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Regional Aid: Recent Trends and Some Historical Background
(with special focus on large investment projects)

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ABSTRACT

Adopted on 24 June 2009, the Communication on the criteria for in-depth regional aid assessments of large investment projects represents only the last step of a lengthy modernisation process in the field of regional aid.

By retracing the long evolution of the European Commission's regional aid policy through a detailed analysis of the most significant pieces of legislation issued by the Commission over time, along with its implementing practice and the relevant case-law, the article submits that the Commission has succeeded in setting the right balance between automatic application and refined economic analysis in the assessment of individual projects. The new system maintains the positive aspects of old legislation while keeping a firm course towards modernisation and subsidiarity. Moreover, it sets aside automaticity in the application of the rules in well defined significant cases in favour of a case-by-case approach where great importance is attributed to economic analysis. This is consistent with the approach set out in the State Aid Action Plan in 2005. The article continues by analysing the shortcomings of the present system and the author, while praising the work carried by the Commission, points out some critical aspects and advocates specific solutions.

Regional Aid: Recent Trends and Some Historical Background
(with special focus on large investment projects)

Massimo Merola[1]

I. Introduction

After more than 50 years since the entry into force of the Treaty of Rome, several aspects of the State aid discipline still seem (rather increasingly so), and probably objectively are, subject to huge uncertainties. For instance, it has been acutely observed that the more one is involved with, and goes deeper into, the notion of State aid, "the more he realises how elusive it is"[2]. When compared with the notion of aid and other aspects of State aid discipline, the rules governing regional aid have shown relatively high stability. This carries some importance as, from a statistical point of view, regional aid has traditionally represented a significant proportion of the overall volume of aid being granted within the EU. To provide just one figure, regional economic aid accounted for 19 per cent of total horizontal aid in 2007, according to the Commission's 2007 State Aid Scoreboard[3]. Although the evolution of regional aid rules has experienced setbacks, it has nevertheless been reasonably linear when compared to more controversial aspects of State aid rules.

It is therefore possible to illustrate the most recent changes, with respect in particular to large investment projects, on the basis of their historical background, as such changes appear the logic outcome of a long evolution marked by a coherent track to modernisation.

The EU has the most sophisticated ex-ante control system of State aid in the world, and regional aid is an important part of this system. This has to do with the way the EU has been progressively built up, and is certainly an asset worth preserving as this system has prevented a subsidy race among Member States (especially as far as location or relocation subsidies are concerned). However, celebrating this achievement is not helpful as much

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[2] See Luca Rubini, *The 'Elusive Frontier': Regulation under EC State Aid law*, in EStAL 3/2009, p. 277.

[3] *State aid scoreboard, spring 2007 update,* COM (2007) 347. The Scoreboard can be accessed at http://ec.europa.eu/competition/state_aid/studies_reports/archive/2007_spring_en.pdf

remains to be done to improve the present system and ensure its objective, impartial, and predictable implementation. To follow the right path to further improvements requires a clear understanding of not only the current rules, but also the lengthy process followed to achieve the present stage of development of regional aid law. Thus, from this perspective as well, a study of the historical background that inspired the latest developments is a promising exercise.

Regional aid rules underwent a milestone reform in 1998, at the early stage of the modernisation process in the field of competition law, and opened up to more far-reaching changes in the following years. This reform has been a landmark in the evolution of regional aid policy, and was carried out with reference to two fundamental principles underlying the modernisation process namely; administrative efficiency, and greater involvement of national judges in the enforcement of EC competition law. While the former has been pursued by designing the new rules in such a way as to increase automaticity in their application by the Commission, leading up to the adoption of the new guidelines on regional aid[4] and the framework on regional aids for large investment projects[5], the powers of national judges increased through greater recourse to block exemption regulations which judges are able to enforce[6]. The basics principles of regional aid have thus been adapted to the modernisation of competition rules, which had remained largely unchanged since the early seventies.

Pre-empting the conclusions of our analysis, we submit that the Commission went too far in its quest for automatic or mechanical application of the regional aid rules with the 1998 and 2002 reforms, and has recently stepped back, resulting in a satisfactory balance between careful scrutiny of the economic effects, and automatic application intended to foster decentralisation and increase predictability. Some changes, however, are still warranted in order to better reflect the legal principles and policy objectives underlying the regulation of regional aid. To illustrate these considerations and opinions, we will first review the basic aspects of the various reforms that the regulation of regional aid has undergone in the last ten years, with special focus on the rules applicable to large investment projects, which have been the object of special consideration throughout the reform process. Further on, we will try to explain the rationale of the evolution that took place in this field of State aid law over the last ten years, and to then submit some recommendations on the most suitable way forward.

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[4] Guidelines on regional aid, OJ C 74 of 10 March 1998, p. 9.

[5] Communication from the Commission - Multisectoral framework on regional aid for large investment projects, OJ C 107 of 7 April 1998, p. 7-12.

[6] In this respect, see judgments of the Court given in antitrust cases 63/75, *SA Fonderies Roubaix Wattrelos/Société Nouvelle des Fonderies A. Roux et Société des Fonderies JOT*, [1976] ECR 111, §§ 10-11, and C-234/89, *Stergios Delimitis/Henninger Brau AG*, [1991] ECR I-935, §§ 45-46. Given the specific features of block exemption regulations, which are common to both antitrust and state aid law, it is submitted that the mentioned case-law is also applicable to state aid field.

II. Historical background

A. Raisons d'être and content of the 1998 reform

The first comprehensive, and greater ground-breaking regional aid reform was the adoption of new guidelines in December 1997 (published in March 1998 and entered into force in the same year) (referred to below as "RAG 1998" or "1998 Guidelines")[7].

Some of the key points that had been applied by the Commission in the forty years since the Treaty of Rome came into force have largely been maintained (e.g., the basic distinction between Article 87(3)(a) and 87(3)(c) regions (now Article 107(3)(a) and 107(3)(c))[8], as confirmed by the Courts[9], the uniform top ceilings of aid intensity, the concept of regional specificity, the attention to sectoral repercussions, the principle of transparency, the *ex-ante* assessment of aid schemes and ensuing notification exemption for individual aid, and the concept of comprehensive regional aid policy, meaning that regional aid should be granted under a multi-sectoral aid scheme which forms part of a regional development strategy with clearly defined objectives). The Commission began developing all these principles in the seventies. After proposing that Member States give the Commission advance notice of all significant cases of general regional aid, the Commission agreed to draw up general criteria for the review of regional aid schemes. This was first done in 1971, after the Council Resolution that represented the first ever document on the implementation of the regional aid rules of the Treaty of Rome[10], and later in 1975[11], and 1978[12] (after the accession of Denmark, Ireland and the UK, at which time it adopted the first communication on the method of coordination of regional aid).

In the eighties, after the accession of Greece, Portugal, and Spain, and following the reinforcement of the objective of economic and social cohesion with the Single European Act[13], the Commission laid down new rules in the 1988 guidelines on regional aid, which

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[7] See above, footnote 4.

[8] The renumbering is due to the entry into force of the Lisbon Treaty on 1 December 2009. The State aid provisions are now contained in Article 107-109 TFEU (the Treaty on the Functioning of the European Union). All references to the Treaty provisions in this article remain based on the EC Treaty as all the legislation, decisions and judgments discussed in the article predate the entry into force of the Lisbon Treaty. Likewise, all references to case-law do not take into account the renaming of the European Courts.

[9] Judgment of the Court of 14 October 1987, case 248/84, *Germany v. Commission*, [1987] ECR 04013, § 19.

[10] First Resolution of 20 October 1971 of the Representatives of the Governments of the Member States, meeting within the Council, on general systems of regional aid (OJ C 111 of 4 November 1971, p. 1).

[11] Commission communication to the Council, COM(75) 77 of 26 February 1975.

[12] Commission communication to the Council, OJ C 31 of 3 February 1979, p. 9.

[13] With the Single European Act, Member States delegated part of their sovereign power in the field of economic and social cohesion (which has become a new European Community objective) to the EC Institutions. The Act

introduced, quantitative, statistical criteria for the definition of the eligible regions for the first time, and made a first attempt to ensure coordination with the objectives of the structural funds[14].

However, only the adoption of the 1998 Guidelines marks the first comprehensive and substantial reform, whereby the Commission implemented a brand new approach along the traditional principles mentioned above.

On the one hand, the text of the 1998 Guidelines reiterated the validity of several rules embodied in the old pieces of soft legislation, but on the other hand, introduced new elements stemming from Commission practice. Thus, for instance, the Commission confirmed its approach as far as the definition of the regions that fall within the scope of Article 87(3)(a) is concerned. These regions must comply with the objective and exogenous criterion of a gross domestic product per capita below 75% of the Community average measured in terms of buying power, and corresponded to a geographic unit of level 2 of the statistical classification. This disadvantage, when compared with the Community average, was in fact considered in isolation was indicative not only of an abnormally low standard of living, but also of large scale unemployment -the two parameters set forth in Article 87(3)(a). Indeed real unemployment necessarily translates into a decrease in the average standard of living. Besides these elements of continuity, however, the remaining part of the discipline was marked by a thoughtful reform inspired by greater severity.

The first, and most basic innovation that marked this initial modernisation phase, and which is still valid today, was the setting out of a global coverage ceiling in terms of population eligible for regional aid throughout the EU. The underlying idea is that regional aid is conceivable only if used sparingly to support the most disadvantaged regions is[15]. Moreover, the goal of social and economic cohesion demanded to reach no more than half of the Community population with regional aid, as otherwise the gap between poorer and richer regions would never be reduced. In other words, the total coverage of assisted areas

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Simultaneously provided for the reform of the structural funds, considered one of the priorities of the Community policy.

[14] Commission communication on the method for the application of Article 92 (3) (a) and (c) to regional aid (OJ C 212 of 12 August 1988, p. 2-5). Beyond the introduction of quantitative criteria for the definition of eligible regions and the provision of aid intensities adapted to the nature and gravity of the regional handicap, the 1988 Communication sets forth rules for regional operating aid, and a method of application of Article 92 (3) (c) for the first time.

[15] See in this respect P. Olofsson, *L'évolution de la politique des aides à finalité régionale 1956-2004*, in Competition Policy Newsletter, No. 3/2005, pages 17-24. The author explains in depth both the reasons behind the 1998 Reform and the historical and political events occurred during the period of application of the new Framework (2000-2006) which heralded the subsequent reforms. Among such event it is worth recalling the Lisbon and Stockholm summits in March 2000 and March 2001 respectively, the Third Report on Economic and Social Cohesion of February 2004 (that can be consulted on the website: http://europa.eu.int/comm/regional_policy/sources/docoffic/official/reports/cohesion3/cohesion3_en.htm) and finally of course the enlargement of the EU to 25 Member States on 1 May 2004.

must remain less than the coverage of unassisted zones. The Commission therefore decided to set a global ceiling well below 50% (42.7%)[16] that could be modified over time, depending on the health of the Community economy as a whole, the progress accomplished in social and economic cohesion, as well as the aim to progressively reduce the volume of aid while targeting the most disadvantaged regions. This very basic and straightforward principle, which was innovative at the time, is based on the idea that only a truly selective system of regional aid can help stimulate a virtuous circle capable of allowing disadvantaged regions to reduce the gap. This innovation, coupled with the requirement imposed on Member States to notify the Commission of national regional aid maps, was the model on which the Commission's modern regional aid policy was based, and remains a foundation of the present system.

A second novelty that has since remained partially unchanged is the new method of identification of the regions covered by Article 87(3)(c). This implies a two-step analysis[17]. Under the RAG 1998, the two steps were as follows. First, the Commission determined a population ceiling covered for both Articles 87(3)(a) and 87(3)(c) taken together at EU level. This allowed the automatic setting up of the quota left for regions of Article 87(3)(c), by deducting from the global ceiling the percentage value of the EU population covered by Article 87(3)(a), which was based on the objective and invariable statistical method described above. The total coverage for areas eligible under Article 87(3)(c) was then split among the Member States in accordance with an allocation key intended to measures both the position of the region when compared with the EU average, and its development at national level. The allocation of the coverage ceiling among the Member States became part of the Guidelines, and, just as the Guidelines themselves, acquired binding force when accepted by the States[18]. The better the region's position with respect to the EU average, the greater the gap that the region was to suffer in the national context in order to become eligible under Article 87(3)(c)[19]. Second, with respect to the selection of the Article 87(3)(c) regions, the Commission merely set up qualitative criteria that the Member States ought to comply with, while the latter had a wide margin of discretion, within these limits, to determine the methodology and parameters to be applied for the selection of the eligible regions, and, as a consequence, the list of such regions. These regions, together with the regions eligible for aid under Article 87(3)(a), composed the regional aid map.

Since the 1998 reform, Member States are under a duty to notify their regional aid maps to the Commission at the beginning of the programme period (2000-2006 in that case), along with the methodology used for the selection of the eligible regions. The Commission merely exercised control of legality in respect of the qualitative criteria. This control was

[16] Cfr. § 3.2 of the 1998 Guidelines.

[17] Cfr. §§ 3.8 - 3.10 and Annex III of the 1998 Guidelines.

[18] See judgment of the Court of 18 June 2002, Case C-242/00, *Germany v. Commission*, [2002] ECR, I-5603.

[19] In fact, according to Annex III of the 1998 Guidelines, the distribution of the Article 92(3)(c) Community ceiling between the different Member States is effected by using a distribution key, which takes account of regional disparities in a national and Community context.

intended to ensure the objectivity and transparency of the methodology, and parameters employed, as well as the efficacy of the regional aid, by avoiding too widely dispersed interventions. For the same reason, the regional derogation could, in principle, only be invoked for multi-sectoral aid schemes open to all undertakings active in the assisted regions[20]. The Commission thus had no bearing under the 1998 regulation on the appraisal of the social and economic situation of the selected regions, if compared with the non-eligible ones.

Besides, since the 2000 Agenda adopted in July 1997[21], the Commission has endeavoured to achieve a certain homogeneity and coherence between the reach of the Community regional policy assistance and the national regional policies examined under Article 87 EC by means of these qualitative limits. Further, in its communication to the Member States on regional policy and competition policy of March 1998, synchronised with the 1998 Guidelines, the Commission high lighted that the global population coverage ceiling set for the period 2000-2006 is higher than the 35-40% range indicated in the Agenda 2000 for objectives 1 and 2 of the structural funds. This was intended to make a coherent coordination effort possible, as the Community assistance was supposed to build on the national regional aid for the most disadvantaged regions only, thus permitting the attainment of a critical mass of resources available, and fostering the effectiveness of the global regional policy within the EU.

The 1998 reform also implied a substantial revision/decrease in the aid ceilings previously applied to the different categories of regions. These aid ceiling could be adjusted depending on the size of the recipient undertaking. Similarly, the Commission clarified the notions of "initial investments" and "job creation" in the guidelines, explaining how to ensure the compliance with aid intensities, in terms of either volume of investment or number of jobs created[22]. Regional operating aid, by contrast, was deemed admissible only in exceptional cases, and under certain conditions (i.e. temporary, with digressive aid intensities) and strictly in the most seriously underdeveloped areas (Article 87(3)(a))[23]. In terms of qualification of the eligible expenditures, the reform brought about a widening of that concept, which since then has included not only tangible investments, but also some categories of intangible investments (or wages where job creation is linked to initial

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[20] For instance, in the HAMSA judgment (judgment of the CFI of 11 July 2002, Case T-152/99, *Hijos de Andrés Molina v. Commission*, ECR II-03049, §§ 205-206), the CFI found that a rescue and restructuring aid has an intrinsically sectoral character and can difficultly be categorized as regional aid.

[21] Agenda 2000 - *Summary and conclusions of the opinions of Commission concerning the Applications for Membership to the European Union presented by the candidate countries* - DOC/97/8. Strasbourg-Brussels: European Commission, 15 July 1997.

[22] Cfr. §§ 4.8 and 4.13 of the 1998 Guidelines.

[23] To provide just one example, the Commission considered operating aid in the form of tax concession to companies with no more than 250 employees and located in the new Lander or West Berlin incompatible with the common market because they were not granted for a predetermined period only, did not fall over time, would strengthen the equity base of the recipient firms without ensuring that the capital provided would be used for the economic development of the assisted regions and did not exclude sensitive sectors and firms in difficulty (Commission Decision of 21 January 1998, OJ L 212 of 30 July 1998, p. 50).

investment). Finally, the Commission took the opportunity of this comprehensive reform to review and specify the rules on accumulation of aids, which dated back to 1985[24]. Since then, it has been possible to cumulate not only regional aids granted on the basis of different provisions or schemes and stemming from different legal sources, but also aids intended to satisfy different goals (regional with horizontal aid, for instance). In the first case, aids from different sources, or legal bases can be cumulated within the limits set for the region concerned. In the second case, the expenses eligible under both the regional aid scheme and the horizontal aid benefit from the most favourable aid intensity among the two.

An additional relevant aspect of the 1998 reform, which is still applicable today (despite the profound changes in the content of the pertinent rules), alongside the setting up of the global population coverage ceiling, is the adoption of a multi-sector framework for regional aid to large investment projects. The Commission adopted the Framework ("MSF 1998" or "1998 Framework") at the same time as the new guidelines and published it in April 1998 (one month later than the guidelines). The underlying idea is threefold: first, ensuring a uniform approach in the assessment of large investment projects, irrespective of the sector concerned; second, discouraging competition between MS on location aid, i.e. aid intended to attract foreign investment to their territory; and third, limiting the anticompetitive effects on the product and geographic market concerned of particularly harmful aid, while preserving the industrial competitiveness of investment projects in the least developed regions. Thus, if administrative efficiency was the first drive of the 1998 reform, a stricter approach towards large aid projects aimed at downsizing the volume of aid and reduce the distortion of competition was the second one.

Based on its experience with regional aid up to then, the Commission was aware that the richest Member States continued to spend huge amounts of money on large projects in regions in difficulty, and was increasingly uneasy with the implicit approval given to these projects when authorising regional aid schemes. Therefore, it "sought to devise mechanisms to capture and assess cases of regional aid to large projects or large cases of aid"[25]. Initially, it tried to counter this problem by making its approval of schemes subject to some limitations or conditions, but the risk of litigation involved in the application of these limitations and conditions, exemplified by the Italgrani judgments in 1992 and 1994[26], underpinned the idea that a more radical solution was warranted. Thus, if on the one side the Commission advocated stronger automatism in the application of rules governing regional aid[27], on the other hand it wanted to make large investment projects subject to more severe scrutiny.

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[24] Commission communication on cumulation of aids for different purposes (OJ C 3 of 5 January 1985, p. 2-3).

[25] See F. G. Wishlade, *The Control of Regional Aid to Large Investment Projects: Workable Compromise or Arbitrary Constraint?,* in EStAL 3/2008, p. 495.

[26] Judgments of the Court of 30 June 1992, Case C-47/91, *Commission v. Italy*, [1992] ECR I-4145 and of 5 October 1994, Case C-47/91, *Commission v. Italy*, [1994] ECR I-4635.

[27] F. G. Wishdale (*ibidem*, footnote 23) explains that the case-by-case approach was not seen as a viable option

For the large investment projects (defined as those exceeding EUR 50 million[28]), the challenge was to identify the right balance between the incentive effect of regional aid on the one hand, and the limitation of competition distortion on the other hand. If the challenge remains the same today, as do the principles justifying the provision of special rules for aid to large investment projects, the way to address the problem and establish the right balance, have evolved substantially over time. In 1998, the Commission attempted to address the problem in a very innovative way for the time, i.e. through the application of three assessment criteria (or adjustment factors) that, combined with each other, would expectedly lead to a decrease in the intensity admissible in each specific case when compared with the maximum aid ceiling for the region concerned. The scope of application of this new method was rather broad, as it applied to all economic sectors, except those already covered by sector-specific rules (i.e., agriculture, fisheries, coal industry, steel, shipbuilding, synthetic fibres, motor industry and transport).

The first assessment criterion was based on the competitive situation in the affected market (whether the market is stagnant, mature, declining, or, conversely, developing; and whether there is structural overcapacity[29]). For instance, the existence of structural overcapacity that risks being aggravated by the granting of aid could bring about a very substantial decrease of the maximum aid intensity (up to 75% of the edictal aid ceiling for the region concerned, depending on the gravity of the situation). The high market share of the beneficiary (set at 40% for the purposes of the framework) could also play a role in the determination of the adjustment coefficient.

The second assessment criterion, defined as "capital/labour ratio" (number of jobs created per million invested), governed the application of a coefficient of 0.6 to 0.9, with the consequence of a reduction from 10% to 40% of the maximum aid intensity, depending on the contribution of the aided project to the combat against unemployment in the region concerned. The competition distortion potential of the aid is indeed higher if the project is

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because it is extremely resource-intensive, time-consuming and often costly if external consultants are used. Moreover, it was considered as more easily open to legal challenge. Regarding this last point, we will explain later in this article that the Commission had clearly underestimated the potential for conflicting interpretation and litigation inherent in the automatic adjustment system chosen.

[28] More precisely, according to § 2.1 of the MSF 1998, either of the following two criteria have to be met for a project to be classified as large investment project: firstly, the total project cost has to be at least EUR 50 million, and the cumulative aid intensity expressed as a percentage of the eligible investment costs has to be at least 50% of the regional aid ceiling for large companies in the area concerned and aid per job created or safeguarded amounts at least EUR 40000; secondly, the total aid has to be at least EUR 50 million.

[29] The CFI clarified in this respect that the maximum coefficient allowed under this criterion, equivalent to 1, was justified only if the Commission can ascertain that the market is not declining on the one hand, and that is not characterised by structural overcapacity on the other hand ["*The application of the highest adjustment factor implies a prior finding that there is no structural overcapacity in the sector concerned and also that the market is a declining market"*]. This view was supported by the EJC on appeal (judgment of 11 September 2008, Joined Cases C-75/05 P and C-80/05 P, *Federal republic of Germany v. Kronofrance SA*, not published yet).

capital intensive, because it can carry a proportionally higher reduction of the unit production costs.

The third and last factor attempted to reflect the potential of the project in terms of regional development. In part, this criterion seemed to complete the previous one (capital/labour ratio) which was silent on indirect job creation. The third factor was the only one, among the assessment criteria, which could increase rather than decrease the aid intensity of the project concerned. Since, however, the Member States were not allowed to exceed the global aid ceiling set forth for the region concerned under any circumstances, the positive impact of this assessment criterion could only compensate, partially or totally, the decrease in aid intensity determined by the application of the two previous criteria. The Commission proposed the application of a coefficient of 1 to 1.5 in assessing the third factor, bringing about an increase of up to 50% for Article 87(3)(a) regions of the aid intensity obtained through the adjustment of the uniform aid ceiling on the basis of the two previous criteria.

At the outset, these rules were conceived for all the economic sectors that had not been made subject to specific regulations. As far as the procedure is concerned, the Framework provided for ex-ante review (obligation to notify) of all large investment projects exceeding at least one of the following thresholds: (i) EUR 50 million of aid, or (ii) 50% of the aid ceiling for the region concerned and for large undertakings, and EUR 40.000 per job created. A compulsory notification form was annexed to the Framework.

Albeit innovative and interesting, this system, according to the Commission, showed weaknesses, and gave rise to insurmountable problems when applied in practice. This in turn resulted in a very narrow application (number of notified cases amounted to less than half of what the Commission expected. Moreover, statistics revealed a tendency to opt for award values just below the notification thresholds). Basically, the system was not effective in reducing the level of aid to large projects (in practice the maximum allowable aid intensity calculated with the three adjustment factors mentioned above was often close to the regional aid ceiling) and also gave rise to many difficulties when applied (e.g., difficulty of obtaining appropriate information on apparent consumption, which permits the qualifying of an underperforming market, and total production capacity; difficulty assessing the number of safeguarded and indirect jobs in a reliable way, and risk of double-counting of the same feature through the application of the second and third adjustment factors). We will discuss these weaknesses in more detail in section III.A below.

Whatever the reasons for dissatisfaction may have been, the Commission started almost immediately to reflect upon possible modifications of the system and finally revised it in 2002, while leaving the 1998 Guidelines unaffected[30]. In any event, the modernisation

[30] The review of the 1998 RAG started instead in 2003, when the Commission opened discussions with the

track had been drawn up by then. It included, next to the revision of the method of coordination of regional aid set forth in the 1998 Guidelines and the automatic adjustment of aid intensity to large investment projects, a stronger role for national judges. The Commission had the foresight of understanding that for the effectiveness of a modernised system, national judges had to be involved in the enforcement of competition law in the State aid field as well. It was therefore far more than a mere coincidence that prior to the adoption of the RAG 1998, the Commission proposed that the Council pass a Regulation enabling it to enact block exemption regulations, which judges are able to enforce. This resulted in the adoption of Reg. No. 994/1998[31] by the Council.

B. The 2002 mini-reform (limited to the rules applicable to large investment projects)

The Commission explained the reasons underlying the amendment of the rules applicable to large investment projects as being the need to dispose of a more transparent and straightforward tool than the previous multi-sector framework. It aimed at providing administrative simplification in comparison with the previous regulation and thus to improve predictability and reduce the Commission's workload. It also aimed at decreasing the global volume of regional aid to large investments projects, an objective that the previous framework had failed to attain.

The main innovation of the Multisectoral framework for regional aid to large investment projects published in March 2002[32] ("the 2002 Framework" or the "MSF 2002") lay in the replacement of the three assessment criteria of the old framework with a brand new system based on a scale of investment expenditure and consequential correction towards the lower end of the single aid ceiling for the region concerned[33]. In the Commission's view, this ought to help maintain a sufficient incentive level while avoiding unnecessary distortions of competition and reducing the global amount of regional aid. Under the new system, the reduction of aid level for large investment projects was obtained through the automatic adjustment of the regional aid ceilings on the basis of a scale composed of three thresholds of investment expenditures and related adjustments: (i) up to EUR 50 million (100% of the applicable aid ceiling), (ii) between EUR 50 million and EUR 100 million (50% of the

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Member States to define its approach on national regional State aid for the period after 2006.

[31] Council Regulation (EC) No. 994/1998 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 aids (OJ L 142 of 14 May 1998, p. 1-4).

[32] Communication from the Commission - Multisectoral framework on regional aid for large investment projects (text with EEA relevance, OJ C 70 of 19 March 2002, p. 9-20).

[33] As F. G. Wishdale points out (ibidem, footnote 24) the reduction matrix provided for under the 2002 Framework is "similar in operation to a progressive tax rate".

applicable aid ceiling) and (iii) from EUR 100 million upwards (34% of the applicable aid ceiling).

Paragraph 24 of the Framework represented the most problematic point of the 2002 discipline. It established a threshold for notification of individual aid (i.e., the maximum aid that, depending on the region concerned, could be allowed to an investment of EUR 100 million), while *ad hoc* aid ought to be notified in any event, but also limited the type of scrutiny that the Commission could perform in such cases. In practice, the Commission had no discretionary power whatsoever, as the Framework laid down two very specific scenarios in which the granting of aid was subject to a *per se* prohibition.

The first scenario referred to the market power of the recipient undertaking (it should not account for more than 25% of the products concerned before or after the investment). The second scenario referred to the growth perspective of the sector concerned (the capacity created by the project should not exceed 5% of the total volume of production in the relevant market unless the average annual growth of the products concerned over the previous five years was above the average annual growth of the EEA's GDP (as this would show that the market was performing well and was capable of absorbing the additional capacity, which would thus be unlikely to harm viable competitors). To sum up, the new system featured an entirely automatic mechanism. The scope of application of this mechanism was, however, slightly reduced when compared to the previous system due to the higher notification threshold. A possibility of partial compensation of the reduction of aid ceilings following the application of the scale of adjustments remained possible for projects substantially co-financed from structural funds resources. This was obtained by multiplying the allowable aid intensity by a factor of 1.15, upon the conditions that the contribution by structural funds amounted to at least 10% for Article 87(3)(c) regions and 25% for Article 87(3)(a) regions) and that the candidate project was classified as a major project according to the pertinent provisions. Under no circumstances, however, could the increase in aid level lead to an aid intensity higher that 75% of the unadjusted regional aid ceiling.

The mechanism described above applied to all sectors with the exception of shipbuilding. Sectors suffering from structural difficulties should similarly have been excluded. However, although a list of sensitive sectors was expected to be drawn up and annexed to the framework, the Commission initially delayed it, and finally dropped the idea entirely. Specific rules applied to the steel sector (aid for investment projects prohibited), to the synthetic fibres sector (aid to large investment projects prohibited), to the motor vehicle sector (both the standard reduction scale, and the prior notification requirements were not applicable to this sector, but aid was limited to 30% of the corresponding regional aid ceiling)[34].

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[34] The number of special regimes for specific sectors contributes to explain why the 2002 Framework, as already noticed, was only applied in a limited number of cases. See in this respect F. G. Wishdale, ibidem (supra, footnote

Beyond this, the 2002 Framework put stronger emphasis on transparency than in the past, by providing for a system of ex-post monitoring for all investment aid falling under the framework, and more specifically, for investment projects exceeding EUR 50 million. For the latter category, the Member State concerned had to forward summary information to the Commission upon its own initiative regarding the aid, and this within 20 working days starting from the granting of the aid. In all other cases, the initiative laid with the Commission while the Member State was obliged to keep record and full documentation of all aid granted for a period of ten years. Conversely, however, the notification thresholds were slightly higher than in the 1998 MSF, as advance notification for individual aid granted in accordance with an approved scheme was required only if the proposed aid exceeded the maximum allowable aid that an investment of EUR 100 million could obtain under the reduction scale mechanism.

Although the 2002 Framework was expected to remain applicable for a period ending on 31 December 2009, the Commission decided to amend it again as early as in 2006, alongside the adoption of the new Guidelines.

C. The second milestone reform in 2006

Since 2003, when it launched a preliminary consultation process with the MS, and the EFTA Surveillance Authority for the revision of the regional aid guidelines, the Commission envisaged a second deep reform of its regional aid policy following the 1998 one. No change to the existing system was in any event not an option at that stage, as the enlargement had altered the context of the previous discipline. Furthermore, it is worth recalling that the competition modernisation process had finally invested State aid policy in full through the launch of the State Aid Action Plan ("SAAP"), resulting in: the codification of the principle of less, and better targeted State aid; the increased attention to market failures, and the refinement of the economic assessment; and the debate on the definition of the goal of State aid control (equity and efficiency objectives, total welfare). The application of these principles to the field of regional aid led the modernisation process to return to the exact point from which it had headed off a lustrum earlier, i.e. the regional State aid discipline and the application of sophisticated economic assessment devices in the regional aid guidelines, for one of those perfect circular movements that make history (and sometimes history of law) fascinating.

The new reform of regional aid had become, by then, one element of a comprehensive review of the State aid law and policy, which is identified with the SAAP, and has its

25). The author correctly observes that, for instance, the motor vehicle industry, one of those to which a derogatory discipline applies, accounts traditionally for a substantial proportion of large aided projects.

political key source in the Lisbon agenda. Clearly, the reform of regional aid is just one of the measures listed in the SAAP, and probably not the most relevant, as the emphasis is mainly on horizontal aid intended to directly promote the competitiveness of the European industry (risk capital; research, development and innovation; education and training; small and medium size businesses). However, having the potential to shorten differences between richer and poorer regions, and creating the right incentives for growth and jobs, the regional aid reform has the potential to cope with some of the objectives identified in the Lisbon agenda. The review process launched in 2004 with the SAAP culminated with the adoption of the new Guidelines on National Regional Aid for the period 2007-2013[35] in 2006 (the "2006 Guidelines" or the "RAG 2006"). The modification of the Framework for large investment projects was part of this new reform from the beginning but is mostly limited to a mere codification of the 2002 rules, by integrating the provisions of the 2002 Multisectoral Framework into the new Guidelines. Beyond this, the Commission has only introduced a few clarifications with respect to the 2002 Framework, two of which deserve to be recalled here.

The first clarification concerns the notion of "large investment project" and is aimed at preventing a project from being split into several sub-projects to escape the application of the special provisions embodied in the Framework. All investment projects undertaken in a period of three years are considered a single project if the fixed assets are combined in an inseparable way from an economic standpoint. The second clarification has to do with the assessment of reportable investment projects. When the conditions laid down under point 24 of the 2002 Framework (in terms of market share and/or new production capacity) are met, there is no longer an inflexible ban on the granting of aid, as had been the case under the 2002 Framework, but the Commission has to conduct a detailed investigation through the opening of an Article 88(2) procedure in order to ascertain whether: (i) the aid is strictly necessary to provide an incentive effect for the projected investment, and (ii) the benefits expected thereby outweigh any distortion of competition and trade between MS. This is a sensible clarification ordevelopment[36].

This being said on the discipline of large investment projects in the new RAG, it holds true that the main hints of the 2006 revision concern other aspects. The adoption of the RAG 2006 was indeed mainly intended to cope with the challenges relating to the enlargement of the EU to include countries characterised by a long-lasting history of planned economies, and therefore limited market experience. It was expected that the Commission's workload in the State aid field increase substantially in the first years after enlargement. In order to remedy this situation, the Member States and the Commission

[35] Guidelines on national regional aid for 2007-2013 (text with EEA relevance, OJ C 54 of 4 March 2006, p. 13-44).

[36] What is less clear, however, is why the Commission used wording that can give rise to uncertainties in § 68 of the 2006 Guidelines rather than simply refer to reportable projects or use the same wording as in § of the same text (i.e., projects with aid exceeding the maximum amount that an investment with eligible expenditures of EUR 100 million could receive).

have agreed, for the first time, from a procedural point of view, to exempt not only individual aids, but also transparent aid schemes meeting the conditions of the Guidelines, from the notification obligation. However, since this implies a derogation from the rule laid down under Article 88(3)EC, it requires the adoption of a Commission Regulation implementing Council Regulation No. 994/1998 and is therefore not included in the Guidelines. Exemption from the notification obligation for transparent regional aid schemes meeting the requirements of the Guidelines has therefore been provided for in Regulation No. 1628/2006[37]. This Regulation was later abrogated when the same provision was included in the General Block Exemption Regulation («GBER»)[38].

When the Commission approves the regional aid map submitted by the MS (detailing the areas eligible for regional aid as well as the related aid intensities), the map becomes part of the guidelines, and acquires binding force. The regional aid map also defines the scope of application of the notification derogation laid down by the GBER. In this respect as well, the developments that have come forward in the last years ideally close up the process started in 1998 with the adoption, almost simultaneously with the reform of regional aid, of Council Regulation No. 994/1998, empowering the Commission to adopt block exemption regulations in the field of State aid.

Furthermore, the enlargement of the EU to include less developed countries inevitably implied a huge increase of the overall population of assisted areas within the EU. The population coverage of assisted areas would climb to 52.2% of the EU-25 population and this figure would rise even more at the EU-27 level. At the same time, since the new Member States were characterised by significantly lower GDP rates than the EU-15, most regions falling within the scope of application of Article 87(3)(a) before the enlargement would have lost this status. The reason for this is that they would have suddenly achieved a GDP rate higher than 75% of the EU average. The Commission had to mediate between the conflicting interest of (i) the new Member States, (ii) the old Member States that had traditionally benefited from assistance under Article 87(3)(a) or article 87(3)(c) and (iii) the so-called "cohesion countries", in particular Spain and Greece, which lobbied to defend the generous treatment obtained six years earlier[39]. The Commission eventually took the firm position that both the global population coverage ceiling and the limit of 75% of the Community average in terms of GDP per capita rates (measured in PPS- purchasing power standard) needed to be maintained. It therefore decided to set the overall population coverage ceiling at 42% of the EU-25, with a view to allowing a sufficient degree of flexibility for the accession of Bulgaria and Romania, the entire territory of which is eligible for regional aid. In the EU-27 the global ceiling would rise to 45.5% but would still remain well below 50%. Finally, in order to temporarily limit the negative impact of the enlargement on the old Member States, the Commission allowed a so-called "safety net" to ensure that no Member State loose more that 50% of the population previously covered by

[37] OJ L 302 of 24 October 2006, p. 29.

[38] See Article 44, paragraph 2, Transitional Provisions.

[39] See in this respect J. Battista, *Latest Development in Regional and Horizontal State Aid*, EStAL 3/2005.

regional assistance under the RAG 1998. This brings to a total population coverage of about 46.6% on an EU-27 basis[40].

Beyond these novelties, the other pillars of the 2006 reform are:

(i) the split of the single aid ceilings for the Article 87(3)(a) regions into three differentiated categories depending on the gap between the region's GDP per capita and the EU-25 average (less than 45% of the EU average; between 45.1 and 60% of the EU average; between 60.1 and 75% of the EU average);

(ii) the designation of three separate categories of areas eligible for assistance under Article 87(3)(a): the economically underdeveloped regions, the outermost regions and the statistical effect regions. The new category of "statistical effect" regions is intended to grant phasing out arrangements (up to 31 December 2010) to those disadvantaged regions that do not meet the 75% requirement due to the statistical effect of enlargement (at EU-25 level) but would still have a GDP per capita below 75% of the EU-15 average. With this measure, the Commission intends to smooth the transition to the new regional aid policy post enlargement for those regions that previously qualified for assistance under Article 87(3)(a);

(iii) the global percentage of population coverage that can be allocated among Member States is obtained by deducting the automatic allocation for Article 87(3)(a) regions from the overall population coverage ceiling (set up at 42% for the period 2007-2013, as previously indicated), the equally automatic allocation for statistical effect regions, the allocation for former Article 87(3)(a) regions and finally the allocation for low population density regions. The balance is available for distribution among MS under Article 87(3)(c) using the same allocation key as in the 1998 guidelines (i.e., a key that takes into consideration the degree of regional disparity both within and between Member States, and therefore weighs the region's gap in terms of GDP per capita both in a national and in a EU context. The better the region's position when compared with the EU average, the higher the gap must be in the national context[41];

(iv) as far as Article 87(3)(c) is concerned, the two-step process introduced in 1998 is retained (first, determination by the Commission of the maximum population coverage for each Member State and, second, the selection of eligible regions by the Member States on the basis of a well-defined regional policy). However, the Commission is now stricter in

[40] 1.1% in indeed the share of Community population of the assisted areas falling within the "safety net rule".

[41] For instance, for NL, a given area should have a GDP per capita below 77.2 and/or an unemployment rate above 150 of the national average to become eligible under Article 87(3)(c). For Greece, to the contrary, a region becomes eligible if the following thresholds are met: below 99.5 as GDP per capita and/or above 109 for the unemployment rate). See Annex V of the 2006 Guidelines.

the control of the selection of regions operated by each Member State. As a matter of fact, the selected regions should, in principle, be chosen from a pre-defined list of regions deemed eligible for selection that includes, amongst others: the so called "economic development regions", the list of which is annexed to the Guidelines; the "low population density" regions that should comply with the strict requirements indicated in the Guidelines; the "contiguous regions", i.e. regions which form contiguous zones with a population of at least 100,000 people, and which are located within NUT-II or NUT-III areas with either a GDP per capita below 75% of the Community average, or an unemployment rate higher than 115% of the national average; regions characterised by geographical isolation, etc.. However, as previously mentioned a safety net is applied to ensure that no Member State loses more than 50% of the coverage of its population under the 1998 Guidelines as a consequence of the enlargement.

Other less weighty, yet significant innovations concern:

- the amendment of the notion of "single investment project" (economic indivisibility is now assessed independently from ownership of the beneficiaries) on the basis of technical, functional and strategic links, and the geographic proximity between different production units;
- the stricter definition of "initial investment project", excluding most of the replacement investment;
- the provision of specific, yet merely procedural, requirements to ensure that regional aid produces a real incentive effect;
- the introduction of a separate category of eligible areas (additional localised eligible areas[42]), intended to include both deprived urban areas as defined in the old specific framework[43] withdrawn by the Commission in 2002[44] and other urban areas with particular local difficulties;
- the measurement of aid intensity on the basis of "gross grant equivalent" (GGE) rather than "net grant equivalent" (NGE) as in the past (this implies that differences in national taxation rates and accounting methodologies can no longer be taken into account when assessing the effects of State aid on trade and competition)[45]; and,
- the addition of a new typology of aid for newly created enterprises, providing incentives to support start-up businesses and the early stage development of small enterprises in the assisted areas.

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[42] Cfr. Section 3.4.2 § 32 of the RAG 2007.

[43] Guidelines on State aid for undertakings in deprived urban areas (OJ C 146 of 14 May 1997, p. 6-12).

[44] Commission notice on the expiry of the guidelines on State aid for undertaking in deprived urban areas (OJ C 119 of 22 May 2002, p. 21).

[45] As explained by J. Battista, *Latest Development in Regional and Horizontal State Aid*, EStAL 3/2005, this change was determined by both simplification purposes and the Alzetta judgment (Judgment of the CFI of 15 June 2000, Joined Cases T-298/97, T-312/97, T-315/97, from T-600/97 to T-607/97, T-1/98, from T-3/98 to T-6/98 and T-23/98, *Alzetta Mauro & others v. Commission*, [2000] ECR II-2379, § 89), whereby the CFI stated that taking into account different in national taxation when assessing the compatibility of a State aid would result in an indirect form of fiscal harmonisation.

As to the scope of application of the new rules, they concern all economic sectors except fisheries, coal and the production of agricultural products listed in Annex I of the Treaty, as well as a few sectors suffering from specific structural difficulties which are subject to stricter rules (i.e., steel, where regional aid are deemed not compatible with the common market, and synthetic fibres, where regional investment aid is not permitted).

D. The 2009 implementing Communication on large investment projects

The last step (so far) in the evolution of the Commission's regional aid policy is the Communication concerning the criteria for an in-depth assessment of regional aid to large investment projects published in September 2009 (the "2009 Communication")[46]. This piece of soft legislation complements the discipline set forth under the current RAG, explaining how the Commission intends to carry out the detailed assessment of those cases which fall within section 4.3.2, point 68, of the RAG. By explaining the reasoning that underlies Commission decisions on the compatibility of such aid measures that are subject to an in-depth assessment, the guidance paper increases transparency and predictability. At the same time, it helps public authorities and companies to submit better substantiated regional aid projects. The Commission engages itself, in particular, to follow a more sophisticated economic analysis, in line with the SAAP, and describes the related methodology. The methodology will be adapted, just as the kind of information required, depending on the potential distortions than may be created by the aid.

The starting point, in line again with the SAAP, is the purpose of the aid. Thus, the notifying Member State will need to substantiate both the contribution to the development of the region concerned (equity objective according to the SAAP terminology) and the eventual contribution to address market failures (efficiency objective in the SAAP terminology). Some market failures can indeed be linked to regional handicaps, such as imperfect information and lack of risk capital.

When looking at the positive effects of the aid, the Commission will consider in particular the direct and indirect jobs created (in the local supplier or sub-supplier network) but also, and this is something innovative, the upgrading in the quality of the job/skills required and the training activity foreseen, especially if this is capable of improving the employability of workers outside the firm (positive externality). Likewise, knowledge spillovers will be taken into account. This implies to consider how much technology-intensive the industry concerned is, whether co-operation with local education institutions is foreseen and whether knowledge dissemination can be expected. Finally, the coherence with operational programmes co-financed by the structural funds is considered, as usual, a positive element, along with the duration of the investment: the longer the investment, the stronger the

[46] OJ C 223 of 16 September 2009, p. 3-10.

engagement of the beneficiary in the region, even more so if possible follow-up investments are foreseen.

Next, the Commission looks at the design of the aid measure. Following the approach already tested in other pieces of legislation adopted pursuant to the SAAP[47], emphasis is given in this context to (i) the appropriateness of the aid instrument, (ii) the incentive effect, and (iii) the proportionality test.

(i) To start with, Member State are required to explain why investment aid is the appropriate tool, and is to be given preference over general measures such as infrastructure development, general education, or training initiatives and the like. This is the twofold necessity test as envisaged in the SAAP; State aid should not only be necessary in the sense that market forces alone would not permit to achieve the defined objective of common interest, it should also be a suitable tool when compared with alternative instruments. However, the fact that this factor is included in the assessment of the positive effects of the aid and is worded in a very unassertive way means that it is not construed as a binding, *sine qua non* requirement but as a positive elements amongst others. There seems to be a certain inconsistency in this respect between formal statements on the one hand and the real practice on the other. Ultimately, Member States must be able to argue that the granting of aid is an appropriate tool to remedy the underdevelopment of the assisted region but nothing more. If, for instance, they were capable also of adducing evidence in this respect, by providing an impact assessment of the aid measure when compared with other possible interventions of a general nature intended to improve the business environment of the region, this would of course strengthen their case, although it is not strictly necessary.

(ii) As to the incentive effect, the standard test provided for in the RAG 2006 (based on the chronological order of the event (i.e., the start of the actual investment must follow the commitment undertaken by the State to fund the project) is maintained but a second test, of economic nature, is added. Put in a simple way, Member States should prove that the aid contributes to changing the behaviour of the beneficiary. To this purpose, a description and assessment of the counterfactual scenario is necessary. Two possible incentive effects, and related counterfactual scenarios, can be submitted. Either the project would not be profitable without the aid, irrespective of the location (so-called "investment incentive"), or the project would not be profitable in the assisted region without the aid (so-called "location incentive"). The counterfactual scenario will therefore indicate that the expected

[47] See Community guidelines on State aid to promote risk capital investments in small and medium-sized enterprises (OJ C 194 of 18 August 2006, p. 2-22), §§ from 1.3.3. to 1.3.5; Community Framework for State aid for Research and Development and Innovation (OJ C 323 of 30 December 2006, p. 1), §§ from 1.3.3. to 1.3.5; Community guidelines on state aid for environment protection (OJ C 82 of 1 April 2008, p.1), §§ from 1.3.3. to 1.3.5; Communication from the Commission - Criteria for the compatibility analysis of training state aid cases subject to individual notification (OJ C 188 of 11 August 2009, p. 1), §§ from 2.2. to 2.4. and Communication from the Commission - Criteria for the compatibility analysis of state aid to disadvantaged and disabled workers (OJ C 188 of 11 August 2009, p. 6), §§ from 2.2. to 2.4.

cash flow generated by the project will not permit to achieve profitability without the aid (either in the selected location or at all). To this end, the Member State can refer to one of the following methodologies: the NPV (net present value), the IRR (internal rate of return) or the ROCE (return on capital employed). Clearly, in the area of "location incentive", the counterfactual scenario must be based on alternative locations having no regional handicap or less than the selected location; otherwise, this positive element will have no bearing in the final balancing test and it would be unlikely to compensate for any negative effect.

(iii) Finally, as to the proportionality of the aid, the same principles apply. First, the automatic and progressive scaling-down of the aid intensity set forth in the RAG 2006 remains a mandatory requirement (in no case the allowable aid intensity can be higher than the regional aid ceiling corrected by the scaling-down mechanism) but it is not sufficient by itself, and a detailed economic assessment is needed. Second, in this assessment the same scenarios as for the incentive effect will be considered: the aid will be deemed proportional if it allows a profitability/return on investment not exceeding the rate of return commonly observed in other projects of the company or in the industry concerned; or if it does not overcompensate the difference between the net costs to carry out the project in the assisted region and in an alternative location.

Moving now to the assessment of the negative effects of the aid, we need to distinguish between (i) the effect on competition and (ii) the effect on trade.

(i) Concerning the first, two theories of harm are considered: the creation of market power and the creation or maintenance of inefficient structures (actual or potential overcapacity in a mature or structurally declining market). The analysis of market power aims at preventing the crowding-out of private investment, which would be to the detriment of consumers. The Commission will therefore limit State aid to companies with market power much beyond the normal scaling-down of aid intensity provided for in the RAG 2006. The assessment of market power is conducted using the tools normally employed in antitrust analysis: definition of product and geographic market, calculation of market shares, degree of concentration in the market, barriers to entry (particularly relevant if the beneficiary is an incumbent operator in newly liberalised markets) and buyer countervailing power.

On the other hand, capacity increases financed by the aid can lead to a squeeze on profit margins and have very tough consequences on the recipient's rivals. This can, in turn, result in creating or maintaining inefficient market structures. In the framework of the in-depth assessment of reportable projects, the Commission evaluates the market situation (whether the market can be deemed to be in absolute/structural decline or in relative decline (growing less than the benchmark). This is necessarily a dynamic analysis. Overproduction created by the aid in structurally declining markets when the decline is expected to last in the long-term gives rise to a sort of *per-se* prohibition. Even long-term benefits for the region concerned can indeed be questioned in such a case.

The effect on competition, however, are relevant only for aid producing "investment incentive" (no investment project without the aid); in case of "location incentive", to the contrary, only the effect on trade matters in the assessment of harm according to the Communication.

(ii) In the framework of the detailed assessment, the effect on trade is construed as the risk of merely transferring social problems (mainly jobs cuts) towards existing locations within the Community. This risk exists only in case of investment aid generating a capacity increase exceeding market growth. In all the other cases, the rules contained in the RAG 2006 will in practice suffice and no need for a refined economic analysis will arise in the framework of the detailed assessment. It should therefore be kept in mind that investment aid to large, reportable projects that generate location incentive (as opposed to investment incentive) and do not result in the creation of additional production capacity in excess of market growth will deserve approval by the Commission without any further limitation (despite being subject to the detailed assessment), if the aid is compliant with the rules in the RAG 2006.

Once positive and negative effects have been considered, the Commission carries out its balancing exercise. It claims to enjoy wide discretionary power in this respect, as made clear in the 2009 Communication. It emphasised that it does not intend to use the various criteria mechanically, but rather to proceed to an overall assessment of their relative importance on a case by case basis. The Communication is silent, however, on the impact that the balancing test may have, if any, on the determination of the maximum allowable aid intensity. The doubt arises because the proportionality test is mentioned only as one of the factors to be considered in the assessment of the positive effects of the aid[48]. In any event, it is at least clear that the poorer the assisted region, the stronger the benefit for the EU citizens must be on account of the fundamental goal of improving social and economic cohesion within the Community.

III. Comments on the various steps of the regional aid reform along the last ten years as far as large investment projects are concerned

A. Weaknesses of the 1998 system

When the modernisation process started in 1998, the Commission's first attempt was to limit its ex-ante review to the nation-wide regional aid schemes and to set in place

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[48] One of the stakeholders that participated in the public consultation, White & Case LLP, raised this issue explicitly, suggesting that "the amount and intensity of the aid is determined in the first stage and cannot be an element of the balancing exercise. The Guidance should make clear that the positive and negative effects of the balancing exercise should not have any impact on the aid amount". See "*Response to Commission consultation on Guidance on the in-depth assessment of regional aid to large investment projects*", 27 of February 2009, available at http://ec.europa.eu/competition/consultations/2009_investment_projects/whitecase_en.pdf. , point 10.

automatic, but still qualitative screening criteria for all large individual aids. The reason for this was to adjust the maximum aid ceiling on the basis of each project's potential harm to competition and trade. That initial attempt failed because it was impossible, or at least very difficult to reconcile a qualitative approach with the automatism that the Commission was seeking to introduce. As the Commission prepared to face the challenge of European enlargement, this automatised approach to the application of rules was considered a priority at the time. The means for this was to promote subsidiarity at control level (private enforcement alongside public enforcement) while maintaining the Commission's exclusive power to assess the compatibility of aids. Very soon, however, the Commission's enforcement practice strengthened the opinion of those who feared that this approach was indeed too complex and could result in inconsistent and even contradictory applications. Excessive automation, in particular, produced several drawbacks.

Practitioners witnessed several problems caused by this system, essentially due to the illogical combination of the second and the third adjustments factors. Besides the more general criticism that was often raised against the combination of these factors (i.e. the number of direct jobs created or safeguarded was counted twice), inconsistencies could arise in practice depending on how the two criteria were used. Take for instance two identical investment projects in the same location: for project A the Member State declares a lower number of direct jobs and a higher number of indirect jobs created than for project B, the total of new jobs being the same for both projects, as are the total expenditures and the eligible expenses. If the projects are capital intensive and the lower adjustment coefficient is applied to both of them under criterion 2, the proportion of direct jobs against indirect jobs created can mean project B, with a lower number of direct jobs, obtains an aid intensity higher than project A due to the application of a higher coefficient under criterion 3. This is clearly meaningless. In addition, this may encourage Member States and beneficiaries to distort the qualification of the new jobs as direct or indirect in order to benefit from higher aid intensity.

Many other examples of the same nature could be put forward. In general, once the Member States had secured the application of the 0.9 coefficient under the second adjustment factor, they had an interest in presenting all the remaining jobs created as indirect. Furthermore, an investment that generated many direct jobs was favoured in the application of the second factor but probably penalised in the application of the third, since the fraction denominator (direct jobs) was high. On the other hand, an investment that created or safeguarded a small number of jobs was penalised in the application of the second factor, but likely to be favoured in the application of the third because the fraction denominator was small, and also because investments of this kind are likely to outsource extensively.

Similarly, the first criterion could leave room for manoeuvre by the notifying Member State or the beneficiary. Alleging the inexistence of reliable data on structural overcapacity could lead the Commission to apply a higher coefficient (0.75 instead of 0.25 or 0.50 depending on the beneficiary's market power). In practice, the notifying Member State had an interest in providing data on capacity only if it could claim that coefficient 1 was warranted. Moreover, the ECJ has openly criticised the unclear wording of the MSF 1998 (as regards the first assessment criterion) in the Kronofrance judgment[49]. According to the Court, a certain ambiguity existed in the text of the MSF 1998, as correctly pointed out by the CFI[50]. This ambiguity concerned in particular the application of the adjustment coefficient related to the first assessment criterion. Based on a teleological interpretation in conformity with the principles embodied in Articles 87 and 88 EC, the Commission examined whether the market at stake was declining whenever the data available did not permit excluding the existence of structural overcapacity. In any event the Commission could authorise the application of a coefficient of 1 only when it was able to evaluate the existence of structural overcapacity and come to the conclusion that the market neither presented structural overcapacity nor was declining[51].

In the few cases in which the MSF 1998 was applied[52], it often resulted in controversy between the Commission and the Member State concerned. The recent CFI judgment in the *Kronoply* case[53] provides an almost humorous illustration of this. The case started in 2000 with the notification by Germany of an aid to be granted by the Brandenburg Investitionsbank to Kronoply and was first settled by the Commission in July 2001 with a decision not to raise objections. However, the adoption of such a positive decision was possible because Germany had withdrawn its initial request in terms of aid intensity, which was based on the use of the highest coefficient (i.e. 1) of the first adjustment criterion, related to the competitive conditions in the relevant market. When the Commission objected that a lower coefficient should be applied (i.e. 0.75) due to the creation of new production capacity in a declining market, Germany revised its notification accordingly, probably to speed up the process and be allowed to grant the aid without delay. However, six months later, it asked the Commission to modify its decision and authorise it to grant an additional aid, up to the maximum aid intensity[54]. The

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[49] See above, footnote 28.

[50] See § 89 of the judgment.

[51] Based on this interpretation, coefficient 1 would apply when the Commission finds that the market is not declining nor is characterised by structural overcapacity; coefficient 0.75 would apply when the Commission is unable to check the existence of overcapacity due to the lack of data but can ascertain that the market is not declining; coefficient 0.50 would apply when there is either structural overcapacity or the market is declining and the aid can lead to the strengthening of market power; and coefficient 0.25 would apply when there is either overcapacity, or the market is declining and no market power issue arises.

[52] The Commission adopted only thirty decisions in the period 1998-2002 on the basis of the 1998 Framework, mainly because the Member States were reluctant to refer to the Framework in their notification.

[53] Judgment of the Court of First Instance of 14 January 2009, Case T-162/06, *Kronoply Gmbh & Co. v. Commission*, not yet published.

[54] One question that can logically be raised in this respect is why the State decided to wait more than six months before applying for supplementary aid for the same project and what had happened in the meantime. We guess that a possible answer to this question can be found in a very similar case that was being decided by the CFI in that period. We refer to the *Nuove Industrie Molisane* case (judgment of the CFI of 30 January 2002, Case T-212/00, [2002] ECR II-347), concerning the request for annulment of a Commission decision that authorised aid to a large investment project in Southern Italy. The beneficiary of this aid had challenged the Commission decision before the CFI seeking a partial annulment of the same, solely in so far as the Commission had used the adjustment coefficient 0.75 instead of 1 when applying the first criterion (competition factor) of the MSF 1998. The CFI declared the application inadmissible due to lack of interest because the Commission had declared the aid notified

Commission dismissed this request with a simple letter, so Germany first challenged the Commission's (informal) decision before the CFI and then, when the application was rejected as inadmissible, notified the Commission of a supplementary aid project for the same company and the same investment project previously approved by the Commission. When the Commission inevitably refused to authorise the new aid as it did not comply with both the necessity test and the incentive effect test[55], Germany took the Commission before the CFI again. After two and half years of judicial proceedings, the case was decided in January of this year in the first instance, but an appeal to the ECJ is still pending. The CFI dismissed the application by stating that the Commission was right in considering that the notified project failed to comply with the principle of necessity (which, interestingly, must be appraised, according to the CFI, not merely on the basis of the procedural or chronological requirement as for the incentive effect, but on the basis of the actual economic condition of the execution of the project).

In a previous case (*Nuove Industrie Molisane*)[56], the Italian government faced a similar situation, having likewise accepted a lower coefficient in order to obtain the swift authorisation by the Commission and avoid the opening of an Article 88(2) procedure. Italy unsuccessfully challenged the positive decision in an attempt to secure a higher aid intensity for the project; the CFI declared the action inadmissible due to lack of interest, as the Italian government had voluntarily amended the notification. Indeed, the decision did not contain any condition or limitation with respect to the aid project as notified.

From a procedural point of view, one can maintain that neither the applicant in *Nuove Industrie Molisane* nor the German government in *Kronoply* chose the right option. A Member State wishing to defend its views on the application of the adjustment coefficients set out in the regional aid framework should challenge the Commission to open an Article 88(2) procedure and eventually adopt a conditioned or partially negative decision. As for the aid beneficiary, if the State has accepted to downsize the notified aid project, it should claim that the Commission has pressed the Member State to amend the original notification rather than opening a formal investigation procedure, as it would be obliged to do whenever it has serious doubts on the compatibility of the notified aid, including with respect to the calculation of the aid intensity. Yet, the cases reveal very clearly the Member States' need to obtain a green light quickly on individual regional aid granted on the basis of an approved aid scheme, and their unwillingness

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to it compatible with the common market, as the maximum aid intensity allowable to the project according to the Commission was equal to, or in excess of, the amount of the aid notified by the Italian State. According to the CFI, although the Italian authorities had amended the original notification during the preliminary phase of the investigation in order to reduce the amount of aid initially proposed, the annulment of the decision with respect to the grounds related to the adjustment coefficient would not have resulted by itself in the payment of aid at a higher level. An increase in the amount of the aid "would assume, first, that the Italian authorities had decided to propose new aid and to submit a new notification and, second, that the Commission had then declared the new aid project compatible with the common market". The annulment of the decision would not therefore provide any guarantee that the Italian authorities would pay the applicant any additional amounts. Probably aware of the judgment handed down by the CFI in the *Nuove Industrie Molisane* case, Germany opted for filing a new notification for supplementary aid for the same project.

[55] The Commission argued that the aid was by then unrelated to any new investment and therefore classified it as operating aid, providing no sort of "contrepartie" by the beneficiary and therefore no contribution to the common interest.

[56] See above, footnote 50.

to enter into lengthy discussions on the application of sophisticated assessment criteria.

The *Solar Tech* case[57] offers another perspective of the same problem. The Commission seemed to take in this case a more flexible approach to the application of the competition factor (first assessment criterion), as it applied a coefficient 1 even though insufficient data were available both on the capacity utilisation rate and on the apparent consumption. Nevertheless, the Commission based its decision to apply the maximum adjustment coefficient on the finding that the sector in question appeared to be enjoying rapid growth and there were no fears of structural overcapacity, as well as on its desire to encourage the production of solar energy products, which is in line with its policy to combat climate change[58]. The Commission therefore followed a less formalistic approach than usual, probably also because in the same decision it relied on economic considerations to qualify the beneficiary as a large firm[59]. Despite the fact that the Solar Tech's shareholders who were classified as large firms held only 24% of its shares (and therefore, below the 25% threshold), the Commission stated that purely formal compliance with the Community rules did not constitute sufficient justification for allowing the bonus for SMEs, given that the beneficiary would not suffer from the typical handicaps of this category of enterprises, particularly in the capital market. This may have led the Commission to refrain from taking a purely formalistic and automatic approach in the application of the 1998 Framework. However, the Solar Tech decision has remained a one-off case.

Globally speaking, we can safely assert that the 1998 reform was very well conceived and broadly successful; however, the Commission presumed too much of its own ability when setting out the adjustment mechanism for large investment projects. This was an over ambitious attempt that quickly failed when confronted with real facts. The administrative burden related to the application of this mechanism was simply too high and discouraged both the Member States from referring to the Framework and the Commission from applying it. This explains why the Commission initiated consultation with the Member States on the modification of the multisectoral framework shortly after the entry into force of the reform and this was the only element of the reform that was already reviewed in 2002.

B. The 2002 MSF: did it permit the achievement of the goals proclaimed by the Commission?

The Commission opted at that time for a confirmation of its priority to attain a fully automatic application of the adjustment mechanism and so abandoned its qualitative

[57] Commission Decision 2001/779/EC, *Solar Tech* (OJ L 292 of 9 November 2001, p. 45).

[58] § 54 of the Decision, *supra*, footnote 53.

[59] §§ 36 and 44 of the Decision, *supra*, footnote 53.

screening criteria; it therefore significantly simplified the adjustment mechanism, reducing it to a mere proportional decrease of aid intensities for large investment projects (reduction matrix). The only sophistication in the new system was the addition of two equally quantitative criteria intended to measure the importance of the harm that the aid could generate for competition, due not to its size but to specific market situations (market power of the beneficiary and overcapacity in an underperforming market).

The 2002 mini-reform, however, failed to encourage Member States to notify large investment projects when they really believed, following a serious economic analysis, that these projects deserved high awards. Since the introduction of the 2002 Framework up to the entry into force of the RAG 2006, only a handful of projects were notified to the Commission. The mere fact that the burden of proof in the case of a notification lay with the Member State, and that substantiating the need of high aid intensities could prove really difficult led to a "significant clustering of award values at or just below the level beyond which notification is required"[60]. The 2002 Framework also led to very stereotypical decisions, the most apparent characteristic of which was the incomplete and inadequate quality of the analysis. In practice, the Commission could only check that the notion of "single investment project" (see § 49 of the MSF 2002) be correctly applied, (i.e. the calculation of aid intensities was not based on an artificial partitioning of the investment project to escape the application of the intensities' reduction mechanism) and that the notified aid did not fall within one of the two categories that were prohibited per se under § 24(a) and (b) of the MSF 2002. This indeed implied the need to arrive at a careful definition of the relevant product and geographic market but beyond that, no detailed analysis was required.

The analysis of decisions adopted on the legal basis of the MSF 2002 confirms the impression of a review method that certainly complied with the objective of simplification[61] but at the expense of quality: the analysis of the substantial effects of the aid remained superficial.

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[60] See F. G. Wishlade, ibidem, footnote 23. The author also informs us that since the MSF 2002 was introduced until July 2007 a total of only 14 aid projects were notified and 102 were reported to the Commission ex-post under the transparency mechanism.

[61] One data is of particular significance in this respect, namely the absence of any decision of the Community jurisdictions concerning the MSF 2002. Only one case has been brought before the European judges concerning the MSF 2002, which is still pending before the CFI at the present time. The action was brought by BP Aromatics, seeking the annulment of Commission Decision C(2007) 3202 of 10 July 2007 by which the Commission found State aid notified by the Portuguese authorities in favour of Artensa to be compatible with the common market under Article 87 (3)(a) EC. In support of its application, the applicant alleges that the Commission misconstrued and misapplied the MSF 2002, which requires an analysis based on the EEA market and not on a worldwide market, and therefore committed a manifest error of assessment in concluding that the relevant share of sales of Artensa would be below 25% when in fact it would exceed 25% on an EEA-wide basis.

Decisions adopted after the enactment of the 2006 Guidelines but before their entry into force followed the same path[62]. For example, when the Hungarian authorities, in December 2006 (before the entry into force of the new RAG) awarded aid to finance the construction of a new electricity production unit based on lignite in the Heves region[63], the Commission first verified whether a previous project concerning the establishment of gas turbines, carried out by the same beneficiary in the same location just before (started in 2004 and completed in 2007), was not to be viewed as the first stage of a wide-ranging investment project that the beneficiary aimed to complete with the new aid. The Commission investigated into possible links between the two investment projects from a threefold perspective: technological links, physical links and functionality/operational links. The Commission therefore looked at whether one project was legally or economically dependent on the implementation of the other. Having found that the two investments relied on totally different technologies, were not linked physically or functionally, and neither production unit was dependent on the implementation of the other, the Commission concluded that the two projects could be objectively considered as economically distinct under § 49 of the MSF 2002. Furthermore, the Commission reviewed the compatibility of the investment aid with § 24(a) and (b) of the MSF 2002. While the condition of § 24(b) of the Framework was clearly complied with, the risk of exceeding the threshold under § 24(a) could not be underestimated, as the beneficiary was an incumbent company, previously owned by the State and privatised in 1995, when the majority of its shares were acquired by the RWE Group. The Commission found that the recipient's market share was far below 25% even considering the traditional nation-wide geographic market (despite the Commission's efforts to integrate the different territorial markets in the EU). This applied to both the entire electricity generation/wholesale market and to the free electricity generation/wholesale market. Therefore, the threshold set under § 24(a) of the MSF 2002 would not be exceeded even under the worst case scenario and on the basis of the strictest possible market definition. The Commission was therefore satisfied that the aid fully complied with the MSF 2002. However, the real effects of the aid on competitors and competition dynamics were left unexplored. Whether the project would lead to a strengthening of the beneficiary's market power, or of the RWE Group as a whole was not something that the Commission could examine under the applicable rules of the MSF 2002 notwithstanding the size of the project.

Likewise, in another Hungarian case, concerning an aid to Ibiden Hungary for the construction of a new manufacturing plant for the production of ceramic substrates for

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[62] In the 2006 Guidelines the Commission explained that it intended to apply the new rules to all regional aid to be granted after 31 December 2006, while regional aid awarded or to be granted before 2007 would be assessed in accordance with the 1998 guidelines on national regional aid. Therefore, the RAG 1998 continued to apply to aid awarded under national law before 31 December 2006 although approved by the Commission and granted in 2007. In addition, the Commission clarified that the MS could not proceed to notify regional aid schemes or *ad hoc* aids to be granted after 31 December 2006 until the MS concerned had adopted the regional aid map. This implies that the Commission would continue to examine notified individual aid granted on the basis of old aid schemes in accordance with the RAG 1998 and the MSF 2002.

[63] Commission Decision of 10 July 2007 in case N 907/2006, *Aid to Matrai Erõmũ Zrt* (OJ C 227 of 27 September 2007, p. 3).

diesel engine particulate filters[64], the Commission focused on the notion of a single investment project on the one hand, and the market definition on the other. This time it concluded that, when calculating the aid intensity allowable for the project, a previous aid for investment in the same location ought to be taken into consideration. Works for the old and the new projects had commenced within a period of three years and, in addition, they both concerned the same location and the same production unit. Therefore, they were to be considered as a single investment project in accordance to § 49 of the MSF 2002. As to the market definition, the Commission decided on this occasion to initiate a formal investigation procedure to clarify some doubtful aspects of the product market definition, in particular whether diesel particulate filters and diesel oxidation catalysts were to be considered as substitutable products; had this not been the case, the market share threshold of § 24(a) of the MSF 2002 would have been exceeded. It must be emphasised that the Commission justified the opening of the formal investigation procedure pursuant to Article 88(2) EC alleging the need to carry out a thorough analysis of the measure and determine whether the aid was compatible with the common market[65]; in fact, however, the doubts concerned only the appropriate product market definition and, by consequence, compliant with § 24(a) of the MSF 2002[66]. The real effects of the aid on competitors and competition dynamics were therefore left unexplored also in this case, as the Commission did not have the power to exercise any discretion in the compatibility assessment, in spite of the relevant size of the project.

The common denominator of the two Hungarian cases discussed above was the positive conclusion of the Commission's in-depth investigation, which allowed it to close the proceedings rather swiftly by stating that all the relevant provisions of the RAG 1998 and the MSF 2002, including § 24 (a) and (b) of the latter, had been complied with. However, one case from the same period (at the time or after the enactment of the 2006 Guidelines but before their entry into force) can be used to illustrate the Commission's willingness to escape the strict constraints imposed on it by the irrefutable presumption set out under § 24 of the MSF 2002. This provision, as we have seen before, leaves the Commission with no margin of discretion whatsoever in the appraisal of the economic effects of the aid and, consequently, in the assessment of compatibility with the common market. We refer here to the *Getrag Ford Slovakia* case[67], where a rigorous application of § 24 (b) of the MSF 2002 would have led, unlike in the cases previously discussed, to a declaration of incompatibility of the aid. The formal investigation had indeed resulted in a confirmation of the doubts raised in the decision to initiate the procedure with respect to both the capacity increase generated by the project and the underperformance of the relevant market when compared with the average growth of the European economy.

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[64] Commission Decision of 30 April 2008 in case C 21/2007, *Aid to Ibiden Hungary Gyarto Kft* (OJ L 295 of 4 November 2008, p. 34).

[65] See § 91 of the Decision, *supra*, footnote 60.

[66] See § 87 of the Decision, *supra*, footnote 60.

[67] Decision of February 2006 in case N 158/2005 , *Aid to Getrag Ford Slovakia* (OJ C 236 of 30 September 2006, p. 33).

The case involved a relocation of existing production activities from Germany to Slovakia. If the new production capacity created in Slovakia were considered separately from the shut down of existing installations in Germany and the consequent decrease in capacity in this country, the project would show an increase of capacity beyond the threshold set out under § 24(b) of the MSF 2002[68]. In order to declare the project compatible with the common market, the Commission stretched the interpretation of the concept of additional production capacity and considered the capacity increase of the beneficiary at the level of the group that it belonged to. It therefore accepted to deduct the capacity of the existing site in Germany where production would be discontinued once the project was completed. The Commission justified this approach on the following grounds: (i) where large corporate groups are restructuring their operations, in particular by transferring production from one site to another, and by redeploying the resources freed up at the former site for other purposes, it appears unrealistic to artificially subdivide this activity into a series of different projects; (ii) taking into account the capacity of the Group to which the aid beneficiary belongs is consistent with the concern that lies at the basis of the relevant provisions, i.e. to prevent Member States from funding investment projects likely to cause serious distortions of competition for the production capacity increases that they generate without a corresponding increase in demand. In this respect, the MSF 2002 seemed to have maintained the approach taken in the 1998 Framework, according to which "for the purpose of determining whether the investment will result in a capacity expansion, the relevant capacity is the total viable capacity of the beneficiary (and/or if appropriate, the group to which it belongs)". This approach of looking at the capacity of the aid beneficiary as a whole was also followed in other fields of State aid control, where capacity considerations were relevant, such as aid for rescue and restructuring. For these reasons, the Commission considered that the interpretation proposed by the Slovak authorities, according to which the investment in Slovakia did not lead to a capacity increase for motorcycle transmissions within the meaning of point 24(b) of the MSF, appeared correct.

This case exemplifies the shortcomings of the entirely automatic review system set out under the MSF 2002. Unsurprisingly, the Commission was concerned itself of the value that this case could acquire as a leading precedent and seemed to consider it as absolutely exceptional. It may be said that the Commission dared to adopt this approach only because the modification of the relevant rules was underway within the framework of the new regional aid guidelines, which were published by the Commission just one month later. Under the new rules, the Commission would acquire wider discretion when reviewing in detail cases falling within the categories of § 24 of the MSF 2002.

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[68] More precisely, with respect to motorcycle transmissions (one of the two relevant markets involved, the other being the automotive transmissions market), the Commission noted that if the new production capacity created at Slovakia was to be considered separately from the transfer of capacity in Neuenstein (Germany) to other uses, the project would, on the basis of the data submitted, result in an increase of capacity of [5-10%] in both volume and value terms for the Triad group in Europe. Furthermore, since according to the Slovak authorities, reliable historical data on the evolution of the market in large motorcycles was not available, it was not possible for the Commission to verify that growth in this market was above the average annual growth rate of GDP in the EEA.

Besides, a principle that is worth recalling in this connection is the uniformity of the benchmark to take as a reference when measuring the economic effects of regional aid on the market. If a company relocates a plant to an assisted region, the investment is indeed to be deemed as a new initial investment for that region but can also be qualified as a replacement investment if one looks at a group level. Similarly, a company can create jobs in a new location by transferring in total or in part employees from existing locations. Therefore, if the Commission refers to the beneficiary in the assisted region when measuring the increase in capacity, the same geographic criterion should apply when assessing job creation, the categorisation of the investment as an initial investment or replacement investment, etc. Conversely, if the Commission takes into account the capacity at a group level, the same should be valid for the other aspects of the assessment. The implications of this choice are obviously not trivial and on this issue appropriate clarification was expected after the *Getrag Ford Slovakia* case.

C. Impact of the 2006 Guidelines before the 2009 Communication

Apparently the second milestone in the reform of regional aid in 2006 did not immediately imply the radical changes that one might have expected in the field of large investment projects. The standard decisions (i.e., without in-depth assessment), that have been adopted since then, have continued to examine with some detail only the notion of "single investment project", the market power of the beneficiary, and the existence of excess capacity in underperforming markets. Nevertheless, the analysis of these last two issues has now different legal consequences, as it does not lead to the application of an absolute ban, but only to a decision on the opening of an investigation procedure and the carrying out of a detailed economic assessment. This trend in the Commission's practice on large investment projects has persisted up until recent times.

A review of some of the decisions adopted in 2009 prior to the release of the 2009 Communication shows that the type of assessment carried out by the Commission remains rather stereotypical. Albeit extended to the control of the incentive effect pursuant to the procedural criteria laid down in the 2006 Guidelines, the focus remains on compliance with the concept of single investment project, as well as on the calculation of market share and additional production capacity. The analysis of the incentive effect of large, reportable projects does not differ from that required for all the individual aids exempted from notification. No investigation is dedicated to the concrete effects on rivals, and the overall economic assessment remains relatively superficial and formalistic.

Two decisions concerning Italy can help to illustrate this. The first relates to a Fiat investment project in Termini Imerese (Sicily) for a production unit for the manufacture of a new model of Lancia Ypsilon (a car belonging to the low-end segment)[69]. The Commission first ascertained that the notified project ought not to be considered together with previous aided investment projects in the same location by the same beneficiary or other companies of the same Group (the concept of single investment project according to § 60 of the 2006 Guidelines[70]); it concluded that this was not the case, in spite of the functionality links between the old and the new projects, because more than three years had lapsed between the start of expenditures for the old and the new project. Furthermore, the Commission examined in depth the conformity with § 68(a) and (b) of the Guidelines (former § 24(a) and (b) of the MSF 2002). With respect in particular to § 68(b), the Commission, before even calculating the capacity increase, verified whether the investment was taking place in an underperforming market (i.e., a market characterised by a growth rate in terms of apparent consumption below the average growth rate of GDP in the EEA in the previous five years). Having found that this condition was met, the Commission analysed the second condition of § 68(b), i.e. the capacity increase generated by the project. After verifying that the capacity increase remained below 5% irrespective of the product market definition retained, the Commission authorised the granting of the aid. The assessment of the incentive effect remained rather superficial and based only: (i) on the chronological order of the events (the works did not start before the national decision to grant the aid), (ii)the beneficiary's financial contribution (at least 25% of the eligible costs) as required by the RAG 2006 (at §§ 38 and 39 respectively) for all investment projects irrespective of their size. Nothing is mentioned about any possible harm to rivals.

The second case concerned an aid to the Italian tyre maker Pirelli for an investment project to enlarge and improve an already existing production unit located in the Piedmont Region, in order to diversify its production and make it a specialised plant for innovative high-tech products (super-tyres for luxury cars)[71]. The Commission's assessment correctly focused on the contribution of the project to regional development - particularly in terms of employment and the re-qualification of manpower - and acknowledged its link with some R&D activities that were planned by Pirelli within the same plant with a view to transforming it into a centre of technological excellence. However, the Commission then carried out a simplified and formal verification of the incentive effect and, although not entirely silent on the possible harm to rivals, simply stated that the rather low aid intensity permitted it to consider that the aid would not affect competitive projects. The Commission also considered that the intensity of the aid was lower than the regional aid ceiling foreseen in § 67 of the Framework, and that there would be no cumulation with other aids granted by regional authorities for the same admissible costs. Surprisingly, the Commission did not

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[69] Decision of 29 April 2009 in case N 635/2008, *Aid to Fiat Sicilia* (OJ C 219 of 12 September 2009, p. 3).

[70] The 2006 Guidelines are innovative only in a very minor point on this issue with respect to the MSF 2002. Point 60 of the Guidelines refers to technical, functional and strategic links between the old and the new project, alongside the geographical proximity, as evidence of an economically unitary project. Strategic links were not mentioned in the MSF 2002 but the change is more an interpretation and clarification of the previous wording than a substantial modification of the Commission's approach.

[71] Decision of 29 May 2009 in case N 381/2008, *Aid to Pirelli Industrie Pneumatici S.r.l.* (OJ C 284 of 25 November 2009, p. 11).

even mention in its motivation that the thresholds under §§ 68 (a) and (b) of the RAG 2006 had not been exceeded.

Another decision, concerning the Slovakian authorities' project to grant investment aid to a firm engaged in the extraction and processing of gravel and stone can be used to illustrate the changes introduced with the 2006 Guidelines in the enforcement practice with respect to the analysis of the incentive effect[72]. The Commission refused to authorise the aid at issue on the basis that the counterfactual analysis indicated that no other location was possible for the projected investment, as the location of the site was determined by the availability of natural resources. In situations like this, the decisive factor for the assessment of the incentive effect is whether the beneficiary undertaking should proceed with the investment even in the absence of the aid; if this is so, it can be concluded that the aid would not contribute to regional development - as was the Commission's opinion in the Slovakian case. This case is, to our knowledge, the only example of a substantial and non-formalistic verification of the incentive effect for projects subject to the notification obligation but falling outside the scope of the in-depth investigation regulated by the 2009 Communication.

D. Impact of the 2006 Guidelines after the 2009 Communication

If, as we have pointed out, the entry into force of the RAG 2006 did not immediately change the review method of large investment projects to any significant extent (except, albeit modestly, for the incentive effect), it nevertheless paved the way for a later amendment to the Commission's enforcement practice. The 2009 Communication, which had been announced in the 2006 Guidelines, and was officially seen as merely a guidance or explanatory document, is in fact more than this. Its purpose is to complete the reform and improve the scrutiny of large investment projects without the necessity of waiting for a comprehensive review of the guidelines at the end of the reference period (2007-2013). Indeed, it introduced significant innovations on key points such as proof of the incentive effect, which is the cornerstone of the evolution in the scrutiny of State aid, as per the Lisbon objectives.

Certainly, at first sight, the progress of State aid policy in this field may appear eccentric. The Commission waited more than three years for what was supposed to be a mere interpretative document, theoretically due before the entry into force of the RAG 2006. Also, it ended up passing what is in fact, at least in part, a separate instrument of soft legislation (therefore in a sense stepping back from the objective of simplification that had led to integrating the MSF into the RAG). However, when one looks at the whole process

[72] Decision of 4 June 2008 in case C 57/2007, *Alas Slovakia* (OJ L 248 of 17 September 2008, p. 19).

more thoroughly, the choice made by the Commission, and the direction taken in regional aid, can be quite easily explained. The 2006 Guidelines completed a long reform process intended, among other things, to counter enlargement and the ensuing increased disparities within the EU. The Guidelines internalise the effects of the enlargement in the regulation of regional aid, and at the same time, with the GBER, release the Commission from the heavy task of reviewing all the regional aid schemes adopted at national level, as well as *ad hoc* aid projects. Now that this process has been completed, and the SAAP has in addition put forward the principle of a refined economic assessment, the conditions have been created for the Commission to resume its original role in the scrutiny of large investment projects: the qualitative and intrinsically discretionary review of these projects. Therefore, the fact that the Commission has issued a new piece of soft legislation in September 2009, after almost three years of the entry into force of the RAG 2006, should not come as a surprise: the aim is simply to take advantage of the new regime in order to complete the reform and improve the review of the economic effects of large investment projects as anticipated by the SAAP.

The 2009 Communication has not been applied sufficiently yet to be able to draw conclusive indications. To date, the Commission has only conducted one detailed assessment in accordance with § 68 of the RAG and the 2009 Communication (*Dell Poland*, C 46/2008), when the Commission eventually authorised the aid[73]. A possible second new case of detailed assessment is the *Audi Hungaria Motor* case (N 113/2009), where the preliminary assessment revealed doubts that the 25% market share threshold would be exceeded in some relevant markets[74]. The third and last case to date[75] of an Article 88(2) procedure was opened to conduct an in-depth investigation by virtue of the 2009 Communication is the *Petrogal* case (C 34/2009). This case concerns an aid project worth more than EUR 106 million for an investment by Petrogal, the Portuguese energy company controlled by the incumbent group Galp Energia, in its existing refineries located in Sines and Matosinhos, both areas eligible under Article 87(3)(a) EC[76]. The Commission's preliminary investigation failed to establish a definite delimitation of the relevant product and geographic market to be taken into account for the assessment of the aid. Having found that, should the relevant geographic market be deemed national, the market share of Petrogal would largely exceed the 25% threshold, the Commission decided to initiate the Article 88(2) procedure.

As already mentioned, the only final decision that has been adopted so far upon the

[73] Decision of 23 September 2009 in case C 46/2008, *Aid to Dell Poland*.

[74] See the press release issued on 29 October 2009, IP/09/1631.

[75] Information contained in this article has been updated until the end of November 2009.

[76] According to the Commission's press release of 19 November 2009 "Portugal intends to subsidise the modernisation and integration of the two solo refineries in Portugal, mainly aimed at increasing the production of diesel (and, as a collateral effect, of naphtha) to the detriment of fuel oil production. The aid, which classifies as *ad hoc* aid granted in the form of a tax allowance, would be used to fund an investment project worth more than EUR 1 billion.

conclusion of an in-depth assessment[77] is the *Dell Poland* case, which involved the relocation of some existing production activities (manufacturing PCs and servers) from Ireland to Poland[78]. One of the most problematic issues in the review process was the compliance with the 5% threshold in terms of capacity increase; significantly, the Polish authorities amended the initial notification in order to limit the increase in capacity allowed by the project to 5%, seeking to avoid a detailed assessment. Under this perspective, the reintroduction of a discretionary assessment seems to bring back into fashion a tactic that Member States used to employ under the MSF 1998[79]. However, the 5% increase was calculated by the Polish authorities on Dell's capacity in the EEA taken as a whole, therefore deducting from the capacity increase in Poland, the capacity reduction in Germany. The Polish authorities relied on the *Getrag Ford Slovakia* case, but the Commission referred to the capacity increase by Dell Poland in this case, and not by the beneficiary as a Group. The Commission indicated in this respect that capacity reductions at other production facilities cannot be taken into account if they do not form part of the investment project for which the aid has been notified, and are therefore not affected by the granting of the aid. This reasoning may not be entirely convincing, as no conclusive evidence existed that the decision to shut down a production plant in Ireland was totally unrelated to the possibility of obtaining aid for a new investment in Poland, but the conclusion is certainly correct. The crucial point is that the Commission should adopt a uniform criterion: as already mentioned, if the Commission considers the beneficiary's plants in the assisted region when looking at the increase in production capacity, the same benchmark/context of reference should be used for the analysis of job creation, for the qualification of the investment, etc.. Whatever the right motivation is, however, it is clear that under the new rules, stretching the interpretation of the "capacity increase" condition is no longer necessary, as no ban exists per se.

It must be emphasised here that the Commission's discretionary power is in principle limited to the balancing act[80]. The Commission carries out an assessment in two stages: first, it checks the positive and negative effects of the aid, including the assessment of, necessity, incentive effect and proportionality; second, it balances out the positive and negative effects. In the first stage of the assessment, the Commission applies strict and rigorous requirements and criteria, which should permit the screening out of those cases where either a sufficient case for authorisation cannot be established for the absence of positive effects (lack of incentive effect, limited impact on regional development, aid not being an appropriate tool or being disproportionate), or for the magnitude of potential harm

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[77] The decision was adopted just one week after the publication of the 2009 Communication, and it is very likely to have largely influenced the drafting of the Communication, as the related works were run for a certain period in parallel with the investigation procedure concerning the Dell case.

[78] The final decision is currently available at http://ec.europa.eu/competition/state_aid/register/ii/doc/C-46-2008-WLWL-en-23.09.2009.pdf

[79] Please refer to the *Nuove Industrie Molisane* and *Kronoply* cases, discussed above, footnotes 49 and 50.

[80] Although one of the commentators in the framework of the public consultation (White & Case LLP) had requested an explicit clarification of the analytical process that the Commission would adopt in its assessment, the Commission has not yet done so . The interpretation of the assessment methodology seems however reasonably clear in the sense indicated in the text, even in the absence of an explicit statement.

on competition and trade, that cannot be compensated by any positive factor.

The *Dell* case raises other interesting issues as well, which we can only briefly discuss here. They relate mainly to the burden of proof (with respect to both the incentive effect and the market definition) and to the theory of harm applied by the Commission. On the first issue (burden of proof), the Commission endorses the Polish authorities' view that the only relevant question for the verification of the incentive effect is whether the investment would have been located elsewhere had the aid not been granted. This is certainly in line with the 2009 Communication (distinction between investment incentive and location incentive), but it remains questionable whether this is the most suitable policy approach bearing in mind the Lisbon objectives (see *infra*, section IV). The Commission should at least carry out a rigorous and careful review of the location incentive; but based on the statement of reasons contained in the decision whether it did so in the *Dell* case remains uncertain[81]. Other interesting questions concern the burden of proof for purposes of the market definition, and the importance given to this issue in the decision to initiate the Article 88(2) procedure. On the first point, the decision to initiate the Article 88(2) procedure seems to reverse the burden of proof not in the balancing exercise (on this aspect the burden of proof clearly lies with the notifying Member State), but rather in the verification of the thresholds that trigger the application of the balancing test. The Commission maintains that if it is not possible to confirm beyond any reasonable doubt that the thresholds are respected, a detailed assessment must be carried out. It would be interesting to see in the case of a negative decision whether this interpretation, which seems at odds with the wording of the RAG 2006[82], is endorsed by the Courts and how heavy the burden of proof put on the Commission by Community judges is. As for the second point, it seems that the logic of the system is that the market analysis should be completed in the first phase, save for exceptional and controversial cases. It is important for the Commission to try and stick to this rule in the interest of expediency and efficiency.

Finally, with regards to the theory of harm, the Commission seems satisfied with the argument that in a case of location incentive, the question whether competitors are likely to be affected by the investment is irrelevant[83], as the investment would have likely been carried out in a different location in the absence of the aid. Whether this is a satisfactory application of the principle of refined economic analysis at an *ex ante* level (i.e., from a policy point of view) remains questionable (see *infra*, section IV).

[81] See §§ 190-192 of the Decision, *supra*, footnote 73.

[82] See § 70, according to which "The burden of proof that the situations to which paragraphs 68(a) and (b) refer do not apply, lies with the Member State".

[83] See §§ 202- 204 and 211-213 of the Decision, *supra*, footnote 73.

IV. Concluding remarks - A mature system … still to be improved

The overall impression is that, with the 2009 Communication, the Commission's thinking has now matured - this has led to maintaining the positive aspects of old legislation while keeping a firm course towards modernisation and subsidiarity. In this context, situations that can be treated as automatic bans or derogations are reduced to the minimum. For example, a significant capacity increase that takes place in a structurally declining market or location incentive, where the counterfactual scenario shows that without aid the investment would have been relocated to a poorer region, is unlikely to be compensated by any positive element. Likewise, the positive effects in terms of cohesion and efficiency of regional aid that generates an investment incentive effect, and merely compensates the difference in net costs between the assisted region and an alternative more developed location, and also fulfils the requirement of appropriateness, is likely to outweigh any negative effects in terms of competition or trade.

Beyond these situations, however, the Commission enjoys a wide degree of discretion in the assessment of reportable aid projects (note: is this a technical term?). Furthermore, some positive elements of the Commission's traditional practice before the reform can now be retrieved and revalidated; for instance, the attention paid to the risk of delocalisation of socio-economic problems from one Member State to another (see §§ 51 and 54 of the RAG 2006). The most interesting features of the approach taken at the time of the first multisectoral framework (MSF 1998) can similarly be rescued and reshaped when proceeding to a case-by-case analysis. This applies, for instance, to the evaluation of the positive impact of an aid project on a region in terms of welfare contribution beyond the mere creation of direct jobs. Focusing not only on the creation of indirect jobs, but also on the quality of the jobs and the training related to them is a new and positive development.

To sum up, the Commission seems now able to implement the ideas to reform regional aid policy that it had proposed when times were not as yet mature, because of other priorities, such as the reduction of workload due to enlargement as in the late nineties. The Commission seems to now consistently implement a refined economic approach also in the field of regional aid, at least at the level of enforcement policy and practice (i.e. definition of the assessment criteria and in-depth scrutiny of reportable aid). From this perspective, the innovations introduced with the 2009 Communication are far from negligible. Besides, it is worth remembering that, according to CIRFS case law, the Commission's communication on its policy in a given area, accepted by the Member States, has a binding effect[84]. Therefore, with the same legal force, the Communication binds the Commission just as the RAG does.

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[84] Judgment of the Court 24 March 1993, *Comité International de la Rayonne et des Fibres Synthétiques and others v. Commission*, [1993] ECR I-1125, §§ from 34 to 36.

If a criticism can be raised at this stage about the recent progress of regional aid policy, it may be the refinement of the economic analysis at a law-making or *ex ante* level. Indeed, a certain number of findings and assertions that lie at the heart of the new discipline remain largely undemonstrated. First, the emphasis put on, and the importance given to the GDP per capita as the only parameter of underdevelopment is questionable in a regional aid policy that is expected to be rather more sophisticated from an economic standpoint. For instance, it has been observed that there is no direct correlation between the above indicator and the actual handicaps that investors must overcome to locate new projects in the assisted regions[85]. Variable production costs (in particular manpower and related costs) and to a more limited extent, fixed production costs (land) can be significantly lower in a poor region, and therefore create an advantage for a location if compared with an investment in wealthier regions. With respect to large investment projects, it is clear from the outset that "the flaws in the method to set up aid values are carried over into the mechanism for reducing aid values for large investment projects"[86] given the link made between regional GDP per capita and aid intensity rates. Similarly, in the assessment of the positive effects of aid to large investment projects a satisfactory coordination with the SAAP and the Lisbon strategy's objectives should take into account other goals that can contribute to increasing total welfare in the EU beyond equity (cohesion), which is the objective of regional aid[87]. Although the Commission refers to the correction of market failure in the 2009 Communication, the weight given to this aspect remains to be seen in practice, and is in any event limited to those few, among the large projects, that fall within the scope of the detailed assessment.

It would therefore appear sound to concentrate resources on aid projects characterised by an investment incentive. It is useful to recall here that the first case of implementation of the in-depth assessment (*Dell Poland*) involved, just as the *Getrag Ford Slovakia* case, a relocation of production activities within the EU (shutting down/ reduction of production activities in one Member State and setting up of a new plant in a less developed Member State). These are politically controversial cases. Cases of this kind were extremely rare in the EU-15 (even so the Commission traditionally examined with care the risk of delocalisation of socio-economic problems from one Member State to another - e.g. for rescue and restructuring aid). These cases become frequent in the EU-27 (due to relocation to eastern European countries): should they be encouraged to foster economic and social cohesion or rather the opposite because they tend to displace economic and social

[85] See K. Junginger-Dittel, *Economic and Legal Problems of Regional Aid to Larger Investment Projects*, EStAL conference on The law and economics of European State Aid control, EStAL Institute/European School of Management and Technology, Berlin, 8-9 November 2007.

[86] See F. G. Wishlade, *ibidem*, footnote 23.

[87] Economic efficiency and the correction of market failures are already mentioned in the Communication, at § 13. The Commission also refers to innovation in the explanatory list of indicative criteria that can be used to demonstrate the regional contribution of the aid (Communication, at § 14). Other possible objectives include environment protection, health, safety and security, and consumers' benefit. See in this respect the observations submitted by France in response to the Commission consultation, *Note à la Commission Européenne - Orientations sur l'appréciation approfondie des aides régionales en faveur de grands projets d'investissements*, available at http://ec.europa.eu/competition/consultations/2009_investment_projects/fr_contribution_fr.pdf

difficulties towards another Member State? Rather than answering this question, the 2009 Communication seeks to reach a compromise in the debate on the benefits of relocating economic activities from a richer region to a poorer region within the EU[88] but remains extremely vague. This is shown by the conclusion reached in the *Dell* case that job losses in Ireland were not a direct consequence of the aid awarded to Poland, since the reasons underlying this finding are not sufficiently explained by the Commission.

We advocate for a solution whereby the Commission's aid policy leads to concentrating resources on projects characterised by an investment incentive, and only exceptionally on projects involving a location incentive. It is indeed common sense that the aid projects producing an investment incentive are particularly beneficial in light of the Lisbon objectives. As far as projects involving a location incentive are concerned, aid should be limited to <u>retention subsidies</u> when the counterfactual analysis shows that the alternative location is outside the EU (at least so long as this is compatible with international law), such as in the *Pirelli* case mentioned above[89]. <u>Location or relocation aid within the EU</u> (from one EU region to another) should be limited to those cases where economic analysis shows that it can help reduce inflationary pressures and/or congestion/environmental problems in the more prosperous regions[90]. This strict regulation in the regional aid policy would help free resources that can be used to foster investments in innovative projects located in poorer regions. These projects would deserve high aid intensities. Further, we suggest that the Commission exercise (and be recognised) a certain flexibility, with a measure of discretionary margin that it enjoys at the level of the balancing exercise to adapt aid awards, taking into account both the aid's contribution to the attainment of the various goals that can be relevant in a global perspective, and the outcome of the proportionality test[91].

This, however, is not the only problem raised by this part of the regional aid legislation. The new rules present various difficulties, mainly from a procedural standpoint. The

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[88] § 54 of the 2009 Communication states: "*where there is credible evidence that the granting of aid would result in a substantial loss of jobs in existing locations within the EU, which would otherwise have been likely to be preserved in the medium term, the Commission has to take into account the social and economic effects on that existing location in the balancing exercise*".

[89] See *supra*, footnote 67.

[90] This is even more so when, as in the Dell case, the relocation brings a very relative improvement from a social and economic cohesion standpoint, as it occurs between relocation from one disadvantaged area to another, the location incentive is established through a comparison with a third disadvantaged area (slightly less disadvantaged than the one where the investment project is possibly to be located). As the Commission acknowledges in the Dell decision (paragraphs 217-226), had the aid not been granted the investment would have been located in an area with an allowed maximum aid intensity of 40% Gross Grant Equivalent (GGE). The effect of the granting of the aid is to relocate the investment to an area with an allowed maximum aid intensity of 50%. The difference between 40 and 50% GGE reflected a relatively slight difference between the development rates of the two areas: 45.42% of GDP per capita in relation to the EU-25 average in the first, and 41.45% in the second.

[91] This is unlikely to be deemed possible under the current guidelines, as proportionality is assessed only within the framework of the first phase of analysis, i.e. when measuring the importance of positive and negative effects of the aid.

preliminary analysis that the Commission is expected to carry out is extremely complex, and yet the normal deadline of two months set by Article 4 §5 of Regulation 659/1999 applies. Moreover, the analysis has to be dynamic, based on projections and estimates, as the market power and the production capacity criteria must be assessed not only at the time of the investment but also for the future (at the end of the investment projects). This looking-forward review is particularly demanding. Moreover, its complexity depends on the duration of the project and the Commission itself tends to favour projects with a long duration, which can have a greater and more enduring positive impact on regional development. Further difficulties may originate from the need to gather reliable market data and assessing the long-term economic effects of the investment since the Commission lacks the power to perform a market test as in competition cases. This translates into an extremely broad margin of discretion for the Commission but also makes its tasks more burdensome.

The side effect of these difficulties might be the restoration of the inefficient procedural habits that the precise wording of the RAG 2006 intended to avoid (i.e. the opening of an Article 88(2) procedure in all cases where the market definition or the verification of the market underperformance raise doubts[92]). § 68 of the RAG 2006 seems indeed to indicate that the doubts justifying the opening of a formal investigation procedure are those concerning the assessment of compatibility and the balancing test, while the fulfilment of the conditions that, according to same § 68, require a detailed verification should, at least in principle, be established beforehand. In other words, the Commission should endeavour to reach a preliminary conclusion on the thresholds set out under § 68 (a) and (b) before the opening of a procedure, while the formal procedure should be reserved to those cases where the preliminary conclusion is that either one threshold or both has been exceeded (as in the *Audi Hungarian Motor* case)[93]. It is clear though that the Commission may have recourse to the formal investigation procedure if it determines that the thresholds (or one of them) would be exceeded under one of the possible market definitions, and an in-depth inquiry is warranted to give a final view of the most appropriate market definition. In this respect, strict rules and rigorousness in the Commission's enforcement practice is the only practicable solution. Besides, a detailed assessment performed in the course of the formal investigation procedure remains highly unpredictable, as the circumstances in which negative effects will likely, or unlikely be outweighed by positive elements are not clearly set out, except for very particular cases. In this respect, the Commission is called upon to set up more precise implementing criteria in its enforcement practice.

[92] Some of the stakeholders that submitted observations to the Commission in the framework of the public consultation seem to share this view. For instance, the direct opening-up of the formal investigation procedure by the Commission is seen by SEPI (Sociedad Estatal de Participationes Industriales) as a disproportionate measure. See *Observaciones al documento "Orientationes para una evaluaciòn en profundidad de las ayudas reyonales a los grandes proyectos de inversiòn*, 26 of January 2009, available at http://ec.europa.eu/competition/consultations/2009_investment_projects/sepi_es.pdf

[93] See *supra*, footnote 69.

The substantive test can also attract some criticism. If it is intuitive that large investment projects can affect trade and determine net welfare losses to a more significant extent than projects of a lesser scale, the same is not always true for competition distortion. Similarly, we wonder whether it can simply be assumed, without any reference to specific economic or market conditions, that large investment projects are less affected by the handicaps that characterise disadvantaged areas. Conversely, large investment projects are probably those capable of generating greater positive externalities and spillovers to other sectors, as well as having a clustering effect by attracting further investments in the area. From this perspective, the complexity of the in-depth assessment in terms of information required from the Member State (and ultimately from the beneficiary) is a reason for concern. In particular, the detailed description of the counterfactual scenario required under § 23 of the Communication could end up discouraging companies from asking for the appropriate aid awards and ultimately prevent them from pursuing an investment project, or lead them to downsize the project[94].It is doubtful whether discouraging notifications of large projects to the Commission (due to the high burden of proof and the delays and uncertainties related to an investigation procedure), with investors opting for aid intensities just below the notification thresholds, is a desirable situation. Aid projects that are downsized on purpose to keep awards short of the threshold for notification may not have a sufficient incentive effect to stimulate the innovation and create the positive externalities that can really make the difference and help bring a region up to the level of the others.

The risk is that the 2009 Communication be applied to an even smaller number of cases than expected by the Commission which already acknowledges that it is intended only for very exceptional cases - less than 10% of notified aid projects, which are already relatively rare, as Member States still tend, as they used to do in the past, and even with more reason now, to remain just below the notification threshold. One could say that this indirectly delivers the Commission's objective (i.e. reduce the volume of aid to large investment projects) but this would be a rather simplistic approach mainly because the reduction of aid intensity for large projects can easily be compensated by lesser rigour in the determination of the aid intensity for second tier projects in terms of volume. In other words, the cluster of aid just below the thresholds risks pulling financial resources from the very few really groundbreaking and promising projects towards more ordinary projects of a lesser scale.

Besides, drafting a skilful and sophisticated piece of legislation but destined almost to school cases is probably not a great achievement in itself. For the Commission's regional policy to be effective, qualitative criteria (through individual assessment or otherwise) should capture a much larger number of projects. This also seems justified because the risk of awards exceeding the minimum necessary to compensate for regional disadvantages is at least as high for projects of a lower scale as it is for larger projects. In particular, the risk

[94] See in this respect the observations submitted by France and Ireland in response to the public consultation opened by the Commission concerning the new Guidance for an in-depth assessment of regional aid to large investment projects. These documents can be found at: http://ec.europa.eu/competition/consultations/2009_investment_projects/index.html

of sub-optimal allocation of resources and welfare losses (through windfall gains and deadweight cost related to the granting of aid) is probably very high when a huge number of low scale investment projects are subsidised that escape any ex-ante or ex-post control. In addition, when the Commission declares a notified project incompatible on the basis of a detailed assessment as its effects in a given market are highly distortive, this should logically not remain without consequences on the eligibility of similar projects of regional aid of a lesser amount, as these projects, although not attaining the notification thresholds or those for an in-depth assessment, produce similar results.

Consequently, we wonder whether the next step should not be the provision of a certain number of automatic screening and evaluation criteria to be embodied in the RAG, the implementation of which would be left to the responsibility of the public authorities granting the aid under the control of national judges. It has been observed that in a forward-looking perspective, in line with the principle of subsidiarity, national legislators and/or agencies should be encouraged to implement and carry out a more rigorous control over inefficient national spending[95]. Therefore, by indicating screening and evaluation criteria in the RAG for projects that fall short of the notification thresholds could lead to Member States using resources planned for regional aid purposes better. Contrary to the views expressed by some authors[96], the Commission has an educational role to play to encourage and induce Member States to improve the efficiency of regional aid measures. This should lead to the elimination of deadweight, and to focus on the incentive effect, that is the real cornerstone for the pursuit of the Lisbon agenda and the SAAP objectives. Of course, the criteria should be sufficiently clear and precise so as to avoid any delegation of administrative, and not only technical discretionary power to the national public administrations, as this would be at odds with the system of control of State aid. Setting out a voluntary non-opposition procedure for some borderline situations (e.g. aid projects falling short of the thresholds if previous aid in the same market has been declared inadmissible under an in-depth assessment) with the Commission being given the power to review such projects *ex post*, could also be considered. These, of course, are only preliminary ideas intended to feed the debate.

In any event, it will be particularly important for the Commission in this field to maintain a consistent course in the enforcement practice, and endeavour to increase over time, rather than decrease, predictability. Otherwise, the Commission would contribute to nourish the criticism of those who fear that the current detailed assessment is simply too artificial and leads to an arbitrary analysis (in practice the decision-making power on the most significant cases would be handed over to the economists). This latent, but in our view somewhat defeatist criticism, that many tend to express against the refined economic

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[95] See *The Most Appropriate Economic Tool for a Better Targeted State Aid Policy*, in Economic Analysis of State Aid Rules - Contributions and Limits -, Jacques Derenne and Massimo Merola Eds., p. 62.

[96] See D. Spector, *L'économie politique des aides d'État et le choix du critère d'appréciation*, Concurrences n° 2-2006, p. 34-43 and D. Spector, *State Aids: Economic Analysis and Practice in the EU*, Conference on "Fifty Years of the Treaty: Assessment and Perspectives of Competition Policy in Europe", Barcelona, 19-20 November 2007.

approach[97], would then gain momentum. The same attention should be employed, as already mentioned, to avoid restoring inefficient procedural habits that would nullify some of the progress made with the RAG 2006 and the new internal rules of procedure.

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[97] See, *inter alia*, J. L. Buendia Sierra and B. Smulders, *The Limited of the 'Refined Economic Approach' in Achieving the Objectives of State Aid Control: Time for Some Realism*, in EC State Aid Law - Liber Amicorum Francisco Santaolalla Gadea, Kluwer Law International, 2008.