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COMMISSION WORKING DOCUMENT

Guidance on the in-depth assessment of regional aid to large investment projects

1. INTRODUCTION

1.1. General rules for regional aid measures

1. The Commission Guidelines on national Regional Aid for 2007-2013[1] ("RAG") clarify the general approach of the Commission regarding regional state aid. Under the conditions laid down in the RAG, the Commission may consider State aid compatible with the common market if it is granted to promote the economic development of certain disadvantaged regions within the European Union.

1.1. In general, the RAG take account of the relative seriousness of the problems affecting the development of the regions concerned by introducing specific regional aid ceilings. These maximum aid intensities are graduated between 10% and 50% of eligible investment costs, based primarily on the GDP per capita of the regions concerned, but also allowing Member States some flexibility to take account of local conditions. The regional aid maps for each Member State are published on the Europa site.[2]

1.2. The RAG also foresee specific rules for regional aid to large investment projects[3]. A large investment project is an initial investment with an eligible expenditure above EUR 50 million in present value. Such projects are considered to be relatively less affected by regional handicaps. Therefore, the RAG provide for the automatic, progressive scaling-down of regional aid ceilings for these large investment projects to limit distortions of competition to a level which can generally be assumed to be compensated by their benefits in terms of development of the regions concerned[4].

1.3. Moreover, Member States have to notify individually any aid for investment projects if the aid proposed is more than the maximum allowable amount of aid that an investment with eligible expenditure of € 100 million can receive under the applicable rules (notification threshold)[5]. For these notified cases, the Commission verifies in particular the aid intensities, the compatibility with the general criteria of the RAG and whether the notified investment represents a major increase of production capacities, while at the same time addressing an underperforming or even declining market, or benefits firms with high market shares.

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1 OJ C 54, 4.3.2006.

2 http://ec.europa.eu/comm/competition/state_aid/regional_aid/regional_aid.html

3 Cf. section 4.3 of the RAG.

4 Cf. paragraph 67 of the RAG.

5 Cf. paragraph 64 of the RAG.

1.2. Regional aid measures subject to an in-depth assessment

2. Despite the automatic scaling-down, certain large regional aids for large investment projects could still have significant effects on trade, and may lead to substantive distortions of competition. Therefore, point 68 of the RAG foresees that the Commission will conduct a formal investigation procedure pursuant to Article 88 paragraph 2 of the EC Treaty for cases above the notification threshold where

– the aid beneficiary accounts for more than 25 % of the sales of the product(s) concerned on the market(s) concerned, or

– the production capacity created by the project exceeds 5% of the market, while the growth rate of the market concerned is below the EEA GDP growth rate.

3. In these cases, when one or both of the conditions of paragraph 68 of the RAG are met (the in-depth assessment thresholds), the objective of the formal investigation is to carry out a detailed verification "that the 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 and effect on trade between Member States"[6].

4. In footnote 63 of the RAG, the Commission announced its intention to "*draw up further guidance on the criteria it will take into account during this assessment*". Below, the Commission presents guidance as to the kind of information it may require and the methodology it would follow for measures subject to a detailed assessment. In line with the State Aid Action Plan[7], the Commission will carry out an overall evaluation of the aid based on a balance of its positive and negative effects in order to determine whether as a whole, the aid measure can be approved.

5. The detailed assessment should be proportionate to the potential distortions which may be created by the aid. This means that that the scope of the analysis will depend on the nature of the case. Therefore, the nature and the level of the evidence required will also depend on the features of each individual case. Also, while respecting the provisions governing the conduct of formal investigation procedure as set out in Articles 6 and 7 of Regulation (EC) 659/1999[8], the Commission may, inter alia, ask the Member State to provide independent studies to confirm the information contained in the notification, or seek input from other economic operators active in the relevant markets or from experts in regional development. Moreover, comments by interested parties are welcomed during individual formal investigation procedures. The Commission will identify the key issues on which it is seeking input in the opening of the procedure.

6. The present notice is intended to ensure the transparency and predictability of the Commission decision making process, and equal treatment of Member States. The Commission reserves the possibility to amend and review this guidance in the light of case experience.

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6 Cf. paragraph 68 of the RAG.

7 Cf. paragraphs 11 and 20 of the SAAP.

8 OJ L 83, 27.3.1999, p.1

2. POSITIVE EFFECTS OF THE AID

2.1. Objective of the aid

7. Regional aid has an equity objective of common interest, namely furthering economic cohesion by helping to reduce the gap between the development levels of the various regions of the EU. Paragraph 2 of the RAG sets out that: "*By addressing the handicaps of the disadvantaged regions, national regional aid promotes the economic, social and territorial cohesion of Member States and the European Union as a whole*". Paragraph 3 of the RAG adds that: "*Regional investment aid is designed to assist the development of the most disadvantaged regions by supporting investment and job creation. It promotes the expansion and diversification of the economic activities of enterprises located in the less-favoured regions, in particular by encouraging firms to set up new establishments there*".

8. For those large investment projects that meet the in-depth assessment thresholds, the Member State will be requested to demonstrate that the aid will address the equity objective in question. The Member State will therefore need to substantiate the contribution of the investment project to the development of the region concerned.

9. While the primary objective of regional aid is to foster equity concerns as economic cohesion, regional aid may also address issues of market failure. Regional handicaps may be linked to market failures as imperfect information, co-ordination problems, difficulties to appropriate investments in public goods or externalities from investments. Where, apart from equity objectives, a regional aid also addresses efficiency concerns, the overall positive effect of the aid will be considered larger.

10. The following non-exhaustive list of indicative criteria[9] can be used to demonstrate the regional contribution of the aid, in so far as it leads to attracting additional investment and activity in the region. These positive effects of the aid can be both direct (e.g. direct jobs created) and indirect (e.g. local innovation).

   – The number of direct jobs created by the investment is an important indicator of the contribution to regional development. The quality of the jobs created and the required skill level should also be considered.

   – An even higher number of new jobs might be created in the local (sub-)supplier network, helping to better integrate the investment in the region concerned and ensuring more widespread spillover effects. The number of indirect jobs created will therefore also be taken into account.

   – A commitment by the beneficiary to enter into widespread training activities to improve the skills (general and specific) of its workforce will be considered as a factor that contributes to regional development. Emphasis will also be put on training that improves the knowledge and employability of workers outside the firm. General or specific training for which training aid is approved will not be counted as a positive effect of the regional aid to avoid double counting.

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9 Of course, all investments must comply with the rules of secondary Community law concerning the environment, such as those on energy use and emissions, climate change or biodiversity.

– External economies of scale or other benefits from a regional development viewpoint may arise as a result of proximity (clustering effect). Clustering of firms in the same industry allows individual plants to specialize more which leads to increased efficiency. Physical proximity facilitates the exchange of information, ideas and knowledge between firms. A concentration of economic activities attracts many job seekers, which assures a large pool of workers with different skills available to firms. Access to legal and commercial services is ensured which enhances productivity. In general, a concentration of economic activities may again attract other investments which in turn increase the positive spillover effects (virtuous circle).

– Investments embody technical knowledge and can be the source of a significant transfer of technology (knowledge spillovers). Investments taking place in technology intensive industries are more likely to involve technology transfer to the recipient region. The level and the specificity of the knowledge dissemination are also important in this regard.

– The projects' contribution to the region's ability to create new technology through local innovation can also be considered. Co-operation of the new production facility with local higher education institutions can be considered positively in this respect.

– The duration of the investment and possible future follow-on investments are an indication of a durable engagement of a company in the region.

11. The Member States are, in particular, invited to rely on evaluations of past State aid schemes or measures, impact assessments made by the granting authorities, expert opinions and other possible studies related to the investment project under assessment. The business plan of the aid beneficiary could provide information on the number of jobs created, salaries paid (increase in household wealth as spill-over effect), volume of sales from local producers, turnover generated by the investment and benefiting the region possibly through additional tax revenues.

12. If relevant, the relationship between the planned investment project and the National Strategic Reference Programme, as well as the Operational Programmes being co-financed by the structural funds, also has to be considered. In this regard, the Commission might specifically take account of any Commission decision relating to the measure in the context of the analysis of major projects under the structural funds or the Cohesion Fund[10]. Such a decision is, among other elements, based on "*a cost-benefit analysis, including a risk assessment and the foreseeable impact on the sector concerned and on the social-economic situation of the member state and/or the region and, when possible and where appropriate, of other regions of the Community.*"

[10] Cf. section 2 of Council Regulation (EC) No 1083/2006 of July 2006 Laying down general provisions on the ERDF, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999.

2.2. Appropriateness of the aid instrument

13. State aid in the form of investment subsidies is not the only policy instrument available to Member States to support investment and job creation in the disadvantaged regions. In fact, Member States can use general measures such as infrastructure development, enhancing the quality of education and training, or improvements in the general business environment.

14. Measures for which the Member State considered other policy options, and for which the advantages of using a selective instrument such as State aid for a specific company are established, are considered to constitute an appropriate instrument. The Commission will in particular take account of any impact assessment of the proposed measure the Member State may have made.

2.3. Incentive effect

15. Analysing the incentive effect of the aid measure is one of the most important elements in the in-depth assessment of regional aid to large investment projects. The Commission will assess whether the proposed aid is necessary to produce "*a real incentive effect to undertake investments which would not otherwise be made in the assisted areas*"[11]. This assessment will take place at two levels: first, at a general, procedural level, and, second, at a more detailed, economic level.

16. In point 38, the RAG already contain general criteria to provide an assessment of the incentive effect of regional aid. These criteria apply to all regional aid, not only regional aid for large investment projects.

17. In general terms, the timing of the start of the work on the project, the application for the aid and the commitment of the authorities to grant aid will be important elements in the general assessment of the incentive effect, insofar as they provide a provisional basis to exclude windfall profits to the beneficiary.

18. In the case of regional aid to large investment projects covered by this notice, the Commission verifies in detail "*that the aid is necessary to provide an incentive effect for the investment*"[12]. The objective of this detailed assessment is to determine whether the aid actually contributes to changing the behaviour of the beneficiary, so that it undertakes (additional) investment in the assisted region concerned. Indeed, there are many valid reasons for a company to locate in a certain region, even without any aid being granted.

19. Having regard to the equity objective deriving from cohesion policy and as far as the aid contributes to achieving this objective, 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.

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[11] Cf. paragraph 38 of the RAG.
[12] Cf. point 68 of the RAG.

(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.

20. The Member State should demonstrate to the Commission the existence of an incentive effect and necessity of the aid. It will need to provide clear evidence that the aid is needed by effectively impacting on the investment choice or the location choice. It will have to specify which scenario applies. In order to permit a comprehensive assessment, the Member State will have to provide not only information concerning the aided project but also a comprehensive description of the counterfactual scenario, in which no aid would be granted by the Member State to the beneficiary.

21. In scenario 1, the Member State could provide proof of the incentive effect of the aid by providing company documents that show that the investment would not have been profitable without the aid and that no other location than the assisted region concerned could be envisaged.

22. In scenario 2, the Member State could provide proof of the incentive effect of the aid by providing company documents that show a comparison has been made between the costs and benefits of locating in the assisted region concerned with an alternative region. Such comparative scenarios will have to be considered realistic by the Commission.

23. The Member States are, in particular, invited to rely on risk assessments, financial reports, internal business plans, expert opinions and other studies related to the investment project under assessment. Documents containing information on demand forecasts, cost forecasts, financial forecasts, documents that are submitted to an investment committee and that elaborate on various investment scenarios, or documents provided to the financial markets could help to verify the incentive effect.

24. In this context, and in particular in scenario 1, the level of profitability can be evaluated by reference to methodologies which are standard practice in the particular industry concerned, and which may include: methods to evaluate the Net Present Value of the project (NPV), the internal rate of return (IRR) or the return on capital employed (ROCE).

25. If the aid does not change the behaviour of the beneficiary by stimulating (additional) investment in the assisted region concerned, there is a lack of incentive effect to achieve the regional objective. If the aid has no incentive effect to achieve the regional objective, this aid can be considered as free money for the company. Therefore, in an in-depth assessment of regional aid to large investment projects, aid will not be approved in cases where it appears that the same investment would take place in the region also without the aid.

2.4. Proportionality of the aid

26. For the regional aid to be proportional, the amount and intensity of the aid must be limited to the minimum needed for the investment to take place in the assisted region.

27. The RAG generally ensure that regional aid is proportional to the seriousness of the problems affecting the assisted regions by applying regional aid ceilings in general

and an automatic, progressive scaling-down of these regional aid ceilings for large investment projects (see introduction of this guidance).

28. For regional aid cases that require an in-depth assessment, a more detailed verification of this general principle of proportionality contained in the RAG is necessary.

29. In scenario 1, for an investment incentive, the aid will generally 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 in other investment projects, with the cost of capital of the company as a whole or with returns commonly observed in the industry concerned.

30. In scenario 2, for a location incentive, the aid will generally be considered proportionate if it equals the difference between the net costs for the beneficiary company to invest in the assisted region and the net costs to invest in the alternative region(s). All such costs and benefits need to be taken into account, including for example administrative costs, transportation costs, training costs not covered by training aid and also wage differences.

31. Ultimately, these net costs which are considered to be related to the regional handicaps result in a lower profitability of the investment. For that reason, calculations used for the analysis of the incentive effect, can also be used to evaluate whether the aid is proportionate.

32. The Member State needs to demonstrate the proportionality on the basis of genuine documentation such as the one mentioned under the section on incentive effect.

33. In no case can the aid intensity be higher than the regional aid ceilings corrected by the scaling-down mechanism, as stipulated in the RAG.

3. NEGATIVE EFFECTS OF THE AID

34. To assess market shares and potential overcapacity in a market in structural decline, the Commission needs to define the relevant product and geographic market. Thus usually[13], the relevant market will already have been defined for all regional aid measures subject to an in-depth assessment.

35. Two main indicators of potential negative effects arising from the aid are already identified in point 68 of the RAG, namely high market shares and potential overcapacity in a market in structural decline. They are linked to two theories of harm in a competition context, respectively the creation of market power and the creation/maintenance of inefficient market structures. A prima facie measurement of these two indicators will already have taken place before the opening of the investigation procedure. In order to provide all the elements for the final balancing exercise, the assessment of the two indicators will be refined in the in-depth

[13] Where doubts remain as to the appropriate definition of the relevant market, the Commission will identify these in the decision to initiate the formal investigation procedure pursuant to Article 88(2) EC Treaty.

assessment. A third indicator of potential negative effects arising from the aid that will be assessed in depth is the influence of the aid on trade and location. Although these three indicators are considered as the main negative effects potentially arising from regional aid to a large investment project, the Commission does not exclude that other indicators might also be relevant in specific cases.

36. The Commission will place particular emphasis on the negative effects linked with the notion of market power and overcapacity in cases where the aid gives an incentive to change the investment decision, so where without the aid no investment would take place (scenario 1 of the incentive effect).

37. If, however, the counterfactual suggests that without the aid the investment would have gone ahead in any case, albeit possibly in another location (scenario 2), and if the aid is proportional, possible indications of distortions such as a high market share and an increase in capacity in an underperforming market would in principle be the same regardless of the aid.

3.1. Crowding out of private investment

3.1.1. Market power

38. When establishing its optimum investment level, each firm takes into account the investment carried out by its competitors. If aid induces a particular company to invest more, competitors may react by reducing their own expenditure in that area. In that case aid leads to a crowding out of private investment. If, as a result, such competitors are weakened or even have to exit, the aid distorts competition. In this regard, as discussed above, the RAG distinguishes cases where the aid beneficiary has market power and cases where the aid leads to a significant capacity expansion in a declining market.

39. In general, any aid to one beneficiary in a concentrated market is more likely to distort competition, since the decision of each firm is likely to affect its competitors more directly. This is especially the case if a dominant market player is subsidised. As a result, if due to the aid, the beneficiary can maintain or increase its market power[14], regional aid for large investment projects may have a chilling effect on competitors' investment decisions and thereby generate distortions of competition.. This would be to the detriment of consumers, therefore, the Commission wants to limit state aid to companies with market power.

40. For all regional aid cases that trigger the notification threshold (point 64 of the RAG), the Commission already needs to asses (point 68 (a) of the RAG) the share of the aid beneficiary (or the group to which it belongs) of the sales of the product(s) concerned on the relevant product and geographic market(s). However, market shares can only give a preliminary indication of possible problems. Therefore, in an in-depth assessment, the Commission will also take account of other factors, where

[14] Market power is the power to influence market prices, output, the variety or quality of goods and services, or other parameters of competition on the market for a significant period of time.

relevant, including for example the market structure by looking at the concentration in the market[15], possible barriers to entry[16], buyer power[17] and barriers to exit.

41. The Commission will take account of the market shares and related other factors before and after the investment (normally the year before the investment starts and the year after full production is reached). When assessing negative effects in detail, the Commission will take into account that, while some investment projects are carried out over a relatively short time-scale of one or two years, most large investment projects have a much longer duration. Therefore, in most cases, long-term analyses of the evolution of markets are necessary. However, the Commission will acknowledge the fact that those long-term analyses are more speculative, particularly in the case of volatile markets or markets undergoing rapid technological change. Therefore, the more long-term and thus the more speculative the analysis is, the less weight will be attached to the possible negative effect of market power or the possibility of exclusionary behaviour.

3.1.2. Creating or maintaining inefficient market structures

42. It is a sign of effective competition if inefficient firms are forced to exit a market. In the long term, this process fosters technological progress and an efficient use of scarce resources in the economy. However, a substantial capacity expansion induced by State aid in an underperforming market might unduly distort competition as the possibly created overcapacity could lead to a squeeze on profit margins and a reduction of competitors' capacity or even their exit from the market. This might lead to a situation where competitors that would otherwise be able to stay on are forced out of the market as a consequence of State aid. It may also prevent low cost firms from entering and it may weaken incentives for competitors to innovate. This results in inefficient market structures which are also harmful to consumers in the long run.

43. In order to evaluate whether the aid may serve to create or maintain inefficient market structures, as pointed out above, the Commission will take into account the additional production capacity created by the project and whether the market is underperforming[18]. According to the RAG, additional capacity will only be considered problematic if it is created in an underperforming market and if the additional capacity is more than five per cent of the market concerned.

44. Since capacity created in a market in absolute decline will normally be more distortive than capacity created in a market in relative decline, the Commission will distinguish between cases for which the relevant market is in absolute decline (i.e.

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15 For this purpose, the Commission may consider the Herfindahl-Hirschman index (HHI). This index provides a basic analysis of the market structure. In a market with few market players where several of them have a relatively high market share, a high market share of the beneficiary might be less of a concern for competition.

16 These entry barriers include legal barriers (in particular intellectual property rights), economies of scale and scope, access barriers to networks and infrastructure. Where the aid concerns a market where the aid beneficiary is an incumbent, possible barriers to entry may exacerbate the potential market power by the aid beneficiary and thus the possible negative effects of that market power.

17 Where there are strong buyers in the market, it is less likely that an aid beneficiary can increase prices vis-à-vis these strong buyers.

18 In this context, a market is meant to be "underperforming" if its average annual growth rate in the reference period does not exceed the growth rate of EEA's GDP.

shows a negative growth rate), and cases for which the relevant is in relative decline (i.e. shows a positive growth rate, but does not exceed a benchmark growth rate (see below)). Where the capacity created by the project takes place in a market in absolute decline, the Commission will consider it to be a negative element in the balancing test that is unlikely to be compensated by any positive elements. The long term benefit for the region concerned is also more doubtful in such a case.

45. Underperformance of the market will normally be measured compared to the EEA GDP over the last five years before the start of the project (benchmark rate). Data on past performance are more readily available and less speculative then future projections. Nevertheless, in the in-depth assessment, the Commission may also take into account expected future trends since the increase in capacity will exert its effect in the years following the investment. Indicators could be the foreseeable future growth of the market concerned and the resulting expected capacity utilisation rates, as well as the likely impact of the capacity increase on competitors through its effects on prices and profit margins.

46. Experience also shows that in some cases, considering the growth of the product concerned in the EEA may not be the appropriate benchmark to assess the effects of aid, in particular if the market is considered to be worldwide and there is only limited production or consumption of the products concerned within the EEA. In such cases, the Commission will take a broader view of the effect of the aid on market structures, having regard, in particular, to its potential to crowd out EEA producers.

3.2. Effects on trade and location

47. It is a particular characteristic of regional aid that it is intended to influence the choice made by investors about where to locate investment projects through off-setting the additional costs stemming from the regional handicaps. The RAG, and the regional aid maps already restrict the location effects of the aid by defining exhaustively the areas eligible to grant regional aid, taking account of the equity and cohesion policy objectives, and the eligible aid intensities. Aid may not be granted to attract investments outside of these areas.

48. The Commission considers that attracting an investment to a poorer region (as defined by the higher regional aid ceiling) is more beneficial for regional cohesion than if the same investment locates in a more advantaged region. Thus, under scenario 2, where proof has to be given of an alternative location, an assessment that without aid the investment would have located to a poorer region (more regional handicaps – higher maximum regional aid intensity) or to a region that is considered to have the same regional handicaps as the target region (same maximum regional aid intensity) will constitute a negative element in the overall balancing test that is unlikely to be compensated by any positive elements because it runs counter the very rationale of regional aid.

49. Furthermore, irrespectively of which incentive effect scenario applies, the Commission also considers it necessary to take into account whether the aid leads to the development of additional economic activity or simply results in the displacement of already existing economic activity from one region to the other. In

the second case, any lost jobs, losses for subcontractors and lost positive externalities in the region from where economic activity is relocated should also be taken into account when assessing the overall effects of the aid in terms of regional development[19].

4. Balancing the effects of the aid

50. Having established that the aid is necessary as an incentive to carry out the investment in the region concerned, the Commission will balance the positive effects of the regional investment aid to a large investment project with its negative effects. Careful consideration will be given to the overall effects of the aid on cohesion within the EU. 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.

51. The Commission may, following the formal investigation procedure laid down in Article 6 of Regulation (EC) No 659/1999, close the procedure with a decision pursuant to Article 7 of that Regulation.

52. The Commission may decide either to approve, condition or prohibit the aid[20]. If it adopts a conditional decision pursuant to Article 7(4) of that Regulation, it may attach conditions to limit the potential distortion of competition and ensure proportionality. In particular, it may reduce the notified amount of aid or aid intensity to a level considered to be compatible with the common market.

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[19] The RAG already restrict the granting of aid to finance relocation by only allowing the costs of new investments (in contrast to second-hand or used investments) as a basis to calculate the aid intensity.

[20] When the aid is granted on the basis of an existing regional aid scheme, it is however to be noticed that the Member State retains the possibility to grant such aid up to the level which corresponds the maximum allowable amount that an investment with eligible expenditure of € 100 million can receive under the applicable rules.