



UK State Aid Law Association
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The Role of Economics in State Aid Cases

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Disclaimer (EN): the views expressed are those of the author and cannot be regarded as stating an official position of the European Commission

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Role of economics in state aid

- Distinguish:
 - o Presence of aid (107(1) TFEU) vs. Compatibility of aid (107(3)(c) TFEU)
 - o Design of the rules vs. Application in cases

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State aid assessment Art. 107(1) TFEU

- Various instruments used for giving aid, e.g.
 - Grants
 - Tax exemptions
 - Soft loans
 - State guarantees
 - Repayable advances
 - Capital injections
 - Hybrid instruments
- Central assessment concept: MEIP (Market Economy Investor Principle)

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Example of MEIP: Ciudad le la Luz (2012)

- Public funding to set up a film studio complex
- Funding amount: EUR 265 mln, no private involvement (except for the very beginning)
- Assessment of expected returns (IRR) of investment: based on business plans
- IRR of project 5,74% (at face value). Enough for a private investor? → comparison with the cost of capital

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Ciudad le la Luz (cont'd)

- Weighted average cost of capital (WACC):

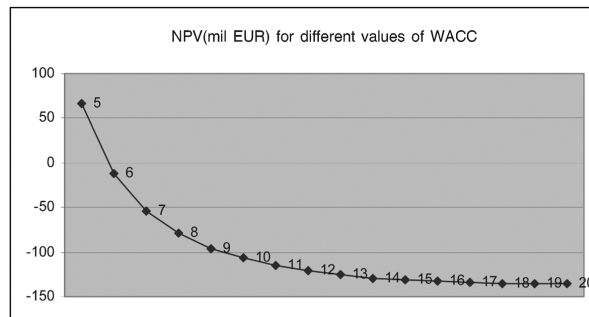
$$WACC = K_e \frac{E}{C} + K_d \frac{D}{C}$$

where K_e is the cost of equity capital, E the amount of equity, K_d the cost of debt capital, D the amount of debt, and $C = E + D$

- Cost of equity estimated on the basis of standard CAPM model, using comparators (other film studios)
- WACC found to be 14.9% (> IRR of the project)

Sensitivity analysis

- NPV (net present value) of the project: negative for range of values of cost of capital around estimated WACC



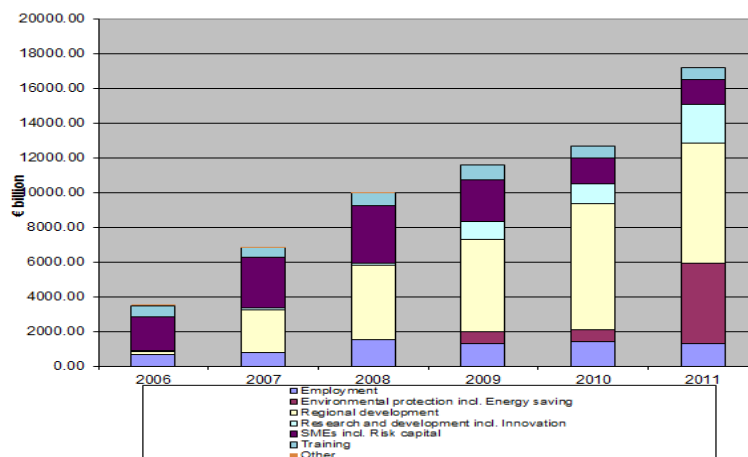
Assessment under Art. 107(3)(c)

- Compatibility assessment essentially about striking a (good) balance between
 - Benefits of state aid (objective/effectiveness)
 - Costs of state aid (distortions)
- Important (increasing) role for economics, but inevitably strong political dimension (trade-offs to be made)
- Necessary to bear in mind: enforcement and compliance costs → architecture of state aid rules
 - Block exemptions (GBER) vs. more substantive analysis of individual cases

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Trend in the block exempted state aid expenditure for industry and services, EU-27
2006-2011



Source: DG Competition.

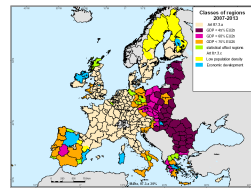
Note: Data for EU-10 Member States are included from 2004 onwards, for Bulgaria and Romania from 2007.

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A closer look at regional aid (RAG/GBER)

- Main objective RAG/GBER: promote the economic development of certain disadvantaged regions (“assisted areas”), while limiting the distortions of competition and trade
 - Important concern: Subsidy races between MS
- Main tool: Defining the regions in which regional aid is possible (regional aid map)
- Specific conditions for Large Investment Projects (LIPs)



Case: VW Sachsen (2009)

- Regional aid for investment project of VW-Group in Zwickau, Sachsen (DE):
 - Change of production process (from platform strategy to module strategy) for small/mid-sized cars (POLK segments A0, A and B);
 - Construction of new manufacturing hall
- Start of works: 12/2009 (completion: 05/2014)
- Eligible cost: EUR 735 mln
- Aid amount: EUR 95 mln à notified on 27.12.2009

VW Sachsen (cont'd)

- Opening of formal investigation procedure (Art. 108(2) TFEU): 13.07.2011
- Assessment of criteria para 68 RAG (triggering formal investigation and in-depth assessment):
 - Market share of beneficiary > 25 % for segments A [if EEA] and B [if EEA]
 - Capacity increase > 5 % in under-performing market for segments A0 [if EEA], A [if EEA] and B [if EEA]

VW Sachsen (cont'd)

- In-depth Assessment Communication (2009) sets out application of "balancing test", i.e. analysis of
 1. objective of common interest
 2. design of the aid measure
 3. distortions of competition and trade; balancing
- Assessment of incentive effect/counterfactual is central à typically assessed on the basis of (contemporaneous) company internal documents
- Notification withdrawn on 05.11.2012



Outlook: State aid modernisation

- Ongoing reform programme (2012-2014), building on State Aid Action Plan (2005)
- Main aims:
 - Support growth-enhancing objectives (emphasis on objective of aid, incentive effect, distortions)
 - Better prioritisation of cases
 - Simplification / More streamlined procedures

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Thank you for your attention

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