

# **Economics in state aid: soon as routine as dentistry ?**

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# I Introduction

1. John Keynes famously hoped – a hope famous at least amongst economists – that economics would one day become as humble and routine as dentistry. As is well known, all this has not become reality. However, in the Commission, we are on the march to make economic analysis as much a routine in the analysis of state aid cases, as it is already in the other main areas of competition policy, namely merger control and antitrust policy.
2. The Commission has embarked, since 2005, on a sustained effort towards a renewed state aid policy. The four pillars of the State Aid Action Plan<sup>2</sup> are by now well known:
  - less and better targeted state aid;
  - a refined economic approach, as a means to achieve "less and better targeted state aid";
  - more effective and predictable rules and enforcement;
  - a shared responsibility between the Commission and Member States:
3. There has been quite some work done and there is still work in progress on all these fronts. In this paper, we will emphasise two crucial issues related to the ongoing reform of state aid policy. These are both topics which are high on the political agenda. The Commission will take a series of important decisions in the coming weeks and months in this respect.
4. First, we will address the issue of incentive effect and the way in which the Commission has and should continue to formulate it both in different policy instruments and in individual decisions. Secondly, we will take up the issue of cooperation between the Commission and the national competition authorities (NCAs) in the state aid field.

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<sup>2</sup> *State Aid Action Plan, less and better targeted state aid: a roadmap for state aid reform 2005 to 2009*, available at [http://europa.eu.int/comm/competition/state\\_aid/others/action\\_plan/saap\\_en.pdf](http://europa.eu.int/comm/competition/state_aid/others/action_plan/saap_en.pdf).

## **II The concept of 'incentive effect' and its implementation in state aid practice**

### **1. *Setting the scene***

5. A significant number of hills and mountains have already been crossed on the road towards reform. The economic balancing test which was set out in the State Aid Action Plan has been formalised and practice now reflects the spirit of analysing subsidy initiatives in the light of this test. In essence, the balancing test asks whether (i) the state aid addresses a market failure or other objective of common interest; whether (ii) the state aid is well targeted and whether (iii) the distortions of competition are sufficiently limited so that the overall balance is positive.
6. It is perhaps useful, by way of introduction, also to say something about the welfare standard to be applied in the state aid area. Whereas in the fields of mergers and antitrust the negative and positive effects are assessed essentially on the basis of the benchmark of the consumer welfare standard, it is not possible to transpose this standard directly to the world of State aid. This is not least because State aid can be justified on the basis of non-economic grounds such as social or regional cohesion which consumer welfare does not measure. The common denominator for exempting State aid under Article 87(3) of the Treaty is that the aid is in the “common interest”. Therefore, the relevant welfare standard for State aid policy – an expression of the common interest objective in economic terms - appears to be the social welfare of the European Union<sup>3</sup>.
7. However, an important number of policy choices remain to be made. These policy choices have to be realised simultaneously with what is probably the most important challenge currently: implementing the new economic approach in practice. Commissioner Kroes has, in a recent speech in Berlin, highlighted this in the following words: “[...] the balancing test is not a mathematical formula. It still requires a good dose of hard facts, sound thinking and sometimes even a pinch of 'Fingerspitzengefühl' – not to say 'Realpolitik'. But it is definitely more consistent, coherent - and I have to say more professional - than what we did in the past.”<sup>4</sup>
8. Economic theory provides useful insights into state aid, but relatively little work has been done in the field of state aid compared to the contributions from around the world on antitrust and merger economics. As a result, it is not always easy to identify general empirical indicators which fit with or mirror the state aid criteria laid down in article 87(3) of the Treaty.

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3 "Some Reflections on the European Commission's State Aid Policy", Philip Lowe, Competition Policy International, Vol. 2, No. 2, Autumn 2006, p. 67. See also "The economic analysis of state aid: Some open questions", by C. Buelens, G. Garnier, R. Meiklejohn and Matthew Johnson, DG ECFIN, European Economy economic papers, Number 286 – September 2007. See also Friederiszick, Röller and Verouden "European State Aid Control: an Economic Framework" forthcoming in: Handbook of Antitrust Economics (P. Buccirossi, ed.), MIT Press 2007.

4 "The Law and Economics of State aid control – a Commission Perspective", N. Kroes, Berlin, Germany Joint EStALI/ESMT Conference, "The Law and Economics of European State Aid Control", SPEECH/07/601.

9. One crucial task ahead consists in bridging the gap between the theory of incentive effect and its practical implementation. To do so, we first need to be understood why this concept of "incentive effect" is so important. Why has it consistently been considered as one of the pillars of the refined economic analysis?

## **2. *The analysis of incentives as the bedrock of the economic approach***

10. Often the key to analysing a particular problem will lie in understanding the motivations of the different stakeholders concerned. A more economic approach is fundamentally the study of motivations based on a systematic assessment of facts: how do individuals, companies, state authorities seek to obtain what they want or what they need. Economists and politicians try to devise stimulations or incentives – taxes or sanctions - in order to change the motivation and thus the behaviour of individuals in private life and of companies on the market<sup>5</sup>.
11. Analysing the extent to which Member States effectively stimulate companies to realise certain specific activities is thus quintessentially economic. More precisely, from an economic point of view, if an aid does not change the behaviour of the recipient, then that aid cannot help to reduce the market failure which it is supposed to address. One could re-formulate this statement in a more legal manner, by saying that if the aid does not change the behaviour of the subsidised companies, then the aid cannot contribute to the furthering of Community objectives, as set out in Article 87(3) of the Treaty. In such a case, the aid should be considered as incompatible with the common market. Beyond the fact that it is liable to distort competition and violate Treaty rules, aid without incentive effect incidentally or otherwise, also constitute a pure drain on taxpayer's money, which has an opportunity cost. Furthermore, the granting of subsidies which are higher than strictly necessary may induce subsidy races between Member states, whereby every Member state ends up worse off. It is thus generally speaking in the common long term interest of both European and national authorities to eliminate such aid.

## **3. *The incentive effect test as formulated in legal texts***

12. The formulation of the incentive effect test is now well established and reads as follows<sup>6</sup>: "aid shall be considered to have an incentive effect if it enables the beneficiary to carry out activities or projects which it would not have carried out as such in the absence of the aid". As regards aid to large enterprises<sup>7</sup>, this condition is – in somewhat simplified terms - considered as being fulfilled if business documentation prepared by the beneficiary establishes:

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<sup>5</sup> Inspired on "Freakonomics. A rogue Economist explores the hidden side of everything", S. Levitt and S. Dubner, Harper Collins, New York, 2005.

<sup>6</sup> See article 8 of the draft GBER as published in the Official Journal C 210 of 8/9/2007, p. 14-40, available at [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52007XC0908\(02\):EN:NOT](http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52007XC0908(02):EN:NOT).

<sup>7</sup> In simplified terms, these are undertakings employing more than 250 workers. See Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.05.2003, p. 36.

- (a) an increase in the size of the project or
- (b) an increase in the scope of the project or
- (c) an increase of the total amount spent by the beneficiary on the project.

13. This formulation is present not only in the draft general block exemption, but also in the guidelines on risk capital and the framework on R&D&I adopted in 2006<sup>8</sup>.

14. It must be highlighted that, both the general block exemption regulation<sup>9</sup> (GBER) and – as a general rule<sup>10</sup> - the recently adopted R&D&I and risk capital guidelines exempt SMEs from the most stringent incentive effect conditions. Indeed, for those SMEs, a presumption of incentive effect exists as soon as an application for the aid has been lodged before works have started on the project or activity concerned. The new - and much discussed - rules concerning incentive effect<sup>11</sup> therefore only apply to large undertakings, without anyhow imposing any additional bureaucracy on SMEs.

#### **4. *The concept of "incentive effect" as it has been applied until now in practice***

15. The concept has already been outlined in policy instruments and applied in a string of recent decisions, especially in the area of training aid and R&D aid, but also in respect of environmental aid.

16. In the training aid area, the Commission has traditionally not analysed in detail what has long been dubbed the "the necessity of aid". However, in its more recent decisions concerning the Ford Genk, General Motors Antwerp and Fiat Auto cases, the Commission clearly established that "incentive effect" was present only under a number of specific conditions. In particular, in the car sector for instance, only training aid relating to qualifications which are not immediately required for the production of cars are considered to have an incentive effect. By contrast, the training expenses associated with the launching of a new (car) model are normally incurred on a commercial basis, i.e. on the sole basis of market incentives. Any additional aid for such activity would thus be a windfall profit<sup>12</sup>.

17. This emphasis on the importance of incentive effect in recent training cases in the car sector is linked to a contemporary economic phenomenon: the ever increasing competition between plants, even if they belong to the same industrial groups. Plants have to bid against each other to get the opportunity to produce new models. This seems to result - most prominently in the car industry - from the higher flexibility of

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<sup>8</sup> The risk capital guidelines and R&D&I Framework also foresee a fourth condition relating to the increased speed of the project/activity concerned: for one of the key elements: scope, size, speed and budget (SSSB). See, for instance, point 6 of the R&D&I Framework.

<sup>9</sup> See Invitation to submit comments on the draft general block exemption of the Commission in the State aid area, OJ C 210, 8.9.2007, p. 14–40.

<sup>10</sup> Section 6 of the R&D&I Framework, implies that most measures in favour of SMEs benefit from a presumption of incentive effect (up to R&D project aid of an amount of €7.5 Million) and that only R&D project aid measures above this amount will be subject to an assessment of size/scope/speed/amount.

<sup>11</sup> See comments of stakeholders published on the Commission website at

[http://ec.europa.eu/comm/competition/state\\_aid/reform/reform.cfm](http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm)

<sup>12</sup> "Recent training cases in the car industry", Garcia Bermudez and Galand, CPN, n° 1, Spring 2007, p. 104.

production lines, which can now accommodate more easily the production of additional models in any plant of the group. In view of this economic reality, there is a risk that training aid provided in certain sectors, does not contribute any more to an objective of common interest, but merely translates into distortive operating aid aimed at retaining or attracting the production of certain models at a certain production site.

18. In the Fiat case decided in June 2007, financial data showed that the beneficiary would raise its training activities, after the receipt of the aid, by an amount exceeding the state aid received. The aid was thus generating an additional commitment by Fiat in favour of its workers. The formulation of the finding in the Fiat case was the following: "the Commission accepts that it is unlikely that the company would have undertaken such a high quality programme without aid"<sup>13</sup>.
19. Analysing the incentive effect of the aid measure is, according to the R&D&I Framework, the "most important condition in analysing State aid for R&D&I"<sup>14</sup>. This Framework also constitutes the instrument where the concept and the applicable conditions of the concept of incentive effect have been developed in the most refined manner: counterfactual analysis, comparisons of profitability of different research scenarios, and time path of cash flows - amongst others - are some of the criteria which can be used in significant cases requiring a detailed economic analysis in the area of RDI.
20. These guidelines have, in the meanwhile, been applied in a string of cases: Neoval, TVMSL and "Bernin 2010", among others<sup>15</sup>. In all of these cases, the Commission's approach was to check, as a first step, whether, *prima facie*, a significant increase could be observed for one of the key elements: scope, size, speed and budget (SSSB) of the subsidised activities. The Commission then went on to verify whether, in the case at hand, this apparent increase was actually caused by the aid.
21. For example, in the Neoval case concerning the development of a new automatic metro, the Commission analysed, on the basis of revenue and cost forecasts provided by the company, the level of profitability (in terms of Net Present Value) of the project, to see whether the company would not have gone ahead with the project in any event, even without the aid<sup>16</sup>. The Commission considered various scenarios as to the stream of net revenues that would accrue in case of success or failure and computed the critical rate of success below which the company would indeed need State support to make the whole project profitable. These critical rates, which should be seen as rough approximations, were compared with expert information on the actual level of risk of the project. The risk of the project appeared to be of such a magnitude that it was indeed unlikely for the company to go on with the project without aid.

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<sup>13</sup> Commission decision of 13/6/2007 in the Fiat case, N 541/2006, available at [http://ec.europa.eu/comm/competition/state\\_aid/register/ii/doc/N-541-2006-WLWL-EN-13.06.2007.pdf](http://ec.europa.eu/comm/competition/state_aid/register/ii/doc/N-541-2006-WLWL-EN-13.06.2007.pdf)

<sup>14</sup> Community Framework for State aid for Research and Development and Innovation OJ C 323 of 30.12.2006, p. 1, point 7.3.3.

<sup>15</sup> Cases N 674/2006, N 854/2006 and N 887/2006 respectively, available at [http://ec.europa.eu/comm/competition/state\\_aid/register/ii/](http://ec.europa.eu/comm/competition/state_aid/register/ii/)

<sup>16</sup> "Premier cas d'application du nouvel encadrement communautaire des aides d'Etat à la recherche, au développement et à l'innovation: l'aide de l'Agence française de l'innovation industrielle au programme NeoVal", Neale-Besson and Djelalian, CPL 2007, n° 2, p. 61. See also Albaek and Neven, "Economics at DG Competition 2006-2007", Review of Industrial Organization 2007.

22. The analysis further revealed that according to internal rules for allocating budgets within the company, the project would not have been undertaken without the aid and that the company, before having applied to the French State for a subsidy, was on track to do a different, less ambitious project, as opposed to the more elaborate NeoVal project. On the basis of this evidence, it was concluded that the aid was necessary and proportionate.

## **5. Incentive effect ensured through other substantive conditions?**

23. Whereas the most advanced individual applications of the condition of incentive effect are currently to be found in the area of R&D&I aid, this condition is also present – in a slightly different guise - in the risk capital guidelines dating from 2006. In this area, the lack of incentive effect covers the scenario where enterprises funded through publicly supported measures would have anyhow obtained finance - on the same terms – in the *private* equity market. This implies that because of the State aid measure, private capital is crowded out of the financial market. This concern has, in practice, largely been taken care of by the requirement that aid to support risk capital is only allowed when there is an equity gap (i.e. absence of risk capital provision by the market). Further, the incentive effect is indirectly bolstered by another requirement of the risk capital guidelines: the minimal participation by private investors in the risk capital investment funds. Indeed, at least 50 % of the funding of the investments made under the risk capital measure must be provided by private investors, thereby largely diminishing the risk of crowding out<sup>17</sup>.
24. The fact that the condition of incentive effect might be occasionally ensured wholly or partially through other substantive conditions also occurs to a certain extent in the environmental aid area. In the latest draft environmental guidelines, the incentive effect condition is worded as follows: "State aid for environmental protection must result in the recipient of the aid changing its behaviour so that the level of environmental protection will be higher than if the aid had not been granted."<sup>18</sup>
25. Simultaneously, for all environmental investment aid measures, the eligible cost basis is the so-called "extra cost", which a "green" investment project carries as compared to a "grey" investment project. With this eligible cost basis and a maximum allowable aid intensity below 100 %, subsidised environmental investments will, as a rule, lead to a higher level of environmental protection as compared to an investment without aid. It is obvious that a precondition to achieve an incentive effect is the correct calculation of extra costs. This again implies that all operating benefits – for instance, benefits accruing from a lower energy consumption – have been taken into account. If, after accounting for all the operating benefits, an extra cost is still borne by the company for realising a green investment, then subsidising part of this extra cost should, according to a number of stakeholders, lead both to a higher level of

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17 Community guidelines on state aid to promote risk capital investments in small and medium-sized enterprises, OJ C 194, 18.8.2006, p. 2–21, section 4.3.4.

18 Second draft of the Community guidelines on State aid for environmental protection of 5/10/2007, available at [http://ec.europa.eu/comm/competition/state\\_aid/reform/reform.cfm](http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm).

environmental protection and to an increased own private financial contribution of the beneficiary as compared to its contribution for the "grey" investment. They claim that, in this manner, an incentive effect is structurally guaranteed. One could argue that a similar extra cost approach is to be found - more or less explicitly - in state aid regulations concerning employment measures in favour of disabled workers<sup>19</sup>.

26. A possible overlap between the methodology for establishing the extra costs linked to a green project and the condition of incentive effect could incidentally also be identified in individual decisions taken by the Commission in the environmental aid area, even before the implementation of the SAAP. One example is the "Stora Enso" case<sup>20</sup> where the Commission approved €23 million environmental aid in favour of Stora Enso's paper mills in Belgium. Nevertheless, a substantial part of the eligible costs claimed by Belgium – for a total of 34 million €- were rejected on the basis of a precise calculation of the extra costs. This cost calculation led to a series of explicit statements by the Commission that part of the envisaged aid measures had an incentive effect, whereas others did not. Similarly to the training aid cases mentioned above, the formulation of the findings of the Commission as regards the presence of incentive effect is a prudent one: "Any paper producer that wishes to remain technologically and environmentally competitive in the long run has to make such investments in innovation from time to time. The incentive effect of the aid, therefore, remains doubtful, even if the investment would be considered as going beyond the 'state-of-the-art'"<sup>21</sup>.

## **6. A bird's eye view on the existing practice**

27. This brief overview highlights the fact that the incentive effect criterion appears under different guises. On the one hand, important R&D&I, training aid or environmental cases, trigger a so-called in depth assessment by the Commission, whereby the existence of an incentive effect is examined on the basis of a series of economic and financial indicators, requiring quite some technical knowledge, as well as an understanding of the sector of industry concerned (car sector, transport services, paper recycling sector, etc...) <sup>22</sup>.
28. Such assessments typically constitute a complex economic assessment implying a degree of margin of appreciation<sup>23</sup>, in deciding, for example, whether an investment in a particular production technology constitutes a risky innovation, or a mere catching up with the competitors. This type of assessment can only be realised in the course of an interaction between the Commission, the Member States and the beneficiary in the

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<sup>19</sup> See articles 5 and 6 of Commission Regulation (EC) No 2204/2002 of 12 December 2002 on the application of Articles 87 and 88 of the EC Treaty to State aid for employment, OJ L 337, 13.12.2002, p. 3, and articles 31 and 32 of the draft GBER.

<sup>20</sup> Commission Decision of 8 September 2004 concerning investment aid in favour of Stora Enso Langerbrugge notified by Belgium, OJ L 53 of 26/2/2005, p. 66 and more particularly, points 79 and 84 of the decision.

<sup>21</sup> Point 84 of Stora decision, cited above.

<sup>22</sup> The importance of sectoral knowledge for the application of competition tools – including state aid rules - is highlighted by the fact that DG Competition has moved to a more explicitly "sectoral" organisation.

<sup>23</sup> See generally the case-law of the CFI and the ECJ concerning the limited judicial review exercised by these courts on complex economic assessments realised by the Commission. See, amongst others, judgment of the CFI of 15/06/2005, Regione Sardegna/Commission, T-171/02, ECR, p. II-2123.



course of which economic and financial data are examined and discussed together. In other words, such assessment can only be realised in the context of a notification, and more particularly, for reasons of priority setting, in the context of the notification of important cases<sup>24</sup>.

29. On the other hand, the assessment of the presence of an incentive effect in the context of a regulation with "direct effect"<sup>25</sup>, like the upcoming GBER, cannot imply any similar margin of appreciation. Indeed, the existence of such a margin would lead to legal uncertainty both for the subsidising authorities and for the beneficiaries of aid. It is for this reason that the concept of incentive effect, as implemented in the draft GBER, is based on an exhaustive list of straightforward criteria.

## **7. *Incentive effect in the context of the GBER***

30. One of the main challenges currently faced is integrating the concept of "incentive effect" into a Commission Regulation that is directly applicable. The general importance of the requirement both in the GBER and in general has been highlighted above: whereas the underlying principle should remain the same as in the guidelines, the criteria through which it takes form must be different, on the one hand, for a regulation to be applied directly by numerous companies authorities and judges throughout the 27 Member States, and, on the other hand, for guidelines to be applied by the Commission.
31. The draft GBER therefore proposes that large undertakings which benefit from State aid are under an obligation to submit to the Member State concerned a business plan establishing the incentive effect on the basis of one or more suggested criteria. Member States will have to check that these conditions are fulfilled to claim the benefit of the GBER for the subsidy measures they envisage. During the two consultation rounds organised with respect to the GBER, this specific proposal has met some anxiety.<sup>26</sup>
32. Two main queries have been raised. First, there is the fear that this condition would add a layer of red tape. Secondly, that it would create legal uncertainty. The first argument does not seem substantiated. It is not likely that any large company would embark on a substantial investment project at large commercial activity without drawing up in advance a business plan with alternative strategies and a serious cost/benefit analysis of the project. The cases which the Commission has investigated - especially in the R&D&I area - confirm that such planning documentation exists for purely internal business reasons. Moreover, it is difficult to imagine that a Member State would spend significant amounts of money without knowing what the likely impact of the aid would be. In other words, this requirement is nothing but obtaining a confirmation that already existing standard business practices of the beneficiary and administrative practices of the authorities are present.

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<sup>24</sup> An "important case" could be defined as a case where there is a risk, prima facie, of aid giving rise to a significant distortion of competition and/or where the result of the compatibility test – as formalised in the balancing test – is far from straightforward.

<sup>25</sup> See article 249 EC Treaty

<sup>26</sup> The results are available on the Commission website  
[http://ec.europa.eu/comm/competition/state\\_aid/reform/reform.cfm](http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm)

33. The argument concerning legal uncertainty, on the other hand, is more plausible when looking at the current wording of article 7 and recital 24 of the GBER. The GBER should indeed only include clear-cut conditions which can be easily applied by non-competition specialists within national administrations, within companies - be they beneficiaries or their competitors – and, last but not least, by national judges<sup>27</sup>.
34. One important task is indeed to increase legal certainty, whilst another objective is the need to focus the GBER on "better targeted aid", i.e. on aid which leads beneficiaries to provide their input to realise commonly agreed Lisbon objectives. This means that whilst maintaining legal certainty the effectiveness of the principle of incentive effect should be maximised. It is crucial that the main instrument by which the Commission pushes Member States to target their state aid on Lisbon objectives – the GBER – would also incentivise Member States to ensure that these Lisbon objectives are met in practice.
35. Various solutions can be devised in order to accomplish these two complementary objectives. One possibility is to clarify the intention of the text without amending its substantial requirements. . For instance, a series of uncertainties have arisen with respect to the application of the "traditional" criteria to SMEs. However, the recently published memorandum of the Commission services on the GBER clarifies that the positive presumption of an incentive effect in favour of SMEs – as formulated in article 8.2 GBER - applies not only to the provisions of the GBER which are expressly addressed to SMEs - like articles 12 or 20 for instance - but also to all other provisions which apply to all types of undertakings, such as articles 11 or 30 GBER: in all those cases, the beneficiary of the aid provided under that provision is considered as an "SME" as defined in Annex I of the GBER<sup>28</sup>.
36. In a similar fashion, the precise relationship between the principle of incentive effect, as laid down in article 8.1 of the GBER, and the conditions as laid down in articles 8.2 (for SMEs) and 8.3 GBER (for large undertaking) could be clarified. In essence, the sole purpose of article 8.1 is to set a principle, without requiring any substantive conditions. It could perhaps be moved to the recitals to avoid confusion as regards its status. This would leave in the text of the article only the conditions, as stipulated in art. 8.2 and 8.3, that needs to be checked and fulfilled for the GBER to apply. The text of recital 24 should also more clearly reflect this approach.
37. In this manner it should become clear that the conditions laid down for large undertakings in the GBER would not imply any assessment of the sort realised in the Ford Genk or Stora Enso cases. For instance: there is no need to make any assessment of the industrial choices made by the beneficiary as compared to other companies. In the context of the GBER, authorities should not need to carry out a fully fledged refined economic analysis. The only thing they need to check is whether, on the basis of the information available at the time, it seems credible that the (envisaged) aid will

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<sup>27</sup> See SAAP, points 55 and 56.

<sup>28</sup> See revised memorandum of the Commission services on the GBER, point 38, available at [http://ec.europa.eu/comm/competition/state\\_aid/reform/reform.cfm](http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm). Annex I of the GBER corresponds to Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, OJ L 124, 20.05.2003, p. 36.

lead to: (a) the increased size of the project/activity or (b) the increased scope of the project/activity or (c) the increased total amount spent by the beneficiary on the project/activity. These conditions are quite straightforward and do not imply any sort of complex economic assessment.

38. Finally, some uncertainty might have arisen from the fact that it is not yet known how the Commission will eventually monitor the application of this condition. One thing should be clearly spelt out: monitoring will only take into account information available at the time of the granting of the aid, to the exclusion of facts which occurred thereafter. The Commission could not, for instance, claim that the incentive effect requirement has not been met because in a given R&D project - expanded due to the presence of state aid from product A to products A and B – it appears that the R&D is only successful on product A. As long as the state aid has indeed led to R&D conducted on both products A and B (increased scope of the project), the subsidised project will be considered to have an incentive effect at the moment of the grant, irrespective of the commercial outcome of the R&D.
39. Similarly, a project will be considered to have an incentive effect as soon as the beneficiary moves from business option A without aid (costs 5 M€) to another, more ambitious project B (costs 8 M€, with a subdivision of 6 M€ private capital and 2 M€ public capital). The increase in the private contribution from 5 M€ to 6 M€ is sufficient to show that an incentive effect is present. With some clarifications and a more straightforward wording of recital 24 and article 8 of the GBER, a satisfactory solution would thus appear possible for the final text.

## **8. Conclusion on incentive effect**

40. In a recent speech in Berlin, Commissioner Kroes stated about the implementation of the State Aid Action Plan (SAAP): "Of course, more work and time will be needed to fully reap the benefits of enhanced economic reasoning. But I think it is fair to say that, so far, we have managed to keep a good balance. We are probably becoming more inquisitive in assessing the necessity of State aid and evaluating its negative effects"<sup>29</sup>. As regards the implementation of the concept of incentive effect, in particular, the aim is also to find the appropriate balance between legal certainty and ensuring "better targeted aid".

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<sup>29</sup> "The Law and Economics of State aid control – a Commission Perspective", N. Kroes, Berlin, Germany Joint EStALI/ESMT Conference, "The Law and Economics of European State Aid Control", SPEECH/07/601.

### **III The role of National Competition Authorities in the state aid area: scope for an improved cooperation?**

#### **1. Introduction**

41. Collaboration between Member States and the Commission is needed to conceive and then implement in practice the refined economic analysis, in general, and the concept of "incentive effect", in particular. Neither the conception nor the implementation of the rules is a Commission monopoly. The Commission has tried to be as open as possible and to stimulate a broad and intensive debate about the different instruments adapted in the context of the SAAP<sup>30</sup>. There has been in general positive feedback about the consultation processes regarding the recently adopted guidelines, de minimis regulation and the ongoing discussions on the draft GBER.
42. With respect to a modernised state aid policy, national authorities and the Commission are partners in a "learning by doing" process.<sup>31</sup> The fact that an improved state aid policy depends on initiatives of both the Commission and the Member States was acknowledged in the SAAP: "While the Commission has the competence to adopt detailed state aid rules, the successful implementation of the rules and procedures depends to a large extent on Member States. [...] In this context, the Commission will examine whether independent authorities in Member States could play a role as regards facilitating the task of the Commission in terms of state aid enforcement (detection and provisional recovery of illegal aid, execution of recovery decisions)<sup>32</sup>."
43. The SAAP mentions as well that the Commission would "request more transparency in the general principles of state aid control and consider establishing a network of state aid authorities or contact points in order to facilitate the flow of information and exchange of best practices; promote advocacy, awareness and understanding of state aid control at all levels to help the granting authorities in designing measures that are compatible with the treaty rules"<sup>33</sup>.
44. Finally, the SAAP states that the Commission "will also encourage Member States to engage in benchmarking to verify that state aid is achieving the objective and is the best type of state intervention for any given objective. This could be done in partnership with national Courts of Auditors"<sup>34</sup>.
45. In order to further improve the cooperation between Member States and the Commission, we considered in the State Aid Action Plan that we should establish a network of state aid authorities to facilitate the flow of information and exchange of best practices. The underlying idea is that enhanced interaction between national

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<sup>30</sup> See the results of the two stakeholders consultations on the Commission website : [http://ec.europa.eu/comm/competition/state\\_aid/reform/reform.cfm](http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm)

<sup>31</sup> "Concluding remarks - 5th experts' forum on new developments in European State", L. Evans, Brussels European State aid Law Institute (EStALI), 22 May 2007, available at [http://ec.europa.eu/comm/competition/speeches/text/sp2007\\_03\\_en.pdf](http://ec.europa.eu/comm/competition/speeches/text/sp2007_03_en.pdf)

<sup>32</sup> "State Aid action plan: Less and better targeted state aid: a roadmap for state aid reform 2005 – 2009" available at [http://ec.europa.eu/comm/competition/state\\_aid/reform/reform.cfm](http://ec.europa.eu/comm/competition/state_aid/reform/reform.cfm), point 51.

<sup>33</sup> SAAP, point 53.

<sup>34</sup> SAAP, point 54

administrations and the Commission is crucial to build up a common "State aid culture". It should be added that the additional proposition in the action plan of examining whether independent authorities within Member States could play a role in terms of state aid enforcement did not provoke immediate enthusiastic support. It is worthwhile nevertheless looking into the practical experience in some Member States where NCAs do play a certain role in the field of state aid.

46. Several reasons might explain this under-development. The main reason probably stems from the different roles played by the national authorities towards the Commission as state aid and antitrust fields. On the one hand, ministries defend draft aid schemes or individual state aid cases which the Commission has exclusive powers to approve. Occasionally, those same parties meet in the context of advisory committees in order to discuss legislative or quasi-legislative Commission proposals<sup>35</sup>. NCAs, when operating in the merger and antitrust fields, on the other hand, are in a relationship of associates with the Commission, trying to achieve identical goals of consumer welfare, on the basis of a common set of rules providing them with largely similar competencies. Moreover, NCAs have been consulted on important draft Commission decisions in the antitrust and merger area for many years<sup>36</sup>. A balanced cooperation mechanism has also been set up by Regulation 1/2003, ensuring consistency of national and European decisions applying articles 81 and 82 of the EC Treaty<sup>37</sup>.
47. Despite the differences which have just been identified, some NCAs are also playing - aside from their traditional antitrust tasks – a role in the conception and implementation of state aid policy.

## **2. Short overview of the roles currently played by NCAs in the state aid area**

48. In the different Member States, coordination and supervision of State aid issues seems to be organised around one of the following three models:
1. They are part of the competences of the NCA.
  2. They are given to some other independent monitoring authority.
  3. They are fully integrated in the governmental structure.
49. The latter model is by far the most frequently used model, with ministries of economics, finance or foreign affairs – or administrative committees composed of representatives of such ministries- taking the lead, at national level, for steering individual cases and/or representing the Member States' position with respect to draft regulations and guidelines of the Commission. Amongst the older Member States, only the Danish Competition Authority<sup>38</sup> and since very recently the Spanish

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<sup>35</sup> See procedure foreseen in Council Regulation (EC) No 994/98 of 7 May 1998 on the application of Articles 92 and 93 of the Treaty establishing the European Community to certain categories of horizontal State aid, OJ L 142, 14.5.1998, p. 1.

<sup>36</sup> See article 14 of Regulation 1/2003 and Article 19 of Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings, OJ L 24, 29.1.2004, p. 1.

<sup>37</sup> See especially articles 3 and 11 of Regulation 1/2003.

<sup>38</sup> See <http://www.ks.dk/english/state-aid/>

Competition Authority<sup>39</sup> have explicit state aid related competencies. Moreover, a number of NCAs of the newer Member States (Czech Republic<sup>40</sup>, Lithuania<sup>41</sup> and Poland<sup>42</sup>) also have such responsibilities. These competencies of NCAs often originate from the so-called "Association Agreements"<sup>43</sup> signed between the EU and the accession country preceding accession. Under those agreements candidate countries were obliged to set up independent authorities for State aid control. In a number of instances, these independent state aid monitoring authorities have been maintained within the NCAs. The British Office of Fair Trading<sup>44</sup> also regularly issues position papers on state aid policy, with an emphasis recently on economic analysis in the state aid area.

50. The main task of the NCAs is to provide guidance to subsidising authorities on state aid rules. Occasionally, they are also involved in the design of subsidy measures and in notifying state aid to the Commission. A number of them are in charge of establishing and updating a "state aid register" containing all state aid measures granted in that Member States<sup>45</sup> and responsible for establishing the annual reports to be provided to the Commission<sup>46</sup>. Finally, some of them undertake analytical background work or carry out ex post evaluation and monitoring exercises focused on effectiveness and impact on competition of state aid measures. The Office of Fair Trading and the Danish Competition authority, amongst others, have published studies on public subsidies and their effect on competition<sup>47</sup>. It is also to be noted that some NCAs appear to have the power to request state aid related information also from beneficiaries and to impose fines in the event of beneficiaries not fulfilling such obligations<sup>48</sup>.

51. Apart from those Member States where the NCA possesses a series of state aid competencies, Cyprus<sup>49</sup> and Malta should also be mentioned because they have set up specialised entities for state aid control. In Cyprus, this independent authority advises other authorities on subsidy measures and provides a binding legal opinion on the application of European block exemption regulations in Cyprus, including the de minimis regulation.

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<sup>39</sup> See Competition act 15/2007 of 3 July 2007, Official State Gazette No. 159, 4/7/2007, available at <http://www.cncompetencia.es/PDFs/legislacion/47ing.pdf>

<sup>40</sup> See <http://www.compet.cz/en/state-aid/>

<sup>41</sup> See <http://www.konkuren.lt/english/stateaid/legislation.htm>

<sup>42</sup> See [http://www.uokik.gov.pl/en/state\\_aid/occps\\_competence\\_in\\_the\\_field\\_o/](http://www.uokik.gov.pl/en/state_aid/occps_competence_in_the_field_o/)

<sup>43</sup> See <http://ec.europa.eu/comm/competition/international/enlargement/archive.html>

<sup>44</sup> See [http://www.oft.gov.uk/oft\\_at\\_work/](http://www.oft.gov.uk/oft_at_work/)

<sup>45</sup> In respect of state aid registers, see, amongst others, 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, OJ L 379, 28.12.2006, p. 5.

<sup>46</sup> See, for instance, section 10.1.1 of the Community Framework for State aid for Research and Development and Innovation

<sup>47</sup> "Public subsidies, A report by the Office of Fair Trading", November 2004, OFT 750, available at [http://www.oft.gov.uk/advice\\_and\\_resources/resource\\_base/market-studies/subsidies](http://www.oft.gov.uk/advice_and_resources/resource_base/market-studies/subsidies) and <http://www.ks.dk/english/state-aid/publications/>

<sup>48</sup> See <http://www.compet.cz/en/state-aid/competence-in-the-area-of-state-aid/>

<sup>49</sup> See "The principal ingredients and particularities of the state aid control system in Cyprus", C. Andreou (Commissioner for State aid control), ESTALI, 5<sup>th</sup> Experts Forum 2007, p. 23.



52. Taking into account the fact that ex post evaluation of the effectiveness of State aid measures is primarily a responsibility of the Member States, the Commission has invited Member States to enhance the exchange of best practices in the area of evaluation of the effectiveness of subsidy measures. In this perspective, it is to be noted that the evaluation of State aid at national level with respect to effectiveness and impact on competition is one of the main discussion topics of the 5<sup>th</sup> multilateral meeting with Member States on follow-up to the Council conclusions on State aid, which took place on 13-14 November 2007.

### **3. *Some areas where more active role of NCAs could improve state aid policy***

53. In view of the existing practise of independent bodies dealing at national level with state aid matters and of the ongoing developments related to the implementation of the SAAP, a series of best practices could be envisaged, both in Member States where NCAs already exercise state aid competencies and in other countries.

54. First, it must be noted that both de minimis regulation n° 1998/2006 and the GBER, which will be adopted in the course of 2008, substantially widen the scope of application of the existing block exemption regulations<sup>50</sup>. Therefore, there is certainly a role for NCAs and independent bodies entrusted with the task of controlling state aid, to assist subsidising authorities in setting up measures complying with those block exemption regulations<sup>51</sup>. This role could become crucial in view of the fact that the new generation of block exemption regulations include a series of features unknown before, like the condition of transparency of aid<sup>52</sup>. NCAs could indeed operate as "advising intermediaries" between the Commission and other national authorities, since they combine in depth knowledge of both the European and the national legal systems as well as the economic context. One could also envisage that, like in the area of antitrust, NCAs could intervene as amicus curiae in national legal proceedings in order to assist national judges in applying state aid rules<sup>53</sup>. All such NCA activities could indeed help creating and spreading a "state aid culture" within Member States.

55. Secondly, as the recently adopted guidelines occasionally require new type of more economic data to be submitted<sup>54</sup>, NCAs might assist the national authorities in organising and presenting such data on the basis of the experience they have in dealing with business information in antitrust and merger cases. Indeed, several NCAs have already assumed a central role in providing annual state aid reports to the Commission.

## **IV Overall conclusion**

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<sup>50</sup> For an overview, see [http://ec.europa.eu/comm/competition/state\\_aid/legislation/legislation.html](http://ec.europa.eu/comm/competition/state_aid/legislation/legislation.html). See also the revised memorandum on the GBER, available at [http://ec.europa.eu/comm/competition/state\\_aid/reform/revised\\_final\\_memoandum\\_gber.pdf](http://ec.europa.eu/comm/competition/state_aid/reform/revised_final_memoandum_gber.pdf)

<sup>51</sup> See SAAP, points 55 and 56.

<sup>52</sup> See article 2.4 of regulation 1998/2006 and article 5 of the draft GBER.

<sup>53</sup> See as regards antitrust, article 15.3 of Regulation 1/2003.

<sup>54</sup> See, for instance, section 7.1 of the risk capital guidelines.

56. The Commission cannot improve state aid rules and the operation of the state aid system without the effective support of Member States. We need to work together to improve "precautionary dentistry" in the state aid area, so as to avoid costly and painful extractions at a later stage. NCAs have, for a long time, been the privileged partners of the Commission in tackling commercial behaviour damaging competition. Their participation in the setting up and subsequent implementation of the decentralised antitrust rules has been crucial to establish an effective network protecting consumers' interests.
57. NCAs and Commission can be proud of their common track-record in the merger and antitrust areas. As intense an interaction between NCAs would probably be difficult to achieve in the short and medium term in the state aid area, because their respective competencies do not overlap as in the antitrust area. One should also be aware of the fact that the attribution and organisation of competencies related to coordination, scrutiny and evaluation of state aid measures at national level is a sovereign right of Member States. This fact should not inhibit the Commission and the NCAs from building on this excellent antitrust relationship in order to enhance our interaction and collaboration in the state aid area. NCAs could be acting both as crucial input providers into state aid policy documents at the European level and as ambassadors of state aid policy at the national level.
58. As a result, through close partnership the Commission and the NCAs could contribute to realising the common objective of "less and better targeted aid" and, by so doing, achieve better outcomes both at the national and the European level.