EFTA SURVEILLANCE AUTHORITY

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Dec. No. 145/97/COL

EFTA SURVEILLANCE AUTHORITY DECISION

OF 14 MAY 1997

TO PROPOSE APPROPRIATE MEASURES TO NORWAY
WITH REGARD TO STATE AID IN THE FORM OF
REGIONALLY DIFFERENTIATED SOCIAL SECURITY TAXATION
(AID NO. 95-010)

THE EFTA SURVEILLANCE AUTHORITY,

Having regard to the Agreement on the European Economic Area[1], in particular to Protocol 26 and to Articles 61 to 63 of the Agreement,

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(1) of Protocol 3 thereof,

WHEREAS:

I. FACTS

1. Introduction

Article 1(1) of Protocol 3 to the Surveillance and Court Agreement provides *that "the EFTA Surveillance Authority shall, in co-operation with the EFTA States, keep under constant review all systems of aid existing in those States. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the EEA Agreement."*

By letters of 16 June 1995 and 30 August 1995, the EFTA Surveillance Authority requested the Norwegian authorities to submit full details on the existing system of social security taxation in Norway, in particular with reference to the system of regionally differentiated social security contributions paid by employers, in order to examine whether this system might constitute State aid in the meaning of Article 61(1) of the EEA Agreement.

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[1] Hereinafter referred to as the EEA Agreement.
[2] Hereinafter referred to as the Surveillance and Court Agreement.

The Norwegian authorities responded to the requests for information by letters dated 5 and 19 September 1995. The scheme of regionally differentiated social security contributions levied on employers has been the subject of several informal and technical meetings with the Norwegian authorities between the Spring of 1995 and March 1997. The Norwegian authorities have i.a. in relation to the above-mentioned meetings, submitted further information relevant to the Authority's examination.

The Authority has in accordance with Protocol 27 (f) of the EEA Agreement informed the Commission's services of its examination of the measures under consideration and received their comments[3] to the Authority's assessment and proposal for appropriate measures.

2. The Norwegian national insurance scheme and its financing

2.1 The Norwegian national 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 including i.a. old age pension, benefits for survivors, disability, rehabilitation, medical care and occupational injury, wage compensation in cases of illness and maternity leave, and daily cash payments during unemployment. Total expenditure for the national insurance scheme amounted to NOK 125 billion in 1995.

When the Norwegian national insurance scheme was established, it was financed from four sources of revenue, namely;
- social security contributions from employees,
- social security contributions from employers,
- grants from central government and
- grants from local government.[4]

The national insurance scheme's historical sources of financing have for a number of reasons become grossly insufficient. The estimated total revenue from the specific insurance levies amounted in 1995 to approximately NOK 86 billion. The national insurance scheme, therefore, has been 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 revenues and expenditure items are fully integrated into the Fiscal Budget.

2.2. Regionally differentiated social security contributions paid by employers

The social security contributions paid by employers are, after VAT, the single most important source of income for the central government. For 1995, the tax revenue stemming from the employers' social security contributions was estimated at approximately NOK 47 billion, which represents 11 % of revenue in the Fiscal Budget. Social security contribution rates (hereinafter also referred to as tax rates) are,

[3] Letter from European Commission, Directorate General IV- Competition State Aids of 28 March 1997 (ref. Doc. No. 97-1924 A).
[4] Abolished from 1992 onwards

together with other taxes and duties, decided annually by the Norwegian Parliament as part of the Fiscal Budget.

The tax rates are calculated on the basis of the individual employee's gross salary income. The tax rates vary between 0.0 % and 14.1, depending on the tax zone where the employee has his registered permanent residence. The differences in tax rates between the respective tax zones do not, however, in any way impinge on the acquisition of individual rights within the national insurance scheme.

The system of regionally differentiated tax rates was introduced in 1975[5] 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 of the system affecting both the geographical scope and the levels of taxation according to zone, have been introduced over time. Table 1 below shows the current tax rates and population according to tax zones[6].

Table 1 Employers' social security contributions.

Tax zone	**Area**	**Tax rates[7] in %**	**Share of population in % of total**
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

The tax zones were 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:

- The tax level is related to the registered permanent residence (municipality)[8] 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.
- 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 employee.
- 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.

[5] Bill to the Norwegian Parliament, Ot prp nr 12 1974-75

[6] A detailed overview of the area covered by tax zones 2-5 and a map indicating the delimitations of tax zones 2-5 are contained in Annex 1.

[7] Last revised in 1994 with effect from 1995.

[8] As defined in Act No 1 of 16 January 1970 "Lov om folkeregistrering"

3. The area covered by tax zones 2-5

The method[9] which has been applied by the Norwegian authorities to delimit tax zones 2-5, is similar to the one applied for their selection of assisted areas eligible for regional investment aid[10]. This implies i.a. that the borders of the various tax zones do not coincide with the administrative borders of the respective counties (NUTS III Level regions).

Tax zones 2-5 account for 27 % of total population, while the assisted areas eligible for regional investment aid account for 25 % of the population. These areas are to a large extent overlapping. Their common area covers 23 % of the population. Seven municipalities located in tax zone 1 with a combined population of 57 000 inhabitants (1.3 % of total population)[11] are only eligible for regional investment aid, while 28[12] municipalities with a combined population of 122 000 inhabitants (2.8 % of the population) are covered by tax zones 2-5, but not located within the map of areas eligible for regional investment aid. Annex 1 contains a list of all municipalities covered by tax zones 2-5 and a map showing the areas covered by tax zones 1-5, respectively.

The Norwegian map of assisted areas eligible for regional investment aid was approved by the Authority on 16 November 1994[13]. The approval is valid until 31 December 1997. A review of the present system for awarding regional investment aid, in co-operation with the Norwegian authorities, is foreseen before the authorization expires.

The Authority's examination of the current map of assisted areas in November 1994 showed that the northernmost parts of Norway, namely the county of Finnmark and four neighbouring municipalities in the county of Troms, covering 2 % of the population, qualified for regional aid on the basis of Article 61(3)(a) EEA. The Authority's examination was based on the method established for that purpose, ref. section 28.1.1. of the Authority's Procedural and Substantive Rules in the Field of State Aid adopted on 19 January 1994 (State Aid Guidelines)[14].

However, most of the area eligible for regional investment aid, covering 23 % of the population, qualified for regional aid according to Article 61(3)(c) EEA on the basis of the population density test contained in section 28.2.3 of the State Aid Guidelines

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[9] The method is based on the following indicators; 1) centrality (travel distance to centres of a given population), 2) share of population in villages or towns, 3) share of population age 20-49 years, 4) sex ratio 5) net migration, 6) share of population receiving disability pension, 7) unemployment rate, 8) educational level, 9) average income, 10) share of labour force employed in primary sectors, and 11) share of labour force employed in selected tertiary sectors.

[10] See Dec. No. 157/94/COL of 16 November 1994 on the map of assisted areas (Norway)

[11] Sigdal, Bø, Sauherad, Voss, Kristiansund, Averøy, Frei

[12] Herøy, Volda, Ørsta, Haram, Aukra, Frosta, Bømlo, Tysnes, Kvinnherad, Fusa, Samnanger, Austevoll, Vaksdal, Osterøy, Meland, Radøy, Lindås, Austrheim, Forsand, Finnøy, Bokn, Vindafjord, Eidskog, Nord-Odal, Midtre Gauldal, Selbu, Ølen, Iveland

[13] Dec. No. 157/94/COL

[14] OJ No L 231, 3.9.1994

(as amended by the Authority on 20 July 1994[15]). According to this test, regions corresponding to NUTS III Level regions with a population density below 12.5 inhabitants per square kilometre may qualify for the exemption for regional aid laid down in Article 61(3)(c) EEA.

Table 2 below, shows the population density of each county (NUTS III Level regions), and of those parts of each county which are covered by tax zones 2-5. The nine counties listed in the upper half of table 2 have an average population density of less than 12.5 inhabitants per square kilometre, while those listed in the lower half have an average population density above that threshold. The nine counties which meet the population density criterion, account for 31 % of the total population.

Table 2 Population density, population and tax zones (1995)

Counties/Nuts III	**Whole county**		**Part covered by tax zones 2-5**		**Tax zone**
	Inhabitants	**inh/km^2**	**Inhabitants**	**inh/km^2**	
Counties with < 12.5 inh/km^2					
Finnmark	76’629	1.7	76’629	1.7	zone 5
Troms	150’636	6.0	150’636	6.0	zones 4 and 5
Nordland	241’426	6.6	241’426	6.6	zone 4
Nord-Trøndelag	127’537	6.1	52’621	3.2	zones 1, 2 and 4
Sogn og Fjordane	107’609	6.0	107’609	6.0	zone 2
Aust-Agder	99’615	11.7	14’426	2.3	zones 1 and 2
Telemark	163’141	11.5	46’830	3.9	zones 1 and 2
Oppland	183’301	7.6	73’769	3.6	zones 1 and 2
Hedmark	186’593	7.2	62’198	3.0	zones 1 and 2
Sum:	1’336’487		826’144		
Counties with ≥ 12.5 inh/km^2					
Oslo	483’401	1'133.2	0	-	zone 1
Akershus	434’451	94.7	0	-	zone 1
Østfold	239’382	61.6	0	-	zone 1
Vestfold	203’240	95.0	0	-	zone 1
Buskerud	228’498	16.4	24’443	3.0	zones 1 and 2
Vest-Agder	149’500	21.8	5’681	1.9	zones 1 and 2
Rogaland	354’447	41.0	22’332	5.0	zones 1 and 2
Hordaland	422’554	28.1	107’249	9.1	zones 1 and 2
Møre og Romsdal	240’146	16.4	101’087	8.2	zones 1, 2 and 3
Sør-Trøndelag	256’304	14.3	69’750	4.4	zones 1, 2 and 3
Sum	3’011’923		330’542		
Total	4’348’410		1‘156’686		

Source: Ministry of Local Government and Labour

[15] OJ No L 240, 15.9.1994

Table 3 below, shows the distribution of villages/towns (densely populated areas) within tax zones 2-5. Tax zones 2-5 cover only two towns with more than 20’000 inhabitants namely Tromsø and Bodø, both located in tax zone 4.

Table 3 Number of population centres[16] according to size (1996)

Number of inhabitants	zone 2	zone 3	zone 4	zone 5	Total all zones
> 50’ 000	-	-	-	-	0
50’000 - 20’000	-	-	2	-	2
20’000 - 10’000	-	-	3	1	4
10’000 - 5’000	5	-	4	2	11
5’000-2’000	24	-	14	7	45
2’000- 1’000	43	1	16	8	68
< 1’000	160	8	80	20	268

Source: Ministry of Local Government and Labour

Tax zones 2-5 cover a wide geographic area. Table 4 below, indicates the average distances[17] between tax zones 2-5 to more densely populated central areas for land and seagoing[18] transports, respectively.

Table 4 Average distances from tax zones 2-5 to the Oslo region / 60° north

	- direct line to the Oslo-region	- by road to the Oslo region	- by boat to 60° north
zone 2			
-zone 2 average	266 km	328 km	283 km
-inland part	154 km	213 km	n.a.
-coastal part	326 km	457 km	n.a.
zone 3	440 km	634 km	430 km
zone 4	895 km	1439 km	949 km
zone 5	1318 km	1863 km	1413 km

Source: Ministry of Local Government and Labour

4. Economic effects of the scheme

4.1 Estimated benefits of lower tax rates in zones 2-5

The Authority has commissioned a study on the scheme’s economic effects by an independent consultant, Professor Arild Hervik at BI, Norwegian Business School of Management (hereinafter referred to as the consultant). The consultant’s report, “Benefits from reduced pay-roll taxes in Norway”, describes the estimated benefits derived from the differentiated tax rates by industrial sector, size of firm, tax zone, and region. The estimated benefits are, in this context, defined as the difference between the actual revenue from the employers’ social security contributions and the

[16] The term population centre refers to a technical term applied i.a. in regional policy, referring to actual population concentrations. Such centres may, geographically, differ from the administrative units they otherwise are associated with. This may be illustrated by the case of Tromsø, where the town (population centre) of Tromsø has 47104 inhabitants, while the municipality of Tromsø, which covers a significantly larger geographic area, has 55676 inhabitants.

[17] The distances presented in table 4, show the average distances, weighted by their relative population, from the respective municipalities in each tax zone to the Oslo-region/60° north

[18] The latitude of 60° north, close to Bergen is taken as a point of reference for domestic seagoing transport.

estimated revenue that would have been obtained if the highest tax rate (of tax zone 1) had been generally applicable[19] for enterprises in tax zones 2-5. The report is based on primary data and covers observations in the period from 1980 to 1994.

Table 5 below shows for 1994 the estimated volume and distribution of benefits by tax zone and industrial classification. The total benefits calculated in accordance with the above definition are estimated at NOK 4'473 million. 3'102 million NOK, or close to 70 % of the total amount, may be attributed to Northern Norway (tax zones 4-5).

As concerns the sectoral distribution of the estimated benefits, it may be seen from table 5 that 1'519 million NOK, corresponding to more than one third of the total benefits, may be attributed to the public sector (municipalities and counties). The manufacturing industries account for some 17 % of the total amount.

Table 5 Estimated benefits by zone and industrial classification. NOK million (1994)

Industrial classification (ISIC)	**Zone 5 0.0 %**	**Zone 4 5.1 %**	**Zone 3 6.4 %**	**Zone 2 10. 6 %**	**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 %
% of total	19.3 %	50.1 %	1.5 %	29.1 %	100.0%	

Source: Hervik, "Benefits from reduced pay-roll taxes in Norway"

Table 6 below, presents the estimated benefits in 1994 by zone and size of firm within the manufacturing industry. Approximately 23% of the Norwegian manufacturing industry with a combined turnover of NOK 79 billion is located in tax zones 2-5[20]. The estimated benefits for manufacturing enterprises in the same area amounted to NOK 767.7 million, corresponding to approximately 1 % of their turnover. 16 % of that amount, NOK 124.9 million, may be attributed to large firms with more than 250 employees.

The Authority's consultant has estimated the benefits for the manufacturing industries, per employee, per year, at NOK 7'000 in zone 2, NOK 19'000 in zone 4 and NOK 29'000 in zone 5, respectively.

[19] 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 zone 2-5 will tend to be overestimated.

[20] Measured in terms of turnover.

Table 6 Estimated benefits for the manufacturing industry by size of firm and tax zone. NOK million (1994)

tax zone	Estimated benefits according to size (number of employees) of firm				
	< 50	50-249	>250	Total	% of total
zone 2, southern Norway	138.2	121.3	64.7	324.1	42.2
zone 3 mid-Norway	n.a.[21]	n.a.	n.a.	12.7	1.7
zone 4, most of northern Norway	149.7	111.3	51.3	312.2	40.7
zone 5, Finnmark and parts of Troms	53.2	56.6	8.9	118.9	15.4
Total[22]	341.1	289.2	124.9	767.9	100.0
% of total	44.4	37.7	16.3	100.0	

Source: Hervik, “Benefits from reduced pay-roll taxes in Norway”

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, it is to be expected that the social security contributions from employers in a given tax zone usually relate to employees resident in the same zone. This is confirmed by table 7. The intra-regional observations presented diagonally and in bold in table 7, 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 of course not be seen in the case of tax zone 5 where the tax rate is zero and no revenue is collected.)

Table 7 Revenue from employers social security tax by tax zones. NOK Million (1994)

		Employees’zone of residence					
		Zone 1	Zone 2	Zone 3	Zone 4	Zone 5	Total
Location of employers	Zone 1	**33916**	750	8	73	0	34747
	Zone 2	322	**3209**	1	4	0	3537
	Zone 3	4	2	**47**	0	0	53
	Zone 4	71	11	1	**1219**	0	1302
	Zone 5	14	2	0	5	**0**	20
	Not stated	666	48	1	17	0	732
	Total	34993	4022	58	1318	0	40391

Source: Hervik, “Benefits from reduced pay-roll taxes in Norway”

4.2. Effects on wage formation

The immediate effect of a reduction in employers’ social security contributions will be a reduction in the employer’s total wage costs. If such a reduction, on the other hand induces an increase in wages, parts of the benefits will be passed over to the wage earners (carry-over effects) . The possible existence of carry-over effects implies that

[21] Separate figures showing the distribution of estimated benefits according to size of firm in zone 3, are not presented in the consultant’s study.

[22]As separate figures are not available for zone 3, this implies that the sub-totals and the percentages of totals according to size of firms presented in table 3 do not add up to the total for the manufacturing industry or to the percentages of 100 %, respectively.

the net benefits to the enterprises may be smaller than total benefits associated with the lower tax rates.

The Authority's consultant has evaluated whether it may be relevant to take into account possible carry-over effects. The Norwegian authorities have commissioned a separate study[23], on the same subject by Dr. oecon. Nils Martin Stølen, Statistics Norway.

The conclusions of the above studies are in short that:

- No empirical studies provide precise answers to how the wage formation process is influenced by changes in the employers' social security contributions. Empirical studies based on national data contain estimates of carry-over effects ranging between 20 % and 80 %.
- All empirical studies based on national data indicate that reductions in employers' social security contributions lead to reduced wage costs for the enterprises in the short run. A majority of studies indicate that the 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 the economic benefits related to a reduction in pay-roll taxes, in the long run, are to a certain extent passed over to wage earners in the form of higher wages.
- Studies based on regional data indicate that a geographical differentiation of pay-roll taxes has a significant effect on the relative wage costs between regions both in the short and in the long run. Compared to a general reduction in pay-roll taxes, the effects of a regional reduction appear to be more limited, implying that a lesser part of the benefits appear to be passed over to the employees when the reduction in pay-roll taxes is introduced only for certain regions.

5. Additional transport costs

In addition to the problem of under-population in certain regions, there are regional handicaps specific to the Nordic countries*, "namely the extra costs to firms occasioned by very long distances and harsh weather conditions*[24]". Against this background the State Aid Guidelines foresee that operating aid aimed at providing for *"partial compensation for the additional cost of transport*[25]*"* may be justified in accordance with Article 61(3)(c) if certain criteria are met. The criteria for awarding regional transport aid are laid down in section 28.2.3.2 of the State Aid Guidelines.

Against this background, the Authority has addressed the concept of "the additional cost of transport" and the problem of quantifying such costs in its examination of whether the measures under consideration may be justified according to Article 61(3)(c) of the EEA Agreement.

An initial inquiry into the existing studies on transport costs in Norway, showed that official statistics were not readily available in a format which would match the type of analysis foreseen in section 28.2.3.2. of the State Aid Guidelines.

[23] "Effects on wages from changes in pay-roll taxes in Norway"
[24] Paragraph 28.2.3.2 (1) of the State Aid Guidelines
[25] Paragraph 28.2.3.2 (2) of the State Aid Guidelines

Therefore, the Authority's services examined in co-operation with the Norwegian authorities, the potential for identifying the additional costs of transport based on existing statistical data and the need for collecting new primary data. It was i.a. found necessary to undertake a new survey on transport costs, which allowed a closer examination of the actual transport costs of a representative selection of individual firms.

The Norwegian authorities have submitted to the Authority that

"…enterprises located in remote regions experience distance-related disadvantages related to their localization. It is relevant to distinguish between observable direct transport costs related to inward and outward transport of goods, and other types of distance related costs such as contract costs, costs reflected in higher insurance premiums, product damage and storage costs. There are for instance reasons to believe that enterprises located far from markets have relatively higher travel costs related to marketing and establishing business contracts compared to enterprises located in central areas.

Some enterprises may experience accrued costs related to low population densities and relatively long distances within a region. Disadvantages such as long distances to the "home-market" of the district (on the demand and supply-side), limited availability of skilled personnel and the lack of networks between enterprises may lead to higher operating costs for remotely located enterprises.

The Institute of Transport Economics (TØI) (1992)[26] *applies the concept of generalized delivery costs, defined as the costs of serving markets and the costs of securing the ability to deliver. The concept includes transport-related and contract-related costs. The contract-related costs are according to the report just as important as transport-related costs."* [27]

The Norwegian authorities refer also to it being *"difficult to quantify all distance-related disadvantages". They explain that their "estimates of additional transport costs presented to the Authority refer to additional costs related to inward and outward transport of goods and persons. Other distance-related costs must therefore be taken into account in other ways than through quantified estimates*". The Norwegian authorities have therefore not presented any such estimates to the Authority. Nevertheless, it is held that *"the significance of contract-related distance costs must not be under-estimated in the overall assessment of the additional costs enterprises experience due to their geographical location, ref. TØI (1992)."*

The Norwegian authorities have presented various estimates of the additional transport costs for manufacturing and mining and quarrying enterprises located in tax

[26] TØI (1992): "Modellbedrifters konkurranse-evne i Distrikts-Norge". TØI Rapport 0109/1992 (J. Ludvigsen and M. Nymoen), is a contra-factual study of goods-producing high-tech (model) enterprises located in the Oslo-region. The (model) enterprises produce exported goods and serve as examples of future oriented categories of enterprises with optimised transport costs and good access to their export markets.

[27] Letter from the Ministry of Finance of 7 March 1997 (Doc. no. 97-2265 A). Office translation from Norwegian by the Competition and State Aid Directorate of the Authority.

zones 2-5, and compared them with the estimated benefits of lower social security contributions. The estimates are based on statistics supplied by Statistics Norway, i.a. Industry Statistics, External Trade Statistics, and Transport Statistics. Different methodological approaches have been applied. Estimates of additional transport costs in tax zones 2-5 have been determined by subtracting the estimated (notional) transport costs of enterprises located in tax zone 1 (represented for calculation purposes by the Oslo/Bergen regions.) The applied price indicators reflect the mode of transport, types of goods and regions in question. All calculations are carried out at an aggregate level of industry and to a various degree are based on average values of i.a. prices and quantities. On the assumptions made, the different calculations show invariably that the sum of additional transport costs estimated for each tax zone exceed by a good margin the benefits related to the lower tax rates.

Although the aggregate figures based on existing statistics provide useful background information for establishing a general picture of the relative transport cost disadvantages facing enterprises located in tax zones 2-5, the Authority came to the conclusion that more detailed firm specific information would be necessary for its assessment. Against this background the Norwegian authorities agreed to commission a special study on the relations between additional transport costs and the lower social security contributions in tax zones 2-5 for individual export and import competing enterprises within manufacturing and mining.

The selection of enterprises to be covered by the study was carried out as explained below. Statistics Norway first identified the total number of enterprises within mining and manufacturing, classified by Statistics Norway as export or import competing, located in tax zones 2-5 and having more than 50 employees. Some 180 enterprises were identified as falling within this category. The selection of individual enterprises for further examination, out of the some 180 referred to, was carried out by Statistics Norway and TØI to attain a representative sample which would reflect the actual pattern of industrial activities in the manufacturing industry in tax zones 2-5. 36 firms were finally selected for a detailed examination. Enterprises covered by certain specific sectoral rules on State aid, e.g. shipbuilding were not included. Neither were companies engaged in the extraction of oil and natural gas. 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 are covered by the study.

The actual study[28] was undertaken by TØI which carried out a close examination of the transport costs and benefits from lower social security contributions of the selected firms.

TØI's examination of the additional transport costs was to a wide degree based on the accounts of the firms in question. The estimates of additional transport costs refer to costs related to inward and outward transport of goods within national borders, and part of the additional travel costs within national borders for certain categories of key personnel. The general findings of the study are illustrated by table 8 below. In aggregate terms, the additional transport costs exceed by far the estimated benefits to

[28]TØI "Industribedrifters transportvolum og kostnader, Arbeidsdokument av 27. desember 1996

the enterprises. Furthermore, it was found for all the 36 individual firms that were covered by the study, that the additional transport costs exceeded the benefits of lower social security contributions. The observations for individual firms show results where the ratio between the estimated additional transport costs and the estimated net benefits vary between a ratio of 1.2 as the lowest to a ratio of 28 as the highest observation. The estimated benefits of the lower tax rates have been calculated according to the method applied by the Authority's consultant. The impact of possible carry-over effects were not taken into account in the calculations.

Table 8 Comparison of additional transport costs and benefits from lower social security contribution rates for selected enterprises. NOK mill. (1995)

Zone[29]	**Additional transport costs**				**Estimated benefits**	**Ratio between additional transport costs and estimated benefits**
	Inward transport of goods	**Outward transport of goods**	**Transport of key personnel**	**Total transport costs**		
2	94	110	27	231	50	4.6
4	41	48	4	93	25	3.7
5	1	49	1	51	17	3.0

Source: TØI and Ministry of Local Government and Labour

II. APPRECIATION

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 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 measure under consideration is the system of lower social security contribution rates paid by employers in tax zones 2-5. The employers' social security contributions are compulsory payments from employers to the State. These contributions constitute one of the Norwegian Government's most important sources of revenue.

One effect of the system of the lower tax rates in tax zones 2-5 is that certain enterprises, capable of benefiting from the lower tax rates in tax zones 2-5, are relieved from a part of their tax burden compared to enterprises not capable of doing so. The latter category of enterprises are therefore obliged to pay the highest tax rate of 14.1 % in tax zone 1. The benefits resulting from a relief in the tax burden will depend on the number of employees, their salaries and not least their residence, as this

[29] There were no observations for zone 3.

latter factor determines an enterprise's capability of taking advantage of the lower tax rates in zones 2-5.
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 of the area covered by tax zones 2-5, that there is a high level of correlation between the zone of location of an enterprise and the zone of permanent residence of its work force, ref. table 7.

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 2-5, ref. table 5. The enterprises which are capable of benefiting from the lower tax rates are typically enterprises located in municipalities covered by tax zones 2-5, while enterprises located in tax zone 1 are, normally, not capable of doing so or only to a very limited extent, ref. table 7.

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. As the relief in the tax burden benefiting certain enterprises is established through State legislation, such aid is granted through State resources within the meaning of Article 61 of the EEA Agreement.

The wording of Article 61(1) indicates that distortion of competition may occur when a measure favours <u>certain</u> enterprises or the production of <u>certain</u> goods. The main criterion for distinguishing State aid from a general economic measure is, in other words, whether or not the measure is selective in nature. The Authority considers that the selectivity criterion is fulfilled i.a. when the effect of a measure is to favour enterprises located in certain regions as opposed to enterprises in other regions which are not capable of benefiting from the measure.

The information provided by the Norwegian authorities shows that the geographical scope of tax zones 2-5, enjoying lower tax rates, is determined at the discretion of the Norwegian Government and that a particular method has been applied for the purpose of selecting the eligible regions.

As mentioned in part I of this decision, the Norwegian Government has pointed out that the employers' social security tax rates for each zone are neutral with regard to industry, size of enterprise, occupation, public or private activity. The fact that the scheme is neutral with respect to the above parameters, does not, however, affect the applicability of Article 61(1) EEA as it has already been shown that the lower tax rates are selective according to their regional effects.

A measure, such as the one under consideration which favours enterprises located in certain regions, must be regarded as constituting State aid unless the lower rates are justified by the nature and general scheme of the system[30]. That might have been

[30]See paragraph 15, Judgement of the Court of 2 July 1974, *Italy v Commission* Case 173/73 [1974-5] ECR 631 - 892 at page 719

considered to be the case if, for example, the lower tax rates were linked to the rights accrued. The Norwegian authorities have not supplied any evidence indicating that the lower tax rates under consideration are linked to other properties of the tax system or the social security system to which they belong. In fact, the Authority has observed that the lower rates do not impinge on the rights acquired under the National insurance system and that the tax rates in each tax zone may be determined i.a. each year as part of the State's Fiscal Budget.

The Authority accepts that it may reasonably be assumed that reduced social security contributions may have an effect on the wage formation process as referred to in point I.4.2 of this decision. This implies that the financial benefits related to the lower tax rates in tax zones 2-5 may be shared between employers and wage-earners, so that the enterprises are not receiving the full benefits of the measures under consideration. Notwithstanding the difficulties related to assessing precisely in what proportions the benefits are shared, the Authority considers it to be beyond reasonable doubt that a substantial amount of the benefits provided in the form of lower social security contribution rates in zone 2-5 remain with the enterprises capable of benefiting from these measures.

Against this background, the Authority must conclude that the system of lower rates in tax zone 2-5 has a direct effect on the production costs of the enterprises which are capable of benefiting from the lower rates. Therefore, the measure under consideration is liable to enhance the ability of enterprises located in certain regions to compete with enterprises in other EEA States. Since the lower tax rates under consideration apply to all economic sectors in certain regions except for central government, it is clear that the economic effects of lower tax rates extend, potentially, to enterprises in all sectors covered by the EEA Agreement. The lower tax rates in tax zones 2-5 must therefore be deemed liable to affect competition and trade between the Contracting Parties.

Against the points discussed above, the Authority must conclude that the lower tax rates in tax zones 2-5 of the Norwegian system of regionally differentiated social security contributions from employers constitute State aid in the meaning of Article 61(1) of the EEA Agreement.

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

2.1 General

The scheme under consideration is expressly considered by the Norwegian authorities as an instrument of regional policy. Against this background, the Authority has examined the tax scheme's compatibility with the rules on regional aid based on Articles 61(3)(a) and (c) of the EEA Agreement. Articles 61(3)(a) and (c) read as follows:

"The following may be considered to be compatible with the functioning of this Agreement:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest;"

The effect of the system of lower social security contribution rates in certain areas is to reduce the labour costs for enterprises employing persons living in tax zones 2-5. As pointed out above, this effect translates by and large to reducing labour costs for firms located in the same regions.

The lower tax rates in tax zones 2-5 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 character, which has the effect of reducing labour costs, must be regarded as operating aid. The EFTA Surveillance Authority has in its State Aid Guidelines[31], declared its reservations in principle as to the compatibility of operating aid with the functioning of the EEA Agreement. However, as indicated below, there are certain exceptions to this principle.

<u>Article 61(3)(a)</u>

The Authority has expressed the view i.a. in section 28.1.5. of the State Aid Guidelines that it may authorize 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.

When the Authority approved the map of assisted areas eligible for regional investment aid in Norway[32], it found that the northernmost parts of Norway, namely the county of Finnmark and four municipalities in Nord-Troms (Target zone A for regional investment aid), qualified for regional aid on the basis of Article 61(3)(a) EEA. This area corresponds by and large to tax zone 5.

Article 61(3)(a) might likewise have been applied in the Authority's examination of tax zone 5. The Authority may in accordance with section 28.1.5.(4) of the State Aid Guidelines authorize certain operating aid in Article 61(3)(a) regions, on certain conditions. One of the conditions implies that the aid must be *"limited in time and designed to overcome the structural handicaps of enterprises in Article 61(3)(a) regions"*. However, the Authority's examination of the disadvantages facing enterprises located in most of the area covered by tax zones 2-5 has revealed that they experience disadvantages occasioned by circumstances of a relatively permanent nature such as under-population, harsh weather conditions and very long distances. The existence of such disadvantages affect enterprises located in a much wider area than Target zone A which the Authority has classified as an Article 61(3)(a) region. The Authority has therefore found that it would, at present, base its assessment of the

[31] See i.a. paragraph 26.1.(8) of the State Aid Guidelines
[32] Decision 157/94/COL of 16 November 1994 on the map assisted areas in Norway

compatibility of the lower social contribution rates in tax zones 2-5 on Article 61(3)(c). This does not prejudge future applications of Article 61(3)(a).

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 shall help 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 Authority's examination[33] of the Norwegian map of areas eligible for regional investment aid, showed that areas covering 31 % of the population qualified in principle for regional investment aid according to Article 61(3)(c) in the first stage of analysis with reference to the population density test. In comparison, only a limited area covering 6.5 % of the population would have qualified for regional investment aid in the first stage of analysis due to a relatively low income (measured by GVA per capita) compared to the national average and no areas would have qualified with reference to the unemployment criterion.

Against this background, the Authority has in the case at hand focused on the population density criterion.

Paragraph 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)." It is further more referred to in* paragraphs 28.2.3.1.(4)-(6) of the State Aid Guidelines which are partly reproduced below that:

(4) "...special features shared by the Nordic countries: they derive from geography - the remote northern location of some areas, harsh weather conditions and very long distances inside the national borders of the country concerned - and from the very low population density in some parts...

(5) A test of eligibility must therefore be used which reflects these problems. Such a test should be of general application, i.e. potentially applicable to any country. It should also be integrated into the method for the application of Article 61(3)(c) of the EEA Agreement in order not to disrupt the method of assessing regional aid. If it is to be an objective test which is valid erga omnes, it must be an alternative to the unemployment and GDP tests used in the first stage of the method. This would mean that any region corresponding to NUTS Level III region presenting the required level of unemployment or GDP or satisfying the new test could be accepted as qualifying for regional aid in the appropriate circumstances and subject to approval by the EFTA Surveillance Authority.

[33] Decision 157/94/COL of 16 November 1994 on the map assisted areas in Norway

(6) *On those grounds, it could be held that a population density threshold of less than 12.5 per km2 reflects the addressed regional problems in an appropriate manner. All regions corresponding to NUTS Level III regions with a population density below that figure may then qualify for the exemption for regional aid laid down in Article 61(3)(c) of the EEA Agreement, subject to assessment and decision by the EFTA Surveillance Authority."*

It may against this background be concluded that it is relevant to examine whether tax zones 2-5 may be classified as Article 61(3)(c) regions by applying the population density criterion.

The provisions of section 28.2.3.2 of the State Aid Guidelines on regional transport aid, reproduced below, are based on Article 61(3)(c). They 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 considered to be 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. These factors affect regional development in two ways: they may induce firms to relocate to less remote areas which hold better prospects for economic activity or they might dissuade firms from locating in such remote areas.

The Authority has examined in the following 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 Authority's interpretation of the criteria for awarding regional transport aid is based on Article 61(3)(c) of the EEA Agreement from which they are derived.

The criteria defined in section 28.2.3.2 of the State Aid Guidelines can be grouped into the following main categories, namely, i) Areas eligible for regional transport aid, ii) Compensation for additional transport costs and iii) Conditions related to certain sectors.

3. Areas eligible for regional transport aid

The first bullet of section 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"*

The Authority will in its examination of whether regional transport aid is justified in an Article 61(3)(c) region not only take into account whether the region in question fulfils the population density test, but also whether it has been shown in accordance with the second bullet of section 28.2.3.2.(2) of the State Aid Guidelines "*that compensation is needed on objective grounds*". Therefore, the Authority may take into account other factors in addition to the population density of certain region, in its assessment of an area's eligibility for regional transport aid.

It is the established practice of the EC Commission and the Authority to apply the indicators referred to sections 28.2.2 and 28.2.3 of the State Aid Guidelines during the first stage of analysis in a pragmatic manner when examining an area's eligibility for regional aid according to Article 61(3)(c). The Authority found i.a. in its decision approving the Norwegian map of areas eligible for regional investment aid that *"Compared to the method for application of Article 61(3)(c) laid down in Section 28.2 of the State Aid Guidelines, the Norwegian system of designating assisted areas has led to a map of assisted areas where on one hand the more prosperous parts of certain counties*[34] *that otherwise qualify for regional aid as a whole under Article 61(3)(c) are excluded from the map of assisted areas. On the other hand, remote and less prosperous areas in counties*[35] *which do not qualify for regional aid under Article 61(3)(c) in the first stage of analysis have been included. By these readjustments the map of assisted areas remains as a contiguous area. The overall effect of these readjustments is a more efficient regional policy by targeting regional investment aid to those regions with the greatest need of such support for economic development and an overall reduction of the areas eligible for regional investment aid from 29 to 23 % of the total population compared to the method laid down in Section 28.2. of the State Aid Guidelines."*

The Authority has applied similar principles in the case at hand. For the purpose of identifying areas that may be designated for regional transport aid based on the population density test, it has developed the principles contained in Annex 2 to this decision and applied them in its examination of the area covered by tax zones 2-5.

Nine counties (NUTS III level) out of nineteen meet the population density criterion of less than 12.5 inhabitants/km^2 at the first stage of analysis. These counties account for 31 % of the population, while tax zones 2-5 cover 27 % of the population.

Four of the nine counties are as whole 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 counties (Nord-Trøndelag, Aust-Agder, Telemark, Oppland and Hedmark) only certain parts are covered by tax zones 2-5. The parts of these counties benefiting from lower tax rates are sparsely populated. In all cases they have an average population density considerably lower than 12.5 inhabitants/km^2, ref. table 2.

Six counties out of the remaining ten (Buskerud, Vest-Agder, Rogaland, Hordaland, Møre og Romsdal, Sør-Trøndelag) which do not meet the population density test as a whole, 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/km^2, ref. table 2.

The distance-related handicaps of sparsely populated areas, vis-à-vis more densely populated areas, must be taken into account in a way which ensures that regional transport aid is confined to areas which experience objective handicaps related to an unfavourable demographical, topographical and geographical situation. Areas eligible for regional transport aid should therefore, in principle, be contiguous and construed in a way to exclude regions which do not experience objective transport handicaps. Areas

[34]Hedmark, Oppland, Telemark, Aust-Agder, and Nord-Trøndelag
[35]Vest-Agder, Rogaland, Hordaland, Buskerud and Sør-Trøndelag

located close to larger cities which are not hampered by objective handicaps, should therefore not benefit from regional transport aid.

The Authority has found that if the Norwegian authorities after having received the Authority’s current proposal for appropriate measures notify an area to be designated for regional transport aid, then the whole of the counties of Finnmark, Troms, Nordland and Sogn og Fjordane, and the parts of Nord-Trøndelag, Aust-Agder, Vest-Agder, Telemark, Oppland, Buskerud and Sør-Trøndelag, which today make up parts of tax zones 2-4, 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.

It is laid down in paragraph 28.2.3.1.(6) of the State Aid Guidelines that eligibility for regional aid is subject to the assessment and decision by the Authority. The Authority has taken into account that the map of assisted areas eligible for regional investment aid is valid only until the end of 1997[36]. The Norwegian Government should therefore submit to the Authority, a detailed proposal on the general map of assisted areas eligible for regional aid not later than 15 October 1997. The proposal should indicate the area to be designated as eligible for regional transport aid and regional investment aid. Upon receipt of such a proposal, the Authority will decide on the precise area to be designated for regional aid measures as of 1 January 1998.

4. Regional transport aid to manufacturing and extractive industries

4.1 Compensation for additional transport costs

Section 28.2.3.2 of the State Aid Guidelines, contains criteria indicating the level of aid that may be justified as compensation for the specific permanent disadvantages of certain regions in the Nordic countries referred to in that section. The criteria read as follows:

> *(1) The population density test may provide a satisfactory response to the problem of underpopulation in certain regions, but it does not address another regional handicap specific to the Nordic countries, namely the extra costs to firms caused by very long distances and harsh weather conditions. These factors affect regional development in two ways: they may induce firms in such regions to relocate to less remote areas which hold out better prospects for economic activity and they might dissuade firms from locating in such outlying areas.*
>
> *(2) The EFTA Surveillance Authority could therefore decide to authorise aid to firms aimed at providing partial compensation for the additional cost of transport, on a limited basis and at its discretion, in order to safeguard the*

[36] Decision 157/94/COL of 16 November 1994 on the map assisted areas in Norway

common interest. Such compensation must however comply with the following conditions:

- *Aid may be given only to firms located in areas qualifying for regional aid on the basis of the population density test.*
- *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 will have 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 must be based on the most economical form of transport and the shortest route between the place of production or processing and commercial outlets.*
- *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.).*
- *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 1a of Annex XV to the EEA Agreement.*[37]
- *Agricultural products within the scope of Annex II to the EC Treaty, and falling within the scope of the EEA Agreement are not covered by this measure.*[38]
- *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*[39].

The Authority has examined the information supplied by Norway on the level of indirect compensation for additional transport costs obtained by the system of lower tax rates in zones 2-5, and has come to the following conclusions:

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

[38] The corresponding condition in the Commission Notice referred to in footnote 1 reads as follows: "les produits agricoles relevant de l'Annexe II du Traité CE, autres que les produits de la pêche, ne sont pas couverts par les present dispositions". The different condition in the present State Aid Guidelines is due to the fact that the EFTA Surveillance Authority lacks competence in respect of State aid in the fisheries sector.

[39] This provision refers to the last paragraph of point 2.6. text of Commission notice of 1 June 1994 on *Changes to the method for application of Article 92(3)(c) of the EC Treaty to regional aid*, OJ No C 364 of 20 December 1994.

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 the additional transport costs of individual firms reflect 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 i.a 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 pay-roll 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. Furthermore, contract-dependent cost disadvantages in tax zones 2-5 have been taken into account only to a limited extent.

The Authority has considered the existence of compensation schemes for coastal transport (Aid no 93-383 'Aid for coastal transport' (Hurtigruten)) and regional aviation (Aid no 93-173 Aid to regional air transportation network (Short take-off and landing network)). Compensation measures also exist in favour of ferries which constitute part of the road transport infrastructure in coastal regions. The information available to the Authority does not indicate that the Norwegian schemes of assistance to transport, which may be covered by Articles 49 and 51 EEA, 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, with reference to possible effects the schemes referred to above might have i.a. on transport prices, to adjust the estimates of additional transport costs.

Against this background, the Authority accepts that the data presented by Norway, part of which are reproduced in table 8, show that manufacturing enterprises located in tax zones 2-5 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, the lower tax rates are not considered by the

Authority to be targeted at the promotion of exporting enterprises. Accordingly, it has concluded that the lower tax rates of zones 2-5 do not constitute export aid[40] .

The estimates presented by the Authority's consultant show that the aid is objectively quantifiable in advance. A set of indicators reflecting aid-per-kilometre or an aid-per-kilometre and an aid-per-unit-weight ratio must be included in the annual reporting obligations for the scheme introduced by this decision. Such indicators may be construed on the basis of i.a. the information on additional transport costs the Norwegian authorities have presented to the Authority.

As concerns the transport costs of the individual enterprises covered by the study referred to above, it follows from the fact that the enterprises were obliged to cover transport costs out of their own means, that they therefore had economic incentives to minimize their transport costs by choosing the shortest routes and the most economical forms of transport.

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 to adjust the level of indirect compensation for the additional costs of transport in zones 2-5. A general reduction in the present level of indirect compensation for additional transport costs is therefore not proposed by the Authority.

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, or introducing new measures which would imply an increase in the level of compensation for additional transport costs.

4.2. Conditions related to certain sectors

4.2.1. Industries covered by specific sectoral rules

The following industrial sectors are currently subject to specific sectoral rules on State aid; shipbuilding, ECSC steel industry, non-ECSC steel industry, textiles industry, synthetic fibres industry and motor vehicle industry.

While the rules referred to in the above paragraph remain applicable and unaffected by the present decision, consultation has taken place between the Authority and the Norwegian authorities to clarify the precise scope of these rules and their relevance given the present industrial structure in Norway. To this end the Authority has, at the request of the Norwegian authorities, conveyed the following understanding:

[40] '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 footnote 2, page 37 ,paragraph 12.1.(5) of the State Aid Guidelines on the *de minimis* rule and its application.

When evaluating for the present purposes whether the above mentioned sectoral rules apply for regional transport aid, the relevant facts to consider are a given firm's *actual* volume of production falling within the definition of a sensitive sector, and not the firm's *potential capacity* due to its equipment or plants.

According to the act referred to in point 1b of Annex XV to the EEA Agreement (Council Directive No. 90/684/EEC), operating aid may be authorized for the shipbuilding sector, provided it does not exceed a common maximum ceiling for such aid as laid down by the EFTA Surveillance Authority. Aid to shipbuilding and conversions in the form of lower social security contributions are possible only to the extent that aid provided to the sector under other aid schemes is lower than the ceiling. No operating aid can be allowed for ship repairs covered by the Directive.

According to the act referred to in point 1a of Annex XV to the EEA Agreement (Commission Decision No 3855/91/ECSC[41]) on aid to the ECSC steel industry, no operating aid is allowed except aid for closures.

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 (ø > 406.4 mm).

As regards the textile industry no special notification requirements apply.

Aid to the synthetic fibres 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 license or patents of a vehicle manufacturer. The fact that the design has been specified by the buyer, and that the producer is not allowed to sell parts with the given design to other motor vehicle manufacturers, does not, in itself, entail that such production is covered by the sectoral rules of the motor vehicle industry.

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* rule 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.

[41] Commission Decision No 3855/91/ECSC expired at the end of 1996. By Commission Decision No 2496/96/ECSC, new Community rules for State aid to the ECSC steel industry have been established. In view of Article 5 of Protocol 14 to the EEA Agreement, it can be expected that the EEA Joint Committee will in due course adopt a corresponding act to apply in the context of the EEA Agreement.

The above understanding implies that the following adjustments are required for the current system of regionally differentiated social security tax in Norway:

- As the presently applicable schemes in Norway for aid to the shipbuilding sector make full use of the admissible level of operating aid to the industry, enterprises covered by the act referred to in point 1b of Annex XV to the EEA Agreement (Council Directive 90/684/EEC on aid to shipbuilding) must be subject to the tax rate applied in zone 1, irrespective of their location.
- Producers of ECSC steel products, of which there is currently only one according to information from the Norwegian authorities, must be subject to the tax rate applied in zone 1, irrespective of their location.
- According to information submitted by the Norwegian authorities, there appear at present to be no enterprises engaged in 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 synthetic fibres 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 an acceptable means of implementing in the present context the special notification requirements in these sectors, that the Norwegian authorities must commit themselves to notify the Authority of all existing and any future recipients falling within the scope of the above rules benefiting from the lower tax rates under consideration. Furthermore such notifications must be followed up by annual reports which i.a. contain, as a separate item, the estimated amounts of indirect compensation for additional transport costs in the form of lower social security contributions foreseen and/or any direct transport aid received.

4.2.2 Enterprises with no alternative location

The rules on regional transport aid foresee according to the sixth bullet of section 28.2.3.2.(2) of the State Aid Guidelines, 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.).*"

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

The rule referred to above, excluding aid toward the transport or transmission of products of enterprises without an alternative location, is not to be considered in isolation. When examining whether certain sectors should be excluded from the scheme in order to comply with the rules on regional transport aid, the Authority has taken account of whether other necessary conditions are met.

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It is therefore necessary to examine whether there are arguments which would provide a compensatory justification for the aid, i.e. ensuring that the aid facilitates the development of certain economic activities or of certain areas, in the meaning of Article 61(3)(c) of the EEA Agreement.

Activities related to the "the products of enterprises without an alternative location" falling into the following groups of economic activities; i) Production and distribution of electricity, ii) Activities related to the extraction of petroleum and natural gas and iii) Mining and quarrying, are considered below.

Production and distribution of electricity

It follows from the wording of the State Aid Guidelines section 28.2.3.2. that "*No aid may be given towards the .... transmission 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 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 considered that the whole sector (NACE 40.1 Production and distribution of electricity) must be subject to the tax rate applied in zone 1 for all employees.

Activities related to the extraction of petroleum and gas

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, cf. "*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 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) be subject to the tax rate applied in zone 1 for all employees.

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 of many veins and large reserves. There are therefore circumstances where an enterprise engaged in the extraction of certain natural resources is, in principle, free in its choice of location because its 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 considers therefore that enterprises engaged in the mining of metal ores (NACE 13) and/or in activities related to the extraction of the industrial minerals nefeline syenite (HS 2529.3000) and olivine (HS 2517.49100), should as a general rule be subject to the full rate of tax zone 1 for all employees.

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

The Authority has found with reference i.a. to the geological information provided by the Norwegian authorities and the arguments referred to above on the extraction of minerals based on relatively abundant resources, that it is <u>not</u> required for industrial minerals other than nefeline syenite and olivine to be subject to the highest tax rate of tax zone 1. The Authority has on this point taken into account that the activities in question often have a local nature, that there is a significant incidence of relatively small enterprises and the fact, 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. Quarrying of stone and gravel and aggregates are based on the extraction of abundant mineral resources. Such activities are therefore not considered to be geographically bound.

5. 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 2-5 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 assessment of compatibility of the measures under consideration i.a. vis-à-vis the service sectors.

The Authority has therefore, at its discretion, applied a broader perspective with regard 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 sectors 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[42], while the average transport costs for the retail and wholesale sector as a whole have been estimated at 33 % of value added[43].

The Authority accepts that the very low population densities observed for the areas covered by tax zones 2-5 and the geographical and topographical circumstances of the regions in question give rise to additional costs also for the service sectors and other non-manufacturing activities. The Authority has i.a. observed that the whole of tax zone 5 and the greatest part of tax zone 4 which enjoy the most gracious benefits in the form of tax reductions are located north of the Arctic circle. 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 communication. 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 accepts the fact that the lower social charges in tax zones 2-5 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[44].

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 non-existent and, on the other hand, their potential in terms of job creation is great[45]. The Authority is thus normally able to adopt a positive stance on such measures. Some of them do not fall within the scope of Article 61(1) of the Agreement because the activities of the recipients, often very small firms, are not the subject of trade between EEA States. This is particularly true for local services. Others are growth niche markets or sub-sectors that hold out the prospect of job

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42 TØI Prosjekt O-1238 Næringslivets transportkostnader for rør- og sanitær grossister (Hagen)

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

44 OJ No C 265 12.10. 1995, p. 3. 3rd 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, revitalization 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.”

45 See, for example the “OECD Study on Employment - Taxation, employment and unemployment”, OECD 1995.

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, ref. table 5. The Authority has noted the European Commission's interpretation of Article 92(3)(c) EC in its draft 'Guidelines on State aid for undertakings in deprived urban areas'[46] and in its 'Notice on monitoring of State aid and reduction of labour costs'[47]. The lower tax rates are against this background found to apply to activities[48] which contribute to higher levels of employment in tax zones 2-5.

The very low population densities observed for most of the area covered by tax zones 2-5 as indicated by table 2, and the pattern of settlement as indicated by table 3, 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 service enterprises in tax zones 2-5 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 revised *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, below which Article 61(1) EEA could be considered inapplicable in view of the lack of noticeable effects on trade between the Contracting Parties, at ECU 100 000 per firm over a period of 3 years.

Against this background, the Authority has found that the lower tax rates are justified as aid for regional development on the basis of Article 61(3)(c), as concerns service activities and non-manufacturing activities <u>not</u> explicitly referred to in the following, as long as the lower tax rates are limited to an area which the Authority can approve for regional transport aid.

The Authority has found, however, that the disadvantages which may justify the lower tax rates in certain regions qualifying for regional transport aid and the positive effects on employment, do not outweigh the effects on competition and trade for parts of the following service activities, namely, financial services, transport and telecommunications.

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[46] Not yet published.
[47] Adopted by the European Commission on 18 June 1996
[48] See OJ No C 265 12.10. 1995, p. 3, 3rd paragraph

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 2-5 may in fact have a significant part of their activities taking place outside areas experiencing the permanent disadvantages, which may justify the provision of regional transport aid. The Authority considers therefore that enterprises with more than 50 employees engaged in activities classified as Freight transport by road (NACE 60.24) must be subject to the tax rate applied in zone 1, for all employees.

The Authority further considers that enterprises in the telecommunications sector (NACE 60.20) 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), must be subject to the tax rate applied in zone 1. The reasons for the Authority's proposal 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 latest information technology implies that the service activities referred to above may only to a very limited extent be considered to be permanently hampered by long distances and harsh weather conditions. The Authority can, however, accept that branch offices in tax zones 2-5 e.g. in banking, may be exempted from paying the tax rate in zone 1 provided that the branch offices in question are only providing local services.

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

As pointed out and shown in table 7, 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 2-5, 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 activity.

In sectors where the Authority has found that the tax rate of zone 1 should apply to every employee in all cases, like the petroleum sector, the residence of the employee would be of no significance.

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

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.

7. Cumulation of aid

Certain counties covered wholly or partly by tax zones 2-5 operate direct transport aid schemes[49]. 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 Authority therefore considers that the Norwegian authorities must introduce specific rules, to ensure that possible over-compensation due to the cumulation of regional transport aid from different sources will not occur. A satisfactory way of ensuring that overcompensation does not take place, would be to require that an enterprise's estimated benefits related to lower social security contributions in a given year are subtracted from the the maximum compensation level applicable to schemes providing direct transport aid. Such a rule would imply that a given enterprise would not be eligible for direct transport aid, if the estimated benefits related to the lower social security contribution rates exceed the maximum level of compensation for documented transport costs otherwise foreseen when direct transport aid is awarded.

The Authority will, concerning direct transport aid schemes, not be prepared to accept that direct grants compensating for documented costs of transport exceed 45 % of an enterprise's combined costs related to inward and outward transport of goods.

8. 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 to ensure that all existing systems of State Aid in the EFTA States are subject to constant review as to their compatibility with Article 61.

The Authority considers with reference to the exceptional nature of the lower tax rates under consideration, and the volume of aid involved, that submission of detailed annual reports in accordance with the format indicated in Annex III of the State Aid Guidelines is required for the system of lower social security contribution rates in tax zones 2-5. The annual reports must, as foreseen in Chapter 32 of the State Aid Guidelines, cover two financial years. The first report on the measures under consideration should be sent to the Authority not later than 1 July 1998. Subsequent annual reports for an amended system of lower social security contribution rates where the appropriate measures proposed by the Authority have been taken into account must be submitted not later than sixth months after the end of the reporting year.

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. The Authority considers that annually updated information showing the

[49] At present 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).

operation of the ratios referred to above, should be an integral part of the detailed annual report.

The annual reports must also 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 fibres industry and non-ECSC steel industry).

Finally, a full review of the scheme must take place with regular intervals. The review periods should normally not exceed four years and the re-examinations should be carried out in connection with the general reviews of the maps of areas eligible for regional investment aid and regional transport aid.

HAS ADOPTED THIS DECISION:

The EFTA Surveillance Authority proposes to Norway, on the basis of Article 1(1) of Protocol 3 to the Surveillance and Court Agreement, the following appropriate measures with regard to the State aid involved in the system of regionally differentiated rates of employers' social security contributions in order to consider the scheme as regional aid compatible with Article 61(3)(c) of the EEA Agreement:

i) The Norwegian Government must submit a detailed proposal for a general map of assisted areas by 15 October 1997. The proposal must indicate the areas to be designated for regional transport aid and regional investment aid, respectively.

ii) As concerns economic activities <u>not</u> referred to in point iii) below the Norwegian Government shall take the necessary measures to ensure that the application of the system of lower social security contribution rates, such as the one presently applied in tax zones 2-5, is confined to an area that is authorized for regional transport aid.

iii) The Norwegian Government shall, in addition, take the necessary steps to effect adjustment of the relevant provisions of the tax legislation on the employers' social security contributions in such a manner as to :

a) Ensure that the following activities are subject to the tax rate applied in tax zone 1 for all employees:
- Production and distribution of electricity (NACE 40.1)
- Extraction of crude petroleum and gas (NACE 11.10)
- Service activities incidental to oil and gas extraction excluding surveying (NACE 11.20)
-mining of metal ores (NACE 13),
-activities related to the extraction of the industrial minerals nefeline syenite (HS 2529.3000) and olivine (HS 2517.49100)

b) Ensure that enterprises with more than 50 employees engaged in freight transport by road (NACE 60.24) are subject to the tax rate applied in tax zone 1 for all employees.

c) Ensure that enterprises in the telecommunications (NACE 60.20) sector are subject to the tax rate applied in tax zone 1 for all employees.

d) Ensure that enterprises having branch offices established abroad or otherwise being engaged in cross-border activities in the following sectors, with the exception of branch offices only providing local services, are subject to the tax rate applied in tax zone 1 for all employees:
- Financial intermediation (NACE 65),
- Insurance and pension funding (NACE 66) and
- Services auxiliary to financial intermediation (NACE 67)

e) Ensure that the discipline on aid to industries covered by specific sectoral rules is respected by
- applying the tax rate in zone 1 to all employees of producers of ECSC steel,
- applying the tax rate of zone 1 to all employees of enterprises covered by the act referred to in point 1b of Annex XV to the EEA Agreement (Council Directive 90/684/EEC on aid to shipbuilding) and
- implementing, in the present context, the special notification requirements in the specific rules on State aid to the motor vehicle industry, the synthetic fibres industry and the non-ECSC steel industry by notifying the Authority of all existing and future recipients benefiting from lower social security contribution rates.

(iv) Detailed annual reports must be submitted on the system of regionally differentiated rates of employers’ social security contributions in accordance with the format indicated in Annex III of the State Aid Guidelines. The annual reports must show the operation of an aid-per-kilometre ratio or of an aid-per-kilometre and an aid-per-unit-weight ratio. The reports must contain as separate items, the estimated amounts of indirect compensation for additional transport costs in the form of lower social security contributions foreseen and of any direct transport aid received by enterprises in the sectors covered by special notification requirements (motor vehicle industry, synthetic fibres industry and non-ECSC steel industry). The annual reports must, as foreseen in Chapter 32 of the State Aid Guidelines, cover two financial years and be submitted to the Authority not later than six months after the end of the financial year, starting with the annual report for 1997.

(v) The system of lower social security contributions must be re-examined periodically. The review periods should normally not exceed four years and be carried out in connection with the general reviews of the maps of areas eligible for regional investment aid and regional transport aid.

(vi) The Norwegian Government shall signify its agreement to the above proposal, or otherwise submit its observations within two months from the receipt of this decision.

(vii) The Norwegian authorities shall inform the EFTA Surveillance Authority in due time and in any case not later than 15 October 1997 of the measures to be taken to adapt the system of regionally differentiated lower social security contribution rates to fulfil the adaptations proposed in points (i)-(iv) above .

(viii) The measures to be undertaken to fulfil the proposed adaptations to the system of regionally differentiated social security contribution rates stated in points (i)-(iv) above, shall enter into force not later than 1 January 1998.

Done at Brussels, 14 May 1997

For the EFTA Surveillance Authority

Knut Almestad
President

Bernd Hammermann
College Member

Annex 1

Overview of municipalities covered by tax zones 2-5

County	zone	Area enjoying lower tax rates
Finnmark	5	All municipalities
Troms	5	Kåfjord, Skjervøy, Nordreisa, Kvænagen, Karlsøy, Lyngen, Storfjord
	4	Tromsø, Harstad, Kvæfjord, Skånland, Bjarkøy, Ibestad, Gratangen, Lavangen, Bardu, Salangen, Målselv, Sørreisa, Dyrøy, Tranøy, Torsken, Berg, Lenvik, Balsfjord
Nordland	4	All municipalities
Nord-Trøndelag	4	Namsos, Namdalseid, Lierne, Røyrvik, Namsskogan, Grong, Høylandet, Overhalla, Fosnes, Flatanger, Vikna, Nærøy, Leka,
	2	Meråker, Verran, Snåsa, Frosta, Leksvik, Mosvik
Sør-Trøndelag	3	Hitra, Frøya, Åfjord, Roan, Osen
	2	Oppdal, Rennebu, Meldal, Røros, Holtålen, Tydal, Hemne, Snillfjord, Midtre Gauldal, Selbu, Ørland, Agdenes, Rissa, Bjugn,
Møre og Romsdal	3	Smøla
	2	Surnadal, Rindal, Aure, Halsa, Tustna, Gjemnes, Tingvoll, Sunndal, Norddal, Stranda, Rauma, Nesset, Stordal, Midsund, Sandøy, Eide, Vanylven, Sande, Herøy, Volda, Ørsta, Haram, Aukra
Hedmark	2	Trysil, Åmot, Stor-Elvdal, Rendalen, Engerdal, Tolga, Tynset, Alvdal, Folldal, Os, Grue, Åsnes, Våler, Eidskog, Nord-Odal
Oppland	2	Dovre, Lesja, Skjåk, Lom, Vågå, Sel, Søndre Land, Nordre Land, Sør-Aurdal, Etnedal, Nord-Aurdal, Vestre Slidre, Øystre Slidre, Vang, Nord-Fron, Sør-Fron, Ringebu, Gausdal
Telemark	2	Notodden, Nome, Hjartdal, Drangedal, Seljord, Kviteseid, Nissedal, Fyresdal, Tokke, Tinn, Vinje
Buskerud	2	Flå, Nes, Gol, Hemsedal, Ål, Hol, Rollag, Nore og Uvdal
Aust-Agder	2	Gjerstad, Vegårshei, Åmli, Evje og Hornnes, Bygland, Valle, Bykle, Iveland
Vest-Agder	2	Åseral, Audnedal, Hægebostad, Sirdal
Rogaland	2	Utsira, Hjelmeland, Suldal, Sauda, Kvitsøy, Forsand, Finnøy, Bokn, Vindafjord
Hordaland	2	Fedje, Masfjorden, Jondal, Odda, Ullensvang, Eidfjord, Ulvik, Granvin, Kvam, Modalen, Etne, Bømlo, Tysnes, Kvinnherad, Fusa, Samnanger, Austevoll, Vaksdal, Osterøy, Meland, Radøy, Lindås, Austrheim, Ølen
Sogn og Fjordane	2	All municipalities

Municipalities eligible for regional investment aid, but not enjoying lower tax rates
Population: 57 000 (1.31 %): Sigdal, Bø, Sauherad, Voss, Kristiansund, Averøy, Frei

Municipalities enjoying lower tax rates but not regional investment aid
Population: 122 000 (2.81 % of total population)
Herøy, Volda, Ørsta, Haram, Aukra, Frosta, Bømlo, Tysnes, Kvinnherad, Fusa, Samnanger, Austevoll, Vaksdal, Osterøy, Meland, Radøy, Lindås, Austrheim, Forsand, Finnøy, Bokn, Vindafjord, Eidskog, Nord-Odal, Midtre Gauldal, Selbu, Ølen, Iveland

Annex 2

Method for assessment - Area eligible 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 (inh/km^2).

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 proposed.

1) If that NUTS III region qualifies as a whole, then the proposed part qualifies if its population density is less than 12.5 inh/km^2. 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) above, 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 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.