# CHAPTER XIX
# STATE AIDS

## A- TREATY PROVISIONS (Arts. 92-94)

Article 92(1) prohibits any aid granted by a Member State 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. According to the Commission the following constitute prohibited aids: direct subsidies, tax exemptions, preferential interest rates, guarantees of loans on especially favourable terms, acquisitions of land or buildings either gratuitously or on favourable terms, provision of goods and services on preferential terms, indemnities against losses and other measures of similar effect [1]. This list was further extended to include reimbursement of costs in case of success, direct or indirect state guarantees of grants or credits, preferential application of discount rates, preferential settlement of public accounts, deferred collection of fiscal and social contributions[2].

The list is not exhaustive as indicated by case law of the Commission and the ECJ[3].

Article 92(2) exempts aids which have a social character or are intended to alleviate hardship resulting from natural disasters or other extraordinary events. Exemption may also be claimed for aids intended for regional development; to promote an important European project and for aids specified by the Council on a proposal from the Commission.

The Commission has a duty to keep under constant review all systems of aid existing in the Community and if it finds that an aid is incompatible with the Treaty it shall call upon the State concerned either to alter or abolish the aid. In the case of an illegal aid the Commission has the power to order its cessation and any advantages received have to be paid back to the government. Failure to comply renders the Member State concerned subject to prosecution by the Commission.

Recently the nature of the Community control of state aids began to change as certain policies, notably the regional policy and industrial policy, as a result of which the Community will provide aids from the so-called "structural funds" whilst state aids ought to be administered according to Community guidelines. So far the Commission has established a framework for investment aids in support of the manufacture and marketing of certain dairy products[4] and for agricultural advertising[5]. The Structural funds system affects at present most substantially the ship-building industry.

Since state aids are not absolutely prohibited Member States will continue supporting disadvantaged areas or industries within the limits allowed by the Treaty until the state responsibility has been taken over by the Community. Turkey has to be considered as a country in need of further development and Community aid. The government would have to consider the various schemes for the development of industry and disadvantaged regions not only in order to avoid a collission with Community law but also to secure Community aids in the same measure as the Mediterranean countries have done so far.

For the depressed area of shipbuilding the Community issued in 1988 Regulation 2506/88 instituting the so-called "Reneval Programme" with the object of modernizing European shipyards. Community funds are used to enable these shipyards to operate with the most advanced technology, to provide assistance for early retirement of surplus personnel and for mobility and retraining of personnel working in shipyards threatened with the consequencies of the decline in this industry. Turkey would be eligible for such assistance.

## B- IMPLICATIONS FOR TURKEY[6]:

### Turkish Incentive System

The incentive system in Turkey can basically be classified into two categories; these are, investment incentives and export incentives.

### i. Investment Incentives

The investment incentive system of Turkey is regulated by decrees published each year and guided by the principles laid down under the five year development plans and annual programs. Latest decree has been published on 29th of January 1993 in the Turkish Official Journal.

Under the decree the investment projects that may be considered to have preferential status and will be encouraged are those that;

-are included in the positive list which enumerates sectors and products in which investments can receive incentives

-meet certain conditions such as:

"Minimum investment limits" : for an investment project to be eligible for an investment incentive, the minimum value considered is in general TL 5 billion. For investment projects aiming at environmental protection, research and development and financial leasing this limit is TL. 250 million. For investment projects in priority development regions, free zones and some sectors such as tourism, ready made garments, software development and for expansion investments, the limit stands at TL. 1 billion.

"Minimum level of own sources (loan/equity ratio) : Minimum equity requirements for the financing of investment benefiting from investment incentives are 15 percent for investment projects aiming ship and yacht building, 10 percent for investment projects aiming financial leasing and dwelling, 30 percent in the first degree priority development regions, 40 percent in the second degree priority development regions, 50 percent in normal regions and 60 percent in developed regions.

-"And" minimum level of exports.

In order to benefit from incentive measures on investments a certificate of incentive relative to the investment must be issued by the Undersecretary of Treasury and Foreign Trade. Nevertheless, it is also possible to benefit from some of the incentives without obtaining a certificate of incentive.

Investment projects are also evaluated in accordance with their feasibility, technological advancement, competitive strengths, in addition to their ability to meet the general conditions mentioned above in order to receive incentives.

The major investment incentive measures provided under this decree can be devided into three groups: tax benefits, soft loans and pecuniary support.

1- Tax Benefits

-Customs Exemption

Imported machinery and equipment for investments are exempted from customs duties and other taxes on imports. In order to benefit from this exemption the investment should satisfy the minimum economic capacity requirement for the related sector and/or project and bring new technology and increased international competitevenes. However, with few exemptions, such imports are subject to a fund payment (that is a tax which contributes to the fund for encouragement of investments and foreign currency earning services) of 5 to 20 percent. Except imports of cars, buses, trucks, videos and tv sets.,small refgregirators, furniture, raw materials (within the framework of new investment projects), imports for investments realized in the priority development regions (except infrastructure investments), are exempted from the fund payment.

Also at the operation stage, the customs exemption is provided to new investments for their initial (three to six months) requirements of raw materials and auxiliary materials within the following limits;

-in projects in which the cost of fixed investment exceeds 20 billion TL: not more than 20 % of the cost of machinery and equipment,

-in projects in development priority regions: not more than 30% of the cost of machinery and equipment,

-in big projects : not more than 40% of the cost of machinery and equipment;

-for spare parts in general, not more than 5% of the cost of machinery,

-in subcontraction projects, not more than 10% of the cost of machinery.

However, 5 to 13 percent of the fob value of the above listed imports contribute to the fund for encouragement of investments and foreign currency earning services.

-Investment Allowance

The investment allowance is applied in the form of a tax exemption for investment projects for which a certificate of incentive has been granted. A certain percentage of the investment expenditure may be deducted from the company's yearly taxable corporate income. This allowance constitutes a tax benefit by relieving the company of corporate or income tax until its revenues have reached the calculated level of exemption. If the company fails to make a profit or suffers losses this allowance may be continued with regard to the taxable income of subsequent profitable years.

The percentage of the investment eligible for the investment allowance is 30 percent in developed regions. However this ratio is applied at 40 percent in agricultural investments and in investments to be undertaken in normal regions that are related to regional developmente. The amount of investment allowance is 60 percent in investments to be undertaken in regions with secont priority in economic development and 100 percent for R & D investments, fishing investments and investments to be undertaken in regions with first priority in economic development and those to be undertaken by capital companies and cooperatives in sectors of special significance.

-Exemption of Taxes, Fees and Duties

This exemption is applicable to medium and long-term credits extended by banks to selective investments which include a pledge for a certain annual export volume. The incentive covers all taxes, duties and charges required to be paid on banking operations, notary public, and title deed formalities in connection with the receipt and repayment of such credits.

The minimum percentage rates of the export guarantee requirement to benefit the exemption of credit charges are as follows:

-% 20 of the annual production in investments planned in developed regions,

-% 10 of the annual production in investments planned in normal regions,

-% 5 of the annual production in investments planned in the regions which have priority of development.

2- Soft Loans

2.1. Loans from the fund for encouragement of investments and foreign currency earning services.

In order to support investments benefiting from the certificate of incentive, a credit with favorable conditions is provided from the fund's resources. The interest to be paid by investors is 10 per cent in investments to be undertaken in regions with first priority in economic development, 15 percent in regions with second priority in economic development 30 percent in normal regions that are related to regional development and 30 percent in developed regions. These loans are paid back in five years. Payments requirement starts from the third year. The interest rate during the first two years is 10 percent, irrespective of the region. Maximum amount of the credit is Tl 50 billion in general and Tl100 billion in big projects.

2.2. Medium and long-term domestic and externally funded loans investment projects on which a certificate of incentive has been granted can benefit from medium and long term domestic and externally funded loans as far as they are registered on the certificate and conform to the amounts and ratios stated on it. However, for medium and long-term credits available:

a) from the Turkish Development Bank (supported from the Turco-German special credit fund) and,

b) from the mass housing fund and public partnership administration fund (only for companies established in the regions of development priority),

neither the certificate of investment nor the amounts and ratios set in cases where a certificate of incentive has been granted is required.

-Credits for Working Capital

Working capital requirement of investments that have not reached the operation (production) stage or partially reached the operation stage are provided from the sources of the Turkish development bank or other banks approved by this bank. The conditions of these credits are decided by the undersecretary of treasury and foreign trade. For companies in regions with development priority interest rate of the credits for working capital is applied at 30 per cent and credit (principal and interest) is required to be repaid in one year.

3- Pecuniary Support

-Investment Premium

This is a monetary incentive paid from the sources of the fund for encouragement of investments and foreign currency earning services to investors in case of obtaining machinery and the equipment from the domestic market. The premium equals to the amount of value added tax on the value of these capital goods.

-Incentives based on social insurance premium, other social charges (compulsory saving, housing),

For investments that have reached the operation stage 50 per cent of the employer's share of social insurance premium and a 100 per cent of the employer's share of compulsory saving and housing premiums are paid from the sources of the fund,

a) In regions with development priority;

-for the first year of operation for big investments which amount to between 25 and 50 billion Tl.

-for the first two years of operation for big investments which amount to between 50 and 100 billion TL.

-for the first there years of operation for big investments which amount to more than 100 billion TL.

b) In normal regions;

-for the first year of operation for big investments which amount to between 200 and 400 billion TL.

-for the first two years of operation for big investments which amount to between 400 and 750 billion TL.

-for the first there years of operation for big investments which amonut to more than 750 billion TL.

c) In regions with development priority;

-for the first there years of operation for agro-industry investments.

-Energy Incentive

30 per cent of the electricity consumption of the above stated big investments and agro-industry investment is paid from the sources of the fund during the periods stated below.

a) In regions with development priority;

-for the first year of operation for big investments which amount to between 25 and 50 billion TL.

-for the first two years of operation for big investments which amount to between 50 and 100 billion TL.

-for the first there years of operation for big investments which amount to more than 100 billion TL.

b) In normal regions;

-for the first year of operation for big investments which amount to between 200 and 400 billion TL.

-for the first two years of operation for big investments which amount to between 400 and 750 billion TL.

-for the first there years of operation for big investments which amonut more than 750 billion TL.

c) in regions with development priority;

-for the first there years of operation for agro-industry investments.

ii. Export incentives

Export incentives available during the operation period can be grouped under the following headings:

-Monetary and Fiscal Incentives

1. Exemption from Taxes, Duties and Charges

Under Turkish export incentive legislation, all transactions related to exportation including all banking and insurance transactions, services given by the banks, insurance companies and public institutions and export financing credits are exempted from all types of taxes, duties and charges.

2. Exemption From Value Added Tax

Exporters are exempted from value added tax on all goods and services exported.

3. Export Exemption From Corporate Tax

This incentive provides manufacturer-exporters of which bring export revenues exceeding $ 1.0 million annually to deduct 8.0 percent of their exports revenues from their corporate tax base.

4.Customs Exemption

Exporter and manufacturer-exporter companies are allowed to import raw, semi-finished and packaging materials used in producing goods to be exported without paying any customs duty.

5. Export Credits

Various export credit schemes are offered by Export-Import bank (Eximbank) of Turkey. These credit schemes such as special export rediscount credits, post shipment and preshipment export credits and buyer's credits are designed to meet the financial needs of exporters during the export phase. Credit interest rates range between 35-51 with maturities between 30-120 days.

Turkish Incentive System and the Membership of the EC

Before commenting on what will Turkey's position be in the case of EC membership in respect of state aid applications we may look at first how are state aids treated today in Turkey-EC relations. Under article 43 of the Additional Protocol to the Association Agreement which lays down the conditions for the transition period, Turkey has been granted a least-developped region status which is identical to that is defined under article 92/3(a) of the EC Treaty.

Turkey will continue to benefit from this preferential status which tolerates aids of up to 100 percent of investment with regional development purposes, until the end of the transition period, that is 1995. But this should not affect trade between Turkey and the member states and parties to the association agreement not being permitted to subsidize their exports to each other.

This status of Turkey will most likely be maintained even after Turkey's accession to the EC. State aids given by the government to investments will be under close control of the Commission and Turkey will not be able to subsidize her exports to the other EC member states.

However, there are such facilities as state support for export promotion at the stage of market development, i.e. supplying information about export markets, providing consultancy by export organisations, educating export/sales personnel, financing the establishment of a distribution network at export markets or showrooms, financing the establishment of a distribution network at export markets or show-rooms, financing export fair fees or providing airline tickets bought to attend fairs.

The export credit, insurance and gurantee systems are also employed extensively in EC and other western economies, namely within the OECD, but within the limits agreed by consensus. More specifically, in the EC the system works on the basis of transparency. The Member States are obliged to notify other member states, the Commission and the council of the EC. So long as the other Member States and the above-stated community bodies do not object on the basis that the application will damage their industries or affect their trade, member states may put such schemes into operation.

I should again stress that the community is, as the Treaty provides, strongly against subsidisation of exports between Member States. Therefore, these systems can be operational only if they do not serve to subsidize exports.

After membership, Turkey's incentive system will come under control and supervision of EC Commission. As a part of adaptation to" acquis communautaire" Turkey will not be able to put a state aid or aid plan in force before submitting it for Commission's approval. In this way Turkish incentive system which seems highly complex and far from being directed to well defined goals, will be forced to become more efficient, and have less effect on effective distribution of resources and income and be directed to more specific goals. This will also help Turkey to integrate into the EC and changing world industrial and market conditions.

The current EC state aid rules,however, do not allow for increase in capacity in Community's industrial sectors where Turkey has relative competitive advantage, such as textiles, clothing and shipbuilding. These are the Community sectors in difficulty and the community approve national aid schemes for these sectors only on condition of restructuring. This will pose a difficulty for Turkey because on the one hand it will not be possible to subsidize capacity incerases in these sectors anymore and will necessitate a radical change in states' role in industry as an entrepreneur on the other.

But since Community's attitude is positive regarding restructuring, in my opinion Turkey will be in a better position in the next century to channel her resources to more value-added content segments of such industries and accelerating the adaptation and privatization process in the public sector.

Turkey's membership will restrict her subsidies to industries or undertakings, including those under state ownership, that are in difficulty. The only exception to this will be economic crisis situation. Under article 92/1 (b) Member States are permitted to use state aids to minimize the negative effect of the crisis, provided that related industries or companies are economically healthy but suffering difficulties because of conjunctural problems. In such cases, this aid may be directed to maintaining employment or preventing dismissals.

On the other hand, Turkey will be free, although under certain limitations and commission's strict control, to subsidize regional development, research and development, vocational training and small and medium sized company development.

It will however be more rational to reshape the state's involvement in industry to limit it mostly to providing consultancy services, high quality education and training, techno-parks, and enterprise zones, and pooling industrial patents, encouraging common research projects and university-industry cooperation instead of using more monetary and financial subsidy instruments.,

In respect of external EC trade relations Turkey, will adopt EC commercial policy legislation, including measures against subsidised imports from third countries. To that end, Turkey has already adopted the Law on Prevention of Unfair Competition (Law no.3577) in july 1989, which involves measures against subsidised exports which are same as those provided in the EC legislation and GATT subsidies code.

In conclusion, since Turkish economy is subject to substantial government intervention and subsidised in many ways the various schemes now in existence will have to be carefully scrutinised to see whether they can be contained within the EC rules.

NOTES :

1 OJ 1963, 2235

2 Doc. 20.502 / IV/68

3 E.G. purchase of company's shares to assist an ailing company - Case 40/85: Belgium v EC Commission (Re Aid to Bosch SA) (1988) 2 CMLR 301; See also the British Aerospace Case (Re Rover Group) sub judice

4Practice Notice (1988) 1CMLR 275

5 Practice Notice (1988) 1CMLR 545.

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