

Enhancing the Contribution of Business on Islands to Economic Development: A Proposal for a Flexible Application of the De Minimis Amount within the State Aid Framework

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Overview

- Challenges for Business in EU Islands to fulfil the Potential within the EU Single Market
- The need to integrate special mechanisms, identify new policy areas and set up place-based strategies with respect to Islands
- Flexibility in State Aid Rules for Enhanced Business Development in Islands
 - Methodology for the establishment of the maximum de minimis ceiling
 - Business Development Themes
 - The Need for and Plausibility of the Budget Limit
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Challenges for Business in EU Islands to fulfil the Potential within the EU Single Market

Islands ... their heterogeneity and importance

- Despite the heterogeneity in the characteristics of EU islands in terms of size, population density, connectivity and distance to mainland it is widely recognised that islands face multiple socio-economic development challenges that are well-documented
- Islands as a distinct territorial specificity have a key role to play towards the development of the European Union and the Single Market
- The total population of islands in the EU amounted to just under €20 million in 2018, equivalent to 4% of the EU-28 population. The Gross Value Added as a percentage of the EU-28 amounted to 3% in 2016 whilst per capita GDP amounted to €17,740 in comparison to the EU average of €26,261 in 2016

Islands...their disadvantages

- Lack of suitable access to critical masses of resource inputs and consumer bases
- Excessively dependent on niche market specialization and struggle to develop new niches
- Shortages of human capital: low fertility rates & low educational attainment
- Fewer resources and capabilities to devote to R&D activity
- Constrained land resources and fragile habitats
- Remoteness from urban centres and weak energy networks
- Over-reliance on Government, part of bigger administrative units and lack necessary powers to provide optimally for public service needs

Addressing these challenges...

- Requires the mainstreaming of the relevant issues within the overall approach to economic and social policy at various levels, so as to ensure sustainable development for island business based on their potential comparative advantage
- Promoting and exploiting the territorial potential of islands contributes not only to the region itself but also to the nation and the European perspective
- Business in islands is not only worth saving, but is above all worth nurturing for the development, diversification and strength of the EU Single Market

The need to integrate special mechanisms, identify new policy areas and set up place-based strategies with respect to Islands

Islands...can become lands of opportunities

...Through fair and proportionate compensatory measures mainstreamed within policies and measures, islands can become 'lands of opportunities' (European Parliament, 2016)

- Also well-documented by the European Commission, European Economic and Social Council and ESPON projects
- From a policy perspective, the EU recognises the specificity of the geographic characteristics of islands particularly in terms of accessibility, Cohesion Policy and Energy Policy.
- On the other hand, Competition Policy recognises a special arrangement with respect to State Aid only in relation to less favoured regions, without making a direct or specific reference to islands

Success of policy flexibility in Cohesion Fund interventions

- Enhancing connectivity for islands:
 - physical (eg. the treatment of islands in TEN-T guidelines)
 - digital (eg. care infrastructures in Sareema)
 - consequent retention and attraction of human capital, as well as innovation activities (eg. food projects in Bornholm and in North Aegean Islands)
 - Business funding mechanisms (eg. JAIME financing package in Malta and Gozo, and the InnovFin SME guarantee scheme)
- Integrated, place-based strategies to promote the territorial potential of islands with particular relevance to business competitiveness:
 - Research and innovation
 - Education and training
 - Sustainable tourism
 - Climate change

Flexibility in State Aid Rules for Enhanced Business Development in Islands

The policy of State Aid remains significantly underdeveloped ...

... in terms of the need to provide flexibility with respect to island territories

- Exceptions to mandatory notification exists for aid covered by a Block Exemption, aid granted under an aid scheme already authorised by the Commission as well as de minimis aid not exceeding €200,000
- The CPMR Islands Commission has called for the raising of the de minimis ceiling from €200,000 to €500,000
 - De minimis aid is considered to be one of the best instruments to meet the needs of islands
 - The Commission has downplayed the importance of the proposal, arguing that the ceiling is rarely reached
 - The counterargument is that islands offer limited dynamism for micro firms to grow, especially within the context of the unlevel playing field in the market

Opinion Paper: Way Forward (1/3)

- Provision of a technical justification for the need to **increase the de minimis amount of business operating in islands to €500,000**
 - Founded on business and regional statistics data published by Eurostat
- Extending the implementation framework of the increased amount for islands, subject to the following provisions:
 1. Business benefitting from the increased de minimis amount would be involved in activities, either through output produced or inputs utilised, which would contribute to enhance the performance of the island in which they are located with respect to one or more of the following **themes: Creativity and Innovation, Sustainable Tourism; Clean Energy; New-to-Island Mobility; Social Enterprises.**
 2. The increased de minimis amount is operated in a **tapered manner** to individual businesses, allowing an amount of **€500,000 for the first three rolling years, €350,000 for the next three-year period, until reaching the statutory level of €200,000 thereafter**, so as to discourage long term dependence on aid and encourage activities which neutralise the costs of doing business on islands.

Opinion Paper: Way Forward (2/3)

3. An eligible business would be entitled, at any point in time, to apply to benefit from the flexible de minimis amount on a tapered basis - it would be **eligible to apply again after the expiry of a nine-year period** from the first year of benefitting from the maximum de minimis limit, to meet the requirements of new investment or changing business environment
4. In order to enable the building of critical mass and reaping of economies of scale, **separate businesses with the same ultimate beneficiary owners shall not be subject to the cumulation of aid amounts under one de minimis limit provided that they are contributing to different thematic areas**

Opinion Paper: Way Forward (3/3)

5. There would be a **limit on the total budget to beneficiary firms operating on an island** so as to prevent any undue influence on EU trade, up to an amount of €5,000 per year per inhabitant on the island.
6. This framework would ideally be **applicable to all islands as per Eurostat NUTS3 statistical definition** – alternatively, it would be applicable at least to all individual island territories with a population of at most 50,000 or island regions at NUTS 3 level with a population of at most 450,000.

Furthermore, a transition period of nine years is suggested for territories which cease to be eligible under these criteria, in consideration of the need for long-term planning in business.

Methodology for the establishment of the €500,000 maximum de minimis ceiling (1/3)

- Establishment of the ceiling is based on the estimates regarding the higher costs to turnover ratio which firms experience when operating from islands in comparison to those that operate from mainland EU countries
- Based on six EU countries whose island regions are considered to have the strongest contribution to the national economy

Rank	Contribution of Island Regions to the National Economy	Comparison Group of Countries*
1	13.2%	Greece
2	7.9%	France
3	4.5%	Portugal
4	4.3%	Malta
5	1.2%	Spain

Source: E-Cu⁷d Consultants workings based on Eurostat Regional Statistics

Methodology for the establishment of the €500,000 maximum de minimis ceiling (2/3)

Ratio of Micro Firms to total

Ratio of Micro Firms (0-9 employees) to Total	EU Average	Comparison Group*
Number of Firms	93.1%	95.2%
Turnover (€m)	18.2%	22.3%
Gross Value Added (€m)	20.8%	24.2%
Employment	29.4%	36.1%

Source: E-Cubed Consultanworkings based on Eurostat data

- Even though firms within the micro category are predominant, the ceiling is based on firms employing 20-49 workers
- The increase in the ceiling is mostly needed in this category as:
 - Firms of this size find significant obstacles to growth
 - Compensation for additional costs of doing business due to marked contribution to output and employment and possibility of support incentivizes firms to grow

Methodology for the establishment of the €500,000 maximum de minimis ceiling (3/3)

Analysis of Firms employing 20-49 workers

Small-Sized firms (20-49 employees)	Average per firm	
	EU Average	Comparison Group*
Turnover	5,880,135	6,561,062
Gross Value Added	1,398,505	1,467,427
Employment	31	32
Costs to turnover ratio	76.2%	77.6%

Source: E-Cubed Consultants workings based on Eurostat data

- The cost of doing business from islands is estimated to be 1.4 p.p higher than the EU mainland
- On the basis of the higher costs to turnover ratio for the comparison group, the average increase in costs amounts to €93,027 per annum in comparison to the EU average, which rounds up to around €300,000 over a period of three years
- Basis for proposing an increase in the de minimis ceiling from €200,000 to €500,000

Business Development Themes

- Any business would be eligible to the de minimis €500,000 for the first three years of the introduction of the new rules if it is investing and/or operating in activities which are encompassed within any one or more of the business development themes.
- **Themes have been selected to be in line with the findings of studies as well as the best practice examples** for their role in helping island business to maximise its contribution to socio-economic development and to target market failures creating an unlevel playing field for business in Islands
- Determined on the basis of a **specific test** which would be devised for the purpose and adapted to specific island situations, including criteria for the **minimum generation of employment on the island that should be commensurate with the aid received**
- This framework thus covers businesses that:
 - make a contribution to their respective islands under one or more of the identified themes, **irrespective of the economic sector in which they operate**
 - could involve social enterprise which promotes social inclusion and introduces innovative practices

The Need for and Plausibility of the Budget Limit

- Maximum budget for a given island is needed to **reduce the possibilities for business with no nexus to benefit from this regime**
- This arrangement:
 - Requires the creation of employment specifically on the island, apart from other contributions under the selected development themes
 - **minimises the potential for trade distortion** through the implementation of this proposal
- As an example, under the flexible arrangement, an island with a population of 50,000 persons would have a total de minimis maximum budget allocation of €250 million to provide in terms of aid, equivalent to around 500 firms on the island benefiting from the maximum ceiling of €500,000
 - Considered to be adequate and proportional to the needs for State Aid regime flexibility with respect to island territories.

The Tapering Provision

- Tapering is needed to allow new firms to benefit from the maximum ceiling to reduce the cost of doing business from islands, within the limits of the budget allowed to the island territory.
- Once that firms start to benefit from this support, the amount is slowly reduced to the current maximum limit to allow other firms to benefit from higher limits within the context of the budget available.

Conclusion

An approach that applies flexibility in relation to the de minimis amount without imposing interference in the Single Market that is...

- **Justified** - through a study on the additional costs of doing business in islands underpinned by Eurostat data
- **Targeted** - in terms of focusing on business that operate in key thematic areas that are the centre of policy objectives at the level of island regional needs and development of the EU as a whole;
- **Proportionate** - by allowing for a maximum budget per island territory in the extent to which the flexibility of the de minimis amount is to be applied;
- **Efficient** - in providing dynamic incentives for reduced dependence on aid through a tapering mechanism, together with increased incentives for the growth of micro firms