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(Acts whose publication is not obligatory)

EUROPEAN ECONOMIC AREA

EFTA SURVEILLANCE AUTHORITY

EFTA SURVEILLANCE AUTHORITY DECISION

No 165/98/COL

of 2 July 1998

with regard to State aid in the form of regionally differentiated social security taxation
(Norway) (Aid No 95-010)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area⁽¹⁾, and in particular to Articles 61 to 63 and to Protocol 26,

Having regard to the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice⁽²⁾, in particular to Article 24 and Article 1 of Protocol 3 thereof,

Having regard to comments received on its decision to open the procedure provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement,

Whereas:

I. INTRODUCTION

By letter dated 16 June 1995 (reference 95-3560-D), the Authority requested the Norwegian authorities to submit full details on the system of regionally differentiated social security contributions⁽³⁾ paid by employers. The request was made in order to examine whether certain elements of this system might constitute State aid within the meaning of Article 61(1) of the EEA Agreement and if so, to examine to what extent any of the derogations according to Article 61(3) might be applicable.

The Norwegian authorities responded to the Authority's request by letters dated 5 September (reference 95-4968-A) and 19 September 1995 (reference 95-5441-A). In the period up to

⁽¹⁾ Hereinafter referred to as the 'EEA Agreement'.

⁽²⁾ Hereinafter referred to as the 'Surveillance and Court Agreement'.

⁽³⁾ Hereinafter also referred to as 'tax rates'.

March 1997 several informal and technical meetings took place between the Authority's officials and the Norwegian authorities. The Norwegian authorities submitted further information relevant to the Authority's examination in the course of these meetings.

Following an examination of the available information, the Authority concluded⁽⁴⁾ on 14 May 1997, that the lower rates in zones 2 to 5 of the Norwegian system of regionally differentiated social security contributions from employers led to disbursements of State aid within the meaning of Article 61(1) and that a general exemption was not warranted. Being an existing aid scheme, the Authority proposed therefore, in the same decision, a number of 'appropriate measures' for the system of regionally differentiated rates of employers' social security contributions to be compatible with the EEA Agreement.

The Commission's services, i.e. Directorate-General IV/G responsible for State aid, has throughout the Authority's examination, been kept informed in accordance with Protocol 27(f) of the EEA Agreement. The Authority had also, therefore, prior to the proposal of appropriate measures, received comments⁽⁵⁾ to its initial assessment from Directorate-General IV/G.

The Authority requested the Norwegian Government to signify its agreement to the proposal for appropriate measures, or otherwise submit its observations within two months from the receipt of the decision. By letter of 11 July 1997 (reference 97-5170-A), the Norwegian Government responded that they could not concur with the Authority's proposal for appropriate measures. The Norwegian authorities maintained *inter alia* that the differentiated social security contributions were part of the general taxation system falling outside the scope of Article 61(1). After having received the reply from Norway, the Authority decided to open the procedure provided for in Article 1(2) of Protocol 3 to the Surveillance and Court Agreement. Referring to the 'Mezzogiorno' case⁽⁶⁾ (95/455/EC), Directorate-General IV/G of the European Commission agreed with the Authority to open a formal investigation (reference 97-7524-A).

The Authority's decision to open the formal investigation procedure was taken on 19 November 1997 (Decision No 246/97/COL). The Norwegian Government was informed by means of a copy of the decision on the same date, whereby it was invited to submit its comments to the Decision.

The gist of the Decision was published in the form of a notice⁽⁷⁾ in the EEA section of the *Official Journal of the European Communities* and the *EEA supplement* thereto, thereby informing other EFTA States parties to the EEA Agreement, European Union Member States, and other interested parties, and inviting them to submit comments within one month from the date of publication.

The European Commission was informed, in accordance with Protocol 27 of the EEA Agreement, by means of a copy of the Decision.

The Norwegian authorities replied to the Authority's decision to open the investigation procedure by letter of 23 January 1998 (reference 98-696-A), explaining why they considered that the scheme did not constitute State aid within the meaning of Article 61(1), see section III.2.

The Authority received comments from the European Commission to its decision to open the investigation procedure by letter of 5 March 1998⁽⁸⁾ expressing *inter alia* that the Commission:

⁽⁴⁾ Decision No 145/97/COL.

⁽⁵⁾ Letter from the European Commission, Directorate-General IV — Competition/State aids of 28 March 1997, reference 97-1924-A.

⁽⁶⁾ OJ L 265, 1.3.1995, p. 23/29.

⁽⁷⁾ OJ C 38, 5.2.1998, p. 6/17, and the EEA supplement thereto.

⁽⁸⁾ Reference SG(98) D/1946 (98-1420-A).

- considers that the system constitutes operating aid for regional purposes to undertakings located in tax zones 2 to 5,
 - affirms that the Norwegian scheme has to be assessed on the basis of the relevant State aid rules, and in particular on the basis of the rules concerning operating aid to compensate for additional costs of transport in favour of firms located in low population density areas,
 - fully agrees with the Authority's interpretation of these rules,
 - shares the Authority's assessment that the Norwegian system in its present form is partially incompatible with the functioning of the EEA Agreement,
- and
- strongly supports the Authority's proposal for appropriate measures of 14 May 1997.

In the same letter, the European Commission drew the Authority's attention to its decision of 30 July 1997 to propose appropriate measures pursuant to Article 93(1) of the EC Treaty with respect to a similar Swedish aid scheme (State aid E 8/96 — regionally differentiated social security system).

The Norwegian Government was informed of the European Commission's comments by letter of 6 March 1998 (reference 98-1433-D). The observations from Norway to the European Commission's letter were received by letter of 20 April 1998 (reference 98-2560-A). The Norwegian authorities replied that they maintained their view as presented in previous letters, and the Swedish differentiated social security system had a number of features which deviated from the Norwegian system.

II. FACTS

1. General

Some general elements of the Norwegian national social insurance scheme and the system of regionally differentiated contributions from employers are presented in the following. A more elaborate description of the factual background may be seen from the Authority decision of 19 November 1997 to open the investigation procedure. That decision also contains a more detailed overview of the scheme's economic effects and regional disadvantages which may justify regional transport aid.

2. The Norwegian national social insurance scheme ('Folketrygden')

Compulsory insurance applies to all persons residing or working in Norway according to the National Insurance Act of 17 June 1966. Persons covered by the scheme are entitled to a wide range of benefits related *inter alia* to pensions, rehabilitation, medical care, wage compensation, and cash payments during unemployment.

Social security contributions are levied on employees and on employers and are calculated in relation to gross salaries. The national insurance scheme's historical sources of financing have for a number of reasons become insufficient, requiring additional financing from the State. The national insurance scheme has therefore gradually developed from a more traditional 'insurance' scheme, to a fully integrated part of central government finances. There is no earmarking of revenues, and both revenue and expenditure items are fully integrated into the fiscal budget.

The social security contributions paid by employers are, after value added tax, the single most important source of income for the central Government. For 1995, tax revenue stemming from

employers' social security contributions was estimated at 11 % of the overall revenue in the fiscal budget. The respective social security contribution rates are, together with other taxes and duties, decided annually by the Norwegian Parliament as part of the fiscal budget.

The taxes are calculated on the basis of the individual employee's gross salary income. The tax rates vary between 0 and 14,1 %, depending on the tax zone where the employee is residing. The differences in tax rates between the respective tax zones do not impinge in any way on the acquisition of individual rights within the national insurance scheme.

The system of regionally differentiated tax rates was introduced in 1975⁽⁹⁾ for reasons of regional policy. The country was then divided into three tax zones. Three tax rates of respectively 17, 16 and 14 % replaced the previous single rate of 16,7 %. Several adjustments to the system affecting both the geographical scope and the levels of taxation according to zone, have been introduced over time. The tax rates applicable from 1 January 1995 and the share of population according to tax zones are presented in Table 1. An average tax rate can be calculated at 12,6 %.

Table 1

Employers' social security contributions (1995)

Tax zone	Area	Tax rates (%) ⁽¹⁾	Share of population (in %) ⁽²⁾
1	Central regions southern Norway	14,1	73,0
2	Other regions southern Norway	10,6	14,8
3	Coastal area mid-Norway	6,4	0,4
4	Northern Norway (except zone 5)	5,1	9,5
5	Finnmark/Northern part of Troms	0,0	2,3

⁽¹⁾ The Norwegian Government proposed in May 1998 to marginally lower the tax rates to respectively, 14,0 %, 10,5 %, 6,3 %, 5,0 % and 0 % in zones 1 to 5, see 'St.prp. 54 Grønne skatter, Forslag til vedtak om fastsetting av arbeidsgiveravgiften for 1999'.

⁽²⁾ By 1 January 1995.

The geographical scope of the tax zones was last revised in 1988. Only minor adjustments have been made to the scheme since then.

The main features of the system of differentiated employer's social security contributions are described by the Norwegian authorities as follows⁽¹⁰⁾:

- The contribution rates are related to the registered permanent residence (municipality)⁽¹¹⁾ for each employee and not the location of the enterprise.
- The system is automatically applied on the basis of objective criteria and is not limited in time.
- The system is neutral with respect to industry, company size, occupation/economic activity, form of ownership, etc.

⁽⁹⁾ Bill to the Storting, Ot prp nr 12, 1974—75.

⁽¹⁰⁾ Reference letter dated 19 September 1995 (reference 95-5441-A).

⁽¹¹⁾ As defined in Act No 1 of 16 January 1970 'Lov om folkeregistrering'.

- The system applies to all employees in both the private and the public sector except for central Government which has to pay the maximum rate regardless of the residence of the employees.
- The system applies to foreign employees residing in Norway if they are covered by the national social security system.
- The employers' social security contributions are neutral with respect to the nationality of the employer.

3. Tax zones 2 to 5 — demographic situation

Regions corresponding to NUTS III regions (county level) with a population density below 12,5 inhabitants per square kilometre may qualify for regional transport aid in accordance with point 28.2.3 of the Authority's procedural and substantive rules in the field of State aid, adopted and issued by the Authority on 19 January 1994⁽¹²⁾ as amended on 20 July 1994 (State aid guidelines).

Nine counties⁽¹³⁾ accounting for 31 % of the Norwegian population have low population densities, defined as less than 12,5 inhabitants per square kilometre. The delimitation of tax zones 2 to 5 does not follow county borders. Some counties are as a whole inside tax zones 2 to 5, while only parts of other counties are inside. All counties or parts of counties covered by tax zones 2 to 5 have a population density less than 12,5 inhabitants per square kilometre. Tax zones 2 to 5 account for 27 % of the total population, while the area covered by the map of assisted areas eligible for regional investment aid accounts for 26 % of the population. These areas and tax zones 2 to 5 are to a large extent overlapping.

4. Economic effects of lower tax rates in zones 2 to 5

Volume and sectoral distribution of financial benefits

The Authority has commissioned a study⁽¹⁴⁾ on the scheme's economic effects by an independent consultant. The consultant estimated the benefits derived from the differentiated tax rates by industrial sector, size of firm, tax zone, and region. The benefits were estimated with reference to the difference between the estimated revenue that would have been obtained if the highest tax rate (of a tax zone 1) had been generally applicable⁽¹⁵⁾, and the actual revenue from the employers' social security contributions for enterprises in tax zones 2 to 5.

Total benefits were estimated at NOK 4 473 million (in 1994), see Table 2. Of that amount NOK 3 102 million, or close to 70 % of the total amount, could be attributed to northern Norway (tax zones 4 to 5). NOK 1 519 million, corresponding to about one third of the total benefits, could be attributed to the public sector (municipalities and counties), while manufacturing industries were found to account for some 17 % of the total amount.

⁽¹²⁾ OJ L 231, 3.9.1994 and OJ L 240, 15.9.1994.

⁽¹³⁾ Finnmark, Troms, Nordland, Nord-Trøndelag, Sogn og Fjordane, Hedmark, Oppland, Telemark and Aust-Agder (population figures in this paragraph refer to 1995).

⁽¹⁴⁾ *Benefits from reduced payroll taxes in Norway* by Arild Hervik, Norwegian School of Management, BI (1996).

⁽¹⁵⁾ It is implicitly assumed that neither the wage and activity levels nor the distribution of economic activities according to sector and region are affected by the level of taxation. The assumption implies that the amount of benefits to enterprises in zones 2 to 5 will end to be overestimated.

Table 2

Estimated benefits by zone and industrial classification, NOK million (1994)

Industrial classification (ISIC)	Zone 5	Zone 4	Zone 3	Zone 2	Group total	% of total
Primary industry	12,9	48,6	6,2	46,5	114,2	2,6
Oil extraction, mining and quarrying	38,1	28,6	0,4	22,6	89,7	2,0
Manufacturing	118,9	312,2	12,7	324,1	767,9	17,2
Electricity, gas and water supply	20,7	45,3	1,4	37,6	105,0	2,3
Construction	47,1	146,2	5,9	99,3	298,5	6,7
Wholesale/retail trade, restaurants, hotels	121,6	338,2	5,6	150,7	616,1	13,8
Transport, storage and communication	55,6	175,4	6,2	79,1	316,3	7,1
Financing, insurance, etc.	39,5	150,3	2,8	64,4	257,0	5,7
Other community and personal services	79,2	146,7	5,2	81,1	312,2	7,0
Municipalities and counties	312,0	812,9	19,9	374,5	1 519,3	34,0
Not stated	16,5	35,6	1,6	23,3	77,0	1,7
Group total	862,1	2 240,0	67,9	1 303,2	4 473,2	100
Percentage of total	19,3	50,1	1,5	29,1	100	

Approximately 23 % of the Norwegian manufacturing industry⁽¹⁶⁾ with a combined turnover of NOK 79 billion in 1994 was located in tax zones 2 to 5. The financial advantage favouring manufacturing enterprises in the same area has been estimated at NOK 767,9 million, corresponding to approximately 1 % of their turnover. Of that amount, 16 % i.e. NOK 124,9 million, could be attributed to large firms with more than 250 employees. The study also showed that service activities, *inter alia* transport and financial services, benefit from lower taxes in zones 2 to 5.

Regional distribution

As explained above, the employers' social security contributions are calculated as a percentage of the gross salary income of each employee. The actual rate applied is dependent on the registered residence of the employee. As most employees have their place of work in the vicinity of where they reside, the social security contributions from employers in a given tax zone are mostly calculated on income from employees resident in the same zone. This observation is

⁽¹⁶⁾ Measured in terms of turnover.

confirmed by Table 3. The intra-regional figures presented diagonally and in bold in Table 3, show that most of the tax revenue may be associated with employees residing in the same tax zone as their place of work. (This may not of course be seen in the case of tax zone 5 where the tax rate is zero and no revenue is collected.)

Table 3

Revenue from employers' social security tax by tax zones NOK million (1994)

		Employees' zones of residence					
		Zone 1	Zone 2	Zone 3	Zone 4	Zone 5	Total
Location of employers	Zone 1	33 916	750	8	73	0	34 747
	Zone 2	322	3 209	1	4	0	3 537
	Zone 3	4	2	47	0	0	53
	Zone 4	71	11	1	1 219	0	1 302
	Zone 5	14	2	0	5	0	20
	Not stated	666	48	1	17	0	732
	Total	34 993	4 022	58	1 318	0	40 391

Source: Hervik, *Benefits from reduced payroll taxes in Norway*.

Effects on wage formation

The immediate effect of a reduction in employers' social security contributions will be a reduction in employers' total wage costs. If such a reduction, on the other hand, induces an increase in wages, part of the benefits will be passed over to wage earners (carry-over effects). The possible existence of carry-over effects implies that net benefits to enterprises may be smaller than the loss of tax revenue associated with the lower rates in zones 2 to 5.

The Authority's consultant examined the existence and magnitude of possible carry-over effects. The Norwegian authorities commissioned a separate study⁽¹⁷⁾ on the same topic.

The Norwegian authorities refer in their letter of 23 January 1998 to a more recent study⁽¹⁸⁾, where it is estimated that the share of changes in payroll taxes passed over to wages may be in the range of 60 to 100 %.

The conclusions of the abovementioned studies are in short that:

- no empirical studies provide precise answers to how the wage formation process is influenced by changes in the level of payroll taxation. Empirical studies based on national data contain estimates of carry-over effects ranging between 20 and 100 %,

⁽¹⁷⁾ *Effects on wages from changes in payroll taxes in Norway* by Dr. oec. Nils Martin Stølen, Statistics Norway.

⁽¹⁸⁾ *Wage and employment effects of payroll taxes and investment subsidies*, Frode Johansen and Tor Jakob Klette, discussion papers, May 1997, Statistics Norway.

- all empirical studies based on national data indicate that reductions in employers' social security contributions lead to reduced wage costs for enterprises in the short run. A majority of studies indicate that enterprises' wage-related costs are also influenced in the longer run, but to a lesser degree. In other words, a majority of the studies indicate that, in the long run, the economic benefits of lowered payroll taxes are to a certain extent passed over to wage earners in the form of higher wages,
- certain studies based on regional data indicate that the carry-over effects related to a regional reduction in payroll taxes may be more limited than a general reduction, implying that a lesser part of the benefits are likely to be passed over to employees when a reduction in payroll taxes is introduced only for certain regions.

5. Additional transport costs

In addition to low population density, there are regional handicaps specific to the Nordic countries, 'namely the extra costs to firms occasioned by very long distances and harsh weather conditions' ⁽¹⁹⁾. Against this background the State aid guidelines foresee that operating aid aimed at providing for 'partial compensation for the additional cost of transport' ⁽²⁰⁾ may be justified in accordance with Article 61(3)(c) if certain conditions laid down in point 28.2.3.2 of the State aid guidelines are met.

The Authority's services have, in cooperation with the Norwegian authorities, examined the potential for identifying additional costs of transport based on existing statistical data. The respective calculations based on existing statistics showed invariably that the sum of additional transport costs estimated for each tax zone exceeded by a good margin the benefits related to the lower tax rates.

In addition, the Norwegian authorities have commissioned a special study on the relations between additional transport costs and the lower social security contributions in tax zones 2 to 5 for individual export and import competing enterprises in the manufacturing and mining industries.

The study covered a representative sample of 36 enterprises, reflecting the existing pattern of industrial activities in the manufacturing industry in tax zones 2 to 5 chosen from a total population of 180 such enterprises with more than 50 employees. Typical Norwegian export products such as metals (including aluminium and ferro-alloys), wood and wooden products, furniture, textiles, plastic products, fabricated metal products and equipment, processed fish products, and mining and quarrying products were covered by the study, while producers of steel and shipbuilding activities were not covered.

The study showed that in aggregate terms, additional transport costs exceeded by far the estimated benefits to the enterprises of lower social security contributions. For each individual firm covered by the study, the additional transport costs exceeded the estimated benefit. The estimated benefits of the lower tax rates were calculated according to the method applied by the Authority's consultant. The impact of possible carry-over effects was not taken into account in the calculations.

III. ASSESSMENT

1. Applicability of Article 61(1)

Article 61(1) of the EEA Agreement provides that:

'Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort

⁽¹⁹⁾ Point 28.2.3.2(1) of the State aid guidelines.

⁽²⁰⁾ Point 28.2.3.2(2) of the State aid guidelines.

competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement.’

The first question to be assessed is whether or not lower social security contributions from employers shall be considered as State aid favouring certain enterprises or the production of certain goods. The notion of aid is very broad, which follows already from the wording of Article 61(1) (‘in any form whatsoever’). It follows also from the jurisprudence of the Court of Justice of the European Communities that the notion encompasses both decisions which give undertakings or other persons resources as well as procure for them advantages⁽²¹⁾. Several other rulings by the Court of Justice⁽²²⁾, and the administrative practices of the European Commission⁽²³⁾, permit it to be firmly concluded that the notion of aid employed in Article 61(1) is not restricted to contributions in the form of transfer of tangible resources, but also extends to relief or exemption from burdens that the State in general is imposing, including sickness insurance schemes or social security charges⁽²⁴⁾, without anything adequate being required in return.

The effect of the system of the lower tax rates in tax zones 2 to 5 is that certain enterprises, able to benefit from these rates, are relieved from a tax burden compared to enterprises not able to do so. The measure in question is a result of State legislation (*Lov om folketrygd*) and of annual decisions by the *Storting* which sets the contribution rates each year.

Providing thus through the State budget a benefit to certain enterprises, a measure, such as the one under consideration, must be regarded as constituting State aid to the extent that the lower rates are not justified by the nature and general scheme of the system⁽²⁵⁾. The measure could have been considered justifiable if, for example, the lower rates had been linked to the rights accrued. In fact, the Authority has observed that the lower rates do not impinge on the rights acquired under the national insurance system.

It may be argued that reduced social security contributions may have an effect on the wage formation process and that the enterprises in question are not receiving the full benefits of the measures under consideration. On this point, the Authority has noted that the reduced rates obviously constitute a benefit. The studies on carry-over effects referred to in Part II of this decision, confirm that this benefit results in reduced wage costs. This being so, the observation that over time the benefits may to some extent be shared with employees, does not alter the fact that the enterprises enjoy a benefit within the meaning of Article 61(1).

Article 61(1) prohibits measures which favour certain enterprises or the production of certain goods. The main criterion for distinguishing a measure constituting State aid for the purpose of Article 61(1) from a general economic measure not covered by the prohibition is, in other words, whether or not the measure is selective in nature. The Authority considers that the selectivity criterion is fulfilled *inter alia* when the effect of the measure is to favour enterprises located in certain regions as opposed to a majority of enterprises in other regions which are not able to benefit from the measure.

The provision that the lower tax rates depend on the registered residence of the employee and not technically on the location of the enterprise, must be examined according to its effects. The Authority has found, with reference to the size, topographical and geographical circumstances

⁽²¹⁾ Case C-61/79, *Amministrazione della Finanze v. Denkavit Italiana*, [1980] ECR 3, paragraph 31.

⁽²²⁾ Case C-30/59, *Steenkolenmijnen v. High Authority*, [1961] ECR 1, p. 91.

⁽²³⁾ See *inter alia* XXIIInd, report on competition policy 1992, p. 264/66; Commission Decision of 1 March 1995 (OJ L 265, 8.11.1995, p. 23/29). State aid E 8/96 — Regionally differentiated social security system (Sweden).

⁽²⁴⁾ Case C-203/83, *Commission v. Italy*, [1983] ECR 2525; Case C-173/73, *Italy v. Commission*, [1974] ECR 475 and Case C-301/87, *France v. Commission*, [1990] I-307.

⁽²⁵⁾ Case C-173/73, *Italy v. Commission*, [1974] ECR p. 475, paragraph 15.

of the area covered by tax zones 2 to 5, that there is a high level of correlation between an enterprise's zone of location and its workforce's zone of permanent residence, reference Table 3. Therefore, the effect of the scheme is to favour specific enterprises, namely enterprises which are situated so that, as a rule, a significant part of their workforce has a permanent residence in municipalities covered by tax zones 2 to 5. The enterprises which are capable of benefiting from the lower tax rates are typically enterprises located in municipalities covered by tax zones 2 to 5, while enterprises located in tax zone 1 are, normally, not able to do so or only to a very limited extent, reference Table 3.

The prohibition in Article 61(1) extends to measures which distort or threaten to distort competition, in so far as they affect trade between Contracting Parties.

The enterprises benefiting from the lower social security contribution rates, experience a competitive advantage by being relieved from part of their tax burden through State measures which directly contribute to a reduction in their wage and production costs and, hence, to a distortion of competition.

The lower tax rates in zones 2 to 5 apply to all undertakings employing persons residing in these zones including undertakings in these zones exposed to intra-EEA competition, *inter alia* to undertakings engaged in export activities and to domestic undertakings facing competition from foreign EEA producers of goods and services. It should be emphasised in particular, that undertakings⁽²⁶⁾ benefiting from the lower tax rates in zones 2 to 5 are in competition with producers in tax zone 1 or producers in other EEA States, e.g. producers of aluminium, ferro alloys, steel and shipyards, to mention a few, located in or close to tax zones 2 to 5, currently benefit from lower labour costs than otherwise would have been the case, due to the lower tax rates in zone 2 to 5. Compared with a situation where these lower rates would not have been applicable, the aid strengthens the position of such undertakings relative to other undertakings competing within the EEA, thus affecting the latter. Reference is here made to the Court's judgment in Case 730/79 Philip Morris v. Commission⁽²⁷⁾. Consequently the aid involved distorts or threatens to distort competition within the EEA.

According to the 'Family Allowance Judgment'⁽²⁸⁾, it suffices to show that the aided undertakings or products are in competition with undertakings or products in other States within the EEA, in order to conclude that trade between the Contracting Parties is affected within the meaning of Article 61(1). As already referred to above, this is so in the present case. The fact that the lower rates also apply to economic activities sheltered from international competition does not eliminate this effect. Furthermore, the Authority has not raised any objections to the application of lower rates to such activities.

In light of the points discussed above, the Authority must conclude that the system of regional differentiation of employers' social security contributions in Norway involves State aid which according to Article 61(1) of the EEA Agreement is incompatible with the functioning of the Agreement.

2. The reply from the Norwegian Government

In their reply⁽²⁹⁾ to the Authority's decision to open a formal investigation, the Norwegian authorities maintain that the regionally differentiated tax system does not fall within the scope of Article 61(1) of the EEA Agreement.

⁽²⁶⁾ See Table 2.

⁽²⁷⁾ Judgment of 17 September 1980, Case 730/79, Philip Morris v. Commission, paragraph 11.

⁽²⁸⁾ Case 173/73, Italy v. Commission, paragraph 19.

⁽²⁹⁾ See letter of 23 January 1998 (98-696-A).

Their description of the system of differentiated social security contributions from employers concurs with the short description of the Norwegian National Social Insurance scheme ('Folketrygden') in Part II of this Decision. In addition, they point out that social security contributions are also levied at different rates on employees, on self-employed persons, and *inter alia* on pensioners, respectively. It is, furthermore, stated in the reply that if the highest rate (of zone 1) for employers' contributions had been applied generally for the whole country, total State revenue for 1994 would have increased by approximately NOK 4,5 billion.

The Norwegian authorities support their views with a number of reasons and arguments which the Authority has summarised and enumerated as points (a) to (h), presented and commented upon below:

- (a) The Norwegian authorities maintain that the differentiated social security contributions from employers are an integrated part of the general tax and transfer system in Norway and that the scheme is a general tax measure falling outside the scope of Article 61(1) of the EEA Agreement, and also outside the Agreement as the Agreement does not cover taxation as such.

ad (a) The Authority agrees that the EEA Agreement does not contain provisions concerning the harmonisation of the Contracting Parties' tax schemes. However, it is clear that the Contracting Parties may not apply tax measures which violate the Agreement by infringing the State aid or other rules. Article 14 of the EEA Agreement provides an explicit example in this respect. Reference is made to the Judgment of the European Court of Justice in Case 57/86 Greece v. Commission, paragraph 9, where the Court held that the exercise by the Member States of their powers in the monetary field did not permit them to unilaterally adopt measures prohibited by the Treaty.

- (b) The Norwegian authorities assert that one of the main objectives of the Norwegian tax and transfer policy is to create more equal standards of living regardless of place of residence. Differentiated social security contributions are one of several measures to achieve this goal. In this context reference is made to a comprehensive system of Central Government transfers to municipalities, and to reduced personal tax rates in the very northernmost parts of the country. It is maintained that such measures and differentiated social security contributions from employers have several common long term characteristics, *inter alia* in the sense that their effects are modulated by the market economy, influencing the behaviour of market participants and hence wage formation. It is stated that a reduction in personal income taxes will initially increase employees' disposable income, but in the long run such gains will be shared with employers through the wage formation process. Likewise, reduced social security contributions from employers will at the outset increase employers' profits, but in the long run this gain will be shared with wage earners due to increased wages. Reference is made to a recent study⁽³⁰⁾ indicating that substantial parts of reductions in social security contributions are passed on to employees through increased wages (carry-over effects). It is concluded that the functional similarities between various aspects of the tax and transfer system underscore the need to see the differentiated social security scheme as part of the total tax and transfer system designed to achieve the objectives referred to.

ad (b) The Authority does not deny that the system of regionally differentiated social security rates may be perceived as part of the Norwegian tax and transfer system and that this has the objective of creating more equal standards of living. However, the fact that the regional differentiation may be viewed this way, does not alter the fact that the regional differentiation of social security contributions from employers constitutes a specific tax scheme whereby undertakings contribute to finance the social security system, and where the lower tax rates favour certain undertakings, as explained in Section III.1, and distort

⁽³⁰⁾ Frode Johansen and Tor Jakob Klette, op. cit.

competition and trade. The fact that the regionally differentiated tax provisions are part of a general system does not eliminate the distortion of competition caused by the regional differentiation. Thus the argument brought forward is not relevant. Clearly, if this argument were to be relevant and be given decisive weight, almost any tax measure would escape the selectivity criterion embodied in Article 61(1) since the measure would normally belong to a general tax system. The alleged fiscal nature of the scheme cannot suffice to shield it from the application of Article 61 of the EEA Agreement⁽³¹⁾. The fact that one of the aims of the general tax system in Norway is to enhance income equalisation, can not alter the conclusion that the scheme involves State aid (see *ad (c)*). Concerning the carry-over effects, the Authority finds that it is reasonable to assume that certain parts of a reduction in social security rates levied on employers are passed over to wage earners in the form of higher wages. This does not however alter the fact that enterprises enjoying low rates experience a cost advantage and hence a competitive advantage compared to those not enjoying it.

- (c) The Norwegian authorities accept that certain tax rules may be in conflict with the State aid provisions although general taxation policy falls outside the scope of the EEA Agreement. Reference is made to the 'Family Allowance Judgment'⁽³²⁾, where the Court of Justice of the European Communities ruled that reduced social charges in the Italian textile industry were exemptions from the normal application of the general social security system, 'without there being any justification for this exemption on the basis of the nature or general scheme of this system'. According to the Norwegian authorities, this judgment establishes the principle that the application of the criteria depends on an assessment of the economic environment and the circumstances in each case, and that, in this context, the objective of the measure is a factor to be taken into account. Being an integral part of the Norwegian tax system with *inter alia* the objectives mentioned above, the Norwegian authorities state that 'these considerations are not in conflict with the State aid provisions of Article 61(1) of the EEA Agreement'.

As differentiation of social security charges is based on the residence of employees and not on the location of enterprises, the Norwegian authorities argue that employees from low rate zones are accorded advantages in the labour market, which in combination with other tax and transfer measures, strengthen regional employment and promote income equalisation. The Norwegian Government holds the view that when a taxation measure has general features and effects of this kind, it cannot be regarded as State aid within the meaning of the EEA Agreement.

- ad (c)* The Norwegian authorities' view that the objective of a certain policy measure, for example to strengthen regional employment and promote income equalisation, is a factor to be taken into account in the application of Article 61(1), is not in accordance with established case-law. The Court of Justice of the European Communities stated *inter alia* in the 'Family Allowance Judgment' that Article 92 of the EC Treaty (corresponding to Article 61 of the EEA Agreement) does '*not distinguish between the measures of State intervention concerned with reference to their causes or aims but defines them in relation to their effects*'⁽³³⁾. The argument of the Norwegian authorities is therefore not relevant with regard to the question of the application of Article 61(1) of the EEA Agreement, but may be considered in the context of exemptions based on Article 61(3) of the EEA Agreement.
- (d) The Norwegian authorities assert that the scheme of reduced social security contributions is applied automatically on the basis of objective eligibility criteria, *inter alia* the residence of the employee, where no undertaking is excluded from the scheme. There is no time limit for the application of the scheme. Reduced rates apply in relation to a large number of people, in 1995 some 850 000 out of a total of about 3 200 000 employees. According to the Norwegian authorities, these factors underscore

⁽³¹⁾ Case 173/73, Italy v. Commission, paragraph 13.

⁽³²⁾ Case 173/73, Italy v. Commission.

⁽³³⁾ Case 173/73, Italy v. Commission, paragraph 13.

the general character of the scheme. While it is admitted that undertakings tend to be localised in the same zone as where their employees reside, the possibility of commuting and hence for undertakings in a high tax zone to employ people residing in low tax zones, is presented as a further reflection of the general nature of the scheme. It is held that differentiation of this kind cannot be seen as favouring 'certain undertakings or the production of certain goods' as provided for in Article 61(1) of the EEA Agreement.

- ad* (d) The Authority does not dispute the factual observations that the scheme is operated automatically on the basis of objective criteria, *inter alia* the residence of the employee. However, the fact that the system also has certain technical features like these, cannot alter the conclusion that the regional differentiation involves State aid. The lower tax rates in zones 2 to 5 imply that certain undertakings are granted a financial advantage by the State which distorts or threatens to distort competition between undertakings in the area covered by the EEA Agreement. The facts referred to by Norway do not mean that this competitive advantage is eliminated.

The provision that the lower tax rates depend on the registered residence of the employee must be examined according to its effects. The Authority considers in this regard that the *de facto* situation is clear, namely that employers situated in zone 1 who employ a major share of the Norwegian work force, have typically very limited possibilities of lowering their wage related operating costs by employing persons with a permanent residence in zones 2 to 5.

In 1995, the lower tax rates in zones 2 to 5 applied to some 850 000 persons *i.e.* 26,5 % of the total number of employees, while the highest rate in zone 1 applied to a majority of 73,5 %. The Authority considers that such a differentiation cannot be regarded as a general measure, *i.e.* excluding the application of Article 61(1).

The observation that certain enterprises in a high tax zone may employ persons from a low tax zone, does not alter the fact that the beneficiaries are by and large enterprises located in tax zones 2 to 5, reference Table 3.

- (e) The Norwegian Government points out that the reduced social security rates in Norway cannot be regarded as rates diverging from a generally applicable rate, as the situation was in the 'Family Allowance Judgment'. Legislation does not provide for a standard rate with exemptions for certain regions, but for a five rate system with rates specific to each region. The Norwegian Government also emphasises that the Norwegian scheme under scrutiny is not directly aimed at export industries or other industries exposed to international competition. It is in this context mentioned that most export industries in Norway are located in central areas, and that the rate in such areas (zone 1) was raised to maintain State revenue when the regional differentiation was first introduced in 1975. Again, the Norwegian Government maintains that the differentiated social security tax on employers cannot be considered to be aid directed at 'certain undertakings or the production of certain goods'.

- ad* (e) The fact that the scheme is based on a five-rate system does not alter the effect of the differentiation, namely that enterprises located in tax zones 2 to 5, are typically subject to lower social security contributions than enterprises located in zone 1. The argument that a standard rate is not defined in the scheme's provisions, cannot exclude the applicability of Article 61(1). Again, it is the effects of the tax measure which are decisive.

The Norwegian authorities seem to claim that the situation in the 'Family Allowance Judgment' is not comparable to the case under consideration. It is stated that this is so since the aid in the 'Family Allowance Judgment' was, contrary to the present case, solely aimed at export industries. Thus, the Norwegian authorities seem to submit that the principles laid down in the 'Family Allowance Judgment' would only be applicable to State aid schemes aimed at export undertakings. However, there is nothing in the

judgment of the Court of Justice of the European Communities to support the view presented by Norway. To the contrary, it follows from paragraph 19 of the judgment that the aid would affect trade and thus be contrary to Article 92 of the EC Treaty, to the extent the Italian textile industry was in competition with textile industries in other Member States and not only if Italian textile industries exported their products. Thus Article 92 of the EC Treaty would have been applicable in that case even if the Italian industry did not export its goods but only faced competition from imported products. Thus, the statement in paragraph 19 does not lend support to the view presented by the Norwegian authorities. Further, there are no other statements in the judgment which indicate that the principles laid down by the Court in that judgment are limited in scope as suggested by Norway. Thus the case is relevant to the present case.

- (f) The Norwegian Government also draws attention to the fact that there are currently a number of differentiated taxation schemes in countries of the European Union, and refers in this connection to the Belgian 'Maribel Quater' scheme which was approved by the Commission.

ad (f) The possible existence of other tax schemes which after scrutiny may also be found to involve State aid according to Article 61(1) of the EEA Agreement is not a valid reason for the Authority to refrain from taking action in the case at hand.

The information⁽³⁴⁾ available to the Authority shows that the European Commission based its approval of the Belgian 'Maribel Quater' scheme on the finding that the reduced social security contributions for manual workers under the conditions proposed by the Belgian Government did not constitute State aid. The Commission found that the effects of the scheme would not be specific in the sense that 'Maribel Quater' would not favour certain undertakings or the production of certain goods. The scheme was considered to be a general measure applicable to all undertakings employing manual labour.

- (g) The Norwegian authorities also refer to what they see as a paradox, namely that differences in economic policies and in particular in taxation systems between countries within the EEA are acceptable, while the Authority in the case at hand has questioned the acceptability of differences in taxation within a country. It is held forth that relative taxes within Norway are of minor importance when assessing competition between enterprises in different EEA countries. It should rather be carried out a comparison of absolute taxes on competing businesses within the EEA, where a whole range of taxes relevant to business activities should be considered. It would be apt to investigate whether tax wedges for businesses in tax zones 2 to 5 in Norway are significantly lower than those for competing businesses in other EEA countries. It appears that the Norwegian authorities are of the opinion that regional variations in taxation within the same country, based on fiscal autonomy of regional authorities, are outside the scope of Article 61.

ad (g) It would go beyond the scope of the EEA Agreement to aim at a harmonisation of all factors which influence production costs of enterprises in the various States of the EEA. As recognised by the Norwegian authorities this also pertains to taxes. Hence, it should be clear that a comparison of absolute tax burdens on competing undertakings, as suggested by Norway, is not relevant when assessing whether State aid is granted contrary to Article 61(1).

The question of whether measures resulting from regional fiscal autonomy within a country fall inside or outside the scope of Article 61(1) of the EEA Agreement must be assessed according to the circumstances of each case. In the case at hand, there are no such measures involved since the differentiated rates are laid down in State legislation.

⁽³⁴⁾ See the Commission's letter of 15 April 1997, SG(97) D/2850, Objet: Aide d'État n° N 132/97 — Belgique.

- (h) For a measure to be considered as State aid within the meaning of Article 61(1) of the EEA Agreement, trade between the Contracting Parties has to be affected. The Norwegian Government maintains that the Authority in its decision to open a formal investigation procedure did not explain how this condition is fulfilled in the current case.
- ad (h)* As the Authority noted in the decision to open the investigation procedure, Statistics Norway has identified some 180 export and import competing enterprises with more than 50 employees only in the manufacturing sector (in addition to steel and shipbuilding), which are located in tax zones 2 to 5 and therefore benefit from the lower tax rates. Furthermore, Statistics Norway has published information showing that there are manufacturing and mining enterprises in all Norwegian countries which export their production⁽³⁵⁾ and that the share of production exported rose⁽³⁶⁾ in the period from 1986 to 1994. It is therefore beyond doubt that financial advantages arising from the lower rates are liable to have an impact on trade between the Contracting Parties.

A final comment from the Norwegian Government is that when the *Storting* (Parliament) gave its consent to ratify the EEA Agreement, continuation of the system of regionally differentiated social security rates of employers was an important condition.

Concerning this issue, the Authority notes that when the Norwegian Parliament (*Storting*) gave its consent to ratify the EEA Agreement, it accepted the Agreement in its entirety, including *inter alia* the provisions on State aid and the provision (Article 6 of the EEA Agreement) stating that the relevant rulings of the Court of Justice of the European Communities would apply when interpreting the rules of the Agreement. More specifically, neither the EEA Agreement nor any other documents related to the ratification of the EEA Agreement, contain provisions which could be taken to limit the scope of the State aid rules of the EEA Agreement with regard to Norway's system of regionally differentiated social security contributions.

3. Applicability of Articles 61(3)(a) and (c)

3.1. General

The Authority has not received arguments or information in the course of the investigation procedure which have given it any reason to alter the view it took in its decision of 14 May 1997 to propose appropriate measures to Norway, namely that the system as such, without any modifications does not merit exemptions according to Article 61(2) or (3) of the EEA Agreement.

The scheme under consideration is expressly considered by the Norwegian authorities as an instrument of regional policy. The Authority has examined the scheme's compatibility with the rules on regional aid based on Article 61(3)(a) and (c) of the EEA Agreement. The Authority has also examined other exemptions under Article 61(2) and (3) and found them not applicable in the case at hand.

The lower tax rates in tax zones 2 to 5 have a direct effect on the operating costs of enterprises because the rates are based on the gross salary of each employee. The lower rates are not related to investment and they do not require any contribution on the part of the beneficiary. Aid of the above nature which has the effect of reducing labour costs, must be regarded as operating aid. In its State aid guidelines⁽³⁷⁾, the EFTA Surveillance Authority has declared its reservations in principle as to the compatibility of operating aid, *i.e.* aid that is not conditional on initial

⁽³⁵⁾ See Table 1 to 'Regional fordeling av leveranser i industri og bergverk, Vedleggsundersøkelse til industristatistikken' by Kenneth Årdalen og Terje Søsæter, Notat 25/96, Statistics Norway.

⁽³⁶⁾ See 'Ukens Statistikk Nr 22/96', Statistics Norway.

⁽³⁷⁾ See *inter alia* point 26.1.(8) of the State aid guidelines.

investment or job creation, with the functioning of the EEA Agreement. However, the Authority may, as set out below, consider certain operating aid to be compatible with the Agreement.

3.2. *Article 61(3)(a)*

The Authority has expressed the view in Section 28.1.5 of the State aid guidelines that it may authorise operating aid to overcome particular or permanent disadvantages in specific circumstances and subject to certain conditions when it concerns aid to promote the economic development of regions qualifying for the exemption in Article 61(3)(a) of the EEA Agreement.

However, when the Authority approved the map of assisted areas eligible for regional investment aid in Norway⁽³⁸⁾, it found that no areas in Norway qualified for regional aid on the basis of Article 61(3)(a) of the EEA Agreement.

The Authority is therefore obliged, at present, to base its assessment of the compatibility of the lower social contribution rates in tax zones 2 to 5 on Article 61(3)(c).

3.3. *Article 61(3)(c)*

An assessment of whether or not an aid measure qualifies for exemption from the general prohibition against State aid according to Article 61(1) with reference to the derogation in Article 61(3)(c), involves evaluating to what extent the aid measure can be expected to make a contribution, in the case of regional aid, to regional development. This in turn presupposes that the region concerned faces specific regional development handicaps which the measure is intended to overcome. Such development handicaps may be reflected in the level of income, the existence of structural unemployment or the population density of a certain region, the last-mentioned criterion being of particular interest in the present case, given the demographic situation in the geographic areas concerned.

Point 28.2.3.1(1) of the State aid guidelines states that 'In order to take account of special regional development problems arising out of demography, regions corresponding to NUTS level III regions with a population density of less than 12,5 per square kilometre may also be considered eligible for regional aid under the exemption set out in Article 61(3)(c).'

Accordingly, it is relevant to examine whether tax zones 2 to 5 may be classified as Article 61(3)(c) regions by applying the population density criterion.

The provisions of point 28.2.3.2 of the State aid guidelines on regional transport aid, based on Article 61(3)(c), constitute a set of criteria which ensures that such operating aid is justified as compensation for certain specific handicaps. The provision of regional transport aid is a justified means of compensating for certain handicaps specific to the Nordic countries, in particular the extra costs induced by very long distances to markets and harsh weather conditions.

The Authority has examined to what extent operating aid in the form of lower social security contributions may be justified as indirect compensation for extra transport costs (indirect transport aid) to enterprises producing goods.

The criteria defined in point 28.2.3.2 of the State aid guidelines can be grouped into the following main categories, namely, (i) areas qualifying for regional transport aid, (ii) compensation for additional transport costs and (iii) conditions related to certain activities.

⁽³⁸⁾ Decision 110/98/COL of 28 April 1998 on the map of assisted areas (Norway).

3.4. *Areas qualifying for regional transport aid*

The first indent of point 28.2.3.2(2) of the State aid guidelines foresees that regional transport aid '... may be given only to firms located in areas qualifying for regional aid on the basis of the population density test.'

Nine counties (NUTS III level) out of 19 meet the population density criterion of less than 12,5 inhabitants/km² at the first stage of analysis. These counties account for 31 % of the population, while tax zones 2 to 5 cover 27 % of the population.

Four of the nine countries fully covered by favourable tax zones (Sogn og Fjordane (zone 2), Nordland (zone 4), Troms (zones 4 and 5) and Finnmark (zone 5)). In five of the nine countries (Nord-Trøndelag, Aust-Agder, Telemark, Oppland and Hedmark), only certain parts are covered by tax zones 2 to 4. The parts of these countries benefiting from lower tax rates are sparsely populated. In all cases they have an average population density considerably lower than 12,5 inhabitants/km².

Six countries out of the remaining 10 (Buskerud, Vest-Agder, Rogaland, Hordaland, Møre og Romsdal, Sør-Trøndelag) which do not fully meet the population density test, are partly covered by tax zones 2 and 3. These parts are also relatively sparsely populated with a population density of less than 12,5 inhabitants/km². Four counties are fully within tax zone 1.

According to point 28.2.3.2(2) of the State aid guidelines, for an area to be eligible for regional transport aid, it has to be authorised for this purpose by the Authority. The Authority will base its assessment of areas to be eligible for regional transport aid on the principles set out in Annex I to this Decision.

As for the present case, the Authority has found that if the Norwegian authorities after having received the Authority's decision, notify an area to be designated for regional transport aid, then the whole of the countries of Finnmark, Troms, Nordland and Sogn og Fjordane, and the parts of Nord-Trøndelag, which belong to tax zones 2 to 4, may be considered eligible for regional transport aid. However, the Authority is not convinced by the information presented so far, that regional transport aid is justified for all municipalities presently covered by tax zone 2 in the counties of Rogaland, Hordaland, Møre og Romsdal and Hedmark. This concerns in particular those parts of the latter counties which do not form in principle a contiguous area with other municipalities in tax zone 2, those which are located close to larger cities, or those which otherwise appear not to need compensation of a permanent nature to ensure regional development.

3.5. *Compensation for additional transport costs*

The second to fifth indents of point 28.2.3.2(2) of the State aid guidelines say:

- aid must serve only to compensate for the additional cost of transport. The EFTA State concerned will have to show that compensation is needed on objective grounds. There must never be overcompensation. Account is needed to be taken here of other schemes of assistance to transport, notably under Articles 49 and 51 of the EEA Agreement,
- aid may be given only in respect of the extra cost of transport of goods inside the national borders of the country concerned. It must not be allowed to become export aid,
- aid must be objectively quantifiable in advance, on the basis of an aid-per-kilometre ratio or on the basis of an aid-per-kilometre and an aid-per-unit-weight ratio, and there must be an annual report drawn up which, among other things, shows the operation of the ratio or ratios,

- the estimate of additional cost be based on the most economical form of transport and the shortest route between the place of production or processing and commercial outlets.

With regard to the level of indirect compensation for additional transport costs obtained by the system of lower tax rates in zones 2 to 5, Norway has presented a detailed study of the additional transport costs of 36 export and import competing enterprises, which shows that none of the enterprises received benefits in the form of lower social security contributions exceeding their additional costs of transport. These individual observations have furthermore been supported by calculations at a more aggregate level based on various sources of statistical information.

The Authority has noted that the sample of enterprises covered by the specific study of individual firms' additional transport costs reflects the pattern of Norway's most important exports of manufactured goods. The sample of enterprises is found by the Authority to contain a representative selection of enterprises within the relevant tax zones. The study covers *inter alia* a sample of producers of energy intensive products such as raw aluminium and ferro-alloys located by the coast. The Authority has also noted that enterprises in the shipbuilding sector, ECSC steel and non-ECSC steel, which are covered by specific sectoral rules, have not been included in the above study.

The estimated benefits of lower payroll taxes are calculated with reference to the difference between the actual social security contributions paid, and what it would have been if the tax rate of zone 1 had been applied without any differentiation. The impact of possible carry-over effects has not been taken into account.

The information available to the Authority does not suggest that the Norwegian schemes of assistance to transport, which may be covered by Articles 49 and 51 of the EEA Agreement, contain elements of compensation exceeding the amounts that may be attributed to reimbursements for the discharge of public service obligations. The Authority has therefore not found it necessary to adjust the estimates of additional transport costs, with reference to the possible effects these schemes might have *inter alia* on transport prices.

Against this background, the Authority accepts that manufacturing enterprises not belonging to sectors excluded from the referred study, and located in tax zones 2 to 5, face significant additional transport costs, and that the additional transport costs are not overcompensated by the financial benefits associated with the lower social security contribution rates in the same regions.

Only domestic transport costs inside national borders have been taken into account in the calculations. The Authority has noted that typical export-oriented sectors of the Norwegian economy are adequately covered in the studies and calculations referred to above. Furthermore, since the lower tax rates are applicable to all sectors of the economy except for Central Government and to all enterprises irrespective of their activities, the lower tax rates are not considered by the Authority as targeting the promotion of export enterprises. According, it has concluded that the lower tax rates of zones 2 to 5 do not constitute export aid⁽³⁹⁾.

The estimates presented in the study referred to above, show that the aid is objectively quantifiable in advance. As concerns the transport costs of the individual enterprises covered by the same study, it follows from the fact that the enterprises were obliged to cover transport costs by their own means, that they were economically motivated to minimise their transport costs by choosing the shortest routes and the most economical forms of transport.

⁽³⁹⁾ 'Export aid' means any aid directly linked to the quantities exported, to the establishment and operation of a distribution network or to current expenditure linked to the export activity, see State aid guidelines, footnote to point 12.1(5).

Against this background, the Authority has found that the information presented by Norway on the ratios between the additional costs of transport for the manufacturing industries and the benefits arising from the lower tax rates, does not indicate a need for a general adjustment at the level of indirect compensation for the additional costs of transport in zones 2 to 5. A general reduction in the present level of indirect compensation for additional transport costs is therefore not called for.

As required by the State aid guidelines (point 28.2.3.2(2)), a set of indicators reflecting aid-per-kilometre or an aid-per-kilometre and an aid-per-unit-weight ratio must however be included in annual reporting obligations for the scheme, in order to meet the criteria for regional transport aid.

The rules on regional transport aid foresee that 'Future schemes of assistance to transport will have to be limited in time and should never be more favourable than existing schemes in the relevant EFTA State'. This implies that the Authority is not prepared to accept the observance of relatively high additional transport costs as an argument for increasing the level of differentiation between tax rates, for introducing new measures which would imply an increase in the level of compensation for additional transport costs, or for expanding the area where indirect compensation for additional transport costs is granted in the form of lower social security contribution rates.

3.6. *Conditions related to certain activities*

3.6.1. *Enterprises with no alternative location*

The sixth indent of point 28.2.3.2(2) of the State aid guidelines says that. 'No aid may be given towards the transport or transmission of the products of enterprises without an alternative location (products of the extractive industries, hydroelectric power stations, etc.)'.

This rule must be considered in relation to the rules already quoted in paragraph 3.5, in particular the rule saying that is needed on objective grounds.

A remote region, richly endowed with a commercially exploitable natural resource, must in itself be regarded as a strength and not a handicap of the region even though it may have other handicaps when it comes to general industrial development. As concerns activities based on the exploitation of a natural resource, they may not need subsidisation for transport costs, as the benefits of the resource may outweigh the transport costs and relocation of the production to locations with lower transport costs may be ruled out by definition.

The activities that are to be considered are (i) production and distribution of electricity, (ii) extraction of petroleum and natural gas and incidental services, and (iii) mining and quarrying.

Production and distribution of electricity

It follows from the wording of the State aid guidelines point 28.2.3.2 that 'no aid may be given towards the ... transmission (underlined here) of the products of ... (... hydroelectric power stations ...)'. The reason for introducing this requirement into the rules on regional transport aid is basically that the whole electricity sector must be regarded as resource based. The Authority has found that the need for regional transport aid is not evident, that such aid would not significantly contribute to regional development and that there is, in addition, a perceived risk of spill-over effects of the aid towards export-oriented industries. The Authority has not found that transport costs in the electricity distribution sector (presumably mainly loss of power) can be related to the handicaps that may be overcome by relocation of some activities (for example control stations) to more central areas. For these reasons the Authority has concluded that the sector NACE 40.1 (production and distribution of electricity) cannot be allowed to benefit from the lower tax rates applied in zones 2 to 5.

Activities related to the extraction of petroleum and natural gas and incidental services

The Authority has found that activities related to the extraction of petroleum and natural gas should be excluded from the benefits of the measures under consideration. The Authority's position is not dependent only on considerations related to location decisions. The position is based more generally on the view that the sector is highly profitable and therefore not in need of regional transport aid. Consequently it does not meet the requirement which is implicit in Article 61(3)(c), and explicit in the criteria on regional transport aid, see 'The EFTA State concerned will have to show that compensation is needed on objective grounds.' Operating aid in favour of the extraction of petroleum and natural gas is therefore not considered justified with reference to regional development. The Norwegian authorities must therefore ensure that the sector NACE 11.10 (extraction of crude petroleum and gas) and the sector NACE 11.20 (service activities incidental to oil and gas extraction excluding surveying) do not benefit from the lower tax rates applied in zones 2 to 5.

Mining and quarrying

The mining and quarrying industry consists of several segments. The resource availability is unique to each segment. The industry can therefore be divided into (i) mining of metal ores; (ii) industrial minerals; (iii) quarrying of stone and (iv) gravel and aggregates.

The industry is characterised by the extraction of natural resources. This implies that the industrial activities of this sector are linked to geologically determined endowments of minerals which necessarily are geographically bound.

The availability of mineral resources influences the extent to which investment decisions for the purpose of undertaking mining and quarrying activities are geographically bound. The extraction of a resource characterised by small reserves and few known veins, will tend to be more geographically bound than a source with many veins and large reserves. There are therefore circumstances where an enterprise engaged in the extraction of certain natural resources is, in principle, free to choose its location because the production is based on significant reserves spread over a large area. The Authority therefore accepts that the mining and quarrying sector also contains enterprises that are confronted with location dilemmas similar to other industrial companies.

The Authority regards the mining of metal ores as geographically concentrated activities which are based on limited natural reserves. The same conclusion is reached as concerns the exploitation of the industrial minerals nefeline syenite and olivine.

The Authority concludes therefore that enterprises engaged in the mining of metal ores (NACE 13) and/or activities related to the extraction of the industrial minerals nefeline syenite (HS 2529.3000) and olivine (HS 2517.49100), should not be allowed to benefit from the lower tax rates applied in zones 2 to 5.

The Authority is aware that certain enterprises in the Norwegian mining industry have experienced financial difficulties. The Authority is prepared to consider, upon notification and individual examination, whether such enterprises qualify as being in a rescue or restructuring situation and are thus eligible for aid which *inter alia* may be justified with reference to social considerations.

The Authority has found with reference *inter alia* to the geological informations provided by the Norwegian authorities and the arguments referred to above on the extraction of minerals based on relatively abundant resources, that it is not required for industrial minerals other than nefeline syenite and olivine to be excluded from the possibility of benefiting from the lower tax rates applied in zones 2 to 5. The Authority has on this point taken into account that the activities in question often have a local nature, and that there is a significant incidence of relatively small enterprises. It has also taken into account, in the case of industrial minerals, that further local processing of industrial minerals from their natural state is likely to contribute to employment and regional development. Activities concerning quarrying of stone, gravel and aggregates are generally based on the extraction of abundant mineral resources. Such activities are therefore not considered to be geographically bound.

3.6.2. Industries covered by specific sectoral rules

The seventh indent of point 28.2.3.2.(2) of the State aid guidelines says that: transport aid given to firms in industries which the EFTA Surveillance Authority considers sensitive (motor vehicles, textiles, synthetic fibres, ECSC products and non-ECSC steel) are subject to the sectoral rules for the industry concerned and must in particular respect the specific notification obligations stipulated in the relevant chapters of these guidelines or in the Act referred to in point 1.A of Annex XV to the EEA Agreement⁽⁴⁰⁾.

In addition, specific rules apply to shipbuilding. The presently applicable schemes in Norway for aid to the shipbuilding sector provide for contract-related production aid of 7 % of the contract value before aid, for vessels whose contract value is at least ECU 10 million and 3,5 % for vessels of a contract value less than ECU 10 million, as well as for major ship conversions. The Norwegian authorities have not provided any information showing that shipbuilding enterprises in Norway suffer from permanent handicaps which may be compensated by regional transport aid, nor have they provided information on additional transport costs of such enterprises or of the volume of the aid in the form of reduced social security tax in relation to authorisable levels of operating aid to the shipbuilding industry. The Authority therefore concludes that enterprises covered by the act referred to in point 1.B of Annex XV to the EEA Agreement (Council Directive 90/684/EEC on aid to shipbuilding) must not, irrespective of their location, be allowed to benefit from the lower tax rates applied in zones 2 to 5.

According to the act referred to in point 1.A of Annex XV to the EEA Agreement (Commission Decision No 2496/96/ECSC) on aid to the ECSC steel industry, no operating aid is allowed except aid for closures. Hence, producers of ECSC steel products must not, irrespective of their location, be allowed to benefit from the lower tax rates applied in zones 2 to 5.

As regards non-ECSC steel production, the special notification requirements set forth in the sectoral rules only apply for the present purposes to production of seamless tubes and large welded tubes ($\varnothing > 406,4$ mm). As regards the textile industry no special notification requirements apply. Aid to the synthetic fibre industry is not covered by the specific notification requirements set forth in the sectoral rules, if the produced synthetic fibres only have a transitory existence before being used to produce ropes, fishing nets or other non-woven products. Aid for production of motor vehicle parts or accessories is not covered by the specific rules on aid to the motor vehicle industry, except when such aid is provided to motor vehicle manufacturers or their subsidiaries or for the manufacture of parts or accessories under licence or patents of a vehicle manufacturer.

If the estimated benefit of a lower rate of social security contributions for a firm related to production within either motor vehicle, non ECSC steel or synthetic fibres does not exceed ECU 100 000 over a three-year period, the *de minimis* rules applies. As for activities within these sectors, where notification requirements are applicable, any cases of possible transport aid to such activities will have to be notified individually and assessed on a case-by-case basis according to the relevant sectoral rules.

According to information submitted by the Norwegian authorities, at present there do not appear to be any enterprises engaged in the production of products falling within the scope of the special notification requirements under the rules on aid to the non-ECSC steel industry. As for the synthetic fibre and motor vehicle industries, no production currently takes place which falls within the scope of the sectoral rules for these industries. In view of these facts, the Authority considers it acceptable to implement in the present context the special notification requirements in these sectors, by requesting the Norwegian authorities to commit themselves in the future to notifying the Authority of any recipients falling within the scope of the above rules benefiting from the lower tax rates under consideration. Furthermore, such notifications must

⁽⁴⁰⁾ Commission Decision No 3855/91/ECSC of 27 November 1991 establishing Community rules for aid to the steel industry (OJ L 362, 31.12.1991, p. 57).

be followed up by annual reports which *inter alia* contain, as a separate item, the estimated amounts of indirect compensation for additional transports costs in the form of lower social security contributions foreseen and/or any direct transport aid received.

3.7. *The service sector and other non-manufacturing activities*

The Authority has examined the possible compatibility of the lower social security contributions rates in tax zones 2 to 5 on the basis of Article 61(3)(c) for sectors not producing goods, namely the service sectors or other non-manufacturing activities such as the construction sector.

The rules on regional transport aid are designed in such a way that they are mainly applicable *vis-à-vis* enterprises producing goods, and therefore less suitable for the Authority's compatibility assessment of the measures under consideration *inter alia vis-à-vis* the service sectors.

The Authority has therefore applied a broader perspective with regard to the applicability of Article 61(3)(c). It has in particular taken into account the impact a reduction in social charges will have on the employment situation, and assessed the effects of the lower tax rates under consideration with respect to the effects on competition and trade for certain service sectors.

A systematic overview of the situation with respect to the transport costs for the service sectors is not available. However, it is clear that certain parts of the service sector face significant transport costs and are therefore likely to be negatively affected by additional transport costs in the same way as the goods producing sectors. The average transport costs in one segment of wholesale trade have been estimated at approximately 5 % of turnover⁽⁴¹⁾, while the average transport costs for the retail and wholesale sector as a whole have been estimated at 33 % of value added⁽⁴²⁾.

The Authority accepts that enterprises in most service sectors located in regions that may be found eligible for regional transport aid may be negatively affected in a direct or indirect way by long distances to markets, or by long distances in intra-regional communications. The presence of harsh weather conditions is an additional qualitative factor which may increase the operating costs of economic operators also in the service sectors.

The Authority acknowledges that the lower social charges in tax zones 2 to 5 contribute to the improvement of the employment situation by lowering the costs of labour in the said areas.

Reduced social charges can, from the point of view of employment promotion, only be genuinely effective if they also relate to sectors which are less exposed to international competition. Examples of such sectors were identified by the European Commission in its communication entitled 'A European strategy for encouraging local development and employment measures'⁽⁴³⁾.

Measures to reduce social charges directed at the sectors referred to above, have a two-fold advantage. On the one hand, their effects on competition and EEA trade are often weak or

⁽⁴¹⁾ TØI Prosjekt O-1238 Næringslivets transportkostnader for rør- og sanitærgrossister (Hagen).

⁽⁴²⁾ TØI rapport 297/1995 Analyse av kostnadsutviklingen i innenlandske godstransporter (Hagen).

⁽⁴³⁾ OJ C 265, 12.10.1995. p. 3. Third paragraph, the Commission pinpointed 17 fields with potential for meeting the new needs of Europeans and offering substantial employment prospects: home help services, child care, new information and communication technologies, assistance to young people facing difficulties, better housing security, local public transport services, revitalisation of urban public areas, local shops, tourism, audio-visual services, the cultural heritage, local cultural development, waste management, water services, protection and conservation of natural areas and the control of pollution.

non-existent and, on the other hand, their potential in terms of job creation is great⁽⁴⁴⁾. The Authority is thus normally able to adopt a positive stance on such measures to the extent they fall within the scope of Article 61(1) of the Agreement. This is particularly true for local services. Others are growth niche markets or sub-sectors that hold out the prospect of job creation in respect of which the Authority will be more favourably disposed, provided they do not distort competition to an extent contrary to the common interest.

Approximately 65 % of the estimated benefits associated with lower social security contributions are allocated in sectors where the exposure towards trade may be assumed to be relatively limited or in sectors to which Article 61 of the EEA Agreement does not fully apply, namely the public sector, construction activities, wholesale/retail trade, restaurants and hotels and other community and personal services, reference Table 2. The Authority has noted the European Commission's interpretation of Article 92(3)(c) of the EC Treaty in its 'Guidelines on State aid for undertakings in deprived urban areas'⁽⁴⁵⁾ and in its 'Notice on monitoring of State aid and reduction of labour costs'⁽⁴⁶⁾. The lower tax rates are against this background found to apply to activities⁽⁴⁷⁾ which contribute to higher levels of employment in tax zones 2 to 5.

The very low population densities observed for most of the area covered by tax zones 2 to 5 and the pattern of settlement show that this area does not contain any population centres with more than 50 000 inhabitants, and that most of the population in the area is scattered over a wide geographical area, where the population centres rarely exceed 5 000 inhabitants. These observations imply that services enterprises in tax zones 2 to 5 have limited scope for expansion and that their activities are typically oriented towards local markets. Furthermore, the Authority has taken into account that the pattern of settlement, both on the Norwegian side of the border, as well as in the neighbouring regions in Sweden and Finland, indicates that the lower tax rates are not likely to have a significant effect on cross-border trade in services between the Nordic countries.

Finally, the Authority has taken into account the provisions of the *de minimis* rule in Chapter 12 of the State aid guidelines adopted by the Authority on 15 May 1996, when assessing the lower tax rates under consideration. The Authority has fixed the amount of aid at ECU 100 000 per firm over a period of three years, below which Article 61(1) of the EEA could be considered inapplicable in view of the lack of noticeable effects on trade between the Contracting Parties.

Against this background, the Authority has found that, as concerns service activities and non-manufacturing activities other than those referred to below, and to the extent that they fall within the scope of Article 61(1), the lower tax rates are justified as aid for regional development on the basis of Article 61(3)(c), as long as the lower tax rates are limited to an area which is authorised by the Authority for indirect compensation for additional transport costs.

The Authority has found, however, that the lower tax rates in zones 2 to 5 cannot apply to parts of the following service activities, namely, financial services, transport and telecommunications.

As concerns transport activities, the Authority has taken into account that there is competition between road hauliers from different EEA States in particular for cross-border transports. The Authority has found that there is a risk that benefits related to the lower tax rates may have a spill-over effect on other sectors if they are available to enterprises engaged in cross-border road transports. Furthermore, certain road transport enterprises located in tax zones 2 to 5 may in fact have a significant part of their activities taking place outside the areas experiencing the permanent disadvantages, *i.e.* under circumstances where the provision of regional transport aid is not justified. The Authority concludes therefore that enterprises with more than enterprises

⁽⁴⁴⁾ See for example, *OECD Study on Employment — Taxation, employment and unemployment*, OECD 1995.

⁽⁴⁵⁾ OJ C 146, 14.5.1997, p. 6.

⁽⁴⁶⁾ OJ C 1, 3.1.1997, p. 10.

⁽⁴⁷⁾ OJ C 265, 12.10.1995, p. 3, paragraph 3.

with more than 50 employees (the upper limit for small enterprises according to the State aid guidelines) engaged in activities classified as freight transport by road (NACE 60.24) must not be allowed to benefit from the lower tax rates in zones 2 to 5.

The Authority further considers that the same must apply to enterprises in the telecommunications sector (NACE 64.20) and enterprises with branch offices established abroad or enterprises otherwise engaged in cross-border activities in sectors classified as financial intermediation (NACE 65), insurance and pension funding (NACE 66) and services auxiliary to financial intermediation (NACE 67). The reasons for the Authority's position on this point are partly that the EEA Agreement contains specific provisions aiming at promoting trade and competition in these sectors, and more generally, that the introduction of the most recent information technology implies that the service activities mentioned may only to a very limited extent be considered as permanently hampered by long distances and harsh weather conditions. The Authority can accept, however, that branch offices in tax zones 2 to 5 may be allowed to benefit from the lower tax rates in these zones provided that the branch offices in question are only providing local services.

3.8. *Lower social security contributions paid by enterprises located in zone 1*

As pointed out and shown in Table 3, most of the benefits from reduced social security contributions received by enterprises located in a low tax zone, relate to employees resident in the same tax zone. However, if an enterprise in tax zone 1 employs individuals resident in zones 2 to 5, the enterprise in question will benefit from a lower tax burden.

A considerable amount of such benefits may reasonably be assumed to benefit employers in sectors where the effects on trade and international competition are of little relevance, e.g. the service sector and construction activities.

Furthermore, the number of employees residing in a tax zone differing from the one where the enterprise is located would normally make up a small fraction of the total number of the enterprise's employees.

Against this background and in view of the *de minimis rule*, the Authority has not found reason to object to the possibility that lower social security contributions may favour certain enterprises in this way. It follows from the above considerations, that the Authority has decided not to raise objections to the fact that the employers' social security contributions are determined according to the registered residence of each employee.

3.9. *Cumulation of aid*

Certain counties covered wholly or partly by tax zones 2 to 5 operate direct transport aid schemes⁽⁴⁸⁾. This implies that situations may occur where certain enterprises may seek to benefit both from the lower tax rates under consideration and direct grants from county authorities compensating for documented transport costs. The Norwegian authorities must therefore introduce specific rules to ensure that over-compensation due to the cumulation of regional transport aid from different sources will not occur.

3.10. *Annual reports and periodic reviews*

It is the established policy of the Authority to request annual reports for all systems of existing aid in the EFTA States, in order to fulfil its obligation of ensuring that all existing systems of State aid in the EFTA States are subject to constant review with regard to their compatibility with Article 61.

⁽⁴⁸⁾ Møre og Romsdal (Aid No 93-207), Sør-Trøndelag (Aid No 93-208), Nord-Trøndelag (Aid No 93-209), Nordland (Aid No 93-210), Troms (Aid No 93-211) and Finnmark (Aid No 93-212).

A scheme based on the rules of regional transport aid requires submission of detailed annual reports in accordance with the format indicated in Annex III of the State aid guidelines. A first report should be submitted to the Authority by 1 July 2000. Subsequent annual reports shall be submitted not later than six months after the end of each reporting year, and shall cover two financial years.

The rules on regional transport aid foresee the submission of information on the operation of an aid-per-kilometre ratio, or of an aid-per-kilometre and an aid-per-unit-weight ratio. Annually updated information showing such ratios as referred to above, shall be an integral part of a detailed annual report.

Such annual reports must contain, as separate items, the estimated amounts of indirect compensation of additional transport costs in the form of lower social security contributions, and any direct transport aid received by enterprises in sectors covered by specific notification requirements (motor vehicle industry, synthetic fibre industry and non-ECSC steel industry). Annual reports must also provide information on direct transport aid enabling an assessment of aid cumulation.

As referred to above, the State aid guidelines provide that 'Future schemes of assistance to transport will have to be limited in time ...'. The Authority considers it appropriate that a scheme based on this provisions should have a maximum duration of five years. Possible extensions would be dependent on new notification and assessment.

4. Conclusion

The system of regionally differentiated social security contributions involves State aid in the meaning of Article 61(1) of the EEA Agreement. Parts of this aid may on certain conditions be exempted according to Article 61(3), while other parts cannot be exempted. Norway must undertake the necessary measures to ensure that the identified infringements of Article 61(1) are brought to an end.

HAS ADOPTED THIS DECISION:

1. The system of regional differentiation of employers' social security contributions in Norway is incompatible with the EEA Agreement in so far as:
 - (a) it applies to activities not referred to in point (b), unless it is confined to areas which have been notified to the Authority and found eligible for regional transport aid;
 - (b) it allows for the following kind of enterprises to benefit from the lower social security contribution rates applied in zones 2 to 5,
 - enterprises engaged in production and distribution of electricity (NACE 40.1),
 - enterprises engaged in extraction of crude petroleum and gas (NACE 11.10),
 - enterprises engaged in service activities incidental to oil and gas extraction excluding surveying (NACE 11.20),
 - enterprises engaged in mining of metal ores (NACE 13),
 - enterprises engaged in activities related to the extraction of the industrial minerals nefeline syenite (HS 2529.3000) and olivine (HS 2517.49100),
 - enterprises covered by the act referred to in point 1.B of Annex XV to the EEA Agreement (Council Directive 90/684/EEC on aid to shipbuilding),
 - enterprises engaged in production of ECSC steel,
 - enterprises with more than 50 employees engaged in freight transport by road (NACE 60.24),
 - enterprises engaged in the telecommunications sector (NACE 64.20),

- enterprises having branch offices established abroad or otherwise being engaged in cross-border activities related to the following sectors, namely, financial intermediation (NACE 65), insurance and pension funding (NACE 66), and services auxiliary to financial intermediation (NACE 67), with the exception of branch offices only providing local services.
2. For the system of regionally differentiated social security contributions from employers to be adapted in such a way that it would become compatible with the rules on regional transport aid as reflected in the Authority's State aid guidelines and allow the Authority to carry out its surveillance functions in accordance with Article 1 of Protocol 3 to the Surveillance and Court Agreement, in addition to the adjustments required by points 1 (a) and (b) of this Decision, the following conditions would have to be complied with:
 - (a) The applicability of the system would have to be limited in time, not going beyond 31 December 2003. Before that time, a request for extension may be submitted for examination by the Authority.
 - (b) The Norwegian Government would be required to submit detailed annual reports on the aid scheme in accordance with the format indicated in Annex III of the State aid guidelines. As foreseen in Chapter 32 of the State aid guidelines, those reports would have to cover two financial years and be submitted to the Authority not later than six months after the end of the financial year. The first report is to be submitted before 1 July 2000.
 - (c) In accordance with the rules on regional transport aid, the detailed annual reports would have to show, in addition to information required according to point (b), the operation of an aid-per-kilometre ratio, or of an aid-per-kilometre and an aid-per-unit-weight ratio.
 - (d) The detailed annual reports would also have to contain, in addition to information required according to points (a) and (c), the estimated amounts of indirect compensation for additional transport costs in the form of lower social security contributions received by enterprises in the sectors covered by special notification requirements (motor vehicle industry, synthetic fibre industry and non-ECSC steel industry).
 - (e) For production covered by the specific sectoral rules related to synthetic fibres, motor vehicles and non-ECSC steel, the Norwegian Government would have to notify the Authority of any recipients of aid benefiting from the lower social security contribution rates in zones 2 to 5.
 - (f) The Norwegian authorities would have to introduce specific rules to ensure that overcompensation due to the cumulation of regional transport aid from different sources will not occur.
 3. Norway shall take the necessary measures to ensure that the aid which the Authority has found incompatible with the functioning of EEA Agreement is not awarded after 31 December 1998 and, where applicable, that the conditions in point 2 of this Decision are complied with. It shall inform the Authority forthwith of the measures taken.
 4. This Decision is addressed to Norway. The Norwegian Government shall be informed by means of a letter containing a copy of this Decision.
 5. This Decision is authentic in the English language.

Done at Brussels, 2 July 1998.

For the EFTA Surveillance Authority
Knut ALMESTAD
The President

ANNEX I

METHOD FOR ASSESSMENT — AREAS QUALIFYING FOR REGIONAL TRANSPORT AID ON THE BASIS OF THE POPULATION DENSITY CRITERION⁽¹⁾

- (i) First assessment is done at the NUTS III level. The threshold for maximum population coverage is determined at this level by examining which NUTS III level regions have a population density of less than 12,5 inhabitants per square kilometre (inhabitants/km²).
- (ii) A NUTS III level region may qualify for regional transport aid if the region as a whole passes the population density test.
- (iii) Principles to be applied when part of a NUTS III region is assessed,
 - 1. If that NUTS III region qualifies as a whole, then the part qualifies if its population density is less than 12,5 inhabitants/km². Normally the qualifying part must be adjoining eligible regions in other NUTS III regions.
 - 2. If that NUTS III region does not qualify as a whole, then the proposed part qualifies if each municipality passes the population density test and the area adjoins other eligible regions. In exceptional circumstances a contiguous area of municipalities can qualify if this area as a whole passes the population density test.
 - 3. Sub-regions of NUTS III regions which do not meet the population density test according to points 1. and 2. must be assessed individually paying particular attention to their remoteness, geographical and topographical situation in addition to the population density test at municipality level. This implies that other factors, which may reasonably be considered to induce additional transport costs on enterprises located in remote regions will be taken into account in addition to the population density criterion in the Authority's assessment of a certain region's eligibility for regional transport aid.
 - 4. Municipalities which do not meet the population density test, but have all or a significant part of their population on islands may be assessed on an individual basis.
- (iv) The final outcome of adjustments based on (iii) should be a map showing a contiguous area where the population threshold determined according to point (i) is not exceeded.

⁽¹⁾ The method outlined below intends to establish the necessary conditions for delineating an area as eligible for regional transport aid based on the population density criterion. Other criteria, related to centrality, etc. will form additional parameters for deciding on the exact delimitations of the area eligible for lower social security contributions.