

# State aid for restructuring the steel industry in the new Member States

Max LIENEMEYER, Directorate-General Competition, unit H-1 <sup>(1)</sup>

## 1. Introduction

Steel is an important industrial sector in many of the new Member States. Altogether they produce 23 million tonnes of liquid steel: Poland produces about 9 million, the Czech Republic about 6 million, Slovakia 5 million, Hungary 2 million and Slovenia about 0.5 million tonnes. Moreover, the four candidate countries, i.e. Bulgaria (2 million), Romania (6 million), Croatia and Turkey have also a significant steel production. Altogether they have an annual output of almost 50 million tonnes (about 5% of the world production) and provide about 220,000 jobs.

The steel producing capacity in the new Member States is today about 30 million tonnes. As the capacity has been above 50 million tonnes in the beginning of the 90ies it has already significantly decreased. Similar overcapacities occurred also in the old Member States in the 80ies and 90ies, where an intensive restructuring has taken place. It was complemented by privatisation and consolidation of the former State owned companies. Thereafter, the ECSC Treaty, and after its expiry in June 2002, the EC Treaty have implemented sector specific rules prohibiting any kind of rescue and restructuring aid.

However, there is a common understanding that these rules cannot immediately be applied to acceding Member States but that they should also have the opportunity to restructure and privatise their industry before being subject to the strict EC

State aid rules. Therefore, after a short overview about the EC State aid rules on steel <sup>(2)</sup>, this article will present the existing transitional rules for some new Members States <sup>(3-5)</sup> and some candidate countries <sup>(6)</sup>.

## 2. The EC State aid rules for steel

Financial support of Member States to their industry generally amounts to State aid, which is under the EU rules, Article 87 (1) EC Treaty, prohibited. However, the Communication from the Commission on Community guidelines on State aid for rescuing and restructuring firms in difficulty (hereinafter 'EC Restructuring guidelines') <sup>(2)</sup> expresses that restructuring aid to firms in difficulty may if certain strict conditions are met not be contrary to the Community interest.

On the other hand, the 1996 Steel Aid Code <sup>(3)</sup> of the European Coal and Steel Community (ECSC) prohibited restructuring and investment aid completely. This was the result of lessons learned from the overcoming of the steel crisis which started in the early 80ies and continued until the mid 90ies. A reduction of overcapacity was only achieved after the Steel Aid Code made capacity reduction a precondition for State aid. <sup>(4)</sup>

Since the expiry of the ECSC Treaty in 2002 <sup>(5)</sup>, the general EC State aid rules apply to the steel sector <sup>(6)</sup>. However instead of the EC Restructuring guidelines, the EC issued a so called *Communication from the Commission on Rescue*

<sup>(1)</sup> This Article summarises the result of the work of many colleagues in the Commission Services with whom DG Competition has collaborated on this issue. In DG Competition, many issues have been in the last two years successfully solved thanks to the contribution of Ewa Szymanska.

<sup>(2)</sup> OJ C 244, 1.10.2004, p. 2.

<sup>(3)</sup> Commission Decision No 2496/96/ECSC, OJ L 338, 28.12.1996, p. 42.

<sup>(4)</sup> These principles were embodied in the person of the former EC Industry Commissioner, the Belgian Etienne Davignon. The Davignon plan resulted in the dismantling of about 32 million tonnes of hot rolled steel in 1985 in exchange for about € 40 billion of State aid. In the 90ies 19 million tonnes of hot rolled capacity were closed, 100,000 people laid off, while about € 17 billion of aid was granted.

<sup>(5)</sup> See the Communication from the Commission concerning certain aspects of the treatment of competition cases resulting from the expiry of the ECSC Treaty, OJ C 119, 22.5.2002, p. 22.

<sup>(6)</sup> That means that various horizontal regimes were opened to the steel sector, including all State aid block exemption regulations, for example the 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 L 10, 13.1.2001, p. 30.

and Restructuring aid and closure for the steel sector <sup>(1)</sup> which stipulates that rescue and restructuring aid in the steel sector is not permitted. Only closure aid, as an exception from the prohibition to grant restructuring aid, is exceptionally allowed. Such closure aid may be aid to redundant employees that are laid off or aid to support companies to close their facilities. The latter is however only accepted if the entire legal entity is closed.

In addition, also regional investment aid is prohibited under point 27 of the *Multisectoral framework on regional aid for large investment projects*. <sup>(2)</sup> In sum, essentially any kind of significant investment aid in the steel sector, be it for restructuring or other purposes, is prohibited. The Commission has made sure that its laws were not circumvented by abusing the defence that the investments were allowed in view of the market investor principle <sup>(3)</sup>. Consequently, the Commission has in recent years only authorised a very limited amount of aid for objectives such as environmental protection or research and development (R & D).

### 3. Overview of the transitional rules for the new Member States

The restructuring of the steel industry was initiated on the basis of several Europe Agreements. This was the case for Poland, the Czech Republic, Hungary, Slovakia, and Slovenia. For example, Article 8(4) of Protocol 2 of the Europe Agreement with Poland stipulated that, during the first five years after entry into force of the Agreement, Poland could exceptionally, as regards steel products, grant State aid for restructuring purposes, given three conditions.

These conditions are that:

- restructuring leads to the viability of the benefiting firms under normal market conditions at the end of the restructuring period;
- the amount and intensity of restructuring aid is strictly limited to what is absolutely necessary in order to restore viability and that the aid is progressively reduced; and

- restructuring is linked to a global rationalisation and reduction of overall production capacity.

In the event the restructuring could not be achieved in the five years grace period, which was the case of Poland and the Czech Republic, an extension of the grace period for granting State aid in the steel sector was negotiated. However, the EU indicated that it would consider the prolongation under condition that a national restructuring programme was set up, which was eventually accepted by a Council decision and then incorporated into the Treaty of Accession. In fact, the Treaty of Accession signed in Athens on 16 April 2003 by the Heads of State and Government of the enlarged EU incorporated *Protocol No 2 on the restructuring of the Czech steel industry* and *Protocol No 8 on the restructuring of the Polish steel industry* <sup>(4)</sup>. Moreover, point 4 (2) of Annex XIV allows the application of a fiscal aid scheme to the Slovakian steel sector.

These rules essentially provide for an exception of the rule that restructuring aid for the steel sector is prohibited and are also *lex specialis* to the normal transitional rules in the Accession Treaty <sup>(5)</sup>.

Thus, Protocol 2 of the Europe Agreement and the Accession Treaty protocols provide the legal background for the steel restructuring. The national restructuring programmes are the common denominator of most transitional regimes and have generally been a precondition for the EU's approval exceptionally allowing the candidate States to derogate from the normal rules.

### 4. Key Parameters of a National Steel Restructuring Programme

There are no clear EC Guidelines for setting up a steel restructuring programme. However, Protocol 2 of the Europe Agreement indicates the main parameters of a restructuring programme, i.e. viability, the minimum amount of State aid necessary to achieve viability and the reduction of capacity. Moreover, the overall aim of the requirement to produce a national restructuring programme in a pre-accession context is clearly to obtain transparency in the steel sector.

<sup>(1)</sup> OJ C 70, 19.3.2002, p. 22.

<sup>(2)</sup> OJ C 70, 19.3.2002, p.8. The Commission also emphasised in this framework the incompatibility of investment aid to the steel sector for large individual aid grants made to small and medium-sized enterprises (SMEs) within the meaning of Article 6 of Council Regulation (EC) No 70/2001, which are not exempted by the block exemption regulation.

<sup>(3)</sup> Commission Decision *Carsid* of 15 October 2003, OJ L 47, 18.2.2005, p. 28.

<sup>(4)</sup> OJ L 236, 23.9.2003, p. 934 (Protocol No 2) and p. 948 (Protocol No 8).

<sup>(5)</sup> This means that steel restructuring aids were not subject to the so called 'existing aid mechanism' under the Accession Treaty. This was confirmed in Commission Decision of 14 December 2004, Restructuring aid to the Czech steel producer Trinecké Zelezárný a.s., OJ C 22, 27.1.2005, p. 2.

In addition, some guidance can be drawn from the general EC Restructuring guidelines. While these guidelines are not directly applicable to the steel industry because the EC regime prohibits restructuring aid for the steel sector, these general rules should however at least be considered as a source of inspiration for the exceptional case where restructuring in the steel sector is nevertheless allowed. Although the rules in the EC Restructuring guidelines appear to limit the availability of aid far more than it can be observed during the recent steel restructuring, point 56 of the guidelines mitigates against this presumption as it allows for less stringent rules in assisted areas especially regarding the implementation of compensatory measures and for the beneficiary's own contribution. The candidate countries and especially the steel regions could generally be viewed as assisted areas.

#### 4.1. Viability

The first point of Article 8 (4) of Protocol 2 of the Europe Agreement and the EC Restructuring guidelines are based on the principle that the overall aim of any restructuring is to achieve long term viability of the companies concerned. The restructuring programme must therefore show that viability of the beneficiary companies under normal market conditions will be restored at the end of the restructuring period. In order to do so individual business plans of all beneficiaries of State aid must be presented.

Viability for the Commission essentially implies that the companies return to profitability at the end of the restructuring period. According to long-standing practice, which is also reproduced in Annex 3 of the Polish and Czech Steel restructuring protocol, the Commission considers that the companies should achieve a reasonable operating margin (i.e. an EBITDA over turnover of at least 10% for steel companies and 13,5 % for integrated mills) and a minimum return on sales (i.e. the EBIT must be at least 1.5% of the sales) <sup>(1)</sup>.

While it remains that the above two criteria are the benchmarks of financial performance in the Commission's viability test, some special accounting conditions must also be observed, which have the purpose to safeguard against companies 'under-investing' to boost short-term

performance as a means of satisfying the viability criteria. These special accounting conditions include minimum levels of financial charges (3.5%) and depreciation (5% for steel companies and 7% for integrated mills), expressed as a percentage of steel sales revenue, and a price-cost squeeze. If the special accounting criteria are not met in the companies actual forecast, the projections need to be adjusted by simulating that financial charges and depreciations are meeting the special accounting criteria.

The viability test should be performed on the basis of an individual business plan of a company which concentrates on the company's steel products related revenues and costs only. Therefore, the variable costs associated with non-steel products revenue must be ignored. The viability test should be applied to a sound set of financial projections for the restructuring period, i.e. profit and loss accounts, balance sheets and cash-flow statements. The financial projections should be prepared in current, not constant, prices taking into account inflation and exchange rate movements. This is necessary since costs are subject to widely differing inflation rates, some of which have no relationship with product prices.

#### 4.2. Minimum amount of State aid necessary to restore viability

The main condition for establishing the amount of admissible State aid is emphasised in the second point of Article 8 (4) of Protocol 2 as well as in the EC Restructuring guidelines, i.e. that the intensity of aid should be strictly limited to the necessary amount to reach the objective of the restructuring programme (i.e. viability).

The 'minimum necessary' is determined by two factors. It is the result of the total amount of funds needed to achieve viability minus the amount that the beneficiary himself is able to contribute. While in the EU a significant own contribution is necessary, this rule has in the past not been applied systematically in the accession countries <sup>(2)</sup>. Indeed, in cases where State owned companies in difficulties are on the brink of privatisation, an own contribution by the old owner does, in most cases, not make sense, as the restructuring is not assessed in view of the credibility of the existing owner but because of the envisaged privatisation.

<sup>(1)</sup> It cannot be excluded that the Commission will review the viability criteria in the near future, in particular in order to take account of changes in the International Accounting Standards.

<sup>(2)</sup> The EC Restructuring guidelines establish in their 2004 version in point 44 the rule that the contribution must be at least 25% in case of small enterprises, 40% for medium and 50% for large enterprises. Owner contributions were for example not an issue in Poland and the Czech Republic.

On the other hand, the more a company's eligibility for restructuring is questionable given that the company is on the verge towards viability, the more an owner contribution is indispensable.

In order to assess the 'minimum necessary', the restructuring programme needs to provide information about the total amount of restructuring aid granted to the steel industry from the entry into force of the grace period until the end of the restructuring period. The information should be given at a company level and per year.

Apart from restructuring aid, also all other aid should be identified for each company. If these aids are compatible under the other rules applicable in the EC they will not be considered as restructuring aid and need not to be compensated. However, it is doubtful whether other aid, with the exception of closure aid or aid that is exempted under a block exemption, can be compatible, as aids, such as environmental aid or aid for R & D, are normally apt to promote public policy objectives and it is doubtful whether firms in difficulty are the right vehicle to promote such objective <sup>(1)</sup>. But that does not mean that such aid is prohibited. Rather, if financial support is for example given to help an ailing company to comply with environmental standards it should simply be considered as restructuring aid.

Another difficulty is to properly quantify the amounts of State aid. There are certain rules to calculate the aid values. For instance, for direct subsidies <sup>(2)</sup> the Commission accepted in the past <sup>(3)</sup> that the aid values were assessed by looking at their net grant equivalent, which reduces the subsidy by the amount of potential tax liability on the gross amount. This is however questionable, as restructuring aids are normally assessed by reference to their gross grant equivalent whereas the concept of net grant equivalent is only used in the context of regional investment aid. A net calculation makes indeed sense for regional aid in order to compare aids in different regions with different tax systems and in order to achieve similar standards of living. This is however not necessary for restructuring firms in difficulty (which should hardly be liable for tax) where the

aim is solely to achieve viability of the company with the minimum necessary amount of State aid.

Finally, for certain instruments the aid value needs to be established. For example, in case of a credit the aid is the difference between the interest paid compared with an average rate, the so called reference rate, which may need to be increased by 4% or more for companies in difficulty depending on the financial risk involved (it can be up to 100% if no bank would provide the loan without a guarantee) <sup>(4)</sup>.

In the end, in order to assess the proportionality of the aid, the restructuring aid is considered and assessed on a case by cases basis. The main factor is whether the granting of restructuring aid is sufficiently compensated, in particular through capacity reductions.

#### 4.3. *Compensatory measures — Capacity reductions*

In exchange for restructuring aid, the Commission normally requests that capacities are reduced over the restructuring period to offset the distortive effects of the aid granted <sup>(5)</sup>.

However, this must be seen against the background of the factual situation in the last century where there was a clear presumption of the existence of overcapacities. Their reduction was therefore a logical prerequisite to make any public support compliant with the common interest. Today, the focus has shifted onto the reduction of inefficient capacities. The degree of reduction can thus only be established on a case-by-case basis. Where no inefficient capacities exist also other compensatory measures may be feasible <sup>(6)</sup>.

While the restructuring programme should indicate the historical evolution of the national capacities up to the end of the restructuring period, the emphasis should clearly be on identification of each company's capacities (see in this respect Annex 2 of the Protocols). The identification of an individual capacity is necessary to monitor that capacity reductions have been/will be realised. Capacities will only be considered reduced when designated facilities are permanently closed, i.e.

<sup>(1)</sup> Point 20 of the EC Restructuring guidelines.

<sup>(2)</sup> In addition, in case of subsidies that will be disbursed in the future their current net present value must be calculated by discounting the aid value to the base year.

<sup>(3)</sup> This was the case in Poland and the Czech Republic but not any longer in Romania.

<sup>(4)</sup> Commission notice on the method for setting the reference and discount rates, OJ C 273, 9.9.1997, p. 3.

<sup>(5)</sup> The Commission normally looks at reductions in *finished products* capacity only.

<sup>(6)</sup> See point 40 of the EC Restructuring guidelines. The Commission has for example accepted production and sales caps in Slovakia, see details under 5.3.

where the key elements of a facility are physically destroyed so that they cannot be restored to service <sup>(1)</sup>.

In the past, the reduction in capacity was considered mainly at an aggregated national level. Although this may very well have been the motivation and starting point for many restructuring programmes, it is *de jure* not enforceable. Instead, a capacity reduction can only be requested from companies that have received aid. Only for them concrete capacity reductions are negotiated and can be remedied by recovery of State aid in case of non-compliance. Other companies, which have not received State aid, must in a market economy remain free to do what they want and may thus also increase capacity.

#### 4.4. Scope of a restructuring programme

The scope of a restructuring programme follows mainly from the above analysis. The companies participating in the programme are selected by the Government depending on being eligible in view of the prospect of viability and proportionality.

The length of the restructuring programme, i.e. the restructuring period also follows from the timing for achieving viability. To this end, the programme must be as short as possible. In any event, a limited period of ideally five years is recommended in order to work with realistic assumptions.

Moreover, the restructuring period does not need to be identical with the grace period within which the granting of aid is permitted. It is rather logical that the restructuring period will be longer, as viability is so to speak the fruit of the State aid. Furthermore, restrictions on capacity should generally last at least throughout the restructuring period.

### 5. The existing transitional regimes in the new Member States

#### 5.1. Poland

Poland is the biggest steel producer amongst the new Member States, with a crude steel output of 9.1 million tonnes in 2003 (about 8.5 million tonnes hot rolled products). The country is a net exporter of steel. Exports in 2003 amounted to 3.5 million tonnes.

#### *The basis for the Polish steel restructuring: Protocol 8*

The rules for granting State aid to the Polish steel industry are laid down in Protocol No 8 to the Accession Treaty on the restructuring of the Polish steel industry. The Protocol is based on a national restructuring plan (Restructuring and Development Plan for the Polish Iron and Steel Industry).

Background is that in March 2003 this national restructuring plan was adopted after extensive work and after in-depth assistance of various consultants. The Commission assessed the restructuring programme in a proposal for a Council Decision on the fulfilment of the conditions laid down in Article 3 of Decision 3/2002 of the Association Council (extension of the grace period for public aid in the steel sector). The Member States approved the proposal in July 2003, and prolonged the grace period to grant State aid as foreseen in the Europe Agreement retroactively as of 1 January 1997 until 2006 (provided however that State aid is granted only until 2003).

In the end, Protocol No 8 transforms the results of the negotiation about the national restructuring plan into law. It comprises 18 paragraphs, which stipulate all the conditions for the exception to the rule that restructuring aid for the steel sector is prohibited. The Protocol also comprises procedural rules for a revision of the rules on the basis of changes in the individual business plans or the national restructuring plan (point 10).

In order to ensure that the conditions laid down in the Protocol are complied with, Protocol No 8 sets out detailed provisions for monitoring and reporting. Poland has to submit reports to the Commission every six months concerning the fulfilment of the obligations and requirements contained in the Protocol. In addition, an independent evaluation is carried out by a consultant in 2003, 2004, 2005 and 2006. Last summer the Commission presented a Communication to the Council and Parliament about the progress achieved during 2003, the first year of monitoring the Polish and the Czech steel restructuring <sup>(2)</sup>.

#### *State aid, Viability and Capacity*

On the basis of the plan, the Protocol accepts the granting of State aid for the period of 1997 until 2003 up to a maximum of PLN 3.39 billion (in

<sup>(1)</sup> Capacity reductions are defined in Commission Decision 3010/91/ECSC OJ L 286, 6.10.1991, p. 20.

<sup>(2)</sup> Report from the Commission to the Council and the European Parliament — First monitoring report on steel restructuring in the Czech Republic and Poland, of 07.07.2004 — COM(2004)443 final.

2003 about € 770 million <sup>(1)</sup>). The granting of aid is made subject to several conditions, *inter alia* that viability is reached by 2006. Moreover, the Protocol lays down that during the restructuring period from 1997 to 2006 restructuring aid may only be granted to companies listed in Annex 1 of the Protocol (point 6, last sentence). Poland has selected 8 companies to be included in this list <sup>(2)</sup>.

The monitoring shows that Poland granted a total amount of PLN 2.75 billion (€ 625 million) in the period 1997-2003. The majority of aids was granted in 2003 (PLN 2.1 billion). The figures of total State aid granted are below the ceilings specified in the Protocol. As no more State aid may be provided after 2003, the amount of State aid which has been approved by the Protocol but was not granted, i.e. 20% of the Protocol ceiling, is forgone.

The aid was focused primarily on financial restructuring to address the debt burden of the companies so as to facilitate their access to financing and their acquisition by strategic investors. The above mentioned Commission Communication concluded that the fact that the amount of State aid granted is lower than envisaged will not have a critical effect on the financial projections of the beneficiary companies, as the aid granted is deemed sufficient to help the companies to achieve viability by 2006. Nevertheless, the Commission is putting pressure on Poland to profit from the current favourable conditions as much as possible and to advance its investments.

Since the beginning of the 1990s, the Polish steel industry has gone through a process of restructuring and conversion. As a result, the production capacity was reduced considerably between 1992 and 2002, *inter alia*, the overall crude steel capacity was reduced from 19.7 million tonnes per annum in 1992 to 12.2 million tonnes per annum at the end of 2002, representing a 40% reduction over that period. Reductions in hot rolled production capacity were not as significant. They were reduced from 10.5 million in 1992 to 9.27 million in 1997.

Protocol No 8 specifies that the net reduction of capacities in the years 1997-2006 will amount to a minimum of 1.35 million tonnes. Details as well as

a timetable for the closure and dismantling of installations are set out in Annex 2 of Protocol No 8. In 2003 about 900,000 tonnes were closed in Poland as scheduled.

The restructuring of the Polish steel industry has followed the process of the EC steel restructuring. As the Commission concludes that Poland is so far meeting its Protocol obligations concerning State aid and capacity reduction, the restructuring process is, apart from some investments that have not been made, successful.

#### *The prohibition of granting additional restructuring aid to the steel industry*

In order to ensure that no additional restructuring aid is granted for the period of 1997 until 2006, point 18 of the Protocol gives the Commission the power in case of non-compliance to take 'appropriate steps requiring any company concerned to reimburse any aid granted'. The Commission considers this as an appropriate basis to open proceedings under Article 88 (2) EC Treaty.

Therefore, the Commission has, on 19 May 2004, taken its first decision to launch an in-depth probe into possible aid granted to a steel company in a new Member State <sup>(3)</sup>. The company concerned is the Polish steel producer Huta Czysta S.A. As the company is in financial difficulties, Poland is currently planning financial measures in order to restructure the company. The Commission is therefore seeking clarification whether restructuring State aid was and will still be granted to the company.

### *5.2. Czech Republic*

The factual and legal conditions for the restructuring of the Czech steel industry were similar to those of Poland. The Czech restructuring was originally based on Article 8(4) of Protocol 2 of the Europe Agreement. On the basis of a national restructuring plan the grace period was prolonged by a Council decision and special rules are now laid down in the special protocol to the Accession Treaty, Protocol No 2 on the restructuring of the Czech steel industry <sup>(4)</sup>.

<sup>(1)</sup> 1 € = 4.3996 PLN, average exchange rate in 2003.

<sup>(2)</sup> There are 17 steel companies in Poland. The main steel group is MPS, Mittal Steel Poland, formerly called Polskie Huta Staly (PHS), which has been taken over by LNM holdings (see Commission Decision of 5.2.2004 — Case IV/M.3326 — LNM / PHS). The Protocol concerns the following eight steel producing companies: PHS, Huta Bankowa, Huta Bucek, Huta Lucchini-Warszawa, Huta Labedy, Huta Pokoj, Huta Andrzej and Huta Batory. The last two in the meantime went bankrupt.

<sup>(3)</sup> OJ C 204, 12.8.2004, p. 6.

<sup>(4)</sup> As Protocol 2 and 8 are in most points identical the Czech Protocol will not be discussed in detail.

### *State aid, Viability and Capacity*

Protocol No 2 stipulates that State aid may be granted to three beneficiary companies <sup>(1)</sup>. It is limited to a maximum of CZK 14.14 billion (€ 444 million <sup>(2)</sup>) to be granted in the period 1997-2003 and specifies maximum amounts for each of the three beneficiary companies.

The monitoring shows that the Czech Republic granted a total amount of CZK 12 billion (€ 377 million) in the period 1997-2003. In 2003, a total of CZK 4.4 billion (€ 138 million) of restructuring aid was granted.

The aid also focused primarily on financial restructuring to address the debt burden of the companies so as to facilitate their access to financing and their acquisition by strategic investors. The Commission's monitoring communication concludes again that although the amount of aid granted is lower than envisaged, this will not have a critical effect on the financial projections of the beneficiary companies and the aid granted is deemed to be sufficient to help the companies to achieve viability by the end of the restructuring period.

The Protocol specifies that the net capacity reduction to be achieved by the Czech Republic for finished products (hot rolled and cold rolled) during the period 1997-2006 must reach a minimum of 590,000 tonnes. A timetable for the dismantling of installations, as well as for new capacities to be installed, is specified in Annex 2 of the Protocol. Companies confirmed that the closures scheduled for the years 2004-2006 will be realised <sup>(3)</sup>.

Similar to Poland also the restructuring of the Czech steel industry is comparable with the EC steel restructuring, whereas the reduction of capacity goes beyond the ratio of State aid and capacity reduction in the EU in the past. The Commission concluded in its Communication that the Czech Republic is meeting its Protocol obligations concerning State aid and capacity reduction. However, the Commission is insisting that the Czech Republic profits from the current favourable conditions as much as possible and advances its investments.

### *The prohibition of granting additional restructuring aid to the steel industry*

In order to ensure that no additional restructuring aid is granted in the period from 1997 until 2006, point 20 of Protocol No 2, similarly to the above mentioned provision in the Polish Protocol, provides for the possibility to take appropriate steps requiring any company concerned to reimburse any aid granted.

Therefore, on 14 December 2004, the Commission decided under Article 88 (2) EC Treaty to launch an in-depth probe into possible State aid in favour of Trinecké Zelezářny, a.s. <sup>(4)</sup>, a steel producer in the Czech Republic. The Commission has reason to believe that certain transactions between the Czech Government and the company executed in April 2004 could involve State aid which might not be compatible with EC State aid rules.

Similar as in the above mentioned Polish case, the Commission underlined with the opening of proceedings in this case its readiness to follow up the granting of any illegal restructuring aid to the steel sector, even if it was granted before the accession of Poland or the Czech Republic to the EU.

### *5.3. Slovakia*

Protocol 2 of the Europe Agreement with Slovakia is identical to those of Poland and the Czech Republic. It states that State aid for the restructuring of the steel sector could only be granted during the grace period, which expired in March 1997.

However, initially and in contrast to the two other countries, Slovakia did not request a prolongation, so that aid to the steel sector should have been covered by the general rules on State aid from April 1997 on. However, in 1999, Slovakia adopted a law providing for an income tax exemption to certain sensitive sectors with the aim of stabilising employment. This measure was also applied to Kosice Steel Works, the largest Slovak steel company, which was taken over by US Steel in 2000.

The Commission considered this measure as a breach of the Europe Agreement. Therefore, it was

<sup>(1)</sup> The beneficiaries are Ispat Nova Hut, Válcovny plechu Frýdek-Místek (VPFM) and Vítkovice Steel.

<sup>(2)</sup> 1 € = CZK 31.846, average exchange rate in 2003.

<sup>(3)</sup> The Czech Republic has obtained on 3 March 2005 the Commission's agreement for a postponement of the closure of capacity of hot rolled products in VPFM from the end of 2005 until mid 2006 (case N 600/04).

<sup>(4)</sup> Commission Decision of 14 December 2004, Trinecké Zelezářny a.s., OJ C 22, 27.1.2005, p. 2.

agreed in 2002 to limit the authorisation of State aid in form of the tax regime under Annex XIV of the Accession Treaty to an amount of USD 500 million for a period of up to 2009, under the condition that production would be capped at 3% and sales would be capped at 2%. Annex XIV of the Treaty of Accession thus entailed a transitional exemption from the EU State aid rules, under which Slovakia could continue to grant fiscal aid to US Steel Kosice until 2009.

However, the level of production of products covered by the agreement was already in 2002 more than 3% higher than the corresponding 2001 level and even higher in 2003. As the Commission found this to be a breach of the Accession Treaty, it adopted in 2004 a decision of appropriate measures, essentially requiring US Steel Kosice to pay back some of the aid and reducing the ceiling for permissible aids of USD 500 million considerably <sup>(1)</sup>.

#### 5.4. New steel producing Member States without transitional rules

Several other new Member States with considerable steel production capacities have not requested any transitional mechanism. However, restructuring aid was granted by these States before accession under the Europe Agreements.

Slovenia's Protocol 2 to the Europe Agreement contains identical provision than Article 8(4) of Poland. Therefore, Slovenia has come up with a restructuring programme allowing State aid of a permissible amount of € 220 million until the end of 2001 in return for capacity closure. The Commission confirmed in 2001 that the Slovenian steel restructuring programme was considered in compliance with Protocol 2 and established that only € 162 million of State aid had been granted.

Slovenia has thereafter voluntarily reported on the implementation of the restructuring programme. However, privatisation of State owned companies was not achieved and thus leaves room for doubts regarding the viability of the steel companies.

Hungary granted restructuring aid for its steel sector on the basis of the Europe Agreement. In the period between 1992 and 1996 about

€ 670 million of aids were granted for restructuring or as operating aid. Hungary envisaged a prolongation of the grace period, because the steel producer DAM was receiving aid between 1997 and 1999. However, when DAM was liquidated in March 2000, Hungary withdrew its request for a prolongation. In the meantime, the main Hungarian steel producers, Dunaferr, DAM and OAM are privatised.

## 6. Transitional regimes in Candidate countries

All four candidate countries have a significant steel production and asked for a grace period to grant State aid for restructuring their steel industries. While discussions with Croatia and Turkey are still ongoing, the EU has agreed on a transitional regime with Bulgaria in 2004 and the Commission has agreed on the main parameters of a national restructuring programme with Romania in the beginning of 2005.

The concept of the regimes for Bulgaria and Romania is based on the Protocols for Poland and the Czech Republic. However, in particular as regards Romania the EU is introducing a series of additional safeguards, amongst others the postponement clause, which allows the Council with qualified majority in case of non-compliance with the main parameters of the steel restructuring commitments (*inter alia* that no State aid is granted after 2004) to postpone enlargement for one year <sup>(2)</sup>.

### 6.1. Bulgaria

The total crude steel capacity of the entire Bulgarian steel industry amounted to about 3.2 million tonnes in 2002. The national production capacities for hot-rolled steel were 4.4 million tonnes in 2002.

For Bulgaria, Article 9(4) of Protocol 2 of the Europe Agreement stipulated the usual exception as described above. After expiry of the five year grace period, Bulgaria requested a prolongation and submitted a national restructuring plan to the Commission in March 2004, which was approved by the Council. Because the restructuring will be finalised before accession, no special protocol to the Accession Treaty will be necessary.

<sup>(1)</sup> Commission decision of 22 September 2004, C (2004) 349 fin in case SK 5/04, Reduction of a tax concession granted by Slovakia to U. S. Steel Kosice, Slovakia, not yet published.

<sup>(2)</sup> See K. Van de Castele, *Next EU enlargement, Romania and State aid control*, in this edition.



The national restructuring programme includes the granting of State aid up to 2005 for one steel company, Kremikovtzi AD, in order for it to attain viability by the end of 2007. In sum, the programme fixes an amount of about BGN 450 million (around € 220 million) in exchange for a capacity reduction of about 0.5 million tonnes.

## *6.2. Romania*

Also Romania was, under 9(4) of Protocol 2 of its Europe Agreement, allowed to grant public aid for steel restructuring purposes. In the beginning of this year, a prolongation of the grace period has been accepted by the Council and a Protocol to the Accession Treaty similar to those of Poland and the Czech Republic has been drawn up.

The national restructuring programme, which is the basis for the Protocol, authorises an overall amount of State aid of about ROL 50 billion (approximately € 1.3 billion) for the grace period between 1993 and 2004 for six companies. Since 31 December 2004, no further State aid could be granted to any steel mill.

Most of this aid relates to the amounts granted in the privatisation of Ispat — Sidex in the past. It also includes State aid that resulted from the privatisation agreements of other companies. The largest part of the State aid consists of debt write-offs and waivers of penalties related to the late payments of the debt. In exchange, the programme identifies a reduction of capacities in finished

product of a minimum of 2 million tonnes to be closed until 2008.

## **7. Conclusion**

Not only because of the very favourable economic conditions in the steel sector, restructuring of the steel industry in most of the new Member States can so far be seen as a success. Inefficient capacities have been closed, privatisation has been achieved in most new Member States and it seems that many companies will restore viability. However, the steel industries still have to increase their efforts and make the scheduled investments, and should not rely on a continuation of the positive economic situation.

The Commission will continue to closely monitor the results. Moreover, the Commission will follow up cases where Member States do not comply with the restructuring programmes, in particular where aid is given to companies which are not foreseen as beneficiaries in a restructuring programme (also if they are situated in countries that have not made use of the possibility of a restructuring programme).

In so far as the restructuring has been successful, it is certainly also due to the pre-accession cooperation between the stakeholders, i.e. the steel industry and the administration in the Accession States as well as the Commission services (besides DG Competition also DG Enterprise, DG Enlargement and DG Trade).