



# Crisis, what crisis? Business as usual for EU Competition Policy and Regional Aid Control

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## Preface

This paper aims to provide a review and assessment of EU competition policy control of regional State aid. The paper has been prepared by the European Policies Research Centre (EPRC) under the aegis of EoRPA (European Regional Policy Research Consortium), which is a grouping of national government authorities from countries across Europe. The Consortium provides sponsorship for the EPRC to undertake regular monitoring and comparative analysis of the regional policies of European countries and the inter-relationships with EU Cohesion and Competition policies. EoRPA members currently comprise the following partners:

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#### Disclaimer

It should be noted that the content and conclusions of this paper do not necessarily represent the views of individual members of the EoRPA Consortium.

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## EXECUTIVE SUMMARY

Since Autumn 2008, European Commission control of State aids has operated against the backdrop of unprecedented economic turmoil. The upheaval in the financial markets has affected not only credit institutions themselves, necessitating massive government support, but has also spilt over into the so-called ‘real’ economy. The severity of the crisis has prompted fears of protectionist policies to preserve national champions as well as concerns at whether the whole edifice of the single market could withstand the impact of the crisis and whether the authority of the Commission in matters of State aid could survive the onslaught of demands from Member States.

The Commission has responded to exceptional events with exceptional measures. For the first time, extensive use has been made of Article 87(3)(b), which enables aid to “remedy a serious disturbance in the economy of a Member State”. This has been used as the basis for special temporary measures to support both the banking sector and the wider economy.

Regional aid policy has remained largely immune from this; the Commission has resisted requests to relax regional aid control and it has refused the use of Article 87(3)(b) for measures restricted to particular regions. Regional aid spending has probably fallen in the last year as firms retrenched rather than expanded their activities. Moreover, regional policy considerations *per se* have not been high on the agenda - instead, the emphasis has been on addressing problems where they occur, rather than in relation to a preordained map of assisted areas; it is not yet clear what new patterns of spatial inequality might emerge as the recession recedes.

State aid to address the crisis has dominated the Commission agenda in the past year or so. However, it has continued to follow its ‘road map’ for reform in the shape of the 2005-09 State Aid Action Plan. For regional aid policy, an important component of this has been the introduction of a ‘more economic approach’ to the treatment of large investment aids, reflected in the publication of the Commission’s Guidance on how it will handle such cases. Commission persistence with this agenda suggests that it anticipates an orderly return to standard State aid control.

Against the backdrop of the turmoil created by the financial and economic crisis, the final section aims to draw out a number of issues as the basis for further consideration.

- Perceptions of the Commission’s performance in controlling State aids in the crisis has been mixed, but so far broadly positive
- Most commentators consider that intervention in the banking sector is justified; there is less consensus regarding other sectors
- Policing State aid in other sectors, especially the motor industry, is likely to prove a significant challenge
- The implications of the crisis for regional aid as Europe emerges from recession are uncertain

- A ‘business as usual’ approach to regional aid control may constrain regional policy in the post-recession period
- The long-term implications of the economic crisis for State aid control are unclear.

## 1. INTRODUCTION

Since Autumn 2008, European Commission control of State aids has operated against the backdrop of unprecedented economic turmoil. The upheaval in the financial markets has affected not only credit institutions themselves, necessitating massive government support, but has also spilt over into the so-called 'real' economy.

The severity of the crisis has prompted fears of protectionist policies to preserve national champions as well as concerns at whether the whole edifice of the single market could withstand the impact of the crisis and whether the authority of the Commission in matters of State aid could survive the onslaught of demands from Member States.

The Commission has responded to exceptional events with exceptional measures. For the first time, extensive use has been made of Article 87(3)(b), which enables aid to "remedy a serious disturbance in the economy of a Member State". This has been used as the basis for special temporary measures to support both the banking sector and the wider economy.

At one level, regional aid policy has remained largely immune from this; the Commission has resisted requests to broaden the scope of regional aid, for example, by extending the assisted area maps; it has also refused the use of Article 87(3)(b) for measures restricted to particular regions. On the other hand, the measures authorised by the Commission in response to the crisis can be applied in the assisted areas as elsewhere. The temporary nature of the crisis measures and the use of a separate legal basis for authorisation has meant the creation of a 'parallel universe' for State aids to address the financial and economic crisis involving volumes of aid that dwarf regional policy expenditure.

The longer-term implications of the crisis are difficult to predict on any level. The last decade or so has seen a decline in the use of subsidies, partly in response to Commission pressures but also because of domestic concerns about their negative impacts, their cost to the public purse and doubts about their efficiency. The events of the past year will dramatically reverse recent expenditure trends, but it remains to be seen whether the expiry of the temporary provisions in 2010 will mark a return to previous patterns of *total* aid spending. At the same time, *regional* aid spending has probably fallen in the last year as firms retrenched rather than expanded their activities. Moreover, regional policy considerations *per se* have not been high on the agenda - instead, the emphasis has been on addressing problems where they occur, rather than in relation to a preordained map of assisted areas; it is not yet clear what new patterns of spatial inequality might emerge as the recession recedes.

In the last year, the main focus of EU competition policy in relation to State aids has been on measures to address the financial and economic crisis. This is reflected in Section 2 of this paper which outlines the regulatory framework for these measures and gives an indication of overall levels of spend. Regional aid has not been a major component of the recovery packages of the Member States and in most countries regional aid spending continues to decline. Nevertheless, there are wide variations between the Member States, on which the Commission partly bases its action on regional aid control. Section 3 provides

an overview of regional aid spending, setting it in the context of the crisis measures, and considers to what extent Member States have used regional aid in response to the crisis. State aid to address the crisis has dominated the Commission agenda in the past year or so. However, it has continued to follow its 'road map' for reform in the shape of the 2005-09 State Aid Action Plan. For regional aid policy, an important component of this has been the introduction of a 'more economic approach' to the treatment of large investment aids. The long-awaited publication of the Commission's Guidance on how it will handle such cases is discussed in Section 4, along with an overview of large regional aid cases since 2002. Against the backdrop of major competition policy concessions in response to the crisis, but firm controls on regional aid, Section 5 aims to identify some issues and questions as a basis for further discussion.

## 2. STATE AID AND THE ECONOMIC AND FINANCIAL CRISIS

Since autumn 2008 the European Commission has acted swiftly and decisively in reframing the State aid rules to take account of the economic and financial crisis; the Commissioner has been keen to stress that the State aid rules should be 'part of the solution, not part of the problem',<sup>1</sup> in rhetoric that has been echoed in numerous presentations by DG Competition staff in the past months.

From a legal perspective, recent policy developments represent a major departure from past practice: measures to address the crisis have been based on Article 87(3)(b) of the Treaty, which states that:

“Aid to promote the execution of an important project of common European interest or remedy a serious disturbance in the economy of a Member State” [may be compatible with the common market].

This provision has scarcely been applied in the history of the Community;<sup>2</sup> indeed the Commission and the Court have resisted its use, maintaining, for example, that the effects of German reunification on the national economy were insufficiently serious to justify its application. A key point to note is that, unlike Article 87(3)(c), Article 87(3)(b) makes no mention of the need to take account of the “common interest”.

In present circumstances, the deployment of Article 87(3)(b) is not only clearly appropriate, given the magnitude of the crisis, but also has the major benefit of separating measures aimed at the addressing the crisis from the existing State aid framework, which remains unchanged. All the measures introduced in the context of the crisis are end-dated, which should, from a legal point of view at least, ease the return to the standard rules in due course.

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<sup>1</sup> Neelie Kroes (2009) *EU state aid rules - part of the solution*, EStALI conference, Luxembourg, 5 December.

<sup>2</sup> It has been used in two instances in Greece; the provision on major projects has been invoked more frequently, for example in the case of the Channel tunnel rail link.

Since October 2008 and based on Article 87(3)(b), the Commission has introduced a number of Communications setting out its approach to State aid in the crisis. Four of these concern the financial sector; a fifth, the so-called 'real' economy. This section provides a brief overview of measures to address the financial crisis (2.1) and the economic crisis (2.2)

## 2.1 Intervention in the financial sector

In the course of 2007 a number European banks were affected by the beginnings of the financial crisis in the US. As a result, the Commission dealt with a number of individual State aid cases from the summer of 2007. These included Sachsen LB and IKB, Northern Rock, West LB, Roskilde Bank, Hypo Real Estate and Bradford & Bingley. These were assessed under the standard rescue and restructuring aid guidelines.<sup>3</sup> However, the deepening financial crisis, precipitated by the collapse of Lehman Brothers and its aftermath, led to the need to intervene systemically in the banking sector, as well as in individual cases of difficulty. In October 2008, Member State governments agreed to implement national rescue packages in order to safeguard the stability of the banking sector, restore the normal functioning of the wholesale credit markets and sustain the supply of credit to the economy. These were subject to the following principles:<sup>4</sup>

“support must in principle be temporary; the Member States will be watchful regarding the interests of taxpayers; existing shareholders should bear the due consequences of the intervention; governments should be in a position to bring about a change of management; management should not retain undue benefits; governments may have inter alia the power to intervene in remuneration; the legitimate interests of competitors must be protected, in particular through the state aids rules; negative spillover effects must be avoided.”

Against this background, the Commission moved to apply Article 87(3)(b), introducing a number of Communications over the course of 2008 and 2009, enabling it to authorise far-reaching intervention.

This section begins by outlining the main regulatory steps taken by the Commission with respect to the financial sector before going on to attempt some assessment of the scale of intervention involved.

### 2.1.1 *The regulatory framework for financial sector support*

In the State aid arena, the Commission has taken four steps to address the financial crisis; all of these are temporary - in principle they are applicable until end 2010, subject to review - and based on Article 87(3)(b). The EFTA Surveillance Authority has taken equivalent steps in respect of the EEA Member States, Iceland, Lichtenstein and Norway.<sup>5</sup>

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<sup>3</sup> *Communication from the Commission – Community guidelines on State aid for rescuing and restructuring firms in difficulty*, OJEU C 244/2 of 1 October 2004 (as amended - extended to October 2012).

<sup>4</sup> ECOFIN Council Meeting No 2894 of 7 October 2008, 13784/09.

<sup>5</sup> See: [http://www.eftasurv.int/fieldsofwork/fieldstateaid/state\\_aid\\_guidelines/](http://www.eftasurv.int/fieldsofwork/fieldstateaid/state_aid_guidelines/) Part VIII.

First, on 13 October 2008, the Commission adopted the so-called ‘Banking Communication’.<sup>6</sup> This aimed to stop or prevent runs on financial institutions by setting out guidance on how Member States could support the banking sector in ways which were compatible with the State aid rules. Based on Article 87(3)(b), it provided for swift authorisation of support such as guarantees or recapitalisation, provided it was well-targeted, proportionate to the objective of stabilising the financial markets and contained certain safeguards against negative effects on competition - such as, for example, non-discrimination on nationality grounds.

Second, on 5 December 2008, the Commission adopted the ‘Recapitalisation Communication’<sup>7</sup> which complemented and refined the Banking Communication. The Communication aimed to take account of the growing impact of the financial crisis on the ‘real’ economy, leading to even financially-sound banks requiring State capital in order to ensure adequate levels of lending to firms. The Communication distinguishes between ‘sound’ and ‘distressed’ banks (those whose business model has brought about a risk of insolvency), requiring greater safeguards, thorough restructuring and higher remuneration in return for capital injections for ‘distressed’ banks. More generally, the Communication reinforced the need to prevent State capital being used to fund aggressive commercial behaviour to the detriment of un-aided competitors.

Third, on 25 February 2009, the Commission provided guidance on the treatment of what it termed ‘impaired assets’, such as underperforming loans, US sub-prime mortgage backed securities and other ‘toxic’ assets. The Impaired Assets Communication<sup>8</sup> addresses the ‘clean-up’ phase of financial institutions’ balance sheets by outlining various mechanisms to ensure that foreseeable losses are disclosed and properly handled in order to restore confidence in the banking sector and enable capital to be used to resume normal lending in the real economy rather than as a cushion against possible losses. These mechanisms include ‘bad banks’ and assets insurance schemes. The Communication sets out the budgetary and regulatory implications of asset relief measures and the application of the State aid rules to them. In particular, it provides methodologies for the valuation of impaired assets, the remuneration for asset relief and criteria to be used for evaluating the State aid given.

Fourth, on 23 July 2009, the Commission presented guidelines on restructuring aid to banks.<sup>9</sup> The Commission is dealing with a number of individual cases of bank restructuring,

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<sup>6</sup> *Communication from the Commission – The application of State aid rules to measures taken in relation to financial institutions in the context of the current global financial crisis*, OJEU No. C270/8 of 25 October 2008.

<sup>7</sup> *Communication from the Commission – The recapitalisation of financial institutions in the current financial crisis: limitation of aid to the minimum necessary and safeguards against undue distortions of competition*, OJEU C10/2 of 15 January 2009.

<sup>8</sup> *Communication from the Commission - Treatment of impaired assets in the Community banking sector*, not yet published in the OJEU, but available at: [http://ec.europa.eu/competition/state\\_aid/legislation/impaired\\_assets.pdf](http://ec.europa.eu/competition/state_aid/legislation/impaired_assets.pdf)

<sup>9</sup> The adoption of the text will be formalised through publication in the OJEU, in the meantime, it is available here: [http://ec.europa.eu/competition/state\\_aid/legislation/restructuring\\_paper\\_en.pdf](http://ec.europa.eu/competition/state_aid/legislation/restructuring_paper_en.pdf)

following on from rescue measures which were approved on condition that a restructuring plan would follow within six months. The guidelines aim to ensure the transparency and predictability of the Commission decisions, which are based on three key principles. First, that aided banks must be viable in the long term, without further State aid. This means that, in devising future strategies, banks will have to undergo a so-called 'stress test' involving a diagnosis of strengths and weaknesses, which may include disclosing and dealing with impaired assets and even the consideration of whether takeover or winding-up is the most appropriate action. The second principle is that banks and their owners must bear a fair share of the restructuring costs; this requires, in particular, that the State is, at some stage, adequately remunerated for the aid provided. The third principle is that the distortion of competition should be limited. The Communication notes that approval of State support may be conditional on structural measures, such as divestitures, or behavioural measures such as constraints on acquisitions or on aggressive pricing and marketing strategies and that it will pay particular attention to national market structures.

### *2.1.2 The scale of intervention in the financial sector*

Between October 2008 and July 2009, the European Commission approved a range of national schemes for the banking sector, notably in the form of guarantees and recapitalisation as well as *ad hoc* interventions. The total volume of approved guarantee measures runs to some €2,900 billion,<sup>10</sup> with a further €313 billion on recapitalisation. In addition, many Member States have notified other specific measures, such as asset relief and direct lending to banks. The scale of the intervention involved expressed as a proportion of GDP is illustrated in Figure 1.

The total volume of crisis measures for the financial sector approved by the Commission amounts to around one-third of EU27 GDP.<sup>11</sup> Two points should be made about this figure. First, it refers to the intervention approved, not to that actually taken up; at mid-May 2009, the support taken up stood at 12.6 percent of EU27 GDP. Second, this figure represents the overall maximum amount of guarantee umbrellas, rescue and restructuring packages and other measures approved; this is different from the State aid element, the value of which can only be calculated *ex post*. Nevertheless, these volumes are striking: intervention approved runs to around a third of EU GDP, while the EU budget own resources ceiling is just 1.24 percent of EU GNI; in just five months, Member States committed more to *ad hoc* interventions in banks (€400 billion)<sup>12</sup> than is allocated to EU Cohesion policy for seven years (€347 billion); and the scale of this exposure - totalling over €3 trillion - dwarfs annual State aid expenditure of around €49 billion or 0.4% of EU GDP in 2007.

In general, intervention has been heavily concentrated in the EU15 countries, all of which have taken action. Among the new Member States, only Hungary, Latvia and Slovenia have

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<sup>10</sup> Excluding the approved Italian scheme, for which no sum was given.

<sup>11</sup> This is an estimate since the Italian guarantee figure is unknown.

<sup>12</sup> This excludes the early cases such as Bradford & Bingley, Northern Rock, Sachsen LB, etc which predated the crisis package.

deployed measures for the banking sector.<sup>13</sup> Guarantee schemes have been the most widely used instrument. From October 2008 until mid-July 2009, the Commission approved 11 guarantee schemes, six recapitalisation schemes and five combination schemes. A further 40 *ad hoc* interventions have been approved. *Ad hoc* cases may occur either because no scheme is or was in place when intervention was required, or because the recipient could not meet all of the criteria set out in the relevant Communication.

Figure 1: Approved public intervention in the banking sector - % of GDP

	Approved measures to 17 July 2009					Effective total to mid-May 2009
	Capital injections	Guarantees	Impaired assets relief	Liquidity and bank funding	Total	
Austria	5.0	25.7	0.4	1.6	32.8	8.7
Belgium	5.3	76.6	10.1	n/a	92.0	26.7
Bulgaria						
Cyprus						
Czech Rep						
Denmark	6.1	253.0		0.3	259.4	0.5
Estonia						
Finland		27.7			27.7	0.0
France	1.2	16.6	0.2		18.1	5.6
Germany	4.4	18.6	1.4		24.4	9.1
Greece	2.0	6.1			11.4	4.6
Hungary	1.1	5.9		3.3	7.1	2.7
Ireland	6.6	225.2			231.8	229.4
Italy	1.3	n/a			n/a	0.0
Latvia	1.4	25.7		10.9	37.9	8.9
Lithuania						
Luxembourg	6.9	12.4		0.9	20.2	8.8
Malta						
Netherlands	6.4	34.3	3.9	7.5	52.0	25.4
Poland						
Portugal	2.4	10.0			12.5	3.3
Romania						
Slovakia						
Slovenia		32.8			32.8	0.4
Spain		9.3		2.8	12.1	5.0
Sweden	1.6	48.5		0.1	50.2	8.9
UK	3.5	21.7		16.4	41.6	26.8
EU27	2.6	24.8	0.8	2.9	31.2	12.6
Norway	6.5					

Note: Approved measures cut-off date 17 July 2009; effective total is provisional, cut-off date mid-May.

Source: DG Competition (2009) *DG Competition's review of guarantee and recapitalisation schemes in the financial sector in the current crisis*, 7 August. Available at: [http://ec.europa.eu/competition/state\\_aid/legislation/review\\_of\\_schemes\\_en.pdf](http://ec.europa.eu/competition/state_aid/legislation/review_of_schemes_en.pdf); Own calculations for Norway based on EFTA Surveillance Authority decision no 205/09/COL and Eurostat data.

<sup>13</sup> As this paper went to print, the Commission approved measures for the financial sector in Poland - see: Rapid Press Release (2009) *State aid: Commission approves Polish support scheme for financial institutions*, IP/09/1360, 25 September.

The scale of intervention varies widely between countries. In Denmark and Ireland, for example, the *potential* exposure of the public purse is more than double national GDP; by contrast, in other EU15 countries, exposure is comparatively modest - in France, Greece, Portugal and Spain it is less than 20 percent of GDP. Clearly the ranking changes when sums are viewed in absolute terms because of the different sizes of national economies. Some estimates of the absolute amounts are given in Figure 2.

Figure 2: Estimated intervention in financial sector (€ billion)

	Approved measures to 17 July 2009	Effective total to mid-May '09
United Kingdom	756.9	487.6
Germany	606.9	226.4
Denmark	603.1	1.2
Ireland	421.6	417.2
France	352.6	109.1
Belgium	316.4	91.8
Netherlands	309.9	151.4
Sweden	165.0	29.3
Spain	132.5	54.8
Austria	92.4	24.5
Finland	51.1	0.0
Greece	27.7	11.2
Portugal	20.8	5.5
Italy	20.4	0.0
Slovenia	12.2	0.1
Latvia	8.7	2.1
Hungary	7.5	2.9
Luxembourg	7.4	3.2
Norway	5.1	n/a

Note: There is no figure for the following: Italian guarantees approved; Luxembourg guarantees granted; and liquidity and bank funding support in Belgium (either approved or granted). Data for these countries under the corresponding heads (approved or effective) is therefore an underestimate.

Source: Own estimates from Figure 1 and Eurostat data.

Figure 2 suggests that the UK 'led' the ranking both in terms of approved amounts and the actual uptake of measures by May this year; Germany and Denmark follow relatively closely in terms of sums approved. However, the scale of support for the banking sector in Ireland is particularly striking, with guarantees actually granted running to around €400 billion, more than double national GDP.

The take-up rate (the actual use of the measure relative to the budget committed) is significantly higher for recapitalisation schemes (54.8 percent) than for guarantees (32.8 percent). However, DG Competition notes that this is a preliminary indicator of the adequacy of a measure. Low take up rates for guarantees may be due to the amounts budgeted exceeding needs or ease of access to funds on the market. More generally, the very presence of a scheme may be effective in restoring financial stability, even without take-up, since it provides reassurance of government commitment to support the sector.

## 2.2 Temporary measures in response to the economic crisis

In December 2008, the Commission adopted a Temporary Framework for State aid measures to support access to finance in the crisis.<sup>14</sup> As for the financial sector, the measures are based on Article 87(3)(b), which enables the Commission to authorise measures to “remedy a serious disturbance in the economy of a *Member State*” [emphasis added]. Reflecting this, some subnational governments (such as Scotland and Vlaanderen) had proposals for such measures turned down on the basis that the conditions in the ‘economy of the *Member State*’ constituted the underlying justification for any authorisation - although clearly there are also administrative benefits to the Commission in terms of the potential number of notifications. An equivalent package has been adopted by the EFTA Surveillance Authority in respect of EEA States.<sup>15</sup>

### 2.2.1 The regulatory framework for economic crisis measures

The framework has two main objectives: (i) to allow measures that unblock bank lending to firms and thereby guarantee continuity in access to finance; and (ii) to facilitate aid schemes that encourage continued investment, especially in sustainable growth. Proposed measures must be notified and approved by the Commission prior to implementation, but thereafter individual aid within the terms of the approved scheme can be offered immediately and without further notification.

Under the framework, a number of conditions apply:

- all measures apply only to firms which were not in difficulty on 1 July 2008; they may apply to firms which entered into difficulties thereafter as a consequence of the economic and financial crisis;
- all measures are applicable to 31 December 2010;
- approved temporary measures may not be cumulated with *de minimis* aid in respect of the same eligible expenditure;
- approved temporary measures may be cumulated with other compatible aid or with other forms of Community financing, provided that the maximum aid intensities in the relevant guidelines or General Block Exemption Regulation are respected.

The Temporary Framework comprises both new instruments and the (temporary) modification of existing instruments. The key forms of aid which can be authorised under the framework are as follows.

- *A lump sum of up to €500,000 per undertaking.* This is only applicable to aid *schemes* (as opposed to *ad hoc* intervention). Firms in fisheries sectors and in primary production

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<sup>14</sup> The consolidated version including the February 2009 amendments is published as Temporary Community framework for State aid measures to support access to finance in the current financial and economic crisis, OJEU No C 83/1 of 7 April 2009.

<sup>15</sup> See: [http://www.eftasurv.int/fieldsofwork/fieldstateaid/state\\_aid\\_guidelines/](http://www.eftasurv.int/fieldsofwork/fieldstateaid/state_aid_guidelines/) Part VIII.

of agricultural products are ineligible as is support for exporting. If the undertaking has already received *de minimis* aid (broadly a maximum of €200,000 over three years)<sup>16</sup> prior to the entry into force of the temporary framework, the sum of the aid received under this measure and the *de minimis* aid received must not exceed €500,000 between 1 January 2008 and 31 December 2010.

- *State guarantees for loans at a reduced premium.* The reduction is up to 25 percent for SMEs and 15 percent for large firms on the annual premium calculated in accordance with the 'safe harbour' provisions annexed to the Framework or a methodology already accepted by the Commission.<sup>17</sup> The loan must not exceed the wage bill of the firm, and the guarantee may not exceed 90 percent of the loan.
- *Subsidised interest rates.* The rate which the Commission will accept must be at least equal to the central bank overnight rate, plus a premium equal to the difference between the average one year interbank rate and the average of the central bank overnight rate over the period 1 January 2007 to 30 June 2008, plus the credit risk premium corresponding to the risk profile of the recipient.<sup>18</sup> This method can apply to all contracts concluded until 31 December 2010 and may cover loans of any duration. The reduced interest rates may be applied for interest payments before 31 December 2012.
- *Soft loans for 'green' products.* The same methodology applies as for subsidised interest rates, but there is an interest rate reduction of 25 percent for large firms and 50 percent for SMEs for loans to finance the production of new products that significantly improve environmental protection.
- *Risk capital.* The Framework provides for a temporary derogation from the Risk Capital Guidelines<sup>19</sup> in respect of the size of investment per target enterprise and the proportion of private participation. The maximum investment is raised from €1.5 million to €2.5 million; while the minimum private participation in firms in non-assisted areas is lowered from 50 percent to 30 percent - ie. to the same level as firms in assisted areas.
- *Export credit insurance.* The Framework allows for the simplification of the requirements of the export credit Communication.<sup>20</sup> This Communication includes an

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<sup>16</sup> Commission Regulation (EC) No 1998/2006 of 15 December 2006 on the application of Articles 87 and 88 of the Treaty to *de minimis* aid, OJEU No L379/5 of 28 December 2006.

<sup>17</sup> Notably in the context of the GBER, where approval of calculation methodologies may render otherwise 'intransparent' aid transparent.

<sup>18</sup> As stipulated in the Communication from the Commission on the revision of the method for setting the reference and discount rates, OJEU No C14/6 of 19 January 2008.

<sup>19</sup> Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises, OJEU No C 194/2 of 18 August 2006.

<sup>20</sup> *Communication of the Commission to the Member States pursuant to Article 93 (1) of the EC Treaty applying Articles 92 and 93 of the Treaty to short-term export- credit insurance*, OJEC No C 281/4 of 17 September 1997, as amended.

‘escape clause’ which, in certain circumstances, enables temporarily non-marketable risks to be covered by the State.

### 2.2.2 *The scale of intervention under economic crisis measures*

Since the introduction of the Framework a large number of measures have been approved by the Commission. These are summarised in Figure 3 along with the budgets committed, where this information is available.

Figure 3 suggests that the uptake of the package by Member States generally has been high. By end July, the Commission had approved measures in all but three Member States - Bulgaria, Cyprus and Poland being the exceptions.<sup>21</sup> However, there are wide variations in the use made of the Framework. Almost all countries have introduced schemes, or amended existing schemes, to take account of what is often termed the new *de minimis* ceiling of €500,000,<sup>22</sup> but this measure has not been taken up in Belgium, Denmark, Romania or Sweden. Moreover, in both Sweden and Denmark quite a restrictive approach has been taken: the Danish response is limited to an export credit insurance mechanism; and in Sweden there are no measures of general application at all, with the guarantee scheme cited in the table being specific to Volvo.

Several countries - France, Germany and the UK, for example - make use of most or all of the provisions of the Temporary Framework. However, use of some instruments is quite limited: only France, Germany, Spain and the UK have implemented the soft loan provisions for ‘green’ products; only Austria, France, Germany and Italy are using the temporary risk capital facility; and only Denmark, Finland, Germany and Luxembourg make use of the export credit mechanism.

The scale of intervention is difficult to assess. This is partly because the amounts to be committed were not always known when the schemes were notified and approved and partly because some schemes are open-ended and/or expenditure cannot be calculated *ex ante*. This applies, for example, to many of the French schemes, the precise operation of which has been adjusted in line with the framework and which involve concessions on taxes paid to local authorities, where lost revenue is later reimbursed by central government. A further complication is the lack of precise information about the budgets committed for guarantees; it is not always apparent whether the figures given refer to the total amounts guaranteed or to the aid element therein.

Notwithstanding the gaps in the data available, overall expenditure under the framework appears to be significant, albeit with variations between countries. Figure 3 implies that at least €17 billion are being committed under the ‘temporary *de minimis*’ facility and that total commitments exceed €51 billion. These figures exclude a large number of schemes -

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<sup>21</sup> On 17 August 2009 the Commission approved support under the framework for Poland, but no details are yet available.

<sup>22</sup> In reality, this is a misnomer since *de minimis* aid falls outside the scope of Article 87(1), whereas the limited amount of aid under the Temporary Framework does not.

including most or all of those in France and Italy, among others, so that this sum is a substantial underestimate of total commitments.

Figure 3: Measures approved for the 'real' economy (€m) as at end August 2009

		€500,000	Guarantee	Soft loan	Green prods	Risk capital	Export credit	Total
Austria	Case Budget	N47a 10000				N47d 25		10025
Belgium	Case Budget		N117 1500					1500
Czech	Case Budget	N236 1000		N237 97				1097
Denmark	Case Budget						N198 n/a	n/a
Estonia	Case Budget	N387 n/a						n/a
Finland	Case Budget	N224 250	N82b n/a				N258 n/a	250+
France	Case Budget	N7 n/a	N23 n/a	N15 n/a	N11 500	N119 N36 n/a		500+
Germany	Case Budget	N668 2000	N27 6000	N661 N38 6750	N426 n/a	N39 50	N384 n/a	14800+
Greece	Case Budget	N304 n/a	N308 500	N309 500				1000+
Hungary	Case Budget	N77 n/a	N144 N203 7600	N78 n/a				7600+
Ireland	Case Budget	N186 100						100
Italy	Case Budget	N248 n/a	N266 n/a	N268 n/a		N279 n/a		n/a
Latvia	Case Budget	N124 29	N139 357					286
Lithuania	Case Budget	N272 43						43
Lux	Case Budget	N99 15	N128 500				N50 25	540
Malta	Case Budget	N118 40						40
Neths	Case Budget	N156 n/a						n/a
Portugal	Case Budget	N13 750						750
Romania	Case Budget		N286 n/a					n/a
Slovakia	Case Budget	N222 400						400
Slovenia	Case Budget	N228 n/a	NN34 n/a					n/a
Spain	Case Budget	N307 1400			N140 100			1500
Sweden	Case Budget		N80 n/a					n/a
UK	Case Budget	N43 1159	N71 3089	N257 3089	N72 3089			10426
Total EU		17186+	19546+	10436+	3789+	75+	25+	51057+
Norway	Case Budget	235/09 n/a						

Note: Where a budget applies to several schemes, it is divided equally between them for the purposes of this table.

Source: Compiled from: <http://ec.europa.eu/competition/elojade/isef/index.cfm?clear=1>

Policymaker reactions to the temporary framework have been mixed. Some have considered the package to be something of a 'sell out', enabling generous support with very little in the way of constraints on eligible expenditure or other conditions, noting, for example, that €500,000 is a substantial sum in 'untied' aid at least for SMEs. Others have argued that the complexity of the package essentially discriminates against small firms who will be unwilling / unable to juggle the change in criteria and rates that will apply when the temporary package expires. Others still, especially at the subnational level, have bemoaned the complicated calculations required for setting award values, notably for soft loans, and have argued that this has undermined the usefulness of the package. More generally, there is evidence that some countries have experienced significant delays in implementation, partly owing to domestic administrative arrangements (and budgetary constraints), but also due to the complexity of the measures.

At this juncture, it is difficult to know what the uptake of the measures is, or is likely to be. An important point to note is that the package is intended for firms that have encountered difficulties as a result of the economic and financial crisis, and not those that were already experiencing problems. On this basis, for example, the German authorities refused support to *Arcandor*,<sup>23</sup> the retail and travel group, under the temporary framework - although assistance was later secured on the basis of the standard rules applicable to rescue and restructuring for its wholly-owned subsidiary *Quelle*.<sup>24</sup>

Many of the high profile cases of aid, or potential aid, have involved the motor industry. As part of a wide-ranging package for the sector,<sup>25</sup> the French government committed loans of €6.5 billion at an interest rate of six percent over five years to *Peugeot* and *Renault*; these were agreed with the Commission following a high-level political dispute amid concerns that the package contained protectionist elements. In Germany, the prospect of State aid has apparently been a key issue in the negotiations over the sale of *Opel*.<sup>26</sup> In the UK, rescue aid for *LDV* in the form of a modest bridging loan was not provided under the temporary framework and was deemed to be unnotified aid by the European Commission, although ultimately the Commission concluded that it was compatible with the Treaty. On the other hand, *Tata Motors*, the owner of *Jaguar Land Rover* eschewed government support when it dropped a request, allegedly involving some £800 million, for government funding on the basis that commercial financing was available on less onerous terms.<sup>27</sup> If nothing else, these examples serve to show how highly politicised the use of State aid in the current climate has become.

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<sup>23</sup> Financial Times (2009) *German state aid*, 23 June.

<sup>24</sup> Rapid Press Release (2009) State aid: Commission approves €50 million rescue aid loan to German retailer Quelle, IP/09/1062 of 30 June.

<sup>25</sup> Présidence de la République (2009) *Pacte Automobile*, 9 February.

<sup>26</sup> Financial Times (2009) *General Motors Europe*, 21 August.

<sup>27</sup> Financial Times (2009) *Tata drops plea for State aid to Jaguar*, 12 August.

### 3. STATE AID CONTROL, REGIONAL POLICY AND THE ECONOMIC CRISIS

By contrast with Commission action to address the turmoil in the banking sector and its wider economic fallout, developments in the control of regional aid have been very low key. This is partly because a reconsideration of the Regional Aid Guidelines for the post-2013 period is still premature and maps and schemes are largely settled for the remainder of the period, and partly because the Commission has expressly favoured new *temporary* instruments to address the crisis rather than relaxing the use of *existing* measures. At the same time, at the national level, current evidence is that the regional implications of the crisis are not high on the agenda, and it remains to be seen whether the general measures taken in response to the crisis will accelerate the long-term decline in regional aid spending or lead to a reappraisal of the use of financial incentives.

Against this background this section begins with some general observations on regional aid spending and goes on to consider what role regional incentives have played in addressing the economic crisis.

#### 3.1 Regional aid spending in perspective

Earlier sections of this report have drawn attention to the scale of potential spending in response to the financial and economic crisis. The outturn of the commitments made is currently highly uncertain, but it can be said that the exposure of the public purse is unprecedented.

European Commission estimates suggest that the measures approved for the banking sector amount to between €3 trillion and €4 trillion; of this the bulk is in the form of guarantees and it remains to be seen what calls are made on these. In addition, the commitments made under the temporary framework run to over €51 billion, with budget estimates unavailable in many cases, mainly because expenditure will be committed at the subnational level or because it takes the form of tax revenue foregone.

Alongside these sums, regional aid expenditure appears exceedingly modest. According to Commission scoreboard figures, in 2007 regional aid spending amounted to just €9.8 billion for the EU27 as a whole (see Figure 4); less than a fifth of the commitments under the Temporary Framework and a minute fraction of that for the financial sector. Of course, these data need to be treated with considerable caution and are not suitable for direct comparisons. In particular, the regional aid data, in principle, concern actual *payments* under regional aid schemes rather than *commitments*; in all probability, the level of commitments (which would have been spread over a number of earlier years) would have been considerably higher. In addition, the aggregate nature of the data means that not only is it not possible to know to which schemes the expenditure relates, but also that the data may not be strictly comparable since they rely on national (or even subnational) classifications of the primary purpose of the aid. Notwithstanding these caveats, it is undeniable that the orders of magnitude of spending on the crisis and regional aid spending are vastly different.

Figure 4: Regional aid expenditure 2002-07 (€ million)

	2002	2003	2004	2005	2006	2007
<b>EU27</b>	<b>11318</b>	<b>9690</b>	<b>9011</b>	<b>8985</b>	<b>9671</b>	<b>9869</b>
<b>EU15</b>	<b>10505</b>	<b>8840</b>	<b>8150</b>	<b>7941</b>	<b>8483</b>	<b>8822</b>
<b>NMS12</b>	<b>813</b>	<b>850</b>	<b>860</b>	<b>1045</b>	<b>1189</b>	<b>1047</b>
<b>Austria</b>	87	112	79	94	110	10
<b>Belgium</b>	559	169	168	120	166	57
<b>Bulgaria</b>	19	30	23	19	24	16
<b>Cyprus</b>	29	2	7	5	6	4
<b>Czech Rep</b>	83	91	118	255	264	300
<b>Denmark</b>	10	5	3	5	4	0
<b>Estonia</b>	6	2	3	3	2	2
<b>Finland</b>	56	51	54	78	74	46
<b>France</b>	1073	897	916	1251	1533	2484
<b>Germany</b>	3584	3267	2788	2696	3109	2216
<b>Greece</b>	322	290	351	258	299	476
<b>Hungary</b>	231	246	211	294	179	236
<b>Ireland</b>	151	99	84	129	122	109
<b>Italy</b>	2465	1635	1184	1194	1079	701
<b>Latvia</b>	11	8	22	22	19	24
<b>Lithuania</b>	3	12	16	19	17	9
<b>Luxembourg</b>	43	32	15	13	7	9
<b>Malta</b>	-	-	-	-	-	-
<b>Netherlands</b>	130	72	33	27	23	64
<b>Poland</b>	142	218	211	197	415	296
<b>Portugal</b>	37	49	69	42	39	108
<b>Romania</b>	223	107	106	47	61	11
<b>Slovakia</b>	58	122	135	140	153	117
<b>Slovenia</b>	10	13	10	44	48	31
<b>Spain</b>	1233	1179	1079	1098	1171	1792
<b>Sweden</b>	54	60	61	128	148	203
<b>United Kingdom</b>	702	924	1267	805	596	548

Source: <[http://ec.europa.eu/competition/state\\_aid/studies\\_reports](http://ec.europa.eu/competition/state_aid/studies_reports)>

It is worth noting in passing that regional aid spending varies very widely between countries. Direct comparisons are not straightforward, but some indicators are provided in Figure 5, based on averages for the period 2002-07. These figures suggest that regional aid spending, as a proportion of total aid spending, varies in importance between countries. For example, in some countries regional aid accounts for more than a third of all State aid expenditure (Greece, Latvia, Slovakia, Bulgaria, Luxembourg), while in others it accounts for less than 10 percent (Romania, Austria, Sweden, Cyprus, Netherlands, Portugal, Denmark).

In absolute terms, regional aid spending ranges from over €1 billion a year on average (Germany, Italy, France, Spain) to less than €20 million (Latvia, Lithuania, Cyprus, Denmark, Estonia). Clearly, however, this is at least partly a function of country size and these differences narrow when expenditure is considered as a proportion of GDP. Nevertheless, it is worth noting that many of the least-prosperous Member States spend much more in relation to the size of their economies than do richer Member States. For example, Slovakia, Hungary, Czech Republic, Latvia, Romania and Greece (along with Spain

and Germany) all spent over 0.1 percent of GDP on regional aid in 2002-07, while Finland, Sweden, Austria, the Netherlands and Denmark (along with Estonia and Portugal) all spent less than 0.04 percent of GDP.

Figure 5 also indicates expenditure per head in the recipient regions, which, in principle, might be regarded as the most accurate measure of the intensity of regional aid spending. This suggests that while some (more prosperous) countries spend in excess of €50 per head of assisted area population (Luxembourg, Germany, Sweden, France, Belgium and Italy) other (predominantly poorer) countries spend less than €10 per head (Latvia, Poland, Portugal, Denmark, Romania, Lithuania, Bulgaria, Estonia).

Figure 5: Regional aid spending indicators (average 2002-2007)

	% of total aid to industry and services	Annual average spending - €m	% of GDP	€ per head of assisted area population
EU27	18.5	9757	0.0849	37.1
EU15	18.8	8790	0.0816	55.2
NMS12	19.5	967	0.1343	9.4
Austria	8.7	82	0.0326	36.5
Belgium	23.0	207	0.0676	64.8
Denmark	0.4	5	0.0021	5.0
Finland	10.7	60	0.0370	28.0
France	19.3	1359	0.0757	76.6
Germany	17.6	2943	0.1275	104.6
Greece	79.9	333	0.1603	30.0
Ireland	21.8	116	0.0709	32.3
Italy	25.7	1376	0.0931	55.7
Luxembourg	33.7	20	0.0645	146.2
Netherlands	5.0	58	0.0112	28.2
Portugal	3.7	57	0.0360	5.9
Spain	29.7	1213	0.1255	38.2
Sweden	6.0	109	0.0346	76.7
United Kingdom	20.5	807	0.0424	45.2
Cyprus	5.3	9	0.0627	12.7
Czech Republic	29.9	185	0.1722	18.7
Estonia	24.9	3	0.0253	2.2
Hungary	25.9	233	0.2502	23.0
Latvia	66.5	18	0.1056	7.7
Lithuania	28.1	13	0.0540	3.7
Malta	~	~	~	~
Poland	17.2	246	0.0967	6.5
Slovakia	58.7	121	0.3052	22.9
Slovenia	18.7	26	0.0843	12.8
Bulgaria	45.5	22	0.0886	2.8
Romania	8.8	92	0.1003	4.3

Source: Own calculations from European Commission Scoreboard, Eurostat data and assisted area coverage data.

In practice, such calculations should be treated with caution, and this for two main reasons. First, not all aid schemes for a given country apply in all designated areas. In

France, for example, the figures probably include expenditure on the DOM,<sup>28</sup> which is relatively high, but covers a very small proportion of the overall population, and is also skewed by spending exclusively targeted on Corsica; as a result, expenditure per head in mainland France is likely to be much lower than the figure given here, while that in the DOMs and Corsica would be very much higher. The position would be similar in Germany, where the investment allowance is available only in the new *Länder*, while the investment grant is available in all assisted areas. Second, the data concern payments related to earlier commitments. These commitments may have been made to projects in areas which were within the map prior to 2000, but ceased to be so for the period 2000-07.

In the absence of more detailed data on the schemes to which the data relate, it is not possible to reach robust conclusions about regional aid spending. However, the data as presented support the Commission's view that regional aid award rates should be lowered across the board because poorer countries lack the budgetary capacity to compete with richer ones and reinforce the Commission's perception of its success in constraining regional aid in the richer Member States, since trend data indicates falling regional aid spending in the EU15 and rising expenditure in the new Member States (see Figure 4).

### 3.2 Some national perspectives on regional aid in the crisis

Regional aid responses to the economic crisis have varied, although it is true to say that in general the regional policy response has not been a high profile component of government actions. In broad terms, two main approaches can be identified among the partner countries: an active response where regional aid instruments are marshalled alongside other measures; and a broadly neutral response where regional aid policy is largely unaffected.

France and Germany have taken what can be termed an 'active' regional aid response to the crisis - although in reality the measures involved are minor components of the overall package.

In *Germany*, the federal government's first fiscal stimulus package of November 2008 allocated additional funding of €200 million to the Regional GA (the joint *Land*-federal task for regional policy); the annual budget is typically around €600 million, of which 6/7<sup>th</sup> are earmarked for the new *Länder*. Half of the funding can be spent in 2009, with remainder to be committed in 2010 and 2011. As in the case of core GA funding, individual *Länder* must provide match-funding in order to draw down the federal contribution. However, unlike core GA funding, these new resources are divided equally between the old and the new *Länder*, although obviously funds can still only be expended in designated development areas. Each *Land* is free to decide whether to use the additional GA funding for direct aid to businesses, business-oriented infrastructure or soft measures.

In addition, the GA has taken advantage of the increased flexibility under the Commission's temporary framework to raise the level of small-scale aid to €500,000, from the standard

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<sup>28</sup> Although the Commission data do not enable this to be confirmed.

*de minimis* level of €200,000. This change applies to designated C and D areas which are not eligible under Article 87(3)(c), but which the German authorities designate for domestic purposes and in which *de minimis* aid is available. The investment allowance, which has a budget of around €2.3 billion over 2010-13 and is restricted to the new *Länder* is not affected by these changes. However, the scheme is being progressively phased out over this period.

In *France* the approach has been slightly different, although there are some common elements. There is no additional funding for the main regional incentive grant, the *prime d'aménagement du territoire* (PAT), for which the annual budget is rather modest at around €40 million; however, some eligibility criteria have been relaxed in recognition of the additional constraints facing firms as a consequence of the crisis. In particular, the minimum eligible investment for extension projects was reduced from €25 million to €10 million; for takeover projects the minimum number of jobs safeguarded was lowered from 150 to 80 and the minimum investment from €15 million to €5 million.

In addition to the PAT, and far more significant in overall budgetary terms, France operates a large number of spatially-discriminating fiscal incentives. The precise total involved in these schemes is difficult to quantify, but has been estimated at over €910 million annually;<sup>29</sup> moreover, it is unclear whether this includes only the cost to central government or also the cost to local authorities where the concessions are not reimbursed by the State. Nevertheless, it is clear that overall expenditure on such measures dwarfs that under the PAT. Many of these schemes have been operated on the basis of the *de minimis* Regulation and have therefore generally been limited to €200,000 over three years. The measures target a number of spatially-restricted objectives, including support for urban development, rural development, redevelopment of defence closure areas, priority employment zones, standard PAT areas, competitiveness poles, etc. Each of these comprises a mix of instruments including tax credits, reductions and exemptions in relation to a number of taxes, including those levied nationally, such as corporation tax and some social security contributions, but also several that are levied at the subnational level, notably the *taxe professionnelle* and local property taxes. As in Germany, the French authorities have used the temporary framework effectively to increase the *de minimis* aid level until end 2010. The budgetary implications of this are unclear. Informally, the cost of the measures under the 'new *de minimis*' limit was estimated at around €1.5 billion, but this includes many schemes with nationwide application and not just those that target problem regions.

One last point to note in the context of French regional aid concerns the assisted area map. The French authorities had sought the extension of eligibility for the temporary aid areas which expired at the end of 2008, and justified this on the basis of the impact of the financial crisis; however, this was turned down by the Commission. On the other hand, the French authorities have made a second use of the population reserve to extend the assisted

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<sup>29</sup> Sénat (2009) Rapport Général fait au nom de la commission des Finances, du contrôle budgétaire et des comptes économiques de la nation sur le projet de loi des finances pour 2009, Tome III, Annexe No. 19.

areas map; this reserve had been kept at the time of the initial designation process in order to respond flexibly to economic changes as they arose, but each change obviously requires Commission approval. The initial reserve comprised a population of around 250,000; this second extension of the map uses up the remainder of that quota. Ten additional areas have been added to the map; nine of these as a consequence of the impact of defence restructuring.

In *Italy* there have been some indirect changes insofar as the domestic strand of regional policy funded through the *Fondo Aree Sottoutilizzate* (FAS - fund for the underdeveloped areas) has been cut in order to provide resources for the (nationwide) crisis measures. Only some of this funding involves regional incentives, and there appears to be some doubt in Italy about the capacity to implement crisis aid measures within the schedule of the Temporary Framework. Nevertheless, in principle, such moves could be seen as an erosion of regional policy measures.

In the *United Kingdom*, the SME components of the main regional incentives - Grant for Business Investment (GBI) in England and Regional Selective Assistance (RSA) in Scotland have been extended. Until now, as well as the designated 'a' regions and 'c' areas, so-called Tier 3 areas have been chosen on the basis of domestic criteria; within these areas assistance has been available to small firms at the rate of 10 percent of eligible investment and medium-sized firms at the rate of 7.5 percent. In response to the crisis, Tier 3 has, in effect, been extended to all regions not covered by 'a' region or 'c' area status and the rates of award in these areas raised to 20 percent and 10 percent for small and medium-sized firms respectively. In practice this move essentially just takes full advantage of the possibilities provided for SME aid under the General Block Exemption Regulation.

In most EoRPA partner countries - Austria, Finland, Netherlands, Norway, Poland and Sweden - there have been no changes to regional aid policies as a consequence of the crisis. In general the rationale for this is that it is not considered to be the role of regional policy to act as a 'fire-fighter' in times of crisis and that regional policy should have a longer-term strategic approach.

Notwithstanding the more proactive elements in German and French regional aid policy with respect to the crisis, it is evident that regional policy *per se* has so far had only a small role in response to the recession. In many respects this is scarcely surprising. In part owing to EU competition policy constraints, regional aid policies are designed to encourage new investment and the value of aid is tied to that investment and/or job creation. In the current period, new investment has been scarce; indeed many regional aid administrators report a significant downturn in regional aid applications and, even where regional aid measures have been enhanced or relaxed in response to the crisis, the uptake appears to have been limited. By contrast, the measures available under the Temporary Framework are more likely to appear attractive in the current climate. This is perhaps particularly true of the 'temporary *de minimis*' aid which can take the form of grants or tax relief untied to any specific expenditure. Although there might be concerns that the nationwide availability of such measures threatens to undermine the advantage that regional aid confers on the problem regions, such views do not take account of the spatial distribution of the crisis measures. In practice, little is currently known about this - or about the implementation of

the crisis measures more generally - nevertheless, it can be said that in many instances firms within the problem regions will benefit from the crisis measures. For example, the motor industry has received high levels of assistance in several countries and is often heavily concentrated in the designated areas.

#### 4. REGIONAL AID TO LARGE INVESTMENT PROJECTS

The control of regional aid to large investment projects within approved schemes has long been a preoccupation of the Commission. However, it is only within the last decade or so that the Commission has introduced the means to achieve this. The first such mechanism was introduced in the late 1990s in the form of the so-called 1998 Multisectoral Framework.<sup>30</sup> This provided that aid exceeding specified ceilings had to be notified individually and assessed by the Commission against a set of predetermined criteria. In practice, the 1998 Multisectoral Framework failed to have any real impact on award values, largely owing to the design of the assessment criteria. It was replaced by the 2002 Multisectoral Framework (MSF 2002),<sup>31</sup> which in turn was incorporated into the 2007-13 Regional Aid Guidelines,<sup>32</sup> albeit with some changes.

Since MSF 2002, there have been two main strands to Commission action on aid to large projects. First, the systematic lowering of aid maxima for all projects involving eligible investments exceeding €50 million and the reporting of all aid to such projects (whatever the amount of aid). Second, the prior notification and approval of very large awards and their assessment against the terms of RAG 2006 by the Commission; *individual* notification is required where the aid proposed is higher than that which a project involving eligible investment of €100 million could have obtained on the basis of the application of the formula. Such cases may lead to the opening of the investigative procedure before aid can be approved. Indeed, where notified cases raise issues related to market share or capacity, the Commission must explicitly set competition considerations against the regional development benefits that the project might bring. In 2009, somewhat belatedly, the Commission published its Guidance on the criteria it would use in this assessment.

The discussion that follows is in three parts: the first provides an outline of the regulatory framework for regional aid to large projects; the second considers the Guidance for in-depth project assessment; and the third provides a brief overview of reported and notified aid since MSF 2002.

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<sup>30</sup> Multisectoral framework on regional aid for large investment projects, OJEC No C 107 of 7 April 1998.

<sup>31</sup> Multisectoral Framework on regional aid to large investment projects - Rescue and restructuring aid and closure aid for the steel sector, OJEC No C 70/8 of 19 March 2002.

<sup>32</sup> RAG 2006, Section 4.3.

## 4.1 The regulatory framework for regional aid to large projects

### 4.1.1 Award values

The essence of the provisions on large investment projects is to reduce rates of award under existing regional aid schemes to projects with eligible investment of more than €50 million. This is achieved through a reduction scale (the larger the project, the lower the rate of award) incorporated into the regional aid schemes operated by the Member States, as set out in Figure 6.

Figure 6: Rate reduction matrix for large investments

Eligible expenditure	Aid ceiling
Up to € 50 million	100 % of regional aid ceiling
For the part between € 50 and € 100 million	50 % of regional aid ceiling
For the part exceeding € 100 million	34 % of regional aid ceiling

As Figure 6 shows, projects involving investments of less than € 50 million are unaffected by the matrix. However, for large projects the standard award rate is progressively reduced. This is illustrated in the Regional Aid Guidelines as follows:<sup>33</sup>

$$\text{Maximum rate of award} = R * (50 + 0.5B + 0.34C)$$

Where R is the unadjusted regional aid ceiling; B is the eligible expenditure between € 50 million and € 100 million; and C is any expenditure above € 100 million

The impact of this formula on the standard award maxima under the 2007-13 Regional Aid Guidelines is shown in Figure 7.<sup>34</sup> As would be expected, the higher the amount of eligible investment, the lower the rate of award applicable since an increasing proportion of the investment qualifies for aid at only 34 per cent of the prevailing regional aid rate. Thus, for an investment of € 500 million, the maximum rate of award in a 10 percent rate 'c' area would be 4.22 percent of eligible investment - a maximum of € 21.1 million.

Figure 7: Impact of the large investment project provisions on award rates

	Standard ceilings (% GGE)					
	10	15	20	30	40	50
Eligible expenditure	Adjusted ceilings (% GGE)					
€ 50 m	10.00	15.00	20.00	30.00	40.00	50.00
€ 100 m	7.50	11.25	15.00	22.50	30.00	37.50
€ 150 m	6.13	9.20	12.27	18.40	24.53	30.67
€ 200 m	5.45	8.18	10.90	16.35	21.80	27.25
€ 300 m	4.77	7.15	9.53	14.30	19.07	23.83
€ 500 m	4.22	6.33	8.44	12.66	16.88	21.10

<sup>33</sup> 2007-13 Regional Aid Guidelines, para 67.

<sup>34</sup> In MSF 2002 there was a significant exception to this principle: the reduction matrix did not apply to the motor vehicle industry where, instead, the aid ceiling was set at 30 percent of the prevailing rate for all projects with investment exceeding € 50 million or an aid amount exceeding € 5 million. This provision is important in the later discussion of individual aid cases.

### 4.1.2 Notifiable projects

Importantly, however, *individual* notification is required where the aid proposed is higher than that which a project involving eligible investment of € 100 million could have obtained on the basis of the application of the formula. As Figure 8 shows, for very large projects the notification thresholds bite at very low levels of aid when expressed as a percentage of investment. In a 10 percent rate area, the notification threshold in proposed aid would be € 7.5 million, just 1.5 percent of a € 500 million investment.

Figure 8: Individual notification ceilings for large investment projects

	Standard ceilings (% GGE)					
	10	15	20	30	40	50
	Aid notification threshold (€ million)					
	7.5	11.25	15.0	22.5	30.0	37.5
Eligible expenditure	Notification threshold (% of eligible expenditure)					
€ 50 m	~	~	~	~	~	~
€ 100 m	~	~	~	~	~	~
€ 150 m	5.0	7.5	10.0	15.0	20.0	25.0
€ 200 m	3.75	5.63	7.5	11.25	15.0	18.75
€ 300 m	2.5	3.75	5.0	7.5	10.0	12.5
€ 500 m	1.5	2.25	3.0	4.5	6.0	7.5

For individually notifiable projects where either:

- a) the aid beneficiary accounts for more than 25 per cent of the sales of the products concerned on the markets concerned (either before or after the investment); or
- b) the capacity created by the project is more than 5 per cent of the size of the market measured in apparent consumption, except in rapidly growing markets;

the Commission will only approve regional aid after opening the Article 88(2) investigative procedure and a “detailed verification... that the aid is necessary to provide an incentive effect for the investment and that the benefits of the aid outweigh the resulting distortion of competition and effect on trade”.<sup>35</sup> In the course of 2009, the Commission produced its guidance on the criteria to be used for making this assessment; this is discussed in the section that follows.

## 4.2 In-depth assessment of regional aid to large investment projects

The publication of the Guidance on the in-depth assessment of regional aid to large investment projects was long-awaited;<sup>36</sup> the Guidelines on National Regional Aid for 2007-13 provided that the Commission would issue its criteria before the entry into force of the Guidelines, ie. 31 December 2006. It was not until November 2008 that the Commission put out a draft to consultation (for comments by February 2009), with the final version adopted in June 2009; there was little substantive change between drafts. The delay in producing

<sup>35</sup> 2007-13 Regional Aid Guidelines

<sup>36</sup> Communication from the Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects, OJEU C223/2 of 16 September 2009.

this Communication perhaps reflects the considerable challenge involved in verifying that “aid is necessary to provide an incentive effect for the investment and that the benefits of the aid measure outweigh the resulting distortion of competition”.

In practice, the number of cases in which the guidance will be applied will be very few. A small number of proposed awards exceed the notification threshold annually; of these the great majority raise no market share or capacity issues so the application of the Guidance is likely to be rare. Nevertheless, it is an important contribution to Commission’s interpretation of the ‘more economic approach’ to State aid control proposed in the State Aid Action Plan.

The starting premise for the guidance is that graduated aid intensities are the simplest and most direct way for the Commission to balance the *positive effect* which regional investment aid can have in promoting cohesion through the attraction of investment to eligible areas against the *negative effects* inherent in aid to individual undertakings. However, since *large* investments are less affected by important region-specific problems in disadvantaged areas, there is an increased risk of impact on trade and of a distortion effect in relation to other competitors. Also, the Commission perceives there to be a risk that the aid is more than the minimum necessary to compensate for regional disadvantages and that State aid to such projects leads to perverse effects such as inefficient location choices, higher distortion of competition and, since aid involves a transfer from tax payers, net welfare losses. Moreover, for very large projects (those proposed to receive a higher amount of aid than a €100 million project would be awarded), these risks are considered to be more acute. For this reason, under MSF 2002 where these very large projects exceeded the market share or capacity thresholds set out in the Guidelines, the Commission did not authorise additional aid beyond that calculated under the award formula; indeed, MSF 2002 did not afford the Commission the discretion to do this. Under the 2007-13 Regional Aid Guidelines, a more ‘individualised’ approach is taken, setting the cohesion and other benefits against the trade and competition impacts “in as concrete a fashion as possible.”

Given this context, the Guidance aims to “ensure the transparency and predictability of the Commission decision making process, and equal treatment of Member States.” The Guidance deals first with the positive effects of aid, including a consideration of the objectives of aid, the appropriateness of the aid instrument, the incentive effect and proportionality. It goes on to consider the negative effects, including the crowding-out of private investment and the effects on trade. Last it refers to balancing the effects of aid.

#### *4.2.1 Positive effects*

Regarding the positive effects, the *objectives* of aid (equity and possibly efficiency) are given an extensive treatment. There is a list of indicative criteria which may be used to demonstrate the regional contribution of the aid insofar as it may attract additional investment and activity to the region. The list is non-exhaustive, but includes:

- the number of direct jobs created, as well as their quality and the skills level;
- indirect job creation, for example in the (sub)supplier network;

- the commitment of the beneficiary to general and specific workforce training;
- external economies of scale or other benefits arising from a clustering effect;
- the technological intensity of the activity and the scope for knowledge spillovers;
- the contribution of the project to the region's ability to create new technology through local innovation - eg through cooperation with higher education;
- the duration of the investment and scope for possible follow on investment.

Member States are encouraged to rely on past evaluations of State aid measures, impact assessments and other studies, as well as the business plan of the beneficiary (for instance, regarding job creation, salaries paid and other direct and indirect effects).

Where relevant, the Commission will also consider the relationship between the planned investment, the National Strategic Reference Framework and the Operational Programme co-financed by the Structural Funds. In particular, it may take account of any Commission decision on the measure in the context of so-called 'major projects' under the Structural Funds which, among other things, is based on a cost-benefit analysis, including a risk assessment and the foreseeable sectoral and socio-economic impacts.

The *appropriateness* of the aid instrument is also mentioned, but it is not clear what the practical outcome of this consideration is; could the outcome be that the Commission deems other measures to be more appropriate in a given case?

Analysis of the *incentive effect* of the aid measure "is regarded as one of the most important elements" of the analysis. The Guidance notes that this is assessed at two levels. The first, essentially procedural, concerns the timing of the application in relation to the project start, with the presumption being that aid is not necessary if the project starts before a decision on the application is made. The second element is more complex and involves a verification "that the aid is necessary to provide an incentive effect for the investment". The aim of this analysis is to determine whether or not the incentive alters the investment behaviour of the firm such that it undertakes additional investment in the assisted region - in part reflecting the fact that there may be valid reasons for a firm to locate in a given area without any aid being granted. In practice, this closely mirrors attempts by some national governments to improve 'value-for-money' and reduce windfall gains in incentive administration. In the UK, for example, the additionality criterion has traditionally been an important component in the analysis, with investors being required to show that, in the absence of aid, the project would not go ahead on the proposed scale, timeframe or in an assisted area location. Subsequent evaluations have, however, suggested that 20 percent of projects (as a proportion of aid paid) would have gone ahead on the same basis without the aid.<sup>37</sup> This outcome is testament to the difficulty in making realistic assessments in the face of information asymmetries.

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<sup>37</sup> Arup Economics and Planning (2000) *Evaluation of Regional Selective Assistance 1991-95*, Final Report for DTI, National Assembly for Wales, Scottish Executive.

The Guidance envisages that an incentive effect can be proven in two possible scenarios:

1. The aid gives an incentive to change the investment decision because an investment that would otherwise not be profitable for the company at any location can take place in the assisted region.
2. The aid gives an incentive to change the location decision because it compensates for the net handicaps and costs linked to a location in the assisted region.

The circumstances in which Scenario 1 might arise are not explained. It may be surmised that the number of cases involving a project which raises market power or capacity issues, but which is not profitable in any location, would be few; in what circumstances would an investor contemplate such a project? Is the presumption that the project would never be profitable and might it therefore require long-term state aid to sustain it? It is perhaps also questionable what such a project would ultimately contribute to regional development.

Regarding Scenario 2, two main points are worth making. First, an assisted area location may not be more costly. Of course, in theory, this should mean that the investor would be drawn to the lower cost location anyway. In practice, such decisions may be affected by bounded rationality, the perceived (but unquantifiable) risks associated with a first investment in a given location or other qualitative criteria. In this context, financial incentives may be required to offset such perceptions. Second, the approach largely mirrors that taken under the now-defunct Frameworks on State aid to the motor vehicle sector, which used an analysis of comparator locations in order to illustrate the net costs and handicaps. In practice, the application of this criterion relies very heavily on information provided by the investor; it has been noted that under the motor vehicle frameworks, on some occasions, firms were willing to accept less in aid than the apparent cost handicap, suggesting that either non-cost factors were responsible or that the firm was withholding quantifiable information.<sup>38</sup> Moreover, there is anecdotal evidence that it is simply a question of selecting the 'right' comparator to obtain the desired result. In short, while the premise of this criterion seems rational, its practical application may be undermined by information asymmetry and it may fail to take adequate account of non-cost factors.

The Guidance stresses that aid must be *proportionate* - the amount and intensity should be limited to the minimum necessary for the investment to take place in the assisted region.

In Scenario 1 aid will be considered proportionate if, because of the aid, the return on investment is in line with the normal rate of return applied by the company, the cost of capital for the company as a whole or returns commonly observed in the industry. In the absence of any explanation of what project might be contemplated under this scenario, it is difficult to envisage the circumstances in which it would be justifiable to authorise aid to a project which raises capacity or market power concerns but has no prospects for profitability.

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<sup>38</sup> "The Sources and Processes of Tax and Subsidy Competition" by Kenneth P. Thomas, *Comments by Rod Meiklejohn* at: [http://www.hhh.umn.edu/projects/prie/pdf/meiklejohn\\_comments.pdf](http://www.hhh.umn.edu/projects/prie/pdf/meiklejohn_comments.pdf)

In Scenario 2 aid will generally be considered proportionate if it equals the difference between the net costs in an assisted area location and those in the alternative regions. The relevance of this sum and the difficulties involved in calculating it have been alluded to already. A further question is whether the alternative location(s) could also have assisted area status?

#### 4.2.2 *Negative effects*

For projects undergoing this detailed analysis, there is a presumption of concern either in relation to the creation of excessive *market power* and/or potential overcapacity in a market in structural decline which maintain *inefficient market structures*. Understandably, these elements are to be given particular emphasis in Scenario 1 cases - those where the investment would not take place anywhere without the aid. The corollary is that, if the investment would have gone ahead anyway, albeit in another location (Scenario 2), and if the aid is proportional, then the impact on competition such as higher market share or capacity increase in an underperforming market would be the same regardless of aid. The Guidance also considers that aid could have a *negative effect on trade*.

The rationale for limiting aid to firms with *market power* is that aid to one beneficiary in a concentrated market is more likely to distort competition because investment decisions in oligopolistic markets affect competitors more directly; this is considered all the more so if the dominant player is subsidised. In the initial analysis, the assessment is based on the share of the beneficiary in the relevant product and geographic markets. However, this is considered to give only a preliminary indication of possible problems and, in an in-depth assessment, the Commission proposes to take account of other factors. These could include:

- market structure - where, for example, there are a few market players, but all have a relatively high share of the market, the high market share of the beneficiary might be of less concern;
- barriers to entry - including economies of scale and scope, legal barriers (such as intellectual property rights), access barriers to networks and infrastructure;
- 'buyer power' - where there are strong buyers, the beneficiary is less likely to be able to increase prices; and
- barriers to exit - where there are significant costs attached to leaving a given market - such as writing off capital investment or redundancy; these costs may be higher than remaining within the market.

The assessment will take account of these and market share related factors both before and after the investment - normally the year before the investment starts and the year after full production is reached. A key problem in applying the criteria related to the market analysis seems likely to be that of credible data, for a sufficient time period and at the requisite level of product detail.

Regarding *market structures*, the Guidance states that it is a sign of efficient competition if inefficient firms are forced to exit a market. However, an increase in capacity in a market already in overcapacity could lead to competitors, who would otherwise remain, being forced out of the market. It may also inhibit low-cost entrants and weaken incentives to innovate; ultimately, inefficient market structures may harm consumers.

The Guidance distinguishes between markets that are in absolute and relative decline. *Absolute* decline - ie. a negative growth rate - is considered unlikely by the Commission to be compensated for by any positive elements. *Relative* decline is defined as showing a positive growth rate, but below that of EEA GDP growth over the last five years before project start - the so-called benchmark rate. The Commission may also take into account expected future trends in the growth of the market, capacity utilisation rates and the impact of the capacity increase on competitors through its effects on prices and profit margins. In the in-depth analysis the Commission will also consider whether the EEA is the appropriate benchmark to assess the effects of the aid.

The Guidance also refers to the impact on *trade*. It argues that when regional aid is offsetting the additional costs stemming from regional handicaps and supports additional investment in the assisted areas, it contributes not only to the development of the region, but also ultimately to cohesion in the EU as a whole. The negative effects of regional aid are perceived to be recognised in and to some extent limited by the regional aid guidelines. However, in one of the few changes to the initial draft, the Guidance requires the Commission to have “all necessary information to consider whether State aid would result in a substantial loss of jobs in existing locations within the European Union.” The Guidance adds that, where production capacity is added in a declining market, the negative effects on trade may be felt through the loss of economic activity in other regions. It seems certain that this provision was added to the Guidance as a consequence of concerns in several Member States about job relocation; however, it is unclear how the Commission assessment would handle this information.

#### *4.2.3 Balancing the effects of the aid*

This final section of the Guidance is short and gives no real insight into how the most important element of the analysis - the ‘balancing’ of the positive and negative effects - will be carried out in practice. Indeed, its terms seem to reinforce the scope for Commission discretion rather than “ensure the transparency and predictability of the Commission decision making process”. The Guidance states that careful consideration will be given to the overall effects of aid on cohesion but that the Commission “will not use the criteria set out in this guidance mechanically but will make an overall assessment of their relative importance. No single element is determinant, nor can any set of elements be regarded as sufficient on its own to ensure compatibility”.

Two points do, however, emerge. The first is that, in Scenario 2 where proof has to be given of an alternative location, if, *without aid*, the project would have located to a poorer region (higher aid intensity) or to a region with the same disadvantage (same aid intensity), then this will constitute a negative element in the balancing test that is unlikely to be compensated for. Conversely, where aid “merely compensates for the differences in net

costs” relative to a more developed location, the positive effect will normally be considered to outweigh the negative effect. To some extent, this is stating the obvious: the overall objective of regional aid is to influence location decisions in favour of problem regions and a potential aid beneficiary would clearly be ill-advised, for the purposes of this analysis, to select an *even more* disadvantaged region as its location of choice in the absence of aid. Similarly, the ‘ideal’ situation is where aid simply compensates for the additional costs of a problem region location. There are, however, considerable difficulties involved in establishing this sum; moreover, the informational asymmetries involved seem likely to favour the beneficiary. A further point to note is that the Guidance makes no explicit mention of the possibility of a non-EU location; it is not clear whether this is implicit in the consideration of comparator locations.

The second point is that, where there is credible evidence that State aid would result in a substantial loss of jobs elsewhere in the EU, and which would otherwise have been preserved in the medium-term, the economic and social effects on the existing location must be taken into account in the balancing exercise; the Guidance does not specify how.

The overall outcome of the Guidance is that, while there is a relatively clear indication of the (abundant) documentation that will be sought from aid authorities and applicants, there is scant detail on how that information will be interpreted in practice.

A more fundamental issue is the impact of the Guidance itself on the incentive effect of regional aid. The Guidance here comes into play after a project has been notified and has undergone a preliminary analysis that has concluded that there may be market power or capacity concerns. The application process which preceded the notification may itself have been lengthy; the prospect of an investigative procedure adds to the delay. There is an inherent conflict in the requirement that aid be needed (incentive effect) and the uncertainty created by the investigative procedure. It can be argued that the incentives most likely to alter business behaviour are those that are predictable and can be factored into business decisions at the outset. The length and complexity of the notification and investigative procedure create considerable uncertainty and delays for applicants. This may lead to aid being discounted in the investment decision and treated as a bonus should aid ultimately be approved. In other words, the bureaucratic process may itself result in higher windfall gains - ie. less incentive effect - because applicants are able to exploit information asymmetry to meet the requirements of the Guidance.

### 4.3 Reported and notified aids to large investment projects

An important element of recent State aid reforms is the emphasis on transparency. Since MSF 2002, two new sources of information on large projects have emerged.<sup>39</sup> First, the

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<sup>39</sup> MSF 1998 also required notification and priori approval of measures above certain aid and investment levels and this experience informed the changes introduced under MSF 2002. However, there was no general reporting requirement for assistance to large projects and no published information.

Commission has required *ex-post* reporting of aid to projects exceeding €50 million. Second, as described above, Member States must notify to the Commission cases where the aid proposed is higher than that which a project involving eligible investment of €100 million could have obtained on the basis of the application of the formula; aid above this limit must have the prior approval of the Commission. The sections which follow consider the output from the general reporting requirement and the notification requirement in turn.

#### 4.3.1 Reported large aid cases

Under the *reporting* requirement, some 200 award cases have been reported in the period 2003-09. These are summarised in Figure 9, which shows that Germany, Spain and Hungary together account for more than half of all large aided projects reported and that a significant number of countries have not reported any instances of aid to large projects. Meanwhile, three countries (Austria, Romania and Sweden) have only reported one case in the whole period.

Figure 9: Reported aids to investments exceeding €50 million - number of cases to date

	2003	2004	2005	2006	2007	2008	2009	Total
Austria			1					1
Belgium		1		4		3		8
Czech Rep		1			10	1		12
Germany		2	6	9	12	14		43
Greece						4		4
Spain		4		8	20	3		35
France			1	3	1			5
Hungary		1	6	11	6	7	1	32
Ireland				5	8	3		16
Italy		3		3				6
Netherlands				1				1
Poland			1	3	3	1		8
Portugal		1			14			15
Romania						1		1
Sweden			1					1
UK	1	1	4	2	1	3	1	13
Total	1	14	20	49	75	40	2	201

Source: Collated from data in the transparency system on regional aid, available at: [http://ec.europa.eu/competition/state\\_aid/register/](http://ec.europa.eu/competition/state_aid/register/)

Partly reflecting the number of cases, the amounts of aid involved also vary between countries (see Figure 10). It is difficult to draw conclusions from this data since the number of cases varies widely from year to year. Nevertheless, it can be seen that, for example, Germany and Hungary, and to a lesser extent Spain and the Czech Republic, are consistently high spenders on large projects, while the UK spends relatively small amounts.

Figure 10: Reported aid amounts to large projects (excluding notified projects)

	2003	2004	2005	2006	2007	2008	2009
Austria			14.1				
Belgium		18.0		31.5		38.0	
Czech Rep		31.5			313.2	22.1	
Germany		42.3	156.3	184.4	226.7	214.2	
Greece						146.0	
Spain		130.5		165.5	222.8	24.6	
France			18.4	16.9	11.3		
Hungary		11.2	107.1	226.4	171.0	132.0	19.2
Ireland				37.2	72.0	13.3	
Italy		88.9		78.7			
Netherlands				8.8			
Poland			9.5	23.6	20.8	25.3	
Portugal		69.4			278.6		
Romania						25.4	
Sweden			4.9				
UK	2.9	7.3	36.1	27.7	10.1	30.8	10.1
Total	2.9	399.0	346.4	800.6	1326.4	671.7	29.3

Note: These figures should be treated with some caution since they are current nominal values and the dates refer to the year of reporting, not necessarily the year of award.

Source: Collated from data in the transparency system on regional aid, available at: [http://ec.europa.eu/competition/state\\_aid/register/](http://ec.europa.eu/competition/state_aid/register/)

#### 4.3.2 Notifiable large aid cases

As mentioned above, projects involving aid beyond that for which a €100 million project could qualify have to be *notified* individually and approved prior to being aided. In practice, few cases have been notified to the Commission on the basis of these provisions, and very few have been subject to formal investigation. By August 2009, a total of 41 cases had been notified under either the 2002 Multisectoral Framework or the 2007-13 Regional Aid Guidelines (see Figure 11); of these, one (*Intel*) was withdrawn when it seemed likely that the Commission would open the investigative procedure and find against the aid proposed. The Commission has opened the investigative procedure in five cases.

In *Ibiden* the Commission reached the only negative decision to date.<sup>40</sup> The case concerned the definition of the relevant market for diesel engine exhaust systems and the share of the recipient in that market. The Commission concluded that the relevant market was the diesel particulate filter (DPF) market and that the share of IBIDEN in the European DPF market substantially exceeded the 25 percent threshold both before and after the investment; it therefore prohibited aid (some €9.56 million) above the notification threshold, although the initial €29.73 million was unaffected by this decision. An important point to note here is that this case was decided under MSF 2002; this did not provide the Commission with any discretion in the event that competition concerns arose. Under the 2007-13 Regional Aid Guidelines, the Commission would have had the discretion to authorise the aid, if it considered it appropriate, based on the guidance for the in-depth assessment of aid to large projects discussed above.

<sup>40</sup> Commission Decision of 30 April 2008 on State aid C 21/07 (ex N 578/06) which Hungary is planning to implement in favour of IBIDEN Hungary Gyártó Kft., OJEU No. L 295/34 of 4 November 2008.

In *Sovello*<sup>41</sup> and *BVG*<sup>42</sup> the Commission reached positive decisions. In *Sovello*, the decision largely turned on whether a previous aided investment constituted part of the same project, in which case the aid ceiling would have been lower. Following the investigation, the Commission concluded that the projects were separate and that the positive impact on regional development outweighed the potential distortions of competition. In *BVG* the Commission examined whether the production capacity created by the project remained below the 5 percent threshold; it concluded that it did so and the aid was approved.

In *Dell*, the Commission investigated proposed aid for a computer manufacturing plant in Lodz, Poland.<sup>43</sup> The case turned on a number of elements, including the definition of the relevant product market (are desktops and laptops part of the same market? How to segment the server market?), the relevant geographical market and the calculation of market capacity for the purposes of paragraph 68(b) of the Guidelines - see above. The Commission reached a positive decision on the aid in September 2009,<sup>44</sup> noting that this case involved the first application of its Guidance on aid to large projects (discussed above). Details of the decision have not yet been published.

An investigation is also underway into proposed aid to *Deutsche Solar* for a solar wafer production facility in Sachsen.<sup>45</sup> Deutsche Solar already has two plants - Freiburg South and Freiburg Saxonia - and intends to create a third in Freiburg East. A proposed extension at Freiburg South is also being aided, but the investment involved is less than €50 million, so that the German authorities did not consider that notification was required. However, given the timing of the two investments, the Commission has opened the investigative procedure to assess the links between the two investments and establish whether they should in fact be considered as a single project, in which case a lower aid amount would apply.

One feature of recent notifications to which it is worth drawing attention is that they now include the motor vehicle sector. Indeed, these are among the bigger cases - see *Ford* (two cases), *Mercedes* and *Fiat*. Under MSF 2002, cases in this sector did not require individual notification, instead a flat reduction rate was applied; under the 2007-13 Regional Aid Guidelines, the same rules apply to all sectors.

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<sup>41</sup> Decision not yet published in the OJ, but see Commission decision in C21/2008 available at: <http://ec.europa.eu/competition/elojade/isef/index.cfm?clear=1>

<sup>42</sup> Decision not yet published in the OJ, but see RAPID Press Release (2008) *State aid: Commission endorse €47 million aid to BVG in Poland*, IP/08/1941 of 11 December 2008.

<sup>43</sup> State aid – Poland – State aid C 46/08 (ex N 775/07) – Large Investment Project – Aid to Dell Products Poland – Invitation to submit comments pursuant to Article 88(2) of the EC Treaty, OJEU No C25/9 of 31 January 2009.

<sup>44</sup> Rapid Press Release (2009) *State aid: Commission approves €54.5 million investment aid to Dell plant in Łódź, Poland*, IP/09/1348 of 23 September 2009.

<sup>45</sup> State aid – Germany – State aid C 34/08 (ex N 170/08) – Large investment project – Deutsche Solar – Invitation to submit comments pursuant to Article 88(2) of the EC Treaty, OJEU No C 217/19 of 26 August 2008.

Figure 11: Notified cases under MSF 2002 and 2007-13 Regional Aid Guidelines (€m)

	Beneficiary	Aid	Investment	Outcome
<b>2004</b>				
FR	Total	48.0	547	
IE	Intel	~	~	Withdrawn
<b>2005</b>				
IE	Centocor	48.3	618	
SK	Getrag Ford Transmissions	53.5	265	
SK	INA Kysuce	34.7	142	
<b>2006</b>				
DE	AMD	292.5	2,354	
DE	Quimonda	165.7	1,200	
DE	HighSi GmbH	76.6	520	
DE	Avancis	42.9	273	
DE	Q-Cells	41.4	227	
DE	First Solar	45.5	116	
DE	Papierfabrik Adolf Jass Schwarza	36.7	265	
HU	Matrai Eromu Zrt	112.5	670	
HU	Hankook Tire Hungary Ltd	92.6	425	
IT	Atlantica Invest AG	97.5	505	
PT	About the Future	52.4	543	
PT	Soporcel	63.6	187	
PT	Artensa	99.3	358	
PT	CELBI	89.9	319	
PT	Repsol Polimeros	150.0	750	
SK	Samsung	75.2	321	
<b>2007</b>				
DE	Propapier	82.5	644	
DE	Wacker Schott Solar	47.0	322	
HU	IBIDEN Hungary Gyarto Kft	62.6	191	Investigation
RO	Ford Craiova	143.0	600	
<b>2008</b>				
DE	Intico Solar	73.1	585	
DE	Deutsche Solar	48.0	350	Investigation
DE	Sovello AG (formerly EverQ)	31.1	115	Investigation
DE	Figlass borde	31.5	188	
DE	Masdar Solar Modules	28.6	144	
DE	Ersol Thin Film GmbH	59.7	466	
DE	Sunfilm AG	56.1	393	
DE	Hamberger Sprengberg GmbH	40.6	250	
ES	Ford	51.9	494	
HU	Mercedes	111.5	548	
IT	Fiat	46.0	319	
IT	Digital Display	180.0	900	
PL	Dell	52.7	214	Investigation
PL	BVG Medien Beteiligungs GmbH	47.0	160	Investigation
PL	Sharp	48.3	169	
<b>2009</b>				
IT	En Plus Centrale Termoelettrica di San Severo (FG)	n/a	n/a	

Note: Most data are in nominal values at current prices; figures in *italics* are in net present value. Unless shown otherwise, the Commission raised no objections to the aid proposed.

Source: Compiled from individual Commission case decisions available at: <http://ec.europa.eu/competition/elojade/isef/index.cfm?clear=1>

Some geographical and sectoral concentrations are also worth noting. First, most countries have not notified any case under this mechanism; on the other hand, Germany has notified 17 cases, followed at some distance by Portugal with five and Hungary and Italy with four each. At least in part this is a reflection of the largely automatic nature of the Investment Allowance operated in the new *Länder*. With such a small number of cases it is difficult to draw firm conclusions about any particular sectoral orientation of aid. Clearly there are several in the motor industry and associated activities, a number in the paper and pulp industries and a significant number of projects in electronics and other high-tech activities, within which, notably in east Germany, there appears to be a significant cluster of firms associated with the solar energy sector.

## 5. ISSUES AND CONCLUSIONS

The last year has been marked by government intervention in the economy on an unprecedented scale. The potential volume of aid authorised by the European Commission in the context of the crisis runs to almost one-third of EU GDP, while over the last decade, annual State aid expenditure has generally been around 0.6 percent of EU GDP. At times, the very architecture of State aid control seemed to be under threat as some called for a suspension of the rules in order for the effects of the crisis to be addressed. Others warned of the risks of protectionism policies, arguing that policy responses to the Depression prolonged the slump in the 1930s. The Commission cannily opted to allow intervention on the basis of Article 87(3)(b), enabling a parallel set of rules to operate for a temporary period while retaining the existing framework intact. Moreover, during this time, the Commission has pursued the State Aid Action Plan, effectively reaching the end of its so-called ‘roadmap’ in mid 2009.<sup>46</sup>

Against the backdrop of this period of turmoil, this final section aims to draw out a number of issues and questions as the basis for further consideration.

*(i) Perceptions of the Commission’s performance in controlling State aids in the crisis has been mixed, but so far broadly positive*

The nature and scale of the financial and economic crisis necessitated rapid action on the part of the European Commission and this, arguably on two levels. First, special measures were needed in order to prevent a systemic failure of the financial sector; and second, a commanding and quick response was required in order to preserve the authority of the Commission and the basic principles that underpin State aid control.

There has been some negative comment about Commission action, with concern expressed at the ‘rubber-stamping’ of State aid proposals<sup>47</sup> and claims of a ‘U-turn’ from previous State aid law and policy.<sup>48</sup> In particular, concerns have been expressed at the speed with

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<sup>46</sup> Most elements have been addressed, but the Commission has not issued a Communication on direct business taxation, as indicated in the original plan.

<sup>47</sup> A. Bartosch (2009) ‘On competition or its leftovers’, *European State Aid Law Quarterly*, 2.

<sup>48</sup> R. D’Sa (2009) ‘“Instant” State Aid Law in a Financial Crisis - A U-Turn?’ *European State Aid Law Quarterly*, 2.

which some of the early decisions in the banking sector were reached and doubts cast on the depth of the analysis that could have been carried out in the circumstances. Other commentators have been more positive, arguing that the Commission “has done a reasonable and good job so far”<sup>49</sup> and, sounding a more political note, suggesting that one of the most remarkable achievements of the Commission is that it is still in charge at all.<sup>50</sup> Certainly it can be argued that if the Commission had failed to act to enable Member States to intervene, then it would anyway have been sidelined, with serious consequences for the long-term credibility both of the Commission and of the principles of State aid control.

*(ii) Most commentators consider that intervention in the banking sector is justified; there is less consensus regarding other sectors*

Intervention in the banking sector has been justified on the basis of its particular role in the economy, and the consequences of its failure for all other sectors. The issues of ‘confidence’ and ‘contagion’ are distinctive characteristics of the sector<sup>51</sup> and justify special treatment: banks cannot survive a loss of confidence; the interconnected nature of the sector means that the collapse of one bank quickly renders others vulnerable; and the lubrication that banks provide to the rest of the economic system through borrowing and lending, both to one another and other sectors, dries up. These characteristics created a compelling argument for intervention to address the financial crisis.<sup>52</sup> That said, some have expressed concerns over the conditions attached to restructuring of the banking sector,<sup>53</sup> and their implications for pan-European operations.<sup>54</sup> It has also been argued that the measures have had the effect of rewarding inefficient or inept banks and encouraging other sectors, notably the motor industry, to seek special treatment.<sup>55</sup> Moreover, the scale of the uptake of aid and its longer term implications for the sector remain unclear for the time being, not least since government action has reinforced the moral hazard associated with rescuing organisations deemed ‘too big to fail’.

If intervention in the banking sector has largely been welcomed, more concerns have been expressed about State aid to other sectors. In principle, aid to other sectors under the Temporary Framework is restricted to firms that were not in difficulty prior to the onset of the crisis and were aimed at easing access to credit. However, it has been suggested that, if recapitalisations and loan guarantees prove too expensive to persuade banks to lend, then it would be preferable for governments to take active control of the banks they are

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<sup>49</sup> C. Koenig (2008) “‘Instant State Aid Law’ in a Financial Crisis, State of Emergency or Turmoil: Five Essential and Reasonable Requirements under the Rule of Law’, *European State Aid Law Quarterly*, 4.

<sup>50</sup> R. Luja (2009) ‘State Aid and Financial Crisis: Overview of the Crisis Framework,’ *European State Aid Law Quarterly*, 2.

<sup>51</sup> Vickers, J. (2008) ‘The Financial Crisis and Competition Policy: Some Economics’ *GCP*, December 2008, available at: [www.globalcompetitionpolicy.org](http://www.globalcompetitionpolicy.org)

<sup>52</sup> Lyons, B. (2009) ‘Competition Policy, Bailouts and the Economic Crisis’ *CCP Working Paper 09-4*, University of East Anglia.

<sup>53</sup> Branton, G. (2009) ‘Economic Crisis and State Aid - UK Perspectives’ Romanian Competition Council Conference: Economic Crisis and State Aid Perspectives, 24 February.

<sup>54</sup> Financial Times (2009) *Weber hits out at Brussels*, 21 April.

<sup>55</sup> D’Sa, R. *op cit*.

subsidising and for loans to be decided by independent trustees, rather than for governments to provide subsidies directly to firms or sectors of activity.<sup>56</sup> It has also been commented that the Temporary Framework diminishes the impact of the General Block Exemption Regulation, a core element of the State Aid Action Plan.<sup>57</sup>

*(iii) Policing State aid in other sectors, especially the motor industry, is likely to prove a significant challenge*

The banking sector aside, the most prominent casualty of the crisis has been the motor industry. Job losses and short-time working have taken place in a number of car plants and in the supply chain. To some extent, the sector has been sustained by the scrappage schemes operated in many countries, but these are not a long term solution to the overcapacity in the industry. Moreover, overcapacity is not the only problem facing the sector - the disappearance of cheap finance, demographic change and environmental concerns are likely to favour the production of small cars over large ones, and small car production is significantly less profitable.<sup>58</sup> The scale of the sector within European manufacturing means that potential plant closures and restructuring have become of considerable domestic political importance. This is reflected in French concerns that State loans to Renault and Peugeot should be linked to maintaining jobs in France and in German government State aid commitments in the negotiations over the takeover of Opel. In both cases the Commission issued stern warnings, stating that French aid should not contain any conditions relating to the location of their activities or suppliers<sup>59</sup> and that it would examine carefully whether non-commercial conditions have been attached to proposed German aid to Opel<sup>60</sup> or indeed by other Member States with an interest in the future of the firms' plants.<sup>61</sup> More generally, the Commission has made much of the fact that it intends to scrutinise any support carefully in order to prevent 'beggar-thy-neighbour' policies and to ensure that it stays in line with the State aid rules.

So far, the motor industry has undergone comparatively little restructuring - especially given some estimates of production overcapacity running at 30 percent for car manufacture<sup>62</sup> - but plant closures seem certain to be required in the medium-term. It is unclear how and whether government support can be provided within the constraints of the Temporary Framework, but the tensions between the need for a significant shake-down in the sector, the job implications of scaling down, the cross-border effects of subsidies

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<sup>56</sup> Lyons, B. *op cit*.

<sup>57</sup> D'Sa, R. *op cit*

<sup>58</sup> The Economist (2009) *Trouble down the road*, 19 September.

<sup>59</sup> Rapid Press Release (2009) *State aids: the Commission obtains guarantees from the French government on the absence of protectionist measures in the French plan for aid to the automotive sector*, MEMO/09/90, 28 February.

<sup>60</sup> Rapid Press Release (2009) Neelie Kroes European Commissioner for Competition Policy Address to debate on restructuring of European car industry (Opel case) Plenary session of European Parliament Strasbourg, 14th September 2009, Speech/09/388.

<sup>61</sup> Rapid Press Release (2009) *State aid: Commission statement on aid for Opel Europe*, MEMO/09/411, 23 September.

<sup>62</sup> Financial Times (2009) *A shift in gear*, 19 September.

offered and the respective roles of domestic authorities and the European Commission are already in evidence.

*(iv) The implications of the crisis for regional aid as Europe emerges from recession are uncertain*

With the exception of France and Germany, which made some modest policy adjustments to regional incentive policy, governments have not deployed regional aid as part of their recovery packages. In fact, most policymakers anticipated a downturn in regional aid expenditure commitments in 2008-09 since regional aid must be linked with investment and job creation - the tendency in this period has obviously been to retrench rather than expand.

The likely role of regional incentives as Europe emerges from recession is unclear. In most western European countries, regional aid spending has seen a significant decline in the last decade - will this trend continue or might regional aid spending increase, especially if a still fragile banking sector remains averse to lending? It is plausible to suggest that regional aid will be subject to considerable tensions - on the one hand, public expenditure constraints will affect regional policy, on the other, there is likely to be increased competition for any mobile investment that does take place.

*(v) A 'business as usual' approach to regional aid control may constrain regional policy in the post-recession period*

The Commission's approach to addressing the crisis has been based on a temporary framework that is both sectorally and spatially neutral; moreover, it has explicitly rejected calls for an extension of the assisted areas. So far, this response may not have constrained national policymakers unduly; regional incentives have not been used extensively as part of national recovery packages. However, as the spatial effects of the recession become apparent, new unemployment blackspots may emerge, creating pressure for special treatment of regions outside the current assisted areas; the expiry of the Temporary Framework may increase such pressures.

The current Regional Aid Guidelines do not enable Member States to exceed their assisted area population ceilings, but would require 'exchanging' eligible for ineligible regions in order to remain within the population quota. Longer-term, the Commission's traditional measures of regional disparity - GDP(PPS) per head - may prove an unsuitable guide to varying degrees of prosperity, not least since, if the current system is rolled forward, the future designation of 'a' regions would be based on data for a snapshot of the recession.

*(vi) The long-term implications of the economic crisis for State aid control are unclear*

The Commission has been astute in allowing State aid to address the crisis on the basis of exceptional and temporary measures, as opposed to a suspension of the standard State aid control framework. This has enabled it to pursue a number of outstanding elements under the State Aid Action Plan while allowing some flexibility for measures to address the crisis. At the current time, the implementation of measures and actual spending commitments under the Temporary Framework are unclear; in principle, Member States are to report to

the Commission on this by end October 2009 (and annually thereafter, as applicable),<sup>63</sup> but it is not known whether these reports will ultimately be made public.

The Temporary Framework has an end date of 31 December 2010. In principle, this should enable an orderly return to the standard State aid rules after that date. However, it remains to be seen whether the Commission will come under pressure to extend the Framework; there is already evidence in several Member States of the considerable administrative hurdles involved in establishing the relevant machinery to provide aid under the Framework, leading to long delays in doing so. Moreover, perceptions of the duration of the crisis and its impacts are likely to differ between Member States and many may be tempted to press for a continued relaxation of the rules.

More generally, it remains unclear how the events of the past year will affect the role of governments in the market. The scale and severity of the financial and economic crisis has led some to a reappraisal of free market economics. Governments have been quick to intervene in the economy - whether in waiving merger policy to enable the Lloyds TSB takeover of HBOS or in their large scale systemic interventions in the banking sector. Some politicians have denounced the 'Anglo-Saxon' model seen as among the root causes of the crisis - perhaps most notably President Sarkozy in declaring the end of the dictatorship of the free market.<sup>64</sup> Others, however, have cautioned that government intervention exacerbates the problem, creates uncertainty and slows the market response.<sup>65</sup> There is, it has been argued, a need for a broader reflection on how Member States view the role of State aid in their economies.<sup>66</sup> There is also a need for the Commission to reflect on where its response to the crisis leaves State aid control: the 'more economic approach' and the increasingly restrictive regime of recent years arguably pushed against an open door, but the Commission has not so far acknowledged that the crisis challenges the ideological premises of the 'more economic approach'.<sup>67</sup> It may be optimistic to assume that 'normal service will resume shortly.'

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<sup>63</sup> See point 6 of the Temporary Framework and the Commission questionnaire available at: <[http://ec.europa.eu/competition/state\\_aid/overview/temporary\\_framework\\_questionnaire\\_en.rtf](http://ec.europa.eu/competition/state_aid/overview/temporary_framework_questionnaire_en.rtf)>

<sup>64</sup> Speech in Toulon, France, 25 September 2008, available at: <http://www.elysee.fr>

<sup>65</sup> Financial Times (2009) Do not let the 'cure' destroy capitalism, 19 March.

<sup>66</sup> Ungerer, H. (2009) 'After the State Aid Action Plan: the EU's new State Aid Framework', *EU State Aid Summit - State aid policy, procedure and enforcement through the economic crisis and beyond*, C5 Business Information in a Global Context, 23-24 June, Brussels, available at: [http://ec.europa.eu/competition/speeches/text/sp2009\\_11\\_en.pdf](http://ec.europa.eu/competition/speeches/text/sp2009_11_en.pdf)

<sup>67</sup> Kaupa, C. (2009) 'The More Economic approach - a Reform Based on Ideology?' *European State Aid Law Quarterly*, 3.