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REVIEW # 4

PARLIAMENTARY EXPERT GROUP

FEATURING: STATE AID TO UNDERTAKINGS



**PARLIAMENTARY
EXPERT GROUP ON
EUROPEAN INTEGRATION**

Parliamentary Expert Group on European Integration is an independent expert community established by the Open Society Foundation NGO to promote implementation of the EU – Ukraine Association Agreement by improving the quality of lawmaking processes.

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The implementation of Ukraine's obligations in the field of state aid to undertakings on the basis of the EU-Ukraine Association Agreement (further referred to as the "Agreement") is highly relevant for country's further economic and innovative development. These obligations include, in particular, the alignment of the existing schemes and state aid measures of Ukraine with the EU rules, as well as the development of the new schemes and measures based on these rules (Article 264 of the Agreement).

The EU state aid rules mainly aim to prevent the distortion of economic competition within the EU common market, so that the support of economic activity at the expense of the Member States does not turn into a "subsidy war". Unlike the GATT/WTO rules, which require the state aid measures to be reported post-factum by the countries and possibly be subject to arbitration, the EU law provides for a broad list of essential requirements that Member States' governments must use at the programming stage.

The key feature of the EU rules in the field of state aid is to distinguish between measures of:

- selective aid, and
- general aid measures, that is, those that are a priori available to all market participants.

Selective state aid leads to the benefits to its recipient and the corresponding losses of the state (in particular, local governments, state and municipal enterprises, state banks, etc.), and negatively affects the competition and trade. In this case the government of a Member State should rely on state aid rules for the preparation or adjustment of programs and measures. Otherwise, when measures of the state aid are of a general nature, state aid rules do not apply.

The regulation of state aid in the EU has been practiced by at least 50 years. The rules are being constantly improved. During the periods of recession and economic crises, the European Commission noted that significant amounts of budget funds were spent on non-competitive industries and enterprises. This policy distorted

competition in the EU internal market and undermined European competitiveness in general. On the other hand, certain types of aid that serve pan-European interests, such as regional development, industry restructuring, aid having a social character or aid aimed to promote important individual projects, have always been supported.

The new EU Member States have positive experience of the implementation of state aid rules while preparing for joining the EU and after obtaining membership. The development of the industrial zones of the Czech Republic was actively taking place during 1998-2006, when the emphasis was put on the development of production sites with the support from the state budget. Local governments and private companies could apply for such support. During this period, the government of the country attracted almost 162 billion Czech crowns of investments, while spending only 7.2 billion crowns (4.5% of the total investment). After 2006, following the initial establishment of the industrial zones, the government limited its support to strategic industrial zones only. At the same time, the investment incentives were provided directly both to investors and to municipalities to build the industrial zones. The industrial zone development policy during 1998-2006 additionally resulted in the creation of a market for industrial land plots.

In the case of Slovakia's industrial parks, the investment support policy had two components: support for municipalities and support for investment projects. In the first case, the municipality could receive a targeted subvention for infrastructure development. In the second case, the company-participant of the park received a budget subsidy for the implementation of the investment project. One of the main criteria for deciding on state aid provision was the impact on creating the new jobs. Industrial parks have positively influenced the restoration of the business climate, the transfer of modern technologies, helped to restructure and modernize the economy and create new jobs, especially in the

regions of Kosice, Žilina, and Bratislava. On the contrary, the regions which did not have such parks, faced rather unsatisfactory economic situation and high unemployment.

The core elements of the EU state aid rules include:

- establishing a list of eligible expenses;
- distinguishing between operational expenses and investment expenses, and
- establishing the intensity level of state aid for certain projects.

The intensity indicator varies depending on the size of the recipient and the level of development of the region. Small businesses in the underdeveloped regions can, as a rule, rely on state aid of higher intensity.

Thanks to these elements, the state aid control mechanism also contributes to the efficient use of budget funds (or public resources in the general sense) and greater transparency of state aid.

Application of the EU state aid rules in Ukraine is important for the development of export policy and the establishment of deep and comprehensive free trade area with the EU. Direct export subsidies are prohibited by both the GATT/WTO norms and the Association Agreement. The compliance with the EU state aid rules will help to develop country's export potential and ensure that no international obligations of Ukraine are violated. On the other hand, failure to comply with these rules will create risks for future access into the EU market.

The Verkhovna Rada of Ukraine have registered more than 30 bills on granting privileges or subsidies to participants of free (special) economic zones and industrial parks, and certain industries (like shipbuilding or the aerospace industry). For other undertakings, which are not members of the mentioned zones, parks or industries, the proposed measures are selective. Provision of tax and customs privileges will lead to losses of state or local budgets, while their recipients will enjoy the financial benefits. In this way, the scheme will potentially negatively affect the competition in those markets where the recipient undertakings operate. In accordance with the EU law, as well as the Law of Ukraine On State Aid to Undertakings, such scheme is considered a state aid.

At the same time, the fact that the measure of support will constitute a state aid to undertakings does not mean its prohibition. In this case, it must comply with the EU state aid rules,

including a list of eligible expenses, assistance goals, and the share of coverage (intensity) of state expenses. Depending on the assistance goals, the developer can choose between the rules for regional state aid, rules for assistance for research, development and innovation, or other rules.

The issues of state aid are covered by Part Two of Chapter 10 (Competition) of the Association Agreement. In particular, according to Article 262 of the Agreement, the state aid may be considered compatible with the proper functioning of the Agreement, if:

- aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions contrary to the interests of the Parties;
- aid to achieve objectives allowed under the EU rules horizontal block exemption regulations and horizontal and sectoral state aid rules granted in line with the conditions set out therein.

Ukraine should bring its own state aid schemes in line with the EU rules during the first five years after the entry into force of the Agreement (Article 267).

The Law of Ukraine On State Aid to Undertakings, which came into force on August 2, 2017, was directed to the implementation of the provisions of the Agreement on state aid. The Antimonopoly Committee of Ukraine, as the authorized body in the field of monitoring state aid to undertakings, will prepare conclusions on the admissibility of state aid for competition (i.e. compliance with the provisions of the Agreement).

Article 6 of the Law stipulates that the state aid may be recognized as admissible for competition if it is granted, for example, to facilitate certain types of economic activity or undertakings in specific economic zones, provided that this does not contradict the international treaties of Ukraine, ratified by the Verkhovna Rada of Ukraine. To be considered admissible, the state aid project must meet the evaluation criteria approved by the Cabinet of Ministers of Ukraine. These criteria will be based on the EU state aid horizontal and sectoral rules.

Expert recommendations:

To take into account the provisions of the Association Agreement when drafting bills providing for selective (targeted) support to undertakings in Ukraine.

EUROPEAN INTEGRATION BILLS CONSIDERED CURRENTLY BY THE VERKHOVNA RADA OF UKRAINE (III QUARTER 2017)

N ^o	Registration number	Title	Stage
1.	0906	On the government control to observe the compliance with laws on safety and quality of food and animal feedstock, on animals' health and welfare	Signed by the President and returned to Parliament
2.	2009a-A	On Environmental Impact Assessment with the proposals of the President of Ukraine as of 28.10.2016	Signed by the President and returned to Parliament
3.	2431	On amending legislation on protection of economic competition regarding establishment by the Antimonopoly Committee of Ukraine the size of penalties for violations of the competition laws	Handed for additional second reading (26.01.2016)
4.	2845	On Animal Feedstock Security and Hygiene	Released by the Committee to be approved in principle (30.06.2015)
5.	3445	On amending legislation on protection of flora and fauna under international agreements	Prepared for the second reading (29.11.2016)
6.	4126-1	On Consumer Information on Food	Returned for revision to the introducing body (03.10.2017)
7.	4493	On the Electricity Market of Ukraine	Signed by the President and returned to Parliament
8.	4571	On amending Article 5 of the Law on Distribution of Copies of Audiovisual Works, Phonograms, Videograms, Computer Programs, Databases to combat piracy and improve the investment climate	Received the Committee submission for consideration
9.	4577	On amending Article 31 of the Law on Employment on regulating public works	Declined
10.	4578	On amending legislation on employment of disabled persons	Released by the Committee to be approved in the first reading (17.06.2016)

№	Registration number	Title	Stage
11	4579	On amending certain legislative acts of Ukraine to acquire, exercise and protect the copyright and related rights	Recalled (03.10.2017)
12	4584	On amending certain laws of Ukraine that regulate government statistics	Received the Committee submission for consideration (31.05.2016)
13	4589	On amending certain food safety laws of Ukraine	Released by the Committee to be approved in principle (06.12.2016)
14	4591	On Business Ombudsman	Endorsed in the first reading (31.05.2016)
15	4593	On Rail Transport of Ukraine	Returned for revision to the introducing body (21.02.2017)
16	4611	On Requirements to Food Contact Items and Materials	Released by the Committee to be approved in principle (20.09.2016)
17	4614	On amending the Customs Code of Ukraine to protect intellectual property in the movement of commodities across customs borders of Ukraine	Not included onto the agenda
18	4615	On amending the Customs Code of Ukraine to comply with the EU – Ukraine Association Agreement	Not included onto the agenda
19	4619	On amending the Tax Code of Ukraine (in regard to tobacco products taxation)	Voted as an amendment (06.12.2016)
20	4629	On amending certain legislative acts of Ukraine to protect the copyright and related rights in the Internet	Recalled (03.10.2017)
21	4644	On amending certain legislative acts of Ukraine to harmonize them with the EU legislation on transportation of dangerous goods	Declined
22	4646	On amending the Law of Ukraine On Accounting and Financial Reporting in Ukraine to improve certain provisions	Considered while revising the bill 4646-А

№	Registration number	Title	Stage
23	4683	On amending certain automotive transport acts of Ukraine to harmonize them with the EU regulatory acts	Returned for revision to the introducing body (21.02.2017)
24	4685	On Electronic Trust Services	Adopted
25	4775	On amending certain laws of Ukraine related to European groupings of cross-border cooperation	Received the Committee submission for consideration (07.02.2017)
26	4776	On amending the Tax Code of Ukraine regarding peculiarities of taxation of import of goods to Ukraine by authorized economic operators	Received the Committee submission for consideration (11.07.2017)
27	4777	On amending the Customs Code of Ukraine regarding authorized economic operator and simplified customs formalities	Received the Committee submission for consideration (11.07.2017)
28	6229	On Ensuring Transparency in Extracting Industries	Included onto the agenda (25.05.2017)
29	4901	On Commercial Accounting of Utility Services	Signed by the President and returned to Parliament
30	4941-A	On the Energy Efficiency of Buildings	Signed by the President and returned to Parliament
31	5448	On the basic principles and requirements for the organic production, handling and labeling of the organic products	Received the Committee submission for consideration (14.03.2017)
32	5548	On amending legislation on protection of consumer rights	Being studied by the Committee
33	5598	On the Energy Efficiency Fund	Signed by the President and returned to Parliament
34	5627	On amending the Customs Code of Ukraine to bring transit procedures in line with the Convention on a common transit procedure and Convention concerning the simplification of formalities in trade in goods	Received the Committee submission for consideration

№	Registration number	Title	Stage
35	6106	On Strategic Environmental Assessment	Endorsed in the first reading, prepared for the second reading
36	6016	On the Audit of Financial Statements and Audit Activity	Returned to the Committee for revision
37	6023	On amending certain legislative acts of Ukraine to improve the legal protection of geographical values	Received the Committee submission for consideration
38	6085	On amending legislation on cross-border cooperation	Endorsed in the first reading
39	6598	On amending legislation on implementation of provisions of certain international agreements and EU directives on protection of flora and fauna	Recalled (03.10.2017)
40	6602	On amending the Law on Waste regarding the implementation of EU directives on waste management	Being studied by the Committee