

## PART III: HORIZONTAL RULES

### Criteria for an In-depth Assessment of Regional Aid to Large Investment Projects<sup>1</sup>

#### 1. Introduction

##### 1.1. General rules for regional aid measures

- (1) The Chapter on national regional aid for 2007-2013 in the EFTA Surveillance Authority's Guidelines (hereinafter the "Regional Aid Guidelines") clarifies the general approach of the Authority regarding regional State aid<sup>2</sup>. In accordance with the conditions laid down in the Regional Aid Guidelines, and notwithstanding the negative effects that regional State aid may have on trade and competition, the EFTA Surveillance Authority (hereinafter the "Authority") may consider State aid compatible with the functioning of the EEA Agreement if it is granted to promote the economic development of certain disadvantaged regions within the EEA.
- (2) In general, the Regional Aid Guidelines take account of the relative seriousness of the problems affecting the development of the regions concerned by introducing specific regional aid ceilings. These maximum aid intensities are graduated between 10 % and 50 % of eligible costs, based primarily on the GDP per capita of the regions concerned, but also allowing EFTA States some flexibility to take account of local conditions. The regional aid maps for each EFTA State are published on the Authority's website<sup>3</sup>. These graduated aid intensities reflect, in essence, the balancing exercise which the Authority must perform between, on the one hand, the positive effects that regional investment aid can have, in particular in terms of promoting cohesion through attracting investment to disadvantaged areas, and, on the other hand, limiting the potential negative effects that can occur when granting such aid to individual undertakings, for example the negative impact for other economic operators and for regions whose relative competitive advantage is correspondingly diminished.
- (3) A large investment project is an initial investment with an eligible expenditure above EUR 50 million<sup>4</sup>. Large investment projects are less affected by the handicaps that characterise disadvantaged areas than investment projects of a lesser scale. There is an increased risk that trade will be affected by large investment projects and thus a risk of a stronger distortion effect vis-à-vis competitors in other regions. Large investments also run the risk of the amount of aid exceeding the minimum necessary to compensate for the regional disadvantages, and there is the risk that State aid for these projects would lead to perverse effects such as inefficient location choices, higher distortion of competition and, since aid is a costly transfer from taxpayers in favour of aid recipients, net welfare losses, i.e. the cost of the aid exceeds the benefits to consumers and producers.

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<sup>1</sup> This chapter corresponds to Communication from the European Commission concerning the criteria for an in-depth assessment of regional aid to large investment projects, OJ C 223, 16.9.2009, p. 3.

<sup>2</sup> The Chapter on national regional aid for 2007-2013 corresponds to Communication from the Commission – Guidelines on national regional aid for 2007-2013, OJ C 54, 4.3.2006, p. 13.

<sup>3</sup> <http://www.eftasurv.int/state-aid/state-aid-register/>

<sup>4</sup> As defined in paragraph 49 and footnotes 46 and 47 of the Regional Aid Guidelines.

- (4) The Regional Aid Guidelines foresee specific rules for regional aid to large investment projects<sup>5</sup>. The Regional Aid Guidelines provide for the automatic, progressive scaling-down of regional aid ceilings for these large investment projects to limit distortions of competition to a level which can generally be assumed to be compensated by their benefits in terms of development of the regions concerned<sup>6</sup>.
- (5) Moreover, EFTA States have to notify individually any aid for investment projects if the aid proposed is more than the maximum allowable amount of aid that an investment with eligible expenditure of EUR 100 million can receive under the applicable rules (notification threshold)<sup>7</sup>. For these notified cases, the Authority verifies in particular the aid intensities, the compatibility with the general criteria of the Regional Aid Guidelines and whether the notified investment represents a major increase of production capacities, while at the same time addressing an underperforming or even declining market, or benefits firms with high market shares.

## **1.2. Regional aid measures subject to an in-depth assessment**

- (6) Despite the automatic scaling-down, certain large amounts of regional aid for large investment projects could still have significant effects on trade, and may lead to substantive distortions of competition. For this reason, it was formerly Authority policy not to authorise aid for large investment projects above the following thresholds<sup>8</sup>:
  - the aid beneficiary accounts for more than 25 % of the sales of the product(s) concerned on the market(s) concerned, or
  - the production capacity created by the project exceeds 5 % of the market, while the growth rate of the market concerned is below the EEA GDP growth rate.
- (7) However, under the current Regional Aid Guidelines, the Authority has opted for a more individualised approach, which allows the cohesion and other benefits that can be derived from such projects to be taken into consideration, in as concrete a fashion as possible. Any such benefits must, however, be weighed against the likely negative effects on trade and competition, which should also be identified in as concrete a manner as possible. Therefore, paragraph 57 of the Regional Aid Guidelines foresees that the Authority will conduct a formal investigation procedure pursuant to Article 1(2) in Part I of Protocol 3 of the Surveillance and Court Agreement for cases above the notification threshold and meeting one or both of the conditions set out in points (a) and (b) of paragraph 57 of the Regional Aid Guidelines (the in-depth assessment thresholds which are the same as the thresholds described in paragraph 6 of this chapter). In these cases, the objective of the formal investigation is to carry out a detailed verification “that the aid is necessary to provide an incentive effect for the investment and that the benefits of the aid measure outweigh the resulting distortion of competition and effect on trade between Contracting Parties”<sup>9</sup>.

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<sup>5</sup> Cf. section 4.3 of the Regional Aid Guidelines.

<sup>6</sup> Cf. paragraph 56 of the Regional Aid Guidelines.

<sup>7</sup> Cf. paragraph 53 of the Regional Aid Guidelines.

<sup>8</sup> Cf. point 26A.3(4) of Chapter 26A of the Authority’s Multisectoral framework on regional aid for large investment projects which corresponded to the European Commission’s Multisectoral framework on regional aid for large investment projects (OJ C 70, 19.3.2002, p. 8, as amended in OJ C 263, 1.11.2003, p. 3).

<sup>9</sup> Cf. paragraph 57 of the Regional Aid Guidelines.

- (8) In footnote 55 of the Regional Aid Guidelines, the Authority announced that it “may in due course draw up further guidance on the criteria it will take into account during this assessment”. Below, the Authority presents guidance as to the kind of information it may require and the methodology it will follow for measures subject to a detailed assessment. In line with the European Commission’s State Aid Action Plan<sup>10</sup>, the Authority will carry out an overall evaluation of the aid based on a balance of its positive and negative effects in order to determine whether, as a whole, the aid measure can be approved.
- (9) The detailed assessment should be proportionate to the potential distortions which may be created by the aid. This means that the scope of the analysis will depend on the nature of the case. Therefore, the nature and the level of the evidence required will also depend on the features of each individual case. Also, while respecting the provisions governing the conduct of the formal investigation as set out in Articles 6 and 7 of Part II of Protocol 3 to the Surveillance and Court Agreement, on the Functions and Powers of the EFTA Surveillance Authority in the field of State aid, the Authority may, inter alia, ask the EFTA State to provide independent studies to confirm the information contained in the notification, or seek input from other economic operators active in the relevant markets or from experts in regional development. Moreover, comments by interested parties are welcomed during formal investigations. The Authority will identify the key issues on which it is seeking input in the opening of the procedure.
- (10) The present chapter is intended to ensure the transparency and predictability of the Authority decision-making process and equal treatment of EFTA States. The Authority reserves the possibility to amend and review this guidance in the light of case experience.

## **2. Positive effects of the aid**

### **2.1. Objective of the aid**

- (11) Regional aid has an objective of common interest which reflects equity considerations, namely furthering economic cohesion by helping to reduce the gap between the development levels of the various regions of the EEA. Paragraph 2 of the Regional Aid Guidelines sets out that: “By addressing the handicaps of the disadvantaged regions, national regional aid promotes the economic, social and territorial cohesion of EFTA States and the EEA as a whole”. Paragraph 3 of the Regional Aid Guidelines adds that: “National regional investment aid is designed to assist the development of the most disadvantaged regions by supporting investment and job creation. It promotes the expansion and diversification of the economic activities of enterprises located in the less-favoured regions, in particular by encouraging firms to set up new establishments there”.
- (12) For those large investment projects that meet the in-depth assessment thresholds, the EFTA State will be requested to demonstrate that the aid will address the equity objective in question. The EFTA State will therefore need to substantiate the contribution of the investment project to the development of the region concerned.
- (13) While the primary objective of regional aid is to foster equity concerns as economic cohesion, regional aid may also address issues of market failure. Regional handicaps may be linked to market failures such as imperfect information, co-ordination problems, difficulties for the beneficiary to appropriate investments in public goods

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<sup>10</sup> Cf. paragraphs 11 and 20 of the State Aid Action Plan (COM(2005) 107 final).

or externalities from investments. Where, apart from equity objectives, regional aid also addresses efficiency concerns, the overall positive effect of the aid will be considered greater.

(14) The following non-exhaustive list of indicative criteria can be used to demonstrate the regional contribution of the aid, in so far as it leads to attracting additional investment and activity in the region. These positive effects of the aid can be both direct (e.g. direct jobs created) and indirect (e.g. local innovation).

- The number of direct jobs created by the investment is an important indicator of the contribution to regional development. The quality of the jobs created and the required skill level should also be considered.
- An even higher number of new jobs might be created in the local (sub-) supplier network, helping to better integrate the investment in the region concerned and ensuring more widespread spillover effects. The number of indirect jobs created will therefore also be taken into account.
- A commitment by the beneficiary to enter into widespread training activities to improve the skills (general and specific) of its workforce will be considered as a factor that contributes to regional development. Emphasis will also be put on training that improves the knowledge and employability of workers outside the firm. General or specific training for which training aid is approved will not be counted as a positive effect of the regional aid to avoid double counting.
- External economies of scale or other benefits from a regional development viewpoint may arise as a result of proximity (clustering effect). Clustering of firms in the same industry allows individual plants to specialise more which leads to increased efficiency. Physical proximity facilitates the exchange of information, ideas and knowledge between firms. A concentration of economic activities attracts many job seekers, which assures a large pool of workers with different skills available to firms. Access to legal and commercial services is ensured which enhances productivity. In general, a concentration of economic activities may again attract other investments which in turn increase the positive spillover effects (virtuous circle).
- Investments embody technical knowledge and can be the source of a significant transfer of technology (knowledge spillovers). Investments taking place in technology intensive industries are more likely to involve technology transfer to the recipient region. The level and the specificity of the knowledge dissemination are also important in this regard.
- The projects' contribution to the region's ability to create new technology through local innovation can also be considered. Co-operation of the new production facility with local higher education institutions can be considered positively in this respect.
- The duration of the investment and possible future follow-on investments are an indication of a durable engagement of a company in the region.

(15) The EFTA States are, in particular, invited to rely on evaluations of past State aid schemes or measures, impact assessments made by the granting authorities, expert

opinions and other possible studies related to the investment project under assessment. The business plan of the aid beneficiary could provide information on the number of jobs created, salaries paid (increase in household wealth as spill-over effect), volume of sales from local producers, turnover generated by the investment and benefiting the region possibly through additional tax revenues.

- (16) If relevant, the relationship between the planned investment project and the national strategic reference framework, as well as the relationship between the project and the operational programmes co-financed by the structural funds, also have to be considered.

## **2.2. Appropriateness of the aid instrument**

- (17) State aid in the form of investment subsidies is not the only policy instrument available to EFTA States to support investment and job creation in disadvantaged regions. EFTA States can use general measures such as infrastructure development, enhancing the quality of education and training, or improvements in the general business environment.
- (18) Measures for which the EFTA State considered other policy options, and for which the advantages of using a selective instrument such as State aid for a specific company are established, are considered to constitute an appropriate instrument. The Authority will in particular take account of any impact assessment of the proposed measure the EFTA State may have made.

## **2.3. Incentive effect**

- (19) Analysing the incentive effect of the aid measure is one of the most important elements in the in-depth assessment of regional aid to large investment projects. The Authority will assess whether the proposed aid is necessary to produce “a real incentive effect to undertake investments which would not otherwise be made in the assisted areas”<sup>11</sup>. This assessment will take place at two levels: first, at a general, procedural level, and, second, at a more detailed, economic level.
- (20) In paragraph 30, the Regional Aid Guidelines contain general criteria to provide a formal assessment of the incentive effect of regional aid. These criteria apply to all regional aid, not only regional aid for large investment projects.
- (21) In the case of regional aid to large investment projects covered by this chapter, the Authority will verify in detail ‘that the aid is necessary to provide an incentive effect for the investment’<sup>12</sup>. The objective of this detailed assessment is to determine whether the aid actually contributes to changing the behaviour of the beneficiary, so that it undertakes (additional) investment in the assisted region concerned. There are many valid reasons for a company to locate in a certain region, even without any aid being granted.
- (22) Having regard to the equity objective deriving from cohesion policy and as far as the aid contributes to achieving this objective, an incentive effect can be proven in two possible scenarios:

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<sup>11</sup> Cf. paragraph 30 of the Regional Aid Guidelines.

<sup>12</sup> Cf. paragraph 57 of the Regional Aid Guidelines.

- (i) The aid gives an incentive to adopt a positive investment decision because an investment that would otherwise not be profitable for the company at any location can take place in the assisted region<sup>13</sup>.
  - (ii) The aid gives an incentive to opt to locate a planned investment in the relevant region rather than elsewhere because it compensates for the net handicaps and costs linked to a location in the assisted region.
- (23) The EFTA State should demonstrate to the Authority the existence of an incentive effect of the aid. It will need to provide clear evidence that the aid effectively has an impact on the investment choice or the location choice. It will have to specify which scenario applies. In order to permit a comprehensive assessment, the EFTA State will have to provide not only information concerning the aided project but also a comprehensive description of the counterfactual scenario, in which no aid would be granted by the EFTA State to the beneficiary.
- (24) In scenario 1, the EFTA State could provide proof of the incentive effect of the aid by providing company documents that show that the investment would not be profitable without the aid and that no other location than the assisted region concerned could be envisaged.
- (25) In scenario 2, the EFTA State could provide proof of the incentive effect of the aid by providing company documents that show a comparison has been made between the costs and benefits of locating in the assisted region concerned with an alternative region. Such comparative scenarios will have to be considered to be realistic by the Authority.
- (26) The EFTA States are, in particular, invited to rely on risk assessments (including the assessment of location-specific risks), financial reports, internal business plans, expert opinions and other studies related to the investment project under assessment. Documents containing information on demand forecasts, cost forecasts, financial forecasts, documents that are submitted to an investment committee and that elaborate on various investment scenarios, or documents provided to the financial markets could help to verify the incentive effect.
- (27) In this context, and in particular in scenario 1, the level of profitability can be evaluated by reference to methodologies which are standard practice in the particular industry concerned, and which may include: methods to evaluate the net present value of the project (NPV), the internal rate of return (IRR) or the return on capital employed (ROCE).
- (28) If the aid does not change the behaviour of the beneficiary by stimulating (additional) investment in the assisted region concerned, there is a lack of incentive effect to achieve the regional objective. If the aid has no incentive effect to achieve the regional objective, such aid can be considered as free money for the company. Therefore, in an in-depth assessment of regional aid to large investment projects, aid will not be approved in cases where it appears that the same investment would take place in the region even without the aid.

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<sup>13</sup> Such investments may create conditions allowing further investments that are able to survive without additional aid.

## **2.4. Proportionality of the aid**

- (29) For the regional aid to be proportional, the amount and intensity of the aid must be limited to the minimum needed for the investment to take place in the assisted region.
- (30) The Regional Aid Guidelines generally ensure that regional aid is proportional to the seriousness of the problems affecting the assisted regions by applying regional aid ceilings in general and an automatic, progressive scaling-down of these regional aid ceilings for large investment projects (see paragraphs 1 and 3).
- (31) For regional aid cases that require an in-depth assessment, a more detailed verification of this general principle of proportionality contained in the Regional Aid Guidelines is necessary.
- (32) In scenario 1, for an investment incentive, the aid will generally be considered proportionate if, because of the aid, the return on investment is in line with the normal rate of return applied by the company in other investment projects, with the cost of capital of the company as a whole or with returns commonly observed in the industry concerned.
- (33) In scenario 2, for a location incentive, the aid will generally be considered proportionate if it equals the difference between the net costs for the beneficiary company to invest in the assisted region and the net costs to invest in the alternative region(s). All such costs and benefits need to be taken into account, including for example administrative costs, transport costs, training costs not covered by training aid and also wage differences.
- (34) Ultimately, these net costs which are considered to be related to the regional handicaps result in a lower profitability of the investment. For that reason, calculations used for the analysis of the incentive effect, can also be used to evaluate whether the aid is proportionate.
- (35) The EFTA State needs to demonstrate the proportionality on the basis of appropriate documentation such as that mentioned in paragraph 26.
- (36) In no case can the aid intensity be higher than the regional aid ceilings corrected by the scaling-down mechanism, as indicated in the Regional Aid Guidelines.

## **3. Negative effects of the aid**

- (37) To assess market shares and potential overcapacity in a market in structural decline, the Authority needs to define the relevant product market and geographic market. Thus, usually<sup>14</sup>, the relevant markets will already have been defined for regional aid measures subject to an in-depth assessment.
- (38) Two main indicators of potential negative effects arising from the aid are already identified in paragraph 57 of the Regional Aid Guidelines, namely high market shares and potential overcapacity in a market in structural decline. They are linked to two theories of harm in a competition context, respectively the creation of market power and the creation or maintenance of inefficient market structures. A prima facie measurement of these two indicators will already have taken place before the opening

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<sup>14</sup> Where doubts remain as to the appropriate definition of the relevant markets, the Authority will identify these in the decision to initiate the formal investigation procedure pursuant Article 1(2) of Part I of Protocol 3.

of the investigation procedure. In order to provide all the elements for the final balancing exercise, the assessment of the two indicators will be refined in the in-depth assessment. A third indicator of potential negative effects arising from the aid that will be assessed in depth is the influence of the aid on trade. Although these three indicators are considered as the main negative effects potentially arising from regional aid to a large investment project, the Authority does not exclude that other indicators might also be relevant in specific cases.

- (39) The Authority will place particular emphasis on the negative effects linked with the notion of market power and overcapacity in cases where the aid gives an incentive to change the investment decision, so that without the aid no investment would take place (scenario 1 of the incentive effect).
- (40) If, however, the counterfactual analysis suggests that without the aid the investment would have gone ahead in any case, albeit possibly in another location (scenario 2), and if the aid is proportional, possible indications of distortions such as a high market share and an increase in capacity in an underperforming market would in principle be the same regardless of the aid.

### **3.1. Crowding-out of private investment**

#### *3.1.1. Market power*

- (41) When establishing its optimum investment level, in markets with a limited number of market players (a situation typical for large investment projects) each firm takes into account the investment carried out by its competitors. If aid induces a particular company to invest more, competitors may react by reducing their own expenditure in that area. In that case aid leads to a crowding-out of private investment. If, as a result, such competitors are weakened or even have to exit, the aid distorts competition. In this regard, as discussed in paragraph 38, the Regional Aid Guidelines distinguishes between cases where the aid beneficiary has market power and cases where the aid leads to a significant capacity expansion in a declining market.
- (42) In general, any aid to one beneficiary in a concentrated market is more likely to distort competition, since the decision of each firm is likely to affect its competitors more directly. This is especially the case if a dominant market player is subsidised. As a result, if, due to the aid, the beneficiary can maintain or increase its market power<sup>15</sup>, regional aid for large investment projects may have a deterrent effect on competitors' investment decisions and thereby generate distortions of competition. This would be to the detriment of consumers. Therefore, the Authority wants to limit State aid to companies with market power.
- (43) For all regional aid cases that trigger the notification threshold (paragraph 53 of the Regional Aid Guidelines), the Authority needs to assess (paragraph 57(a) of the Regional Aid Guidelines) the share of the aid beneficiary (or the group to which it belongs) of the sales of the product or products concerned on the relevant product market(s) and geographic market(s). However, market shares can only give a preliminary indication of possible problems. Therefore, in an in-depth assessment, the Authority will also take account of other factors, where relevant, including for

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<sup>15</sup> Market power is the power to influence market prices, output, the variety or quality of goods and services, or other parameters of competition on the market for a significant period of time.

example the market structure by looking at the concentration in the market<sup>16</sup>, possible barriers to entry<sup>17</sup>, buyer power<sup>18</sup> and barriers to exit.

- (44) The Authority will take account of the market shares and other related factors before and after the investment (normally the year before the investment starts and the year after full production is reached). When assessing negative effects in detail, the Authority will take into account that, while some investment projects are carried out over a relatively short time-scale of one or two years, most large investment projects have a much longer duration. Therefore, in most cases, long-term analyses of the evolution of markets are necessary. However, the Authority will acknowledge the fact that those long-term analyses are more speculative, particularly in the case of volatile markets or markets undergoing rapid technological change. Therefore, the more long-term and thus the more speculative the analysis is, the less weight will be attached to the possible negative effect of market power or the possibility of exclusionary behaviour.

### *3.1.2. Creating or maintaining inefficient market structures*

- (45) It is a sign of effective competition if inefficient firms are forced to exit a market. In the long term, this process fosters technological progress and an efficient use of scarce resources in the economy. However, a substantial capacity expansion induced by State aid in an underperforming market might unduly distort competition as the overcapacity could lead to a squeeze on profit margins and a reduction of competitors' capacity or even their exit from the market. This might lead to a situation where competitors that would otherwise be able to stay on are forced out of the market as a consequence of State aid. It may also prevent low cost firms from entering and it may weaken incentives for competitors to innovate. This results in inefficient market structures which are also harmful to consumers in the long run.
- (46) In order to evaluate whether the aid may serve to create or maintain inefficient market structures, as pointed out above, the Authority will take into account the additional production capacity created by the project and whether the market is underperforming<sup>19</sup>. According to the Regional Aid Guidelines, additional capacity will only be considered problematic if it is created in an underperforming market and if the additional capacity is more than five per cent of the market concerned.
- (47) Since capacity created in a market in absolute decline will normally be more distortive than capacity created in a market in relative decline, the Authority will distinguish between cases for which, from a long-term perspective, the relevant market is structurally in decline (i.e. shows a negative growth rate), and cases for which the relevant market is in relative decline (i.e. shows a positive growth rate, but does not exceed a benchmark growth rate (see paragraph 48)). Where the capacity created by the project takes place in a market which is structurally in absolute decline,

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<sup>16</sup> For this purpose, the Authority may consider the Herfindahl-Hirschman index (HHI). This index provides a basic analysis of the market structure. In a market with few market players where several of them have a relatively high market share, a high market share of the beneficiary might be less of a concern for competition.

<sup>17</sup> These entry barriers include legal barriers (in particular intellectual property rights), economies of scale and scope, access barriers to networks and infrastructure. Where the aid concerns a market where the aid beneficiary is an incumbent, possible barriers to entry may exacerbate the potential market power wielded by the aid beneficiary and thus the possible negative effects of that market power.

<sup>18</sup> Where there are strong buyers in the market, it is less likely that an aid beneficiary can increase prices vis-à-vis these strong buyers.

<sup>19</sup> In this context, a market is meant to be 'underperforming' if its average annual growth rate in the reference period does not exceed the growth rate of EEA's GDP.

the Authority will consider it to be a negative element in the balancing test that is unlikely to be compensated by any positive elements. The long term benefit for the region concerned is also more doubtful in such a case.

- (48) Underperformance of the market will normally be measured compared to the EEA GDP over the last five years before the start of the project (benchmark rate). Data on past performance are more readily available and less speculative than future projections. Nevertheless, in the in-depth assessment, the Authority may also take into account expected future trends since the increase in capacity will exert its effect in the years following the investment. Indicators could be the foreseeable future growth of the market concerned and the resulting expected capacity utilisation rates, as well as the likely impact of the capacity increase on competitors through its effects on prices and profit margins.
- (49) Experience also shows that, in some cases, considering the growth of the product concerned in the EEA may not be the appropriate benchmark to assess the effects of aid, in particular if the market is considered to be worldwide and there is only limited production or consumption of the products concerned within the EEA. In such cases, the Authority will take a broader view of the effect of the aid on market structures, having regard, in particular, to its potential to crowd out EEA producers.

### **3.2. Negative effects on trade**

- (50) As explained in paragraph 2 of the Regional Aid Guidelines, the geographical specificity of regional aid distinguishes it from other forms of horizontal aid. It is a particular characteristic of regional aid that it is intended to influence the choice made by investors about where to locate investment projects. When regional aid is offsetting the additional costs stemming from the regional handicaps and supports additional investment in assisted areas, it is contributing not only to the development of the region, but also to cohesion and ultimately benefits the whole EEA<sup>20</sup>. With regard to the potential negative location effects of regional aid, these are already recognised and restricted to a degree by Regional Aid Guidelines and the regional aid maps, which define exhaustively the areas eligible to grant regional aid, taking account of the equity and cohesion policy objectives, and the eligible aid intensities. Aid may not be granted to attract investments outside of these areas. When appraising large investment projects subject to this guidance, the Authority should have all necessary information to consider whether State aid would result in a substantial loss of jobs in existing locations within the EEA.
- (51) More concretely, when investments adding production capacity in a market are made possible because of State aid, there is a risk that production or investment in other regions of the EEA may be negatively affected. This is particularly likely if the capacity increase exceeds market growth, which will generally be the case for large investment projects meeting the second criteria of paragraph 57 of the Regional Aid Guidelines. The negative effects on trade, corresponding to the lost economic activity in the regions affected by the aid, may be felt through lost jobs in the market concerned, at the level of subcontractors<sup>21</sup> and as a result of lost positive externalities (e.g. clustering effect, knowledge spill-overs, education and training, etc.).

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<sup>20</sup> In particular, additional activity or increased standard of living in the assisted area may increase demand for products and services originating from other parts of the EEA.

<sup>21</sup> Especially if they operate in local markets in the region.

#### **4. Balancing the effects of the aid**

- (52) Having established that the aid is necessary as an incentive to carry out the investment in the region concerned, the Authority will balance the positive effects of the regional investment aid to a large investment project with its negative effects. Careful consideration will be given to the overall effects of the aid on cohesion within the EEA. The Authority will not use the criteria set out in this communication mechanically but will make an overall assessment of their relative importance. In this balancing exercise, no single element is determinant, nor can any set of elements be regarded as sufficient on its own to ensure compatibility.
- (53) In particular, the Authority considers that attracting an investment to a poorer region (as defined by the higher regional aid ceiling) is more beneficial for cohesion within the EEA than if the same investment is located in a more advantaged region. Thus, under scenario 2, where evidence has to be given of an alternative location, an assessment that without aid the investment would have been located to a poorer region (more regional handicaps – higher maximum regional aid intensity) or to a region that is considered to have the same regional handicaps as the target region (same maximum regional aid intensity) will constitute a negative element in the overall balancing test that is unlikely to be compensated by any positive elements because it runs counter to the very rationale of regional aid. On the other hand, the positive effects of regional aid which merely compensate for the difference in net costs relative to a more developed alternative investment location (and thus fulfils the proportionality test above, in addition to the ‘positive effect’ requirements as to objective, appropriateness and incentive effect), will normally be considered, under the balancing test, to outweigh any negative effects in the alternative location for new investment.
- (54) However, where there is credible evidence that the State aid would result in a substantial loss of jobs in existing locations within the territory covered by the EEA Agreement, which would otherwise have been likely to be preserved in the medium term, the social and economic effects on that existing location will have to be taken into account in the balancing exercise.
- (55) The Authority may, following the formal investigation procedure laid down in Article 6 of Part II of Protocol 3 to the Surveillance and Court Agreement, close the procedure with a decision pursuant to Article 7 of that Protocol.
- (56) The Authority may decide either to approve, condition or prohibit the aid<sup>22</sup>. If it adopts a conditional decision pursuant to Article 7(4) of that Protocol, it may attach conditions to limit the potential distortion of competition and ensure proportionality. In particular, it may reduce the notified amount of aid or aid intensity to a level considered to be proportional and thus compatible with the common market.

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<sup>22</sup> When the aid is granted on the basis of an existing regional aid scheme, it is however to be noted that the EFTA State retains the possibility to grant such aid up to the level which corresponds to the maximum allowable amount that an investment with eligible expenditure of EUR 100 million can receive under the applicable rules.