

TC
MARMARA ÜNİVERSİTESİ
AVRUPA TOPLULUĐU ENSTİTÜSÜ
AVRUPA BİRLİĐİ HUKUKU ANA BİLİM DALI

**HARMONISATION OF TURKISH STATE AID SYSTEM WITH THE
EUROPEAN UNION RULES TOWARDS EU MEMBERSHIP**

YÜKSEK LİSANS TEZİ

AYŞEGÜL BAYBARS

271100120020003

TEZ DANIŞMANI : Doç Dr. HAKAN ÜZELTÜRK

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PREFACE

The European Union or EU is a supranational organization of European countries, which currently has 25 member states. It is a group of European countries that have chosen to integrate many of their economic activities, including forming a customs union and harmonizing many of their rules and regulations.

Turkey and European Union relationship which starts with the Ankara Agreement in 1963, has come to new dimension with the Helsinki European Council in 1999, where Turkey was officially recognized as a candidate country to join the Union. At the European Commission's progress report on Turkey dated 6th October, 2004, it provides a full account of the sweeping reforms realized since the Helsinki European Council. 2004 proved to be an extremely important year for Turkey-EU relations in view of the decision taken by the Brussels European Council on 17 December 2004 to further Turkey's membership process with the initiation of accession negotiations in 2005. In order to initiate full membership negotiations, Turkey has to harmonize its legislation with the EU acquis. One of these legislations is state aids and incentives.

In this respect, in my thesis, I try to evaluate state aid rules both in the EU and Turkey. As it is known that in order to be a member of the EU, Turkey has to do much for integration and harmonization with the EU acquis. In this regard, my thesis aims to put forward state aid implementations and rules applied in the EU and then tries to explain the current state aid legislation applied in Turkey and to come to the conclusion that it is needed to make legislation in order to control state aids and to ensure its consistency with the EU acquis.

In my view, writing about that subject is very important in these days. Because, every day, too many developments and new policies regarding the state aid policy are adopted in the EU. On the other hand, Turkey's commitments which it engages by the establishment of Customs Union with respect to the competition and state aid policy still remain. Moreover, we are few weeks away from the initiation of accession negotiations. Therefore, to highlight the recent developments on EC State Aid Policy and to show the approach of EU regarding the state aid implementations and also focus

on harmonisation of Turkish state aid system with the EU rules is very important and useful.

ABSTRACT

This study basically emphasizes the urgent need of approving state aid legislation in Turkey which must be compatible with the EU acquis and need of establishment of an independent state aid monitoring and controlling authority. It also focuses on the state aid implementation both in Turkey and EU and comparison between them.

My thesis can be separated into six chapters. Before starting to define state aid and determine types of it and mention its consistency with the competition policy, in the first chapter a short introduction has been done. Second chapter is focused on general view of state aids and its relation with the competition. In the third chapter, EU's approach to the state aid policy is explained while considering all types of state aids. In addition, procedural legislation, control of state aids and some other relevant issues are pointed out. In the fourth chapter, Turkey's incentive policy, current state aid system, Turkey's obligations under the Association Council Decision and National Program, and its compatibility with the well-functioning of Customs Union is examined. Finally, by the fifth chapter, recent developments in EU's state aid policy and its comparison with the Turkish incentive system is explained and it is tried to put forward the necessary amendments and modifications will be made in the Turkish legislation towards the membership to the EU.

As a result, my thesis aims to gain better understanding of EU's state aid policy and its approach of controlling and monitoring state aids. It is also tried to be understood Turkish state aid policy during the harmonization process. Consequently, after making some explanations in the aforementioned issues, this study shows that Turkey, with a few absent issues, is on the right track in order to adopt its legislation with the EU rules and establish an independent authority for controlling.

ÖZET

Bu çalışma, Türkiye’de Avrupa Birliği müktesebatı ile uyumlu olacak devlet yardımları mevzuatının kabul edilmesi gerekliliğini ele almakta ve acil olarak devlet yardımları izleme ve denetleme kurumuna duyulan ihtiyacı ortaya koymaktadır. Ayrıca, bu çalışma, Türkiye ve Avrupa Birliği’ndeki devlet yardımları uygulamalarını izah etmeye çalışmakta ve bunlar arasındaki farklar üzerinde durmaktadır.

Tez, başlıca altı bölüme ayrılmaktadır. Devlet yardımı tanımını, bunların çeşitlerini ve rekabet politikası ile uyumlarını anlatmaya başlamadan önce ilk bölümde teze kısa bir giriş yapılmaktadır. İkinci bölümde, devlet yardımlarına genel bir bakış açısı ile yaklaşılmakta ve devlet yardımları rekabet politikası ile uyumlaştırılmaktadır. Üçüncü bölümde, Avrupa Birliği’ndeki devlet yardımlarının çeşitleri incelenip değerlendirilirken, Avrupa Birliği’nin devlet yardımları politikası izah edilmektedir. Buna ek olarak, devlet yardımlarının bildirimine ilişkin mevzuat, devlet yardımlarının denetlenmesi ve ilgili diğer konular üzerinde durulmaktadır. Dördüncü bölümde ise, Türkiye’nin teşvik mevzuatı, mevcut devlet yardımları sistemi ele alınmakta ve ayrıca Ortaklık Konseyi Kararı ve Ulusal Program çerçevesinde Türkiye’nin taahhüt ettiği yükümlülükleri ve Türkiye’deki uygulamaların Gümrük Birliği’nin işleyişi ile bağdaşımı anlatılmaktadır. En son olarak, beşinci bölümde, devlet yardımları politikasına ilişkin Avrupa Birliği’nde yaşanan son gelişmeler ve bunların Türk teşvik sistemi ile kıyaslaması yapılmakta ve Avrupa Birliği’ne üyelik yolunda Türkiye’nin yapması gereken değişiklikler ve yenilikler ele alınmaktadır.

Sonuç olarak, tezimin yazılmasındaki amaç, Avrupa Birliği’nin devlet yardımları politikasının ve devlet yardımlarının denetlenip izlenmesine ilişkin sistemin daha iyi anlaşılmasını sağlamak ve bununla birlikte de Türkiye’nin Avrupa Birliği müktesebatına uyum sürecinde Türkiye’deki devlet yardımları politikasını izah etmektir. Sonuçta, yukarıda belirtilen hususlarla ilgili olarak gerekli bazı açıklamalar yapıldıktan sonra, Türkiye’nin Avrupa Birliği kurallarını benimsemesi ve devlet

yardımlarına ilişkin bağımsız bir otorite kurması yolundaki çalışmalarının, bazı eksikler olsa da, doğru bir şekilde ilerlediği gösterilmeye çalışılmaktadır.

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ABBREVIATIONS

CFI	: Court of First Instance
CU	: Customs Union
EC	: European Community
ECJ	: European Court of Justice
ECSC	: European Coal and Steel Community
EEC	: European Economic Community
EU	: European Union
FIFG	: Financial Instrument for Fisheries Guidance
GATT	: General Agreement on Trade and Tariffs
GDP	: Gross Domestic Product
GDFI	: General Directorate of Foreign Investment
IGEME	: Center of Export Developing
LASA	: Lesser Amounts of State Aids
LET	: Limited Effect on Trade
NAFTA	: North American Free Trade Area
NGE	: Net Grant Equivalent
NPAA	: National Program for the Adoption of the Acquis
NUTS	: Nomenclature of Territorial Units for Statistics
OECD	: Organization of Economic Cooperation and Development
OJ	: Official Journal
R&D	: Research and Development
SAAP	: State Aid Action Plan
SGEI	: Services of General Economic Interest
SME	: Small and Medium Sized Enterprise
TSE	: Turkish Standards Institution
TUBITAK	: The Scientific and Technological Research Council of Turkey
VAT	: Value Added Tax
WTO	: World Trade Organization

I. INTRODUCTION

European Union rules on competition flow from Article 3(g)¹ of the EC Treaty, which provides that the activities of the Community must include "a system ensuring that competition in the internal market is not distorted". The main areas to which this applies are restrictive agreements between undertakings and the control of state aid. The Community acquis in the competition field thus consists of a set of rules and procedures aimed, on the one hand, at combating anti-competitive behavior by firms and, on the other, at preventing the public authorities from granting state aid that is liable to distort competition. The maintenance of a strong and effective control to ensure that aid granted by Member States does not distort competition is an essential part of the competition policy of the EU.

Therefore, from the competition point of view, it will already become apparent that there are number of factors which make it difficult for the competition policy of the European Union to be consistently applied in all its markets in an identical and universal manner. In the real world, the enforcement of such a policy is subjected to many imperfections and outside influences which can impose themselves upon the competitive process and may indeed considerably reduce its effectiveness.

One of these imperfections with which the Commission has had to contend is the growing need for individual Member States to provide financial assistance in a variety of ways to individual undertakings, in a way which often gives such undertakings a significant advantage over their rivals in national as well as sometimes in other markets. The framers of the EC Treaty were, of course, aware of this tendency in Member States to respond such domestic pressures by the giving of aid and whilst permitting it for particular purposes, sought to anticipate this temptation and control it within reasonable limits. What the framers of the Treaty, however probably could not have anticipated was that the economic difficulties arising particularly in the early 1970s, mainly as a

¹ Article 3/g of the EC Treaty: "For the purposes set out in Article 2, the activities of the Community shall include, as provided in this Treaty and in accordance with the timetable set out therein: a system ensuring that competition in the internal market is not distorted."

result of the oil crisis, would greatly increase both the number and variety of schemes by Member States for intervention in the affairs of specific industries; this intervention would have the specifically political aim of lessening the pain of this hard economic climate upon such undertakings. During the first fifteen years after the EC Treaty, the administration of those Articles dealing with the topic, namely article 87-89 inclusive, raised relatively few problems. Since then, however, the increasing importance of the subject is illustrated by the increasing proportion of the Annual Reports on Competition Policy now given over to this topic. Clearly in this area, the task of the Commission has become both more difficult and more central within the range of competition policies which has to administer².

In assessing the extent to which State aids by Member States can be controlled by the Commission, it is essential to understand the structure of these three articles. Article 87 sets out the basic principle that State aids are incompatible with the Common Market, a principle which logically flows from both the letter and spirit of earlier Articles in the Treaty.

According to the Commission's competition policy notes (Commission's tenth Report on Competition Policy, 1981), state aid is incompatible with the Common market because of its distortive effect on competition. State aid is therefore a "bad thing". But if this statement told the whole story, the function of state aid policy would merely be to seek out existing aids, prohibit them and prevent of grant of any new aid. That alone would not be a simple task. But the policy is even more complicated, as state aid may also be a very good thing on occasion. It may help to achieve the EC Treaty's market integration goals and help to reduce economic and regional disparities within the Union, or it may serve to complement other EU policies³.

As state aid control plays a key role in creating a well-functioning economy, effective application and enforcement of such a policy was also a crucial component of the enlargement process of the European Union. In practice, before joining the Union, each of the new Member States has to establish a State aid monitoring authority which

² D.G. Goyder, *EC Competition Law*, Oxford European Common Law Series, 1988, p.372.

³ Michelle Cini and Lee McGowan, *Competition Policy in the EU*, The EU Series, 1998, p.137.

screened awards of the State resources to determine whether or not they constituted state aid as defined in 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 has to either adapt them to Community standards or abolish them or gradually phase them out. Therefore, the Commission must be satisfied with the progress achieved in each Member State and then the accession negotiations will be concluded.

Lately, as it is going to be explained in the following chapters, in April 2004, the Commission adopted a Communication entitled “*A pro-active Competition Policy for a Competitive Europe*”. In the field of state aid, the reforms already undertaken and that on-going aim at refocusing State aid policy towards a more economic-based approach with the purpose of eliminating harmful state aid, while leaving Member States with more flexibility to adopt horizontal measures to support, in particular, the Lisbon objectives will be mentioned in the following chapters. More specifically, in 2005-2006, a large number of the Commission’s existing regulations, frameworks and guidelines come up for renewal including all the state aid exemption regulations, the regional aid guidelines, the framework for research and development aid and the risk capital communication. The environmental aid guidelines expire at the end of 2007. These factors, together with the beginning of a new programming period for the Community’s structural funds in 2007, provide an unprecedented window of opportunity for a comprehensive review of the horizontal state aid rules to take account of the horizontal, particularly Lisbon, objectives and the new cohesion policy set out in the forthcoming Structural Funds regulations, as well as to consolidate, and wherever possible simplify the rules.

Compared to EU Member States, the government of Turkey has more flexibility and freedom to grant aid to the enterprises. The relation between Turkey and EU started with the Ankara Agreement come to a new stage by entering Customs Union in January 1, 1996 and by being a candidate country of Turkey in the Helsinki Summit in December 10-11, 1999. Under the Agreement, in order to start accession negotiations, Turkey

committed itself to approximating its legislation to that of the EU, including the main substantive competition rules; in particular, state aid rules are one of them.

All of the regulations, frameworks, guidelines (including secondary legislation) and current application rules of EU are actually binding for the Turkey. The legislation covers regulations, frameworks and rules regarding notification procedure, state aids which are compatible with the common market, regional aid threshold, sensitive sectors subject to the private rules, de minimis aids, maximum aid amount, and horizontal aid etc. In this regard, Turkey tries to realize its obligations and harmonize its legislation with the EU's state aid rules and tries to ensure the effective and well-functioning economy in the market which does not effect trade and distort competition.

In this regard, to understand the state aid policy of the EU, firstly we have to answer the questions “what is state aid? Why do we need to monitor and control of the state aid from the competition point of view?” State aid is basically a financial assistance provided by the state or through state resources. Actually, there are too many definitions describe the state aid. They will be examined in the following chapters. In this case, the question “what kinds of state interventions are deemed as state aid? needs to be answered. How the world and the EU define the state aid and what is the scope of it? These questions are essential part of understanding the system. In the second and third chapters the above-mentioned questions will be answered and types of state aids will be highlighted. Furthermore, the importance to monitor and control of the state aid policy and its legal basis will be figured out in these chapters. Third chapter also provides an introduction to the Commission's state aid regime, placing it firmly in a common market context. The third chapter provides a brief assessment of state aid control, focusing in particular on the political and controversial aspects of the policy. The fourth chapter will outline the improvements in Turkey regarding the state aid rules and the last chapter will describes the comparison of the state aid rules between the Turkey and the EU and point out the need of harmonization of the state aid rules of Turkey with the EU rules.

Briefly, my thesis aims to gain better understanding of forces shaping Turkish state aid policy, in order to be able to anticipate the problems it may encounter, once subject to the EU state aid rules as a candidate country to the EU. My thesis does not only focus on the said subject but also tries to analyze the treatment of EU that gives to the state aid policy and its comparison with the Turkish system.

II. DEFINITION AND TYPES OF STATE AIDS AND ITS CONSISTENCY WITH THE COMPETITION POLICY

General View on State Aids

2.1.1. What is State Aid?

State aid is any financial assistance provided by the State or municipal institutions directly or indirectly, the purpose or result of which is to increase the competitiveness of an enterprise, a group of enterprises or a sector of the economy.

The concept of aid is wide, going beyond mere subsidy, and comprises any form of intervention or assistance which has the same or similar effects to as subsidy⁴. In *Steenkolenmijnen*⁵, a case under the ECSC Treaty⁶, the Court of Justice held:

“A subsidy is normally defined as a payment in cash or in kind made in support of an undertaking other than the payment by the purchaser or consumer for the goods or services which it produces. An aid is a very similar concept, which however, places emphasis on its purpose and seems especially devised for a particular objective which can not normally be achieved without outside help. The concept of an aid is wider than that of a subsidy because it embraces not only positive benefits, such as subsidies themselves, but also interventions which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without, therefore, being subsidies in strict meaning of the word, are similar in character and have the same effect.”

The Court of Justice went on to hold “.... The expression “aid” necessarily implies advantages granted directly or indirectly through State resources or constituting an additional charge for the State or for bodies designated or established by the State for that purpose...” Although those statements were made in the context of the ECSC

⁴ P. M. Roth QC, *European Community Law of Competition*, Bellamy & Child, Fifth Edition, 2001, London, p. 1216.

⁵ Case 30/59 *Steenkolenmijnen v. High Authority* (1961), See also *Italy v. Commission*, Case 61/79 *Amministrazione delle Finanze v. Denkvit Italiana* (1980), Case C-200/97 *Ecotrade v. AFS* (1998), Case C- 256/97 DMT (1999).

⁶ See art 4(c) and 67 of the ECSC Treaty.

Treaty, the judgment in fact emphasizes the conceptual similarity between aids under that Treaty and aids under the EC Treaty.

According to the Dr. Lasok⁷, “while it is convenient to analyze State aid as comprising either the transfer of resources to the favored undertaking or relieving the favored undertaking from the obligation to dispose of its own resources (to a greater or lesser extent), the classification arising from that analysis should not be regarded in too rigid a light. For example, where the advantages consists of the State (or a State body) making available an asset or providing services free of charge or at an undervalue, the aid can be characterized either as the conferral of a positive benefit or as a mitigation of the charges that the favored undertaking would otherwise have to bear, depending upon one’s point of view. On another view, such a situation can quite properly be regarded as an example of an aid that is both positive benefit and a mitigation of charges.”

Dr. Lasok has discussed whether the imposition of a disadvantage constitutes a State aid. After giving some examples regarding the situation, he came to the conclusion that the advantage (positive benefit or the mitigation of a charge) is the aid, and the disadvantage is the competitive consequence that engages the operation of the State aid rules in the Treaty. Therefore, as to him, it is in fact incorrect to analyze the disadvantage suffered by a competitor or by competing goods as “the aid”: the disadvantage is the consequence of the aid, not the aid itself. So, we can easily say that, in order to determine whether a State measure constitutes aid, it is necessary to establish whether the recipient undertaking receives an economic advantage which it would not have obtained under market conditions.

The basic substantive rules on the control of State aid in the European Union are set out in the Article 87-89⁸ of the European Community Treaty (EC Treaty or Treaty). Article 87 contains substantive rules on the lawfulness of state aids. Article 87/1 provides a basic prohibition that State aids are in principle incompatible with the

⁷ K. Paul E. Lasok, *State Aids and the Consequences of their Illegality under EC Law*, *Marmara Journal of European Studies*, Volume 8, No: 1-2, 2000.

⁸ By the Amsterdam Treaty which is entered into force on May 1, 1999, articles with respect to state aids have been changed from Article 92, 93 and 94 to Article 87, 88 and 89.

common market. According to the 87/1, state aid, in whatever form, which could distort competition by favoring certain undertakings or the production of certain goods, is compatible with the common market, unless otherwise mentioned in the EC Treaty. Such aids are declared to be incompatible with the common market to the extent to which they effect trade between Member States. Article 87/2 then supplies a list of types of aid that are compatible with the common market, whereas Article 87/3 contains a list of those that may be considered to be compatible with the common market. Article 88 establishes procedures whereby the Commission may supervise both existing and new aid. Article 88/1 charges the Commission to act in cooperation with the Member States and to “keep under constant review all system of aid existing in those States”. Under 88/3 plans to grant or alter aid shall be notified in advance to the Commission, a procedure that serves to intensify cooperation between Commission and Member States.

According to Laurence W. Gormley⁹, the aim of these provisions is clear, and the Court of Justice has confirmed that they form an essential complement of the free movement provisions¹⁰. Thus the free movement of goods and services made possible by those provisions and the optimum division of labor would be seriously undermined if Member States were to confer on their trade and industry an artificial advantage over their competitors in other Member States through means of state aids.

When we come to the question that “what is a State aid?” it has been seen from the Treaty that a State aid must possess the following features.

- It must be “granted by a Member State or through State resources”;
- It must “distort or threaten to distort competition”;
- It must favor certain undertakings or the production of certain goods”; and
- It must effect trade between Member States.

⁹ Laurence W. Gormley, *Introduction to the Law of the European Communities, From Maastricht to Amsterdam*, Kluwer Law International, Third Edition, 1998, p.811.

¹⁰ Case 18/84 *Commission v. France* (1985), Case 103/84 *Commission v. Italy* (1986), Case C- 21/88 *Du Pont de Nemours Italiana SpA v. Unita sanitaria locale No 2 di Carrara* (1990).

Although the wording of Article 87/1 permits those features to be separated from one another, there is in practice a close relationship between them. For example, the implication from the use of the word “aid” is that a State aid is something that is advantageous to the recipient. The same emerges from the third feature of a State aid that it “distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods”. As a result, it is difficult to conduct a discussion of what is a State aid by disaggregating the different parts of Article 87/1 and examining them individually and in isolation from the other parts.¹¹

Given the major threat which State aids pose to the unity of the common market, it is not surprising that the Court has interpreted the concept of an aid widely. In one of the earlier decisions¹² of the ECJ, the Court found that the concept of an aid “refers to the decisions of Member States by which the latter, in pursuit of their own economic and social objectives, give, by unilateral and autonomous decisions, undertakings or other persons resources or procure for them advantages intended to encourage the attainment of the economic or social objectives sought.” According to Laurence W. Gormley¹³, this definition makes it clear that the essential element of the concept of State aid in Article 87/1 of the Treaty is the creation of an artificial advantage of whatever nature costs the state money. Such advantages may lower the costs of investment, production and distribution and thereby distort existing or potential competition.

Examples of State aids include¹⁴ investment grants,¹⁵ subsidies to cover operating losses,¹⁶ loans at reduced rates of interest,¹⁷ loan guarantees,¹⁸ preferential fiscal treatment,¹⁹ selective reduction of public charges such as employers’ social

¹¹ K. Paul E. Lasok, *State Aids and the Consequences of their Illegality under EC Law*, *Marmara Journal of European Studies*, Volume 8, No: 1-2, 2000.

¹² Case 61/79 *Amministrazione delle Finanze dello Stato v. Denkavit Italiana Srl.* (1980)

¹³ Professor of European Law.

¹⁴ For more illustrations, see the State aids section of the annual Reports on Competition Policy.

¹⁵ Cases 62 & 72/87 *Executif Regional Wallon v. Commission* (1988).

¹⁶ Case 94/87 *Alcan* (1989), Case – 305/89 *Italy v. Commission (Alfa Romeo)* (1991), e.g. aids to coal industry under Dec. 3632/93/ECSC.

¹⁷ Case 323/82 *Intermills v. Commission* (1984), Case 84/82 *Germany v. Commission (Textiles)*

¹⁸ See Commission notice on the application of Article 87 and 88 of the EC Treaty to State aid in the form of guarantees.

¹⁹ Case C-387/92 *Banco Exterior de Espana* (1994), *Germany v. Commission (new Lander)*.

security payments, preferential energy tariffs that are not commercially justified,²⁰ the provision of logistical and commercial assistance by a public undertaking to its subsidiaries on terms that differ from those that an undertaking acting under normal market conditions would offer,²¹ cross-subsidy by a public undertaking,²² debt write-offs,²³ payment of bonuses needed to attract workers to a particular industry,²⁴ discretionary State financing of an employer's social plan,²⁵ and funding of television channels by license fees.²⁶ As has been seen, provision of capital can also be a State aid.²⁷ Aids for exports to other Member States are classic examples of aids caught by Article 87.²⁸ Aid to export outside the EU and aid for direct investment abroad can also fall within Article 87 where they have an effect on competition within the Union. Other examples of State aids include the use of a levy for collective research and the renewal of industrial and commercial structures²⁹ and for the advertising and promotion of the products of a particular industry.³⁰

When we look at the Commission's latest report on State aid scoreboard³¹, Commission considers state aid as "State aid is a form of state intervention used to promote a certain economic activity. It implies that certain economic sectors or activities are treated more favorably than others and thus distorts competition because it discriminates between companies that receive assistance and others that do not. In order to determine whether a measure constitutes State aid, a distinction has thus to be drawn between the situation where the support is directed at certain undertakings or the

²⁰ Cases 67/85, etc... Van der Koy, Case C- 169/84 CdF Chimie AZF v. Commission (1990).

²¹ Case C- 39/94 SFEI (1996),

²² Case T- 106/95 FFSA v. Commission (1997).

²³ Case C – 294/90 British Aerospace and Rover v. Commission (1992)

²⁴ Case 30/59 Steenkolenmijnen v. High Authority (1961): German Government's payment of a miners' shift bonus held to be a subsidy because such bonus was necessary in order to attract men into the industry.

²⁵ Case C- 241/94 France v. Commission (1996), See also the Commission's guidelines on aid to employment, OJ 1995 C 334/4 and the Communication on the monitoring of state aid and reduction of labor costs, OJ 1997 C1/10.

²⁶ Kinderkanal and Phoenix, and BBC News 24 (TV License fees). XXXIXth Report on Competition Policy (1999).

²⁷ Case C-305/89 Alfa Romeo (1991).

²⁸ Cases 6 & 11/69 Commission v. France (1969), Case 57/86 Greece v. Commission (1988).

²⁹ Case 47/69 France v. Commission (1970), however aids granted to bodies engaged in research on a non-profit-making basis are not caught by Article 87/1.

³⁰ Case 78/76 Steinike and Weinlig v. Germany (1977), Case 222/82 Apple and Pear Development Council v. Lewis (1983).

³¹ Commission of the European Communities, Report on State Aid Scoreboard, 20.04.2005.

production of certain goods, as specified in Article 87/1 of the EC Treaty, and the situation where the measures in question are equally applicable throughout the Member State and are intended to favor the whole of the economy. In the latter case, there is no State aid within the meaning of Article 87/1.”

2.1.2 Key Criteria

For a measure to be classified as state aid in the sense of Article 87/1, the following four characteristics have to be fulfilled simultaneously:

a. It (the advantage) is granted by the State or through State resources: State aid rules relate only to measures involving a transfer of State resources, which implies higher budget spending or lower revenues. State resources include public funds administered by Member State through central, regional, local authorities or other public and private bodies designated or controlled by the State. It includes indirect benefits such as tax exemptions that affect the public budget.

In the past it has not been entirely clear from the case-law whether those criteria are alternatives, as a literal reading would imply, or cumulative. In *Openbaar Ministerie v. Van Tiggele Adv. Gen. Carpotorti* stated that “aid granted by a Member State or through State resources” means “an advantage entailing a burden on the public finances in the form either of expenditure or of reduced revenue.”³² The other case law has emphasized the need for State resources to be involved. In *Sloman Neptun*³³, the Court of Justice stated:

“The wording of this provision itself (Article 87) and the procedural rules laid down in Article 88 of the EC Treaty show that advantages granted from resources other than those of the State do not fall within the scope of the provisions in question. The

³² Case 82/77 Van Tiggele (1978). The fixing of minimum prices was not an aid since it did not impose a burden on the State’s resources.

³³ Cases C-72 & 73/91 *Sloman Neptun v. Bodo Ziesemer*, (1993)

distinction between aid granted by State and aid granted by State resources serves to bring within the definition of aid not only aid granted directly by the State, but also granted by public or private bodies designated or established by the State.”

The distinction between aid granted by the State and aid granted through State resources does not therefore signify that all advantages granted by a State, whether financed through State resources or not, constitute aid.³⁴ In *Commission v. France*³⁵ (*Caisse Nationale de credit agricole*) the Court of Justice stated that aid does not need to be read in the context of the case which involved disbursement of private funds by a public body under State control³⁶. The Court of Justice has also held that a tax exemption is an aid even though it involves no transfer of State resources³⁷. Thus it would appear that measures which involve payments from State funds, payments from funds (whether public or private) managed by the State, preferential exemptions from tax or levy payments, and any other burdens on the public finances are generally to be regarded as measures satisfying the “by a Member State or a through State resources” criteria.

b. It favors certain undertakings or production of certain goods (selectivity):

The aid is available to certain undertakings but not others in the Member State, eg. It selects individual businesses, sectors, areas, size of business or production of certain goods. A benefit available for all businesses is not State Aid but is a general measure. “Selectivity” has to be distinguished from “general measures” which apply in an

³⁴ P. M. Roth QC, *European Community Law of Competition*, Bellamy & Child, Fifth Edition, 2001, London, p. 1223.

³⁵ See. Adv. Gen. Mancini in Case 290/83 *Commission v. France* (*Caisse nationale de credit agricole*), 1985.

³⁶ Adv. Gen. Fenerally in *Ecotrade*, see footnote 3.

³⁷ Case C- 387/92 *Banco Exterior de Espana v. Ayuntamiento de Valencia* (1994). That case can probably be explained as involving the renunciation of tax revenue and hence the renunciation of State resources. See Case C-156/98 *Germany v. Commission (new Lander)* (2000). The Commission considers that a tax exemption is equivalent to a consumption of State resources (Commission Notice on the application of State aid rules to direct taxation, cited with approval by Clarke L.J. in *R v. Commissioners of Customs and Excise ex p. Lunn Poly* (1999). However it is difficult to explain *Sloman Neptun* on this basis as a partial non-application of German employment law involved a loss of tax revenue in *Sloman Neptun* as an inherent feature of the employment legislation. See also *Ecotrade*, where the Court of Justice rejected the Commission’s view that the fact that the special insolvency regime might lead to a loss of tax revenue did not itself mean that this was a State aid.

automatic manner across the board to all enterprises in all economic sectors. These general measures do not constitute State aid.

It favors certain undertakings by conferring an advantage on them. An advantage may be direct or indirect, e.g. grants or favorable loan terms and services provided at less than market cost, or relief from charges a business would normally bear.

Therefore, State aid must be selective and thus affect the balance between certain firms and their competitors. Article 87 refers to an aid which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods. It is therefore necessary to distinguish between an advantage granted to undertakings generally and one that is granted only to certain undertakings.³⁸ It is only the latter that falls within Article 87, for example where the advantage is granted to one undertaking or to all undertakings in a particular region or industry. In the case of social and economic measures it is not always easy to determine whether or not measure favors particular undertakings.³⁹

In *France v. Commission (Kimberley Clark)*⁴⁰ the Court of Justice held that the financial participation by the State's participation was not limited by sector or territorially or by reference to a restricted category of undertakings, there was an element of discretion in the disbursement of the funds. The Court of Justice also held that an insolvency regime, which was intended to apply selectively to large industrial undertakings in difficulties that owed debts to mainly public creditors and whose application was in part enforced by a concern to maintain the undertaking's economic activity in the light of national industrial policy conditions, favored particular undertakings.

³⁸ Case T- 55/99 *CETM v. Commission* (2000)

³⁹ In Case 249/81 *Commission v. Ireland (Buy Irish)* (1982), the Commission took the view that State action favoring all domestic products, was not be caught by Article 87 since the measure was too general to favor certain, but not all, undertaking within that Member State.

⁴⁰ Case C-241/94 *France v. Commission* (1996)

c. It distorts or threatens to distort competition: It potentially or actually strengthens the position of recipient in relation to the competitors. Almost all selective aid will have potential to distort competition without consideration of the scale of potential distortion or market share of the aid recipient. The Court of Justice, specially emphasis in its judgments *Deufil*⁴¹, *Belgium*⁴² and *Italy*⁴³ that the effects of the aid is much more important than type and aim of the aid⁴⁴. As it has been seen in the case *Kingdom of Belgium v. Commission*⁴⁵, the person who has been granted state aid has to gain economic advantages that can not provide in the normal circumstances.

In a decision finding an aid within Article 87, the Commission must set out circumstances which show that the aid is capable of distorting or threatening to distort competition.⁴⁶ In *Philip Morris*,⁴⁷ the Court of Justice held that where financial aid granted by a State strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, competition must be regarded as distorted. In that case, the Commission had prohibited an aid designed to help enlarge Philip Morris's production capacity in the Netherlands which would then amount to nearly 50 per cent of cigarette production in the country, of which 80 per cent was destined for export to other Member States. Although Philip Morris criticized the Commission for not identifying the relevant market, the territory and the pattern of the market in question, the Court found that the Commission's conclusion that the purposed aid would threaten to distort competition between undertakings and effect trade between Member States was justified on the facts set out in the decision. Where an undertaking competes in a market which experiences economic difficulties, an aid granted to an undertaking runs the risk of seriously distorting competition. Similarly, where an aid

⁴¹ Case 310/85 *Deufil v. Commission* (1987)

⁴² Case C-234/84 *Belgium v. Commission* (1986)

⁴³ Case 73/73 *Italy v. Commission* (1974)

⁴⁴ Hakan Uzelturk, *Avrupa Birliği-Türkiye: Devlet Yardımları, Vergi Sorunları Dergisi*, Sayı: 154, Temmuz 2001, s. 110.

⁴⁵ Case C-56/93 *Kingdom of Belgium v. Commission* (1996)

⁴⁶ Cases 296 & 318/82 *Netherlands and Leeuwarder Papierwarenfabriek v. Commission* (1985), Cases C-329/93, etc. *Germany and others v. Commission* (1996), Cases C-15/98 & 105/99 *Italy and Sardegna Lines v. Commission* (2001).

⁴⁷ Case 730/79 *Philip Morris v. Commission* (1980).

granted to an undertaking operating in a sector which is characterized by intense competition, there is a distortion, or a risk of distortion of competition.⁴⁸

The Commission has taken the view that small amounts of aid (de minimis aid) do not have potential effect on competition and trade between Member States. It therefore considers that such aid falls outside the scope of Article 87/1 of the Treaty.⁴⁹

d. It effects trade between member states: This includes potential effects. Most products and services are traded between Member States and aid for almost any selected business or economic activity is capable of effecting trade between Member States even if the aided business itself does not directly trade between Member States.

Unlike Articles 81 and 82 which refer to practices which may affect trade between Member States, Article 87 simply refers to aids which effect trade between Member States. There is no indication; however, that the omission of the word “may” in Article 87 is material. On the contrary, in *France v. Commission*⁵⁰ the Court held that an aid fell within Article 87 it was capable of effecting trade between Member States.

In case C-156/98 *Germany v. Commission*, Advocate General Saggio considered that the primary effect of the aid was to make investment in the undertakings benefiting from the aid more attractive and that that meant that there was an effect on intra-State trade because, in principle, investment in every undertaking established in another Member State that did not benefit from the aid was possible under less favorable conditions.

⁴⁸ Case C-42/93 *Spain v. Commission (Merco)* (1994), the aid in that case was characterized as operating aid which was held in principle to distort competition.

⁴⁹ European Commission’s factsheet, Community Rules on State Aid (vade-mecum).

⁵⁰ Case 102/87 *France v. Commission (FIM)* (1988), where the ECJ held that a subsidized loan to a French brewer was capable of effecting trade between member States and distorting competition where that undertaking’s products competed with products coming from other Member States even if he aided undertaking did not itself export its products. See also Case C- 75/97 *Belgium v. Commission Maribel* (1999).

Therefore, in the light of the above-mentioned key criteria, some state aids have been found in the presence of the following⁵¹:

- Interventions, which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which without being subsidies are similar in character and have the same effect,
- The payment of a proportion of the cost of production by someone other than the purchaser,
- An advantage entailing a burden to public finances in the form of either expenditure or reduced revenue,
- A grant from the state for no consideration,
- Assumption by the state of costs which are normally assumed by undertakings,
- Assumption by the state of part of the risk which is normally assumed by undertakings,
- Compensation from the state to a company or receipt of reduced revenue of the state,
- The grant of resources or advantages by the state to encourage the attainment of economic and social objectives,
- Any type of support granted by a member state or through state resources other than for commercial purposes.

All these examples are taken from Court rulings. They indicate the broad range of instruments dedicated to providing financial assistance to undertakings.

2.1.3. State Aids, which are, or may be, Compatible with Article 87/1 of the EC Treaty

⁵¹ Taken from A. Evans & S. Martin, *Socially Acceptable Distortion of Competition: Community Policy on State Aid*, ELRev, 1991, p.79, *et seq.*

The principle of incompatibility of State aid with the EC Treaty is not absolute. An article 87 paragraph (2) and (3) contains a number of exemptions under which State aid may be considered acceptable by the Commission, some of which are always applicable and others of which are applicable only if the Commission is so persuaded. In particular, Article 87(3) states that the Commission may consider compatible with the common market “*aid to facilitate the development of certain economic activities where such aid does not adversely affect trading conditions to an extent contrary to the common interest*”. In exercising its wide discretionary powers for the application of this exemption, the Commission balances the necessity and the proportionality of the aid measure in achieving a Community objective versus the distortion of competition brought by it. In order to inform Member States about its approach and the criteria used in the assessment, the Commission has issued a number of documents based on the Article 87/3 (c) in the form of regulations, communications, notices, frameworks, guidelines and letters regarding various categories of aid based on the form of the aid, its purpose, the size of the undertakings, their location, or the sector of the economy.

The drafters of the EC Treaty were to a certain extent conscious of the social dimension of the free market policies advocated by them. This is the revealed particularly in their approach towards state aids, some of which are compatible with the common market as of right, and some of which may under certain circumstances be compatible⁵².

Article 87/2 of the Treaty sets out those State aids which can in principle be reconciled with the requirements of the common market. The followings are the mandatory exceptions.

- Aids having social character granted to individual consumers, provided that such aid is granted without discrimination as to the origin of the products involved,⁵³

⁵² Introduction to EU Law, Walter Cairns, 2nd Edition, 2002, p.249.

⁵³ In Case 52/76 Benedetti v. Munari (1977), Adv. General Reischl considered that the buying of wheat at the intervention price and its resale at a lower price by a state agency with the object of making bread cheaper might be an aid having a social character granted to individual consumers within the meaning of Article 87/2(a).

The Commission considers that discrimination under this section refers to the geographical origin of the supplier of the product concerned and not to measures distinguishing between that products and competing products.

- Aid aimed at making good the damage caused by natural disasters or exceptional events.

The phrase “exceptional events” has included internal disturbances or strikes, and with certain reservations and depending on their extent, nuclear or industrial accidents and fires which result in widespread loss.

- Aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of the country, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

That provision,⁵⁴ which refers to the division of Germany into two zones in 1948, relates only to economic disadvantages caused by that division and can not be used to compensate economic backwardness of the new German Lander following German reunification. Following German reunification, aids to the areas specified in Article 87/2(c) are now generally considered by the Commission under Article 87/3(a) and 87/3(c).

Article 87/3 of the Treaty sets out those state aids which “may be” compatible with the common market. For these categories, the Commission will have to act as a referee and authorize the aids in question. So, in the following cases, the aid may be compatible with the common market:

- Aid to promote economic development of areas where the standard of living is abnormally low or where there is serious unemployment,

⁵⁴ There is no equivalent provision in Article 61(2) of the EEA Agreement.

This relates to the underdeveloped areas of the European Union. In relation to the concepts of an abnormally low standard of living and serious underemployment mentioned in that provision, the Court has held that these indicate that Article 87/3(a) “concerns only areas where the economic situation is extremely unfavorable in relation to the Community as a whole.”⁵⁵

- Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of the Member State,⁵⁶

In *Executif Regional Wallon v. Commission (Glaverbel)*⁵⁷ the Court of Justice endorsed the Commission’s view that a project is not of common European interest unless it forms part of a transnational European programme supported jointly by a number of Member States or arises from concerted action by Member States to combat a common threat such as environmental pollution. An aid will not fall within the provision if it leads to the transfer of an investment which could have taken place another Member State which is in less favourable situation.⁵⁸

- Aid aimed at facilitating the development of certain economic activities or of certain economic areas, on condition that such aid does not affect trading conditions in such a way as to prejudice the general interest,

The compatibility heading of Article 87/3(c) which deals with regional aid - which in practice is the most important heading – is interpreted in the case-law, following the next of that provision, more widely, “as it permits the development of certain areas without being restricted by the economic conditions laid down in Article 87/3(a), provided such aid “does not adversely effect trading condition to an extent contrary to the common interest”.

⁵⁵ Case 248/84 *Germany v. Commission* (1987), Cases C-278-280/92 *Spain v. Commission* (1994).

⁵⁶ Article 87/3(b) was used by the Commission approved aid to a new subsidiary of companies in Grek public sector as it considered that the crisis in the Grek economy went beyond any one sector of the economy. The severity of the situation was reflected by the safeguard measures Greece had been allowed to take under EEC Treaty, Seventeenth Report on Competition Policy (1987).

⁵⁷ Cases 62 & 72/87 *Executif Regional Wallon v. Commission (Glaverbel)* (1988)

⁵⁸ Case 730/79 *Philip Morris v. Commission* (1980).

- Aid seeking to promote culture and heritage conservation where such aid does not affect trading conditions and competition in a way which would be against the general interest,

It is unclear whether this derogation has widened the scope of Article 87/3 since aids which can be authorized under Article 87/3(d) were previously authorized under what is now Article 87/3(c). Thus prior to the entry into force of the Treaty of European Union on 1 November 1993, the Commission was prepared to authorize under Article 87/3(c) aids with a cultural objectives. Since the entry into force of Article 87/3(d) the Commission has authorized aid to a national film industry as within that provision whereas previously aid to the film industry was capable of being authorized under Article 87/3(c).⁵⁹

- Any other categories of aid as may be specified by a decision of the Council, acting on a proposal by the Commission.

For instance, in 1998, the Commission approved to grant aid which has social character to the public of Madeira Island for the flights between the Madeira Island and rest of the Portugal.

Article 87/3 of the EC Treaty is clearly phrased so as to give the Commission discretion.⁶⁰ In this context the Commission enjoys a wide discretion, the exercise of which involves assessments of an economic and social nature in a Community context, although the reasoning which it follows must remain consistent.⁶¹ In the evaluation of the compatibility of a proposed aid with the common market, significant weight attaches to the question whether the impact on the proper functioning of the common market (which in principle excludes state aids) is compensated by the positive contribution which the aid may deliver to the achievement of certain community objectives.

⁵⁹ See XXVIIth Report on Competition Policy (1997). For examples of earlier aids to the film industry authorised under Article 87/3(c), see XIIth Report on Competition Policy (1992).

⁶⁰ Case 730/79 Philip Morris Holland BV v. Commission (1980).

⁶¹ Cases C- 278-280/92 Spain v. Commission (1994).

2.1.4. Why We have State Aid Rules?

Ever since the signing of the Treaty of Rome in 1957, state aid policy has been an integral part of competition policy and the European Commission has been in charge of preventing that aid granted by Member States unduly distorts competition.

State aid control comes 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. There is a particular need to be concerned with those state aid measures, which provide unwarranted selective advantages to some firms, preventing or delaying the market forces from rewarding the most competitive firms, thereby decreasing overall European competitiveness. It may also lead to a build-up of market power in the hands of some firms, for instance when companies that do not receive state aid (e.g. non-domestic firms) have to cut down on their market presence, or where state aid is used to erect entry barriers. As a result of such distortions of competition, customers may be faced with higher prices, lower quality goods and less innovation.

In addition, State aid rules aims to ensure fair competition and a single common market. Granted aid to some businesses would;

- harm business competitors,
- risk distorting the normal competitive market,
- hinder the long-term competitiveness of the Community.

Therefore, unsubsidized firms who must compete with those receiving public support may ultimately run into difficulties, causing loss of competitiveness and endangering the jobs of their employees. Ultimately, the entire market will suffer from State aid, and the general competitiveness of the European economy is imperiled.

These are the reasons that EU has state aid rules and EC Treaty generally forbids State-funded aid which would favor certain businesses or good production.

On the other hand, the State aid rules contribute to the effective functioning of the Single Market and economic reform of the European Union in two key ways:

- i. They prevent State aid that would seriously distort competition – thereby helping to achieve a fair market for businesses in all Member States;
- ii. They allow State Aid that promotes economic development and other legitimate policy objectives, where this benefit outweighs any distortion of the competition.

State aid rules come 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, and to avoid Member States getting locked into contest where they try to outbid each other to attract investment. Preserving competitive markets is the best way for European citizens to get the products they want, at low prices and to foster innovation and growth in the EU. Besides this, state aid rules help to control unfair subsidy races among Member States, creation of unemployment abroad, delocalization, market foreclosure. The state aid regime justifies its existence by claiming to promote competition, to encourage the operation of free and fair European markets and to create a level playing field for European industry.

Additionally, State aid discipline has a key role to play in managing the economic reform agenda. We should not forget the primary role of competition in state aid policy. Effective state aid control maintains a level playing field for free and fair competition in the single market, the key to competitiveness. The Commission controls state subsidies, because in general they distort the market.

But efficient and equitable state aid can also stimulate competition and support the economic reform process in new ways, acting as a driver for the virtuous circle of economic growth, better standards of living, and more and better jobs.

To sum up at this stage, in my view state aid policy plays an important and critical role in the integrated approach to achieving competitiveness.

2.1.5. Forms of State Aid

All State aid represents a cost or loss of revenue to the public authorities and a benefit to recipients. Article 87 of the EC Treaty prohibits any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain firms or the production of certain goods. State aid instruments differ within the scope of Article 87/1 of the EC Treaty and some are as follows:

- State grants,
- Interest rate relief,
- Tax relief,
- Tax credits,
- State guarantees or holdings,
- State provision of goods or services on preferential terms,
- Direct subsidies,
- Tax exemptions,
- Preferential interest rates,
- Guarantees of loans on especially favorable terms,
- Acquisition of land or buildings either gratuitously or on favorable terms,
- Provisions of goods and services on preferential terms,
- Indemnities against operating losses,
- Reimbursement of costs in the event of success,
- State guarantees, whether direct or indirect to credit operations preferential re-discount rates,
- Dividend guarantees,
- Preferential public ordering,

- Reduction of, or exemption from charges or taxes, including accelerated depreciation and the reduction of social contributions,
- Assistance financed by special levies,
- Capital transfers,
- Certain state holdings in the capital of undertakings.

2.1.6. Monitoring State Aid in the European Union

The Commission has wide power to control and monitor State aid. It may refuse approval which the State needs for granting aid to the recipients. It may approve State aid under Article 87/3 or other possible exceptions, either by formal legal regulation or after individual scrutiny and approval of a proposed aid scheme or project. Commission uses formal guidelines and frameworks. In considering proposed aid, it is guided by criteria in published frameworks or guidelines that apply particular aid categories or purposes and in all Member States. If relevant guidelines do not exist or if proposal does not fit the guidelines, even if a proposed State Aid does not precisely fit formal frameworks or guidelines, or is in a category or for a purpose for which there are no relevant published framework or guidelines, the possibility exists that the Commission may still approve State aid for development of certain economic activities and areas if it considers that it does not effect competition and trade to an extent contrary to the general interest.

Commission controls the granting of national subsidies, the word “subsidy” does not really do justice to the Commission’s conception of state aid. Indeed “state aid” is a more inclusive term than “subsidy” encompassing tax concessions, state guarantees and state participation in industry, as well as straightforward financial assistance⁶². While the EC Treaty was rather vague about what was and was not state aid, both the Commission and the ECJ have gone some way towards clarifying what is covered by the aid rules. In addition, it has become clear that to be subject to these rules and aid

⁶² Competition policy in the EU, Michelle Cini, Lee McGowan, the EU Series 1998, p.136

must be specific to certain firms, must at least threaten to distort competition and (in the context of the Commission's rules) must effect interstate trade within the Union (Schrans, 1973, pp 173-8; Quigley, 1988, p.242).

Therefore, State aid control is exercised through the implementation of regulatory instruments. These may take the form of legal instruments binding both on the Commission and on Member States or of soft law texts binding only on the Commission, such as guidelines, frameworks or communications. Regulations lay down the procedures for the notification and assessment of aid and exempt certain non-problematic types of aid from notification. Certain specific texts also set out the State aid rules applicable to particular sectors (e.g. shipbuilding). Soft law texts endeavour to clarify the criteria upon which the Commission bases its assessment in specific areas.

The Commission monitors, moreover, the recovery of unlawful aid by Member States, as well as aid measures which are exempted from notification, on the basis of specific legal instruments. Such monitoring will gradually be extended to all State aid decisions containing conditions with which the Member States have to comply.⁶³

Furthermore, the Commission is in charge of controlling state aid. Member States have different traditions of state intervention and different levels of financial resources. The European Commission, as an independent body, is best able to represent the common interest of all European citizens and to control the national governments use state aid to serve the common interest. Member States have to notify a proposed state aid to the Commission, before it can be implemented. The Commission may authorize the aid, if on balance the presumed benefits for the common interest outweigh the distortions to competition and trade.

2.1.7. Legal Basis for the Control of State Aid

The legal basis of policy and action on State Aids in the European Union has remained substantially unchanged since the Treaty of Rome. The key provisions are

⁶³ See Commission's XXXIIIrd Report on Competition Policy, p.77.

Article 87-89. In short, as mentioned in this chapter, Article 87 provides for a general prohibition of State aids insofar as they affect trade between the Member States, but then goes on to identify those aids which are compatible with the Treaty and those aids which may be compatible with the Treaty.

Since the Commission has wide discretionary powers to control and monitor of the state aid, the Commission has developed specific approaches depending on the size of the firm, its location, the industry concerned, the purpose of the aid etc. Because its power is discretionary, the Commission has sought to publicize its approach in order to ensure that its discretion is exercised with proper openness and that authorities and businesses are clear about their legal position. To do so, it has published the criteria it uses when deciding whether aid measures notified to it qualify for exemption. These publications have taken the form of regulations, communications, notices, frameworks, guidelines and letters to Member States.⁶⁴

2.2. State Aid Policy within the Framework of Competition Policy of the EU

State aid policy is certainly the most original of the EU's competition policies. In restricting the capacity of governments to support their national firms, the policy sounds death-knell of purely national industrial strategies by granting the Commission the task of ensuring that aids granted within the EU are compatible with common market objectives⁶⁵.

State aid policy is a rather anomalous part of the Commission's competition regime. It is a distinctively supranational policy which does not exist in any national context, and is not considered part of any domestic competition policy.

The policy involves Commission scrutiny of nationally granted state aid. According to the Commission, nationally granted state aid to an undertaking gives it an

⁶⁴ All relevant regulations, communications, notices, frameworks and guidelines are available on the DG Competition web-site: <http://europa.eu.int/comm/dg04/lawaid.htm>.

⁶⁵ Michelle Cini, Lee McGowan, op. cit. p.135.

advantage over others and tend to effect competition. In this respect, there may be a presumption that aid distorts or threatens to distort competition, unless exceptional circumstances exist. In determining whether there is a distortion of competition or threat in accordance with the Article 87/1, the Commission may have regard not only to the direct and immediate effects of aid on the market position of the recipient. The Commission may also consider the effects for potential competitors. The Commission may even consider the effects on competition in industries which purchase goods from the aided undertaking or the effects of aid to the production of raw materials on the costing of the final product and profit margins⁶⁶. Therefore, since the state aid policy has a big impact on competition and trade between Member States and is the most important cornerstone of the EC's competition policy, the Commission has a big role of monitoring and controlling the state aid.

Commission considers State aid policy important for the effectiveness of the competition policy of the Union. There is strong enforcement of Commission's policy to control State aid policy which is very important key element of the competition policy. There is a lot to do in this area, one of the innovations introduced in recent years in order to ensure greater transparency in the State aid field has been the State aid Scoreboard. It is very pleasing to see the latest Commission State aid Scoreboard, that the Member States are on the right track and the volumes of State aid granted are progressively being reduced.

In seeking to overall aid levels in general, and the more distortive aids in particular, the Commission has essentially two different approaches available, the use of general policy instruments, such as guidelines, regulations and frameworks, and through the treatment of specific cases. In some cases, the Court of First Instance has actually endorsed the general approach taken by the Commission.

Of course, from May 2004, by the enlargement Commission has taken different approaches and has to pay more attention to the state aid policy.

⁶⁶ (Dec 84/508 (OJ 1984 L283/42) on the aid granted by the Belgian Government to a producer of polypropylene fibre and yarn

Enlargement presents a challenge both from the procedural and substantive point of view. In terms of substance, it is needed to ensure the application of the State aid rules in the economies which are in some respects still different from those of the current Member States, and which have not always yet fully completed the process of transition from centrally planned to market-based economies.

In terms of procedure, the Commission has to deal with additional workload created by examining State aid measure in ten new Member States, working in new Community languages alongside the existing workload. Rough estimates suggest that enlargement increases State aid workload by about 40% and although the budgetary authority makes some additional resources available.⁶⁷

2.3. Types of State Aids

2.3.1. According to the Purpose of the State Aid

2.3.1.1. State Aids for the Purposes of Incentives

The main purpose of this kind of state aid is to increase the production capacity of the undertakings in the certain sectors or regions or to encourage undertakings to make investments to the regions determined by the State⁶⁸. In case it does not seem possible that certain undertakings or certain production branches reach the expected production capacity in a stable economy, the State may grant some kind of aid to those undertakings or production branches. These kind of state aids aim to increase the production capacity and to orient the undertakings towards the high risky areas which needs overcapitalization.

⁶⁷ Mario Monti (Member of the European Commission responsible for competition), New Challenges for State Aid Policy, June 2003.

⁶⁸ Tevfik Pekin, Teşvik Tedbiri Olarak Sübvansiyonlar ve İşletme Kararları Üzerine Etkileri, Türkiye Vakıflar Bankası Yayını, Bornova, Mayıs 1988, s.35

State aids for the incentive purposes are granted to the undertakings for various aims like encouraging investments and exportation, increasing the international competitive power, encouraging foreign investment, regional economic development, promoting prevention of environmental pollution, developing well-qualified labor force etc.

2.3.1.2. State Aids granted to Support and Continuance of the Production

This kind of aids aims to support enterprises, which lose the productivity and the competitive powers in a market, to regain their competitive powers and to provide continuance of the production. For such state aids, the Government contributes to the domestic producer a part as the difference between the world price and the domestic price⁶⁹.

Production-oriented aids are granted to encourage the enterprises to work with full capacity and to restructure the public and private enterprises which are in difficulty. These aids are considered in this kind of state aids.

2.3.2. According to the Granting Methods

State aids are also classified as the granting methods like pecuniary/financial aid, aids in kind, government security and state guarantee, tax advantages, state purchase and guarantee prices⁷⁰.

⁶⁹ İsmail Aydoğuş, Türkiye'nin Avrupa Birliği ile Bütünleşme Sürecinde Devlet Yardımları, Afyon 2000, p.7

⁷⁰ İsmail Aydoğuş, op.cit, p. 7

2.3.2.1. Aids in Kind

The State allocates to the private enterprises public lands with low prices or free of charge. The government also sells the feed, fertilizer and agricultural drugs to the individuals and/or legal entities which are active in agriculture sector with low prices or free of charge. In this respect, by granting this kind of aid, the government withdraws its budget incomes.⁷¹

2.3.2.2. Monetary Aids

These kinds of state aids are classified into two groups; uncovered monetary aids and covered aids.

Uncovered monetary aids are aids which the State grants aid to the private enterprises as premium and/or donation. In the covered aids, State grants to the certain sectors and production branches credit with a too low interest in comparison with the current market interest. The provision of credit, assistance with the costs of obtaining credit and interest rebates as well as the grant of a loan with inadequate security or with a premium too low to reflect the risk actually involved may constitute aid.

These kinds of state aids are aids which state participates to the equity capital of the firms through stock-purchase or the state purchases stocks of the firms in return for its receivables because firms are in difficulty. The main characteristic of this kind of aids is the amount of aid can be calculated beforehand.

2.3.2.3. Tax Concessions

⁷¹ İsmail Aydoğus, op.cit, p.7

Aid may be entailed where the state reduces the public charges generally imposed on enterprises through tax concessions. For example, such concessions may mean that a bank is able to finance investments which other are unable or unwilling to finance. In such circumstances, aid may be found to be present. This kind of state aids are those which the state imposes low tax rates to the certain sectors or exempts some undertakings from tax or extends the period of taxes which must be paid in a certain period. These implementations constitute additional source for the enterprises like providing credit with free of interest.

More particularly, special depreciation rules, deferment of tax payments, failure by the public authorities to take proceedings to enforce tax debts, and any divergence from the ordinary procedure fore recovering tax debts may entail the grant of aid, as may exemption from rules requiring a delay in making value-added tax deductions.

2.3.2.4. State Guarantees

The provision of a state guarantee including a “comfort letter... assuring the lenders that the Government is behind” an undertaking, constitutes aid⁷². By granting aid in the form of guarantee, the state, being the guarantor of the undertakings, shares the risk with the private enterprises.

State guarantees, whether of loans, coverage of losses or through unlimited liability state holdings in an enterprise, will usually be considered to be State aid under Article 87/1, whether or not the guarantee is called upon, because they remove the element of risk that the enterprise would otherwise have to bear.

⁷² Andrew Evans, A Textbook on EU Law, Hart Publishing, Oxford, 1998, p.409.

2.3.2.5. State Aids in the form of State's Preferential Purchase, Support Buying and Guaranteed Prices

In order to encourage producer and prevent the low prices in the market, the state sometimes purchase the product over the real market price and support the producer.

In order to promote the production in a certain sector, the state will sometimes guarantee the purchase of the product over a definite price in case the producer does not sell its product in the market.

Preferential state purchases are aids which the public undertakings intentionally prefer domestic firms to buy product and service. This implementation of the state prevents the entrance of foreign firms to the local market. Since this kind of aid distorts competition, badly effects the international trade, "State Purchase Code" is signed in the Tokyo Round in 1979. The countries, signed the code, accept not to make discrimination against any of the producer or product in the public procurements.

While the Code is signed by several countries in the Tokyo Round, the Code rearranged in the Uruguay Round and obliges all of the member states to obey it⁷³.

⁷³ İsmail Aydoğuş, op.cit, p. 9.

III. STATE AIDS IN THE EUROPEAN UNION

In contrast to most other trade blocs, such as the North American Free Trade Area (NAFTA), the European Union has supranational regulations on subsidies or state aid.⁷⁴ In return for this supranational regulation of state aid, the member states of the EU have relinquished their right to use countervailing duties against the subsidies given by other member states, as permitted by GATT rules. As mentioned earlier, Article 87/1 of the EC Treaty states that “Any aid granted by a Member State or through state resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far effects the trade between Member states, be incompatible with the common market.” Although this appears to be a strong prohibition of state aid, Article 87/2 lists a number of exceptions that are always compatible with the common market while Article 87/3 lists a number of exceptions that may be exempted by the European Commission.

Responsibility for the implementation of the regulations on state aid in the EC Treaty lies with the Directorate-General for Competition Policy of the European Commission (DG-IV). The Commission’s state aid policy relies on the prior notification of new or altered aids. This is an obligation placed on member state authorities. The obligation to notify set out in Article 88/3 of the Treaty, which states

⁷⁴ Behboodi (1994) discusses the different approaches used to control subsidies by the GATT, EU and NAFTA.

that the Commission “shall be informed in sufficient time to enable it to submit its comments, or any plans to grant or alter aid.” So, they can determine whether it qualifies for the exemption. Actually, with the completion of the Single market in 1992, DG-IV has argued that there is greater need to control state aid in order to create a “level playing field”⁷⁵. However, as governments often see the state aid rules as constraints upon their capacity to pursue an independent industrial policy, it should come as no surprise to find an “implementation gap” at this stage in the decision-making process, with non-compliance still one of the most persistent problems facing DG-IV staff⁷⁶.

Since the formation of GATT in 1947, barriers to international trade have steadily been reduced. The completion of the Uruguay Round has resulted in the average trade-weighted tariff of the EU. This has led, inevitably, to an increase in market penetration of imports in the EU market. It seems reasonable to conjecture that an increase in import penetration might effect the incentive of the Member States of the EU to give state aid and that of the European Commission to control it. In the absence of international trade, when all EU Member States give state aid to their undertakings, the result will often be a prisoner’s dilemma situation where they all lose and their welfare can be increased by the European Commission prohibiting state aid. With the international trade, state aid can be used by Member States as a strategic trade policy against foreign firms.

When the liberalization stream starts, this shows us that trade liberalization strengthens the incentive for EU Member States to give state aid to their firms. When the EU market is supplied by foreign firms, all of the EU Member States are importers, so state aid acts as a strategic trade policy and improves their terms of trade. Second, when there are fewer foreign firms than EU firms, the prohibition of subsidies would increase the welfare of all Member States. When there are more foreign firms than EU firms, the prohibition of subsidies will not increase the welfare of all EU member states. Prohibiting state aids prevents Member States from pursuing strategic trade policies

⁷⁵ David Collie, *Trade Liberalization and state aid in the European Union*, p. 190.

⁷⁶ Michelle Cini, Lee McGowan, *op.cit.*, p.139

primarily against foreign firms. Hence, according to the David Collie⁷⁷, it is clear from the results that trade liberalization will increase the incentive for EU member states to give state aid and reduce the incentive for the EU to prohibit state aid.

According to the general thought, there are three approaches to the general control of subsidies. Multilateral regulation through the GATT/WTO; unilateral regulation through the use of countervailing duties and supranational regulation of which the EU state aid policy is a unique example. The multilateral approach has not always been very effective, while the unilateral approach risks increased trade conflict. Increasing regionalization suggests that the supranational approach may therefore offer a solution to the problem of controlling state aids that is both effective and avoids the risk of trade conflicts.

Therefore, state aid policy of the EU is a rather anomalous part of the Commission's competition regime. It is a distinctively supranational policy which does not exist in any national context, and is not conventionally considered part of any domestic competition policy. Enforced by DG-IV, it has characteristics that are very different from the Commission's restrictive practices, monopoly and merger policies, not least since the objects of its regulation are governments rather than firms.

Briefly, in order to understand the competition policy and the fair trade rules in the world, we have to pay attention especially to the EU's view to the state aid and approaches to the control and monitor of the state aids.

3.1. State Aid Policy of the EU

State aid is a long established method of regulation of the economy. The giving of state aids to a particular undertaking or industry or a definite region distorts competition and undermines the free movement of goods. The establishment of a true

⁷⁷ David Collie, op.cit, p.192.

common market and a system of undistorted competition requires that Member States are prohibited from granting to undertakings aid that distort, or threaten to distort competition and trade between Member States. It is therefore not surprising to find that both the ECSC Treaty and EC Treaty⁷⁸ have provisions regulating the granting of aids by Member States. As the Commission has stated, State aids may be used:

“..... as a form of protectionism, to benefit national producers, to give them competitive advantages, to avoid necessary structural adaptation: in short, to transfer difficulties on to competitors in other States. In view of the importance of trade in industrial products in the Community, such aids, however beneficial they may appear from a short-term national point of view, could endanger and threaten the unity of the common market, the very existence and development of which provides the best opportunity of overcoming the recession. In this situation, the control exercised by the Commission under the powers granted to it by Article 87 etc. of the EC Treaty over the granting of State aids are of increasing importance in the development of the Community and in particular the maintenance of the unity of common market.”⁷⁹

However, the rules on State aids have considerable flexibility. While Article 87(1) of the EC Treaty prohibits state aids, Article 87(2) and (3) allow the Community to approve particular types of State aids that are generally beneficial. Therefore, although the main aim of the Commission, which has the principal responsibility for administering the State aid rules, is to avoid distortions of competition and to strengthen the unity of the common market.

The importance of state aids can be seen from the fact that the Commission has in recent years taken well over more than 350 decisions a year (excluding aids to agriculture, fisheries, transport and coal).

⁷⁸ Article 87-89 (ex 92-94) of the EC Treaty. The provisions in the ECSC Treaty are Art 4(c) and 67.

⁷⁹ Twelfth Report on Competition Policy (1982), point 158. See XXVIIth Report on Competition Policy (1997) points, 196-197; XXVIIIth Report (1998), points 181-192 and XXIXth Report (1999), points 201-204. See also the Commission's Eighth Survey on State aid in the EU, Com (2000) 205.

3.2. Types of State Aid Which are Compatible with the Common Market

3.2.1. Horizontal Aids

3.2.1.1. Aid for Small and Medium-sized Enterprises

Legal Basis of aid for small and medium-sized enterprises (SMEs) is Commission Regulation No. 70/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty on State Aid to Small and Medium-sized Enterprises (OJ L 10, 31.01.2001, p.33) and Commission Regulation No. 364/2004 of 25 February 2004 amending regulation No. 70/2001 as regards the extension of its scope to include aid for research and development (OJ L 63, 28.02.2004, p.22).

According to the Regulation, definition of SMEs is as follows:

A medium-sized enterprise is an enterprise satisfying all of the following criteria:

- has fewer than 250 employees and
- has either an annual turnover not exceeding € 40 million, or a balance-sheet total not exceeding € 27 million, and
- is independent.

A small enterprise is an enterprise that satisfied all of the following criteria:

- has fewer than 50 employees and

- has either an annual turnover not exceeding € 7 million, or a balance-sheet total not exceeding € 5 million, and
- is independent.

The criteria must be applied to the company as a whole (including subsidiaries located in other Member States and outside EU).

The following new SME-definition entered into force on 01.01.2005:

Regulation No. 70/2001 refers to the definition of SMEs, as contained in the Commission Recommendation 96/280/EC of 3 April 1996. On 6 May 2003, the Commission has adopted a new definition which as of 1 January 2005 replaced the previous one. Since the reference contained in the regulation is not a dynamic character, the regulation has to be amended accordingly.⁸⁰

Content of new SME-definition:

- substantial increase of the financial ceilings (turnover of balance sheet total) as a result of inflation and productivity increases since 1996
- Introduction of a clear typology of enterprises (autonomous, partner and linked) to give a more realistic picture of their economic strength
- Within the typology of enterprises an exemption is introduced for investment in spin-offs by universities and research institutes to promote investment in research

Table 1.1. SMEs definition according to the balance sheet and turnovers

Enterprise category	Headcount	Turnover or	Balance sheet total
Medium-sized	< 250	≤ 50 mill €	≤ 43 mill €

⁸⁰ Commission Staff Working Document, Community Rules on state aid for innovation, 15.11.2004.

		(1996: 40 mill)	(1996: 27 mill)
Small	< 50	≤ 10 mill€ (1996: 7 mill)	≤ 10 mill € (1996: 5 mill)

Source: Commission staff working document, November 2004.

Regulation No. 71/2001 allows aid to SMEs for investment in tangible assets (land, buildings, and plant/machinery) and in intangible assets (expenditure entailed by technology transfer) as well as for consultancy from outside providers and for costs of first participation in a fair or exhibition. Permissible instruments are grants, soft loans, tax deductions and exemptions, and guarantees. Furthermore, as a result of recent amendment⁸¹ the Regulation also covers aid for research and development costs borne by SMEs as defined in the framework for State aid for research and development. The size of the beneficiary enterprise is also relevant, as the maximum level of aid is more generous for small firms than for medium-sized firms.

Table 1.2. Aid Intensities of SMEs

Aid Intensities		Non-assisted Regions	Article 87/3(a) regions	Article 87/3(c) regions
	Investment		Regional	Regional
	Small firms	15 %	aid ceiling	aid ceiling
	Medium-sized firms	7.5 %	+15 %	+10 %
	Services by outside Consultants	up to 50 %	up to 50 %	up to 50 %

Source: Commission staff working document, November 2004.

The important issue is the maximum intensity of investment aid should never be allowed to exceed 30 % net in the case of Article 87/3(c) region, nor 75 % net in the case of Article 87/3(a) regions.

⁸¹ Commission Regulation No. 364/2004 of 25 February 2004 amending Regulation No. 70/2001 as regards extension of its scope to include aid for research and development.

Aid measures satisfying the conditions laid down in the Regulation are exempted from the ex ante notification requirement. However, large projects satisfying the following thresholds are not exempted from individual notification:

- The total eligible costs of the whole project are at least € 25.000.000 and the gross aid intensity is at least ½ of the applicable aid intensity ceiling or,
- the total gross aid amount is at least € 15.000.000.

Within 20 working days following the implementation of the exempted aid scheme or the granting of the exempted individual aid, the Member State must submit to the Commission a summary description of the aid measure.

Final date of Regulation 70/2001 for implementation in the Member States is 31 December 2006.

3.2.1.2. Training Aid

Regulation No 68/2001⁸² and Commission Regulation No 364/2004⁸³ allow granting of aid for training performed by the beneficiary undertaking or by public or private institutions on its behalf. Permissible instruments are grants, soft loans, tax deductions and exemptions and guarantees⁸⁴.

The Regulation applies to aid granted by a Member State to a company for training purposes. The training may be in any field. It is defined as specific training where it is principally applicable to the employee's present or future position and general where it provides qualifications that are largely transferable to other firms or

⁸² Commission Regulation No 68/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to training aid.

⁸³ Commission Regulation No 364/2004 of 25 February 2004 amending Regulation No 68/2001 on the application of Article 87 and 88 of the EC Treaty to training aid.

⁸⁴ Commission Staff Working Document, Community rules on state aid for innovation, vade mecum, 15.11.2004, p. 6.

fields of work. It is defined as general training where training involving tuition which is not applicable only or principally to the employees present or future position in the assisted firm, but which provides qualifications which are largely transferable to other firms or fields of work and thereby substantially improve the employability of the employee. Training is considered general if, e.g. it is jointly organized by different independent enterprises, or if employees of different enterprises may avail themselves of the training. It is also considered general if it is recognized, certified or validated by public authorities or bodies on which the Member State or the Community conferred the necessary powers.

Training aid is exempt from the notification requirement, provided that the aid intensity does not exceed a certain percentage of the project's overall cost.

Table 1.3. Aid Intensities regarding training aid

Aid Intensities	Maximum aid (gross percentages)		
		Specific Training	General Training
	Standard rate (large firms outside assisted areas)	25 %	50%
	Top-ups on standard rate:		
	SMEs	+10 %	+20 %
	Article 87/3(a) region	+10 %	+10 %
	Article 87/3(c) region	+ 5 %	+ 5 %
	Beneficiaries: categories of disadvantaged workers	+ 10 %	+10%

Source: Commission staff working document, November 2004.

The eligible costs of a training project are:

- trainer's and trainees remuneration,
- trainer's and trainees travel expenses,
- Other current expenses (materials, supplies etc.)

- Depreciation of tools and equipment, to the extent that they are used exclusively for the Training scheme in question,
- Cost of guidance and counseling services with regard to the training project.

Final date of Regulation 68/2001 for implementation in the Member States is 31 December 2006.

3.2.1.3. De Minimis Aid

Regulation No 69/2001⁸⁵ provides that small amounts of up to € 100.000 per beneficiary undertaking over any three-year period do not constitute State aid within aid meaning of Article 87/1 and which are therefore not subject to the notification requirement. This is based on the assumption that they do not have an effect on competition and trade between Member States. This also means that such amounts may be granted by Member States in addition to State aid permissible under any other relevant rule. De minimis amount may be granted in any form (grants, loans, tax breaks etc.) and for any objective.

This *de minimis* rule does not apply to the transport sector and a specific de minimis rule apply in the field of production, processing or marketing of agricultural and fisheries products listed in Annex I to the EC Treaty.

The *de minimis* rule sets a threshold figure for the aid below which Article 87/1 can be said not to apply, so that the measure need no longer be notified in advance to the Commission.

In order to benefit from *de minimis* rule, aid has to satisfy the following criteria:

⁸⁵ Commission Regulation 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to de minimis aid, OJ No L 10, 13.01.2001, p.30.

- The ceiling for the aid covered by *de minimis* rule is € 100.000 (cash grant equivalent) over any three year period. The relevant period of three years has a mobile character, so that for each new grant of *de minimis*, the total amount of *de minimis* aid granted during the previous three years need to be determined.
- The ceiling will apply to the total of all public assistance considered to be *de minimis* aid. It will not effect the possibility of the recipient obtaining other State aid under schemes approved by the Commission.
- The ceiling applies to aid of all kinds, irrespective of the form it takes or the objective pursued. The only type of aid which is excluded from the benefit of the *de minimis* rule is export aid.

The above ceiling (€ 100.000 of *de minimis* aid over a three year period) applies to the total amount of *de minimis* aid granted to a single company.

When granting a *de minimis* aid to a particular undertaking, the Member State concerned must check whether the new aid will not raise the total amount of *de minimis* aid received by that undertaking during the relevant three year period above the € 100.000 ceiling.

The Member State is responsible for establishing the instruments needed to ensure an effective control of the respect of the *de minimis* cumulation ceiling. This can be done in two ways:

- Either the Member State sets up a central register of *de minimis* aid containing complete information on all *de minimis* aid granted by any authority within the Member State.
- Alternatively, the Member State explicitly informs the enterprise about the *de minimis* character of the aid and obtains from the enterprise concerned full information about other *de minimis* aid received during the previous three years. Under all conditions, the Member State remains responsible for ensuring the respect of the cumulation ceiling.

Final date of Regulation 69/2001 for implementation in the Member States is 31 December 2006.

3.2.1.4. State Aid for Employment

Regulation No 2204/2002⁸⁶ allows aid for the creation of jobs (including for instance the recruitment of early graduates), the recruitment of disadvantaged or disabled people or coverage of additional costs of employing disabled people. Permissible instruments are grants, soft loans, tax deductions and exemptions, and guarantees relating to wage costs (including compulsory social security contributions).

In the light of experience gained in applying employment aid provisions, the Regulation exempts employment aid where it is intended for areas that qualify for regional aid, or for small and medium-sized enterprises (SMEs) rather than large enterprises. The Regulation takes account, however, of the guidelines on national regional aid and of Regulation 70/2001 on State aid to small and medium-sized enterprises.

The Regulation applies to two categories of employment aid: aid for job creation and aid to promote the recruitment of disadvantaged and disabled workers. Other types of employment aid are not prohibited, but they must be notified to the Commission in advance.

In accordance with Article 87/1 of the EC Treaty, aid exempted by the Regulation must have as its object and effect the promotion of employment, while leaving trade unaffected. Export aid is not covered by the Regulation.

With regard to employment aid intended for job creation, the Regulation lays down the following ceilings:

⁸⁶ Commission Regulation No 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment, OJ L337, 13.12.2002, pp.3-14.

- For SMEs in non-assisted areas: 15% (small enterprises) or 7.5% (medium enterprises)
- In Article 87/3(a) areas: regional aid ceiling +15% (maximum 75%)
- In Article 87/3(c) areas: regional aid ceiling +10% (maximum 30%)

The above ceilings apply under the following conditions:

- Employment must represent a net increase in the number of employees
- Employment must be maintained for at least 3 years (2 years for SMEs)
- New employees must have never had a job or must have lost their previous job
- The higher regional ceilings apply only if the beneficiary's contribution to financing new employment is at least 25% and if the employment is maintained in the qualifying region.

The Regulations contains definitions of “disadvantaged workers” and “disabled worker” that are broad enough.

For disadvantaged people, percentage of wage costs over a period of one year following recruitment: 50%. Disadvantaged people include: young persons below 25 years or within 2 years from completing full-time education; migrant workers within the EU; members of ethnic minorities and requiring development of linguistic, vocational training or working experience; persons absent from working life and education for 2 years due to family reasons; single adults looking after children; unemployed persons without secondary qualification; unemployed persons above 50 years; long-term unemployed persons; people convicted and imprisoned for criminal charges.

For disabled people, percentage of wage costs over a period of one year following recruitment: 60%. Disabled person include handicapped due to serious physical, mental or psychological impediment.

To receive aid, the beneficiary must submit an application to the Member State before the employment is created.

Final date of Regulation 2204/2002 for implementation in the Member States is 31 December 2006.

3.2.1.5. State Aid for Research and Development

The Community Framework for State aid for research and development⁸⁷ allows aid to companies that undertake research and development projects that they would not have undertaken without the State support. Aid intensity depends in particular on how far the research is from the market, ranges from 100% for fundamental research, to 75% for industrial research and 50% for precompetitive development including top-ups (e.g. for projects involving SMEs). Permissible instruments are grants, soft loans, tax reliefs as well as state guarantees and loans that are reimbursable in case of success of the research activity. Innovation in the R&D framework does not constitute a separate category of R&D, but many costs relating to innovation activities fall within the existing categories for which R&D aid may be allowed⁸⁸.

This Framework covers all measures under which State aid is provided for company research and development.

R&D support not considered to constitute State aid:

- Public financing of R&D activities by public non-profit-making higher education or research establishments;
- R&D commissioned from firms by public authorities according to market conditions (open tender procedure)

Sectors of shipbuilding, steel and motor vehicle industry need to be applied special rules and notification is required for each case.

⁸⁷ OJ C45, 17.02.1996. The Community Framework is amended by the Commission Communication amending the Community framework for State aid for research and development (OJ C 48, 13.02.1998 p.2) and Commission Regulation No 364/2004 of 25 February 2004 amending Regulation No 70/2001 as regards the extension of its scope to include aid for research and development.

⁸⁸ Commission staff working document, Community rules on state aid for innovation, 15.11.2004, p. 37.

The effects that State aid for R&D has on the market vary. The Commission makes a distinction between:

- *Fundamental research*: Activity designed to broaden knowledge not linked to industrial or commercial objectives;
- *Industrial Research*: Planned research aimed at the acquisition of new knowledge, the objective being that such knowledge may be useful in developing new products, processes or services;
- *Precompetitive research*: The shaping of the results of industrial results into a plan, arrangement or design for new, altered or improved products (including the creation of a prototype which could not be used commercially, demonstration projects, pilot projects)

The R&D framework does not concern fundamental research, which is always compatible with the competition rules. The communication covers aid which may have anti-competitive effects on the market, such as aid for industrial research and precompetitive development activity.

Eligible costs are:

- Personnel costs of staff employed solely on the research activity;
- Costs of instruments, equipment, land and premises used solely and on a continual basis for the research activity (normal investment is excluded);
- Cost of external consulting and equivalent services;
- Additional overheads incurred directly as a result of the R&D;
- Other operating expenses incurred directly as a result of the research activity.

Table 1.4. Aid Intensities regarding R&D

Aid Intensities	Type of R&D	Fundamental	Industrial	Precompetitive
	Standard rate (large firms outside the assisted areas)	100 %	50%	25%
	The following bonuses may apply:			
	SME	-	+10%	+10%
	Article 87/3(a) region	-	+10%	+10%
	Article 87/3(c) region	-	+5%	+5%
	Project linked to EU R&D framework programme	-	+15%	+15%
	Project involving cross-border co-operation	-	+10%	+10%

Source: Commission staff working document, November 2004.

Important note is that cumulation of the standard rate and the above business is subject to an absolute limit of 75% for industrial research and 50% of pre-competitive development.

In case where schemes apply to large companies, aid must be shown to have an incentive effect on company R&D (quantifiable indicators, demonstration of market failures, etc.). Aid for research and development, aid for technical feasibility studies and aid for patenting costs to SMEs can be exempted under the Commission Regulation No 364/2004 if its conditions are met. For each scheme, annual reports on implementation are required.

Notification should be given of any aid scheme which does comply with this framework or the de minimis rule by means of a standard form. Notification should

also show that the aid in question encourages firms to undertake R&D activities in addition to their normal day-to-day operations, and that without the aid these would not have taken place or would have been less ambitious.

The Commission is reviewing the framework for five years time. Further to a review of the framework commenced in March 2001, the Commission decided to continue applying the current rules until 31 December 2005.

3.2.1.6. State Aid for Environmental Protection

The environmental aid guidelines⁸⁹ stipulate that State aid for R&D in the environmental field is subject to the rules set out in the Community framework for State aid for research and development. However, these guidelines may be applied for other innovative State aid measures in the environmental field provided that their criteria are met. In such cases, permissible instruments are in particular grants and tax reductions or exemptions.

The Guidelines cover aid for actions designed to remedy or prevent damage to our physical surroundings or natural resources or to encourage the efficient use of these resources.

The Guidelines do not apply to:

- Aid for R&D and training in the environment field (R&D framework and training aid regulation apply).
- The production, processing and marketing of agricultural products listed in Annex I of the Treaty (Community guidelines for State aid in the agricultural sector apply).
- Sectors for which special rules apply: steel

⁸⁹ Community guidelines on State aid for environmental protection, OJ C 37, 03.02.2001, p.3.

The guidelines recognize three main types of environment aid, namely;

- **Operating aid to promote waste management and energy saving:** Firms should normally bear the costs of treating industrial waste in accordance with the “polluter-pays” principle. However, operating aid may be tolerated where national standards are introduced which are more stringent than the applicable Community rules or where national standards are introduced in the absence of Community rules, with the result that firms temporarily lose competitiveness at international level. All such operating aid is subject to a limited duration of five years where the aid is “digressive”. Its intensity may amount to 100% of the extra costs in the first year but must have fallen in a linear fashion to zero by the end of the fifth year. Where the aid is non-digressive, the intensity must be limited to 50% of the eligible costs. For want of European harmonization, operating aid in the form of tax reductions or exemptions must comply with certain specific provisions.

Operating aid is allowed in cases where it contributes significantly to the protection of the environment. The following types of operating aid may be authorized:

- Operating aid to promote environmentally-friendly forms of waste management and to promote energy saving
 - Operating aid in the form of reductions of or exemptions from taxes levied on certain activities for reasons of environmental protection (e.g. CO₂ levy)
 - Operating aid to promote renewable energy sources
 - Operating aid for the combined production of electric power and heat.
- **Aid for small and medium-sized enterprises (SMEs) for advisory/consultancy services in the environment field:** This type of aid can be approved in accordance with Regulation No 70/2001.
 - **Investment aid:** The investments concerned are investments in land which are strictly necessary in order to meet environmental objectives, investments in buildings, plant and equipment intended to reduce or eliminate pollution and nuisances, and investments to adapt production methods with a view to

protecting the environment. Eligible costs must be confined strictly to the extra investment necessary to meet the environmental objectives.

As there are different types of investment aid (transitional investment aid to help SMEs, investments in energy saving etc), the guidelines spell out for each type of aid the conditions and ceilings applicable.

- *Aid for investment to adapt new compulsory EU environmental standards or to improve on such standards*

Eligible costs: limited to extra costs of investments in land, buildings, equipment and intangible assets necessary to achieve compulsory standards and/or meet the environmental objectives.

Aid for investment to adapt to new compulsory EU standards: to SMEs only for a period of three years from the adoption of these new standards.

- *Aid for investment in energy saving, in renewable sources of energy and in combined heat and power installations (CHP)*

Eligible costs: limited to the extra costs of the investment in land, buildings, and equipment and intangible assets necessary for environmental objectives.

In case of renewable or CHP, the extra costs are defined as three extra costs compared to the costs of a comparable conventional power plant.

- *Aid for the rehabilitation of polluted industrial sites*

Eligible costs are the cost of the work to repair the environmental damage less the increase in the value of the land.

If the person responsible for the pollution is not identified or cannot be made to bear the cost, the person responsible for the rehabilitation of the land may receive aid.

- *Aid for the relocation of firms*

Aid for the relocation of the companies can be granted only if the change of location is dictated on environmental protection grounds and if it is ordered by administrative or judicial decision and the strictest standards are complied with.

- *Aid for advisor services*

Conditions for the SME Regulation apply.

Table 1.5. Maximum Aid for Investment Aid

Maximum aid for investment aid	Maximum aid intensities as a percentage of eligible costs	Outside assisted areas (GGE)⁹⁰	In assisted areas (GGE)
	(a) investment to adapt to compulsory EU Standards (SMEs only)	15%	15%
	(b) investment to improve on compulsory EU standards and relocation of firms	30%	40% or regional aid ceiling +10%
	(c) investment in energy saving and in CHP	40%	40% or regional aid ceiling +10%
	(d) investment in renewable sources of energy () 40%40% or regional aid ceiling +10%	40%	40% or regional aid ceiling +10%
	(e) Rehabilitation of polluted industrial sites	100 % of eligible 15% of the cost of	costs + the work

Source: Commission staff working document, November 2004.

In order to enable the Commission to assess any substantial amounts of aid granted under authorized schemes and to decide whether such aid is compatible with the common market, any individual case of investment aid must be notified in advance to the Commission where in the eligible costs exceed EUR 25 million and where the aid exceeds the gross grant equivalent of EUR 5 million.

The environmental aid guidelines lapse on 31 December 2007.

3.2.1.7. State Aid for Rescuing and Restructuring Firms in Difficulty

In order to authorize under the certain conditions the granting of state aid for rescuing and restructuring firms in difficulty, Community guidelines on state aid for

⁹⁰ gross grant equivalent.

rescuing and restructuring firms in difficulty⁹¹ was in force. In the course of the forthcoming review of the current guidelines, which are due to expire in October 2004, the Commission considered the possibility of imposing stricter conditions in order to reduce to a minimum aid which distorts competition, and therefore new guidelines on rescue and restructuring aid for companies in difficulty entered into force on 10 October 2004. The guidelines clarify the approach the Commission intends to take in individual cases where the State financially supports a rescue and restructuring operation in favor of individual enterprises. In so doing, Commission decisions in individual cases should become more predictable for companies and the public at large.

The rules clarify the eligibility of a firm: a firm is regarded as newly created (and thus ineligible for rescue or restructuring aid) during 3 years from start of operation. The so-called “one-time, last time” has been reinforced to exclude all kinds of repeated interventions with the exception of restructuring aid following rescue aid within the same operation. The new rules also strengthen the Commission’s recovery policy through a prohibition of new rescue or restructuring aid for firms which do not reimburse aid previously declared incompatible⁹².

Unlike the current rules, the new Guidelines allow for the undertaking of the first urgent structural measures during the rescue period. However, rescue aid can still only be granted in the form of reimbursable liquidity while other interventions, such as capital injections from public authorities which can not be undone, remain prohibited as rescue aid. Moreover, the rescue period is clearly limited to 6 months including the reimbursement of the rescue aid.

In order to speed up procedures, Member States have the possibility to opt for a lighter procedure to approve rescue aids if the amount of the aid does not exceed the result of a standard formula and, in any event, € 10 million. Furthermore, with the aim of concentrating resources on those cases that really pose a threat to competition, the Commission will no longer assess the viability of restructuring plans for SMEs.

⁹¹ OJ C288, 09.10.1999.

⁹² European Commission, Report on State Aid Scoreboard, 16.11.2004, COM(2004) 750 final.

To avoid distortions of competition, a principle has been introduced that compensatory measures are necessary except for small undertakings. Compensatory measures can take the form of divestment of assets, reduction in capacity or market presence, reduction of entry barriers, etc. It is also explicitly confirmed that activities which would have been abandoned anyway are not included in the assessment of compensatory measures.

The new Guidelines clarify that the contribution by the beneficiary should be real and free of aid. For small enterprises, it should in principle be at least 25% of the restructuring costs, for medium-sized enterprises at least 40%, and for large undertakings at least 50%. In exceptional circumstances and in case of particular hardship the thresholds can be reduced.

3.2.2. Regional Aids

The guidelines on national regional aid⁹³ are reserved for particular regions and have as their specific aim the development of those regions. Regional aid is designed to develop less-favored regions by supporting productive investment (initial investment) and job creation. It promotes the expansion, modernization and diversification of the activities of enterprises located in those regions and encourages new firms to settle there. The granting of such aid is conditional on the maintenance of the investment and the jobs created during a minimum period. The form of the aid is variable: grant, low-interest loan or interest rebate, government guarantee, tax exemption, reduction in social security contributions, amongst others.

According to the Article 87, State aids granted by Member States are in principle incompatible with the common market. There are, however, exceptions to this rule, in particular for:

⁹³ OJ C74, 10.03.1998, p.9 and OJ C258 09.09.2000, p.5

- Aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment (Article 87/3(a))
- Aid to facilitate the development of certain economic activities or certain economic areas, where such aid does not adversely effect trading conditions to an extent contrary to the common interest (Article 87/3(c)).

These two exceptions directly concern regional aid. Regional aid differs from the other categories of State aid (aid for research and development, small and medium-sized enterprises, training) because it is restricted to specific geographical areas and aims specifically at encouraging the economic development of those areas by providing support for investments and job creation.

The Commission considers that regional aid can justify the distortion of competition it causes provided that it adheres to certain principles: it must be exceptional in nature and limited in time, concentrated on the most disadvantaged regions and ensure that the resulting distortions of competition do not outweigh the advantages of the aid in terms of economic development.

The guideline apply to regional aid granted in every sector of the economy except the production, processing and marketing of agricultural products, fisheries and the coal industry, which are covered by special rules. Transport, steel, shipbuilding, synthetic fibres and motor vehicles are also subject to special rules over and above those set out in these guidelines. Moreover, *ad hoc* aid for firms in difficulty is governed by specific rules and not conceived of as regional aid as such.

The Commission considers that the total extent of regions eligible for regional aid in the Community must remain smaller than that of unassisted regions. Using the percentage of population covered as the unit for measuring the scale of the aid, the total coverage of regional aid in the Community must be less than 50% of the Community's population. For 2000-2006, the Community ceiling is 42.7% of the Community's

population, broken down in national thresholds for each Member State⁹⁴. Within the limits of these thresholds, priority is given to the regions effected by the most acute problems, in order to achieve a spatial concentration of aid.

To categories of eligible regions can be distinguished:

- *Article 87/3(a) regions:* These regions where the standard of living is abnormally low or where there is serious underemployment (NUTS⁹⁵ II region with a GDP/cap lower than 75% of the EU average).
- *Article 87/(c) areas:* These are problem areas defined on the basis of national indicators proposed by the Member States.

To allow effective control, the Commission sets an overall ceiling for the coverage of regional aid in the Community (42.7% of the Community's population for 2000-2006) covering all the regions eligible for the derogations in Article 87/3(a) and 87/3(c).

Three forms of regional aid are permitted:

Initial Investment: Investment on fixed capital relating to the setting up a new establishment, the extension of an existing establishment, or the starting up of an activity involving a fundamental change in the product or production process of an existing establishment.

Operating Aid: Aid aimed at reducing a firm's current expenditure (e.g. salary costs, transport costs, rents,...)

Aid for Job Creation: Regional aid may also focus on job creation linked to the implementation of an initial investment project. To be eligible for aid, jobs must have

⁹⁴ For example: Greece, Ireland and Portugal: 100%; Spain: 79.2%; Italy: 43.6%; Finland: 42.2%; France:36.7%; Germany:34.9%; Luxembourg: 32%; Belgium: 30.9%; United Kingdom: 28.7%; Austria: 27.5%; Denmark: 17.1%; Sweden: 15.9%; Netherlands: 15%.

⁹⁵ NUTS is the Nomenclature of territorial units for statistics.

been created within three years of the completion of the investment, and must exclusively concern the activity to which the investment relates. Jobs created following an increase in the utilization rate of the capacity created by the initial investment are also eligible. As with investment aid, aid may be granted for job creation only where the jobs created are maintained for at least five years and the aid must reflect the nature and seriousness of the regional problems it addresses.

Large investment projects⁹⁶ are initial investment project with eligible investment costs that are at large € 50 million.

Under the regional aid guidelines, the aid intensity is calculated as *Net grant equivalent*, which represents the final benefit which the firm is deemed to derive from an aid after corporate taxes payable on this aid have been deducted.

Aid for initial investment can be provided in relation to the following categories of expenditure:

- Investment in tangible assets (land, buildings, plant/machinery) and in intangible assets (expenditure entailed by technology transfer). Expenditure on transport equipment in the transport sector is not eligible.
- Gross-wage cost, calculated over a period of two years multiplied by the number of jobs created (net job creation in the establishment concerned).

Table 1.6. Aid Intensities regarding regional aids

Aid Intensities	Maximum Aid		Large Firms		SME ⁹⁷
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⁹⁶ Large investment projects are arranged with the multisectoral framework on regional aid for large investment projects (OJ C70, 19.03.2002)

⁹⁷ The absolute maximum aid intensity for SMEs is 30% NGE in (c) areas and 75% NGE in (c) areas.

		Standard regions NGE	Outermost regions NGE	Low population density NGE	Exc.transport Sector Gross
	Article 87/3(a) region				
	* GDP/cap < 60% of EU average	50%	65%	50%	+15%
	* GDP/cap > 60% of EU average	40%	50%	40%	+15%
	Article 87/3(c) areas				
	Standard	20%	30%	30%	+10%
	Prosperous ⁹⁸	10% ⁹⁹	20%	20%	+10%

Source: Commission staff working document, November 2004.

In any case, aid must be made conditional on the maintenance of the investment or of the employment created for at least 5 years. Cumulation rules have to be respected.

Operating aid may be granted in Article 87/3(a) regions, and only if all of the following conditions are satisfied:

- It is justified in terms of its contribution to regional development;
- Its level is proportional to the handicaps it seeks to alleviate;
- It is limited in time and progressively reduced;
- Any operating aid intended to promote exports between Member States is ruled out.

Member States must demonstrate the existence and importance of any handicaps.

⁹⁸ Regions with unemployment rate below and GDP/cap above EU average.

⁹⁹ 20% far for Article 87/3(c) areas that are adjacent to Article 87/3(a) regions.

Besides horizontal aids, some sectors are subject to specific rules and can be considered in different categories from the horizontal aids.

3.2.3. Sectoral Aids

Some sectors are binding with the special rules of the state aids. These sectors are; shipbuilding, motor vehicle sector, coal and steel, public broadcasting, transport, agriculture and fisheries. These sectors are generally those which can not compete with the competitor firms, and/or in crisis or need restructuring and support. In my thesis, only threes of them are going to be explained in order to understand the general view of the Commission on the sectoral aids.

3.2.3.1. State Aid to the Agricultural Sector

The new Commission Regulation 1/2004 granting exemptions for certain types of state aid accorded to SMEs agricultural enterprisers entered into force on 24 January 2004. Member states will no longer be required to notify these aids to the Commission in advance to obtain approval. The new Regulation will be applicable until the end of 2006.

The Regulation concerns State aid granted to small and medium-sized enterprises in the agricultural sector. In view of the definition of SME mentioned above, almost all holdings or enterprises in the agricultural sector come under these provisions.

Under Articles 3 and 19 of the Regulation, for individual aid or an aid scheme to be exempted, Member States must “at the latest 10 working days before the entry into force of an aid scheme, or the granting of individual aid outside any scheme, exempted

by this Regulation, [.....], forward to the Commission, with a view to its publication in the Official Journal of the European Union, a summary of the information regarding such aid scheme or individual aid in the form laid down in Annex I.”

On 6 October 2004, the Commission adopted a new Regulation on the application of Articles 87 and 88 of the EC Treaty for “de minimis” aid in the agricultural and fisheries sectors¹⁰⁰. It foresees that aid up to € 3000 per farmer/fisherman can be granted over a period of three years without being notified to the Commission, provided that the global amount of such aid does not exceed 0.3% of production in the agricultural or fisheries sector of Member State concerned. From 1 January 2005, Member states is able to grant aid that is in line with the Regulation without the Commission having to approve the aid in advance, but they also have to provide information certifying that two ceilings have been complied with.

3.2.3.2. State Aid to the Fisheries Sector¹⁰¹

The fisheries sector is a sector which is the subject of extensive public intervention, at the Community level as well as at the national level, due to its characteristics of a social and economic nature. With reference to the guidelines for the examination of State aid to fisheries and aquaculture, the Commission has assessed the compatibility with the Community law of national schemes granting State aid in the fisheries sector.

On 1 November 2004, a new set of rules on state aid to the fisheries sector came into force. These rules bring state aid policy into line with the reformed Common Fisheries Policy, adopted in December 2002. The new rules provide for a “block exemption” for certain types of aid which will no longer have to be notified and approved by the Commission before Member states can implement them. State aid in

¹⁰⁰ Commission Regulation No 1860/2004 of 6 October 2004 on the on the application of Articles 87 and 88 of the EC Treaty for “de minimis” aid in the agricultural and fisheries sectors, OJ L 325 of 28.10.2004, p.4.

¹⁰¹ Report on State Aid Scoreboard by the Commission, 20.04.2005, COM (2005), 147 Final, Brussels.

the fisheries sector which does not fall within the block exemption Regulation¹⁰² will still have to be notified to the Commission. Such State aid will be subject to new Guidelines for the examination of State aid to fisheries and aquaculture, which also entered into force on 1 November 2004.

The measures covered by the block exemption relate to aid unlikely to threaten conservation or distort competition in a manner not in line with the EU interest and which therefore have never given rise to investigation procedures by the Commission. The aid concerned has to comply strictly with the criteria set out in the block exemption regulation, which are identical to those governing the allocation of EU funds under the Financial Instrument for Fisheries Guidance (FIFG). The block exemption will apply to aid granted to small and medium-sized enterprises (SMEs) for amounts below € 1 million or to aid designed to finance measures with a maximum eligible amount of € 2 million. To ensure the proper allocation of such aid, monitoring will take place through simplified ex-ante information of the Commission on the aid to be granted, published on the internet and the Official Journal, and ex-post reporting obligations.

3.2.3.3. State Aid to the Transport Sector

De minimis

On 3 March 2004, the Commission adopted a draft regulation proposing to amend Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid. In the draft regulation, it is proposed to remove,

¹⁰² Commission Regulation (EC) No 1595/2004 of 8 September 2004 on the application of Articles 87 and 88 of the EC Treaty to State aid to small and medium sized enterprises active in the production, processing and marketing of fisheries products (OJ L 291, 14.9.2004, p.3)

with the exception of the acquisition of vehicles by road hauliers, the exclusion of transport from the *de minimis* rule, except in certain defined cases, and to exclude the coal sector from the scope of this regulation. Indeed, in the light of the Commission's experience in many State aid cases in the transport sector over the years, the Commission considers that it can be established that, with the exception of the acquisition of vehicles by road hauliers, aid to transport companies not exceeding a ceiling of EUR 100 000 over a period of three years is not liable to affect trade between Member States and does not distort or threaten to distort competition. With regard to the coal sector, which has been covered by the EC Treaty only since 24 July 2002, following the expiry of the ECSC Treaty, it has been subject to specific rules which prevent the application of other exemption regimes. During 2005, and in accordance with Council Regulation (EC) No 994/98, the Advisory Committee on State aid will be consulted twice on the draft proposal (before publication in the OJ and prior to adoption of the final regulation) which is expected to be finally adopted by the Commission in autumn 2005.

Aviation

In the Commission decision concerning advantages granted by the Walloon Region and the publicly-owned Brussels South Charleroi Airport (BSCA) to the airline *Ryanair* in connection with its establishment at Charleroi, the Commission gave indications as to the means by which public authorities may support the opening of new air links from secondary airports and hence make better use of secondary airports providing regional benefits and a reduction of air congestion. Following this decision the Commission services have presented to the Member States (9 March 2005) a set of draft Community guidelines on financing of airports and start-up aid to airlines departing from regional airports, which aim to clarify and make more transparent the different possibilities that are at the disposal of regional airports to develop themselves on the market in total conformity with Community rules on State aid. The final text was expected for adoption by mid 2005.

Rail

Revitalising the railway sector is one of the main objectives of European transport policy. Complementary to the gradual opening of the freight railway market, control of State aid will play an essential role in the establishment of a railway industry which is competitive and efficient. Therefore the Commission is envisaging a framework concerning the public financing of railway companies, which will be based on the principles of transparency, nondiscrimination and proportionality, while taking into account the main objectives of European transport policy. This framework should provide Member States and third parties with the necessary transparency and clarity with regard to the application of the State aid Treaty rules to the railway sector and also take into account the ongoing liberalization of the rail freight sector. A proposal for such a framework is envisaged for the end of 2005.

Maritime

On 17 January 2004 a new set of rules on State aid to maritime transport came into force. The main changes are the introduction of a nationality requirement for seafarers on intracommunity passengers' traffic, the introduction of an EU-flag requirement for a share of ships benefiting from aid and a clarification on how and to which extent the guidelines could apply to the towage and dredging activities.

After examining the aforementioned rules regarding rules on the assessment for approval of State aid with horizontal objectives (training, employment, environmental protection etc.), rules on the assessment for approval of regional aid and rules on the assessment for approval of aid to particular sectors (agriculture, fisheries, transport), we have four more remaining to examine which is rules on the assessment of certain financial transfers and transactions as State aid so as to the following.

3.2.4. State Aid in the Form of Guarantees¹⁰³

¹⁰³ Rules applicable to state aid, State aid in the form of guarantees, <http://www.europa.eu.int/scadplus/leg/en>

The Notice on State aid in the form of guarantees¹⁰⁴ explains the principles applied by the Commission in assessing whether State guarantees constitutes State aid within the meaning of Article 87/1. Among the criteria required to exclude presence of an advantage for an enterprise are that the guarantee is linked to a specific financial transaction, covers less than 80% of the amount of the loan and is not granted to enterprises in financial difficulty. Furthermore, the terms of guarantee must be based on a realistic risk assessment and must reflect the market price for a similar guarantee.

A state guarantee enables a firm to obtain better financial terms for a loan than those normally available on financial markets. It can thus facilitate the setting up of new businesses and enable some businesses to raise money in order to pursue new activities or simply remain active instead of being eliminated or restructured. Such aid can easily result in distortions of competition.

Without prejudice to the system of ownership in Member States, the notice applies to state aid granted in the form of guarantees by State or state resources. It covers all forms of guarantees except export credit guarantees. Any guarantees granted directly by the State, e.g. by central, regional, local authorities, and any guarantees granted by undertakings under the dominant influence of public authorities constitute aid.

Generally speaking, aid is caught by Article 87/1 of the Treaty if it is likely to favor a borrower or a lender (defined as aid to the borrower or aid to the lender) and has the effect of distorting competition or effecting trade between Member States.

The aid beneficiary is usually the borrower. However, in certain situations, the lender may also benefit.

The Commission considers that there is aid to the borrower in the form of a guarantee in cases where:

¹⁰⁴ Commission notice on the application of Articles 87 and 88 of the EC Treaty to State aid in the form of guarantees, OJ C71, 11.03.2000, pp.14-18

- The State forgoes the premium intended to cover the risks of non-payment of the guarantee;
- The legal form of the enterprise rules out bankruptcy or other insolvency procedures or provides an explicit state guarantee or coverage of losses by the State;
- The acquisition by a State of a holding in an enterprise if unlimited liability is accepted instead of the usual limited liability.

Even if the aid beneficiary is usually the borrower, it can not be ruled out that, under certain circumstances, the lender too will benefit from the aid. This is the case, for example, where a guaranteed loan is used to pay back another, non-guaranteed loan to the same credit institution. It is then possible that the lender will also benefit from the aid in so far as the security of the loan is increased.

Guarantees granted individually or under a scheme are referred to as individual guarantees or public guarantee schemes. The Commission considers that any state aid fulfilling the following conditions is compatible with the competition rules and thus exempt:

Table 1.7. Individual and Public Guarantees Scheme

Individual Guarantees	Public guarantee scheme
The borrower is not in financial difficulty.	The borrower is not in financial difficulty.
The borrower would, in principle, be able to obtain a loan on market conditions from the financial markets without any intervention by the State.	The borrower would, in principle, be able to obtain a loan on market conditions from the financial markets without any intervention by the State.
The guarantee is linked to a specific financial transaction.	The guarantee is linked to a specific financial transaction.
The guarantee gives rise to payment of a premium on the market price.	A realistic assessment of the risk has been carried out.
-	The guarantee is subject to a review of overall financing at least once a year.
-	The premiums cover both the normal risks associated with granting guarantees and the administrative costs of the scheme and

	allow a normal return on the initial capital.
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Source: <http://www.europa.eu.int/scadplus/leg/en>

Failure to comply with the above conditions does not mean that such a guarantee or guarantee scheme is automatically regarded as state aid.

Member States are required to notify the Commission in advance pursuant to Council Regulation No 659/1999. Member States are also required to present an annual report to the Commission giving the total amount of state guarantees outstanding, the total amount paid in the preceding year by the State to borrowers and the premiums paid for the state guarantees in the same year.

3.2.5. State Aid Elements in Sales of Land and Buildings by Public Authorities

The legal instrument to provide guidance concerning sales of land and buildings by public authorities in compliance with the competition rules is Commission Communication on State aid elements in sales of land and buildings by public authorities.¹⁰⁵

In line with the approach taken in most Member States, where provision is made for rules ensuring that public property is, in principle, not sold below its value, the Commission has taken the initiative of providing Member States with some guidance¹⁰⁶:

- Describing procedure for handling sales of land and buildings in a way that automatically precludes the existence of state aid,
- Specifying clearly the cases of sales of land and buildings that should be notified to the Commission so as to enable it to assess whether or not given transaction contains aid,

¹⁰⁵ Official Journal No C 209 of 10.07.1997

¹⁰⁶ Rules applicable to state aid , <http://www.europa.eu.int/scadplus/leg/en>

- Enabling the Commission to deal expeditiously with any complaints or submissions from third parties.

This guidance concerns only sales of publicly owned land and buildings. It does not concern the acquisition or the letting or leasing by public authorities of land and buildings.

The Commission presumes that the sale of land and buildings by a public authority does not contain aid if either one of the two procedures below has been followed:

- The sale was concluded on the basis of a sufficiently well-publicized, open and unconditional bidding procedure, accepting the best or only bid.
- The sale is conducted at the market value as established by independent valuers. The price at which the land or buildings concerned are sold should conform at least to the price indicated by an independent “asset valuer” in his expert evaluation.

If after a reasonable effort to sell at the value indicated in the expertise it is clear that the land/building can not be sold at that price, a divergence of up to 5% from the original value can be deemed to be in line with market conditions.

Member States should notify to the Commission, without prejudice to the *de minimis* rule any sale which was not concluded in conformity with either one of the procedures described above. A third party may contact the Commission if it suspects that an agreement for the sale of land and buildings by public authorities comprises a state aid element.

3.2.6. State Aid Elements in Direct Business Taxation

The Commission notice on the application of the State aid rules to direct business taxation¹⁰⁷ focuses on the form of aid rather than on its objective. Its objective¹⁰⁸ is to ensure consistency and equality of treatment between Member States in the application of the State aid rules to measures relating to direct business taxation and to ensure that Commission decisions are transparent and predictable. The Commission notice confirms that State aid rules apply to all aid measures whatever their form, and therefore also to tax measures. It clarifies the distinction between selective tax measures that constitute aid and general measures that are open to all economic agents and do not confer discretionary powers on the tax administration. The notice also explains under which conditions a certain tax measure does not constitute State aid as it is justified “by the nature or general scheme of the tax system”.

With a view to harmonizing Member States’ tax rules, the EC Treaty made provision for the Council to adopt directives unanimously (Article 94) and for the Commission or the Council, acting by qualified majority, to address certain differences between the general rules in force in Member States that could distort competition (Article 96 and 97). Distortions of competition stemming from state aid are governed by Article 88 and must be notified to the Commission.

The Council made known its intention to draw up a code of conduct for business taxation¹⁰⁹. The code of conduct improves transparency in the tax field through a system of information exchanges between Member States and assessment of any tax measures that may be covered by it.

The Commission uses the following criteria with respect to the State aids from the tax point of view¹¹⁰.

¹⁰⁷ Commission notice on the application of the State aid rules to measures relating to direct business taxation, OJ C384, 10.12.1998. See also the report on the implementation of the Commission notice on the application of the State aid rules to measures relation to direct business taxation, COM (2004) 434 final, 09.02.2004.

¹⁰⁸ <http://www.europa.eu.int/scadplus/leg/en>

¹⁰⁹ Council Resolution of 01 December 1997, Official Journal C 2 of 6 January 1998.

¹¹⁰ Hakan Üzeltürk, Avrupa Birliği – Türkiye Devlet Yardımları, Vergi Sorunları Dergisi, 2001.

State aid relating to direct business taxation is in breach of competition rules and subject to Article 87 where:

- It confers on recipients an advantage which relieves them of charges that are normally borne from their budgets. For example, whole or partial discount in the tax amount, tax deduction, tax deferral, tax offset.
- The advantage is granted by the State or through state resources. Regional and local authorities are accepted as a public body.
- The measure affects competition and trade between Member States. Phillip Morris v. Commission¹¹¹ can be given as an example.
- The measure is specific or selective in that it favors certain undertakings or the production of certain goods.

The Treaty clearly stipulates that a measure which is sectorally specific is caught by Article 87/1. In addition, according to the ruling delivered by the Court of Justice in 1974, any measure intended partially or wholly to exempt firms in a particular sector from charges arising from the normal application of the general system “without there being any justification for this exemption on the basis of the nature or general scheme of this system” constitutes state aid. However, tax measures which are open to all economic agents operating within a Member State are, in principle, general measures and not state aid.

Any decision of the administration that departs from the general tax rules to the benefit of individual undertakings leads, in principle, to a presumption of state aid and must be analyzed in detail by the Commission.

If a tax measure constitutes aid that is caught by Article 87/1, it can nevertheless qualify for one of the derogations from the principle of incompatibility with the common market provided for in Article 87/2 and 87/3. Furthermore, where the recipient, whether a private or public undertaking, has been entrusted by the State with

¹¹¹ Case 730/79 Phillip Morris v. Commission (1980).

the operation of services of general economic interest, the aid may also benefit from Article 90 of the Treaty.

After examining the compatibility of tax aid with common market, the Commission could not, however, authorize aid which proved to be in breach both of the rules laid down in the Treaty and of the provisions of secondary law on taxation, such as the code of conduct.

If, moreover, the state aid confers continuous tax relief but is not linked to the carrying out of projects such measures constitute “operating aid” and are, in principle, prohibited. The Commission authorizes them at present only in exceptional cases and subject to certain conditions.

If it is to be considered compatible with the common market, state aid intended to promote the economic development of particular areas must be in proportion to, and targeted at, the aims sought. Where derogation is granted on the basis of regional criteria, the Commission must ensure in particular that the relevant measures:

- Contribute to regional development,
- Relate to real regional handicaps,
- Are examined in a Community context.

Member States are required to notify the Commission of all their plans to grant or alter aid and may not put such plans into effect without the Commission’s prior approval. They are also required to submit to the Commission every year reports on their existing state aid systems.

The Commission notice has proved to be a suitable tool for assessing tax aid but, as it is general in scope, the Commission might have to supplement and clarify certain aspects. However, it does not intend to devise specific compatibility criteria for state aid granted in the form of tax measures. As regards tackling harmful taxation, the

Commission believes that it is necessary to strengthen awareness of the tax aid rules among both Member States and businesses.

After the approving of Code of Conduct, the Commission had taken a decision regarding State aids in direct business taxation. The Commission did not apply to the state aid rules in the Treaty but ask for to apply Article 87 of the Treaty more rigid. In this respect, the Commission initiated assessments on various tax implementations. By the aforementioned rigid attitude of the Commission, some tax arrangements outside the scope of state aid can be considered within that extent.

3.2.7. State Aid and Risk Capital

The Commission defined (in SEC (1998) 552 final of 31 March 1998) risk capital as equity financing provided to companies in their start-up and development phases.

On a capital market sometimes short of financial resources, European companies, and in particular small and medium-sized enterprises (SMEs) and the high-technology sector, face an equity gap. Indeed, the provision of equity finance presents numerous challenges both to the investor, who needs to make a careful analysis, and to enterprise, which must agree to share control with an outside investor. In order to ensure that European enterprises do not become over dependent on debt finance, the European Union has developed a general policy in favor of promoting risk capital. However, from the viewpoint of competition, risk capital financing proved problematic in relation to the Commission's general policy on state aid, particularly as regards the essentially commercial nature of such financing on the fact that the beneficiary is often in the private sector. The Commission recognizes the important role that public authorities still have to play but takes the view that risk capital measures must be restricted to addressing certain "market failures" in the knowledge that public capital for enterprises is not the same as state aid.

The Commission Communication on State aid and risk capital¹¹² recognizes a role for public funding of risk capital measures limited to addressing identifiable market failures. Public authorities, under certain conditions, can use public capital in order to increase the supply of risk capital. In general, the Commission assesses the existence of State aid at the level of the investors, the intermediary vehicle (fund) and the enterprises invested in (there are three types of aid beneficiary). The Commission has pointed out that this type of financing is not always considered to be compatible with the EC Treaty, which allows the granting of state aid under certain conditions. The assessment also takes into account whether the proposed measures encourage market investors to provide risk capital to target enterprises and are likely to result in decisions being taken on a commercial basis. The forms of incentives considered include the constitution of investment funds, grants to venture capital funds to cover part of their administrative costs, guarantees to risk capital investors and fiscal incentives to investors. However, the communication is not applicable in the case of measures that provide capital to an enterprise solely in the form of loans.

On the other hand, since certain measures to support risk capital do not have any distortive effect on competition, the Commission has acknowledged following a thorough analysis that state aid for risk capital is admissible where it can be shown that there is a market failure.

When assessing risk capital funds, the Commission examines whether State aid is present at each of the following levels:

Aid to the investors: Where a measure allows investors to participate in a risk capital fund on terms more favorable than if they had undertaken this investment in absence of the measure, then those investors may receive State aid. The same applies where the investors participate in a fund on terms more favorable than public investors.

¹¹² OJ C235, 21.08.2001, p.3

Aid to an intermediary vehicle or fund: Normally, the fund is merely a vehicle for the transfer of aid, rather than being an aid beneficiary itself. However, in certain cases (notably existing funds with several investors), the fund may have the character of an independent enterprise.

Aid to the enterprises invested in: The main test is whether investment in the enterprise has been made on terms acceptable to a normal economic operator in a market economy. Investors whose risks have been reduced, or whose rewards have been increased by a measure, may be said no longer to be such operators.

Market failure is main assessment criterion and can be defined as a situation in which the economic efficiency of supply and demand is not achieved owing to imperfections in the market mechanism. The causes of such market imperfections are often to be found in imperfect information and high transaction costs, which penalize mainly SMEs and new firms. Market failure will normally be assumed in cases where each tranche of finance to an individual enterprise will be below € 500.000 in non-assisted regions or € 750.000 in Article 87/3(c) areas or € 1.000.000 in Article 87/3(a) areas. In cases where these ceilings would be exceeded, clear evidence should be provided of the existence of market failure.

Assessment of risk capital measures on the basis of existing State aid regulations, frameworks or guidelines:

In a few cases, risk capital investments can be approved under the existing regulations, frameworks or guidelines. This would be the case if the equity capital invested in a company is provided in conformity with the provisions laid down in one of these regulations, frameworks or guidelines (e.g. the de minimis or SME aid regulation). In most cases, this will not be possible for a number of reasons (e.g. the difficulty of establishing a grant equivalent of equity capital provided to companies, the difficulty of establishing a link with eligible costs, the fact that no State aid regulation, frameworks or guideline provides any basis for measures providing aid at the level of the investors).

In cases where risk capital measures can not be cleared on the basis of existing State aid regulations, frameworks or guidelines, the Commission will assess the compatibility of State aid measures, taking into account the following elements:

The Commission will regard the following characteristics as positive elements in its evaluation:

- Investments are restricted to small enterprises and/or to medium-sized enterprises in their start-up or other early stages or in assisted areas.
- The measure focuses on provision of risk capital rather than on provision of other forms of finance (e.g. loan capital).
- Decisions to invest are profit-driven. This would be the case if there is a link between the financial performance of the fund and the remuneration of those responsible for the investment decisions. This would also be the case if there is significant involvement of market economy investors, capital being invested on a commercial basis in the equity of the target enterprises.
- The level of distortion of competition between investors and between investment funds is minimized. This could be achieved as a result of an open call for tender for the establishment of any preferential terms given to investors. Alternatively, the preferential terms could be established at the launch of the investment fund and could be made availability to all interested investors.
- Investments by the fund take place on the basis of a business plan.
- The measure provides for a clear exit mechanism.
- There are limits to the cumulation of aid measures to single enterprise.

Specific rules on innovation¹¹³:

- It is recognized that there is an equity gap concerning European SMEs as regards high-tech innovative and mostly young firms with high growth potential.

¹¹³ Commission Staff Working Document, Community Rules on state aid for innovation, 15.11.2004.

- The philosophy underlying the strategy for developing the Community risk capital market attaches primary importance to the creation of new and innovative business through structural and horizontal measures.
- The communication also recognizes the difficulties linked to the traditional concept of “eligible costs” in the field of risk capital especially for many young or innovative enterprises.
- The presence of the market failure concerning imperfect or asymmetric information particularly concerns highly innovative or risky projects, which justifies a certain level of State aid on certain conditions.
- In the compatibility assessment, the communication states that to the extent that many private sector funds focus on specific innovative technologies the Commission is prepared to accept a sectoral focus where this has a commercial as well as public policy logic.

The Commission notice will remain in force for five years provided that no new decision is taken.

3.3. Control of State Aids in the EU

3.3.1. Procedural Legislation

The Commission’s state aid policy relies on the prior notification of new or altered aids. This is an obligation placed on Member State authorities. The obligation to notify is set out in Article 88/3 of the Treaty, which states that the Commission “shall be informed, in sufficient time to enable it to submit its comments, or any plans to grant or alter aid”. However, Article 88 of the Treaty does not lay down any detailed procedural rules for the application of State aid provisions. In the absence of a procedural Regulation akin to 17 under Article 81 and 82 of the Treaty, the procedural

rules applicable to the notification, approval and recovery of State aid developed from the case law of the ECJ and CFI and the administrative practice of the Commission. In order to introduce greater certainty and transparency into the field of State aid, the Council adopted Regulation 659/1999 (“the Procedural Regulation”) laying down detailed rules for the application of Article 88. Council Regulation 659/1999, which was adopted in 1999, was the first significant step towards greater transparency and increased legal certainty in the application of the state aid rules by the Commission by codifying the jurisprudence of the Community courts. A few years later, on 24 March 2004, the Commission adopted a set of rules implementing and clarifying the Procedural Regulation¹¹⁴. The Commission Regulation No 794/2004 (the “Implementing Regulation”) sets out the form and content for notifying state aids and annual reports, in addition to elucidating other elements of state aid procedure that had until then remained frustratingly vague, such as time limits and their calculation and the level of interest rates in case of recovery.

One of the main objectives of the Implementing Regulation is to free the process of examining state aid measures from unnecessary procedural burdens, thereby facilitating rapid decisions. Through a new and compulsory notification form, the Regulations aims at improving the efficiency of the Commission’s assessment of planned state aid measures, as the form contains a set of questions drafted along the lines of the existing framework and guidelines applicable to aid measures.

In the light of the Procedural and Implementation Regulation, before dealing with the review of existing, new and unlawful aid, it is necessary to figure out the scope of notification obligations and the general procedural rules for application of Article 88.

Save as otherwise provided in regulations made pursuant Article 88/3 of the Treaty or to other relevant provisions thereof, any plans to grant new aid must be notified to the Commission in sufficient time by the Member State concerned, which is required to provide all necessary information in order to enable the Commission to take a decision. Any notifiable aid must not be put into effect before the Commission has

¹¹⁴ The legal basis was Article 27 of Regulation EC 659/1999

taken or is deemed to have taken a decision authorizing it (standstill clause). It must be notified on a notification form as set out in Annex I, Part I to Regulation EC No 794/2004. From 1 January 2006 notifications will be transmitted electronically, unless otherwise agreed between the Commission and the notifying Member State¹¹⁵.

If the Commission does have doubts as to the compatibility of the notified measure with the common market, it must open the contentious procedure (formal investigation) set out in Article 88/3 of the Treaty without delay. The Court has held that the expression “without delay” means within two months¹¹⁶. If within that period the Commission has not made its view known, the aid may be granted and then becomes an existing aid. The Member State concerned and interested parties may submit comments within a period of less than one month, which may be extended by the Commission.

Article 88/2 of the EC Treaty which regulates the investigation procedure of the Commission is “If after giving a notice to the parties concerned to submit their comments, the Commission finds that aid granted by State or through state resources is not compatible with the common market having regard to Article 87, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission. If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Article 226 and 227, refer the matter to the Court of Justice.”

If the Commission has serious doubts of compatibility of the notified aid with the common market or if it considers that notified aid will be approved under the certain conditions, it has to open an investigation as an interim decision. In addition, investigation will have been opened in case of misuse of the approved aid and unlawful aid.

¹¹⁵ www.europa.eu.int

¹¹⁶ Case 120/1973, Gebr. Lorenz GmbH v. Germany et al (1973)

The formal investigation proceedings will be closed by means of a decision. The Commission may find that¹¹⁷:

- the notified measure does not constitute aid;
- the doubts as to the compatibility of the notified measure with the common market have been removed and the aid is compatible with the common market (positive decision). The Commission may attach to a positive decision conditions subject to which aid may be considered compatible and lay down obligations to enable compliance with the decision to be monitored (conditional decision);
- the notified measure is incompatible with the common market and may not be put into effect (negative decision).

In general, if the Commission is unable to reach the view that the aid is compatible with Article 87 within a two month period it should initiate the formal procedure under Article 88/2.

If the Member State fails to comply with a conditional or negative decision, the Commission may refer the matter to the Court of Justice direct.

The Member State concerned may withdraw the notification before the Commission has taken a final decision. It may also amend an aid that has already been notified and approved. The amendments, notified using the form given in Annex II to Regulation EC No 794/2004, should not influence the assessment of the aid measure's compatibility with the common market.

The Commission may revoke a decision where it was based on incorrect information.

The Commission may, after giving the Member State concerned the opportunity to submit its comments, adopt a decision requiring the Member State to suspend any unlawful aid (suspension injunction). In the same way, the Commission may adopt a

¹¹⁷ Rules of application and procedure for Article 88 of the EC Treaty, 30.07.2004, <http://www.europa.eu.int>

decision requiring the Member State provisionally to recover any unlawful aid until it has taken a decision on the compatibility of the aid with the common market (recovery injunction) if the following criteria are fulfilled:

- according to an established practice, there are no doubts about the aid character of the measure concerned, and
- there is an urgency to act, and
- there is a serious risk of substantial and irreparable damage to a competitor.

If the Member State fails to comply with any of the above-mentioned injunctions, the Commission is entitled to refer the matter to the Court of Justice and apply for a declaration that the failure to comply constitutes an infringement of the Treaty.

Where negative decisions are taken in cases of unlawful aid, the Commission will decide that the Member State concerned must take all necessary measures to recover the aid from the recipient (recovery decision). The Commission would not require recovery of the aid if this were contrary to a general principle of Community law. The powers of the Commission to recover aid will be subject to a limitation period of ten years.

Where the Commission has serious doubts as to whether decisions not to raise objections, positive decisions or conditional decisions are being complied with, the Member State concerned must allow the Commission to undertake on-site monitoring visits. The officials authorized by the Commission to check compliance will be empowered:

- to enter any premises and land of the undertaking concerned;
- to ask for oral explanations on the spot;
- to examine books and other business records and take or demand copies.

Member States must send the Commission annual reports on all existing aid schemes with regard to which no specific reporting obligations have been imposed by a

Commission decision. The reports must be made out using the standardized reporting format in Annex IIIA to Regulation EC No 794/2004.

As stated in the above-mentioned paragraphs, the general scope of notification obligation of the aid is emphasized on Article 88 of the EC Treaty. While Article 88 draw the lines of the framework of the notification obligations and review of new and existing aid, Procedural Regulation lays down detailed rules for the application of Article 88 of the Treaty. It also sets out provisions for the calculation of time limits in all procedures concerning State aid and of the interest rate for the recovery of unlawful aid. Therefore, in order to understand the procedural rules and facilitate the preparation of State aid notifications by Member States it is necessary to review the extent of the new and existing aid besides unlawful and misused aid.

3.3.2. Review of Existing Aid¹¹⁸

It is important to distinguish between existing aids, which are subject to review under Article 88/1 but not to pre-notification and new aids and alteration of existing aids which require pre-notification. “Existing aids” comprise:

- i. aids in operation when the Treaty came into force or when new member States acceded to the Treaty¹¹⁹;
- ii. authorized aid, namely, aid schemes and individual aid which have been authorized by the Commission or Council;
- iii. aid which is deemed to have been authorized as a result of a failure on the part of the Commission to take a decision as to the compatibility or otherwise of a notified aid;

¹¹⁸ P.M. Roth QC, *op.cit*, p.1252.

¹¹⁹ For an example of pre-accession aid being an existing aid, see Case C-387/92 Banco Exterior de Espana v. Commission (1994).

- iv. aid which is deemed to have been authorized as a result of no action having been taken by the Commission to recover that aid within ten years of its award; and
- v. aid which is deemed to be existing aid because it can be established that at the time it was put into effect it did not constitute an aid, and subsequently became an aid due to the evolution of the common market and without having been altered by the Member State¹²⁰.

In *Namur-les Assurances*¹²¹ the Court of Justice held that the question of whether aid is existing, new aid or an alteration of existing aid is to be determined by reference to the legislative or other provisions for it and not by its scale or amount.

For the review of existing aid schemes, the Commission shall obtain all the necessary information from the Member State concerned¹²². If the Commission considers that an existing aid is not or is no longer compatible with the Treaty, it must first inform the Member State concerned and provide it with the opportunity to submit its comments within a period of the month. Where the Commission, in the light of the information provided by the Member State, concludes that the existing aid scheme is not or is no longer compatible with the common market, it must issue a recommendation proposing appropriate measures to remedy the situation by substantive or procedural amendment, or abolition of the scheme. Such a proposal is not legally binding but has important legal consequences since if the Member State accepts the proposed measures, the Commission recommendation becomes binding¹²³. Where, however, the Member State concerned does not accept the Commission's recommendation, the Commission is then able to proceed to with the formal investigation procedure under Article 88/2¹²⁴.

¹²⁰ Cases T – 298/97, etc. *Mauro Alzetta v. Commission*, the CFI annulled the part of the Commission's decision which found that measures which became aid subject to the Treaty after liberalization of part of the transport sector were new aids; they were to be classified as existing aid.

¹²¹ Case C-44/93 *Namur-les Assurances du Credit SA v. OND* (1994).

¹²² Case C-135/93 *Spain v. Commission* (motor vehicle framework No. 1) (1995).

¹²³ Case C-288/96 *Germany v. Commission* (2000)

¹²⁴ The procedure was initiated against Spain and Germany when they refused to accept the Community framework for State aid to the motor and vehicle industry. In the case of Spain, the procedure was closed after the Spanish authorities decided to apply the framework.

Existing aid or measures adopted under an existing aid scheme may be implemented as long as the Commission has not found such aid to be incompatible with the common market.

3.3.3. Review of New Aid

Article 88/3 provides “the Commission shall be informed in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.”

Article 88/3 concerns aid other than existing aid which is dealt with by Article 88/1, that is to say new aid. Article 2 of the Procedural Regulation requires notification of any plans to grant “new aid”. The Procedural Regulation defines new aid as aid schemes and individual aid, which is not existing aid, including alterations to existing aid. Such notifiable aid awards include those where the Commission has set certain thresholds for the notification of individual aids once the Commission has accepted the general scheme under which the aids are granted or where the Commission has imposed individual notification requirements amongst the terms and conditions of its authorizations¹²⁵.

The notification requirement extends to all necessary information in order to enable the Commission to undertake an assessment of the aid in question. Thus the entire aid scheme must be notified and this includes any modifications to the proposed scheme subsequent to the initial notification. An unnotified alteration to a proposed scheme prevents a Member State from putting the whole scheme into effect unless the alteration is a separate aid measure which should be assessed separately. It would seem

¹²⁵ P. M. Roth QC, *op.cit.*, p.1255.

that there is no need to notify minor adjustments made only in order to take account of inflation. Where the Commission considers that information provided by Member State concerned with regard to a notified measure is incomplete, it must request all necessary additional information to be provided within a specific period and, if such information is not provided, or if incomplete information is provided, the notification is deemed to be withdrawn and the aid thus becomes unnotified notifiable aid.

Council Regulation 994/98 enables the Commission to adopt block exemption regulations in relation to certain categories of aid. The Commission is empowered to declare, by regulation, aid in favor of SMEs, research and development, environmental protection, employment and training, and certain regional aid as compatible with the common market and, as such, exempt from the notification requirements of Article 88/3. As required by Regulation 994/98, the block exemption Regulations specify conditions subject to which the exemption applies, including the purpose of the aid, the category of beneficiaries, the threshold below which the exemption will apply and the sectors which are excluded.

As I said before, aid measures which need notification pursuant to Article 88/3 and Article 2 of the Procedural Regulation shall not be put into effect before the Commission has authorized, or is deemed to have authorized such aid. The Commission takes the view that an aid is out into effect when the legislative measures that enable the aid to be granted without further formality have been adopted. Breach of suspension obligations enables the Commission to issue interim orders¹²⁶.

There is no time-limit for the Commission to review the new aid. But it was held in *Lorenz*¹²⁷ that a period of two months is sufficient time for the Commission to form a view on the compatibility of the notified aid with the Treaty. The time-limit is also adopted in the Procedural Regulation. Time starts to run only from the receipt of a complete notification¹²⁸. By the end of that period, the Commission must adopt, after a

¹²⁶ Case 301/87 *France v. Commission* (1990).

¹²⁷ Case 120/73 *Lorenz v. Germany* (1973).

¹²⁸ Case C-99/98 *Austria v. Commission (Siemens)*, judgment of 15 February 2001 as to when time starts to run.

preliminary examination, one of the decisions set out in the Procedural Regulation. Where new aid has been put into effect in breach of Article 88/3, the Commission is not bound by the two months period. A Member State can not terminate that period unilaterally. If the Commission has not defined its position within that period, the aid is deemed to have been authorized by the Commission and the Member State may implement the plan after giving prior notice to the Commission, unless the Commission takes a decision within 15 days of such prior notice.

3.3.4. Unlawful Aid and Misuse of Aid

This section of my thesis discusses the grant of unlawful aid, which is defined in the Procedural Regulation as new aid put into effect in breach of Article 88/3¹²⁹, and misuse of aid which is defined as aid used by the beneficiary in contravention of a decision by the Commission pursuant to the Procedural Regulation or in contravention of a positive or conditional decision following a formal investigation procedure under the Procedural Regulation.

Court of Justice rejected the Commission's submission that failure to comply with the notification requirement of Article 88/3 rendered an aid incompatible with the common market. The Court considered that the Treaty required that any finding that an aid is incompatible with the common market should be the outcome of the formal investigation procedure by the Commission under Article 88/2. When the Commission has information about an alleged unlawful aid and misuse of aid, it is entitled to request information from the Member State concerned. The Commission is entitled, after giving the Member State an opportunity of submitting its comments, to take an interim decision requiring suspension of unlawful aid or misuse aid pending the outcome of the examination of the aid. In some cases, the Commission considered that an interim decision merely requiring suspension of aid would not go far enough to all or part of the aid has already been awarded. When the Commission decides that unlawful aid is incompatible with the Treaty, it shall issue a decision requiring the Member State

¹²⁹ Hancher, Ottervanger and Slot, *EC State Aids*, 2nd Edition, Sweet & Maxwell, 1999.

concerned to take all necessary measures to recover the aid from the beneficiary. Since the recovery of unlawful State aid is the logical consequence of a finding that it is unlawful and the aim of the recovery is to restore the previous situation, the Commission, will save, in exceptional circumstances, not exceed the bounds of its discretion in seeking recovery¹³⁰. The Commission shall order in its recovery decision the payment of interest at a rate determined by it, payable from the date on which the unlawful aid was at the disposal of the beneficiary until the date of its recovery.

The Commission is not ordered to order recovery of aid after a limitation period of ten years from the day on which the unlawful aid was awarded to the beneficiary either as an individual aid or as aid under an aid scheme.

In *British Aerospace v. Commission*¹³¹ the Court of Justice annulled a Commission decision requiring the United Kingdom to recover £ 44.4 million, being allegedly new aid granted in violation of an earlier Commission decision. If the Commission had considered the aid to be in breach of the earlier decision it should have brought the matter to the Court of Justice under the second paragraph of Article 88/2. If, on the other hand, the new aid fell outside the scope of the earlier decision, the Commission had to open the Article 88/2 procedure. When the Commission could not do was to declare the new aid incompatible with the common market without opening the Article 88/2 procedure. In cases of misuse of aid, the Commission may institute or re-institute the formal investigation procedure.

3.3.5. Liability of National Courts

National courts of the Member States play complementary role on the control of state aid with separate tasks from the Commission. Both the national courts and the Commission have different functions on state aid policy. Commission considers the

¹³⁰ Case C-142/87 *Belgium v. Commission* (1990), Case T-298/97 *Mauro Alzetta v. Commission* (2000).

¹³¹ Case C-294/90 *British Aerospace and Rover v. Commission* (1992)

state aid whether it is compatible with the common market; and national courts consider it with respect to the protection of private rights and fulfilling of obligations¹³². But the Treaty has direct effect on the Member States legislation. Therefore national courts do not able to protect the private rights of the Member States at the procedure initiated pursuant to the Article 88/2 and they must help the Commission to apply the procedural rules stated in the Article 88/3. Within the context of protection of private rights, national courts can give judgments on the annulment actions and compensation claims which third parties will bring against the State and the recipient of the aid. In order to bring such actions by means of private law, it is known that the aid, granted without taken approval of the Commission, is unlawful and the Commission gave negative decision to that aid. In case of the first situation, third parties are able to complain to the Commission.

3.3.6. Liability of Candidate Countries

Obligations of candidate countries by means of EU competition law are determined within the framework of the agreements which draws the lines of the liabilities of the candidate countries with the EC Treaty. In general, institutional structure which suggests monitoring of aids that distort competition and trade in the EU is foreseen. Within the framework of the agreements, candidate countries assign an authority which will work efficiently for monitoring state aids and the authority have to inform Commission about the aid programme of the candidate country.

But these kinds of agreements are not standard. According to the agreements, followings are expected from the monitoring authority of the candidate countries; to inform the Commission about the State aid applications in the EU, to ensure not to be applied of the state aids without approval, to ensure that the state aids are applied by the shape of Commission's approval, to monitor the implementations of the state aids.

¹³² Mustafa Mehmet Özkaraüber, Avrupa Birliği ve Türkiye'de Devlet Yardımlarının Kontrolü, İlk Baskı, Temmuz 2003, Ankara, p.25.

Association Council constituted between the EU and candidate country will decide whether state aids are incompatible with the common market and distort competition and effect trade between the EU and the candidate country. In case, Association Council may not make a decision with respect to the notified aids, aids will be considered in accordance with the relevant articles of GATT. However, according to the Hancher, Ottervanger and Slot¹³³ Article 88 of the EC Treaty must apply to any of the application which is made pursuant to the Article 87.

IV. STATE AIDS IN TURKEY

Relations between the European Union and Turkey are based on the Agreement establishing an Association between the EEC and Turkey, the so-called Ankara Agreement, which was signed on 12 September 1963 and came into force on 1 December 1964. The cornerstone of this agreement is the establishment of a customs union in three stages. A Financial Protocol accompanied this agreement. A second and third Financial Protocol were signed in 1970 and 1977 respectively. The Ankara Agreement also set up an Association Council that meets regularly and discusses the work of the association. This institutional framework was expanded with the implementation of the final phase of customs union. The Association Agreement was supplemented by an Additional Protocol, which was signed on 23 November 1970 and came into force on 1 January 1973, establishing a timetable of technical measures to be taken to attain the objective of the customs union within a period of 22 years. By the decision taken in the Helsinki Summit in 1999 which Turkey has gained a candidate country statute this harmonization has gained both political and social dimension.

Relationship between Turkey and EU has been developed by the Accession Partnership Document prepared in the Helsinki Summit held on 1999. After the 1/95 Association Council Decision which established Customs Union between Turkey and

¹³³ Hancher, Ottervanger and Slot, EC State Aids, 1999, p.106.

EU, the framework of Turkey's obligations against EU have been drawn up by the National Program published in the Official Gazette numbered 24352 and dated 24.03.2001. From that date on, Turkey has entered in an intensive and dynamic process in order to make necessary legal changes and scrutinize the EU acquis.

In order to be a member of EU, Turkey has to adopt and harmonize its legislation with EU acquis. In this case, harmonization of Turkish state aid system with EU and adopt of necessary legislation of EU will become one of the main part of Turkey's obligations. Harmonization of Turkish State aid system with the EU rules and examination of the system within the framework of the EU Acquis has gained an importance by the Association Council Decision numbered 1/95. The necessity to make common study with the Commission regarding technical and administrative arrangements is clear.

Despite Turkey's obligation under the CU to align its legislation and set up the necessary administrative body for state aid monitoring, the legislation concerning state aid control based on EC principles and criteria is still not adopted. Turkey has to align its legislative framework with the acquis and the obligations of the CU, and to establish a state aid monitoring authority. Therefore, we have to pay necessary attention to the Turkish state aid and incentive policy not only after the establishment of customs union, but also before the establishment of customs union. In this regard, it is more useful to separate the Turkish state aid system into two groups; one is investment incentives and other is export incentives.

4.1. Turkey's Incentive Policy

It is possible to see the roots of the state aid system of the Turkey in the 19th century. After the developments made in the government of Turkey, it can easily be said that management structure become central and all incentives in Turkey are granted by central government. In the practice all efforts are performed to make aims (like classifying incentives into two groups; investment and export, to remove imbalance

among regions, to spread the capital to the base, to create employment, to use high technologies which is value added, to support SMEs, to make Turkish firms gain competition power in the international area) be compatible with the state aid policy.

Like in all countries, State aids policy is naturally arranged to encourage industry in Turkey. Incentive legislation whose roots have gone to the Ottoman Empire term had continued in the Republic term and it increased in the period of 1950 – 1960 with the Law of Encouragement of Foreign Investment and Petroleum Law¹³⁴. In the period of 1960-1980, it is determined that protectionism and import substitution made competition power of Turkey's industry weaken and by the January 24, 1980 decisions, import substitution for industrialization is left and export-oriented industrialization model is adopted.

Turkey provides various incentives and grants to the investors for the purpose of facilitating larger investments and capital contributions by the local and foreign investors and eliminating regional imbalances. The current incentive regime is in line with Turkey's commitments under the WTO and customs union; hence, it does not breach the international liabilities and commitments of Turkey. There is no discrimination between the local and foreign investors with respect to the application of incentives.

In other word, the State Aids' principal purpose is to eliminate the inter-regional imbalances, to facilitate a larger capital contribution by the public to the capital structure and also to support activities that have a positive effect on employment. Furthermore, such investments foster activities that attract the import of foreign currency and yield advanced and suitable technology, as well as those which procure international competitiveness so as not to breach international liabilities.

As mentioned before, because of the establishment of CU with the EU, Turkey needs to make some changes on its legislation regarding state aids. Before analyzing them in detailed, analyzing of state aids within two groups will be more beneficial.

¹³⁴ Kemal Erol, Rekabet Bülteni, Devlet Yardımları ve Rekabet.

There are two kinds of incentives in Turkish state aid policy; investment incentives, export incentives.

4.1.1. Investment Incentives¹³⁵

State aids are generally granted in Turkey for investments. For example, firms which would take incentive certificate in order to make investment, they are exempted from custom duties for imported raw materials, intermediate good and operating equipments. Furthermore more tax exceptions could be applied in sliding rates in accordance with the quality, sector and region of the investment¹³⁶.

Incentives generally comprise a mix of tax and non-tax incentives. The investors may qualify for the following general incentives based on the location, scale, and other qualifications of the investment. Incentive tools granted to investors are;

- Investment allowance,
- Exemptions from customs duties and fund levies,
- VAT exemption for machinery and equipment,
- Exemption from certain taxes, duties and fees,
- Grant of subsidized credit.

In order to qualify for the above incentives (except for investment allowance), it is necessary to obtain an incentive certificate before the investment is initiated. An investment must meet a minimum equity ratio of 20% and minimum value of 600.000

¹³⁵ Yatırım Teşvikleri, <http://www.hazine.gov.tr>

¹³⁶ Mustafa Mehmet Özkaraüber, Avrupa Birliği ve Türkiye’de Devlet Yardımlarının Kontrolü, İlk Baskı, Temmuz 2003, Ankara, p. 55.

YTL (USD 420K) for the developed regions, 400.000 YTL (USD 285K) for the normal regions and 200.000 YTL (USD 140K) for priority development regions, and regional requirements to be granted with an incentive certificate.

General investment encouragement program is constituted in 2002. The purpose of the program is to: encourage, support and orient investments; in line with international commitments; in conformity with the objectives of annual programs and development plans, in order to reduce regional disparities within country, create new employment opportunities, while taking advantage of advanced and appropriate technologies with greater added value and to realize international competitiveness. This covers all investment activities related to the production of goods and services, research and development (R&D), environmental protection, and improvement of quality and standards.

As mentioned above, one of the main objectives of the system is to eliminate the interregional imbalances. For this purpose, the following regional classification is established as follows by the Decree Concerning State Encouragements to Investments dated June 10, 2002:

Developed Regions; include Istanbul and Kocaeli provinces where bulk of Turkish manufacturing is located, and the municipalities of Izmir, Ankara, Bursa, Antalya, Adana

Priority Development Regions; mainly the provinces in the east, south east, east central and northern Turkey.

Normal Regions; include those areas outside the developed regions, which include much of western and central Turkey.

As a rule, incentive measures - other than the investment allowance - are applicable only to the investments in the normal regions and priority development regions. The investments in the developed regions do not qualify for the investment incentives.

Eligible investment measures which are granted a certificate can benefit from the following encouragement measures as mentioned above¹³⁷.

Investment allowance is a corporate or an income tax exemptions applied to taxpayers.

Exemption from custom duties and fund levies: This incentive measure ensures that the imported machinery and equipment for the investment can be brought to the country with the exemption of customs duties and fund levies. The machinery and equipment which are to be imported under this measure must be included in the import machinery and equipment list to be approved by General Directorate of Foreign Investment (GDFI)¹³⁸.

VAT exemption for machinery and equipment: The Value Added Tax, which is due to be paid for both the imported and locally purchased machinery and equipment, shall be exempted by this incentive measure. The imported machinery and equipment, which are included in the import machinery list approved by GDFI, can be brought to Turkey without paying Value Added Tax. The locally purchased machinery and equipment should also be included in the locally purchased machinery list to be approved by GDFI.

Exemption from certain taxes, duties and fees: The investors who undertake an export commitment of USD 10,000 upon the completion of the investment are granted exemptions from stamp taxes, duties, and fees related to the company establishments; land registration, capital-in kind contributions transactions. There are also exemptions from taxes on credit charges for investment credits with at least one-year term.

Grant of subsidized credit: Credits may be granted to R&D, environmental protection, projects, priority technological investments determined by the Science and

¹³⁷ With the Law No:4842 and date:09.04.2003, the obligation to have an incentive certificate has been abolished to benefit from the measure called “investment allowance” starting from 24th April, 2003 and to benefit from the measure called “Exemption from Certain Taxes, Duties and Fees” starting from 1st January, 2004.

¹³⁸ <http://www.hazine.gov.tr>

Technology High Council, investment in technology parks, regional development incentives based on certain criteria.

Investment incentives in Turkey may be categorized mainly under the following headings:

- Incentives regarding priority and least developed regions,
- Incentives in Free Zones.
- Tax, fee exemptions in Export Operations
- Incentives and advantages on customs operations (for Customs Procedures with Economic Impact, Simplified Procedures, Handling Operations, the right to obtain Binding Tariff Information)
- Research & Development Subsidies
- Incentives for Environmental Protection
- Incentives on opening specialization fairs in domestic and foreign countries.
- Incentives on expenses of patent, useful model certificate and industrial design
- Incentives on office-shop and enterprise-brand introduction operations
- Tax Incentives on revenues obtained from the operation and transfer of ships registered in the ship register.

4.1.1.1. Aids Granted to SMEs' Investments

While investment incentives are generally explained like above, it is also required to have a look to the aids granted to SMEs' investments. In Turkey, the importance of SMEs for the economy was realized at the beginning of 1990's. In the mid 1990's, with the ratification of Association Council Decision No 1/95, Customs Union with the EU has been established as of January 1st 1996. In order to help survival and competitiveness of the Turkish SMEs in the Customs Union, design of new support mechanisms seemed necessary at that time.

Currently, the investment of SMEs is supported with the Decree No: 2000/1822, dated: December 21st 2000 "Decree for State Aids in Investments of SMEs"

(published on the Official Gazette dated at 18.01.2001 and No: 24291). The Decree Concerning State Encouragements to Investments provides a base for “Aids Granted to Small and Medium Sized Enterprises’ (SMEs) Investments”.

In line with the development plans and annual programs, the related legislation aims to: encourage the investments of SMEs, increase production and improve quality standards, supply the demands in relation to the product development, increase employment, bring about a level competition within the Customs Union.

According to the SME definition within the framework of the Decree, companies which are

- operating in the manufacturing, agro-industry, tourism, education and health, mining, software industries and
- employing

1-9 workers (defined as micro size),

10-49 workers (defined as small size),

50-250 workers (defined as medium size) and

- holding assets with a total value excluding land and building, including Machinery-equipment, installations, vehicles, furniture and office stocks not exceeding 950 Billion TL (operating in the manufacturing and agro-industry)

shall be deemed as SMEs.

The SMEs purchase of machinery-equipment and raw materials are supported within the scope of the Investment Encouragement Certificate granted by the Undersecretariat of Treasury.

The investments of SMEs benefit from the following encouragement elements: Exemption from Customs Duties, Value Added Tax Exemption for imported and domestically purchased machinery and equipment, credit allocation from the Budget.

In order to be eligible for the encouragement measures, machinery-equipment and/or raw material investment subject to the Investment Encouragement Certificate shall not exceed 950 Billion TL (these amounts have been amended with the Circular No: 2003/1, which was published on the Official Gazette dated September 10th, 2003).

The first application of investor shall be made to the related branch of

- Turkish Development Bank for the investments to be made in the tourism, education, health and agro-industry in which it is specialized and
- Halkbank, Turkish Industrial Development Bank for the other sectors.

There are certain ceilings set in respect to the amount of credits to be allocated and the interest rates to be applied depending on the regional location of the investment. The interest rate of investment credits is 10% for the projects in priority development regions and 15% for the projects in other regions. For operational credits, the interest rate is 15% for the projects in priority development regions and 25% for the projects in other regions.

The maximum amount of credit that can be allowed for investment projects in the manufacturing and agro-industry sectors is given below.

**Table 1.8. Maximum investment credit ratios available to SMEs
(as a percentage of fixed investment cost)**

	Priority Region	Development	Normal region	Developed Region
Micro-size companies		60%	50%	40%
Small-size companies		50%	40%	30%
Medium-size companies		40%	30%	20%

Source: <http://www.treasury.gov.tr>

The amount to be allowed can not exceed;

-475 Billion TL for investment credits,
-75 Billion TL for operational credits,
475 Billion TL for investment credits and 190 Billion TL for operational credits when both types of credits are allocated together.

The maximum maturity period of credits to be allocated to SMEs is 4 years for the investment credits and 2 years for the operational credits. In the investment credits no repayment is done in the first year.

4.1.1.2. Energy Support

Energy support is other encouragement investment incentives. Energy support is provided within the context of “Law on Encouragement of Investments and Employment and Amendment of Certain Laws” (No. 5084, dated January 29th 2004) issued by the Ministry of Finance. The Communiqué concerning the Implementation of the energy support (No: 2004/1, published in the Official Gazette No:25487, dated June 9th, 2004) was issued by the Undersecretariat of Treasury and the Minister in charge of Undersecretariat of Treasury is responsible from the implementation of the provisions of this Communiqué. Energy support is provided in the provinces which have a GDP per capita equal to or less than 1500 US \$ as of 2001.

In order to be eligible to benefit from the energy support:

- Companies should be operating in manufacturing industry, mining, animal husbandry (including aquaculture and poultry), greenhouse production, cooling warehouse, tourism, education and health sectors.
- Newly established companies should employ at least 10 workers continuously after starting operation.

- Companies which had started operation before 01.10.2003 in the above mentioned sectors should increase their employment by 20%. However, after increasing employment by 20%, if total employment remains below 10, it must be increased to 10.

The eligible companies can benefit from the energy support according to the below rates:

- For the newly established companies which employ 10 laborers, the energy support rate is 20%. For each additional employment above 10, support rate increases 0.5 point.
- For the existing companies which increase employment by 20%, the energy support rate is 20%. For each additional employment above the determined minimum number, support rate increases 0.5 point.

The maximum rate of energy support is 40% of the electricity cost. This rate is applied as 50% for companies established in the Organized Industrial Zones or Industry Zones.

In order to benefit from the energy support, companies should apply to the Industry and Trade Provincial Directorates.

4.1.2. Export Incentives

By the decisions dated January 24, 1980, export incentives had gained more importance as a tool of opening its economy towards the abroad. Export incentives applied after January 24 decisions are; tax refund, support and Price Stabilization Fund premium payment, Resource Utilization Support Premium payment, corporate tax exemption in export, freight support, energy support¹³⁹.

¹³⁹ VIII. Beş Yıllık Kalkınma Planı, Sanayi Politikaları Özel İhtisas Komisyonu, Devlet Yardımları, Alt Komisyon Raporu.

Being a party to the World Trade Organization agreement dated 1994 and entering to the Customs Union process with the EU as from 1996 bring new arrangements on export incentives.

Aid granted as export incentives covers awards that are categorized under the “horizontal state aid” of the EU and are regulated by the Undersecretariat of Foreign Trade. Exports credits and insurance practices are run by Eximbank. Furthermore, companies qualifying as SME’s are furnished with credit facilities by Halk Bank.

Turkey harmonized its export incentive regime with the European Union in 1995, prior to the start of the Customs Union. Turkey currently offers a number of export incentives, including credits through the Turkish Eximbank, energy incentives, and research and development incentives¹⁴⁰.

Export-oriented aids are entered into force with the decision of Council of Ministers dated 27.12.1994 and numbered 94/6401 and instead of cash incentives, applications regarding following communiqués are performed by the Undersecretariat of Foreign Trade which is prepared in accordance with the EU and GATT rules.

- Communiqué regarding state aid for research and development projects numbered 98/10,
- Communiqué regarding state aid for environmental protection activities numbered 97/5,
- Communiqué regarding market research aid numbered 97/6,
- Communiqué regarding state aid for operating stores abroad numbered 97/9,
- Communiqué regarding state aid for encouraging employment numbered 2000/1,
- Communiqué regarding training aid numbered 2000/2,
- Communiqué regarding trademark aid numbered 2003/3,
- Communiqué regarding abroad fair aid numbered 2004/6,

¹⁴⁰ <http://www.foreigntrade.gov.tr>

- Communiqué regarding state aid for organizing domestic fairs having international status numbered 95/7.

Before analyzing the abovementioned communiqués, it is necessary to pay attention to major export incentive instrument granted by Eximbank.

Eximbank's main objectives are promoting Turkey's exports through diversification of exported goods and services by increasing the share of Turkish exporters in international trade, finding new markets for traditional and non-traditional export goods and providing exporters and overseas contractors with support to increase their competitiveness and to ensure a risk-free environment in international markets. As a means of aiding export development, Eximbank offers specialized financial services through a variety of credit, insurance and guarantee programs. As Turkey's official export credit agency, Eximbank has been mandated to support foreign trade and Turkish contractors/investors operating overseas through various credit, guarantee and insurance programs. Providing financial support for Turkish exporters under the same terms and conditions enjoyed by their competitors abroad has become vital not only for creating new markets for Turkish exporters but also for sustaining their shares in traditional markets. It is from this base that Eximbank strategies have been formulated. Eximbank, by means of its Country Credit and Guarantee Programs, provides financing for export of goods and services to be realized by Turkish companies to priority countries that are determined in line with economic and foreign policy objectives of the Turkish Government in order to establish permanent and long-term relationships. The objective of the program is to strengthen the competitiveness of Turkish companies, by providing a risk-free environment for their activities in the international markets pertaining high risk as well as facilitating the diversification of the Turkish exports. Eximbank also supports exporters, export-oriented manufacturers, overseas investors and companies engaged in foreign currency earning services with short-, medium- and long-term cash and non-cash credit programs. Moreover, export receivables are discounted in order to increase export volume and to ease access into new and target markets through the promotion of sales on deferred payment conditions. Furthermore, Eximbank provides cover for Turkish Exporters, against commercial and political

risks by offering variety of insurance programs. Like most of other officially supported export credit agencies, only political risks are considered under the guarantee of the state, whereas losses due to commercial risks are indemnified by Eximbank from its own sources. However, since commencement of the insurance facility, the Bank has sought to reinsure the major portion (currently 70%) of its underwritten short-term commercial risks on the basis of a quota-share treaty concluded with a group of domestic and overseas reinsurance companies. In addition, the Bank has also started to reinsure 70% of the underwritten short-term political risks (excluding the portion due to OECD countries) within specific country limits set by the treaty-leaders since the beginning of 2000. If it is deemed necessary, commercial and political risks assumed in medium- and long-term insurance cover can be ceded to reinsurers, on facultative basis. Insurance programs of Eximbank are composed of two schemes: short-term export credit insurance; and medium- and long-term export credit insurance¹⁴¹.

4.1.2.1. State Aids for R&D Activities

R&D projects are; (a) production of new product, (b) raise up the quality and standard of the product, (c) application of new techniques for cost cutting and standard raising, (d) improvement of new technology regarding production or adjustment of work and technology to the country conditions that will determine every stage of R&D activities and in conformity with the scientific basis.

R&D aids comprise all industrial establishments and software organizations. Applications are made to TUBITAK and Technological Development Foundation.

The state aids for R&D activities comprise a mix of reimbursement of certain expenses and grant of subsidized credits. The R&D activities to benefit from state aids are the following;

¹⁴¹ <http://www.eximbank.gov.tr>

- Concept development
- Technological and economic feasibility studies
- Design and drawing studies
- Prototype production
- Establishment of pilot facility
- Pilot production
- Patent and license studies
- Post-sales solutions studies for problems arising from product design
- Laboratory studies in the transition stage from design to implementation

The personnel expenses, cost of machinery, equipment and software, consultancy and other service fees, fees paid to scientific institutions, registration fees for patent and industrial designs to the Patent Institution, cost of R&D related materials are reimbursed up to 60%, as a State aid to the R&D activities. State aid is provided for 3 years for each project.

4.1.2.2. State Aids for Supporting of Environmental Costs

Environmental aids express certification expenses on taking ISO 9000, ISO 14000, CE sign and other international environment and quality certificates in order to increase of competition powers of SMEs in international markets and adoption of technical legislation regarding environment, quality and human health. Only SMEs can benefit from this kind of aid, and they have to make application to the General Directorate of Export. Supporting ratio is 50% of expenditures. Expenditures must be certificated from Turkish Standards Institution (TSE) and accredited establishments.

4.1.2.3. State Aids regarding Market Research

Aids regarding market research express market research projects of SMEs, Sectoral Foreign Trade Companies and Producer Organizations and supporting of international cooperation activities between SMEs. Aids regarding market research are granted to the market research projects on condition that projects will be in conformity with the standards determined by Center of Export Developing (IGEME). At most one project is supported by one application. In order to be taken into account of second application, previous project must be completed and approved by the Undersecretariat of Foreign Trade.

Table 1.9. Support Rates to SMEs in Turkey

<u>Support Rate</u>
SMEs;
⇒ Total 75.000 \$ ⇒ Maximum for one project 7.500 \$, ⇒ Maximum in one year 15.000 \$
Sectoral Foreign Trade Companies and producer organizations
⇒ Maximum on a project basis 10.000 \$ ⇒ Maximum in one year 50.000 \$

Source: <http://www.foreigntrade.gov.tr>

Market research projects prepared in conformity with the determined standards and conditions of IGEME, joining of SMEs to the europartenariat and medpartenariat activities arranged by EU Commission are considered within the scope of coordination programs among SMEs.

4.1.2.4. Aids regarding Opening of Office and Stores at Abroad¹⁴²

Within the scope of this type of aid, four kinds of support are provided.

i.Support of opening office, store and depot at abroad so as to selling them with its trademark and title.

In case a company which is located in Turkey makes activities in order to sell its products wholesale and/or retail at abroad with its trademark and title, it benefits from the following supports.

Table 1.10. Support ratios and amounts

Supported expenses	Support ratio (%)		Annual Maximum Support
	1 st Year	2 nd Year	
Purchase of fixed asset (once)	50	-	20.000 \$
Rent cost	50	30	50.000\$
Advertisement expenses	30	20	30.000 \$

Source: <http://www.foreigntrade.gov.tr>

ii.Support of opening branch office to mediate good trade at abroad

In case a company which makes commercial or industrial activities in Turkey would like to open a branch office at abroad to mediate good trade, 50% of rent and presentation expenses of the company/branch/store/depot in first year and 30% of in second year will be covered on condition that these expenses will not exceed USD 30.000 in one year. Support term is 2 years.

iii.Cover of distributorship/representative expenditures

In case a company or sectoral foreign trade company which makes commercial or industrial activities in Turkey gives a representative/distributorship right to the firm in abroad, the followings will be covered;

¹⁴² İhracat Teşvikleri, <http://www.foreigntrade.gov.tr>

- Tax, duties, notary expenses etc. of Turkish company and sectoral foreign trade company and 50% of official expenses of distributorship/representation agreement, on condition that expenses will not exceed USD 100.000,
- 30% of advertisement expenses in first year and 20% of the expenses in second year made by distributor/representative on behalf of Turkish company and sectoral foreign trade company on condition that expenses will not exceed USD 30.000 in one year.

iv.Supporting of sectoral foreign trade company

In case sectoral foreign trade companies establishes a company at abroad for direct marketing, they will be supported between USD 400.000 and USD 1.000.000 according to the number of partners on condition that

Limited with the number of partners as SMEs definition mentioned in the communiqué regarding sectoral foreign trade companies,

Once a time for the same country,

Not exceeding 50% of total expenses.

4.1.2.5. State Aids for Training

By this kind of aid, it is aimed to cover expenses regarding training activities of SMEs and sectoral foreign trade companies made in conformity with the standards of IGEME on foreign trade subjects in the ratio of 50 % for SMEs and 75% for sectoral foreign trade companies for maximum 3 months period.

4.1.2.6. State Aids for Employment

Aim of this kind of aid is to create employment for experienced and high educated manager and staff to perform transactions of sectoral foreign trade companies regarding foreign trade. 75% of their annual salaries are supported.

4.1.2.7. State aids for Activities Aimed at the Promotion of Turkish Trademarks and the Improvement of the Image of Turkish Products Abroad¹⁴³

Expenditures regarding activities of Exporter Associations, Producer Associations, and companies located in Turkey, and Turkish fashion designers with respect to their products which will be a trademark at abroad and expenses regarding establishment and operating of “Turquality” stores are covered by Support and Price Stabilization Fund in accordance with the international rules.

Firms have to apply directly to the Undersecretariat of Foreign Trade about their projects regarding trademark activities. Turquality Committee is authorized for opening of Turquality stores and use of phrase “Turquality from Turkey”. Supports which have been granted are as follows:

- i. Exporter Associations: Presentation and advertisement expenses made related to their sectors (max USD 350.000),
- ii. Producer Associations: Presentation and advertisement expenses made related to their sectors (max USD 100.000),
- iii. Companies, Sectoral Foreign Trade Companies: regarding their trademarks in the related countries, the followings are covered:
 - ✓ Expenses regarding trademark registration max. USD 50.000
 - ✓ Presentation, advertisement and marketing expenses max. USD 300.000
 - ✓ Rental expenditures which they open or will open abroad units, max. USD 300.000

¹⁴³ <http://www.foreigntrade.gov.tr>

- ✓ Rent and commission expenditures regarding their departments which they rent or will rent, max. USD 200.000
 - ✓ Rent and commission expenditures regarding their showrooms which they open or will open, max. USD 200.000
 - ✓ Expenses regarding signs related to human safety and good security, quality certificates of products, max. USD 50.000
 - ✓ Decoration expenses regarding opened stores at the abroad by franchising system, max. USD 50.000.
- iv. Turkish fashion designers: with respect to their trademarks the followings are covered:
- ✓ Presentation, advertisement and marketing expenses max. USD 300.000
 - ✓ Rental expenditures which they open or will open abroad units, max. USD 300.000
 - ✓ Rent and commission expenditures regarding their departments which they rent or will rent, max. USD 200.000
 - ✓ Rent and commission expenditures regarding their showrooms which they open or will open, max. USD 200.000.
- v. Manager(s) of Turquality Stores: Rent, decoration, advertisement, presentation and marketing expenditures of Turquality stores are covered maximum USD 500.000 per store.
- vi. Firms that use the phrase “Turquality from”: Support rates of companies and Turkish fashion designers which take approval from the Turquality Committee to use the phrase “Turquality-from Turkey” on their product labels, packages and/or directly on the products will be increased in the ratio of 10%.
- vii. Firms that use the phrase “Made in Turkey etc.”: Support rates of companies and Turkish fashion designers which take approval from the Undersecretariat of Foreign Trade to use the phrase “Made in Turkey etc.”

on their product labels, packages and/or directly on the products will be increased in the ratio of 5%.

4.1.2.8. State Aids regarding Domestic Speciality Fairs

This kind of state aid is defined as a support regarding promotions and presentations of domestic fairs and to provide participation in an international level. Within this framework, Support and Price Stabilization Fund covers expenses in conformity with standard determined by Undersecretariat of Foreign Trade and related to promotion and presentation activities of domestic organizer before and after the fair.

In this respect, the followings are covered:

- ✓ 50% of activities at abroad up to the USD 25.000
- ✓ 50 % of access expenses of important buyer up to the USD 15.000
- ✓ 50 % of seminar, conference, prize expenses of fair up to the USD 5.000.

4.1.2.9. State Aids regarding Supporting Joining to the Fairs at Abroad

65% of participation fee which is paid to the organizer from Undersecretariat in order to arrange fair at abroad is paid to the participant within the scope of support. In case overseas fair is National Participation or Turkish Export Products Fair, support fee be paid to the participant will not exceed USD 10.000 and in case the fair is a sectoral basis National Participation or sectoral basis Turkish Export Products Fair, support fee will not exceed USD 15.000.

In case individual participation is realized to the sectoral basis international fairs, the followings will be paid in the scope of support:

- ✓ For sectoral basis international fairs, 65% of empty stall rent and 50% of carriage expenses which is paid by the participant on condition that it will not exceed USD 15.000,

- ✓ If the individual participant is sectoral foreign trade company, all of empty stall rent and 75% of carriage expenses on condition that it won't exceed USD 15.000.

4.2. Fundamental Concept of the State Aid Rules within the Framework of Relationship between Turkey and EU

4.2.1. Application of EU Rules

By both of the Association Council Decision numbered 1/95 and Additional Protocol signed between EU and Turkey, Turkey is deemed less developed area where the standard of living is abnormally low or where there is serious underemployment as regards in the Article 87/3(a) of the EC Treaty. This statute is for five years period but, if needs be, it will be ended by the membership of Turkey. Besides this, principles in the Association Council Decision numbered 1/95 are parallel with the EU legislation. In case, Turkey is member of the EU or start to apply the state aid rules as applied in the Member States, it is inevitable to make necessary changes on the current incentive programs or abolish some of them.

State aid policy in Turkey encourages SMEs in various ways. SMEs take more exemptions than other firms because of the application of Article 87/1 of the EC Treaty. For this reason, any aid granted to SMEs will be continued excluding (export incentives) in case of EU rules start to be applied.

Aid applications in Turkey encourage investments made in the priority development regions and industrial regions. It is seen that regional distinction policy which changes number and conditions of incentives that encourage regional

development and certain industrial investments is in conformity with the EU's regional policies. But it is necessary to re-define these regions in accordance with the NUTs (nomenclature of statistical territorial units) criteria and notify to the Commission. Although both Article 34/3(a) of the Association Council decision 1/95 and Article 43/2 of the Additional Protocol define Turkey, in the transition period, in a situation mentioned in the Article 87/3(a) of the EC Treaty, it is clear that, this situation will be ended by the membership to the EU.

Policy regarding export incentives needs too many changes. It is necessary to make different considerations between export to the EU and export to other countries. It is possible that in case exports to the EU are contrary to the common legislation and if no transition period is predicted, they shall be abolished. Otherwise benefits of well functioning of customs union and common market will not be gained in case of the existence of state aids that effect competition. Mainly, there are wide exemption provisions in the EU application and legislation regarding aids other than export incentives can easily be harmonized with the EU rules in case they are granted in accordance with the EU's exemption rules. But the Commission has a strict attitude on the export incentives that will be granted within the common market. Incentives granted to the exports made to other countries than EU is continued to be subject to the GATT rules.

4.2.2. Rules of Customs Union

According to the Article 16 of the Ankara Agreement between Turkey and EU, parties agree to apply competition provisions in their partnership relations. Accordingly, in the Article 43 of the Additional Protocol, Association Council shall

determine the conditions and principles of application mentioned in the Article 87 and 88 of the EC Treaty. Furthermore, Turkey engages with the Association Council Decision numbered 1/95 to harmonize its competition rules with the relevant EU legislation.

Association Council Decision numbered 1/95 and dated 6 March 1995, which underlies the Customs Union in accordance with the Ankara Agreement that foresees establishment of partnership between Turkey and EU, brings some liabilities regarding state aid rules to Turkey with parallel to the liabilities of Member States mentioned in the EC Treaty. In the Association Council Decision numbered 1/95, provisions regarding state aids take place in the second section whose title is competition. Provisions regarding competition rules of the customs union are between the Article 32 and 38. According to the Article 34 of the Association Council Decision, any aid which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between the Community and Turkey, be incompatible with the proper functioning of the Customs Union.

The principle “compatible with the common market” in the Article 87/1 of the EC Treaty is changed into “compatible with the customs union” and Article 87/1 is adopted exactly same. If we glance at the Article 34 of the Association Council Decision whose title is “Competition rules of Customs Union” we will see that it defines state aids which may be or may not be granted accordingly. Article 34 brings some additional exemptions for Turkey to grant state aid. Article 34 is as follows:

1. *Any aid granted by a Member State or Turkey or through state resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain of certain goods, in so far as it effects trade between Community and Turkey is not compatible with functioning of Customs Union.*
2. *Followings are compatible with the functioning of Customs Union:*
 - a. *Aid having a social character granted to individual customers, provided that such aid is granted without discrimination related to the origin of the products concerned;*

- b. *Aid to make good the damage caused by natural disasters or exceptional occurrences;*
 - c. *Aid granted to the economy of certain areas of Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division;*
 - d. *On condition that it does not negatively effect the trade conditions between Turkey and the Community, aids granted to the less developing regions in order to support economical development for the period of five years beginning from the entering into force of the decision.*
3. *The following may be considered to be compatible with the functioning of Customs Union:*
- a. *As compatible with the Article 43/2 of the Additional Protocol, aid to promote economic development of areas where the standard of living is abnormally low or where there is serious underemployment,*
 - b. *Aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State or Turkey;*
 - c. *For five years period beginning from the entering into force of this decision, aids aiming at accomplishing structural adjustment necessitated by the establishment of the Customs Union. The Association Council shall review the application of that clause after the aforesaid period;*
 - d. *aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions between the Community and Turkey to an extent contrary to the common interest;*
 - e. *Aid to promote culture and heritage conservation where such aid does not effect trading conditions between Turkey and the Community to an extent that is contrary to the common interest;*
 - f. *Such other categories of aid as may be specified by Association Council.*

By considering that article, we may come to the conclusion that Turkey undertakes to harmonize its state aid legislation with the EU and decides not to grant state aids which effects competition conditions between EU and Turkey and well functioning of customs union. In spite of this commitment of Turkey, if it acts against the commitment, European Community could apply to the Association Council within the framework of dispute settlement procedure of Association Council Decision and Article 25 of the Ankara Agreement. If Association Council is not able to settle the dispute and decide to settle it by arbitration, European Community could apply to the European Communities Court of Justice¹⁴⁴.

The Association Agreement between the Community and Turkey and the 1970 Additional Protocol set out the basic objectives of the association, which include the establishment of a customs union in three stages; “preparation period” is completed in 1972. Conditions of second stage which was called “transition period” are determined by the Additional Protocol and this stage is continued to the signing of the Association Council Decision numbered 1/95 and dated 6 March 1995.¹⁴⁵

Important provisions like competition, state aids and supporting of export are mentioned in the Additional Protocol. Article 43 of the Additional Protocol considers the common competition policy and state aids.

State aids are mentioned in the Article 43/2 of the Additional Protocol as follows:

“Turkey, in the transition period, can be deemed in the situation prescribed in the Article 87/3(a)¹⁴⁶ of the EC Treaty. In this respect, aids aimed at facilitating the

¹⁴⁴ Kemal Erol, Rekabet Kurumu, Devlet Yardımları ve Rekabet.

¹⁴⁵ T.C. Başbakanlık Hazine Müsteşarlığı, Teşvik ve Uygulama Genel Müdürlüğü, Avrupa Birliğinde Devlet Yardımları Kurallarını Belirleyen Çerçeve ve İlke Kararları, Temmuz 2003, Ankara, p.4.

¹⁴⁶ 3. The following may be considered to be compatible with the common market:

(a) aid to promote the economic development of areas where the Standard of living is abnormally low or where there is serious underemployment;

economical development of Turkey is accepted compatible with the association unless conditions will not be changed against common interest of the Member States.

At the end of the transition period, Association Council takes into consideration the economical situation of Turkey on that date and decides whether it is necessary to extend the implementation of the provision mentioned above.”

Article 43/2 of the Additional Protocol is considered Turkey in the statute mentioned in the Article 87/3(a) of the EC Treaty. Article 34/3-a is also includes same definition with the EC Treaty. This provision will start to work instead of Article 34/2(d) after the first five years (but it could be extended). Because, although the situation is discretionary, while European Commission uses its authority, it depends on the secondary legislation adopted within the framework of the EC Treaty. According to the Article 39/2(d) of the Association Council Decision, Turkey is also subject to the same legislation. Therefore, with respect to the criteria in the current legislation regarding regional aids, Turkey is theoretically a country in the statue mentioned in the Article 87/3(a) of the EC Treaty as other three Member States (Greece, Portugal, Ireland). The main point of this situation is aids within the scope of this article is subject to the rules of not to negatively effect trade conditions. However, Turkey, for the first five years, is bound itself with the rule of not to effect negatively trade conditions by the Article 34/2(d). So this is hard situation to choose one of these conditions and time will show which situation is better¹⁴⁷.

Article 35 of the Decision states “Any practices contrary to Articles 32, 33 and 34 shall be assessed on the basis of criteria arising from the application of the rules of Articles 85, 86 and 92 (new 87) of the Treaty establishing the European Community and its secondary legislation.”

At the same time, due to the Article 37/1 of the Association Council Decision, Association Council shall adopt by the Decision necessary implementations of exemption provisions. According to the Article, Association Council shall, within two

¹⁴⁷ Tunay Köksal, Avrupa Birliği Tam Üyelik Sürecinde Türkiye’de Devlet Yardımlarının Hukuki Çerçevesi, Rekabet Dergisi.

years following the entry into force of the Customs Union, adopt by Decision the necessary rules for the implementation of Articles 32, 33 and 34 and related parts of Article 35. These rules shall be based upon those already existing in the Community and shall inter alia specify the role of each competition authority. However, this decision has not been taken yet. At the same article, it states that until these rules are adopted, the provisions of the GATT Subsidies Code shall be applied as the rules for the implementation of Article 34. As a result of not taking any decision regarding the subject matter, any disputes arisen from the grant of state aids which distorts competition and effect trade between EU and Turkey have been settled within the scope of GATT Subsidies Code and WTO. Naturally, solution of WTO depends on different criteria than EU's rules regarding control of state aids and case-law. In addition, according to Article 38, if the Community or Turkey considers that a particular practice is incompatible with the terms of Articles 32, 33 or 34, and is not adequately dealt with under the implementing rules referred to in Article 37, or in the absence of such rules, and if such practice causes or threatens to cause serious prejudice to the interest of the other Party or material injury to its domestic industry, it may take appropriate measures after consultation within the Joint Customs Union Committee or after 45 working days following referral for such consultation. Priority shall be given to such measures that will least disturb the functioning of the Customs Union.

The legality of the state aid within the relationship with the customs union is subject to the fulfillment of notification condition mentioned in the Article 39/2(c), (e) and (f). Article 39 of the decision whose title is "Approximation of Legislation" states some issues that Turkey should prepare legislation in the field of state aids parallel to the EU acquis. Turkey shall, before the entry into force of this Decision, adapt all its aids granted to the textile and clothing sector to the rules laid down in the relevant Community frameworks and guidelines under Articles 87 and 88 of the EC Treaty. Turkey shall inform the Community of all its aid schemes to this sector as adapted in accordance with these frameworks and guidelines. The Community shall inform Turkey as soon as possible of any procedure related to the adoption, abolition or modification of such frameworks and guidelines by the Community after the entry into force of the Customs Union. After such information as been given, Turkey shall have one year to adopt its legislation. It shall within two years after the entry into force of

this Decision, adapt all aid schemes other than those granted to the textile and clothing sector to the rules laid down in Community frameworks and guidelines under Articles 87 and 88 of the EC Treaty. The Community shall inform Turkey as soon as possible of any procedure related to the adoption, abolition or modification of such frameworks and guidelines by the Community. After such information has been given, Turkey shall have one year to adapt its legislation. Turkey also, within two years after the entry into force of the Customs Union, informs the Community of all aid schemes in force in. If a new scheme is to be adopted, Turkey shall inform the Community as soon as possible of the content of such scheme. It shall notify the Community in advance of any individual aid to be granted to an enterprise or a group of enterprises that would be notifiable under Community frameworks or guidelines had it been granted by a Member State, or of individual aid awards outside of Community frameworks or guidelines above an amount of ECU 12 million and which would have been notified under EC law had it been granted by a Member State.

Regarding individual aids granted by Member States and subject to the analysis by the Commission, on the basis of Article 88 of the EC Treaty, Turkey will be informed on the same basis as the Member States.

According to the Article 40 of the Association Council Decision, the Community shall inform Turkey as soon as possible of the adoption of any Decision under Articles 85, 86 and 92(new 87) of the EC Treaty which might affect Turkey's interests.

According to Köksal¹⁴⁸, Customs Union does not bring additional restrictions to the state aids. Because Turkey is bound with GATT Subsidies Code and rules of this Code contains strict rules and these rules will be applied in the developing countries by the transition periods of 5 and 8 years.

Last articles of Association Council Decision numbered 1/95 mentioned above are summarized expectations of Turkey from the Customs Unions and things to do

¹⁴⁸ Tunay Köksal, Competition Board, Director of International Relations.

accordingly. In 2000, Köksal and Müftüoğlu emphasize necessary things to do as a solution as follows:

“In order to fully apply the customs union in the literal sense, it is necessary to harmonize Turkey’s competition legislation with the EU’s legislation. Because, Customs Union could not be provided by restriction of custom duties and abolishment quantitative measures; it could be provided by adopting identical competition rules and having similar market structure¹⁴⁹.”

Problematic subjects during the harmonization of the legislation are precarious circumstances. Serdengeçti¹⁵⁰ highlights the following issues regarding that subject:

- Legal adjustments with respect to the incentive instruments must be made which do not distort competition and effect trade negatively.
- Other problematic issue which is a matter of concern is technical insufficiency to harmonize with the state aid legislation of EU.
- One of the problematic issues within the process of harmonization by the rules of state aid is application of state aid rules in Turkey is performed by different organizations. While state aid legislation in EU and other developed countries take place within the scope of competition law and one organization is performed these rules, in Turkey state aid policy takes place in different legislations and is performed by separate organizations. It is required to establish single authorized and responsible organization to determine the aid policy and application criteria.

It is also stated in the National Program that it is required to make studies for eliminating the worries about the subject matter.

4.2.3. State Aids in the National Program¹⁵¹

¹⁴⁹ Mustafa Mehmet Özkarabüber, op. cit., p. 58

¹⁵⁰ Turan Serdengeçti, General Director, Undersecretariat of Treasury.

¹⁵¹ Turkey’s National Program, 2001.

As mentioned before, the Helsinki European Council held on 10-11 December 1999 produced a breakthrough in Turkey-EU relations. At Helsinki, Turkey was officially recognized without any precondition as a candidate state on an equal footing with the other candidate states. Thus, Turkey, like the other candidates, became eligible to benefit from a pre-accession strategy to stimulate and support its reforms. Specifically, a single framework for coordinating all sources of EU financial assistance for pre-accession was created. Furthermore, Turkey is to participate in Community programs open to other candidate countries and agencies.

With the inclusion of Turkey in the enlargement process, Turkey's obligation to align with the *acquis communautaire* covered by the customs union was extended so as to cover the whole *acquis* and accordingly the parties had to take the necessary measures to accelerate the harmonization process.

Accordingly, the Council approved the Accession Partnership on 8 March 2001 and the Framework Regulation concerning EU's financial assistance to Turkey on 26 February 2001. The Accession Partnership document, the so-called road map for Turkey's accession, basically sets priority areas where Turkey is expected to further its alignment to EU *acquis* and determines EU's financial schemes that will support Turkey within the accession process.

Within this context, Turkey is to complete its alignment to the *acquis communautaire*, to reinforce its existing administrative structures as well as the establishment of the new ones in various fields, such as technical legislation, state aids, public procurement and customs.

The Framework Regulation, on the other hand, constitutes the legal basis of the Accession Partnership with regard to the priorities and conditions, as well as financial and technical resources Turkey will be entitled to exploit during the pre-accession period.

After the approval of the Accession Partnership, Turkish government announced its own National Programme for the Adoption of the *Acquis* (NPAA) on 19 March 2001. With this document, Turkey heralds a new beginning in its efforts in various

fields such as democratization, human rights and liberal economic policies, as well as common market policies.

The National Programme has been edited with a careful appreciation of the requirements of Turkey as spelled out in the Accession Partnership. This comprehensive document demonstrates the will of Turkey to adopt the EU acquis in all relevant areas that are required for the accession to the EU. More specifically, it lays down the tasks to be accomplished within the short and medium terms and, thus, clarifies the responsibilities of the institutions within the harmonization process¹⁵².

In order to have a look to the content of the National Program in detail, the followings could be explained in this regard. This explanation also draws general framework of Turkey's state aid policy and harmonization process with the EU acquis.

In Turkey, there are various public bodies, institutions and organizations carrying out state aid implementations independently. State aid aimed at investments (internal and foreign) is basically under the responsibility of the Undersecretariat of the Treasury and are awarded through procedures and principles set forth in several decrees and communiqués.

The State aid system for investment is based on the Decree No.2002/4367 and dated 10.06.2002 on state aids for investments, which was still in force but updated in the meanwhile. Last update is done on April 4, 2005 by the decree numbered 2005/8680. Among the regulations under the system for state aid in investment, the General Incentive System and SME's Incentive System are global systems applied countrywide. In those systems, regional differences affect only the intensity of the incentives. Aid granted as export incentives, on the other hand, covers awards that are categorized under the "horizontal state aid" of the EU and are regulated by the Undersecretariat of Foreign Trade. Exports credits and insurance practices are run by Eximbank. Furthermore, companies qualifying as SME's are furnished with credit facilities by Halk Bank.

¹⁵² www.foreigntrade.gov.tr

As required by the provisions of the Association Council Decision numbered 1/95, Turkey was considered to be at the lowest development level for 5 years (which may be prolonged). Therefore, Turkey will have the possibility of utilizing the aids at their maximum levels.

Although the current practices of Turkey are based on geographical grounds, a comprehensive harmonization is required in terms of the statistical geographical units, criteria and computation techniques. Turkey also has to put into practice the legislation covering restrictive and/or prohibitive provisions against the aid in the sensitive sectors of the EU. Turkey's legislation pertaining to "horizontal" aid has already been aligned with the acquis of the EU to a great extent. In complying with the rules of the EU in granting aid, Turkey should also meet the "monitoring and notification" requirements of the Commission. All legal arrangements relating to Competition and State Aid (including the secondary legislation) and the existing implementing rules of EU acquis are binding for Turkey.

As I said that competent authorities regarding state aid implementations are different and not only one, the main competent authorities in the field of State Aid are the Undersecretariat of the Treasury, the Undersecretariat of Foreign Trade, and Eximbank. Moreover, the ministries, institutions, organisations and the banks (such as the Bank of Provinces) entrusted with certain duties in this respect as per their legislation may also be authorized thereof.

Considering the harmonization process, undertaking them one by one in terms of complying with the EU in the field of state aid in investments, will not be sufficient to overcome the problem of harmonization. Joint works at a technical level will be required to tackle possible technical and administrative problems to be encountered and also for shortening the process. In this respect, bilateral study opportunities should be created in order to embody and implement the state aid instruments of the EU (regional and sectoral preferential criteria, SME definition, aid ceilings and rationales) in the state aid system of Turkey, which has a very different structure than that of the EU in economic and social terms. On the other hand, regarding the organization of the

authorities carrying out state aid controls, there exist some administrative structure differences between Turkey and the member states of the EU. In the Community, state aid is granted through a) EU funds, b) central government c) local administrations, while such practices are carried out solely by the central government in Turkey. Furthermore, the Community acquis to be adopted does not only include criteria for the implementation of state aid practices. So, an administrative restructuring may be necessary to control, monitor and evaluate the practices of public bodies responsible for state aid.

4.2.4. Current Status of State Aid Policy of Turkey

In the area of state aid, despite Turkey's obligation under the CU to align its legislation and set up the necessary administrative body for state aid monitoring, the legislation concerning state aid control based on EC principles and criteria is still not adopted. Turkey has to align its legislative framework with the acquis and the obligations of the CU, and to establish a state aid monitoring authority.

However, when we considered the European Commission's regular reports it is obvious that no progress has been made on the adoption of state aid legislation or on the establishment of an operationally independent state aid monitoring authority.

Turkey has tried to do much to align its legislation on Community rules. It is imperative that it continues and attains this objective which demands considerable restructuring, in particular of commercial monopolies. The matter of state aid must be settled without delay.

In 1999, according to the Regular Report on Turkey, arrangements applying in Turkey for state aid were still being discussed by the Commission and the Turkish authorities. The November 2000 Report found that no state aid supervisory authority had been set up, progress in this area was limited. The November 2001 Report highlighted substantial progress on antitrust matters but none whatsoever on state aid (the supervisory authority was not operational until January 2003). The October 2002

Report found that Turkey had continued to make progress in the antitrust field, but that progress on state aid monitoring and the adaptation of state monopolies had been very limited. The November 2003 Report found that, Turkey should urgently adopt legislation on the monitoring of state aid and establish a state aid supervisory authority. The October 2004 Report takes stock of Turkey's progress in the area of antitrust policy but notes that no progress has been made with state aid, a situation that Turkey should urgently remedy. Therefore, the lack of progress on this key question is hindering the implementation of a state aid control regime, resulting in potential distortions of competition in markets via the allocation of public aid. It is also a major factor delaying the adoption of an Association Council decision on the implementation of competition rules, despite the fact that Turkey is committed under the CU and the ECSC Turkey Trade Agreement to align with the EU *acquis* in the state aid sector.

V. HARMONIZATION OF TURKISH STATE AID SYSTEM WITH THE EU RULES

5.1. Recent Developments in State Aid Policy of EU

In the last chapter, it is necessary to look at the current status of the State aid law in the EU and how it might evolve to meet these challenges without undermining the principle of a strict control of State aid to prevent distortions of competition and trade within the Community.

In many respects, EU's state aid rules are based on solid foundations. It has a clear, and relatively strong procedural framework, which is set out in a single regulation which was itself based on the accumulated experience gathered from many years. It has

a series of different frameworks and guidelines which set out the basis on which the Commission will assess the effects of certain types of aid on competition. And EU also benefits from a very substantial body of case-law which gives concrete guidance in many issues.

Yet in many respects of foundations of EU's state aid control are rather weak. There is sometimes lack of clarity, even at the basic conceptual level, of what is or is not a State aid. This makes clear that uncertainty over such basic questions risks to undermine the legitimacy of State aid control. Another weak point lies in the difficulty of ensuring effective recovery of aid in many cases. Community law places an obligation on Member States to ensure effective recovery in accordance with national legal procedures. However, those national procedures do not in general give a high priority to the recovery of illegal aid, particularly when the beneficiary is in financial difficulty.

Besides these sensitive parts of the EU's state aid law, enlargement presents a challenge both from the substantive and the procedural point of view.

The entry of eight central and eastern European countries together with Cyprus and Malta into the European Union has brought additional 74 million citizens to form a common market of some 450 million people. The ten newcomers joined formally on May 1, 2004, the culmination of a long process of preparation and negotiation.

May 1, 2004 is not only going down in the annals of European Union history as the date of the largest enlargement the Union has ever seen, but it is also to be remembered for the root and branch modernization of European competition law and, in parallel, the European Commission's refinement and development of the state aid rules in order to enhance clarity, efficiency and legal certainty.

In practice, before joining to the EU, each of the new member States had to establish a state aid monitoring authority which screened awards of State resources to

determine whether they were compatible with the common market. New Member states had to adopt their legislations with the EU acquis to prevent incompatible aid.

In order to prevent incompatible aid from being imported into the EU on the date of accession, a system was set up to examine measures which were put into effect in the Accessing Countries before 1 May 2004 and were still applicable after that date. This was known as the “existing aid” mechanism. The purpose of this mechanism was to provide Accessing Countries and economic operators with legal certainty as regards State aid measures that are applicable after that date of accession. The system applies to State aid in all sectors, except for agricultural and transport sectors, for which different provisions apply.

In April 2004, the Commission adopted a Communication entitled “A pro-active Competition Policy for a Competitive Europe”. In the field of State aid, the reforms already undertaken and those on-going aim is refocusing State aid policy towards a more economic-based approach with the purpose of eliminating harmful State aid, while leaving the Member States with more flexibility to adopt horizontal measures to support, in particular, the Lisbon objectives. More specifically, in 2005-2006, a large number of the Commission’s existing regulations, frameworks and guidelines come up for renewal including all the state aid exemption regulations, the regional aid guidelines, the framework for research and development aid and the risk capital communication as above-mentioned in my thesis. These factors, together with the beginning of a new programming period for the Community’s structural funds in 2007, provide an unprecedented window of opportunity for a comprehensive review of the horizontal State aid rules to take account of the horizontal and particularly Lisbon objectives and the new cohesion policy set out in the forthcoming Structural funds regulations, as well as to consolidate and wherever possible simplify the rules.

When we go back to the 2000, at the Lisbon European Council, the Union set itself a new strategic goal for the next decade: “to become the most competitive and dynamic knowledge-based economy in the world”. The Council has subsequently emphasized the importance of innovation as the main source of competitiveness and

economic growth, and its key roles in the European Research Area. By the Communication on “A pro-active Competition Policy for a Competitive Europe”, the Commission announced that it would draw up a vade-mecum or “Practitioner’s guide” to provide guidance on measures in support of innovation which can be adopted within the existing State aid regulations, and frameworks to State aid for innovation. The Commission also committed itself to producing in 2005 a Communication in which the need and potential to expand the possibilities to aid innovation will be explored. Consequently, the Commission services prepared a vade-mecum on Community rules on State aid for innovation. This document is based on an economic approach, identifying four key market failures which impede innovation in the European economy. The vade-mecum then describes the different types of State aid measures which might be used to try to address those market failures, using key Commission decisions as illustrations.

Another interesting development in state aid procedure is Commission’s discussion on how to identify aid that is unlikely to produce significant effects on competition while at the same time maintaining strict control of more distortive aids. The result of these discussions was the introduction of two new significant impact tests: the lesser amounts of state aid test (the LASA test) and the limited effect on intra-Community trade test (the LET test). The first approach is primarily based on the limited amount of the aid involved and the objectives of the aid. The second approach could be used to cover aid measures of a higher amount, which can still be considered of limited concern if granted in a non-tradable sector and if a number of conditions are met. LASA and LET aid measure serve to the Commission’s objective for state aids and is useful to point out some important issues about significant impact tests; the LASA test and the LET test. Because the Commission must thoroughly analyze every distortion of competition no matter how minor and confined to a specific Member State it might be. This is simply not workable in an enlarged Union. Ways must be found to give the highest priority to cases which pose a significant threat to competition in Europe.

5.1.1. The LASA Test

Commission recognized that there was scope for further flexibility for the approval of aids that exceeded the de minimis thresholds but fell below the amounts set out in the block exemptions (for example, SMEs, training and employment) and communications or guidelines on aid for R&D, regional and environmental aid, and risk capital aid. Raising the de minimis thresholds was excluded since this would be contrary to the jurisprudence of the Community courts, which have held that even small amounts of aid may affect trade between Member States. Therefore, the Commission issued a Draft Communication concerning certain measures containing lesser amounts of state aid, which serve Community objectives. Measures that pass this test are still considered as aid and must, therefore, be notified, but they will be subject to a much simpler assessment than other aid measures. In particular, a lower burden of proof will be imposed on Member to determine compatibility. These measures will be exempted by virtue of Article 87/3(c) of the EC Treaty¹⁵³.

The main conditions for the application of LASA are as follows:

- Aid measures must demonstrably facilitate the achievement of one of the following Community objectives: the promotion of R&D, the protection of the environment, the creation of new and better employment, the promotion of training, risk capital, the development of SMEs and regional development,
- Aid should be limited to 30 per cent of the eligible costs,
- The maximum amount of LASA may not exceed € 1 million per independent enterprise over a three year period,
- With the exception of de minimis support, LASA may not be cumulated with other aid in respect of the same project,
- The Member State concerned must not exceed its upper state aid threshold, which is the result of the following calculation: Community GDP per capital

¹⁵³ Paris Anestis, Stephen Mavroghenis, Stamatis Drakakakis, Recent developments in EC state aid policy, *The European Antitrust Review* 2005.

multiplied by population multiplied by 0.025 per cent. This method has been established in accordance with Commission calculations in order to ensure that the amount of LASA at Community level does not exceed 5 per cent of other aid granted.

5.1.2. The LET Test¹⁵⁴

Together with LASA, the Commission unveiled a second significant impact test by publishing its Draft Communication for the assessment of limited effect on intra-Community trade to arrive at the conclusion that certain measures do not effect trading conditions to an extent contrary to the common interest and which therefore should not cause of concern at Community level.

The requirement of an effect on trade is a constitutive element of the definition of state aid in Article 87/1 of the EC Treaty. A measure that produces no effect on trade does not constitute state aid. However, the Commission in its Communication summaries the Community court's jurisprudence, which interprets broadly the concept of effect on intra-Community trade. Therefore, if the other elements of state aid exist (transfer of state resources, selectivity and the bestowal of advantage) then the measure will most likely effect trade between Member States and thus qualify as state aid under Article 87/1 of the EC Treaty.

The LET test is designed for measures that exceed the de minimis thresholds, effect intra-state trade and constitute aid. With this test, Commission is seeking to identify and filter those measures that will produce only limited effects on trade and which therefore may be subject to a simplified assessment procedure. Such measures should be notified and can be exempted in accordance with Article 88/3 of the EC Treaty.

¹⁵⁴ Draft Communication from the Commission: A new framework for the assessment of State aid which has limited effects on intra-Community trade.

In order to meet the LET test, the aid measures applied on the activities should fulfill the following additional conditions.

- Aid measures must demonstrably facilitate the achievement of one of the following Community objectives: the promotion of R&D, the protection of environment, the creation of new and better employment, the promotion of training, risk capital or the development of SMEs and regional development,
- Aid is limited to 30 per cent of the costs incurred for the development of aided activity /this limit is defined in terms of project costs)
- The total amount of aid that an enterprise can receive, for all projects combined, is limited to € 3 million per year, including any co-financed Community contribution,
- Aid must be awarded through:
 - A scheme that is open to all companies willing to carry out the identified activities within the jurisdiction of the granting authority, according to objective criteria, and does not allow for a single beneficiary to get more than 10 per cent of the total budget of the scheme actually spent; or
 - A tender procedure which ensures that the amount of aid granted in connection with the project is limited to the minimum necessary.

All aid granted under LASA and LET remains subject to notification and approval by the Commission in accordance with Article 88/3 of the EC Treaty. Notification should be made on the standard notification form established by the Commission and respective Supplementary Information Sheet should also be completed.

The LASA and LET tests will enter into force on the date of their publication in the Official Journal of the European Union and will remain in force, unless otherwise stipulated in a new decision until 31 December 2006. At the time of writing publication is yet to occur.

5.1.3. Services of General Economic Interest

Another area of the state aid rules which has given rise to substantial discussion in recent months concerns status of compensations for the cost of providing services of general economic interest (SGEI).

The interrelation between SGEI and the EC state aid rules has been a highly controversial issue. On the one hand, SGEI differ widely from one Member State to another and cover a broad range of activities, depending to a large extent on the choices made by each Member State. On the other hand, legal nature of compensation paid to undertakings providing SGEI has been contested before the Community courts, which have delivered contradictory judgments in the past.

The Commission adopted in May 2003 a Green Paper as a basis for a broad discussion with the European Union Institutions and Member States on the issue. Following the Altmark judgment¹⁵⁵ of the European Court of Justice, the Commission intensified its efforts and on 18 February 2004 it proposed two measures: a draft Commission Decision and a draft framework. These measures address the assessment of aid measures which do not meet the four Altmark criteria (and therefore fall into the scope of Article 87/1 of the EC Treaty) but are still compatible with the common market on the basis of Article 86/2 of the EC Treaty.

According to Altmark judgment, under certain conditions, public service compensations do not constitute state aid and consequently they are not subject to prior notification to the Commission. However, to my knowledge, most of the existing systems of public service compensation actually do not meet these conditions. Therefore, with a view to providing legal certainty, the Commission has adopted a draft decision concerning the application of Article 86 of the Treaty to state aid in the form of public service compensation. The objective is to specify under what conditions compensation which does constitute state aid can nevertheless be declared compatible

¹⁵⁵ Case C-280/00 Altmark Trans GmbH and others (2003).

with the Treaty. A further aim is to make clear that compensation schemes which meet the specified conditions are exempted from prior notification. The decision will be able to apply to small services of general economic interest, hospital and social housing undertakings. For large undertakings, a draft Community framework mentioned below has also been prepared.

The purpose of the Decision is to set out the conditions under which state aid granted to small-scale services of general economic interest is compatible with the Treaty and to exempt such aid from the prior notification requirement. As mentioned above, the Commission services have also drawn up a draft “Community framework for state aid in the form of public service compensation” which sets out the conditions under which compensation granted to large-scale services of general economic interest constitutes compatible aid. At the time of writing these drafts have not been finalized yet.

It can be said that these draft instruments emphasize that Community law in no way restricts the capacity of Member States to provide high-quality public services for their citizens, but rather serves to prevent harmful abuses, in particular the use of public funds to cross-subsidies activities in sectors open to competition.

5.1.4. State Aid Action Plan: a Roadmap for State Aid Reform 2005-2009¹⁵⁶

Specific challenges call for a comprehensive reform of state aid policy at this moment. Time has come to build a momentum within the Commission and 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. This Action Plan is a consultation document presenting an indicative roadmap for state aid reform during the period 2005 - 2009, which the Commission will conduct in close cooperation with Member States and stakeholders.

¹⁵⁶ State Aid Action Plan, Consultation Document of the Commission.

There are new challenges facing state aid policy at this moment, which call for action. As was clearly expressed by the European Council of November 2004, there is a need for renewed impetus to the so-called Lisbon Strategy, “*Working together for growth and jobs, a new start for the Lisbon Strategy*” has already set out a new Lisbon Action Programme where state aid control plays an important role.

The European Council of March 2005 has called on Member States to continue working towards a reduction in the general level of State aid, while making allowance for any market failures. This movement must be accompanied by a redeployment of aid in favour of support for certain horizontal objectives such as research and innovation and the optimisation of human capital.

The enlargement in 2004 was unprecedented in size. This underlines the need for adaptations of state aid policy and for better governance to ensure an effective control in the enlarged Union.

Besides, the increasing complexity and number of documents progressively adopted by the Commission over time have created a need to streamline state aid policy, focus attention on the most distortive types of aid and make state aid control more predictable and user-friendly, thereby minimizing legal uncertainty and the administrative burden both for the Commission and for Member States. There is also a need to strengthen the commitment of Member States to their obligation to enforce state aid rules.

To face the new challenges requires a thorough modification of the existing state aid rules, as regards both substance and procedures. Any effective assessment of the allocation or distribution effects of State aid must take into account their actual contribution to commonly agreed, politically desirable objectives. The aim is to present a comprehensive and consistent reform package based on the following elements:

- less and better targeted state aid;
- a refined economic approach;

- more effective procedures, better enforcement, higher predictability and enhanced transparency;
- shared responsibility between the Commission and Member States: the Commission cannot improve state aid rules and practice without the effective support of Member States and their full commitment to comply with their obligations to notify any envisaged aid and to enforce the rules properly.

Besides all these developments, Europe's future economic development also depends on its ability to create and grow high-value, innovative and research-based sectors capable of competing with the best in the world. This priority of knowledge and innovation has been clearly endorsed in the Communication to the Spring European Council. In this context, in 2005, the Commission will adopt a Communication on state aid and innovation which will analyze the need and the potential to adapt existing rules in order to create the appropriate framework conditions to foster innovation in the EU.

Additionally by the state aid action plan, EU has also planned (a) to modify the Community Framework for Research and Development, in the light of the Lisbon and Barcelona objectives, (b) to create a better business climate and stimulating entrepreneurship, (c) to contribute to a culture of entrepreneurship and further stimulate investment in the form of risk capital by reviewing Communication on risk capital, (d) to invest in human capital, (e) to provide high quality SGEI, (f) to ensure better governance and facilitate the granting of aid, which is clearly compatible with the Treaty by issuing a general block exemption regulation or simplifying and consolidating of existing block exemption regulation, (g) to review of the Community guidelines on regional aid, and to integrate the Multisectoral Framework on regional aid for large investment projects, (h) to encourage an environmentally sustainable future, (i) to set up modern transport, energy and information and communication technology infrastructures, (j) to modernize the practices and procedures of state aid.

Therefore, SAAP proposes a comprehensive and consistent reform whereby the same general principles are applied in all instruments. The objective is to make state aid policy clearer, simpler and easier to understand. At the same time, rules will also be adapted to ensure high-quality public services, modern transport and energy infrastructures, and social and regional cohesion.

In addition to the above-mentioned aims of the action plan, the reform will tackle the practice and procedures of state aid, to make it more efficient, more transparent, and to improve its enforcement by Member States. This requires a partnership with Member States, who play a critical part in the effectiveness of state aid administration. The Commission intends to simplify, consolidate and extend as much as possible the use of block exemptions and adapt its assessment to the impact that aid has on competition and trade. It intends to use a refined economic approach in order to concentrate its resources on the cases that are creating more important distortions of competition and trade, and to facilitate and accelerate the authorisation of aid that is liable to distort competition less. As a consequence, fewer aid measures will need to be notified to the Commission while other measures will be subject to a control which will be proportionate to their effect on competition and trade.

The Commission presented its action plan for a reform of state aid rules on 7 June 2005. This action plan launches a three-month consultation on the Commission's strategy to reform and simplify EU rules governing financial support from member states to their industries.

5.1.5. Latest Words on State Aid Policy of EU

By all of these recent developments in the EU's state aid policy, the Commission is looking to focus aid on improving the competitiveness of European industry and creating sustainable jobs. Because, Member States need a clear, comprehensive and predictable framework to be able to grant public subsidies which contribute to competitiveness, cohesion and improving public services. State aid policy has to

support the Lisbon Strategy for growth and jobs. This requires incorporating a refined economic approach into state aid control, to support a better targeting of state aid towards the types of interventions where financial markets are more reluctant to lend money that improve economic performance and competitiveness or create sustainable jobs. But this also requires improving social and regional cohesion, favoring environmental protection and promoting cultural diversity.

Besides, state aid policy also needs to be adapted to the new requirements of an enlarged Europe, to be more efficient to reduce the administrative burden on Member States and to focus the action of the Commission on the areas where it really matters. There is a need to strengthen the commitment of Member States to their obligation to enforce state aid rules.

Moreover, the increasing complexity and number of various different rules and guidelines progressively adopted by the Commission over time have created a need to streamline state aid policy and to clarify its core principles. State aid policy should become comprehensible to all, so that all interested stakeholders can get involved and act against unlawful aid, in particular before national judges.

Shortly, EU's state aid policy can be highlighted as follows:

Highlights of the reforms, due over the next five years, include:

- a more refined economic approach to assessing aid, so that less distortive aid can be approved more quickly. This will enable the Commission to concentrate resources on cases involving major distortions of competition and trade;
- exempting more types of aid from the obligation to notify aid granted,
- improved enforcement,
- enhanced transparency,
- greater responsibility given to EU Member States;
- streamlining the current numerous state aid rules into one EU state aid block exemption, and
- streamlining Commission procedure.

The Commission's "roadmap" for implementing the proposed reforms envisages publishing a number of communications on state aid over the next two years. These include:

- a communication on state aid and innovation, and
- a decision on services of general economic interest.

The Commission also states its intention to:

- revise the EU's regional aid guidelines,
- review many of the state aid rules in place, such as the Community Framework for R&D and the Communication on risk capital;
- simplify and consolidate the current numerous state aid block exemptions into one general block exemption and integrate a wider range of exemptions;
- increase de minimis aid thresholds;
- consider introducing best practice guidelines on the better administration of state aid control.

After having finalised the comprehensive review of State aid, the Commission will conduct an evaluation exercise, in order to make sure that the new rules and practice of state aid policy work properly for the benefit of European citizens. If necessary, new actions will be proposed¹⁵⁷.

Table 1.11. An overview of the road map 2005-2009 with an indicative division in three stages.

<i>Modifications</i>	2005/2006	2007/2008	2009
Substance	- Road map for state aid reform 2005-2009, - Regional aid guidelines, - General Block Exemption (SME, employment, training, R&D, <i>de minimis</i> , regional, environment),	- Assessment/modification of the rescue and restructuring aid guidelines, - Notice on state aid in form of guarantees, - Communication on direct business taxation,	-Assessment of the reform and review of existing state aid rules

¹⁵⁷ State aid action plan: a roadmap for state aid reform 2005 – 2009, Consultation document.

	<ul style="list-style-type: none"> - Communication interest rates, - Guidelines R&D and Innovation, - Communication short term credit insurance, - Communication risk capital, - Decision and guidelines on the Services of General Economic Interest and transparency directive, - Guidelines environment, - Framework on State aid to Shipbuilding. 	<ul style="list-style-type: none"> - Communication on state aid to public broadcasting, - Possible additional block exemptions, 	
Consultation documents	<ul style="list-style-type: none"> - Communication on innovation 	<ul style="list-style-type: none"> - Consultation document on possible modification of Council Regulation 659/99. - Consultation document on the different forms of aid 	
Procedure	<ul style="list-style-type: none"> - Internal best practices Guidelines - Promotion of state aid advocacy. Increase monitoring of decisions and recovery - Possible proposal for amendment of the Council Regulation No 994/98 (enabling regulation) 	<ul style="list-style-type: none"> - Possible proposal for amendment of Council Regulation 659/99 (procedural Regulation) - Notice on cooperation between national courts and the Commission in the state aid field 	

Source: State Aid Action Plan, Consultation document of the Commission

5.2. Comparison of State Aids between Turkey and EU

As mentioned previously, the Helsinki European Council held on 10-11 December 1999 produced a breakthrough in Turkey-EU relations. At Helsinki, Turkey was officially recognized without any precondition as a candidate state on an equal footing with the other candidate states. Thus, Turkey, like the other candidates, became eligible to benefit from a pre-accession strategy to stimulate and support its reforms.

Specifically, a single framework for coordinating all sources of EU financial assistance for pre-accession was created. Furthermore, Turkey is to participate in Community programs open to other candidate countries and agencies¹⁵⁸.

With the inclusion of Turkey in the enlargement process, Turkey's obligation to align with the *acquis communautaire* covered by the customs union was extended so as to cover the whole *acquis* and accordingly the parties had to take the necessary measures to accelerate the harmonization process.

Accordingly, the Council approved the Accession Partnership on 8 March 2001 and the Framework Regulation concerning EU's financial assistance to Turkey on 26 February 2001. The Accession Partnership document, the so-called road map for Turkey's accession, basically sets priority areas where Turkey is expected to further its alignment to EU *acquis* and determines EU's financial schemes that will support Turkey within the accession process.

Within this context, Turkey is to complete its alignment to the *acquis communautaire*, to reinforce its existing administrative structures as well as the establishment of the new ones in various fields, such as technical legislation, state aids, public procurement and customs.

Recently, European Commission published its Regular Progress Report on Turkey for 2004 and its recommendation on 6 October 2004. In the document "Recommendation of the European Commission on Turkey's Progress Towards Accession", which formed the basis for the decision of European Council on 16-17 December 2004, it is indicated that Turkey sufficiently fulfils the political criteria and the EU Commission recommends that accession negotiations be opened. In line with the Commission Recommendation of 6 October 2004, the European Council of 16-17 December 2004, decided to initiate accession negotiations with Turkey on 3 October 2005.

¹⁵⁸ <http://www.hazine.gov.tr>

However, according to the Regular Progress Report on Turkey dated 2004, no progress has been made on the adoption of state aid legislation or on the establishment of an operationally independent state aid monitoring authority. The lack of progress on this key question is hindering the implementation of a state aid control regime, resulting in potential distortions of competition in markets via the allocation of public aid. It is also a major factor delaying the adoption of an Association Council Decision on the implementation of competition rules, despite the fact that Turkey is committed under the Customs Union and the ECSC Turkey Trade Agreement to align with the EU *acquis* in the state aid sector.

It has been taught that current incentive legislation applied in Turkey is not generally contrary to the competition and state aid rules mentioned in the EU legislation and international agreements. But it has to be harmonized and Turkey has to do much on the adoption of state aid legislation with the EU *acquis*.

The EU *acquis* constitutes a series of regulations, directives and decisions, jurisprudence and an exceptionally comprehensive secondary legislation (Commission communications) besides the basic rules of the Treaty. With this legislation, the Commission controls and monitors the aid awards of the member states. All legal arrangements relating to Competition and State Aid (including the secondary legislation) and the existing implementing rules are binding for Turkey. For the provisions and criteria of the current legislation to be applicable to Turkey, the above referred regional legislative issues and techniques (NUTs) need to be urgently embodied in the Turkish legislation.

Although the current practices of Turkey in this respect are based on geographical grounds, a comprehensive harmonisation is required in terms of the statistical geographical units, criteria and computation techniques.

Turkey also has to put into practice the legislation covering restrictive and/or prohibitive provisions against the aid in the sensitive sectors of the EU.

Turkey's legislation pertaining to "horizontal" aid has already been aligned with the *acquis* of the EU to a great extent.

In complying with the rules of the EU in granting aid, Turkey should also meet the “monitoring and notification” requirements of the Commission.

When we look at the institution in charge of controlling state aid in the EU, we meet with the European Commission, as an independent body, represent the common interest of all European citizens and control the way national governments use state aid to serve the common interest. Member States have different traditions of state intervention and different levels of financial resources. But Member States also have one institution which controls, monitors and grants state aid. Therefore it is necessary to authorize one institution to control and monitor and grant of the state aid. There is a need for a body in Turkey to act as a National State Aid Monitoring Authority in order to remove difficulties having various public bodies to control state aid.

5.2.1. Necessary Institutional Changes

There are some administrative differences between the bodies responsible for state aid in Turkey and in the EU member states. Aid in the EU is provided through EU funds, central government or local administrations of the member states. However, the Commission monitors all aid schemes in member states from the notification and approval stage until its termination. Therefore, there is a need for a body in member states, to act as a National State Aid Monitoring Authority to inform the Commission regularly. This authority will be entrusted with the task of evaluating the compatibility of state aid practices with the criteria set forth in the acquis of the EU.

Thus, the Commission will be able to carry out its monitoring and control activities by addressing this authority. These activities are only conducted by the central government in Turkey. In this respect, it has become obvious that the legislation with which Turkey must align does not only cover the implementation provisions. So, administrative restructuring is essential in order to notify the EU concerning the control, monitor and the assessment of aid awards of the responsible units.

The body or the authority to be set up will take an active role in notifying changes to legislation and its implementation, exchanging information, ensuring alignment with international agreements such as GATT/WTO and the criteria and methodology followed in the EU, contributing to the establishment of state aid policies in accordance with national interests, preparing legislative procedures, and assessing the results of the practices¹⁵⁹.

5.2.2. Necessary Amendments and Modifications in the Turkish Legislation

In the Accession Partnership Document, it is mentioned as a target for Turkey to adopt a legislation regarding control and monitor of the state aid. In addition, the Commission always repeats the need of establishment of a state aid monitoring authority and lately the Commission stated it again in its Regular Report on Turkey dated 2004.

There are two studies in the subject matter. First one is “Proposal of Law regarding Control and Monitor of State Aids” (Proposal)¹⁶⁰ and other one is “Draft Law regarding Control of State Aids” (Draft). Both of them are drafts and have not become law yet.

Both the Proposal and the Draft envisages to constitute an independent authorization field to control and monitor of the state aid (excluding agriculture and fisheries) and to decide on principles and implementation by ensuring protection of competition and preventing negative effect to the other agreements regarding control of state aids between Turkey and EU. Draft suggests establishing an independent body to use the authorization and Proposal suggest appointing Competition Board for monitoring the market and prevent every action which distorts competition.

It is useful to consider both the Proposal and the Draft within the scope of EU rules and Association Council Decision numbered 1/95 regarding adoption of these

¹⁵⁹ National program of Turkey, 2001.

¹⁶⁰ <http://www.tbmm.gov.tr>

rules in Turkey's legislation. However, because of the difference in the contents between Proposal, Draft and the Association Council Decision, it may be encountered with conflict during the application. So it may be more useful and proper to make reference to the Association Council Decision while approving any proposal to prevent conflict with the Turkey's commitments to the EU.

Most of the arrangements regarding "exemptions" in the EU legislation and Association Council Decision and some of the secondary legislation in the EU are considered in the Article 4 of the Proposal. State guarantees granted in the market conditions, de minimis aids whose thresholds are determined by the Competition Board, aids regarding group exemptions are excluding from the application of Proposal. Absence of some criteria regarding group exemptions makes some difficulties for the Competition Board in the possible preparation of group exemptions.

Furthermore, EU's request from the candidate countries regarding the monitoring of state aids is establishment of a public body in order to assess efficiently all of the information about existing and new aid applications of institutions which grants aid and to inform EU independently about the compatibility of state aids to the Europe agreements (Customs Union)¹⁶¹.

As mentioned earlier, with few differences, Proposal is prepared parallel to the EU rules. However, some changes could be made both in the Proposal and the Draft law.

In order to look generally at the Turkey's state aid policy, we see that necessary amendments in the legislation of state aid could be considered in two separate parts. Due to the fact that state aid controls are under the responsibility of various public bodies too many implementations are regulated. In Turkey, there are various public bodies, institutions and organizations carrying out state aid implementations independently. State aid aimed at investments (internal and foreign) is basically under the responsibility of the Undersecretariat of the Treasury. Aid granted as export incentives is regulated by Undersecretariat of Foreign Trade. Exports credits and

¹⁶¹ Mustafa Mehmet Özkarabüber, Avrupa Birliği ve Türkiye'de Devlet Yardımlarının Kontrolü, Rekabet Kurumu, İlk Baskı, Temmuz 2003, Ankara, p. 63.

insurance practices are run by Eximbank. Furthermore, companies qualifying as SME's are furnished with credit facilities by Halk Bank. Therefore, relevant implementation regulations are enacted separately by different public bodies and for this reason, laws on similar issues should be grouped and these policies on state aid should be in harmony and complementary and the public bodies which granted aid should be united.

Another point in this respect is that although the current incentive legislation is in general not in contradiction with the competition and state aid criteria stipulated in the *acquis communautaire* of the EU and in international agreements, the whole system and its implementation should be made compatible with the EU's regional system based on the NUTs criteria. It should also be noted that the implementation of this system is necessary not only for aid awards, but for future allocation of funds from the Community budget. Therefore, in addition to the regional structures, sectoral practices and the negligible state aid "de minimis rule", implementations regarding SME's and social practices also need to be reviewed with respect to the Community *acquis*¹⁶².

Final target of Turkey is embodying the decisions taken and/or criteria set forth for certain matters by the EU in Turkish legislation. In other words, undertaking them one by one in terms of complying with the EU in the field of state aid in investments will not be sufficient to overcome the problem of harmonization. As I said before, an administrative restructuring may be necessary to control, monitor and evaluate the practices of public bodies responsible for state aid.

¹⁶² Turkey's national program, 2001.

VI. CONCLUSION

State aid rules which try to ensure not to effect intra-trade of Community is one of the essential part of the competition policy of the Union. These rules are aimed to take under control with the national state aid legislation of Member States.

After mentioning all of the aforementioned issues, when we look at the state aid rules from the Community level, we will see that in recent years, Community has pursued the goal of stringent state aid control, based on economic analysis. Such a state aid policy has to be seen as part of a proactive competition policy and state aid policy has to contribute to increase productivity and employment by ensuring fair and strong competition and by allowing corrections of market failures.

As it is known that strong competition is a driver of innovation, efficiency improvements and necessary restructuring in a global market. Competition thereby creates benefits for consumers and society as a whole in the form of lower prices, better quality and greater choice. If, on the contrary, competition is distorted by state aid, this partly destroys the incentive for firms to pursue technological innovations and cost-efficient solutions and, as a result, crucial driving forces behind growth and employment will be lost¹⁶³.

The need for strict control of state aid throughout the Union has been recognized by successive European Councils. At the Stockholm European Council in 2001, Member States committed themselves to continuing their efforts to reduce the general level of state aid and to redirect aid towards horizontal objectives of common interest, including cohesion objectives.

¹⁶³ Mario Monti, State aid enforcement in context: competitiveness, economic reforms and enlargement, 24 April 2004, Brussels.

It must be noted that not all state aids are bad. Better state aid is correcting market failures with a view to improving productivity and achieving a more efficient allocation of resources. For example, horizontal aid is better aid since it increases the level of risk capital and research and development corrects market failures. But it must be noted that the state aid be carefully granted and rules be carefully designed to correct the market failure exactly and keep the distortion to a minimum. Granting the aid carries risk of distortion of competition which may harm competitiveness. On the other hand, forbidding the aid carries risk of missing an opportunity to correct market failure, which may foster competitiveness. In practice, it is a difficult task to achieve the exact balance and get the economic incentives exactly right.

According to the Commission's reports and scoreboard, Member States are on the right track in reducing the general level of state aid. State aid Scoreboard indicates that the majority of Member States appear to be responding positively to the call for "less and better targeted state aid".

Starting with the Lisbon agenda in 2000 which launched the process of reducing the general level of State aids and shifting the emphasis from supporting individual companies or sectors towards tackling horizontal objectives of Community interest, the Council has adopted a series of conclusions on State aid. In 2001, at the Stockholm European Council, Member States committed themselves "to demonstrate a downward trend in State aid in relation to GDP by 2003, taking into account the need to redirect aid toward horizontal objectives of common interest, including cohesion objectives." The latest European Council held on 22-23 March 2005 reiterated its call to Member States "to continue working towards a reduction in the general level of State aid, while making allowance for any market failures"¹⁶⁴.

The overall level of state aid granted by the (then) fifteen Member States was estimated at €53 billion in 2003. In absolute terms, Germany granted the most aid (€16 bn) followed by France (€9 bn) and Italy (€7 bn).

¹⁶⁴ Commission of the European Communities, Report on State Aid Scoreboard, 20.04.2005.

Total State aid granted by the ten new Member States during the four-year period prior to accession was estimated on average at €6.1 billion per year. 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 increase was caused by very large awards of aid in 2002 to the Czech banking sector (€2.6 billion) and in 2003 to the Polish coal sector (almost €4 billion)¹⁶⁵.

When we look at the State aid of new Member States as a percentage of GDP in most of the sectors, it is significantly higher than the EU-15 over the same period.

With 25 Member States, the Commission has to deal with the additional workload created by examining state aid measures in the ten new Member States. It becomes even more crucial that the rules meet their objectives; that they are clear; that procedures are simple; and that cases with a large impact on competition are given the highest priority.

It is obvious that one of the big challenges will be to redefine most the state aid policy in an enlarged Union, reconciling the overall reduction of state aid volumes with the Community objective of economic and social cohesion within the framework of enlargement.

On the other hand, it is necessary to say the last words on state aid policy from the Turkey's point of view. When we look at the last situation of Turkey, it is appeared that not too much thing has been done on the adoption of state aid legislation or on the establishment of a state aid monitoring authority and some steps regarding harmonization has been left half finished.

Export incentive policy has already been harmonized with the EU acquis. In this respect, export incentives has been categorized under the horizontal state aid of the EU

¹⁶⁵ <http://www.europa.eu.int>

and entered into force abovementioned types of communiqués which are compatible with the EU acquis.

In addition, investment incentive policy has been passed to the regional system and some projects are prepared to speed up the harmonization process, but it has not been exactly put into application. It has been taught that state aid legislation regarding investment is compatible with the EU acquis¹⁶⁶, but some technical issues and procedures have to be changed reciprocally with the Commission.

Considering the reality that important part of the arrangements regarding current investment incentives are tax exemptions, tax legislation has to be considered and, if need be, changed by taking into consideration the aim of harmonization to the EU rules.

Turkey commits to take necessary step towards the harmonization of its legislation with EU acquis by preparing National Program for the adoption of acquis. Turkey committed both by the Association Council Decision and by its National Program to make its state aid policy compatible with the EU rules and to establish an independent state aid monitoring authority. In order to fulfill these obligations, Turkey has to own an independent body to control the compatibility of legislation regarding state aid rules with the EU rules and unlawful aids. This requirement is based on the Turkey's Progress Report dated 2001. However, the state aid framework Law has not been adopted, and therefore, there is no alignment with the EC Treaty rules on state aid control.

According to the Regular Report of the Commission on Turkey dated 2003, in the area of state aid, the legislation on state aid monitoring is not in conformity with the *acquis*, and a state aid monitoring authority needs to be established. This is the major factor delaying the adoption of an Association Council Decision on the implementation of competition rules, despite the fact that Turkey is committed under the Customs Union to align and set up a state aid monitoring authority. This is hindering the proper implementation of competition rules, resulting in potential competition infringements in

¹⁶⁶ Tunay Köksal, Avrupa Birliği ile Bütünleşme Sürecinde Türkiye'de Devlet Yardımlarının Hukuki Çerçevesi, Rekabet Dergisi.

markets via the allocation of public resources. Besides, the absence of reporting of state aids based on the EC standards reduces the transparency of financial transactions between the state and undertakings¹⁶⁷.

When we look at most of the developed countries, state aids are determined by Law. One of the essential conditions of the EU from Turkey is to approve the Draft Law of Control and Monitor of the State Aids. This issue is very important for EU and Turkey has to approve the draft law to make best harmonization to the EU.

State aids are granted to certain regions or certain sectors for some reasons in all of the countries in the world. But, while granting state aid to any undertaking, countries has to follow certain procedures and obey certain criteria and law. In this respect, European Union does not find it healthy that governments control state aids. EU requests from Member States or candidate countries to establish an independent authority to control and monitor state aids. In most of the Member States, Competition Authorities are responsible for controlling of state aids.

As it is mentioned previously, there is a draft law and a proposal regarding the subject matter. But they have not been approved and entered into force yet. Because separate institutions which are responsible for granting incentives in different areas do not come to a common conclusion to determine which public body will be authorized for controlling and monitoring state aids.

Authority that controls and monitors state aids must be independent and has an administrative and financial autonomy. Additionally, it has to evaluate whether the granting aid distorts competition or not. Most of the writers and experts regarding the state aid rules think that the responsible authority in Turkey must be Competition Authority which is independent and have a corporate experience and qualified and expert staff. Actually it is rationalist to appoint autonomous body that is to say Competition Authority to control state aids instead of public body which is related to political authority. But the Commission has concerns about it. Because they think that

¹⁶⁷ <http://www.europa.eu.int>.

recent governmental efforts to establish a uniform organisational structure for all independent regulatory authorities (including the Competition Authority) by adopting framework legislation raise concerns about potential political intervention in the operations of the Competition Authority.

Although there are some concerns on the above-mentioned issues, we have to come to the conclusion that Turkey is on the right track to achieve its liabilities against the EU. In order to harmonize its state aid legislation with the EU, Turkey has to approve the Draft Law and the Proposal regarding controlling and monitoring of state aids and authorize the Competition Board as an independent body to control state aids in Turkey.

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