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Dec. No.: 218/03/COL

EFTA SURVEILLANCE AUTHORITY DECISION

OF 12 NOVEMBER 2003

WITH REGARD TO STATE AID IN THE FORM OF REGIONALLY  
DIFFERENTIATED SOCIAL SECURITY CONTRIBUTIONS

(NORWAY)

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area<sup>1</sup>, in particular to Articles 61 to 63 and Protocol 26 thereof,

HAVING REGARD TO the Agreement between the EFTA States on the establishment of a Surveillance Authority and a Court of Justice<sup>2</sup>, in particular to Article 24 and Protocol 3 thereof,

HAVING REGARD TO the Authority's Guidelines<sup>3</sup> on the application and interpretation of Articles 61 and 62 of the EEA Agreement,

HAVING REGARD TO the Authority's decision to propose appropriate measures to Norway<sup>4</sup>,

HAVING REGARD TO the EEA Joint Committee Decision No 88/2002 of 25 June 2002<sup>5</sup> incorporating into Annex XV to the EEA Agreement Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid<sup>6</sup>,

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<sup>1</sup> Hereinafter referred to as the EEA Agreement.

<sup>2</sup> Hereinafter referred to as the Surveillance and Court Agreement.

<sup>3</sup> Procedural and Substantive Rules in the Field of State Aid (State Aid Guidelines), adopted and issued by the EFTA Surveillance Authority on 19 January 1994. Published in Official Journal L 231, 03.09.1994. The Guidelines were last amended 5 November 2003 (not yet published).

<sup>4</sup> Decision No 172/02/COL. OJ C 52, 06.03.2003, p.16, and EEA Supplement No 13, 16.03.2003, p.1.

<sup>5</sup> OJ L 266, 03.10.02, p. 56, and EEA Supplement No 49, 03.10.02, p. 42.

<sup>6</sup> OJ L 10, 13.01.01, p.30.

HAVING CALLED ON interested parties to submit their comments pursuant to the provisions cited above<sup>7</sup>,

WHEREAS the Norwegian authorities by letter dated 26 March 2003 notified to the Authority a three-year transitional period for the regionally differentiated social security contributions as well as a new direct transport aid scheme,

WHEREAS the present decision only concerns the notification of a three-year transitional period for the regionally differentiated social security contributions, and not the notification of a new direct transport aid scheme,

WHEREAS:

## I. FACTS

### 1. Introduction

By letter from the Mission of Norway to the European Union dated 26 March 2003 (Doc. No:03-1846 A), forwarding a letter from the Ministry of Trade and Industry dated 25 March 2003, a letter from the Ministry of Finance dated 25 March 2003 and a letter from the Ministry of Local Government and Regional Development, all received and registered by the Authority on 26 March 2003, the Norwegian authorities notified a three year transitional period, from 2004 to 2007, for the regionally differentiated social security contributions by employers in certain geographical areas (tax zones 3 and 4) and a new national direct transport aid scheme. The Norwegian authorities also described the introduction of a *de minimis* scheme to be applied in relation to employers' social security contributions.

By letter from the Mission of Norway to the European Union dated 15 April 2003 (Doc. No:03-2467 A), forwarding a letter from the Ministry of Trade and Industry dated 10 April 2003 and a letter from the Ministry of Finance dated 10 April 2003, all received and registered by the Authority on 16 April 2003, the Norwegian authorities notified a continuation of regionally differentiated social security contributions in Nord-Troms and Finnmark (zone 5).

By letter dated 16 May 2003 (Doc. No:03-2951 D), the Authority acknowledged the receipt of the above letters and requested additional information.

By letter from the Mission of Norway to the European Union dated 10 June 2003 (Doc. No:03-3707 A), forwarding a letter from the Ministry of Finance dated 5 June 2003, both received and registered by the Authority on 11 June 2003, the Norwegian authorities submitted additional information.

By letter from the Norwegian Ambassador to the European Union dated 4 July 2003 (Doc. No:03-4403 A), the notification concerning zone 5 was withdrawn, as the EFTA States, by common accord in the Standing Committee of the EFTA States on 1 July 2003 (No 2/2003/SC), and by reference to Article 1(2) of Protocol 3 to the Surveillance and Court Agreement, decided that the present scheme in zone 5 was

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<sup>7</sup> Decision No 141/03/COL of 16 July 2003. OJ C 216, 11.09.2003, p.3, and EEA Supplement No 45, 11.09.2003, p.1.

compatible with the EEA Agreement due to the exceptional circumstances in this zone.

By letter dated 16 July 2003 (Doc. No: 03-4598 D), the Authority informed the Norwegian authorities of its decision to initiate the procedure laid down in Article 1(2) in Part I of Protocol 3 to the Surveillance and Court Agreement, with regard to State aid in the form of regionally differentiated social security contributions and direct transport aid (hereinafter “the decision to open an investigation”).

The decision to open an investigation was published in the Official Journal of the European Union<sup>8</sup>. The Authority invited interested parties to present comments on the aid scheme concerned.

The official response of the Norwegian authorities to the decision to open an investigation, was received by fax from the Ministry of Trade and Industry dated 17 September 2003, forwarding a letter from the Ministry of Finance dated 17 September 2003 (Doc. No: 03-6381 A). The letter from the Ministry of Finance dated 17 September 2003 was also forwarded by letter from the Mission of Norway dated 18 September 2003, received and registered by the Authority on 19 September 2003 (Doc. No: 03-6451 A).

The Authority received comments from ten interested parties.

By letters dated 16 October 2003 (Doc. No: 03-7071 D) and 17 October 2003 (Doc. No: 03-7135), respectively, the Authority submitted the comments from third parties to the Norwegian authorities.

By fax dated 21 October 2003, the Ministry of Trade and Industry forwarded a reply dated 21 October 2003 from the Ministry of Finance (Doc. No: 03-7243 A) concerning the comments from third parties. By letter from the Mission of Norway dated 23 October 2003, received and registered by the Authority on 24 October 2003 (Doc. No: 03-7360 A), the letter from the Ministry of Finance was also forwarded to the Authority.

## 2. Background

On 22 September 1999 the Authority approved a proposal from the Norwegian authorities, concerning new regulations in the regionally differentiated social security contributions scheme<sup>9</sup>. The approval was limited in time, not going beyond 31 December 2003.

On 21 December 2000 the European Commission took a negative decision concerning a reduced social contributions aid scheme notified by Sweden<sup>10</sup>. The Commission pointed out that the amount of aid granted under the scheme to an eligible undertaking, did not bear any relation to the additional transport costs actually incurred by that particular undertaking, and that it could not be excluded that there was overcompensation of the additional transport costs, at least in some cases. In the

<sup>8</sup> Decision No 141/03/COL of 16 July 2003. OJ C 216, 11.09.2003, p.3, and EEA Supplement No 45, 11.09.2003, p.1.

<sup>9</sup> Decision No 228/99/COL. OJ C 3, 06.01.2000, p.3, and EEA Supplement No 1, 06.01.2000.

<sup>10</sup> OJ L 244, 14.09.2001, p.32.

decision, it is also pointed out that Norway, by letter dated 27 July 2000, submitted comments to the decision to initiate the procedure, and that the Norwegian authorities confirmed that Norway operates a scheme that is similar to the Swedish scheme.

In the light of the Swedish decision, the Norwegian system was thereafter discussed at several meetings between the Norwegian authorities and the Authority, as well as between the Authority and the services of the European Commission.

By letter from the Authority dated 29 November 2001 (Doc. No: 01-9557 D), the Norwegian authorities were *i.a.* informed that the Authority would start an assessment of the Norwegian system, aimed at formulating a proposal for appropriate measures so that equal conditions of competition within the territory covered by the EEA Agreement were to be re-established.

The Authority initiated a formal review of the Norwegian system by letter to the Norwegian authorities dated 4 June 2002 (Doc. No: 02-4189 D). In this letter the Authority expressed its preliminary view that the Norwegian system of regionally differentiated social security contributions might no longer be compatible with the EEA Agreement.

In the Authority's decision of 25 September 2002<sup>11</sup> to propose appropriate measures, it was concluded that the present regionally differentiated social security contributions scheme did not qualify for the derogation provided for under Article 61(3)(c) EEA. The amount of aid granted under the present scheme does not bear any relation to the additional transport costs actually incurred by a particular undertaking and is not calculated in line with the provisions of Annex XI of the State Aid Guidelines. In the operative part of the Decision it is *i.a.* stated:

1. *“ 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 social security tax (“Geografisk differensiert arbeidsgiveravgift”):*
  - a) *The Norwegian authorities shall take any legislative, administrative and other measures necessary to eliminate any State aid within the meaning of Article 61(1) EEA resulting from the system of regionally differentiated social security tax, or to render such aid compatible with Article 61 of the EEA Agreement,*
  - b) *The Norwegian authorities shall eliminate any such aid or render it compatible with effect from 1.1.2004 unless the Authority agrees to a later date should that be considered objectively necessary and justified by the Authority in order to allow an appropriate transition for the undertakings in question to the adjusted situation; and*
  - c) *The Norwegian authorities shall communicate to the Authority the relevant measures adjusting the aid scheme as soon as possible and in any event no later than 25 March 2003.*
2. *The Norwegian authorities are requested to inform the Authority in writing within one month from receipt of this proposal that they accept, pursuant to Article 1(1)*

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<sup>11</sup> Decision No 172/02/COL.

*of Protocol 3 to the Surveillance and Court Agreement, in its entirety this proposal for appropriate measures.”*

By letter dated 29 October 2002 from the Mission of Norway to the European Union, received and registered by the Authority on 31 October 2002 (Doc. No: 02-7855 A), the Norwegian authorities accepted the appropriate measures.

### 3. Description of the notified aid

#### 3.1 Object and form of the aid

The current social security contributions by employers in Norway are differentiated according to geographical zones. The objective of the geographical differentiation is to stimulate the less favoured regions. The current rates, *i.e.* the rates for 2003, are described in Table 1 below. Table 1 also contains the population coverage and the population density for each of the zones.

Table 1

	Zone 1	Zone 2	Zone 3	Zone 4	Zone 5
Social security contribution rates (percentage)	14,1	10,6	6,4	5,1	0
Percentage of total population	76,6	9,4	2,6	9,4	2,0
Population density (inhabitants per square kilometre)	64,0	4,9	2,8	6,4	1,7

Zone 1 covers the most central and southern parts of the country. Zone 5 covers the very northernmost part of the country. Zones 3 and 4, for which a transition period has been notified, cover municipalities in the counties of Hedmark, Oppland, Sør-Trøndelag, Nord-Trøndelag, Nordland and Troms. Population density in zones 3 and 4 are 2.8 and 6.4 inhabitants per square kilometre, respectively. A detailed overview of the geographical zones is given in Annex 1 to this decision.

The social security contribution is levied on salaries and other remuneration for work. This includes salaries and wages and other remuneration for work or commission (except when performed by self-employed persons), directors' fees, etc., benefits in kind and profits derived from the repayment of expenses and social benefits replacing salaries, etc. Benefits in kind and expenses covered by the employer are, however, only included to the extent they are subject to tax withholding by the employer. Also included are the employers' contributions to pension schemes and certain pension payments. The employers' contributions are levied on gross remuneration. Contributions are related to the municipality of residence of each employee and not the location of the enterprise.

By letter dated 25 March 2003 from the Ministry of Finance, the Norwegian authorities notified a transitional arrangement for zones 3 and 4 for the three-year

period 2004-2007, and presented the following table concerning the escalation of the social security contributions rates<sup>12</sup>:

Table 2

	Current rates	Rates 2004	Rates 2005	Rates 2006	Rates 2007
Zone 1	14,1	14,1	14,1	14,1	14,1
Zone 2	10,6	14,1	14,1	14,1	14,1
Zone 3	6,4	8,3	10,2	12,1	14,1
Zone 4	5,1	7,3	9,5	11,7	14,1

No transition period is therefore notified for zone 2.

For employees aged 62 or more, social security contributions are proposed reduced by four percentage points, compared to the otherwise applicable rates, as presented in table 2 above.

According to the Norwegian authorities, the main reason for proposing a transitional period is that an abolishment of differentiation as from 2004, would raise significant and very serious difficulties, not only for individual firms, but for all firms in zones 3 and 4 (where aid would exceed the *de minimis* threshold) and thus, for the employment situation in the whole area. It is estimated that, if the current system had been prolonged from 2004, the total gross tax relief to the private sector in zones 3 and 4, would be NOK 3030 million (some EUR 370 million). Based on a report by a committee of independent experts ("Effektutvalget"), the Norwegian authorities present *i.a.* various calculations of possible macroeconomic effects of abolishing the regional differentiation of the tax. Provided that there are no incidence effects on wages and product prices, the estimates indicate an employment reduction in the private sector of 15.400 persons in zone 4 and 2.900 persons in zone 3, as a direct effect of the increase in total wage costs. This would represent an isolated reduction of employment in the private sector in these regions of 15,5 per cent (13,8 per cent in zone 3, 15,8 per cent in zone 4). The corresponding reduction in total employment in these regions would be 7,5 per cent in zone 3 and 8,5 per cent in zone 4. The Norwegian authorities also point out that firms have relied on the differentiated system since its establishment in 1975, when deciding their location and investment.

The Norwegian authorities furthermore argue that it is reasonable to believe that a regional increase in the social security contributions will, in the short run, only to a very limited extent be shifted through increased product prices or reduced wage costs, because of the delay in adjusting the economic activity to the new situation. This is supported by the fact that the Norwegian system of wage formation is characterised by a relatively high degree of centralised, collective bargaining, which implies that the wage level will not be adjusted immediately to the increased employer social security contributions. It is argued that parts of the increase in costs will be shifted to wage earners and consumers, but that this will only happen in the long run. In this respect, reference is made to various economic studies.

<sup>12</sup> The Standing Committee of the EFTA States decided on 1 July 2003 (No 2/2003/SC) that the present scheme in zone 5 is compatible with the functioning of the EEA Agreement due to the exceptional circumstances in this zone (see point 1 above).



It is also highlighted that profit margins in zones 3 and 4 are low compared to zone 1 and also zone 2. This information is based on companies' annual reports submitted to the official Company Register and calculated by Statistics Norway.

Secondly, the Norwegian authorities are of the opinion that they received “*no clear signals*” until late autumn 2002 that the system, as such, had to be abolished. The Norwegian authorities state that they did not find it professionally, or politically advisable to request the undertakings to adapt to a situation with no differentiation (beyond *de minimis*), before they saw the contours of a new system. In this respect the Norwegian authorities refer to informal discussions that took place in the wake of the European Commission’s decision on the Swedish system of reduced social security contributions.

By letter dated 16 May 2003, the Authority noted that the notified transition period is three years for zones 3 and 4, and therefore that the relative increases per year are higher in zone 4 than in zone 3. The Authority therefore stated that it would appreciate receiving arguments for why enterprises in zone 3 would need the same transition period as those in zone 4, in spite of facing a smaller increase in the tax burden. The Authority also indicated that it would appreciate receiving additional comments or calculations demonstrating the effects of transition periods of one and two years, respectively, for each of the zones, and compared to the notified three-year period.

By letter dated 5 June 2003, the Ministry of Finance submitted additional comments. The Ministry stated that without a transitional period, the increase in the social security tax corresponded to an immediate increase in the firms’ labour costs of 8.6 and 7.2 per cent in zones 4 and 3, respectively (as soon as the *de minimis* threshold is reached). Assuming general wage increases as forecast by the authorities, no transition period would imply an increase in labour costs for enterprises in zones 3 and 4 in 2004 almost three times higher than the normally expected increase in such costs (*de minimis* effect not taken into consideration). It was maintained that, due to documented rigidities in nominal wages, a possible regional wage response to a significant reduction in firms' profitability can safely be considered very limited in the short run. It was pointed out that without any transition period, a full carry-over of the higher wage costs would imply a significant reduction in nominal wages which is considered to be unrealistic. In relation to the low profitability margins in zones 3 and 4, it was observed that a full tax increase would have constituted a significant part of current operating profits. A transitional period of three years would, according to the Ministry, allow for a higher degree of wage adjustment to take place before the full rate is applied, postpone the rise in costs to firms and reduce the number of closures and jobs lost as a consequence of the increase in the tax rate. As to why enterprises in zone 3 need the same transitional period as enterprises in zone 4, the Ministry stated that three years is a very short period in both zones, that the relative differences in the increases between the zones are very small and that it would be unfortunate with a differentiation in the transitional period.

### **3.2 Eligible sectors/ activities**

The notified aid applies to all undertakings having employees resident in zones 3 and 4, with two main exceptions. The first exception is undertakings falling outside the

scope of the EEA Agreement, while the other exception is undertakings in certain sectors where the full rate applies irrespective of location.

Employers' contributions for employees in the central government administration are also subject to 14.1 per cent tax, irrespective of where the employee is living. Salaries more than 16 times the basic amount of the National Insurance Scheme are subject to an additional contribution of 12.5 per cent on the excess amount. This additional contribution applies irrespective of where the employee lives or type of business.

- **Sectors falling outside the scope of the State aid provisions of the EEA Agreement**

The major part of the primary industries (agriculture/forestry and fisheries sectors) falls outside the scope of the EEA Agreement or outside the scope of the Authority's competence to review State aid, cf. Article 8(3) and Protocols 3 and 9 to the EEA Agreement. The Norwegian Government has decided to maintain the current system of differentiated rates of social security contributions in these sectors. The Norwegian authorities have stated in the notification that they will ensure full compliance with the EEA Agreement, in order to avoid that undertakings not belonging to these sectors, would benefit from the current system.

- **Sectors subject to full rate irrespective of location**

The highest tax rate of 14.1 per cent shall apply to the following enterprises, irrespective of the municipality in which the employee lives:

- enterprises producing electricity from hydropower,
- enterprises involved in extraction of crude oil or natural gas,
- enterprises providing one of more of the following services associated with oil or gas exploitation:
  - test or production drilling on contract,
  - service activities in connection with oil and gas exploitation,
  - drilling or well service on contract.
- enterprises excavating metal ore, except iron ore and iron ore containing manganese,
- enterprises excavating the industrial minerals nepheline cyenite and olivine,
- enterprises that build or repair self-propelled, ocean-going commercial vessels. These vessels are defined as follows:
  - Vessels of at least 100 GRT for transporting passengers or cargo,
  - Vessels of at least 100 GRT for special purposes,
  - Tugs of at least 365 kW,
  - Fishing vessels of at least 100 GRT intended for export to countries outside the EEA area,
  - Floating and movable unfinished hulls of the above vessels.
- enterprises that carry out major alterations to vessels such as those referred to above, if the vessel is above 1 000 GRT,
- enterprises producing ECSC steel,
- financial enterprises (as mentioned in section 1-4 of the Financial Institutions Act or section 7-1, cf. section 1-2, first paragraph, of the Securities Trading Act) if the enterprise has branches, is involved in cross-border activities or has established subsidiaries carrying out similar activities in other states within the EEA area,



- enterprises providing goods transport by road, and employing more than what correspond to 50 man-years,
- enterprises producing telecommunications services.

The enterprises described above that cannot benefit from the regionally differentiated social security tax, may receive *de minimis* aid as described below.

### 3.3 *De minimis* arrangement

The increased rates in zones 2-4 from 2004 onwards described in table 2 above will apply only to aid exceeding the *de minimis* amount.

Employers' social security contributions will be based on the existing rates for zones 2, 3 and 4 in 2003, as long as the difference between the social security contributions based on the highest rate (14,1%) and the social security contributions based on the existing lower rates, do not exceed NOK 270.000 for one year (EURO 100.000 over a three-year period). When this limit is exceeded, the social security contributions will have to be based on the rates otherwise applicable, see table 2 above. This provision does not apply to undertakings in the transport sector. Enterprises subject to the full rate irrespective of location will also benefit from the *de minimis* scheme. Other *de minimis* aid can be granted together with *de minimis* aid under the social security tax system only as long as total *de minimis* aid does not exceed NOK 270.000 on an annual basis.

### 3.4 Budget

The Norwegian authorities have calculated that the reduction in social security contributions due to the reduced rates in 2004, is NOK 997 million in zones 3 and 4 (NOK 896 million in zone 4 and NOK 101 million in zone 3), NOK 674 million in 2005 (NOK 606 million in zone 4 and NOK 68 million in zone 3) and NOK 351 million in 2006 (NOK 317 million in zone 4 and NOK 35 million in zone 3), *i.e.* NOK 2022 million (some EUR 247 million) for the whole three-year period.

## 4. The decision to open an investigation

In its decision to open an investigation, the Authority expressed two doubts in respect of the three-year transition period in zones 3 and 4 for the regionally differentiated social security contributions.

The main consideration expressed by the Authority, was that the Norwegian authorities had not submitted calculations demonstrating the effects of transition periods of one and two years, respectively, for each of the zones, and compared to the notified three-year period. The Norwegian authorities had only submitted comparisons between a transition period of three years and no transition period at all while stating that: "*a transition period of less than three years would be too short*". The Authority also requested arguments as to why enterprises in zone 3 needed the same transition period as those in zone 4, in spite of facing a smaller increase in the tax burden.

Secondly, the Authority disputed the relevance of the argument from the Norwegian authorities that they received "no clear signals" until late autumn 2002 that the system

as such had to be abolished, as a Government could not claim a misunderstanding of EEA rules as an excuse for not fulfilling its obligations under the Agreement.

#### 4.1 The comments from Norway

By letter dated 17 September 2003 from the Ministry of Finance, the Norwegian authorities submitted comments on the Authority’s decision to open an investigation. The Ministry maintained the previous considerations expressed in the letters dated 25 March 2003 and 5 June 2003, and submitted additional comments regarding the effects of transitional periods of one and two years, respectively, for each of the zones and compared with the notified three-year period. The Ministry also submitted additional comments as to why enterprises in zone 3 needed the same transitional period as those in zone 4.

- **Economic effects of transitional periods of one and two years**

The Ministry of Finance submitted the following table showing the effects of the annual increase in labour costs and tax burden, depending on the duration of the transitional period.

Table 3

*“Annual changes in labour costs and tax burden due to increase in tax rates, taking into account the duration of the transitional period”*

		<i>No transitional period</i>	<i>One year transitional period</i>	<i>Two year transitional period</i>	<i>Three year transitional period</i>
<i>Increases in tax rates</i>	<i>zone 4</i>	<i>9.0 pc. points</i>	<i>4.5 pc. points</i>	<i>3.0 pc. points</i>	<i>2.25 pc. points</i>
	<i>zone 3</i>	<i>7.7 pc. points</i>	<i>3.85 pc. points</i>	<i>2.6 pc. points</i>	<i>1.93 pc. points</i>
<i>Increase in nominal labour costs due only to the rise in tax rates (wage growth not included)</i>	<i>zone 4</i>	<i>8.6 per cent</i>	<i>4.3 per cent</i>	<i>2.9 per cent</i>	<i>2.1 per cent</i>
	<i>zone 3</i>	<i>7.2 per cent</i>	<i>3.6 per cent</i>	<i>2.4 per cent</i>	<i>1.8 per cent</i>
<i>Increase in total tax burden due to the rise in tax rates (effect of wage growth not included)</i>	<i>zone 4</i>	<i>1186 mill NOK</i>	<i>593 mill NOK</i>	<i>395 mill NOK</i>	<i>296 mill NOK</i>
	<i>zone 3</i>	<i>134 mill NOK</i>	<i>67 mill NOK</i>	<i>45 mill NOK</i>	<i>34 mill NOK</i>
<i>Increase in nominal total labour costs when normal wage growth is included</i>	<i>zone 4</i>	<i>13.9 per cent</i>	<i>9.2 per cent</i>	<i>7.6 per cent</i>	<i>6.9 per cent</i>
	<i>zone 3</i>	<i>12.6 per cent</i>	<i>8.5 per cent</i>	<i>7.2 per cent</i>	<i>6.5 per cent</i>

Increase in total labour costs (wage growth and tax increase) compared to normal wage growth	zone 4	309 per cent	205 per cent	170 per cent	152 per cent
	zone 3	279 per cent	189 per cent	160 per cent	145 per cent

The Ministry comments upon the figures presented in table 3 above, and points out that with no transitional period, the immediate increase in the social security contributions would be 9 and 7.7 percentage points in zones 4 and 3, respectively, which corresponds to an immediate increase in the firms' labour costs of 8.6 and 7.2 per cent (as soon as the *de minimis* threshold is reached) reflecting an increase in total tax burden in zones 4 and 3 of NOK 1186 million and NOK 134 million. The Norwegian authorities also referred to a research report by Møreforskning<sup>13</sup> that presents slightly higher figures (NOK 1,3 billion and NOK 177 million, respectively).

The Norwegian authorities pointed out that if no transitional period was granted and provided there are no immediate carry-over effect in wages in response to the tax increases, the increase in labour costs of the firms in question in 2004 (when *de minimis* aid is not taken into consideration) would be about 300 per cent of the normal annual increase in labour costs (growth rates of 13,9 and 12,6 per cent in zone 4 and zone 3, respectively), compared with the estimated annual wage growth rate of 4,5 per cent .

With a transitional period of one year, the increase in the social security tax would be 4,5 and 3.9 percentage points in zones 4 and 3, respectively, which corresponds to an annual increase in the firms' labour costs of 4,3 and 3,6 per cent (as soon as the allowed *de minimis* threshold is reached), reflecting an increase in the total tax burden in zones 4 and 3 of NOK 593 million and NOK 67 million respectively. Provided that there is no carry-over effect in wages in response to the tax increases, the annual increase in labour costs (when *de minimis* aid is not taken into consideration) would be about twice of the normal annual increase in labour costs (205 per cent and 189 per cent in zone 4 and zone 3, respectively).

With a transitional period of two years, the ensuing increase in the social security tax rates would correspond to an isolated annual increase in the firms' labour costs of 2,9 and 2,4 per cent (as soon as the *de minimis* threshold is reached), reflecting an increase in total tax burden in zones 4 and 3 of NOK 395 million and NOK 45 million each year. Provided there is no carry-over effect in wages in response to the tax increases, the annual growth in labour costs of the firms in question (when *de minimis* aid is not taken into consideration) would be about 170 per cent and 160 per cent of the normal annual increase in labour costs in zones 4 and 3, respectively.

With a transitional period of three years, the ensuing increase in the social security tax rates would correspond to an isolated annual increase in the firms' labour costs of 2,1

<sup>13</sup> "En analyse av regionale virkninger av omlegging av differensiert arbeidsgiveravgift". Møreforskning, arbeidsrapport M 0309, see website: [www.mfm.no](http://www.mfm.no).

and 1,8 per cent in zones 4 and 3 (as soon as the allowed *de minimis* threshold is reached), reflecting an increase in total tax burden in zones 4 and 3 of NOK 296 million and NOK 34 million. Provided there is no carry-over effect in wages in response to the tax increases, the annual increase in labour costs of the firms in question (when *de minimis* aid is not taken into consideration) would be about 152 per cent and 145 per cent of the normal annual increase in labour costs in zones 4 and zone 3, respectively.

It was furthermore outlined that in the short run, adjustment to increased tax rates may take the form of changes in product prices, wages or production volume. The Ministry of Finance also maintained that a substantial number of enterprises are exposed to international competition and, the fact that the profitability margins of the industry in the concerned regions are low on average, may indicate that in most cases, there are limited possibilities for increasing product prices. Furthermore, it is mentioned that figures referred in Table 3, show that even with a transitional period of three years, the annual increase in labour costs would be much higher than what could be expected to be reflected in corresponding wage adjustments the same year.

It was also referred that no empirical studies provided precise answers as to how the wage formation process was influenced by a change in the level of social security contributions. Analytical results concerning partial regional changes are even more varied as regards the long-term incidence effects. No studies seem to have focused specifically on the time path of incidence effects. It is maintained that, due to nominal downward rigidity, one might expect that the time path of an increase in rates and decrease in rates would be asymmetric. In the case of a significant increase in taxes, one might expect that it would take several years for the firms' costs to adjust to the tax increase. It was pointed out that this implied that the transitional period would not only postpone the rise in costs to firms, but also reduce the maximum level of costs the firms would have to bear the first year the full tax rate of 14,1 percent is applied. Therefore, the Ministry stressed that the length of the transitional period was of greater importance when the adjustment process of nominal wages was taken into consideration.

The Norwegian authorities concluded that a three-year transitional period compared to a two year period, would reduce the number of closures or necessary downscaling of production resulting from the increase of the contribution rate and, hence, reduce the risk of a substantially worsened employment situation, increased depopulation and rise in unemployment.

- **Why do enterprises in zone 3 need the same transitional period as enterprises in zone 4?**

The Norwegian authorities pointed out that the relative differences between the two zones are very small compared to the size of the transitional problems and the time needed for adjustments in both zones. They also referred to the recent very high increase in the number of bankruptcies in zone 3. Furthermore, the Norwegian authorities pointed out that a one-year shorter transitional period in zone 3 than in zone 4 would not imply more equality between the zones, but rather that the increase in costs would be higher in zone 3 than in zone 4 (see table 3 above).

## 4.2 Comments from interested parties

Ten organisations and undertakings from Norway submitted comments to the decision to open an investigation. All comments support the Norwegian government's proposal for a three-year transition period.

Several of the comments pointed out that the system of regionally differentiated social security contributions is the single most important regional policy instrument in Norway, and that it would have dramatic effects on business and industry in the regions concerned if the increase in the social security contributions were to occur all at once, on 1 January 2004. The Authority's approval of the proposed transitional period is therefore considered to be of the greatest importance.

By letter dated 23 October 2003 from the Mission of Norway to the European Union, forwarding a letter dated 21 October 2003 from the Ministry of Trade and Industry and a letter dated 21 October 2003 from the Ministry of Finance, all received and registered by the Authority on 24 October (Doc. No: 03-7360 A), the Norwegian authorities briefly commented upon the comments from third parties. The Norwegian authorities noted that the comments from third parties substantiated the arguments that previously had been presented to the Authority, and that no objections had been raised by third parties to the proposed transitional period.

## II. APPRECIATION

### 1. The existence of aid

Article 61(1) of the EEA Agreement reads as follows:

*“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 EFTA Court stated in Case E-6/98<sup>14</sup>, paragraph 43, that: *“the Norwegian social security contribution scheme constitutes State aid within the meaning of Article 61 EEA.”* For the purpose of assessing whether the notification of a transitional arrangement in zones 3 and 4 involves State aid, it is noted that the main principles of the scheme have not changed compared to the scheme which was subject to the EFTA Court's judgment in Case E-6/98. As the present scheme satisfies all the conditions for the application of Article 61(1) of the EEA Agreement, the Authority takes the view that the notified transitional arrangement in zones 3 and 4 constitutes State aid.

On 22 September 1999<sup>15</sup> the Authority decided not to raise objections to a notification from the Norwegian authorities concerning the measures that the Norwegian Government intended to take in order to comply with the EFTA Surveillance Authority's decision of 2 July 1998. The Authority found that the aid could be

<sup>14</sup> EFTA Court Case E-6/98, *The Government of Norway v EFTA Surveillance Authority* [1999] Report of the EFTA Court, p. 74.

<sup>15</sup> Decision No 228/99/COL. OJ C 3, 06.01.2000, p.3, and EEA Supplement No 1, 06.01.2000.

exempted as regional aid (indirect transport aid) on the basis of Article 61(3)(c) of the EEA Agreement. The approval was limited in time, not going beyond 31 December 2003. Consequently, the current regionally differentiated social security contributions scheme is an existing aid scheme until the end of 2003.

The Authority considers that any State aid resulting from the system of regionally differentiated social security contributions after 1 January 2004, would be new aid.

However, certain aspects of the notified scheme do not involve aid which should be scrutinized by the Authority under Article 61 of the EEA Agreement. This concerns the following provisions:

- Enterprises paying the full rate, naturally, do not receive any aid under the scheme.
- Received *de minimis* aid as described in section I 3.3 above, is not aid in the meaning of Article 61(1) of the EEA Agreement<sup>16</sup>.
- The reduced rate of 4 percentage points to all employees aged 62 years and above, applies to all economic sectors and equally to all regions in Norway. This is therefore considered to be a general measure falling outside the scope of Article 61(1).
- Review of aid to agriculture and fishing falls outside the scope of the Authority's competence<sup>17</sup>.

Against this background, the aid to be assessed in the case at hand, is the aid that stems from the notified transition period of three years for zones 3 and 4.

## 2. Notification requirement

Article 1(3) in Part I of Protocol 3 to the Surveillance and Court Agreement states: "*The EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid.*" Aid provided without notification or aid that is notified late, *i.e.* notified after being "*put into effect*" is considered unlawful aid. The Authority's decision to adopt appropriate measures (Dec. No. 172/02/COL) also stated that the Norwegian authorities should "communicate" to the Authority before 25 March 2003, measures adjusting the aid scheme (see point I 2 above).

By letters from the Mission of Norway to the European Union dated 26 March 2003 (Doc. No. 03-1846 A) and 10 June 2003 (Doc. No: 03-3707 A), the Norwegian authorities have complied with their obligation under Article 1(3) in Part I of Protocol

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<sup>16</sup> Commission Regulation (EC) No 69/2001 of 12 January 2001 on the application of Articles 87 and 88 of the EC Treaty to *de minimis* aid (OJ L 10, 13.01.2001), as incorporated into the EEA Agreement by Decision No 88/2002 of 25 June 2002 of the EEA Joint Committee (OJ L 266, 03.10.2002, and EEA Supplement No 49, 03.10.2002). Cumulation rules ensure that overall *de minimis* aid will not exceed the threshold of 100,000 Euro in the course of three years, ref. Commission Regulation (EC) No 69/2001.

<sup>17</sup> See for example: Articles 8(3), 20 and Protocols 3 and 9 to the EEA Agreement, as well as Article 24 of the Surveillance and Court Agreement.



3 to the Surveillance and Court Agreement and their obligation under the appropriate measures.

### **3. The compatibility of the aid**

#### **3.1 Previous assessment by the Authority concerning the compatibility of the regionally differentiated social security contributions scheme**

In the decision to propose appropriate measures to Norway (Dec. No: 172/02/COL), the Authority considered that the present Norwegian regionally differentiated social security contributions scheme does not satisfy the conditions of Chapter 25.4.(27) and Annex XI of the State Aid Guidelines. Aid granted to an eligible undertaking depends on the size of its wage bill, which depends in turn on the number of persons employed, and their salaries. As such, the amount of aid granted under the present scheme does not bear any relation to the additional transport costs actually incurred by a particular undertaking, and is not calculated in line with the above-mentioned provisions of the State Aid Guidelines. The Authority therefore concluded that the present regionally differentiated social security contributions did not qualify for the derogation provided for under Article 61(3)(c) EEA.

While a continuation of the current Norwegian scheme would be incompatible with Article 61 (3)(c) of the EEA Agreement and the State aid Guidelines, recourse to Article 61 (3)(c) should not be fully excluded, where a transitional arrangement phasing out that aid, would have the effect of avoiding an otherwise serious adverse economic effect to one or several regions. Under such circumstances, transitional arrangements might exceptionally be considered necessary and justified, in order to align the State aid measures with the requirements of the State aid rules, and to enable undertakings to adapt to the new economic environment<sup>18</sup>. However, the requirement of such adverse economic effects to a region as a whole, must be set high, since financial consequences of negative State aid decisions for single undertakings do not have any bearing on the compatibility assessment of a particular aid measure<sup>19</sup>.

In the light of the above, the Authority will assess whether the notified transition period of three years for zone 3 and 4 is objectively necessary and justified in order to allow an appropriate transition for the undertakings in question to the adjusted situation<sup>20</sup>.

#### **3.2 Is a transition period of three years for zones 3 and 4 necessary and justified?**

The Norwegian authorities notably argued in the notification, that no transitional period, or a very short one, would *i.a.* create uncertainty and crises in a large number of regional businesses and may severely hurt economic development in these regions.

<sup>18</sup> The Authority noted that the Commission also authorised transitional arrangements. See for example: Commission Decision No 88/318/EEC of 2 March 1988 on Law No 64 of 1 March 1986 on aid to the Mezzogiorno (OJ L 143, 10.06.1988, p. 37); State aid N 586/2002 – Italy – Aid measures in favour of cableway installations introduced with L.R. 9/98, Regione Lombardia.

<sup>19</sup> Case C-24/95 *Land Rheinland-Pfalz v Alcan Deutschland GmbH* [1997] ECR I-1591.

<sup>20</sup> As regards the Norwegian Government's argument that the Authority had sent "no clear signals", the Authority maintains its view as expressed in its Decision of 16 July 2003 in point 3.1.

In the comments to the decision to open an investigation (see point I 5 above, in particular table 3), the Norwegian authorities *i.a.* submitted calculations regarding the effects of transitional periods of one and two years, respectively, for each of the zones and compared with the notified three-year period.

The Authority notes that, according to the calculations presented by the Norwegian authorities, if the regional differentiation of the social security contributions were to be abolished, and based on an assumption of no incidence effects, it would lead to an employment reduction in the private sector of 15.400 persons in zone 4 and 2.900 persons in zone 3, as a direct effect of the increase in total wage costs. This would represent an isolated reduction of employment in the private sector in these regions, of 15,5 per cent (13,8 per cent in zone 3, 15,8 per cent in zone 4). The corresponding reduction in total employment in these regions would be 7,5 per cent in zone 3 and 8,5 per cent in zone 4.

The Authority furthermore notes that the profitability for enterprises in zones 3 and 4 is low. According to the Norwegian authorities, a (full) tax increase, taking the *de minimis* possibility into account, would, for the year 2001, correspond to about 24 per cent of total operating profit for companies in zone 3 and, correspondingly, almost 40 per cent in zone 4.

Without a transitional period, the increase in the social security tax corresponds to an immediate increase in the firms' labour costs of 8.6 and 7.2 per cent in zones 3 and 4, respectively (as soon as the *de minimis* threshold is reached). Assuming general wage increases as forecast by the authorities, no transition period would imply an increase in labour costs for enterprises in zones 3 and 4 in 2004, almost three times higher than the normally expected increase in such costs (*de minimis* effect not taken into consideration).

The Authority also observes that a gradual phasing out of the differentiated tax rates over a period of three years, means that the annual cost increases for the undertakings will be spread over this period. An immediate abolishment of the current system would, in reality, imply a cost shock to the enterprises concerned. An appropriate transition period will mitigate the shock effects and give the undertakings time to adjust to a new economic environment. In this context, the Authority takes note of the arguments brought forward by the Norwegian authorities that adjustments in the price and wage formation is a process that takes time. Downward wage rigidity is by itself a commonly observed phenomenon. In a regional context, this fact may be reinforced when wage negotiations, to a large extent, are organised at the national level.

Some undertakings may more easily than others, increase prices on their products as a response to increased wage costs. This may result in bankruptcies or closure of business activities. Wage moderation or enhanced productivity are measures that would rectify the consequences of increased social security contributions, but any effects of such factors must be expected to materialize only in the longer run.

All undertakings will benefit from the introduction of the *de minimis* scheme. However, the effect will be significant only for very small enterprises, gradually becoming rather insignificant as the enterprises become larger. An example may illustrate this:

In zone 4, the tax rate applicable for *de minimis* purposes is 5.1 pct (the rate in 2003), which is 9 percentage points lower than the rate in zone 1. An undertaking with a wage bill before social security taxes of NOK 3.000.000 (or lower) will benefit fully from the *de minimis* scheme in the sense that it will continue to pay the same amount in social security contributions as today. 9 per cent tax relief of an amount of NOK 3.000.000 is NOK 270.000. Firms with larger wage bills will also get this benefit for a wage amount up to NOK 3.000.000, but for wage bills exceeding this amount, they will have to pay a higher rate. Undertakings with wage bills in the range of NOK 3.000.000 will, on average, employ some 10 persons. For a medium sized enterprise with some 250 employees, the wage bill would be in the range of NOK 75 million. Being subject to a full tax rate of 14.1 pct., the social security bill will be more than NOK 10 million. A tax relief of NOK 270.000 will thus not be very significant.

Based on key figures for non-financial joint stock companies, the Norwegian authorities have calculated that approximately 50 pct. of the total wage cost basis for these companies would fall outside the scope of the *de minimis* rule in zones 3 and 4.

The conclusion of the effect the *de minimis* scheme is that it alleviates the shock effect of a sudden rise in social security taxes (even eliminates it for the very small firms employing some 10 persons or less), but around 50 pct. of overall employment is in enterprises where the effects of the scheme will be limited.

Another compensatory measure is the intended introduction of a direct transport aid scheme (the notified direct transport scheme will be subject to a separate decision). While the notified direct transport aid would help certain undertakings that have long and costly transports of goods, this scheme would, however, not fully compensate for the abolition of reduced social security rates. Furthermore, many undertakings, for example in the service industries, would not have the possibility to benefit from this scheme. It should also be mentioned that, according to the notified direct transport aid scheme, any benefits from reduced social security taxes, would be deducted from any calculated transport aid. According to the notifications from Norway, in case of an approval by the Authority, transport aid would then be phased in as aid through reduced social security taxes is phased out.

Concerning the difference in tax rates between zone 3 and zone 4, the Authority notes that the difference is not very big and that a shorter period for zone 3 than for zone 4 would imply a steeper rise in wage costs for enterprises in the former than in the latter zone. The Authority is therefore of the opinion that any transition period in the two zones should be of equal length.

Concerning the question of a transition period as such, the Authority is of the view that such a period would be necessary for zones 3 and 4 to dampen the shock effects that would follow from an immediate application of the full social security tax. As regards the length of a transition period, the Authority considers that the Norwegian authorities have demonstrated that time will be needed for undertakings to adjust to the new economic reality. On the basis of this information and the arguments provided, a period of three years seems appropriate. In addition to the arguments mentioned above, it should also be emphasised that the system of differentiated social security taxes has been in effect for almost 30 years and that undertakings have taken their decisions on location and investment under such a system. This also calls for some transitory arrangements.

It has to be borne in mind that the current case does not relate to a single undertaking receiving aid, but to all undertakings in a whole region. These are undertakings that at the outset, and as a whole, are in a weak competitive position. Increasing taxes will further weaken their position. However, it is important to note that the notified aid measure involves operating aid. Regional aid aimed at reducing firms current expenses (operating aid) is normally prohibited. Exceptionally, however, such aid may be granted, for example, in regions of low population density, where the aid partly offsets additional transport costs<sup>21</sup>. As shown in Table 1 above, zones 3 and 4 are low population density regions, less than 12.5 inhabitants per square kilometre. The Authority has to ensure that aid does not adversely affect trading conditions to an extent contrary to the common interest. This is especially important where operating aid is at stake. On the other hand, the Authority has to consider the serious economic and social adverse effects that an abrupt termination of the notified scheme would cause. In carrying out this balancing act, the Authority considers it strictly necessary that the Norwegian authorities comply with the set three-year transitional phasing out deadline. In the Authority's view, a gradual phasing out of the current scheme in the economically fragile zones of 3 and 4, limited to three years, does not adversely affect trading conditions to an extent contrary to the common interest, under the particular circumstances of this case and having regard to all of the above considerations.

#### **4. Conclusion**

The Authority concludes, with reference to the arguments above and given the particular circumstances of this case, that the notified three-year transitional period for the regionally differentiated social security contributions in zones 3 and 4 can be authorised by the Authority.

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<sup>21</sup> State Aid Guidelines, Chapter 25.4.

**HAS ADOPTED THIS DECISION:**

1. The State aid which Norway is planning to implement in form of the notified transitional period for the regionally differentiated social security contributions in zones 3 and 4 is authorised under Article 61(3)(c) of the EEA Agreement.
2. This decision is addressed to the Kingdom of Norway.
3. This decision is authentic in the English language.

Done at Brussels, 12 November 2003,

For the EFTA Surveillance Authority

Einar M. Bull  
President

Hannes Hafstein  
College Member

## ANNEX 1

### Geographical zones and current (2003) tax rates

- Zone I: 14.1 per cent tax.

This zone includes all municipalities not mentioned below under zone II-V.

- Zone II: 10.6 per cent tax.

This zone includes:

- in Nord-Trøndelag county, the municipalities of Meråker, Frosta, Leksvik, Mosvik, Verran,
- in Sør-Trøndelag county, the municipalities of Ørland, Agdenes, Rissa, Bjugn, Rennebu, Meldal, Midtre Gauldal, Selbu,
- in Møre og Romsdal county, the municipalities of Vanylven, Sande, Herøy, Norddal, Stranda, Stordal, Rauma, Nesset, Midsund, Sandøy, Gjemnes, Tingvoll, Sunndal, Haram, Aukra, Eide,
- in Sogn og Fjordane county, all municipalities,
- in Hordaland county, the municipalities of Etne, Ølen, Tysnes, Kvinnherad, Jondal, Odda, Ullensvang, Eidfjord, Ulvik, Granvin, Kvam, Modalen, Fedje, Masfjorden, Bømlo,
- in Rogaland county, the municipalities of Hjelmeland, Suldal, Sauda, Kvitsøy, Utsira, Vindafjord, Finnøy,
- in Vest-Agder county, the municipalities of Åseral, Audnedal, Hægebostad, Sirdal,
- in Aust-Agder county, the municipalities of Gjerstad, Vegårshei, Åmli, Iveland, Evje og Hornnes, Bygland, Valle, Bykle,
- in Telemark county, the municipalities of Drangedal, Tinn, Hjartdal, Seljord, Kviteseid, Nissedal, Fyresdal, Tokke, Vinje, Nome,
- in Buskerud county, the municipalities of Flå, Nes, Gol, Hemsedal, Ål, Hol, Sigdal, Rollag, Nore and Uvdal,
- in Oppland county, the municipalities of Nord-Fron, Sør-Fron, Ringebu, Gausdal, Søndre Land, Nordre Land,
- in Hedmark county, the municipalities of Nord-Odal, Eidskog, Grue, Åsnes, Våler, Trysil, Åmot.

- Zone III: 6.4 per cent tax.

This zone includes:

- in Nord-Trøndelag county, the municipality of Snåsa,
- in Sør-Trøndelag county, the municipalities of Hemne, Snillfjord, Oppdal, Røros, Holtålen, Tydal,
- in Oppland county, the municipalities of Dovre, Lesja, Skjåk, Lom, Vågå, Sel, Sør-Aurdal, Etnedal, Nord-Aurdal, Vestre Slidre, Øystre Slidre, Vang,
- in Hedmark county, the municipalities of Stor-Elvdal, Rendalen, Engerdal, Tolga, Tynset, Alvdal, Folldal, Os



- Zone IV: 5.1 per cent tax.

This zone includes:

- in Troms county, municipalities not included among those listed below under zone V,
- in Nordland county, all municipalities,
- in Nord-Trøndelag county, the municipalities of Namsos, Namdalseid, Lierne, Røyrvik, Namsskogan, Grong, Høylandet, Overhalla, Fosnes, Flatanger, Vikna, Nærøy, Leka,
- in Sør-Trøndelag county, the municipalities of Hitra, Frøya, Åfjord, Roan, Osen,
- in Møre og Romsdal county, the municipality of Smøla.

- Zone V: 0 per cent tax.

This zone includes:

- in Finnmark county, all municipalities,
- in Troms county, the municipalities of Karlsøy, Lyngen, Storfjord, Kåfjord, Skjervøy, Nordreisa and Kvænangen.