Role of economics in state aid

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

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
Ciudad le la Luz (cont'd)

• Weighted average cost of capital (WACC):
  \[ WACC = \frac{E}{C} + \frac{D}{C} \]
  
  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
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/midsized 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 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 ‡ typically assessed on the basis of (contemporaneous) company internal documents
- Notification withdrawn on 05.11.2012
Outlook: State aid modernisation

- Main aims:
  - Support growth-enhancing objectives (emphasis on objective of aid, incentive effect, distortions)
  - Better prioritisation of cases
  - Simplification / More streamlined procedures

Thank you for your attention