



**Department for Business, Energy and Industrial
Strategy**

Written consultation response

**Subsidy control: designing a new
approach for the UK**

The Scottish Council for Development and Industry (SCDI) is an independent and inclusive economic development network representing all sectors and all geographies of the Scottish economy. Our mission is to convene our members and partners across the private, public and third sectors to collaborate to deliver inclusive and sustainable economic growth.

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Subsidy control: designing a new approach for the UK

Introduction

Following the end of the UK's transition period with the EU, the UK is now able to develop and implement a new domestic subsidy control regime to replace EU State Aid rules. SCDI welcomes the opportunity to respond to the proposals contained within the Department for Business, Energy and Industrial Strategy's consultation on this important issue for our members from all sectors and all geographies of the Scottish economy.

Definition

SCDI agrees with the proposed definition of support measures which would be considered a subsidy in line with the definitions used by the World Trade Organisation (WTO) and set out in the UK-EU Trade and Cooperation Agreement (TCA).

Beneficial subsidies

Beneficial subsidies are those which have a strong strategic rationale and are in the public interest because they respond to major social or economic challenges or opportunities and deliver clear social or economic benefits.

Subsidies play a critical role in incentivising or supporting the private sector to invest in research and development, innovation and technological progress. They can deliver gains for businesses and the wider Scottish economy in terms of competitiveness, employment, productivity and inclusive growth. They can also address market failures, reduce inequalities or increase resilience by helping to build domestic industries and supply chains.

It is important that the UK's new subsidy control regime empowers public authorities to intervene flexibly and strategically to achieve major social and economic objectives, not least maximising Clean Growth and delivering a Just Transition to Net Zero.¹

Harmful or distortive subsidies

Harmful or distortive subsidies are those which establish or entrench systems of unfair competition or unnecessarily distort a level playing field between businesses within sectors of the economy or between nations and regions within the UK.

It is important that the UK's new subsidy control regime does not create or contribute to monopolistic and oligopolistic trends and avoids fuelling inefficient 'subsidy races' or 'bidding wars'. These can have a deleterious impact on public finances and unfairly disadvantage more deprived areas with higher levels of need and lower levels of resources. However, there is also a need to recognise the value of innovation and to identify where investment is needed most.

Subsidies should not be used to fund businesses, organisations or sectors which are not likely to become dynamic or competitive in the future, even with government subsidy.

Domestic subsidies can also violate a state's international obligations to trade and treaty partners or the WTO. It is important that the UK's new subsidy control regime underlines and upholds the UK's commitment to an open, rules-based international order and its reputation as an attractive, reliable trade or investment partner.

¹ www.scdi.org.uk/policy/clean-growth-download-our-manifesto

Objectives

The consultation document sets out four proposed objectives for the UK's new subsidy control regime:

1. Facilitating interventions to deliver on the UK's strategic interests

SCDI agrees with this objective.

The design of the new regime should focus on enhancing the ability of public authorities at the central, devolved and local levels to successfully deliver interventions which transform and rebalance the UK economy. This will require a more activist and interventionist approach than that taken to date.

SCDI believes that subsidies should be aligned with the UK's industrial strategy or plan for growth. The new regime should deliver against three broad strategic priorities which represent major social and economic challenges and opportunities for Scotland and the UK in the years ahead:

A. Net Zero

Decarbonising the UK economy, supporting a Just Transition for communities, sectors and workers and fuelling Clean Growth to achieve Net Zero in Scotland by 2045 and across the UK by 2050.²

B. Levelling Up

Recognising where investment is needed most and reducing inequalities between nations and regions to 'level up' the UK economy.³

C. Innovation

Investing in new or highly innovative businesses, sectors and technologies to deliver higher levels of productivity, create new jobs and boost wages.^{4 5}

However, the new regime will require some flexibility across the UK in its design and implementation. There should be no centralisation of subsidy schemes. Public authorities – particularly the Scottish Government, its agencies and local authorities – must have the ability to make strategic interventions in line with their powers and in line with locally determined interests, challenges, opportunities and plans. For example, Scotland's Net Zero target is for 2045 compared to the UK's target for 2050, while several Scottish local authorities have set even more ambitious targets for their cities or regions.

The proposed objectives could be strengthened with an explicit aim to address economic disparities and inequalities within and between the nations and regions of the UK.

There may be a need at a time of economic shocks for short-term interventions to stabilise businesses or sectors which are of strategic significance and importance for the Scottish economy or the UK economy.

The new regime must enhance the ability of central, devolved and local government to support domestic industry to develop internationally competitive local supply chains for the renewable energy sector in Scotland. As part of a wider package of measures and

² www.scdi.org.uk/policy/clean-growth-download-our-manifesto

³ www.scdi.org.uk/policy/consultation-response-uk-advisory-groups-on-economic-recovery

⁴ www.scdi.org.uk/policy/ai-and-data

⁵ www.scdi.org.uk/policy/mindthegap

interventions, subsidies should help to create a more level playing field for the Scottish manufacturing industry in comparison with international competitors in Europe and Asia in receipt of often substantial State Aid.

This would support each of these three strategic priorities by accelerating the transition to a Net Zero economy; creating new green jobs in rural and coastal communities along Scotland's east coast; and supporting the testing, development, deployment and export of new innovations such as carbon capture and storage, floating offshore wind or green hydrogen.⁶

The new regime should also support the development and strengthening of domestic industries, supply chains and innovations in key sectors which are critical to the resilience of our economy and our society, such as manufacturing and health & social care.⁷

2. Maintaining a competitive and dynamic market economy

SCDI agrees with this objective.

It is important that the new regime increases and accelerates investment in the UK in the research and development, innovation and technological progress which fuels a dynamic, modern economy, while also preventing unfair competition which distorts markets with negative impacts for consumers and other businesses. Subsidies should not be used to fund businesses, organisations or sectors which are not likely to become dynamic or competitive in the future, even with government subsidy.

3. Protecting the UK internal market

SCDI members have raised significant concerns about the potentially damaging impact and interpretation of this proposed objective, specifically in relation to Subsidy Control Principle 6.

Under Principle 6, public authorities would have to evaluate proposed subsidies for potential impacts on the UK internal market. There is a lack of clarity in the consultation document about the potential scope of the application of this principle; how it could be interpreted by the proposed independent body; and whether it could compromise schemes implemented by devolved or local public authorities.

It is unclear whether the distinct and often long-standing approaches of Scottish public authorities will be respected and protected under the new regime. There is a risk that the proposed approach could lead to devolved or local subsidy schemes being blocked or challenged despite their effectiveness in delivering strategic objectives and stimulating additional economic activity.

If the new regime fails to guarantee this flexibility, it could create new and significant constraints on the ability of Scottish public authorities to tackle issues or advance strategic objectives specific to Scotland, its regions or local areas. It could also create new and significant constraints on the ability of the UK's nations and regions to pilot and trial different interventions or deliver policy innovation – sharing lessons and best practice from which has been a strength of the status quo.

As is the case at present, Scottish public authorities should be able to maintain existing or introduce new subsidy schemes independently and regardless of whether all other parts of

⁶ www.scdi.org.uk/policy/clean-growth-download-our-manifesto

⁷ www.scdi.org.uk/policy/mindthegap

the UK have comparable schemes. The UK Government or others should have to demonstrate why such schemes are not appropriate in each case if they object, perhaps with consensus reached through a 'four nations council' or reviews conducted by the independent oversight body.

4. Acting as a responsible trade partner

SCDI agrees with this objective.

It is important that the new regime ensures that subsidies granted in the UK are given in line with our international commitments and legal obligations, including the UK-EU TCA. It should underline and uphold the UK's commitment to an open, rules-based international order and its reputation as an attractive, reliable trade or investment partner. It should not make it more difficult to maintain and agree trade deals or reduce and remove barriers to trade with existing partners.

SCDI urges the UK Government and the Scottish Government to urgently agree a way forward for proposals for 'green ports' in Scotland.⁸

UK Internal Market

As noted above, there are important issues to consider in relation to the new regime's potential impact on devolution and the UK internal market. It should allow different parts of the UK to take different approaches in line with their own priorities, targets and strategies.

While the new regime should be part of an agreed, consensual approach between the UK Government and devolved administrations to protect seamless trade across the UK to prevent unnecessary barriers and costs for Scottish businesses and consumers, it must also respect the devolution settlement and must not weaken the subsidy scheme powers of Scottish public authorities.⁹

Guidance for public authorities

Subsidies are administered at all levels of government in the UK. It is important that central government develops clear, useful and timely guidance in collaboration with public authorities at the devolved and local level. Delivering the three major strategic priorities outlined above will require a more activist and interventionist approach from public authorities, who will therefore need clear parameters and guidance in an evolving landscape to encourage ambition and innovation at pace.

The ongoing interim period between EU State Aid rules and the UK's new regime, during which subsidies are governed by the relevant chapter of the UK-EU TCA has created additional uncertainty and legal costs for public authorities.¹⁰ The COVID-19 crisis has in some instances exacerbated this confusion and caused damaging delays, especially in relation to the eligibility of charitable organisations for support.¹¹

The commitment in the consultation document to provide a draft of the Department for Business, Energy and Industrial Strategy's proposed response to the consultation to the devolved administrations and consider their representations before a final report is published is very welcome. It is important that this information is shared in a fair and timely manner to

⁸ www.scdi.org.uk/policy/consultation-response-freeports

⁹ www.scdi.org.uk/policy/consultation-response-uk-internal-market

¹⁰ www.instituteforgovernment.org.uk/blog/uk-subsidy-control-system

¹¹ www.civilsociety.co.uk/news/state-aid-confusion-costing-charities-millions-of-pounds.html

allow for considered, constructive and meaningful dialogue. The UK Government and the Scottish Government should work closely together to agree as far as possible an approach to subsidy controls which respects the devolution settlement and benefits the Scottish economy.¹²

Scottish public authorities at the devolved and local level need further clarity in the following areas to assist with compliance:

- How will the proposed changes to subsidy controls affect their scope to determine the focus and nature of subsidy schemes in their respective nations, regions or communities?
- Will Scottish public authorities be able to maintain existing or introduce new subsidy schemes regardless of whether all other parts of the UK have comparable schemes?
- When will 'no aid' status apply?
- What measures will be taken to minimise the risk of 'subsidy races' while identifying where investment is needed most? Will this process utilise existing processes such as the Assisted Area map?
- How will devolved and local public authorities be able to participate in the design and implementation of any centrally administered subsidy schemes?

Exemptions

SCDI agrees that subsidies under the proposed small amounts of financial assistance threshold be exempt from all obligations under the domestic regime, except for the WTO prohibitions. This will give public authorities a useful degree of flexibility at the lower end of the subsidy scale to enable them to smaller businesses in particular, which are the backbone of our economy, as well as to prevent the emergence of an overly bureaucratic regime of controls.

SCDI agrees that relief for exceptional occurrences be exempted from obligations regarding principles, prohibitions and conditions in the subsidy control regime, although not transparency obligations. It is particularly important in the context of climate change which will increasingly disrupt our economy, our society and our communities through more frequent and more extreme major weather events. The UK's public authorities must have wider scope to compensate businesses and others for drought, flood, severe storms or wildfire.

SCDI agrees that subsidies granted temporarily to address a national or global economic emergency be granted the proposed exemptions. The COVID-19 pandemic has underlined the critical importance of public authorities being able to react swiftly and act boldly during social and economic crises to save lives and livelihoods. There may be a need in such circumstances or at a time of economic shocks for short-term interventions to stabilise businesses or sectors which are of strategic significance and importance for the Scottish economy or the UK economy.

Transparency

¹² www.scdi.org.uk/policy/consultation-response-uk-internal-market

SCDI believes that the highest standards of transparency should be integral to the new regime. It is vital that there is public trust and scrutiny as to the spending of public money. Public authorities should therefore be obliged to make competition impact reviews public in a timely way.

Functions of the independent oversight body

The independent oversight body at UK level to be created under the terms of the UK-EU TCA should have the following key functions:

A. Information and enquiries

The independent oversight body should have a duty and a mandate to engage with public authorities, private businesses, other stakeholders and the wider public about the new regime. It should have the expertise and resources to answer questions from subsidy givers, applications and recipients and to disseminate best practice. It should produce and update guidance for public authorities.

B. Review and evaluations

The independent oversight body should scrutinise and report on the operation and effectiveness of the regime as a whole. It should report regularly to politicians, policymakers and the public to provide transparency on the distribution of public money, to advise on potential systemic changes to deliver improvements and to review whether subsidies are genuinely stimulating additional economic activity. It could also potentially conduct reviews of subsidy schemes which are objected to or facilitate discussions between the 'four nations' to reach an agreed resolution.

C. Scheme development and advice

The independent oversight body should have the expertise to act as a voluntary resource for public authorities in the development and design of subsidy schemes. It could act as a platform or network for collaboration, peer-to-peer learning and the sharing of best practice across the UK.

Decisions by a public authority to award a subsidy will be open to challenge through the courts. The UK Government has committed to maintaining a court and tribunal enforcement system which is competent to review subsidies awarded by public authorities.

It is critical that the independent oversight body takes full account of the distinct needs and characteristics of all the nations and regions in its work and in its decision-making. It should include Scottish representation on a statutory basis. It should consult and engage with Scottish public authorities, businesses, organisations and citizens on a frequent basis and in a pro-active, meaningful and transparent way in carrying out its functions for the whole of the UK.