Facing the challenges of globalisation: aid to outward foreign direct investment projects (cases Cordex, Orfama and Djebel)

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Introduction

State support to outward foreign direct investment projects (FDI) may fall under EU State aid rules and be considered incompatible with the common market. This is notably the case if it is not proven that the aid is necessary for its recipients to carry out the outward FDI projects at stake, and that its positive effects for the internationalization of the EU industry concerned outweigh its negative effects on competition and trade in the EU. In three recent decisions concerning aid to outward FDI, Cordex (2), Orfama (3) and Djebel (4), the Commission concluded that the aid did not fulfil these criteria and could thus not be approved.

The issue of aid to outward FDI arises in the context of globalisation. As barriers to markets fall, companies seek to internationalize in order to become more competitive in both the domestic and international markets. A number of Member States have thus put in place national aid schemes for encouraging the internationalization of their enterprises.

Since the late 90’s, however, the Commission has made it clear that aid to outward FDI projects may affect competition and trade on the EU market. In a number of decisions (5) the Commission acknowledged the importance of foreign direct investment for strengthening links with third countries and for diversifying and internationalizing the European industry, however, the Commission also noted that these factors should be balanced against any negative impact of the aid on the EU market. The Commission noted in this context that aid for foreign direct investment is likely to strengthen the beneficiary’s overall financial and strategic position and thus affect its relative position to competitors on the EU market (6).

The three recent decisions concerning Cordex, Orfama and Djebel confirm this policy and follow the objectives contained in the State Aid Action Plan, whereby aid cannot be authorized unless it is proven that the it is justified by a Community interest (e.g. a market failure), that the aid is necessary and proportionate and that the positive effects of the aid for the internationalization of the EU industry concerned outweigh its negative effects on competition and trade in the EU. In all three cases the Commission found that the aid was not necessary for the recipients to carry out the projects concerned and was likely to have a significant impact on the EU market. In particular, the aid would likely strengthen the position of the beneficiaries on the EU market to the detriment of competitors not receiving aid. Therefore, the aid only had a distortion effect on competition without contributing to the development of the economic activities concerned in the EU and could not be authorized.

The following examines the criteria used by the Commission for assessing aid to outward foreign direct investment projects and explains how these criteria applied to the three recent cases mentioned above.

State aid rules apply in principle to aid to outward FDI

Since its early decisions the Commission acknowledged that aid financing a FDI project of a company “at least partially also strengthens its position on the home market vis-à-vis enterprises which do not receive aid to carry out those activities. Moreover, enterprises located in the European Economic Area may also compete with each other for investment abroad. Therefore, any aid exceeding the de minimis threshold must be considered to distort

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(1) Directorate-General for Competition, unit E-3. The content of this Article does not necessarily reflect the official position of the European Communities. Responsibility for the information and views expressed lies entirely with the author.


(5) Decision concerning guarantees of the Land Brandenburg (Germany) for investment projects in Poland, (OJ L 102, 19/04/1997, p. 36); decision of 5 June 1996 concerning aid that the Republic of Austria intends to grant under the ERP internationalization scheme, (OJ, L 96, 11/04/1997, p. 15); decision of 5 June 1996 concerning aid that the Republic of Austria intends to grant pursuant to the ERP Eastern Europe programme, (OJ L 96, 11/04/1997, p. 23).

or at least threaten to distort competition between EEA enterprises” (7). The same holds true for the effects on trade.

The aid can affect intra-Community trade in two ways:

— The goods are directed to the foreign local market and are not exported to the Community but the beneficiary of the aid reinforces its position in the EU and thereby gains advantage vis-à-vis competitors that do not receive aid;

— The goods produced abroad following the foreign direct investment project are exported to the EU and compete directly with Community goods.

The EU Court Justice has upheld the Commission’s position on this subject. The Court noted in particular that “(…)having regard to the interdependence between the markets on which Community undertakings operate, it is possible that aid might distort competition within the Community (…)” (8). It is true that more recently, the Court of First Instance annulled a decision concerning aid granted by Italy for the internationalization of activities of an Italian company (WAM) for lack of motivation on the effect on trade in the EU (9). However, this judgement is linked to the specificities of the case and it appears that the Court did not intend to raise the standard of proof concerning the impact on competition and trade of aid measures concerning activities outside the EU. The Commission has filed an appeal, which is pending (10).

When can the aid be considered compatible?

The Commission in principle considers positively aid to outward FDI that pursues a clearly identified Community objective and complies with the conditions of existing guidelines or frameworks. This is the case of aid to small and medium sized enterprises (SME). SME play an important role in the economic and social life of Europe and there are market imperfections impeding their development. The market failures impeding the development of SME being (at least) the same, whether their activities take place in Europe or abroad, aid to SME is justified in both cases. The Commission has thus approved a number of national schemes concerning aid to outward FDI investments of SME on the basis of the “SME Guidelines” (11).

Criteria for approving aid to large companies on FDI projects

In the absence of specific guidelines allowing it to assess aid to FDI projects of large enterprises the Commission bases its assessment directly on Article 87(3) (c) of the EC Treaty. This exempts aid that facilitates the development of certain economic activities if it does not adversely affect trading conditions to an extent contrary to the common interest.

The number of cases of aid to large enterprises for FDI projects has, however, been very limited. The Commission has so far only received 5 individual notifications (12). With the exception of the Vila Galé case, where the Commission authorized aid for an investment for a hotel in Brazil, based on the weak position of the beneficiary on the market and the fact that it was its first internationalization experience, a strict approach has been followed in all other cases. Thus, in the LiftgmbH case, which concerned an investment by a ropeway-producer in China, the Commission took a negative decision based on the lack of incentive effect of the aid. The Doppelmayr group, in which LiftgmbH was integrated, was already present in several markets, including China, where it had started production of ropeways in rented facilities prior to applying for the aid. It was therefore not demonstrated that the aid was necessary to further the internationalization process of the Doppelmayr group.

The approach followed in Cordex, Orfama and Djebel

A similar approach was followed in the three decisions concerning investments by Portuguese companies in Brazil (Cordex and Djebel) and Poland (Orfama). In these cases the Commission examined in particular, whether the aid was necessary in view of the international competitiveness of the EU industry concerned and/or in view of the risks involved for investment projects in certain third countries, and assessed the balance between the negative and positive aspects of the aid in the EU.

These schemes are mentioned in footnote 4 above, to which should be added decision N 96/99, concerning fiscal aid for internationalization projects of Portuguese companies (OJ C 375 of 24.12.1999, p.4). These decisions authorize aid to FDI projects of SME but request individual notification for aid to large enterprises.

(7) See para. 23 of the decision concerning the Austrian ERP internationalization scheme and para. 21 of the decision concerning the ERP Eastern Europe programme.

(8) Case C-142/87, “Tubemeusse”, ECR 1990, I-959, para. 35

(9) Joint Cases T-304/04 et T-316/04, not yet published.

(10) Case C-494/06 P.
**Cordex**

Cordex is a producer of ropes and twines that invested in a new production unit in Brazil (*Cordebras Lda*) for producing baler twine (sisal). Portugal notified to the Commission its intention to grant Cordex a fiscal incentive amounting to EUR 401,795. However, the Commission found that other producers competing with Cordex had also invested in Brazil and, in particular, one other Portuguese producer had conducted a similar investment in Brazil without requesting State aid. Cordex had completed the project with own resources and by resorting to commercial loans. There was, thus, no evidence of any general market deficiency associated with this type of project that would prevent Cordex or its competitors from investing in Brazil without State support. In addition, the aid was likely to have a significant impact on the EU market, given that a great proportion of the Brazilian product would be imported in the EU. On the basis of the above there was no evidence suggesting that granting aid to Cordex in respect of its investment in Brazil could help to improve the competitiveness of the European industry concerned. The aid would likely strengthen the position of Cordex on the EU market but to the detriment of competitors not receiving aid.

**Orfama**

Orfama is a producer of fashion knitwear. The project concerned the acquisition by Orfama of two companies, also involved in the clothing and knitwear business, located in Poland. Portugal notified to the Commission its intention to grant Orfama a fiscal incentive of EUR 921,752. However, as in the case of Cordex, the Commission found that the aid had no incentive effect for the company to carry out the project. Orfama concluded the project even before applying for aid, thus not complying with the “incentive effect” criteria normally required by State aid rules (13). In addition, Orfama had already started producing garments under a subcontracting regime with these companies several years before acquiring the companies, so it was familiar with both the Polish and neighbouring markets as well as with the functioning of these companies. The investment was essentially a financial operation that consolidated a previously existing commercial relationship and it was not demonstrated that the aid was necessary to compensate for any specific risks associated with the project.

**Djebel**

The Djebel case also concerned an investment for a hotel in Brazil. However contrary to the Vila Galé case (see above) this was not the first internationalization of the beneficiary, which is part of a group (the Pestana group) that has a significant position in the Portuguese market. Portugal notified aid amounting to EUR € 574 466 to help finance the project. However, the investment took place in 1999 and the request for aid was only submitted in 2000. Portugal only notified the aid in 2005. Any aid granted now for an investment that took place several years ago was unlikely to have any practical link with the investment anymore. The beneficiary had in the meantime expanded its activities. There was therefore no reason to believe that the aid was necessary for the beneficiary to carry out the project or that the aid would contribute to the international competitiveness of the EU tourism industry. The aid would favour its beneficiary vis-à-vis its competitors without counter positive effects for the EU.

**Conclusion**

In assessing aid to outward FDI projects the Commission examines whether the positive effects of the aid outweigh its negative effects on competition and trade in the EU. With the exception of Vila Galé, the Commission has taken a strict approach on aid to support FDI by large companies in so far as it could not be proven that the aid was necessary to facilitate the development of certain economic activities without adversely affect trading conditions in the sense of Article 87(3) (c) Treaty. However, where the aid to outward FDI is justified by a clear Community interest, such as the development of SME, the Commission has taken a positive approach.

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(13) See para. 38 of the Guidelines on National regional Aid for 2007-2013: “It is important to ensure that regional aid produces a real incentive effect to undertake investments which would not otherwise be made (...) Therefore aid may only be granted (...) if the beneficiary has submitted an application for aid (...) before the start of work on the project (OJ L 54 of 4.3.2006, p.13).