JUDGMENT OF THE COURT
20 May 1999

(Action for annulment of a decision of the EFTA Surveillance Authority – State aid – General measures – Effect on trade – Aid schemes)

In Case E-6/98

The Government of Norway, represented by Messrs. Ingvald Falch, Office of the Attorney General (Civil Affairs) and Jan Bugge-Mahrt, Assistant Director General, Royal Ministry of Foreign Affairs, acting as Agents, P.O. Box 8012 Dep., Oslo, Norway

applicant,

v

EFTA Surveillance Authority, represented by Mr Håkan Berglin, Director, Legal and Executive Affairs Department, acting as Agent, 74 rue de Trèves, Brussels, Belgium,

defendant,

APPLICATION for annulment of Decision No. 165/98/COL of 2 July 1998 of the EFTA Surveillance Authority with regard to State aid in the form of regionally differentiated social security taxation (Norway) (Aid No. 95-010),

THE COURT

Composed of: Bjørn Haug, President, Carl Baudenbacher and Thór Vilhjálmsson (Judge-Rapporteur), Judges,

Registrar: Gunnar Selvik,

having regard to the written observations of the parties and the written observations of the Commission of the European Communities, represented by Mr James Flett of its Legal Service, acting as Agent,

having regard to the revised Report for the Hearing,

after hearing oral argument from the parties and the oral observations of the Commission of the European Communities at the hearing on 3 March 1999,

gives the following

Judgment

Procedure before the EFTA Surveillance Authority

1 Under the National Insurance Act of 28 February 1997 (*Folketrygdloven*), replacing a former act of 17 June 1966, all persons residing or working in Norway are subject to a compulsory insurance scheme under which employees and employers pay social security contributions. The scheme covers benefits such as pensions, rehabilitation, medical care, wage compensation and unemployment benefits. Social security contribution rates are decided annually by the Norwegian parliament as part of the fiscal budget. Both revenues and expenditure items are fully integrated into the fiscal budget.

2 The contributions levied on employers are calculated on the basis of the individual employee's gross salary income. A system of regionally differentiated contribution rates ranging from 0 to 14.1% is in place, with the contribution rate depending on the zone where the employee has his or her registered permanent residence. The system of regionally differentiated contribution rates was introduced in 1975 and various adjustments have been made since then. The geographical scope of the zones was last revised in 1988. Since 1 January 1995, the applicable contribution rates have been the following:

Zone 1: Central municipalities in southern Norway	14.1 per cent
Zone 2: Rural districts in southern Norway	10.6 per cent
Zone 3: Coastal area mid-Norway	6.4 per cent
Zone 4: Northern Norway (except zone 5)	5.1 per cent
Zone 5: Spitzbergen/Finnmark/Northern part of Troms	0 per cent

3 The system applies to salaries paid to employees both in the private and the public sector except for the central government, which pays the maximum rate regardless of the residence of the employees. It applies to foreign employees residing in Norway if they are covered by the national social security system.

4 Concluding, after initial examination, that the scheme of regionally differentiated social security contributions in Norway involved State aid within the meaning of Article 61(1) of the Agreement on the European Economic Area (hereinafter variously the "EEA Agreement" and "EEA") and that a general exemption was not warranted, the EFTA Surveillance Authority, in a letter dated 14 May 1997, proposed appropriate measures to Norway, in accordance with Article 1(1) of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice (hereinafter "Protocol 3" and the "Surveillance and Court Agreement", respectively). In examining the matter, the EFTA Surveillance Authority commissioned a study by an independent consultant on the economic effects of the scheme.[1]

5 The Government of Norway responded that it could not concur with the EFTA Surveillance Authority's proposal for appropriate measures, *inter alia* because the rules in question were part of the general taxation system and thus fell outside the scope of Article 61(1) EEA. The Government of Norway commissioned separate studies regarding certain aspects of the system, such as the effects on wage formation[2] and on the relationship between additional transport costs and the lower social security contributions in tax zones 2-5 for individual export and import competing enterprises in the manufacturing and mining industries, excluding producers of steel and shipbuilding activities.

6 Having followed the procedure provided for in Article 1(2) of Protocol 3, on 2 July 1998, the EFTA Surveillance Authority rendered Decision No. 165/98/COL with regard to State aid in the form of regionally differentiated social security taxation (Norway) (Aid No. 95-010) (hereinafter the "Decision"). The EFTA

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[1] Arild Hervik (Norwegian School of Management): "Benefits from reduced pay-roll taxes in Norway" 1996.

[2] Dr. oecon Nils Martin Stølen (Statistics Norway) "Effects on wages from changes in pay-roll taxes in Norway. The Government of Norway referred to further studies regarding the same issues, *i.e.* Frode Johansen and Tor Jakob Klette (Statistics Norway) "Wage and Employment Effects of Payroll Taxes and Investment Subsidies" 1997.

Surveillance Authority found that the system provided, through the State budget, a benefit to certain enterprises and must be regarded as constituting State aid. It further found that the lower rates were not justified by the nature and general scheme of the system. The EFTA Surveillance Authority also concluded that the aid involved distorted or threatened to distort competition within the European Economic Area. It further examined whether the exceptions in Article 61(3)(a) and (c) EEA were applicable and found that no areas in Norway qualified for regional aid on the basis of Article 61(3)(a) EEA. With regard to Article 61(3)(c) EEA, however, it found that certain areas would qualify for regional transport aid. The EFTA Surveillance Authority further concluded, on the basis of its investigation, that manufacturing enterprises located in zones 2-5, excluding producers of steel and shipbuilding activities, were not overcompensated for additional transport costs by the financial benefits associated with the lower social security contribution rates in the same regions.

7 The EFTA Surveillance Authority then examined conditions related to certain activities according to its State Aid Guidelines (see paragraph 15 below) and found that, in principle, enterprises with no alternative location, *i.e.* production and distribution of electricity, extraction of petroleum and natural gas and mining and quarrying, did not qualify for regional transport aid. The same applied to industries covered by specific sectoral rules assessed in the Decision.

8 With regard to the service sector and other non-manufacturing activities, the EFTA Surveillance Authority found that measures to reduce social charges directed at those sectors often had great potential in terms of job creation and their effects on competition were normally weak. Thus, the EFTA Surveillance Authority normally could adopt a positive stance on such measures, in particular regarding local services. The EFTA Surveillance Authority found that approximately 65% of the estimated benefits were distributed among sectors where exposure to trade could be assumed to be relatively limited or in sectors to which Article 61 EEA does not fully apply, namely the public sector, construction activities, wholesale/retail trade, restaurants and hotels and other community and personal services. In light of the foregoing and of the *de minimis* rule in Chapter 12 of its State Aid Guidelines, the EFTA Surveillance Authority found that with regard to service activities and non-manufacturing activities, in so far as they fall within the scope of Article 61(1) EEA, the lower rates were justified as aid for regional development on the basis of Article 61(3)(c) EEA, as long as the lower rates were limited to an area which was authorized by the EFTA Surveillance Authority for indirect compensation for additional transport costs. However, it found that this did not apply to financial services, transport and telecommunications, except for branch offices that only provide local services.

9 The final part of the Decision reads:

> "4. Conclusion
>
> The system of regionally differentiated social security contributions involves State aid in the meaning of Article 61(1) of the EEA Agreement. Parts of this aid may on certain conditions be exempted according to Article 61(3), while other parts cannot be exempted. Norway must undertake the necessary measures to ensure that the identified infringements of Article 61(1) are brought to an end.
>
> HAS ADOPTED THIS DECISION:
>
> 1. The system of regional differentiation of employers' social security contributions in Norway is incompatible with the EEA Agreement in so far as,
>
> a) it applies to activities not referred to in point b) below, unless it is confined to areas which have been notified to the Authority and found eligible for regional transport aid,
>
> b) it allows for the following kind of enterprises to benefit from the lower social security contribution rates applied in zones 2-5,
>
> - enterprises engaged in Production and distribution of electricity (NACE [3] 40.1)
> - enterprises engaged in Extraction of crude petroleum and gas (NACE 11.10)
> - enterprises engaged in Service activities incidental to oil and gas extraction excluding surveying (NACE 11.20)
> - enterprises engaged in Mining of metal ores (NACE 13)
> - enterprises engaged in activities related to the extraction of the industrial minerals Nefeline syenite (HS[4] 2529.3000) and Olivine (HS 2517.49100)
> - 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)
> - enterprises engaged in production of ECSC steel,
> - enterprises with more than 50 employees engaged in Freight transport by road (NACE 60.24)
> - enterprises engaged in the Telecommunications (NACE 64.20) sector

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[3] Note by the Court: General Industrial Classification of Economic Activities Within the European Communities.

[4] Note by the Court: Harmonized Commodity Description and Coding System.

- enterprises having branch offices established abroad or otherwise being engaged in cross-border activities related to the following sectors, namely, Financial intermediation (NACE 65), Insurance and pension funding (NACE 66), and Services auxiliary to financial intermediation (NACE 67), with the exception of branch offices only providing local services.

2. For the system of regionally differentiated social security contributions from employers to be adapted in such a way that it would become compatible with the rules on regional transport aid as reflected in the Authority's State Aid Guidelines and allow the Authority to carry out its surveillance functions in accordance with Article 1 of Protocol 3 to the Surveillance and Court Agreement, in addition to the adjustments required by points 1 (a) and (b) of this decision, the following conditions would have to be complied with:

a) The applicability of the system would have to be limited in time, not going beyond 31 December 2003. Before that time, a request for extension may be submitted for examination by the Authority.

b) The Norwegian Government would be required to submit detailed annual reports on the aid scheme in accordance with the format indicated in Annex III of the State Aid Guidelines. As foreseen in Chapter 32 of the State Aid Guidelines, those reports would have to cover two financial years and be submitted to the Authority not later than six months after the end of the financial year. The first report is to be submitted before 1 July 2000.

c) In accordance with the rules on regional transport aid, the detailed annual reports would have to show, in addition to information required according to point (b), the operation of an aid-per-kilometre ratio, or of an aid-per-kilometre and an aid-per-unit ratio.

d) The detailed annual reports would also have to contain, in addition to information required according to points (a) and (c), the estimated amounts of indirect compensation for additional transport costs in the form of lower social security contributions received by enterprises in the sectors covered by special notification requirements (motor vehicle industry, synthetic fibre industry and non-ECSC steel industry).

e) For production covered by the specific sectoral rules related to synthetic fibres, motor vehicles and non-ECSC steel, the Norwegian Government would have to notify the Authority of any recipients of aid benefiting from the lower social security contribution rates in zones 2-5.

f) The Norwegian authorities would have to introduce specific rules to ensure that overcompensation due to the cumulation of regional transport aid from different sources will not occur.

3. Norway shall take the necessary measures to ensure that the aid which the Authority has found incompatible with the functioning of EEA Agreement is not awarded after 31 December 1998 and, where applicable, that the conditions in point 2 of this decision are complied with. It shall inform the Authority forthwith of the measures taken.

4. This decision is addressed to Norway. The Norwegian Government shall be informed by means of a letter containing a copy of this decision."

10 Reference is made to the revised Report for the Hearing for a more complete account of the legal framework, the facts, the procedure and the written observations submitted to the Court, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

Legal background

11 The rules on State aid are contained in Chapter 2 of the main part of the EEA Agreement, as well as in Annex XV and Protocols 26 and 27 to the Agreement. Article 61 EEA is identical in substance to Article 92 of the Treaty establishing the European Community (hereinafter variously the "EC Treaty" and "EC", now after modification Article 87 EC), prohibiting State aid which distorts or threatens to distort competition, with exceptions as provided for in the second and third paragraphs. The Article reads:

> "1. 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.
>
> 2. The following shall be compatible with the functioning of this Agreement:
> (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
> (b) aid to make good the damage caused by natural disasters or exceptional occurrences;
> (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is

> required in order to compensate for the economic disadvantages caused by that division.
>
> 3. 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;
> (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of an EC Member State or an EFTA State;
> (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;
> (d) such other categories of aid as may be specified by the EEA Joint Committee in accordance with Part VII."

12 According to Article 62(1) EEA, all existing systems of State aid as well as any plans to grant or alter State aid shall be subject to constant review as to their compatibility with Article 61 EEA. Article 62(1) EEA corresponds to Article 88(1) EC (ex Article 93(1) EC) and stipulates further that the EFTA Surveillance Authority shall carry out this review according to Protocol 26 to the EEA Agreement. That Protocol provides that:

> "The EFTA Surveillance Authority shall, in an agreement between the EFTA States, be entrusted with equivalent powers and similar functions to those of the EC Commission, at the time of the signature of the Agreement, for the application of the competition rules applicable to State aid of the Treaty establishing the European Economic Community, enabling the EFTA Surveillance Authority to give effect to the principles expressed in Articles 1(2) (e), 49 and 61 to 63 of the Agreement. The EFTA Surveillance Authority shall also have such powers to give effect to the competition rules applicable to State aid relating to products falling under the Treaty establishing the European Coal and Steel Community as referred to in Protocol 14."

13 Finally, Article 63 EEA refers to Annex XV to the EEA Agreement for specific provisions on State aid. Apart from four acts referred to in that Annex, which at the time of the Decision were Commission Directive 80/723/EEC on the transparency of financial relations between Member States and public undertakings, as amended; Commission Decision No. 2496/96/ECSC establishing Community rules for State aid to the steel industry; Council Directive 90/684/EEC on aid to shipbuilding, as amended; and Council Regulation (EC) No. 3094/95 on aid to shipbuilding, as amended, Annex XV lists non-binding acts, the principles and rules of which the Commission of the European Communities and the EFTA

Surveillance Authority shall take due account of in the application of Articles 61 to 63 EEA and the provisions of Annex XV.

14 Such non-binding acts include letters and communications from the Commission of the European Communities to Member States, Community frameworks and Council resolutions relating to matters such as prior notification of State aid plans, aid of minor importance, State guarantees, regional aid, general aid schemes and cumulation of aid, adopted by the Commission of the European Communities up to 31 July 1991. According to a decision of the EEA Joint Committee (Decision No. 7/94), acts adopted by the Commission of the European Communities after that date are not to be integrated into Annex XV. Rather, corresponding acts are to be adopted by the EFTA Surveillance Authority under Articles 5(2)(b) and 24 of the Surveillance and Court Agreement and published. The EFTA Surveillance Authority is to adopt the corresponding acts after consultation with the Commission of the European Communities in order to maintain equal conditions of competition throughout the European Economic Area. Both the Commission of the European Communities and the EFTA Surveillance Authority are to take due account of these acts in cases where they are competent under the EEA Agreement.

15 The EFTA Surveillance Authority has, as mentioned in paragraph 7, adopted corresponding acts in a consolidated document "Procedural and Substantive Rules in the Field of State Aid (Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement)", adopted and issued by the EFTA Surveillance Authority on 19 January 1994,[5] as subsequently amended on several occasions (hereinafter "the Guidelines"). In the introduction to the Guidelines, the EFTA Surveillance Authority refers to the emphasis of the Contracting Parties on the relevance of the basic principle of homogeneity for the field of State aid and the need for uniform State aid control throughout the territory covered by the EEA Agreement. Reference is also made to the aim to ensure uniform implementation, application and interpretation of Articles 61 and 62 EEA, as contemplated in Protocol 27 to the EEA Agreement.

[5] OJ 1994 L 231, p. 1, 03.09.94; EEA Supplement 03.09.94 No. 32, p. 1

16 At the time of the Decision, Section 28.2 of the Guidelines laid down rules for the application of Article 61(3)(c) EEA regarding *inter alia* criteria for transport aid:

> **"I. 28.2. METHOD FOR THE APPLICATION OF ARTICLE 61(3)(C) TO NATIONAL REGIONAL AID**
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> *(...)*
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> ***28.2.3.* First stage of analysis with regard to regions with a very low population density*****
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> *28.2.3.1. Population density threshold*
>
> (1) In order to take account of special regional development problems arising out of demography, regions corresponding to NUTS[6] 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).
>
> (2) The introduction of this threshold for the interpretation and application of Article 61(3)(c) of the EEA Agreement with regard to regional aid may be based on the grounds set out below:
>
> (3) The Joint Declaration on Article 61(3)(c) of the EEA Agreement acknowledges the fact that the indicators used in the first stage of the method do not properly reflect the regional problems specific to certain Contracting Parties, particularly the Nordic countries (Norway, Sweden, Finland and Iceland). In these countries there are important aspects of the regional situation which the indicators are supposed to describe and which fall outside the scope of the method of analysis of eligibility as described in Section 28.2.2. of these guidelines.
>
> (4) These shortcomings are in a large part due to a number of 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. These are specific factors which are not reflected in the statistical indicators used in Section 28.2.2.
>
> (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

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6 Note by the Court: Nomenclature of Statistical Territorial Units.

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.

(6) On those grounds, it could be held that a population density threshold of less than 12.5 per km^2 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.

28.2.3.2. Criteria for transport aid

(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 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.[1]
- 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.[2]
- Any plans to put into effect new schemes or to amend existing schemes of assistance to transport should contain a limitation in time and should never be more favourable than existing schemes in the relevant EFTA State.

(3) The EFTA Surveillance Authority aims at reviewing the existing schemes of assistance to transport on the basis of these criteria within three years from the entry into force of the EEA Agreement.

* 28.2.3. inserted as new section by EFTA Surveillance Authority Decision of 20 July 1994.

** This section corresponds to the Commission Notice on changes to the method for the application of Article 92(3)(c) of the EC Treaty to regional aid, adopted by the European Commission on 1 June 1994.

1 Commission Decision 3855/91/ECSC of 27 November 1991 establishing Community rules for aid to the steel industry (1991 OJ L 362, p. 57, 31.12.91).

2 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."

17 The functions and powers of the EFTA Surveillance Authority are laid down in the Surveillance and Court Agreement and in Protocol 3 to that Agreement. Article 1 of Protocol 3 sets out the procedures for examination of new and existing aid, which are identical in substance to those set out in Article 93 EC (now after modification Article 88 EC).

18 In accordance with Article 62(2) EEA, the Commission of the European Communities and the EFTA Surveillance Authority shall co-operate with view to ensuring a uniform surveillance in the field of State aid, as further laid down in Protocol 27 to the EEA Agreement. The other issues mentioned include exchange of information and views on general policy and of information regarding all decisions taken by each of the surveillance bodies.

Procedure before the EFTA Court and forms of order sought by the parties

19 By an application of 2 September 1998, lodged at the Court Registry on the same day, the Government of Norway (hereinafter variously the "Government of Norway" and the "Applicant") brought an action under Article 36 of the Surveillance and Court Agreement for annulment of the Decision.

20 On 16 November 1998, pursuant to Article 40 of the Surveillance and Court Agreement, the Applicant applied for suspension of the application of the Decision until the Court had delivered its judgment in the main case. The Court heard the representatives of the Applicant and the EFTA Surveillance Authority on 10 December 1998 and on the following day ordered the suspension of the application of the Decision until delivery of judgment.

21 Before opening the oral proceedings, the Court, by a letter of 12 February 1999, requested supplementary information from the Commission of the European Communities. This information was received at the Court Registry on 26 February 1999 along with comments from the Commission.

22 The Applicant claims that the EFTA Court should:

- annul the Decision of the EFTA Surveillance Authority of 2 July 1998 (Dec. No. 165/98/COL), and
- order the EFTA Surveillance Authority to bear the Applicant's costs.

23 The EFTA Surveillance Authority contends that the EFTA Court should:

- dismiss the application as unfounded, and
- order the Applicant to pay the costs.

Alleged infringement of Article 61 EEA

A general measure

Pleas in law

24 The *Applicant* submits, principally, that the system is a part of the general tax system in Norway and is sufficiently general in nature as not to involve State aid favouring certain undertakings within the meaning of Article 61(1) EEA.

25 The Applicant maintains that various selective elements are inherent in any tax system which, by nature and/or by policy, necessarily create different effects not only between different undertakings or persons, but also between different sectors of the economy and different regions of a State. It cannot be the intention that the notion of aid in Article 61(1) EEA and Article 87(1) EC (ex Article 92(1) EC) include all tax measures where it is possible to identify an effect which differs from one enterprise to another.

26 The Applicant has further stresses that, as the EEA Agreement does not contain any provisions concerning harmonization of tax schemes, it is for each State to design and apply a tax scheme according to its own choices of policy. In the preparations prior to ratification of the Agreement, the Government of Norway expressed its views as to the compatibility of the system with the EEA Agreement and its intention to continue its application.

27 With regard to the selectivity criterion, the Applicant maintains that a regional element is not sufficient in order to establish that aid favours certain undertakings. The Applicant submits that the EFTA Surveillance Authority erred in finding that the selectivity criterion is fulfilled when the effect of a measure is to favour enterprises located in certain regions, as opposed to a majority of enterprises in other regions which are not able to benefit from the measure.

28 The Applicant submits that the decisive factor is not the effects on certain undertakings, but rather the general nature of the criterion applied. The Applicant emphasizes that the scheme is neutral as to the type of industry, company size, occupation and form of ownership and location of the enterprise. The Applicant

further stresses that the scheme is different from that under consideration in Case 173/73 *Italy* v *Commission* [1974] ECR 709, as the Norwegian scheme comprises all sectors of the economy and is not aimed at or designed to favour only those industries or undertakings exposed to intra-EEA trade.

29 The Applicant also states that the EFTA Surveillance Authority has, erroneously, failed to include employment policy considerations as part of its assessment. The Norwegian scheme divides the work force into five categories which correspond to five tax rates. The objective is to strengthen employment and settlement in outlying districts. In the view of the Applicant, the scheme contributes to these objectives by granting employees resident in zones 2 to 5 an advantage on the labour market. The system has a redistribution effect favouring these categories of workers by granting firms employing them an advantage through the system. The objectives pursued through the scheme, *i.e.* maintaining settlement patterns, income equalization and employment equalization throughout the country must be viewed as *legitimate aims* capable of justifying the fact that the effect of the scheme may differ from one undertaking to another. This is so because of the special problems Norway faces, *inter alia* on the labour market, because of its geographical location, long distances, climate, population and settlement patterns.

30 Finally, the Applicant pleads that, in a broader context, the Court is called upon to draw the line between the responsibilities and competence of, on the one hand, the Contracting Parties and, on the other hand, the institutions set up under the EEA Agreement. Article 61 EEA is broadly formulated and there is no case law on a system as general in nature as the Norwegian one. The interests and responsibilities have to be considered in a broad context and the Court should not, as the EFTA Surveillance Authority has done, extend the scope of the State aid concept. As a social and economic system, the Norwegian scheme is purposeful, effective and proportionate when assessed in relation to its objectives. It is also easy to apply and administer and it does not constitute any danger as regards the objectives of the EEA Agreement.

31 The *EFTA Surveillance Authority* and the *Commission of the European Communities* submit that, in principle, geographical or regional selectivity is capable of constituting State aid within the meaning of Article 61(1) EEA and should not be treated differently from sectoral selectivity. The EFTA Surveillance Authority maintains that a measure which grants a benefit to all undertakings in a certain region, but not to undertakings located outside that region, *per se* amounts to a favouring of certain undertakings within the meaning of Article 61(1) EEA. The Commission of the European Communities submits that, even if the point has not been specifically ruled on by the ECJ, the case law strongly implies that regional selectivity is, in principle, caught by Article 87(1) EC (ex Article 92(1) EC). Further, the Commission refers to established Commission practice, under

which State aid involving regional selectivity has been found to be incompatible with the common market.

32 The EFTA Surveillance Authority, supported by the Commission of the European Communities, submits that a measure which implies a distinct derogation from the general system with regard to the very element of that system that serves to characterize it as being general in nature cannot be considered justified on the basis of the nature or general scheme of the system itself. In the case at hand, a derogation providing for regional differentiation of the rates cannot be considered justified on the basis of the nature or general scheme of the system as the distortive effects on competition lie in the very derogation, rather than being an incidental result of it.

Findings of the Court

33 The matter before the Court is to determine whether the reduced rates applicable to some employers in Norway regarding contributions to a social security scheme constitute State aid within the meaning of Article 61(1) EEA. The Court must also rule on whether the selectivity criterion inherent in the notion of aid is fulfilled or whether, as argued by the Applicant, the system must be seen as a general tax measure falling outside the scope of Article 61(1) EEA because of the objective criteria on which it is based, its open and non-discriminatory nature and automatic application, and the legitimate policy considerations on which it is based.

34 The *Court* notes first that, as a general rule, a tax system of an EEA/EFTA State is not covered by the EEA Agreement. In certain cases, however, such a system may have consequences that would bring it within the scope of application of Article 61(1) EEA. It is established case law of the ECJ that the fiscal nature of a measure does not shield it from the application of Article 92 EC (now after modification Article 87 EC). Nor does Article 92 EC (now after modification Article 87 EC) distinguish between the measures of State intervention by reference to their causes and aims but rather defines them in relation to their effects (see Case 173/73 *Italy* v *Commission*, cited above, at paragraph 13). In referring to "any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever", Article 61(1) EEA is directed at all aid financed from public resources. Such measures which favour certain undertakings or the production of certain goods may thus fall within the scope of Article 61(1) EEA.

35 A primary criterion for the generality of a system is that it applies to all undertakings within the territory of a given Contracting Party. Aid programmes may concern a whole sector of the economy or may have a regional scope and be intended to encourage undertakings to invest in a particular area.

36 Article 61(1) EEA does not make any distinction between different kinds of aid and does not provide that any one kind automatically falls within its ambit (see Case 248/84 *Germany* v *Commission* [1987] ECR 4013, at paragraph 18). Each case must be assessed on the basis of the benefits granted and the effects of the measure. However, the Court finds merits in the arguments of the Commission of the European Communities to the effect that the structure of Article 61 EEA supports the conclusion that regional aid is, in principle, caught by Article 61 EEA, as it distinguishes between the issue of whether a measure constitutes aid under Article 61(1) EEA and the possibilities for exemptions found in Article 61(3)(a) and (c) EEA.

37 It is not in dispute that the differentiated contribution system at issue was designed to benefit certain regions. Although the advantageous contribution rates are formally open to all undertakings, the Court finds that the system does in fact confer direct competitive advantages on undertakings in the favoured regions compared to undertakings located elsewhere, due to the high correlation between the zone of location of an undertaking and the place of residence of its workforce.

38 The Court thus finds that the system of regionally differentiated social security contributions must be seen as favouring certain undertakings within the meaning of Article 61(1) EEA, unless it can be shown that the selective effect of the measures is justified by the nature or general scheme of the system itself. Any direct or indirect discrimination which is to be considered justified must derive from the inherent logic of the general system and result from objective conditions within that general system. In the opinion of the Court, these criteria are not satisfied in the present case, where differentiation is based on regional criteria alone.

39 For the assessment under Article 61(1) EEA, it is not decisive whether or not the system is based on certain legitimate policy considerations. On the contrary, the arguments presented by the Applicant on this point rather strengthen the conclusion that the system is aimed at favouring certain undertakings. The policy considerations mentioned by the Applicant, seen in the light of the special geographic and harsh weather conditions of the Nordic countries, may instead be taken into account by the EFTA Surveillance Authority in its assessment under Article 61(3) EEA.

40 With regard to the pleadings of the Applicant on the demarcation of the powers of the institutions set up under the EEA Agreement, the Court observes the following: the provisions of the EEA Agreement shall be interpreted in conformity with the relevant rulings of the Court of Justice of the European Communities (hereinafter “ECJ”) given prior to the date of signature of the EEA Agreement, cf.

Article 6 EEA; rulings given subsequent to the date of signature of the EEA Agreement shall be duly taken account of by the EFTA Surveillance Authority and this Court in the interpretation and application of the Agreement, cf. Article 3(2) of the Surveillance and Court Agreement.

41 The Court notes, however, that the case law of the ECJ does not provide a clear answer regarding the issue of general measures that fall outside the prohibition in Article 92 EC (now after modification Article 87 EC, corresponding to Article 61 EEA) with regard to a system of the scope and nature of the one at issue in the present case. Furthermore, Commission notices and communications, as well as Commission decisions in particular cases, are not binding on the EFTA Court.

42 While such sources may be relevant for the application of Article 61(1) EEA by the EFTA Surveillance Authority, and while the EFTA Surveillance Authority has wide discretion in matters involving economic and social assessment, such as is called for in particular pursuant to Article 61(3) EEA, it is the task of the Court to review the EFTA Surveillance Authority's conclusions regarding the interpretation of Article 61(1) EEA with regard to what constitutes aid (see *e.g.* Case 310/85 *Deufil* v *Commission* [1987] ECR 901, at paragraphs 7 and 8).

43 The Government of Norway has, by its membership in the European Economic Area, accepted to adhere to the framework established under the EEA Agreement. The Government has also agreed to amendments to these rules at later stages. The Court finds that the EFTA Surveillance Authority has not, in its Decision now under scrutiny, acted beyond its competence or wrongly applied the rules on State aid. It follows from the foregoing that the Norwegian social security contribution scheme constitutes State aid within the meaning of Article 61 EEA. The first part of the first submission of the Applicant must therefore be dismissed as unfounded.

Effects on trade

Pleas in law

44 The second and subsidiary part of the first submission of the Applicant is to the effect that, since the EFTA Surveillance Authority has failed to identify the aid which affects trade between Contracting Parties, and thus failed to decide which parts of the system infringe Article 61(1) EEA, the entire Decision must be annulled. The Applicant submits that the EFTA Surveillance Authority erred in finding the system *as such* to be in breach of Article 61 EEA, as the Article provides that State aid is incompatible with the EEA Agreement only in so far as it affects trade between Contracting Parties.

45 The *Applicant* argues, first, that the EFTA Surveillance Authority incorrectly interpreted and applied the condition "in so far as it affects trade between Contracting Parties" in Article 61(1) EEA. In particular, the Applicant maintains that, to establish a breach of Article 61(1) EEA, it must be shown that the undertakings, products or sectors benefiting from the aid are competing in intra-EEA trade. Where different kinds of undertakings in various sectors benefit from an aid scheme, the fact that certain recipients compete in intra-EEA trade does not, in the view of the Applicant, make the entire scheme as such incompatible with the EEA Agreement.

46 The Applicant further argues that the conclusion of the Decision includes various activities which have no effects on trade and therefore fall outside the scope of Article 61(1) EEA, and that the EFTA Surveillance Authority has exceeded its powers under Article 62 EEA and Article 1 of Protocol 3 in declaring that the Government of Norway must notify such aid, and that the aid will only be legal when it has been found eligible for regional transport aid by the EFTA Surveillance Authority.

47 The *EFTA Surveillance Authority* states that the examination of the compatibility of an aid scheme with the EEA Agreement relates to the scheme itself and not to any individual aid granted under the scheme. For the scheme to be approved, it must be compatible with the Agreement in all respects and, if it leaves room for the granting of aid incompatible with the Agreement, it cannot be considered compatible unless altered so as to eliminate the possibility of granting such aid. Further, monitoring of State aid under the EEA Agreement depends on co-operation with the State concerned, and the justification and information necessary in order for a scheme to be approved in part or subject to conditions will, first of all, have to be provided by the State.

48 The EFTA Surveillance Authority submits that the contention of the Applicant to the effect that the EFTA Surveillance Authority misapplied Article 61(1) EEA by finding the system as such incompatible with the EEA Agreement, regardless of the situation of undertakings not operating in intra-EEA competition, and that it exceeded its powers by subjecting the benefits enjoyed by such undertakings to notification or other obligations, is based on a misconception of the scope and implications of the Decision.

49 First, the effect of the Decision is that, after 31 December 1998, a benefit under the system can no longer be considered existing aid within the meaning of Article 61(1) EEA. While this means, in principle, that any benefit granted under the system after that date will be illegal unless notified and authorized, this applies only to benefits constituting aid within the meaning of Article 61(1) EEA. Thus, the finding does not alter the situation prevailing prior to the Decision in respect of

benefits falling outside the scope of the Agreement. Secondly, as regards the necessary adjustments to the system required by the EFTA Surveillance Authority, they are not obligations imposed on Norway, but only indications as to what would be required in case Norway, in order to comply with the Decision, were to opt for retaining the system rather than replacing or abolishing it. If benefits under the altered system did not affect or threaten to affect trade but nevertheless were subject to the reporting condition or other conditions, this would not be a result of the Decision of the EFTA Surveillance Authority but of the fact that the system submitted for approval included both aid and benefits not constituting aid.

50 The *Commission of the European Communities* submits that the EFTA Surveillance Authority has the power to conduct the analysis under Article 61(1) EEA by reference to a scheme (regime or system) expressed in the abstract, rather than by reference to specific undertakings. The Commission of the European Communities further supports the submissions of the EFTA Surveillance Authority to the effect that such a scheme should not be approved unless the terms of the scheme are sufficiently precise so as to make it impossible in law for aid to be granted that would not be consistent with the State aid rules. In the view of the Commission of the European Communities, it is up to the Government of Norway to differentiate between those beneficiaries of the system it considers caught by Article 61(1) EEA and those it does not, so that the Government is estopped from pleading its own failure in defence of the scheme as a whole.

51 With regard to the arguments of the Applicant concerning the effect on trade between the Contracting Parties, the Commission of the European Communities submits that is not necessary, in order for there to be an effect on trade between Contracting Parties, that the product or service in question is actually exported from or imported to the State concerned. It is sufficient if there are undertakings in other States that are in competition with the undertakings receiving the aid. In such a case, the aid strengthens the position of the recipient vis-à-vis its competitor in the other State and potentially reduces the possibilities for the competitor to enter the market of the aid recipient. Such aid is capable of affecting trade between Contracting Parties.

52 Lastly, the Commission of the European Communities argues that, even if it would have enhanced the clarity of the operative part of the Decision to mention expressly that *State aid involved in* the system of regional differentiation was incompatible with the Agreement, instead of only referring to the system as such, this is not a ground of annulment *inter alia* as the conclusion as to the incompatibility of the system as such is correct and as it is implied in the Decision that it is only *State aid* involved in the system which is incompatible with Article 61(1) EEA.

Findings of the Court

53 The *Court* notes at the outset that the Decision was taken in the context of the EFTA Surveillance Authority's examination of existing aid pursuant to Article 1(1) of Protocol 3. According to that Article, 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.

54 If, after giving notice to the parties concerned to submit their comments, the EFTA Surveillance Authority finds that aid is not compatible with the functioning of the EEA Agreement, it shall decide that the EFTA State concerned shall abolish or alter such aid within a period of time to be determined by the EFTA Surveillance Authority.

55 In the present case, where a decision was taken subsequent to the procedure described in Articles 1(1) and 1(2) of Protocol 3, the EFTA Surveillance Authority was correct in basing its assessment on the characteristics of the aid scheme as such.

56 First, it was the scheme of regionally differentiated social security contributions that was under consideration, a scheme which itself did not determine its application with reference to certain sectors, industries or activities. As pointed out by the Commission of the European Communities, the final decision, following a procedure pursuant to Article 1 of Protocol 3, must necessarily relate to the same matters as the opening decision. Secondly, as submitted by the EFTA Surveillance Authority, an assessment on an undertaking-by-undertaking basis, or even on a sector-by-sector basis, as proposed by the Applicant, was not feasible in view of the scope of the system and the factor on which the eligibility for the lower rates was based. Thirdly, in its Decision, the EFTA Surveillance Authority explicitly stated that its conclusions only related to benefits which constitute aid within the meaning of Article 61(1) EEA.

57 As regards the argument of the Applicant to the effect that competition of some undertakings in intra-EEA trade does not make the entire scheme incompatible with the EEA Agreement, the Court finds that the submissions of the EFTA Surveillance Authority must be upheld. Thus, when examining the compatibility with the EEA Agreement of aid granted in accordance with an existing aid scheme, a decision on the matter will relate to the scheme itself and not to individual aids granted under the scheme. In such a case, the EFTA Surveillance Authority may confine itself to examining the characteristics of the scheme in

question in order to determine whether, by reason of the high amounts or percentages of aid, or the nature or the terms of the aid, it gives an appreciable advantage to recipients in relation to their competitors and is likely to benefit undertakings engaged in trade between Contracting Parties, see Case 248/84, *Germany* v *Commission*, cited above, at paragraph 18.

58 In assessing the effects on trade, the EFTA Surveillance Authority took account of the fact that the lower rates in zones 2-5 apply to all undertakings employing persons residing in those zones, including undertakings exposed to intra-EEA competition, *inter alia* undertakings engaged in export activities and domestic undertakings facing competition from foreign EEA producers of goods and services. The EFTA Surveillance Authority found that undertakings benefiting from the lower rates were in competition with producers in zone 1 or producers in other EEA States, *e.g.* producers of aluminium, ferro alloys, steel, as well as shipyards. It also stated that the aid strengthened the position of such undertakings relative to other undertakings competing within the European Economic Area and thus affected trade. The EFTA Surveillance Authority also concluded that the fact that the lower rates also applied to economic activities sheltered from international competition did not eliminate the effect on trade, but it explicitly raised no objections to such activities.

59 According to established case law of the ECJ, when State aid strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade, the latter must be regarded as affected by that aid. For that purpose, it is not necessary for the beneficiary undertaking itself to export its products. Where a Member State grants aid to an undertaking, domestic production may, for that reason, be maintained or increased, with the result that undertakings established in other Member States have less chances of exporting their products to the market in that Member State (see Joined Cases C-278/92 C-279/92 and C-280/92 *Spain* v *Commission* [1994] ECR I-4103, at paragraph 40; Case 730/79 *Philip Morris* v *Commission* [1980] ECR 2671, at paragraph 11; and Case 102/87 *France* v *Commission* [1988] ECR 4067, at paragraph 19). This case law is relevant in interpreting Article 61 EEA.

60 The Court further notes that, in its Decision, the EFTA Surveillance Authority went on to examine possibilities of exemptions pursuant to Articles 61(3)(a) and (c) EEA and found that certain areas and certain activities would qualify for regional transport aid under the latter provision. In this analysis, the EFTA Surveillance Authority took into account sectoral considerations and conditions related to certain activities as well as the issue of effect on intra-EEA trade and *de minimis* considerations. The Court notes that the Applicant has not specifically contested the assessments or conclusions reached by the EFTA Surveillance Authority in this part of its Decision.

61 It follows from the foregoing that the arguments of the Applicant must be rejected. It also follows that the second line of arguments advanced by the Applicant under the second submission, *viz.* that the EFTA Surveillance Authority exceeded its powers in its pronouncement on aid falling outside Article 61(1) EEA, is unfounded. As both the EFTA Surveillance Authority and the Commission of the European Communities have submitted, the Decision has only declaratory effect with regard to the aid scheme as such. Further, it is based on Article 61 EEA, which stipulates that aid which distorts 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 the Agreement.

62 The operative part of the Decision must be read not only in the context of the State aid rules contained in the Agreement, but also in the context of the Decision as a whole and its background. The Court therefore finds that the scope of the Decision and the obligations of the Government of Norway pursuant to the Decision are sufficiently clear, and that the EFTA Surveillance Authority did not exceed its powers in determining the matter.

63 The first submission of the Applicant must therefore be dismissed as unfounded.

Statement of reasons

Pleas in law

64 The *Applicant* submits that the EFTA Surveillance Authority has failed to provide an adequate statement of reasons with regard to the issues referred to under the first submission.

65 The Applicant argues in particular that the EFTA Surveillance Authority has not explained why the neutral parameter (residence of the employee) applied and the policy considerations pursued by the Government of Norway are of “no relevance”.

66 The Applicant also submits that the failure by the EFTA Surveillance Authority to explain why aid to undertakings that are clearly not affected by intra-EEA competition falls within the scope of Article 61(1) EEA constitutes a breach of the EFTA Surveillance Authority’s obligation to set out the “principal issues of law”. Further, the Applicant claims that the failure to draw the line as to which undertakings operate under conditions of intra-EEA trade and which fall outside

the scope of Article 61(1) EEA is an infringement of the EFTA Surveillance Authority's obligation to give clear decisions.

67 The *EFTA Surveillance Authority* submits that the reasoning fully satisfies the requirements laid down by Article 16 of the Surveillance and Court Agreement and further clarified through case law, and that the pleadings of the Applicant are partly based on a misunderstanding of the scope of the Decision. The Commission of the European Communities submits that the reasoning of the Decision satisfies all the relevant requirements.

Findings of the Court

68 The *Court* has in Case E-2/94, *Scottish Salmon Growers* [1994-1995] EFTA Court Report 59, held that to fulfil the requirements of Article 16 of the Surveillance and Court Agreement, a decision by the EFTA Surveillance Authority must set out, in a concise but clear and relevant manner, the principal issues of law and fact upon which it is based and which are necessary in order that the reasoning which led the EFTA Surveillance Authority to its decision may be understood.

69 The Court finds that the EFTA Surveillance Authority has, in a sufficiently clear manner, accounted for the facts and legal issues relevant to the case.

70 However, the Court notes that the EFTA Surveillance Authority cannot be seen to have fully considered the effect of harsh weather conditions or other circumstances which may justify an improvement of the employment situation by lowering the costs of labour in the affected areas. The Court does not find that there are sufficient grounds for annulling the Decision for lack of reasoning covering factors other than those warranting the granting of regional transport aid, but emphasizes that it is the obligation of the EFTA Surveillance Authority, in considering a revised system of regional aid, to consider all aspects of the matter.

Costs

71 Under Article 66(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs if they have been applied for in the successful party's pleadings. Since the Applicant has been unsuccessful, it must be ordered to pay the costs of the EFTA Surveillance Authority. The costs incurred by the Commission of the European Communities, which has submitted observations to the Court, are not recoverable.

On those grounds,

THE COURT

hereby

1. Dismisses the application;

2. Orders the Government of Norway to bear the costs of the EFTA Surveillance Authority.

Bjørn Haug Carl Baudenbacher Thór Vilhjálmsson

Delivered in open court in Luxembourg on 20 May 1999

Gunnar Selvik
Registrar

Bjørn Haug
President