II

(Acts whose publication is not obligatory)

COMMISSION

COMMISSION DECISION

of 26 June 1996

concerning aid granted by Germany to the Volkswagen Group in Mosel and Chemnitz

(Only the German text is authentic)

(Text with EEA relevance)

(96/666/EC)

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community, and in particular the first subparagraph of Article 93 (2) thereof,

Having regard to the Agreement establishing the European Economic Area, and in particular Article 62 (1) (a) thereof,

Having given the parties concerned the opportunity to submit their comments, in accordance with Article 93 (2),

Whereas:

I

By letter dated 14 January 1992 [1], the Commission informed the German authorities of its decision of 18 December 1991 to initiate the Article 93 (2) of the Treaty procedure in respect of planned aid by the German authorities for the plants of the Volkswagen (VW) Group in the new *Länder.*

When initiating the procedure, the Commission expressed serious doubts as to the compatibility of the aid with Article 92 of the Treaty, for the following reasons:

1. the State aid had not been notified to the Commission in accordance with the procedure set out in Article 93 (3) of the Treaty and could not yet be entirely quantified;
2. the apparently high aid intensity proposed for a plan involving a significant expansion of capacity on the European car market could give rise to distortions of competition;
3. insufficient evidence had been presented to justify the duplication of regional aids having a comparatively high intensity in relation to the structural and economic problems in the new *Länder;* indeed, the overall aid intensity could be disproportionately high and incompatible with the criteria of the Community framework document on State aid to the motor vehicle industry [2].

II

By letters dated 19 September and 14 December 1990 and 14 March 1991, the Commission requested notification, in accordance with the Community framework on State aid to the motor vehicle industry, of the aid measures in support of the new investments of Volkswagen AG in the new *Länder,* it stressed that such aid could not be granted without prior notification and approval by the Commission.

The German Government explained by letter dated 29 May 1991 that, in its view, the Community framework did not apply to the new *Länder* between 1 January and 31 March 1991 since it had been due to expire by the end of 1990 and its renewal by the Commission in December 1990 could become legally binding only upon formal

[1] OJ No C 68, 17. 3. 1992, p. 14.

[2] OJ No C 123, 18. 5. 1989, p. 3.

acceptance by the German Government of the extension or upon a formal decision by the Commission in proceedings pursuant to Article 93 (2). Given that the aid measures in question had been approved before 31 March 1991, they could have been scrutinized by the Commission only by reference to the regional aid schemes approved for the new *Länder.*

The legal position taken by the German Government was not accepted by the Commission, on the following grounds:

1. Commission Decision 90/381/EEC [3] amending German aid schemes for the motor vehicle industry, which was not challenged by the German Government, was not limited in time so that the renewal of the Community framework by the Commission in December 1990 did not affect the notification obligations;

2. since the German Government neither challenged nor reacted to the renewal of the framework itself, the Commission could legitimately assume that it would abide by the provisions;

3. when approving the extension of existing regional aid schemes to the new *Länder* (SG(91) D/12002 of 9 January 1991), the Commission stipulated that Community frameworks should be observed;

4. that extension means that the provisions of the 19th Outline Plan for the joint Federal Government/*Länder* scheme (notified by the German Government in July 1991 and approved by letter SG(90) D/27707 of 2 October 1991) must also be observed for aid cases in the new *Länder.* Hence, the provision regarding prior notification of aid to the motor vehicle industry applies in these cases too.

Consequently, the Commission considered these cases as non-notified cases given that the aid had been approved by the German authorities prior to any approval by the Commission.

The decision to initiate the Article 93 (2) procedure was based on an initial detailed analysis of the information contained in the Geman authorities' letters of 16 September and 10 December 1991, on several bilateral contacts between the German authorities and representatives of the Commission, and on a visit to the production site by the Commission in August 1991.

[3] OJ No L 188, 20. 7. 1990, p. 55.

In its letter of 14 January 1992, the Commission requested the German Government not only to comment within one month on the decision to institute the Article 93 (2) procedure in the Volkswagen case but also to confirm within 10 working days that it agreed to suspend all aid payments to Volkswagen for its investments in Mosel, Chemnitz and Eisenach. If such confirmation were not received, the Commission reserved the right to stop payment of any State aid to the projects.

III

By letter dated 29 January 1992, the German Government declared its readiness to suspend further payments of aid until the Article 93 (2) procedure had been terminated. By letter dated 31 March 1992, it gave its observations on the Commission's letter of 14 January 1992.

By letter dated 24 April 1992, the Commission requested the German authorities, the Treuhandanstalt (THA) and Volkswagen to provide further information necessary to compelte its analysis of the case.

The questions discussed at a bilateral meeting on 28 April 1992 and examined in greater detail in the Commission's subsequent letters dated 14 May, 5 June, 21 August and 17 November 1992 were gradually answered in the German authorities' letters of 20 May, 3 and 12 June, 20 and 29 July, 8 and 25 September, 2, 16 and 21 October, 4 and 25 November 1992. Volkswagen provided further information in communications to the Commission dated 15 June and 30 October 1992 and 12 and 20 January 1993. The replies were further discussed at several meetings between the Commission, the various German authorities concerned and Volkswagen on 16 June, 9 September, 12 and 16 October and 3 December 1992 and 8 and 11 January 1993.

In early January 1993, at a time when the Commission had completed its analysis of the case and was ready to take a final decision, Volkswagen informed the Commission off the record that it was reviewing its investment plans in the new *Länder* and suggested that the Commission defer its decision until completion of that review. The suggestion was supported by the German authorities.

On 13 January 1993, Volkswagen decided to postpone substantial parts of its proposed investments by up to three years. As the revised timetable for the project affected a number of basic parameters applied by the Commission in its assessment of the compatibility of the proposed aid measures under the Community framework, the Commission agreed to revise its analysis, taking account of the changes to Volkswagen's investment plans.

Some details of the modified project were presented to the Commission at a bilateral meeting on 5 May 1993. Written information on the new investment plan was submitted by the German authorities by letter of 6 June 1993 and was added to by Volkswagen in letters dated 24 June and 6 July 1993 and in a fax dated 10 November 1993. The new information was discussed at bilateral meetings on 18 May, 10 June, 2 and 22 July 1993. Further information on the VW Group's overall capacity plans was provided by the German Government in a letter dated 15 February 1994 and in a fax dated 25 February 1994.

During a site visit in early April 1994 new evidence on the projects was collected and had to be included in the analysis, since it pointed to changes in the projects. This evidence was discussed at bilateral meetings on 11 May, 2, 7 and 24 June 1994 and supplemented by further written information provided at those meetings and sent by the German authorities and VW on 10 May, 30 June, 4 and 12 July 1994. Furthermore, by letter to VW dated 24 May 1994, the German authorities revised the aid contracts.

On 27 July 1994 the Commission took a final Decision 94/1068/EC [4] concerning the aid proposed by the German authorities for the restructuring of the car, engine and cylinder-head plants which had previously formed part of the IFA-Kombinat but had been taken over by VW (Mosel I, Chemnitz I, Eisenach).

IV

By that decision, the aid case was, however, only partially closed since the German authorities had also proposed regional investment aid for the new car and engine plants of the VW Group to be built in Saxony (Mosel II and Chemnitz II). At the time of that decision, the German authorities promised that VW's definitive investment plans for these new plants would be available by the end of 1994, so that the standard analysis could have taken place.

On several subsequent occasions, the German Government informed the Commission orally of delays in finalizing these plans. A Commission letter dated 12 April 1995 and requesting the submission of VW's plans remained unanswered. By letter dated 4 August 1995, the Commission urgently requested the necessary information, threatening an injunction and ultimately a final decision on the basis of available information in the case of non-compliance. In reply to this letter, the German Government informed the Commission by letter dated 22 August 1995 that VW's investment plans were still not finalized. Given that VW had unlawfully received approximately DM 360,8 million in investment grants and DM 10,6 million in investment allowances before the initiation of the Article 93 (2) procedure, the Commission, by Decision 96/179/EC [5], ordered the German Government to provide all documentation, information and data on the new investment projects of the VW Group in Saxony and on the aid to be granted to them.

In reply to the demand, some information on the project and on production capacity was provided at a meeting on 20 November 1995. This information was supplemented by a letter dated 13 December 1995, which was received on 4 January 1996, and was elaborated on at meetings on 21 and 22 December 1995. Following further questions by the Commission on 15 January 1996 and a meeting on 23 January 1996, most of the missing information was provided by letters dated 1 and 12 February 1996. In reply to a Commission letter dated 23 Feburary 1996 reminding the German authorities of the information which was still lacking, that information was provided at a meeting on 25 March 1996 and discussed at two meetings on 2 and 10 April 1996.

Among the issues concerning the new projects that were considered in the various communications and discussions were:

1. details of Volkswagen's investment plans for the new *Länder* and their relationship to existing Volkswagen activities in the automotive sector;

2. the precise amounts of aid proposed and already paid to Volkswagen;

3. an analysis of the proposed expenditure in order to determine eligibility for aid according to the criteria applied by the Commission in implementing the Community framework on State aid to the motor vehicle industry;

4. a detailed analysis of the net additional costs of the new plants at Mosel and Chemnitz as compared to equivalent plants in a central non-assisted region in the Community to be chosen by Volkswagen as 'comparator plants';

5. capacity, production and cost forecasts for the new plants as well as the planned expansion of annual capacity at all Volkswagen group plants in Europe up to 2002;

6. consideration of any possible adverse effects on the sector as a whole arising from the granting of the proposed aid, in particular with respect to the development of capacities in the sector concerned.

[4] OJ No L 385, 31. 12. 1994, p. 1.

[5] OJ No L 53, 2. 3. 1996, p. 50.

V

As to the compatibility of the proposed State aid measures, the German Government in 1993 presented the following arguments:

1. Article 92 (2) (c)

   This should be the legal basis for assessing the compatbility of the aid measures. Despite the fact that Germany was unified on 3 October 1990, the new *Länder* still suffered from economic disadvantages stemming from the division of Germany.

   Therefore, the Commission should examine whether such economic disadvantages still justified State aid. If so, all other assessment criteria and in particular those set out in the Community framework for the motor vehicle industry, including sectoral considerations and the possible risk of overcapacity, did not apply in these cases;

2. Article 92 (3) (a)

   With regard to the permissible level of aid, the German authorities claimed that the new *Länder* now qualified as least-developed areas if the latest statistics were taken into account. They referred to the Delors II package, in which these areas were proposed as Objective 1 areas, making them eligible for regional aid of up to 75 % net grant equivalent;

3. Article 92 (3) (b)

   The German authorities argued that this was a further legal basis for the granting of aid in these cases. In their view, the problems of integration and restructuring of the former planned economy into a market economy represented a serious disturbance of Germany's economy.

With regard to the investment aid for the new car plant at Mosel (Mosel II) and the new engine plant at Chemnitz (Chemnitz II), the German Government and Volkswagen presented the following arguments:

1. Volkswagen had postponed large parts of its investment in the new plants by up to three years and had singificantly reduced the scale of the project. As a result, the total investment had decreased compared to the amount originally notified (for the reasons see below). This lower level of investment had also led to a decrease in the amount of regional aid envisaged by the German authorities;

2. the high amount of aid was justified because Volkswagen suffered significant cost disadvantages in the new *Länder*, as compared with a greenfield investment in a central, non-assisted area such as Metz (France). Investment cost handicaps arose from infrastructure problems in the area, difficult geological conditions at the construction sites, stricter environmental standards and generally higher construction costs than in France. There was also an environmental risk created by the dumping sites of the former Wismut uranium and silver ore production plants near the Mosel premises. Volkswagen also faced much higher operating costs in the first years of production of the new plants because of the higher labour costs in the new *Länder* from 1995 onwards and because of the higher costs of materials, transport and energy than at the comparator location. The labour cost disadvantage had increased as a result of the postponement of the investment because production at the new plants would now start at a time when eastern German wages could be expected to be fully adjusted to the western German level;

3. the new capacity created at the new plants would not add to surplus capacity in the Community given that it replaced equivalent capacity in the former German Democratic Republic that had been shut down, while at the same time new markets in eastern Europe, where there were relatively fewer cars per head of population and insufficient capacity to satisfy demand, would be supplied;

4. as part of its investment scheme, Volkswagen actively sought to establish a firm base of local suppliers in the new *Länder*, something which could create significant additional benefits for the region.

The German Government also stressed that the cost-beenfit analysis in comparison with a non-assisted area in the EC (such as the site in Metz chosen by Volkswagen) was purely hypothetical given that the only realistic alternative location for each of the new plants would have been another asisted area in the Community or outside the Community (such as the Czech Republic) which offered considerable advantages over eastern Germany; without the political promise of the maximum amount of regional aid, the company would never have chosen any location in the new *Länder*. Moreover, such an analysis ignored the unquantifiable risks which VW has taken by investing in these structurally underdeveloped areas.

VI

The only comment which the Commission received from other Member States following the publication of the decision to initiate the Article 93 (2) procedure in the *Official Journal of the European Communities* [6] was a note from the French Government dated 7 January 1993, in which it pointed out that, in view of the additional car-making capacities created by Volkswagen's investments and other assisted projects in the new *Länder*, it was being particularly vigilant with regard to the Commission's handling of the case. The French Government further stressed that:

[6] OJ No C 68, 17. 3. 1992, p. 14.

1. the new *Länder* should not be exempt from the Community rules on State aid by virtue of Article 92 (2) (c) of the EC Treaty;

2. the approval of any aid by the Commission should be based on a detailed analysis of the incremental costs attributable to structural handicaps in the new *Länder* and of any indirect support provided by the THA.

The German Government replied to the remarks of the French Government by a fax addressed to the Commission on 15 October 1993 and stressing again its position concerning the applicability of Article 92 (2) (c) and (3) (a) of the Treaty.

VII

As explained when the Article 93 (2) procedure was initiated, Volkswagen's investment plans in the new *Länder* stemmed from its decision to meet the additional demand for cars in eastern Germany and eastern Europe that now existed following the political and economic changes in the region, by starting production within this new market itself.

The investment project is in several steps. The first stage was the formation in December 1990 of a joint venture with the THA, the Sächsische Automobilbau GmbH (SAB), in which Volkswagen's stake was initially 12,5 % and which it acquired in full from the THA as of 1 January 1994. The joint venture started the small-scale assembly of the VW Polo (SKD) at the former Trabant plant in Mosel (Mosel I) in May 1990 and began to produce the VW Golf (originally CKD production, but later supplied by the press and body shops of Mosel II; see below) in 1991. The second stage, originally planned for 1994, involves the building of an adjacent new plant in Mosel (Mosel II) under the sole responsibility of Volkswagen Sachsen (VWS), a 100 % subsidiary of Volkswagen, set up in December 1990. In mid-1991 VWS took over from Automobilwerke Eisenach the cylinder-head production activities in Eisenach, where it will continue production until the end of 1996. On 1 January 1992 VWS took over Motorenwerke Chemnitz GmbH, the owner of an existing engine plant (Chemnitz I), from the THA. At this location the second stage involves the construction of a new adjacent engine plant (Chemnitz II), also originally planned for 1994.

According to the information obtained from the German authorities in the course of the Article 93 (2) procedure:

1. the timetable for the entire investment project has been substantially revised since the opening of the procedure. On 13 January 1993 Volkswagen decided to postpone a large part of the investment relating to the new plants. In 1995 it decided to reduce investment in the plants with the result that the planned capacity will be only 750 units per day instead of the 1 200 units originally planned. Consequently, the last shops (paint shop and final assembly) of the new car plant Mosel II, which had originally been scheduled to come on stream in 1994, will now become operational only in 1997;

2. the Mosel II car plant will consist of: a press shop, which came on stream — as originally planned — in 1994 (partly to supply Mosel I); a body shop, which has been operational at reduced capacity to supply Mosel I since late 1992 and will be operating at full capacity by 1997; a paint shop and a trim and final assembly facility, which have yet to be completed. In the first year of production, the plant's paint capacity will be limited to 432 units per day, which is equivalent to the paint capacity of Mosel I (to be closed in the summer of 1997). As of 1998 the plant will have, according to VW, a total annual capacity of 172 000 units (750 cars per day) and will be used for the production of the next-generation Golf cars and the next-generation Passat cars. It will provide approximately 3 000 jobs;

3. the new engine plant Chemnitz II, also originally planned for 1994, will start production in July 1996 and will progressively replace Chemnitz I. After coming on stream in 1996, it will initially produce cylinder heads for the present engine type EA 111 (1,4/1,6 l); in mid-1996 it will start producing cylinder blocks for a new EA 111 aluminium engine (1,0/1,4/1,6 l) and until 1998 will gradually start production of other components for this new engine. The plant will have a total capacity of 376 000 engines per year, would have an assembly line for 202 000 core engines ('Rumpfmotoren') delivered from other plants and to be installed in cars at Mosel. The whole Chemnitz facilities will employ approximately 650 people;

4. total investment in the new plants, Mosel II and Chemnitz II, will be DM 2 940,5 million, of which an amount of DM 2 654,1 million is considered eligible by the Commission for regional aid under the eligibility criteria applied in Germany and approved by the Commission. As a result of the revised timetable and size of the project, the total investment in the new plants is now substantially lower than the DM 4 090,9 million planned at the time the procedure was initiated. This is due mainly to reduced capacity and increased efficiency as well as to the general reduction in the prices of capital goods.

The table below gives the investment in the new plants considered eligible for aid by the Commission:

(million DM)

	Mosel II	Chemnitz II	Total
Total investment	2 314,5	626	2 940,5
Eligible investment Of which:	2 169,1	485,1	2 654,2
Buildings and infrastructure	681,4	123,9	805,3
Machinery and equipment	1 487,7	361,2	1 848,9

5. For Mosel II and Chemnitz II, the German authorities proposed regional investment aid under the joint Federal Government/*Länder* scheme for improving regional economic structures ('Gemeinschaftsaufgabe Verbesserung der regionalen Wirtschaftsstruktur'), the Investment Allowance Law ('Investitionszulagengesetz') and the Assisted Areas Law ('Fördergebietsgesetz'). The proposed aid measures for the new plants and their intensity in relation to the eligible investment as defined by the Commission and expressed in discounted terms are set out below:

	Nominal value		Discounted value		Aid intensity (gross grant equivalent)	
	Mosel	Chemnitz	Mosel	Chemnitz	Mosel	Chemnitz
Eligible investment	2 169,1	485	1 812,7	373,5	—	—
Total aid measures Of which:	638,8	141,1	553,1	102,05	30,51	27,3
Investment grants	499,0	108,8	448,9	79,6	24,76	21,3
Investment allowances	97,1	23,3	67,6	15,3	3,73	4,1
Accelerated depreciation	42,7	9,0	36,6	7,15	2,02	1,9

Measuring the aid intensity in terms of discounted — as proposed to nominal — value is more meaningful because of the considerable time-lags which will arise between receipt of aid and the actual occurrence of investment and operating cost disadvantages taken into account by the Commission in assessing the compatibility of the aid measures under the Community framework;

6. Volkswagen claimed that it faced cost disadvantages of up to DM 989,7 million and further risks of DM 237 million for its investment in the new car plant in Mosel as well as disadvantages of DM 246,2 million and further risks of DM 55,6 million for its investment in the Chemnitz II engine plant as compared to an equivalent investment at comparator plants in France. These cost disadvantages arise from infrastructural and other investment handicaps of the new *Länder* and of the relevant sites in Mosel and Chemnitz, from higher operating costs during the first five years of operation of the new plants (including labour, materials, transport and overhead costs) and from certain environmental and labour-cost risks associated with the investment;

7. in connection with Commission Decision 96/257/EC (7) on restructuring aid to SEAT, Volkswagen undertook to reduce its total EC car-making capacity by the end of 1997. This undertaking included an obligation not to increase Mosel's current capacity of 432 cars per day;

8. as a result of Volkswagen's efforts to build a base of local suppliers in the region, by the end of last year there were already 129 newly established enteprises in the new *Länder* supplying the plants at Mosel and Chemnitz with parts and components;

(7) OJ No L 88, 5. 4. 1996, p. 7.

9. the total number of employees at Mosel II and the new Chemnitz plant is forecast at 3 600, excluding trainees. In addition, the establishment of local suppliers for the new plants and other multiplier effects are expected to lead to the creation of around 20 000 jobs in the new *Länder.*

VIII

When the Commission initiated the procedure provided for in Article 93 (2) of the EC Treaty, its questions relating to the aid measures proposed by the German authorities for the new plants Mosel II and Chemnitz II focused on the following main issues:

The information assembled for the analysis that led to the opening of the procedure pointed to the existence of regional and other aid, the intensity of which still had to be calculated precisely.

The information obtained from the German authorities and Volkswagen in the course of the procedure has enabled the Commission to form a fuller picture of all aid elements in this case, as well as a clear quantification of these aids and their time structure.

The direct aid for the investments in the new plants Mosel II and Chemnitz II, as quantified above, was granted by the German authorities under the joint Federal Government/*Länder* scheme for improving regional economic structures, the Investment Allowance Law and the Assisted Areas Law, which had previously been approved by the Commission.

As the aid measures reduce the financial burden on Volkswagen resulting from its investments in the new *Länder,* they threaten to distort competition between motor vehicle manufacturers within the Commnity. On account of the intensive intra-Community trade in the motor vehicle sector, the proposed measures also affect trade among Member States. They consequently fall within the scope of Article 92 (1) of the EC Treaty and Article 61 (1) of the EEA Agreement.

IX

The German authorities have failed to notify in advance, in accordance with Article 93 (3) of the Treaty, the payment of parts of the regional aid relating to the investments in the plants at Mosel II and Chemnitz II, thereby infringing that Article. Investment grants of DM 360,8 million as well as investment allowances of DM 10,6 million were paid to the company. Special depreciation for the investment was entered by VW in its accounts but has not yet been accepted by the tax authorities. Since the Federal Government did not notify the aid measures in advance, the Commission was not able to give its comments on the measures before they were implemented. Since part of the aid was thus granted in breach of Article 93 (3), it is unlawful.

Since the procedural provisions of Article 93 (3), which are also of significance for public order, are mandatory and since the Court of Justice confirmed their direct effect in its judgment of 19 June 1973 in Case 77/72, *Capolongo* v. *Maya* [8], the unlawful nature of the aid cannot be remedied after the event.

Following initiation of the procedure, the German Government has suspended all further payment of aid until the procedure is terminated.

X

As regards the legal bases on which the Commission should assess the compatibility of the proposed measures, the German Government has stressed that the exemption criteria provided for in Article 92 (2) (c) (certain areas of the Federal Republic of Germany affected by the division of the country), Article 92 (3) (a) (areas where the standard of living is abnormally low or where there is serious underemployment) and Article 92 (3) (b) (serious disturbance in the economy of a Member State) should be applicable to any measures that the Commission might regard as constituting aid.

The derogation in Aricle 92 (3) (b) can certainly not be applied to Germany. It is true that German unification has had negative effects on the German economy, but these alone are not sufficient to apply that provision to an aid scheme. Recently, the Commission took the view that an aid scheme remedied a serious distrubance in the economy of a Member State when, in 1991, aid was approved for a privatization programme in Greece. In its decision the Commission noted that the privatization programme was an integral part of the undertakings given pursuant to Council Decision 91/306/EEC of 4 March 1991 in connection with the consolidation of the national economy as a whole. The German situation is clearly different.

The exemption criterion pursuant to Article 92 (2) (c) should be interpreted narrowly and should not be applied to regional aid for new investment projects. The Commission considers that not only the conditions for exemption provided for in Article 92 (3) (a) and (c) but also, in view of the sector concerned, the Community framework on State aid to the motor vehicle industry allow it to respond appropriately to the problems which the new *Länder* are facing.

[8] [1973] ECR, p. 611.

XI

The following will explain which of the aid measures proposed by the German Government for Mosel II and Chemnitz II can, in the light of its analysis, be accepted by the Commission under the Community framework on State aid to the motor vehicle industry. The framework expressly acknowledges the valuable contribution to regional development which can be made by setting up new motor vehicle and component production facilities in disadvantaged areas. This position is in keeping with the Commission's generally positive attitude towards investment aid granted in order to help overcome structural handicaps in disadvantaged areas of the Community.

It has been the constant practice (9) of the Commission to evaluate regional aid to the motor vehicle industry according to the following steps:

First, it has to be examined whether regional aid can be granted at all. An investigation is carried out into whether the region is eligible for assistance under Community law (normally under an existing aid scheme) and whether the investor has the option of locating the project at another site (mobility of project).

Second, in order to ascertain whether the proposed State aid measure is in proportion to the regional problems it seeks to redress, the Commission uses a standard economic method — a cost-benefit analysis — and compares the costs for the investor of locating the project in that particular assisted area with those in a central, non-assisted region and, in so doing, identifies the handicaps specific to the area. Compensation for such handicaps by way of regional aid is always permissible.

Third, the question of the top-up measures arises. These are increases in aid intensity which should serve as an extra incentive for the investor to invest in the assisted area in question. Such top up is normally approved except in cases where the investment contributes to the creation of capacity problems in the relevant sector. In such cases, the aid will be strictly limited to the net regional disadvantages.

The amounts calculated in the last two steps gives the total amount of aid the Commission can accept. This is normally measured in discounted terms and expressed as a percentage of eligible investment in order to compare it with the gross grant equivalent of the aid.

(9) See, for example, the following aid cases: Ford/VW (OJ No C 257, 3. 10. 1991, p. 5), Opel Eisenach (OJ No C 43, 16. 2. 1993, p. 14), FIAT Mezzogiorno (OJ No C 37, 11. 2. 1993, p. 15), Jaguar (OJ No C 201, 23. 7. 1994, p. 4), FASA Renault (OJ No C 267, 14. 10. 1995, p. 13) and Ford Genk (OJ No C 5, 10. 1. 1996, p. 5).

XII

The Commission has recognized the new German *Länder* as an area where the standard of living is low and which suffers from underdevelopment. Productivity in the region is far below the Community average, and the level of unemployment is exceptionally high and still rising. In order to contribute to the development of the region, high levels of investment and other aid have been authorized. The regions of Mosel and Chemnitz (Saxony), where the new plants will be located, were eligible for investment aid of up to 33 % (until April 1991) and of up to 35 % (after that date) gross aid intensity.

Against the difficult socio-economic situation in the region, the Commission agrees with the German authorities that the proposed investment will make an important contribution to the economic development of the new *Länder*. The investment plan is expected to create directly, or to safeguard, 3 600 jobs in the new *Länder*. A further 20 000 jobs are expected to stem indirectly from the establishment of local suppliers and from other multiplier effects on the economy of the new *Länder*.

However, as was stressed in the Community framework document, the Commission, in evaluating proposals to grant regional aid in this sector, has to ensure that the aid is porportionate to the problems it seeks to resolve and must assess the benefits for regional development against possible adverse effects on the sector as a whole, such as the creation of substantial overcapacity.

While the Commission appreciates that in practical terms the most realistic alternative option for this investor would have been a project in another assisted area within the Community or eastern Europe, it nevertheless considers that the most meaningful measure of the incremental costs arising from the structural handicaps of the region concerned derives from a comparison of the proposed project with a hypothetical greenfield project in a non-assisted area within the Community.

Consequently, the Commission has, with the help of its outside expert, carried out a detailed cost-benefit analysis designed to evaluate the net incremental costs of the new plants at Mosel and Chemnitz as compared with equivalent plants located in Metz (France), the alternative site selected by Volkswagen. These incremental costs include additional investment costs as well as the additional operating costs during the first years of operation of the new plants. The inclusion of operating cost disadvantages during the start-up years in the calculation of cost handicaps is warranted because of the inevitable problems in the early years of operation arising from underdevelopment, partially completed facilities, longer learning periods, geographical remoteness, extra transport costs, insufficient presence of suppliers in the area, lack of skilled workers, etc., which are attributable to the location of the project in a peripheral area.

The Commission's estimate of cost disadvantages, which draws in large part on data provided by Volkswagen and, in part, by independent sources, differs substantially from the first estimate prepared by Volkswagen and submitted by the German authorities in early 1996. These differences arise from the fact that the Commission did not accept the incremental nature of all the cost disadvantages claimed by Volkswagen.

Among those items recognized by the Commission as genuine investment-cost disadvantages are some additional infrastructure costs and expenditures associated with the difficult geological condition at the Mosel and Chemnitz sites as well as higher land prices and building costs. On the other hand, expenditure attributed by Volkswagen to stricter environmental regulations in Germany, in particular as regards atmospheric pollution, were accepted only in part since experience shows that all car manufacturers in the Community, including Volkswagen, strive to achieve high levels of environmental protection in their new plants throughout the Community, even in the continuing absence of appropriate regulations in some Member States.

In its analysis of operating costs, the Commission generally calculates handicaps for greenfield projects (e.g. Ford/VW and FIAT Mezzogiorno; see footnote 9) over a five-year period and for extension projects (e.g. Sevel Val di Sangro ([10]), Jaguar, Ford Genk; see footnote 9) over a three-year period. The term 'greenfield project' does not simply mean that the project is situated in a green field somewhere, but that, from the investing company's point of view, the site is a new, as yet undeveloped one. Consequently, the company faces the following typical special problems as compared with the extension of an existing plant: lack of adequate infrastructure, lack of organized logistics, no trained workforce adapted to the needs of the company, and no established supplier structure. If, however, these services can be provided by a nearby plant belonging to the same group, then the project is treated as an extension, even if it is located in a green field. The Community concept differs from the concept of new investments that may be defined in national law. Since, in the case of a greenfield project as defined in this way, more difficulties arise and the time-span for reaching full capacity and thus viability is somewhat longer, there is justification for calculating the operating cost disadvantages over a longer period. This principle was also recognized by the Commission in the Opel Eisenach case. In Eisenach, there was a former German Democratic Republic car plant but, from Opel's point of view, the location was a new one as the typical disadvantages mentioned above existed. The project was therefore treated as a greenfield project.

In the present case, the Commission had to take into account the fact that the different shops of the investment in Mosel come on stream at different times. Thus, the start-up problems associated with the different subprojects will also occur at different times. Furthermore, the Commission took account of the fact that, through the delay in project implementation, the character of the project has also changed. With the installation of the press and body shops and their link with the modernized paint shop and final assembly halls of the old Mosel I plant, a fully operational car plant was established in Mosel by 1994. This is also demonstrated by the profitability of the VW companies in Saxony since 1994.

The future investment for a new paint and final assembly hall in Mosel II thus no longer constitutes a greenfield investment but represents an extension of existing capacity. Since a supplier structure is already in place (see above), since the infrastructure exists and since most of the workers will be taken over from Mosel I, the typical handicaps associated with greenfield investments will arise to a much lesser degree. This also applies to the Chemnitz II engine plant. As in other cases of capacity extension, the build up of production in these plants is very rapid. Although the German authorities and VW originally suggested an analysis of the period from 1998 to 2002 for all projects in Mosel and Chemnitz, the Commission has analysed the operating handicaps over five years for the proposed greenfield projects, i.e. for 1993 to 1997 (body shop) and for 1994 to 1998 (press shop), and over three years for the extension projects, i.e. 1997 to 1999 (paint shop, final assembly, Chemnitz II). It was also taken into account that the press shop and the body shop will be expanded from a production capacity from 432 cars/day to 750 cars/day during the same period in order to be able to supply fully the new Mosel II paint shop and final assembly. Therefore, the additional operating handicaps for this period (1997 to 1999) that can be attributed to this extension of capacity were also included in the analysis.

The investment handicaps were calculated in great detail and compared with the costs that would arise for similar projects in the comparator plant in Metz. Extra costs claimed by the company for infrastructure, land, buildings, dismantling of existing plant, extra environmental measures due to stricter German rules and other handicaps were examined and either included, in part or in full, in the cost-benefit analysis or disregarded altogether. It was explained in this connection that a comparator plant is meant to represent a realistic and not an ideal location. Many infrastructure measures that were necessary in Saxony would also be necessary in the Metz region but only to a lesser extent (e.g. piling, ground levelling, road access costs).

([10]) OJ No C 298, 11. 11. 1995, p. 9.

For the calculation of the operating cost disadvantages, the Commission has taken into account the relatively low level of labour costs until 1994 and the relatively higher level of future labour costs in eastern Germany, higher costs of materials sourced from local suppliers, extra transport costs and certain cost disadvantages relating to overhead and similar charges as compared with the alternative site in Metz. It is important to note that this analysis is based largely on reasonable assumptions about future developments, since more than 60 % of total cost disadvantages are associated with operating cost disadvantages that emerge during the first three or five years of operation.

In evaluating labour costs, the Commission took into consideration the fact that, following the rescheduling of the investment, which means that the new plants will not come on stream until 1997, VW did not fully benefit from the cost advantage arising from the low wage level in the new *Länder* in the early 1990s. However, by 1997 hourly wage rates in the new *Länder* and other working conditions, such as working hours, holiday entitlement and bonus payments, would still not have fully adjusted to western German levels either. As a result, VW will not suffer either from the full labour cost disadvantage of its western German plants compared with the alternative location.

Taking into account a probable reduction in disadvantages as a result of such developments, a realistic estimate of the total investment and operating cost disadvantages is 22,3 % of eligible investment in discounted terms in the case of Mosel II and 20,8 % in the case of Chemnitz II. This calculation was presented to VW and the German authorities for comments and — after a few clarifications — was basically accepted as a fair estimate. Since the proposed aid intensity of 30,5 % (in discounted terms) for Mosel II and 27,3 % for Chemnitz II clearly outweighs the disadvantages, it can no longer be considered to be in proportion to the problems to be resolved. Therefore, the Commission cannot accept the regional aid for both projects in full, even if they did not lead to adverse effects on the sector as a whole.

With regard to the likely repercussions of the aid on the Community motor industry as a whole, it has to be recalled that the Community framework was introduced at a time when no surplus capacity existed in the Community. This changed dramatically in 1993, when demand fell by 15 %. The Commission notes that most of the car producers in the Community have recently undertaken investment programmes which were conceived in the boom period (1989 to 1992) and were designed to increase their capacities by the mid-1990s so as to satisfy the expected growth in demand for new cars in Europe. In some cases the increases in capacity are substantial. Although the weaker development of the motor vehicle market since 1993 has, to some extent, led to a reassessment of these expansion plans, it has failed to prompt a fundamental revision of the industry's capacity forecasts. Additional capacities from Japanese investments in plants in the Community undertaken in recent years will also come on stream during this period. Capacity-extension schemes in eastern Europe by major European manufacturers, including VW through its Skoda mark, will also have an impact on the Community market, to which these products have relatively free access. Taking the latest estimates, the Commission puts western European car production capacity at some 18 million units in 1995 and at around 20 million units per year by 1999. Assuming that EC demand will continue to increase slowly from the bottom of the downturn and that the Community trade balance in cars will not deteriorate further, the most recent market forecasts expect demand to reach between 13 and 14 million units by the year 2000. This suggests that the present serious overcapacity problems in the Community, where average capacity utilization last year was only some 70 %, will persist during most of the decade unless the industry decides to close down excess capacities over the next few years. Since, in industries suffering from large overcapacity, the distortive effect on competition caused by State aid granted to individual producers is particularly strong, this general prospect adds to the case for the Commission being especially vigilant in assessing proposals for aid to projects which entail new car production capacity.

As to the realization of Volkswagen's investment plan in the new *Länder* and its likely impact on the car industry at Community level, the Commission notes that the Volkswagen group has revised downwards the size of the Mosel II plant, so that it will have a capacity of 750 cars per day when finally operational. However, it should also be borne in mind that the company can at a later stage double its capacity by investing relatively modest amounts, since the buildings and infrastructure facilities are much larger than is necessary for the capacity level planned at the moment.

In order to comply with its obligations under Decision 96/257/EC on restructuring aid to SEAT, VW has to ensure that the capacity of the Mosel plants does not exceed 432 cars per day until the end of 1997. It intends to close the Mosel I plant in the summer of 1997, when the paint shop at Mosel II comes on stream. Furthermore, it will temporarily limit the capacity of this new paint shop to 432 units per day by not installing a second ESTA installation until the end of 1997. This will create an effective temporary bottleneck that limits VW's capacity in Mosel for the period covered by the conditions of the SEAT decision laid down in Decision 96/257/EC. The observance of this capacity limitation will have to be verified through random on-site inspections for which the German authorities have given their consent.

Taking into account the planned closure of Mosel I, Mosel II would still lead to an increase in capacity as from 1998 of 320 cars per day, i.e. 2,6 % of VW's total capacity. At Chemnitz, the new engine plant (capacity of 376 000 units) will replace the old facility (capacity of 280 000 units), resulting in a net increase of 96 000 units or roughly 3,1 % of the Volkswagen group's total western European engine capacity. In its decision on Fiat's Mezzogiorno plan (see footnote 9), however, the Commission had accepted in November 1992 that an increase of 3 % of the group's car capacity was considered to be in line with the development of the Community car market and that the project thus did not have adverse effects on the sector.

However, since the Commission took that decision, the situation and prospects of the European motor vehicle industry have, as shown above, deteriorated. It has to be concluded therefore that the car industry in western Europe currently suffers from overcapacity which is unlikely to disappear in the medium term. The Commission thus considers that the project planned by VW Sachsen will exacerbate sectoral problems. In cases where an investment has adverse effects on the sector as a whole, it has, however, been the Commission's policy under the framework that aid has to be strictly limited to the net incremental costs facing the investor in the disadvantaged region (Opel Eisenach, SEAT Pamplona, Ford Genk). Accordingly, the Commission can approve regional aid to VW Sachsen and VW Sachsen Immobilienverwaltung (the subsidiary of VW Sachsen responsible for the administration of the real estate of the plants) only for an intensity of 22,3 % in the case of Mosel II and for an intensity of 20,8 % in the case of Chemnitz II. Given the notified timetable for the regional aid and the types of aid proposed, this means approval of an amount of DM 418,7 million in the form of investment grants for Mosel II and Chemnitz II and an amount of DM 120,4 million in the form of investment allowances for Mosel II and Chemnitz II.

The Commission considers it necessary that the German authorities should monitor the realization of the eligible project expenditures as defined by the Commission and the precise payment of the proposed aid. It requests the German authorities to send to it, and to discuss with it, an annual report on the outcome of this monitoring before the payment of aid is scheduled to take place. The purpose of this monitoring is to guarantee that the regional aid intensities expressed in gross grant equivalent, as defined by this decision, are complied with by the German authorities. In line with the existing interim report of the Sächsische Aufbaubank, this monitoring exercise is designed not only to verify compliance with the approved aid intensity but also to check that the eligible expenditure has actually gone ahead. In this context, a transfer of capital goods from Mosel I to Mosel II cannot be eligible for regional aid. Furthermore, the monitoring exercise will have to verify compliance with the capacity plan for the Mosel plants until the end of 1997.

XIII

As was explained above, the Commission has carried out a detailed analysis to establish the net handicaps faced by VW through its investment in Saxony. Given the adverse effect of the project on the sector, the permissible aid has to be limited to compensation for those handicaps. Further aid would no longer be in proportion to the regional problems encountered.

Accordingly, the proposed regional aid to VW Sachsen and VW Sachsen Immobilienverwaltung for the Mosel II and Chemnitz II projects, which exceed the intensities found acceptable in Section XII of this Decision cannot be allowed. Given that the investment allowance is a tax relief which is granted almost automatically, it is approved in its entirety. Since the aid in the form of special depreciation with an estimated nominal value of DM 51,67 million has been identified by the company and the German authorities as a type of aid that can be more easily withdrawn, the Commission agrees that the aid to be withdrawn is to include all the proposed special depreciation. Since the proposed aid exceeds the aid eligible for approval by more than the value of the proposed special depreciation, further proposed regional aid for VW Sachsen and VW Sachsen Immobilienverwaltung for the Mosel II and Chemnitz II projects in the form of investment grants to the tune of DM 189,1 million cannot be allowed either,

HAS ADOPTED THIS DECISION:

Article 1

The following aid proposed by Germany for the various investment projects of Volkswagen AG in Saxony is compatible with Article 92 (3) (c) of the EC Treaty and Article 61 (3) (c) of the EEA Agreement:

— aid granted by Germany to Volkswagen Sachsen GmbH and Volkswagen Sachsen Immobilienverwaltung GmbH for their investment projects in Mosel (Mosel II) and Chemnitz (Chemnitz II) in the form of investment grants (Investitionszuschüsse) of up to DM 418,7 million,

— aid granted by Germany to Volkswagen Sachsen GmbH and Volkswagen Sachsen Immobilienverwaltung GmbH for their investment projects in Mosel (Mosel II) and Chemnitz (Chemnitz II) in the form of investment allowances (Investitionszulagen) of up to DM 120,4 million.

Article 2

The following aid proposed by Germany for the various investment projects of Volkswagen AG in Saxony is incompatible with Article 92 (3) (c) of the EC Treaty and Article 61 (3) (c) of the EEA Agreement and may not be granted:

— the proposed investment aid for Volkswagen Sachsen GmbH and Volkswagen Sachsen Immobilienverwaltung GmbH for their investment projects in Mosel II and Chemnitz II in the form of special depreciation on investment under the Assisted Areas Law ('Fördergebietsgesetz') with a nominal value of DM 51,67 million,

— the proposed investment aid to Volkswagen Sachsen GmbH and Volkswagen Sachsen Immobilienverwaltung GmbH for their investment project in Mosel II in the form of investment grants ('Investitionszuschüsse') in excess of the amount specified in the first indent of Article 1 and constituting an additional DM 189,1 million.

Article 3

Germany shall ensure that the capacity of the Mosel plants in 1997 does not exceed a level of 432 units per day. To that effect, it shall in 1997 send to the Commission monthly reports on the capacity and output of the plants, which should give this information for both Mosel I and Mosel II separately. Germany has also agreed to random on-site checks by Commission officials and experts employed by the Commission to verify these data.

Furthermore, Germany shall send to, and discuss with, the Commission an annual report on the realization on the DM 2 654,1 million of eligible investments in Mosel II and Chemnitz II and the actual payments of aid so as to ensure that the combined effective aid intensity expressed in gross grant equivalent does not exceed 22,3 % for Mosel II and 20,8 % for Chemnitz II. The Commission expects the report on the years 1994 and 1995 to arrive by the end of 1996 and the report for 1996 to arrive by 1 May 1997.

Article 4

Germany shall inform the Commission within one month of the notification of this Decision of the measures taken to comply herewith.

Article 5

This Decision is addressed to the Federal Republic of Germany.

Done at Brussels, 26 June 1996.

For the Commission

Karel VAN MIERT

Member of the Commission