EUROPEAN COMMISSION
Competition DG

Explanatory note on the paper of the services of DG Competition containing draft regional aid guidelines 2014-2020[1]

Context and timing

The RAG are an integral part of the State Aid Modernisation (SAM) exercise. As announced in the SAM Communication adopted on 8 May 2012, the Commission intends to review the compatibility rules for State aid on the basis of a coordinated approach rooted on common principles. The objective of this approach is to improve the compatibility framework and its consistency across the different guidelines and block exemptions, in light of the objectives of the SAM initiative.

The SAM Communication emphasises the need to revive growth and to consolidate public budgets. This double challenge cannot be addressed without more efficiency and effectiveness of State aid measures, which should exploit the potential of the single market for growth in a context of scarce public resources.

Within the SAM initiative the RAG are the first in a series of forthcoming revised guidelines for which concrete drafting proposals are being put forward for discussion with Member States and other stakeholders. The draft RAG contained in the enclosed paper of the services of DG Competition are being presented by DG Competition ahead of other elements of the future State aid framework, including the draft General Block Exemption Regulation (GBER), because of the time necessary for the preparation and adoption of the regional aid maps for the new period starting in January 2014.

Primarily, the compatibility framework should facilitate the treatment of ‘good aid’ (well-designed, targeted at identified market failures and objective of common interests, proportionate and least distortive) and prevent the granting of ‘bad aid’ (which distorts competition, frustrates innovation, delays necessary adjustments, fragments the internal market). All compatibility rules have to be reviewed in light of this objective, also in view of the mixed results of several State aid measures (e.g. lack of effectiveness, doubtful incentive effect, overcompensation, etc.) which point to the need for a strengthened and more systematic evaluation of the impact of aid schemes.

---

[1] This paper of the services of DG Competition containing draft regional aid guidelines (RAG) is part of the impact assessment process in view of adopting new RAG in the second quarter of 2013. It aims at presenting DG Competition’s preliminary views and to collect the opinions and experiences of stakeholders, in line with the ‘Smart regulation’ policy process.

Articulation between the RAG and the GBER

The success of the reform depends on the Commission's ability to deliver a simpler, clear and more effective framework based on a sound economic rationale. In that context the review of the GBER represents a key opportunity. The scope of the GBER will be extended both as regards the categories of measures and the aid amounts.

For regional aid, the following types of measure will be block exempted and will no longer require notification:

- *Ad hoc aid below the notification threshold* will be exempted from notification. Currently, individual aid granted outside a scheme (ad hoc aid) must be notified. In this respect, the distinction between individual aid (awarded under a scheme) and ad hoc aid (individual aid awarded outside a scheme) will be removed.

  Regarding the impact of this proposal, under the current RAG, in the 2007-2012 period, 32 cases of ad hoc aid where notified to the Commission and had to be approved individually; at least a similar number of cases could be block-exempted in the future.

- *Aid for newly created small enterprises*: This type of aid will be covered exclusively under the GBER. The various rules in the GBER on aid to newly created enterprises and start-ups will be consolidated and simplified.

- *Certain types of operating aid for outermost regions and sparsely populated areas*: Given the established case practice and in order to limit the unnecessary administrative burden involved in these types of measures, the Commission services propose to exempt from notification the following operating aid schemes:

  1. Operating aid schemes to compensate additional costs (other than additional transport costs) arising in the pursuit of an economic activity in an outermost region, provided the annual aid amount per beneficiary does not exceed the minimum between 10 % of the annual sales revenues or 10 % of the annual net turnover of the beneficiary incurred by the beneficiary in the outermost region concerned.
  2. Operating aid to schemes compensate the additional transport costs of goods in an outermost region or in a sparsely populated area, as determined in the approved regional aid map for the Member State concerned for the period 2014-2020.

  As for the impact of these proposals, out of the 38 aid approved schemes for outermost regions and sparsely populated areas, 26 could be in principle covered by the future GBER.

Therefore the measures above are not included in this draft proposal of RAG. On the contrary, the measures which will be covered by the future RAG and assessed according to them are:

1. Regional investment aid schemes targeted at specific sectors of economic activity;

2. Individual aid (including ad hoc aid) above the notification threshold: Between €15 million and €37.5 million depending on the region;

3. Investment aid potentially linked to a closure of a similar or same activity in the EEA;
4. Certain regional operating aid schemes, namely: (i) aid to reduce certain specific difficulties faced by SMEs in 'a' areas, (ii) aid to compensate for certain additional costs (other than transport costs) in the outermost regions, (iii) aid to prevent or reduce depopulation in areas with a very low population density.

Articulation between RAG and other guidelines

The new RAG will also be applicable to investments in infrastructure that could be covered under other State aid guidelines such as the Broadband Guidelines adopted by the Commission on 19 December 2012, the forthcoming revised Energy and Environmental Aid Guidelines, and the forthcoming revised R&D&I aid Guidelines. In the framework of the RAG, and in a logic of preserving the internal market, some relevant conditions of those specific guidelines corresponding to the EU policy objectives on broadband, energy, environment and R&D&I will also apply. The aim of this approach is to ensure that the main specific conditions imposed by those guidelines are maintained when aid for such investment is assessed under the RAG, as opposed to under those other guidelines.

The example for broadband is provided in the enclosed paper containing draft RAG proposal. For other sectors, the conditions that will be subsequently included in the final draft RAG proposal will be developed in the context of the revision of the corresponding guidelines during 2013, in cooperation with the relevant services of the Commission, and taking into account discussions with Member States and other stakeholders.

In addition, higher aid intensities could be foreseen for aid awarded in accordance with other State aid guidelines in relation to investments that take place in the assisted areas. The conditions for applying these higher aid intensities will have to be developed as part of the revision of those guidelines.

In the context of the on-going work on the revision of the guidelines under SAM, the Commission services will continue to review possible evidence about the conditions under which state aid intervention can contribute to growth-enhancing policies, including in relation to key growth drivers, and will take the results into account when drawing up the final versions of the guidelines.

Common principles approach and compatibility rules in the paper containing draft RAG

In its compatibility assessment of State aid measures, the Commission analyses whether the positive impact of the aid measure in reaching an objective of common interest outweighs its potential negative effects on trade and competition. For this purpose the future RAG will develop a series of criteria which need to be met in order for the measure to be considered compatible with the internal market. In the spirit of the SAM initiative, these criteria (common principles) will be also applicable to the rest of the future State aid framework and are the following:

1. Contribution to a well-defined objective of common interest;

2. Absence of market delivery of the equity objective;
3. Appropriateness of the aid measure;
4. Incentive effect of the aid;
5. Aid limited to the minimum;
6. Avoidance of undue negative effects;
7. Transparent aid award.

These principles are further explained in Section 3 of the enclosed paper containing draft RAG. In applying them and in order to avoid unnecessary administrative burden, the Commission intends to take into account possible synergies with other EU policies and in particular Regional Policy. Therefore, for example in assessing the contribution to regional development, the Commission will consider these criteria to be met for measures implemented in accordance with regional development strategies defined in the context of the cohesion policy Funds; likewise it will consider as appropriate measures implementing priorities identified in an operational programme co-financed under the cohesion policy Funds.

If any of the above criteria is not met, for example if it becomes clear that the investment would have taken place in the same location without aid (absence of incentive effect) or that an aid measure has a direct causal link with the closure of a similar activity in another area (presence of an undue negative effect), the State aid measure will not be considered to be compatible with the internal market. On the contrary, in cases where these criteria are all met, the Commission will conduct a balancing test of the positive effects of the measure in terms of its contribution to the development of the area against the potential distortions of competition it could cause.

Ensuring effective regional aid – Regional investment aid for large enterprises

Regional aid can contribute to the equity objective without significantly distorting the internal market, only if it changes the behaviour of the aid beneficiary by determining the location of the investment or the decision to invest in the assisted areas designated in the regional aid map.

In the enclosed paper containing draft RAG, DG Competition proposes to limit the possibility of investment aid to large enterprises to 'a' regions. This proposal is based on arguments and economic evidence adduced in favour and against such a change compared to the current RAG, and on DG Competition's own enforcement practice.

There is a strong body of evidence suggesting that regional investment aid is more effective and efficient when geared towards SMEs (i.e. it changes the behavior of the aid beneficiary to undertake an investment that contributes to a common objective)[2]. According to this evidence, compared with SMEs, large enterprises would more often have made the investment

[2] C. Criscuolo, R. Martin, H. Overman, J. Van Reenen (2011), "The causal effects of an industrial policy", mimeo Centre for Economic Performance, London School of Economics for recent research on the effectiveness of the Regional Selective Assistance (RSA) program in the UK (version published at: http://www.nber.org/papers/w17842.pdf).

concerned even without financial support in assisted areas, rendering such support both ineffective and costly with high distortive effects for the internal market.

Available empirical evidence suggests that the lack of incentive effect for large companies could be attributed in part to the observation that access to finance is more often a problem for SMEs than it is for large enterprises. From this perspective, financial support to SMEs can be expected to make more of a difference than financial support to large enterprises. Second, large enterprises typically have more leverage (bargaining power) vis-à-vis public authorities, as they are relatively more important to the region than individual SMEs. The efficiency of financial support given to large enterprises, as measured e.g. in terms of cost per job created, may be adversely affected as a result.

One of the most relevant studies where this conclusion was reached is one carried out by a group of academics of the London School of Economics, having evaluated the causal effects of industrial policy in the UK over a period of 20 years on the basis of the main regional aid support scheme, the authors conclude that the aid had a positive effect on smaller firms (e.g. with less than 150 workers) but not on larger firms. According to the authors, this might be due to larger firms being more able to 'game' the system and take the subsidy without changing their investment and employment levels, possibly combined with financial constraints for smaller firms.[3]

The authors of a recent ex post evaluation of projects co-financed under the ERDF in Italy also come to a similar conclusion.[4] Assessing the impact of enterprise support throughout Italy (Law 488) and various SME schemes in the region of Piemonte, they arrive at the conclusion that there is a lack of incentive effect for large firms: large enterprises are using the money for projects they would have carried out anyhow.

DG COMP further commissioned an ex-post evaluation of the RAG 2007-2013. The consultant evaluated the incentive effect of aid granted on the basis of the current regional aid rules on a sample of 28 projects with investment costs above EUR 50 million[5]. The consultant concluded that the regional aid was not the determining factor to invest or to locate these investments in assisted areas. The main drivers for these investments were pre-existing sites, labour costs, availably of skilled labour force, availability of transport infrastructure or of natural resources, growing demand or existing competition that leads to the need to modernize existing production facilities. This would also suggest that incentive effect of aid may vary across firms.

Our enforcement experience also confirms the doubts about the incentive effects of regional aid. In some of the cases DG Competition has investigated, the aid beneficiary did not consider other alternative locations for the subsidised investment because of pre-existing production facilities or the existence of a highly specialised cluster. As the main drivers for locating the investments in an assisted area were the high economies of scale and agglomeration effects, the location costs were lower than in any other location. Therefore, there is little or nothing to compensate for with regional investment aid.

---

3 See footnote 2.

[4] Enterprise support: support to SMEs and large enterprises in Italy, including a comparison of grants and other financial instruments, A. Martini and D. Bondonio (2012), available on http://ec.europa.eu/regional_policy/information/evaluations/impact_evaluation_en.cfm#1.

5 Final report on the ex post evaluation of the regional aid guidelines 2007-2013 issued by Ramboll on 12 December 2012 (to be published on DG COMP website). The evaluated projects were undertaken by large companies in the pharmaceuticals, solar, internal business services, car manufacturing, cement and paper industry.

These findings, on balance, motivate the proposal to disallow the use of regional investment aid to large firms in 'c' areas. It is useful to recall, however, that aid to large enterprises can still be granted in 'c' areas for aid geared towards specific objectives (e.g. broadband, RDI, energy and environment, etc.).

Main changes compared to the non-paper of December 2011

In December 2011, DG Competition circulated to EU Member States, EEA Member States and the EFTA Surveillance Authority a non-paper setting out the provisional orientations of the services of DG Competition on the topics to be revised in the RAG.

The main changes proposed in the enclosed paper containing draft RAG compared to the non-paper of December 2011 relate to the provisions on the regional aid maps, in particular: (i) the method for the allocation of non-predefined 'c' coverage among Member States (new hybrid method based on a combination of EU and national disparities), (ii) the safety net (50% maximum loss for all MS concerned, minimum population coverage of 7.5%), (iii) some more limited adjustments to the criteria for the selection of non-predefined 'c' areas by Member States.