on the side of the legislation relevant for the D-Zones, and on the side of state aid legislation) in the sense that the total amount of aid derived from such facilities by large investment projects is in compliance with the restrictions resulting from the

²³ The first Report of the Primarolo Group, identifying 66 “harmful tax measures” in the Member States, was made public by the Council at the beginning of the year 2000 - see Council Press Release No. 4901/99 of 29.02.2000. The full text of the Report is available to download from <http://www.uv.es/cde/TEXTOS/primarolo.htm>.

²⁴ See Gabriela Dragan (coordinator), Isabela Atanasiu (2003).

Multisectoral Framework. Moreover, the scheme should be modified so as to ensure that fiscal facilities amounting to operating aid (i.e. aid not directly linked to the carrying out of an investment project or job creation, but rather supporting the normal costs of operation of the firm) are limited in time, progressively reduced, and not available to companies in the sensitive sectors (non-ECSC steel, shipbuilding, synthetic fibers, motor vehicles – we remind that companies operating in the coal and mining sectors are eligible for operating aid only in so far as the support is destined to compensate costs of closure). Last but not least, the D-Zone scheme should be amended to make clearer the conditionality of investment aid upon the maintenance of activity in the D-Zone for a minimum period of 5 years.

- **Industrial Parks:** This scheme does not appear to raise any particular problems from the standpoint of its compatibility with EU state aid regulation. In our opinion, the scheme does however involve state aid – contrary to the position adopted so far by the Competition Council - in so far as being selective and of sectoral application (i.e. it benefits exclusively to companies operating in the “industrial park services sector”).
- Consequently, the application of the scheme should be monitored as such by the Romanian state aid authorities. Moreover, we draw attention on an aspect related to the future functioning of the scheme: problems of incompatibility with EU competition rules may arise in so far as the future companies operating in the industrial park sector would service on preferential terms individual companies to the disadvantage for their competitors, and particularly if such “preferred” beneficiaries belong to one of the ‘sensitive sectors’.
- **Free Zones:** This scheme features one point of incompatibility with EU state aid regulation, in so far as one of the fiscal facilities offered under it, i.e. the exemption from tax on profit from the duration of operation of the zone, amounts to operating aid. This is so as long as the facility is not linked to the carrying out of a specific investment project, but instead supports the day-by-day activity costs of firms licensed to operate in the Free Zones. This particular facility could be either totally excluded, or modified in such a way as to be linked to the carrying out of an investment project or even job creation, or maintained as such, but adjusted to the conditions for the approval of operating aid (i.e.

temporary character, progressive reduction over time, not available to companies in the sensitive sectors).

Some of those noticed aspects were addressed by changing the Romanian fiscal legislation (under the *Romanian Fiscal Code*) and, the other, during the negotiation process.

2.3 The obligations assumed by Romania in the area of state aid control during the negotiation process

As State aid control plays a key role in creating a well-functioning economy, effective application and enforcement of such a policy was therefore a crucial component of the enlargement process. In practice, before joining the Union, each of the new Member States had to establish a State aid monitoring authority which screened awards of State resources to determine whether or not they constituted State aid as defined under Article 87 of the Treaty and whether they were compatible with the common market. Where identified State aid measures were deemed to be incompatible with the EU acquis, countries had to either adapt them to Community standards, or abolish them or gradually phase them out²⁵.

In December 2004, the competition chapters of the accession negotiations with Romania and Bulgaria were closed. Prior to closure, three elements had to be put in place: the necessary legislative framework, an adequate administrative capacity and a credible enforcement record.

During the negotiations, the Commission emphasized in particular the need for the Bulgaria and Romania to strengthen their State aid enforcement record, with special attention given in the case of Romania to the restructuring of its steel sector. A series of *safeguard clauses* are foreseen in the *Accession Treaty*, in the event the acceding countries fail to implement commitments undertaken in the context of the accession negotiations, as well as a provision for the possible postponement of the date of accession by one year in the event of either state being manifestly unprepared to meet the requirements of the membership. In the Romania's case, the Treaty specifies that the Council may, on the basis of a Commission recommendation and after a detailed assessment in the autumn of 2005, decide on such a postponement, if it finds shortcomings in Romania's fulfillment of specific conditions in the competition area. There will be no list with existing aid measures attached to the Accession

²⁵ Commission (2004)750 final, p.4

Treaty of Romania and no application of the interim procedure, until the Commission concludes that Romania's state aid enforcement record has reached a satisfactory level. Bulgaria is generally meeting the commitments and requirements arising from the accession negotiations for the Competition chapter and has not requested any transitional arrangements in the state aid area. The Accession Treaty with both Romania and Bulgaria was signed on 25 April 2005.

Concerning the Romanian regional investments, Accession Treaty provides the following transitional arrangements:

- Phase-out of incompatible fiscal aid by December 2010 under the GEO on Deprived Areas for the undertakings which were given the permanent investor certificate before 1 July 2003, respectively: *three D-zones* by 31 December 2008 (Brad, Valea Jiului, Balan), *22 D-zones* by 31 December 2009 (Comanesti, Bucovina, Altan Tepe, Filipesti, Ceptura, Albeni, Schela, Motru Rovinari, Rosia Montana, Bocsă, Moldova Nouă – Anina, Baraolt, Apuseni, Stei-Nucet, Borod Suncuius-Dobresti-Vadu crisului, Popesti-Derna-Alesd, Ip, Hida-Surduc-Jibou-Balan, Sarvasag-Chiejd-Bobota, Baia Mare, Borsa Viseu, Rodna) and *three D-zones* by 31 December 2010 (Cugir, Zimnicea, Copsa Mica). The aid net intensity must not exceed 50% Net Grant Equivalent (up to 65% for SMEs provided that the total aid intensity does not exceed 75%).
- Phase-out of incompatible fiscal aid by December 2011 under the Law on Free Trade Areas for undertakings which signed commercial contracts before 1 July 2002. The aid net intensity must not exceed the rate of 50% Net Grant Equivalent (up to 65% for SMEs provided that the total aid intensity does not exceed 75%).

Conclusion

Romania's political commitments to the EU in order to ensure timely accession must be met not only by the superficial adoption of legislation that conforms with the *acquis communautaire*, but by the actual implementation and enforcement of these laws. Failure to do so could lead not only to a postponement in joining the EU, but could also act as a

deterrent to potential investors looking for a stable and safe market. This coming November, the European Commission will issue a report on Romania’s progress in, among other areas, competition. Based on the findings of this report, the Commission will either recommend accession in 2007 or a one-year delay. We should notice that Romania is already showing some signs of improving its enforcement record and heeding the advice of EU authorities²⁶. In this period of time, for Romania it is not only important to implement more extensive measures for controlling state aid but also to eliminate all state aid measures which can distort competition and ensure compatibility with EU acquis.

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²⁶ This year, on May 26, the Competition Council issued a 28.5 million-euro fine, its most drastic measure to date, to the country’s three cement producers for price fixing.

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