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Application of Economic Analysis in State Aid Cases: A Progress Report

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Economic analysis in State aid cases: any progress?

- The short answer: Yes. The long answer is … more detailed
- Main areas in which economic analysis plays a role
  - Article 107(1) TFEU – notion of aid
    - Mostly on the question of advantage/MEOP (financial analysis)
    - Much less present in other respects
  - Article 107(3) TFEU – compatibility of aid
    - Application of economic analysis in individual cases vs. application in the design of the rules
    - The action is at both levels

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Compatibility of aid: the "quest for effectiveness"

- Over the years, growing emphasis on the effectiveness of state subsidies in pursuing public policy objectives, while limiting distortions
- State Aid Action Plan (SAAP, 2005): "Less and better targeted aid"
  - Purpose: striking a better balance between
    - benefits of state aid (addressing market failures or equity concerns) and
    - costs of state aid (distortions)
  - Formulated as a "balancing test" (under Art. 107(3)(c) TFEU)
  - Architecture of state aid rules: block exemption (GBER) vs. more in-depth analysis of individual cases
- State Aid Modernisation (SAM, 2014): "Better regulation"
  - Building on SAAP, but much bigger role for GBER
  - Broadening/simplification of GBER counterbalanced by some tightened conditions within GBER and more scrutiny of notified cases

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Effectiveness of state aid

- Key questions:
  - Does state aid make a difference?
  - If so, to what extent?
  - For which types of firms?
- Requires assessment of the counterfactual → what would the company/companies do without aid?
- Effectiveness can be assessed
  - *Ex-ante*: assessment of incentive effect criterion of individual measures
    - based on profitability assessments (NPV, IRR), financing constraints, …
  - *Ex-post*: evaluation of aid schemes
    - comparing the "treatment group" with a "control group" using statistical methods
- Counterfactual also important for understanding the resulting distortions

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Illustration: regional aid / VW Sachsen (2010)

- Regional aid for investment project of VW-Group in Zwickau, Sachsen (DE)
- Project involving
  - Change of production process for small/midsized cars (from platform strategy to module strategy)
  - Construction of new manufacturing hall
- Eligible cost: EUR 735 mln, aid amount: EUR 95 mln
- Timeline:
  - Start of works: 12/2009, completion: 05/2014
  - Notified on 27.12.2010
  - Opening of formal investigation procedure (Art. 108(2) TFEU): 13.07.2011
  - Notification withdrawn on 05.11.2012

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VW Sachsen (cont'd)

- In-depth Assessment Communication (2009): application of "balancing test", i.e. analysis of
  - Objective of common interest
  - Design of the aid measure: incentive effect & proportionality
  - Distortions of competition and trade; balancing
- Prima facie, a good development for the region.
- Assessment of incentive effect/counterfactual central element → assessed on the basis of (contemporaneous) company internal documents
- Doubts on incentive effect
- Even if there was an incentive effect, in which direction would it go?
  - Did the aid merely attract the investment away from other, even more disadvantaged regions?
- Notification withdrawn

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Similar cases

- Audi Gyor - Hungary (2009, EUR 50mln) – withdrawn
- Fiat Powertrain - Poland (2010, EUR 41mln aid) – withdrawn
- Revoz - Slovenia (2011, EUR 40mln aid) – withdrawn
- Linamar Powertrain Saxony - Germany (2011, EUR 26mln aid) – withdrawn
- Ford Valencia – Spain (2011, EUR 24mln aid) – withdrawn
- BMW Leipzig (2010, EUR 45mln aid) – only partly approved (EUR 17mln), currently under appeal

Changes introduced in RAG 2014, GBER 2014

Main changes:

- Limits on eligibility of initial investment projects by large enterprises in ‘c’-areas
  – Reflecting insights (from empirical literature/case experience) that aid to LEs is typically less effective, likely to lead to fierce subsidy races and/or lead to anti-cohesion effects (by drawing away investment from 'a'-areas)
- Approach reflected in GBER: Investment aid for existing activities in ‘c’-areas no longer block exempted
- RAG: Compatibility assessment on the basis of "Common Principles" (similar to balancing test) for all notified cases
- Increased transparency requirements + ex post evaluation of effectiveness (for larger aid schemes)
  – SAM (2014): a shift from ex ante to ex post evaluation (for large schemes) under GBER

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State aid and efficiency incentives: the case of SGEI

- Background: previous SGEI rules (2005) led to rather strict interpretation of "no overcompensation" requirement. Strong emphasis on avoiding overcompensation *ex post* (even annually)
- Problems with this approach:
  - Ex post perspective leads to compensation adjusting to costs incurred and revenues obtained. Takes away incentives for the firm to contain costs/become more efficient over time
  - SGEI contracts often have multi-annual perspective
- 2011 Package (Framework): compensation amount for SGEI can be established on the basis of
  - i. expected costs and revenues (lump sum approach),
  - ii. the costs and revenues actually incurred, or
  - iii. a combination of the two

  depending on the efficiency incentives the authority wishes to provide over the lifetime of the contract. Lower profit allowed if compensation is calculated purely on an ex post basis (because contract bears little risk)

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Conclusion

- Over the past decade, the Commission has paid increasing attention to the effectiveness of state aid
  - assessment of incentive effect
  - ex-post evaluation of the effectiveness of the aid
- Assessment of incentive effect/counterfactual also relevant for understanding the distortions
- Equally, growing emphasis on the efficiency of aid

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Thank you!

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