

NOTICE ON MONITORING OF STATE AID AND REDUCTION OF LABOUR COSTS

(97/C 1/05)

(Text with EEA relevance)

Introduction

1. Job creation and combating unemployment are a priority of Community policy. Reducing labour costs is generally considered to be a potential means of improving the employment situation, particularly at the lower-skilled end of the market. The Commission intends to ensure that there is consistency between the implementation of policies necessary to combat unemployment in the European Union and its competition policy. Most labour-cost-reducing measures do not constitute State aid. Where job-creating measures have fallen within the scope of the State aid rules, the Commission has traditionally adopted a favourable attitude towards them. This communication has a twofold objective. Firstly, it sets out to indicate the reasons why the Commission is nevertheless unable, under the State aid rules, to take a positive stance towards some of the measures which have been implemented or are planned by Member States. Secondly, it aims to propose alternative courses of action which are both effective in terms of job creation and which do not pose the problem of compatibility with the competition rules.

than regressive as they generally are at the moment ..., in order to encourage the provision of more jobs for the relatively less-skilled by reducing their cost to employers ...

— lowering the relative cost of labour with respect to the other production factors (capital, energy and non-energy inputs), for example by reducing the employers' social security contributions and increasing revenue through other means ...

3. Among the measures advocated by the Essen European Council in December 1994 to improve the employment situation is that of 'reducing non-wage labour costs extensively enough to ensure that there is a noticeable effect on decisions concerning the taking-on of employees and in particular of unqualified employees' ⁽¹⁾. Likewise, the Madrid European Council in December 1995 considered it a priority to ensure 'a pattern of non-wage labour costs appropriate to unemployment-reducing objectives'. Elimination of the disincentives to employment in the Community is therefore a priority objective.

Context

2. In December 1993, the Commission called on the Member States, in its White Paper on growth, competitiveness and employment ⁽¹⁾, to 'seek to address the present disincentives to employing less skilled workers'. The European development system is characterized by inadequate use of human resources and excessive use of environmental resources. This imbalance should be corrected by means of 'a range of possible measures, including:

— adjusting taxation systems as they affect employers, notably by making employers' non-wage costs neutral or progressive, rather

4. The Commission ensures that these recommendations are followed up and, on an annual basis, publishes its 'Employment in Europe' reports and an overview of the measures implemented by Member States in the European Employment Survey. The measures recommended normally relate to the overall economy of the Member State in an automatic and non-discretionary fashion. They do not favour 'certain undertakings or the production of certain goods' and do not therefore constitute State aid within the meaning of Article 92 (1). This remains the case even if the measures are targeted at certain categories of workers (low-wage employees, young people in their first job, the long-term unemployed, part-time workers).

⁽¹⁾ Decision of 5 December 1993, Bulletin of the European Communities, Supplement 6/93, p. 131.

⁽²⁾ Essen European Council, 9 and 10 December 1994, Presidency conclusions, Document SI(94) 1 000, p. 5.

5. However, the data thus published and the information gathered by the Commission in monitoring State aid — be it notified by Member States under Article 93 (3) of the EC Treaty, the subject of a complaint lodged by competitors or from another source — reveal that this is not the case for all the measures. Some Member States have decided or plan to adopt measures which distort or threaten to distort competition 'by favouring certain undertakings or the production of certain goods'. Such measures do come under the State aid rules and are dealt with as such by the Commission. Generally they are measures which are targeted at specific sectors of activity, specific regions or enterprises of a specific size. The Commission is well disposed to some of them (see point 10 below).
6. The reasons put forward by Member States to justify the introduction of such aid measures are based on two types of considerations. On the one hand, the need to reduce public deficits in order to create a macroeconomic framework, which is favourable to growth and employment, does not allow them to adopt measures benefiting all firms. On the other, currency fluctuations within Europe have apparently led to adjustment difficulties for some sectors and regions in Member States whose currency remained stable.
7. The Commission is aware of the pressure on public authorities to grant aid to certain firms in order to alleviate the dramatic situation on the labour market. However, it must also draw Member States' attention to the risk which this kind of aid carries for the proper functioning of the internal market and thus for the competitiveness of European industry and long-term job creation. Thus, in its communication on 'The impact of currency fluctuations on the internal market' ^(*), the Commission, while acknowledging the difficulties which result for the Union's economy, insisted on the need to tackle the causes of currency fluctuations and stressed the dangers of measures aimed at correcting their effects on the sectors and regions concerned. In particular it considered that 'it cannot be ruled out that severe currency turmoil can make sectors or regions already affected by structural or cyclical crises even more fragile. However, monetary fluctuations cannot be used to justify any violation of Community mechanisms or rules. If these fluctuations were to aggravate the difficulties of a sector or region appreciably, their effects would be examined, like the effects of any other cause, within the limits of the existing Community rules and mechanisms. In no

circumstances shall this examination put into question either the allocation of structural funds between Member States or between objectives, or their programming rules. At any event, the Commission will seek to ensure strict application of the rules governing the functioning of the internal market in its entirety and a regime of undistorted competition.

The introduction of anti-competitive practices in the form of limits on parallel imports or State aid linked to exchange-rate movements (except in the case mentioned at point 19 ^(*)) would clearly contravene Community rules on competition and would not conform to internal-market rules. Such measures risk setting off a process of refragmentation of the internal market, a reduction in intra-Community trade and a slackening of growth in Europe. They would therefore jeopardize the efforts being made to complete the internal market. The internal market is the cornerstone of the Community construction programme. The Commission and the Member States must therefore consolidate the internal market and make every effort to prevent such refragmentation.'

The Member States broadly supported these conclusions at the Ecofin Council meeting in Brussels in November 1995.

The guidelines on aid to employment

8. In order to make clear to Member States which criteria it uses to determine whether State aid measures for employment are compatible with the common market, in July 1995 the Commission adopted its 'Guidelines on aid to employment' ^(*), which it has notified to Member States.
9. Aid to create jobs is viewed favourably when granted to small and medium-sized firms or to assisted regions. The same applies to aid intended to encourage firms to take on certain groups of

^(*) For the agricultural sector, see Article 42 of the Treaty.

^(*) OJ No C 334, 12. 12. 1995, p. 4; it should be noted that these guidelines do not cover aid to employment linked to investment, which is subject to the normal criteria used to assess investment aid.

workers experiencing particular difficulties entering or re-entering the labour market and to aid to promote job sharing.

10. However, aid to maintain jobs is acceptable in only a limited number of cases (*), i.e. where:

- the circumstances described in Article 92 (2) (b) apply,
- it relates to regions covered by Article 93 (3) (a),
- it relates to the rescue or restructuring of an ailing firm; however, it must in such circumstances be notified according to the relevant guidelines (†) and meet the conditions they lay down.

Employment-support measures which are not covered by the State aid rules

11. A general, automatic and non-discretionary reduction of non-wage labour costs is clearly not covered by the competition rules relating to State aid. For budgetary reasons, Member States which wish to implement measures of this nature are often required to target them carefully according to their cost.
12. However, the fact that employment-support measures are targeted does not necessarily imply that they are covered by Article 92 (1). It is only if targeting favours certain undertakings or the production of certain goods by excluding others (which otherwise are subject to the same objective conditions in relation to the general system of social contributions) that the State aid rules enter into play.
13. The fact that measures benefit certain firms or sectors more than others does not necessarily result in their falling within the scope of the competition rules. For example, measures to reduce labour taxation for all firms have a relatively greater effect

for labour-intensive industries, while the reduction of taxation on capital tends to favour capital-intensive industries. In neither case do such measures constitute State aid.

14. While measures targeted at a particular industry will be regarded as State aid, the same is not true for measures targeted at certain categories of employees, e.g. less qualified or low-wage employees, provided they apply automatically without discrimination between firms. Moreover, modulating the extent to which charges are reduced (or the scale of direct financial support) depending on the personal circumstances of a worker or on the level of his wage might have a redistribution effect between categories of workers which is desirable in view of the structural problems facing the labour market. Its impact, which will be greater in some industries employing a high proportion of unqualified labour, would not be enough for them to be qualified as State aid. Indeed, such measures form part of a policy of reforming the very structure of social-security contributions.

15. An examination of average wages per employee reveals major differences between the various economic sectors. Thus, wages in the basic chemical, oil-refining, office-equipment and computer sectors are on average twice as high as those in the textile industry and three times as high as those in the footwear/clothing and hotel/restaurant sectors (*). Measures targeted at low wages would therefore have much greater effects in the latter than in the former, but would still not constitute State aid.

16. Finally, the possibilities offered by the new *de minimis* rule adopted by the Commission (†) should not be forgotten. In its recent communication, the Commission fixed the amount of aid below which Article 92 (1) of the Treaty could be considered inapplicable in view of the lack of noticeable effects on trade between Member States at ECU 100 000 per firm over a period of three years.

(*) See also the special rules contained in the 'Guidelines for the examination of State aid to Community shipping companies' (SEC(89) 921 final, 3. 8. 1989). The Commission has indicated in its communication 'Towards a new maritime strategy' [COM(96) 81] the intention of reviewing previous orientations, and has begun work in this direction.

(†) Community guidelines on State aid for rescuing and restructuring firms in difficulty (OJ No C 368, 23. 12. 1994).

(*) Source: VISA/DEBA (manufacturing industry) and BDS (services); figures for 1993 and 1994. It should be noted that differences in wage costs between industries may vary from one Member State to another but the order in which the sectors fall varies little between Member States.

(†) OJ No C 68, 6. 3. 1996.

Sectoral aid to employment

17. It is clear from the Guidelines on aid to employment that the Commission has confirmed its consistently less favourable view of aid targeted at specific sectors, in particular at 'sensitive sectors experiencing overcapacity or in crisis'⁽¹⁰⁾. However, the Commission's impression is that it is these sectors which are particularly concerned by the targeted measures implemented or planned by Member States.

18. The Commission's negative stance towards aid for employment targeted at these sectors is based on the following observations:

— 'sectors' in a situation of overcapacity or in crisis are those in which demand for Community products is stagnating or indeed falling. Any drop in production costs for certain operators in these sectors generally has the effect of transferring difficulties — and unemployment problems — directly and on a large scale to competitors which do not enjoy such advantages. The effects on competition and trade are thus particularly harmful. From a Community point of view, there is, more often than not, no net creation of jobs: any jobs created or maintained artificially in one Member State are jobs which disappear in another,

— sensitive sectors are those in which intra-Community trade is significant and in which competition is particularly keen. Any aid granted by a Member State to firms in such sectors therefore directly affects trade between Member States and greatly distorts competition,

— the effects described above lead to a situation in which Member States try to outdo each other in the aid they grant⁽¹¹⁾. The result of this is sizeable public expenditure which neither tackles the root of the problem nor corrects the effects at Community level,

— moreover, it is to be feared that the effects on long-term competitiveness and on employment will be negative, particularly where aid is not accompanied by restructuring measures. This is because the impact of targeted measures aimed at lowering labour costs considerably reduces the need for the recipient firm to readjust. If aid is withdrawn, recipient firms find themselves in an even less favourable position than before because those of their competitors which did not receive aid have in the meantime been required to undergo restructuring or improve their productivity.

19. Currency fluctuations within the Union may also give rise to difficulties for some sectors in countries whose currency has depreciated in value. Even if aid proposals generally emanate from Member States whose currency has appreciated, the argument for a depreciation of the national currency may itself be invoked to justify measures favouring industries directly affected because the increase in inflation and interest rates will also create problems for firms, including those which initially benefited from the devaluation. This phenomenon might ultimately give rise to an aid spiral in all Member States.

20. These considerations justify the Commission's vigilance concerning certain types of aid to employment which are targeted at given sectors. Aid of this type is by nature defensive and contrary to the objectives of the single market. It combines major risks of distorting competition with a zero or even negative impact on employment in the medium and long term. It should also be borne in mind that those sectors which do not benefit from the measures in question indirectly contribute to financing them.

21. Other considerations should also be stressed. The sectors at which Member States currently direct their employment aid are also sectors which are open to international competition (manufacturing industry and some services). In them, the wage-cost differentials between low-wage countries and the industrialized countries are very significant (a ratio of 1 to 10). One must therefore question the contribution which a reduction in social charges makes to the employment situation and carefully assess the short and longer term effects of such measures in view of their costs. It is more on the basis of integrating new production technologies, innovation, quality, commercial approach and training that the Community economy can durably improve its performance in terms of competitiveness and employment.

⁽¹⁰⁾ Point 23 of the abovementioned Guidelines.

⁽¹¹⁾ See, for example, the requests for aid from the German textile industry in response to the Borotra Plan.

22. In employment terms, it should be stressed that market services, some of which are broadly protected from international competition, account for more than 40 % of total employment in Europe. Apart from the fact that the sectors in question do not have to compete with low-wage countries, they are often sectors in which there is a high level of tax evasion and avoidance and in which the share of the black or quasi-black economy is often large. Tax reduction might encourage people to leave the black economy.

Sectorial measures which might be compatible with the common market

23. Aid to employment is *a priori* linked to the concern of maintaining or creating jobs. Reducing social charges in the manner envisaged by some Member States cannot, from that viewpoint, be genuinely effective unless it relates to sectors which are less exposed to international competition, in particular certain services. In contrast to the situation obtaining in sectors greatly exposed to international competition (see point 15 above), reducing wage costs in sectors protected from international competition seems all the more promising in terms of job creation given that the activities in question generally have a high concentration of unskilled labour. Examples of such sectors were identified by the Commission in its communication entitled 'A European strategy for encouraging local development and employment initiatives' ⁽¹³⁾.
24. Measures to reduce social charges targeted at these sectors have a twofold advantage. On the one hand, their effects on competition and intra-Community trade are often weak or non-existent and, on the

other, their potential in terms of job creation is great ⁽¹⁴⁾. The Commission will thus normally be able to adopt a positive stance on such measures. Some of them do not fall within the scope of Article 92 (1) of the Treaty because the activities of recipients, often very small firms, are not the subject of trade between Member States. This is particularly true for local services. Others are 'growth niche markets or sub-sectors that hold out the prospect of considerable job creation', in respect of which the Commission will be more favourably disposed towards aid to create new jobs ⁽¹⁴⁾, provided they do not distort competition or affect trade to an extent contrary to the Community interest in terms of job creation.

Conclusions

25. The Commission recognizes that high non-wage labour costs in most Member States might impede the taking-on of new staff and that reductions of these costs are desirable. However, it must intervene against Member States which opt for measures to reduce these costs which constitute State aid and which are therefore damaging to competition and the internal market and which have probably limited effects on employment at Community level. Such measures are not in the Community interest. By contrast, the Commission wishes to encourage Member States to examine a number of alternatives which are more promising in employment terms, which do not pose any problems as far as competition is concerned or whose effects on competition might be justified in the Community interest.

⁽¹³⁾ See, for example, the 'OECD Study on Employment — Taxation, employment and unemployment', OECD 1995.

⁽¹⁴⁾ Point 23 (final paragraph) of the abovementioned Guidelines.

⁽¹²⁾ OJ No C 265, 12. 10. 1995, p. 3.