

Economic analysis in practice

Some recent case experience

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Overview



- Introduction
- Some insights after two years of implementation
 - Market failures
 - Incentive effects
 - Distortions of competition
- Conclusion

Introduction



- SAAP : “Less and better targeted aid”: enhance effectiveness of state aid by striking a better balance between
 - benefits of state aid
 - efficiency rationales: correcting market failures
 - equity rationales: redistribution/cohesion
 - costs of state aid (distortions)
- Formulated as a “balancing test”
- Locus: Art. 87(3) EC
- Economics is about better targeted aid – no presumption about the level of aid

Introduction



- Economic analysis and political discretion
 - The objectives of common interest can be formulated in terms of efficiency and equity - comprehensively
 - Economics provides tools to assess both and no hierarchy
 - If efficiency has been emphasized at the expense of equity, it results from the exercise of political discretion, not from the application of economic analysis
 - The decision to focus the analysis of equity and efficiency in economic terms is also an exercise of political discretion

Balancing test



1. Is the aid measure aimed at a well-defined objective of common interest? In particular, does the proposed aid address a market failure (efficiency) or enhance equity
2. Is the aid well designed to deliver the objective of common interest ?
 - Is State aid an appropriate policy instrument?
 - Is there an incentive effect, i.e. does the aid change the behaviour of firms?
 - Is the aid measure proportional to the problem tackled, i.e. could the same change in behaviour be obtained with less aid?
3. Are the distortions of competition and effect on trade limited, so that the overall balance is positive?

Implementation



■ In Guidelines/BER

- Risk capital (2006)
- R&D&I (2006)
- Regional aid (2006)
- BER (2008)
- Environmental aid (2008)

■ In cases

- So far mainly in the field of R&D&I (Neoval, Soitec, Homes, TVMSL, Osiris, ITP, Genesis, Maxssimm, Quaero, Minimage, VHD, LowCo2motion, H2E, ADNA ...)
- Training aid cases



"The theory of economics does not furnish a body of settled conclusions immediately applicable to policy. It is a method, rather than a doctrine. An apparatus of the mind, a technique of thinking, which helps its possessors to draw correct conclusions."

Keynes

Market failures



- No reference to perfect market outcomes
- Rather a set of factors which lead firms to make incorrect decisions from a public policy prospective
- Positive externalities/knowledge spill-overs
- Imperfect and asymmetric information
 - Inability to credibly commit/convey information => inadequate funding
 - Incomplete contracts => coordination problems
 - Network effects, self fulfilling expectations => coordination problems



Areas	Specific assessment criteria
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<i>Externalities:</i>	R&D&I Training Environment aid	<ul style="list-style-type: none"> • Existence of similar projects • Possibility to appropriate the benefits of the activity notably through contracts, Intellectual Property Rights, secrecy • Level of dissemination foreseen • Specificity of the externality produced • Transparency about the nature and magnitude of the external effects produced towards consumers and trading partners
<i>Imperfect information</i>	Risk Capital, R&D&I Employment Rescue aid	<ul style="list-style-type: none"> • Type of beneficiary, probability of default – collateral • Scope for ex ante evaluation and ex post monitoring of the targeted activity, notably as regards its profitability and/or quality • Availability of information and expertise in the targeted sector and/or about the targeted activity and recipient
<i>(Coordination problems)</i>	R&D&I Employment aid	<ul style="list-style-type: none"> • Number of undertakings needing to collaborate • Intensity of previous collaboration • Diverging interests between collaboration partners • Problems in designing contracts, importance of unknown contingencies • Problems to coordinate collaboration (linguistic issues, time, distance, travel costs, lack of easy communication channels, sensitive information)

Market failures



- Some misunderstanding. E.g. risk
- Careful consideration of underlying principles (e.g. pecuniary external effects)
- Validation remains crude
- Frequent environmental externalities
- Government failures

Incentive effect



- Incentive effect: does the aid change the behaviour of the firm?
- Counterfactual: what would the company do without aid?
- Indicators :
 - Net present value
 - Probability of success ? Different scenarios. Fall back option in case of failure
 - “critical probabilities of success”
 - Cost of capital

Incentive effects



- Financing constraints
 - Internal ? Scope for abuse
 - External ? Bank loans and equity
- Confidence in the numbers presented by the parties
- But improvements in business plans
- Reports from analysts, banks
- Marginal effect of public support on overall financial prospects

Distortions of trade and competition



- Effects on competitors
 - Reduce output, RDI, investment
 - General concern about dynamic incentives. Rents are allocated by governments rather than competition
- Taking place across countries in terms of trade but also investment
- Misleading to suggest that because state aid control is about state competition and disciplines in the internal market, distortions of competition among firms should not be the focus
- Interactions among states take place through firms and markets

Concluding



- Important progress – learning
- Transparent trade-offs
- Beware of outcomes – self selection
- Procedural reform
- And 87(1) ?
 - Advantage without distortion of competition
 - Distortion of competition without advantage