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Taking back control of subsidies

Replacing EU state aid rules in the UK

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About this report

The future of subsidy control in the UK was one of the main sticking points in Brexit negotiations in 2020. The deal that was eventually agreed goes beyond what most free trade agreements require on subsidies, but still leaves the UK free to design its own regime. The government is now bringing forward legislation for the new system, and this report explores how the government can design a successful regime that satisfies its ambitious objectives.

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Summary

The UK's Brexit negotiators secured freedom for the UK to depart from EU state aid rules and design its own subsidy control system. The government now has an early opportunity to show a 'Brexit dividend' by designing a system that works for the UK better than the EU regime did. But it must ensure the new rules are effective at directing funding to meet stated priorities such as reaching net zero carbon emissions and 'levelling up' while preventing wasteful subsidies – especially subsidy races between the four nations of the UK. This report outlines how the government can make the new subsidy control system a success.

As an EU member state, the UK was an architect and proponent of the EU state aid rules, but the freedom to break away from them became a major sticking point in EU–UK trade negotiations in 2020. In the end, the Trade and Cooperation Agreement (TCA) granted the UK freedom to chart its own course. That agreement requires the UK to design a system to prevent grantors – governments and public bodies – providing harmful subsidies to businesses. But it allows the UK to adopt rules and processes that differ from the EU state aid system. This freedom can deliver benefits to the UK. But the government must design the regime carefully to show this 'Brexit dividend'.

The UK has the opportunity to design a system that is better than state aid for the UK context. State aid practitioners in the UK and elsewhere have complained that the EU rules were inflexible and bureaucratic. This is in part because the European Commission needs to retain control of subsidies in 27 countries with different approaches to public spending control. The UK does not face this constraint (at least not at this scale), so should be able to design a less burdensome system that works better for UK public bodies and businesses, and therefore for taxpayers too.

The new domestic system should include a check on wasteful subsidies and, critically, should guard against subsidy races between different regions and nations in the UK, which would harm the country overall. However, getting the new system right will not be easy. The UK will be unique globally in having a legally binding subsidy control regime that is not based on the EU rules, so there is no alternative 'off the shelf' model from which to work.

A poorly designed regime risks two problems. First, a system that gives governments too much latitude when designing subsidies risks leading to an inconsistent approach across the country and possibly permitting subsidies that are excessive or wasteful, and therefore damaging. Second, a system that fails to deliver legal certainty may have a 'chilling' effect, deterring governments and public bodies from offering subsidies or businesses from receiving them to avoid the risk of legal challenge. This would undermine the system from the perspective of government and taxpayers too, because subsidies cannot be used as effective policy tools if public bodies and businesses are unwilling to offer or receive them. This risk is especially acute for subsidies at low risk of affecting competition, which had a lower-cost route to legal certainty in the EU system.

Recommendations in brief

As the government prepares to bring forward legislation for the new system, this paper recommends how it can ensure it designs a successful regime that meets its objectives, which match those we have previously recommended, and improves upon the EU rules for governments, businesses and taxpayers. The government should:

- **Clarify in regulation and guidance what constitutes an 'allowable subsidy'.** The current 'interim' system that has applied in the UK since the end of the Brexit transition period is based on public bodies assessing for themselves whether their subsidy complies with the principles outlined in the TCA. But those principles are open to wide interpretation. Clear guidance and regulation are needed to ensure subsidies are directed towards genuine public policy priorities, to ensure the system works consistently across the country and to provide additional legal certainty for public bodies and businesses.

- **Choose the Competition and Markets Authority (CMA) as a regulator at the centre of the system.** The UK needs to appoint an independent body to support the new system to avoid the legal uncertainty that has proliferated during the current interim regime. This regulator does not need to have the gatekeeper role that the European Commission has in EU state aid. In its additional capacity as subsidy regulator, the CMA should provide advice to public bodies on a voluntary basis before subsidies are offered. It should also have the power to challenge subsidies, monitor the operation of the system and write guidance. While it is not a perfect fit in every respect, we conclude the CMA's expertise and reputation for independence makes it best suited for this role.

- **Reform the governance of the CMA to make it a genuine four-nation body.** As the subsidy control regulator, the CMA would play an important role protecting competition within the UK. Although the responsibility to legislate for such a regime is reserved to Westminster, it will affect all four nations in the UK and requires the buy-in of all four governments if it is to be effective. The devolved administrations should be able to appoint one member each to the board and should be involved in changes to regulation and guidance.

- **Adopt a 'safe harbours' approach for low-risk subsidies.** The government's consultation acknowledges that it needs to develop a low-cost way for smaller subsidies – more numerous than big, important projects – to comply with the rules. The EU has block exemptions: rules and conditions for subsidy design that automatically guarantee legality. These are widely used but have a bad reputation, as they are complex and difficult to comply with. The UK can and should design better and more flexible template subsidies to guarantee compliance. The so-called 'safe harbours' approach is the best way to provide legal certainty for smaller subsidies at low cost.

- **Design an effective and robust system to demonstrate that Article 10 of the Northern Ireland protocol is no longer necessary.** Article 10 of the protocol means that EU state aid rules will still apply to some subsidies that affect Northern Ireland. But the scope of that provision is contested: the EU argues that more subsidies will be captured by it than the UK government says. This disagreement could undermine the UK system and make grantors reluctant to offer subsidies for fear of challenge under the EU system. An effective subsidy control regime can demonstrate that the Article 10 'backstop' is not necessary to prevent UK subsidies from affecting the EU. Over time, the UK government should look to negotiate a limit to the scope of Article 10 or complete removal.

Introduction

The UK was a supporter of state aid rules while a member of the EU but breaking away from them became a major goal of UK negotiators in Brexit talks. The Trade and Cooperation Agreement (TCA), agreed on Christmas Eve 2020, gives the UK the freedom to design its own regime for how government and public bodies can subsidise businesses. The government will now bring forward legislation, announced in the Queen's Speech,[1] to deliver such a regime.

Subsidies from governments to businesses can play an important role in achieving public policy priorities. Well-designed subsidies can be effective at achieving objectives such as environmental protection, boosting regional growth, and research and development (R&D).[2] As such, subsidies will likely play a key role in the government's manifesto pledges of 'levelling up', reaching net zero carbon emissions and increasing R&D as a share of GDP.

However, subsidies can also be damaging. If used poorly they can waste taxpayer money and damage economic performance, such as by propping up failing businesses. There is also the risk of encouraging 'subsidy races' between parts of the country to attract activity that are detrimental overall. For these reasons the EU, as a bloc comprising greatly differing economies, used state aid rules to restrict when member states could offer subsidies as part of its broader aim of creating a 'level playing field'.

The UK has historically not made as much use of subsidies as other EU countries. In 2018, for example, the UK spent £8 billion (0.4% of GDP) in approved state aid. That ranked 22nd out of 28 as a share of GDP, far below Germany (1.4% of GDP) and little over half that of France (0.7%).[3] Yet despite making relatively little use of subsidies, the UK government made leaving the orbit of EU state aid a priority. This reflected a legitimate desire to reassert sovereignty and no longer be subject to the rulings of EU institutions, to make more flexible use of subsidies, and also frustrations with the bureaucratic nature of the EU regime. But the EU was concerned at the prospect of a large neighbour having complete freedom to design subsidies that might attract activity across the Channel.

The TCA therefore requires that the UK adopts a legal subsidy control regime. This is a requirement that goes beyond any other trade agreement, except for those signed with a view to future EU accession. It will also make the UK unusual internationally because no other countries have a legally binding subsidy control regime of this sort except for EU, or aspiring EU, countries. But the agreement does not dictate the key design details; the UK has substantial freedom to depart from the EU approach. Chapter 1 sets out what restrictions the TCA does impose on the UK regime.

Despite indicating in 2020 that it might not adopt any domestic system for subsidy control,[4] the government has since acknowledged the domestic benefits of such a regime, not least to prevent subsidy races within the UK.[5] It has recently consulted on the design of the new regime and legislation for this was among the 30 bills listed in the Queen's Speech on 11 May. Subsidy control is an early opportunity for the government to show a 'Brexit dividend' by designing a domestic regime that better meets the UK's policy objectives than the 27-nation EU system it has just left.

In Chapter 2, we outline the government's own objectives for the system, which match those that a previous Institute for Government report recommended.[6] The government intends to design an effective regime that prevents harmful subsidies and supports broader industrial policy, while imposing fewer costs on public bodies and businesses than the state aid rules. This will be in the interest of the government and taxpayers, while a system that provides certainty and is not administratively costly will also work well for businesses – whose involvement is, after all, critical in making subsidies an effective policy tool.

There are several design choices that the government faces as it sets up a new system that meets these objectives. This report – based on interviews with (mostly UK-based) policy makers, subsidy control lawyers, economists and practitioners – addresses how the government should design the new regime.

The first set of choices concerns what the subsidy control rules should be. Regardless of exactly how permissive the government wants the system to be – a political choice that could mean a bigger or smaller role for the state – it needs to get the basics right by designing rules that are effective at identifying, permitting and facilitating beneficial subsidies while preventing harmful ones. The way the rules are designed will also affect how flexibly the system operates. Chapter 3 recommends how the government should do this.

The second set of choices, addressed in Chapter 4, concern the operation of the regime and the process that subsidies go through as they are approved and challenged. The EU system requires all subsidies to be approved by the European Commission; this leaves governments and public bodies relatively little discretion when designing subsidies, and practitioners often complain that the process can be slow and bureaucratic. It is the operation of the EU system – as much as the rules themselves – that many interviewees felt the UK could improve in its own domestic system.

These choices centre on what role an independent body or regulator would play in approving subsidies and enforcing non-compliance, and the role of the courts. As well as recommending what the role and powers of the regulator should be, we also address how it should be governed. A subsidy control system will be important to protect competition within the UK, including between the four nations. But for this reason, it is likely to be a source of tension between the UK government and the devolved administrations. An appropriate role for the devolved administrations in the governance of the subsidy regulator will ensure that the system has the stability

and buy-in that will be critical to its success. Chapter 4 also recommends how the process to approve subsidies should work for 'low risk' subsidies such as the relatively small subsidies offered by local authorities.

Throughout most of the paper, we treat the new domestic subsidy control system as if it is the only one that will apply in the UK. In practice, EU state aid law still has some jurisdiction in the UK via Article 10 of the Northern Ireland protocol. In Chapter 5, we ask how the UK regime should adjust to account for the continuing role of EU rules for some subsidies related to Northern Ireland.

1. The restrictions in the Trade and Cooperation Agreement

The Trade and Cooperation Agreement (TCA) covers many aspects of the new relationship between the UK and the EU. Its chapter on subsidy control[1] was one of the most contested of the negotiations, and the eventual deal on it was far from the starting positions of both parties.

The EU's ambition from the outset of the negotiations was to retain some restrictions on the UK's use of subsidies given the size of the UK market and its proximity to the bloc. It proposed that the UK should continue to follow EU state aid rules, with some oversight of the European Court of Justice (ECJ).[2] The UK's negotiators, on the contrary, sought total regulatory sovereignty and the freedom for the UK to subsidise as it saw fit. They argued that free trade agreements (FTAs) – including those negotiated by the EU – typically contained only limited constraints on subsidies, and that the UK–EU deal should follow a similar approach.[3]

The subsidy chapter eventually agreed goes beyond the provisions of almost all other FTAs.* It requires the UK to adopt a subsidy control system – itself a comparatively unusual demand – and imposes some requirements on that system. However, the EU did drop its original demand that the UK continue to follow EU state aid rules and be subject to the jurisdiction of the European courts.

The TCA subsidy chapter is designed to do three things. First, it sets out conditions for what subsidies will be permitted, which both the EU and the UK agree to observe. Second, it sets out a process for both sides to challenge subsidies offered by the other if they deem that a subsidy has violated these conditions. Finally, it imposes some constraints on how the UK domestic regime should function. This chapter focuses on how the TCA will constrain the design of any UK regime.

The constraints on subsidies are new but not controversial

The first role of the TCA's subsidy chapter is to define what constitutes a subsidy and when one can be permitted. Though departing from both EU and World Trade Organization (WTO) usages, the result is not drastic.

* The only exceptions are FTAs signed between the EU and states that intend to accede to the EU in future, where the FTA requires that the country follow EU state aid rules domestically.

The definition of a subsidy in the TCA is new, but standard

The subsidy chapter applies only to measures that meet four criteria:

1. They arise from the resources of the parties [the UK and EU]

2. They confer an economic advantage on one or more economic actors

3. They are specific in so far as they benefit, as a matter of law or fact, certain economic actors over others in relation to the production of certain goods or services

4. They have, or could have, an effect on trade or investment between the parties.[4]

A transfer of resources (which could be a grant, a tax break, a loan at better than market rates or a guarantee) from a government to one or more businesses would constitute a subsidy. The third part of the definition means that a measure that benefits all businesses – such as an across-the-board tax cut – would not constitute a subsidy, but a measure only benefiting one or some businesses (such as an R&D tax credit) would. For the purposes of the TCA, only measures that could affect trade and investment between the UK and EU are covered, although in practice the bar for what "has, or could have, an effect on trade" is low in the EU state aid system and so the definition within the TCA is also likely to be interpreted as such.[5]

These components of the definition of a subsidy use different language to the EU state aid rules and the WTO anti-subsidy and countervailing measures (ASCM) rules.[*,6] But the meaning is substantively similar and so the TCA is consistent with these other systems' understanding of what constitutes a subsidy.

Subsidies will be allowed if they comply with six principles

At the heart of the TCA's provisions on subsidies are six principles, compliance with which will permit their use. They are that:

1. Subsidies pursue a specific public policy objective to remedy an identified market failure or to address an equity rationale such as social difficulties or distributional concerns ("the objective")

2. Subsidies are proportionate and limited to what is necessary to achieve the objective

3. Subsidies are designed to bring about a change of economic behaviour of the beneficiary that is conducive to achieving the objective and that would not be achieved in the absence of subsidies being provided

4. Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy

[*] The WTO system definition includes only the first three criteria.

5. Subsidies are an appropriate policy instrument to achieve the objective and that objective cannot be achieved through other less distortive means

6. The subsidy's positive contribution to achieving the objective outweighs any negative effects, in particular the negative effects on trade or investment between the EU and the UK.[7]

These principles are not controversial and – almost by definition – are evaluations the grantor would be expected to make when designing subsidies. Subsidies that failed to abide by these principles would waste public money (for example, by giving a business money for a project it was already intending to do or offering more money than was necessary for them to deliver the project). Or it would do more harm than good, in violation of the final principle.

The principles mirror the approach taken by the European Commission when assessing whether subsidies should be permitted.* Its compatibility assessment for subsidies – in place long before the TCA was signed – asks whether subsidies satisfy a set of criteria, all of which are reflected in the TCA principles.[8] The commission has a consistent methodology that it applies to different types of subsidies, backed up by case law, to establish whether any subsidy should be approved, including a balancing test to establish whether the benefits exceed the costs.

However, the UK regime need not take the same approach or reach the same conclusions about which subsidies should be permitted as the EU regime. The TCA does not set out *how* an assessment of compatibility with the principles should be carried out, nor when the tests are met and when they are not. Definitions such as 'public policy objective' and 'proportionality' are not clarified in the TCA, and different approaches could yield very different answers on the sixth principle – whether the benefits outweigh the costs – when those costs and benefits are difficult to quantify.

Subsidies banned outright are already prohibited by other agreements

While most subsidies can be permitted if they comply with the six principles, some are prohibited in all circumstances.[9] Four categories of subsidy are banned under all circumstances. The first two are subsidies that are contingent on export performance or contingent on the use of local inputs; these are also prohibited under the WTO ASCM rules,**[10] which the UK is already signed up to. The other two are unlimited state guarantees and the rescue of ailing businesses where there is no credible restructuring plan; these are also prohibited in the EU–Japan FTA (the text for which was replicated in the UK–Japan deal).[11]

Even if these subsidies were not explicitly ruled out they would tend to offer poor value for money and so would be unlikely to be compatible with the principles anyway. Banning them under all circumstances is a sensible way to streamline the system.

* The EU is subject to the same obligations under the TCA but has not made changes to EU State Aid law because the approach is compatible.

** The WTO rules only apply to goods and not to services.

Some subsidies are not covered by the agreement

While the TCA's more general restrictions apply in most instances, there are exceptions.[12] The TCA provisions do not apply to subsidies to agriculture, fisheries or the audio-visual sector. This reflects the different treatment of those sectors in the EU and UK, where agriculture is heavily subsidised and the national film industry and broadcasters receive state support. The audio-visual sector is also excluded from the service provisions of the TCA in general.

Some of the TCA requirements do not apply for temporary subsidies offered in response to emergencies, including natural disasters (such as floods), and there is restricted coverage for measures to respond to global economic crises (such as pandemics).* Furthermore, subsidies of less than £335,000** to any business over three years are automatically compliant with the TCA. There is an equivalent threshold in EU state aid, but that is set at the much lower level of €200,000 (£170,000) over three years.[13]

The TCA does not specify how the regime should operate

The TCA leaves the UK largely free to decide how its system should operate. It does have requirements about transparency: subsidies must be published on a public database within six months of being granted.[14] The Department for Business, Energy and Industrial Strategy (BEIS) has already set up a portal for this purpose.[15] But this does not affect how subsidies are approved – merely that their award should be transparent.

The TCA is especially vague on the role of institutions. Most notably, it requires the UK to "establish or maintain an operationally independent authority or body with an appropriate role in its subsidy control regime"[16] – but it does not specify what an "appropriate role" would be. The EU system is controlled by the European Commission, which approves subsidies that must be notified in advance. Unless approved by the commission, a subsidy is unlawful (see Box 1). The UK system need not operate in the same way. Indeed, the independent body need not have a role approving subsidies at all.

The TCA does set out requirements for the role of the courts of each side. Complainants must be able to challenge subsidies that they judge to have violated the principles in the TCA on judicial review. The commission and UK government are entitled to intervene in such proceedings. But the UK retains freedom over which court will hear those challenges and the extent of the courts' role in the system.

* Measures in response to global crises do not need to demonstrate compliance with the principles but cannot take the form of subsidies that are prohibited by the agreement.

** The threshold is 325,000 Special Drawing Rights, a foreign exchange reserve asset defined and maintained by the International Monetary Fund. As of April 2021 this converts to £335,000, but could change over time as the pound appreciates or depreciates against other global currencies.

But the threat of challenge will impose some constraints

The provisions of the TCA subsidy chapter still go much further than other FTAs. Beyond the binding requirement for the UK to have a domestic regime, the chapter also sets out the process by which the EU can challenge UK subsidies (and vice versa). This includes the possibility that the EU can take "remedial measures" such as imposing tariffs on unfairly subsidised products.[17]

This threat provides an external check on the UK regime. It means that the UK will require a sufficiently rigorous new system to monitor and regulate any subsidies that are subject to the TCA requirements to ensure that the UK does not violate its international obligations and unintentionally generate a dispute with the EU.

This will apply some practical constraints on the system. Most notably, the UK system will need to monitor all subsidies above the TCA's £335,000 three-yearly threshold. While this is almost twice as large as the EU's threshold, it is still low enough that many relatively small subsidies will be captured. This means that the system will need to provide an effective, low-cost route for public bodies to demonstrate that smaller, lower risk subsidies are compliant.

Box 1 **The EU state aid system**

The EU's subsidy control system is known as the state aid regime. Its basis is Articles 107 and 108 of the Treaty of the Functioning of the European Union (TFEU).[18] The practical operation of the system can be summarised by three key features (also seen in Figure 1).

The 'standstill obligation' and the 'gatekeeper' role of the European Commission

Unless a subsidy is approved by the commission, it is unlawful and must be repaid if challenged in a national court.[19] This 'standstill obligation' is central to the operation of the EU state aid regime. It means that all subsidies that are being considered must be notified to the commission and approved *before* they come into operation. In deciding whether to approve a subsidy, the commission applies its own 'balancing test' for whether the benefits of a subsidy outweigh the cost, based on guidance and regulations that it writes. If measures are not notified to the commission, it can investigate them, either in response to a complaint from a third party or of its own volition. In this sense, the commission has a 'gatekeeper role'.

The role of the courts in the appeals process

Commission decisions can be appealed by the granting body or a competitor in the Courts of Justice of the European Union (CJEU) – the general court and the ECJ. The courts' remit is to judge the subsidy measure against Article 107 of the TFEU. That means that the EU courts can find that the commission was wrong to judge that a measure was a subsidy (if it does not meet the definition set out in the treaty). But they do not challenge the commission's assessment of the balance of costs and benefits of a subsidy unless it finds it has failed to look at something it should have.

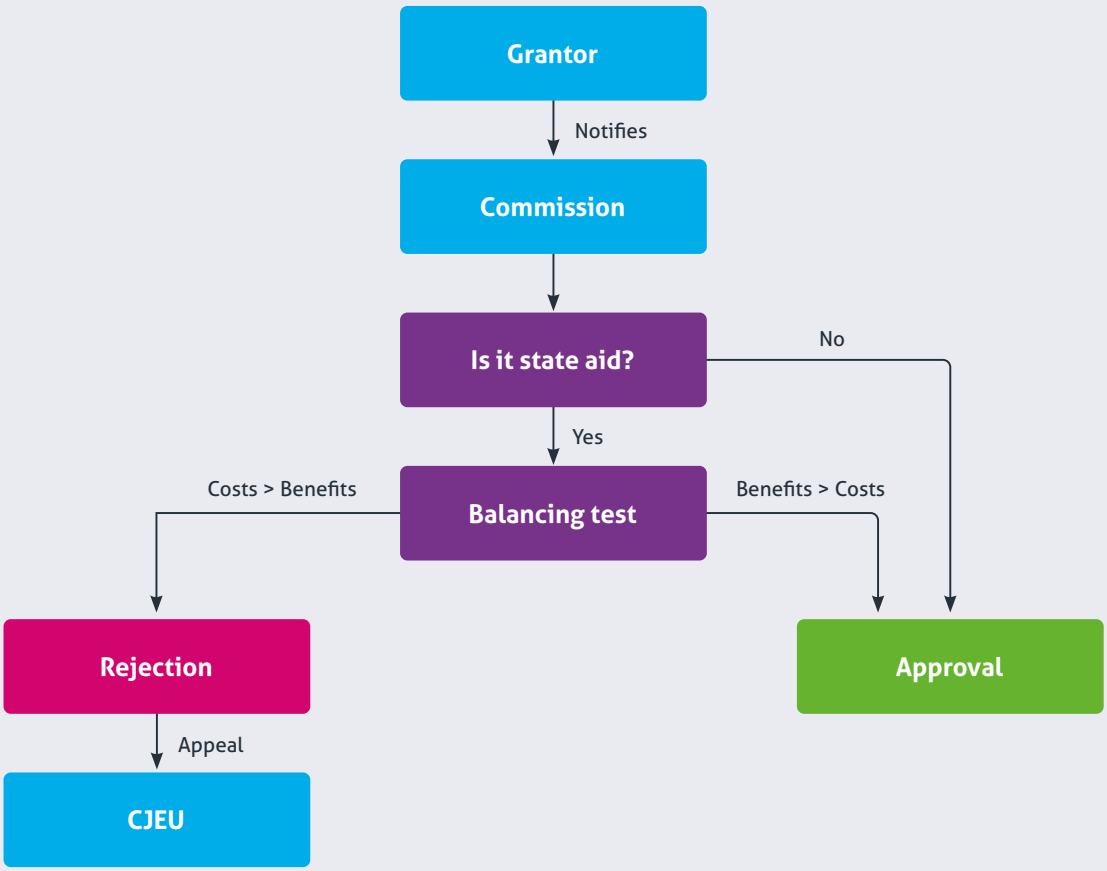
Safe harbours: the General Block Exemption Regulation (GBER)

Until 1998, every subsidy measure – or potential subsidy measure – had to be notified and then approved by the commission.[20] However, this meant that much of the commission's time was spent on relatively small subsidies that resembled others it had approved in the past and that posed little risk of distortion. The commission therefore developed block exemption regulations, which are effectively detailed checklists for subsidies in different categories and set out the compatibility conditions that must be met for a measure to be lawful.
If a subsidy meets all the relevant criteria for one of these block exemptions – for example, the total spend is below a certain amount, the fraction of the total cost supported is below a certain amount, the measure increases employment and so on – the subsidy need not await notification but can instead be approved automatically.

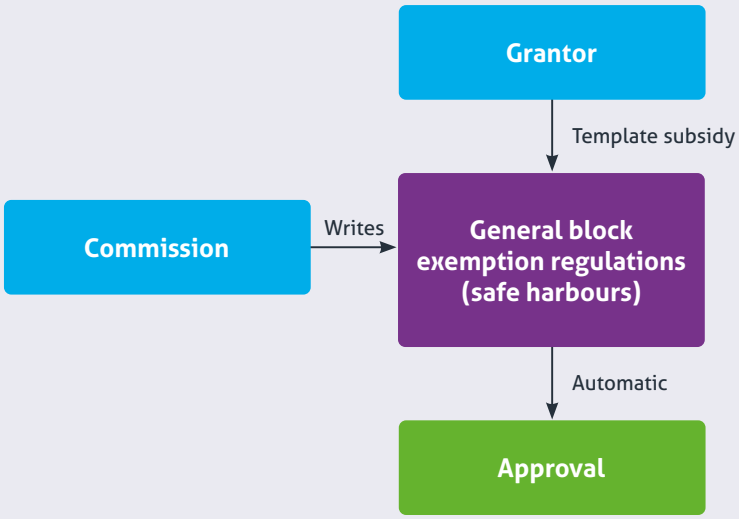
The only requirement is that the subsidy be declared to the commission. More than 90% of the subsidies that are now granted are approved automatically via this 'safe harbour' route, rather than the formal notification route. The latter route is now largely reserved for the biggest subsidies.

Figure 1 **Approval of subsidies in the EU**

Notification route



Safe harbours route



Source: Institute for Government analysis.

2. The objectives of the UK subsidy control system

Before analysing how a UK subsidy control regime should be designed, it is important to establish what the regime is intended to achieve.

The consultation document published by the government in February sets out its objectives for the regime.[1] These are:

- Facilitating interventions to deliver on the UK's strategic interests
- Maintaining a competitive and dynamic market economy
- Protecting the UK internal market
- Acting as a responsible trade partner.

We elaborate on what these objectives mean below. Together, they explain the reasons why a subsidy control regime will play an important role for the UK domestically and internationally.

The system should prevent harmful subsidies and promote beneficial ones

As explored in the Institute for Government's 2020 report *Beyond State Aid*, poorly designed subsidies can waste taxpayer money and damage economic performance.[2] Subsidies that favour one competitor over others risk weakening competition and may also deter foreign companies from investing in the UK market if they cannot guarantee a level playing field. Using subsidies to prop up failing businesses where there is no viable recovery plan – as happened in the UK in the 1970s[3] – limits the dynamism of the economy because workers and capital continue to be tied up in the unproductive, failing businesses rather than moving to more productive businesses and sectors.

Beyond State Aid also highlighted the risk of subsidy races within the UK – where different regions compete to attract investment by offering subsidies – as a particular cause for concern.[4] The devolved administrations in Scotland, Wales and Northern Ireland (as well as other authorities, though to a lesser extent) have the competence and resource to offer subsidies as well. In federal systems, there is an incentive for state governments to compete with one another to attract investment and jobs. But that competition is damaging for the country as a whole, wasting taxpayer money by offering business incentives to move around the country. This is most apparent in competition between US states,[5] but there are also examples in other federal

countries[6] – and the UK would face the same risk if it did not have effective subsidy control rules. For example, a subsidy could be used as an incentive to relocate a manufacturing plant from Newcastle to Glasgow. This is what the objective to "protect the UK internal market" means.

However, the first objective highlights that subsidies can also play a positive role. There is strong theoretical and empirical evidence that subsidies that address externalities – for example, to encourage R&D – have positive effects.[7] The consultation states that the regime should "facilitate" strategic interventions. The system should therefore play a signalling role, helping governments at all levels to identify and deliver subsidies that contribute towards those strategic priorities. This implies the subsidy control rules should form part of the government's broader industrial policy. *Build Back Better: Our plan for growth*,[8] published alongside the 2021 budget, highlights "levelling up" and "net zero" as two priorities for industrial policy. It also emphasises the role of infrastructure, skills and innovation in achieving those goals.

The objective to act as a responsible trading partner – effectively to meet the UK's international commitments – is only the fourth objective for the government's regime. Rather than trying to design a system that does the minimum possible to comply with the TCA, the government is rightly focusing primarily on designing a regime that best serves the UK's domestic interests.

The regime should be less burdensome than the EU system

These objectives alone could, for the most part, have been satisfied by continuing to follow the EU state aid rules. But the government has been clear that it wants to design a better system. In its consultation it emphasises the importance of having a flexible system. A note circulated during the 2019 general election campaign stated that any UK regime would prioritise speed, clarity and consistency and explicitly contrasted these traits with the EU system.[9]

Many interviewees who have applied for subsidies within the state aid system expressed the view that the EU rules are overly complex and occasionally unclear and that contested cases often proceed slowly. In Chapter 4, we outline ways in which a UK subsidy control regime can improve upon the EU rules in these respects.

The government's objectives for the system are ambitious

The government's stated vision is an ambitious goal to design a system that prevents harmful subsidies and plays a broader role in industrial policy – and to do so in a more efficient and less administratively costly way than the EU's state aid regime. State aid rules, or systems in EU satellite countries based on state aid rules, are the only examples of legal subsidy control rules worldwide. The UK cannot pick another model off the shelf.

The rest of the report explores how the domestic subsidy control system should be designed to best meet the government's objectives.

3. What should the subsidy control rules be?

The first set of questions the government must answer when designing the new regime concern which subsidies should and should not be allowed – that is, the rules themselves.

The government faces choices about how the principles listed in the TCA should be put into action and when the system should apply – both what constitutes a 'subsidy' and what any exceptions to the normal operation of the rules should be (for example, in response to natural disasters). These are choices that need to be made regardless of whether the government wants lax or strict rules.

The government should be concerned about domestic competition as well as trade and investment

The TCA is written to prevent subsidies that would harm the flow of UK–EU trade and investment. It defines a subsidy as a measure that "affects trade and investment between the Parties [the UK and the EU]". However, the UK regime has an additional goal: it needs to prevent subsidies that will distort the UK economy, such as giving a business an unfair advantage to the detriment of other competitors in the UK internal market.

This means that the definition of a subsidy in the UK regime cannot just rely on the language of the TCA and on effects on trade and investment. The definition of a subsidy is the first funnel through which measures must pass in the regime; if a measure does not constitute a subsidy on that definition, none of the other obligations apply. The definition therefore needs to be able to capture subsidies that have purely domestic effects – that is, subsidies that could distort competition within the UK without any impact on the EU. For example, a grant could incentivise a manufacturer to move from Newcastle to Glasgow where the business never contemplated a location in the EU – this would not affect the EU but would distort the UK market.

The government's consultation document proposes that the fourth criterion of a subsidy be amended to: "It has, or could have, a harmful or distortive effect on trade or investment **within the UK or internationally**."[1] But this change does not go far enough; the government should further amend this definition to include distortions of competition. Under the above formulation, there is a risk that a measure that distorts competition – for example, a big grant to one large tech company that would give it an advantage over its competitors – will not obviously affect trade or investment so might not be subject to the regime.

The same logic applies to the principles the TCA lays out for the system. In particular, the sixth principle stated in the TCA emphasises negative effects on investment and trade. The government's consultation suggests amending the principle to "Subsidies' positive contributions to achieving the objective outweigh any negative effects, in particular the negative effects on **domestic competition** and international trade or investment".[2] This addition is a sensible and necessary one.

On their own, the principles are not enough

One of the most important questions in the design of the regime is the role that the principles set out in the TCA will play. In its consultation document, the Department for Business, Energy and Industrial Strategy (BEIS) proposes a system that relies on granting authorities (that is, central government departments, devolved administrations and local government bodies) assessing the compliance of their subsidies against the principles.

The principles are reasonable and a solid basis for any regime – but the TCA does not set out how they should be interpreted. This leaves them open to interpretation by different decision makers or in different circumstances. Any resulting uncertainty would undermine the government's objectives for the new subsidy control regime.

The principles leave governments and public bodies lots of latitude – which could mean damaging subsidies are approved

In the words of one subsidy control lawyer from the UK, the principles are "quite broad and woolly" and leave a lot to the discretion of the public body granting the subsidy.

Relying on the TCA principles alone could create a patchwork system, with different authorities taking different approaches. Without a clear definition of what constitutes a legitimate 'public policy objective', for example, public bodies could choose to pursue local objectives that are not policy priorities for the UK as a whole. One authority might argue, for example, that 'protecting local manufacturing jobs' is one of their policy objectives – and would provide incentives for manufacturers to locate there instead of elsewhere – even though that may not be in the UK's broader interest.

Public authorities could also take different approaches to judging whether the benefits of a subsidy outweigh the costs – analysis they are expected to carry out under the final principle. Neither the benefits (the social gain from addressing externalities or addressing inequities) nor most of the costs (distortions to trade and competition) can be quantified to allow for an objective comparison. An authority in one part of the country might easily underweight costs incurred in other parts of the country while judging the benefits in their part of the country to be large. This approach would likely lead to inconsistent awards in different parts of the country, and by different granting authorities, and potentially to far more subsidies being granted than if costs across the whole country were properly weighted.

As well as encouraging this inconsistent and potentially damaging approach, a system based on the principles alone generates uncertainty in terms of compliance. This is already a feature of the 'interim regime' that has applied since the end of the transition period. The government repealed the state aid rules from statute and did not legislate for a separate regime: as a result, the subsidy chapter of the TCA is now the only domestic law that grantors must abide by, leaving self-assessment of the principles as the only way public bodies can be compliant.

Many interviewees told us that the interim regime has led to confusion among public bodies, many of whom are risk averse. One subsidy control lawyer told us that "the real burden is making sure you have enough evidence and reasoning that would satisfy a court. There's no real way to answer that at the moment."

If self-assessment based on the TCA principles continues to be the main mechanism for subsidy control under the new regime, there is a risk that some public bodies will choose not to grant subsidies that could be beneficial, simply for fear that they might be subject to a legal challenge and be unable to demonstrate compliance.

Relying solely on the principles of the TCA could therefore leave the new subsidy control system with the worst of both worlds. Some bodies would decline to offer subsidies that would be worthwhile, while others that take a chance would be able to get subsidies approved which – at the very least – might not fit with broader industrial policy and, at worst, might cause harmful distortions.

A system based solely on the principles would not meet the government's stated objectives

Perhaps one reason the principles-based approach appeals to the UK government is that it is very different from the EU rules. The legislation in EU treaties is general but the system itself gives little latitude to the interpretation of the granting authority. And in case law, guidance and regulation, there are many thousands of words setting out when subsidies will be approved and on what basis – although the European Commission ultimately has the final say. A principles-based system would be much less prescriptive and would give more latitude to the granting body.

However, the government should not design the new UK system just to differ as much as possible from the EU's rules – not least as a system based only on the principles would not meet its own objectives.

First, as noted, there is no guarantee that the system would prevent harmful subsidies. Second, the ability for public bodies to pursue their own policy objectives as opposed to nationwide ones would undermine the objective of "facilitating interventions in the UK's strategic interest". Rather than targeting subsidies towards national priorities such as net zero and levelling up, a principles-based system would more likely lead to haphazard and uncoordinated industrial policy.

The space left by a lack of comprehensive regulations and guidance could, over time, be filled in by the precedent set by the judgments of the new subsidy regulator or the courts. These judgments will determine the relevant legal standard, which will then be followed by future grantors to ensure compliance. It would be much more appropriate for this detail – which will affect industrial policy – to be filled in by the government rather than by unelected officials from a regulator or judges in a court. And it would also be much easier for a regulator to retain a perception of objectivity if it is implementing the government's stated aims for the system rather than making those more subjective judgments itself.

The system should include regulations and guidance to narrow interpretation of the principles

The principles should be supplemented with regulation and guidance. Although BEIS has issued guidance on subsidy control to help public bodies, this is vague on how any assessment of a subsidy's compliance with the principles should be carried out. In the words of one state aid lawyer: "The BEIS guidance is a good summary, but is not very helpful on actually working through the principles." More needs to be done to ensure that public bodies can have more confidence in applying the principles. A list of legitimate policy priorities, including an explanation of what those policy priorities mean, should be set out in regulation. This could be developed over time as governments change and industrial policy evolves but making it regulation rather than guidance would give it more permanence.

The guidance should also be explicit and detailed on how compliance with the principles should be demonstrated. For some of the principles – such as principle two (proportionality) and principle six (the balancing test) – the guidance should specify methodologies to assess compliance. For the others, the guidance should make it clear how much analysis is required to demonstrate compliance.

Abandoning a principles-only approach does not mean that the UK rules need to be the same as those of the EU system. The UK system could continue to provide some latitude and flexibility to granting authorities. However, by clarifying the principles, the UK government can ensure that subsidies are well directed and that any authorities thinking about offering subsidies can do so with confidence.

The system should apply even where the TCA does not

Agriculture, fisheries and audio-visual sector policies are excluded from the provisions of the TCA, as are policies in response to natural disasters and economic emergencies, so the UK is in principle free to offer whatever subsidies it wants in those areas. However, in most instances it will still be in the UK's domestic interest to retain control over those subsidies.

Subsidies in these cases can still cause harm

These areas are excluded from the TCA not because there is no risk of distorting trade and competition but because of the political sensitivity of the industries involved and the need to act quickly in an emergency. But these types of subsidies can still cause lasting distortions to competition.

If a subsidy in response to an economic or natural disaster goes beyond rectifying the damage caused, or if some businesses in some regions are better protected than others, competition can be affected in the future. The experience of EU countries during the pandemic is instructive. The European Commission has operated the EU Covid-19 temporary framework for state aid,[3] which allows for more business support than usual – although it still imposes some restrictions.

Some countries have made more use of this provision than others, and in particular bigger and more fiscally secure governments have supported their businesses more. There is already evidence that this differential approach has distorted the level playing field within the EU.[4] Businesses in Germany have had access to more generous grants and loans – policies that would be captured by subsidy control rules – which means that, on average, they will emerge from the crisis with lower debt and plentiful cash reserves. Businesses in countries that have had less fiscal firepower to provide subsidies will be in a weaker position or will have gone bust and this could lead to long-term competition problems.

This example shows that crisis-related support can distort competition, investment and trade – the negative effects that a subsidy control regime is supposed to avert. Even though these distortions occurred while the state aid rules applied, the distortions might have been even worse had no subsidy control provisions been in place.

The potential for crisis response policies to distort competition provides a rationale for some oversight of these subsidies. The approach that BEIS has adopted for the interim regime suggests that the government agrees with this assessment. Currently, while the UK is no longer subject to EU state aid rules, its local authorities distributing Covid-related grants must still abide by the restrictions set out in the EU Covid-19 temporary framework.[5]

A UK system could apply different rules in different sectors

The agriculture, fisheries and audio-visual sectors are excluded from the TCA obligations because many subsidies that are currently offered in the EU and the UK might risk falling foul of the principles. These include the EU Common Agricultural Policy and funding for public service broadcasters.

One advantage of the UK adopting more guidance and regulation to supplement the principles would be the flexibility to treat different sectors differently rather than applying a blanket approach. For example, the guidance could have a different standard for agricultural subsidies that afforded the government sufficient flexibility to support that sector without abandoning control of subsidies elsewhere. Likewise, in regulation, the role for cultural support for the BBC and other audio-visual subsidies could be specified.

Applying the rules to these sectors does not mean that existing subsidies need to be outlawed, but at the same time those sectors can be regulated to prevent new harmful subsidies that might emerge. For example, guidance could clarify what compliance with the principles should look like for agriculture. The UK system should not exclude these sectors just because the EU ruled them out of scope of the TCA.

The system can still apply when subsidies need to be approved quickly

In a crisis, subsidies need to be fast as well as generous. In normal times, the European Commission usually takes more than six months to approve subsidies.[6] This would clearly have been far too slow for many of the Covid-related support packages offered, almost immediately, from April 2020. In crises, the EU adopts temporary frameworks that are both more permissive and designed to allow for rapid approval, which allowed for the UK schemes to be approved rapidly even though it was still subject to EU rules at that time. This approach had also been used successfully during the 2008 global financial crisis.[7] The UK could adopt a similar approach, with revised guidelines, for crisis situations.

Recommendations

- **The language of the new system should primarily focus on the UK context.** The definition of a subsidy, and the way the principles are worded, in new regulation should focus primarily on the effects on domestic competition.

- **The system should have detailed regulation and guidance to specify compliance with principles.** On their own, the principles will not be enough to prevent the granting of harmful subsidies and leave too much discretion to governments and public bodies in determining what constitutes a legitimate public policy objective. To avoid losing control of the strategic direction of the new system, the government should use regulation to set out a list of legitimate public policy objectives, supplemented with detailed guidance on compliance.

- **The 'gaps' in the TCA should be filled in.** The UK regime should apply to sectors like agriculture and fisheries where the TCA does not. Even in these excluded sectors, subsidies can still cause harm. And the system should also apply, though with more flexible rules, to subsidies offered in response to crises and natural disasters.

4. How should the subsidy control system operate?

The UK made relatively little use of subsidies while a member of the EU, generally favouring less economic intervention than its continental counterparts. Rather than designing laxer rules, or enabling more subsidies, the biggest potential 'win' for a new UK regime is therefore likely to be a better and more efficient approvals process. The new UK rules are an opportunity to make granting subsidies simpler and faster.

While the UK was a member of the EU, many of its most vociferous complaints about the state aid system were that it was overly bureaucratic, inflexible and slow. A House of Lords EU Select Committee inquiry into competition and state aid after Brexit found that it was "frustrations with the application of the rules", rather than the existence or content of the rules, that their witnesses had been most likely to complain about.[1] And this complaint is not unique to UK commentators. In 2015, a paper by two members of the European Free Trade Agreement Surveillance Authority highlighted broader problems of procedural delays in state aid cases.[2]

How the system operates is not just about reduced bureaucracy and simpler rules. The new regime will apply to governments and public bodies across the UK, including the devolved administrations. The system needs to be seen as impartial and working for the whole UK – without that it will be unstable and politically contentious. It is therefore crucial that the system and institutions are set up such that they are independent of Westminster and have the confidence of businesses and authorities throughout the UK.

The operation of the system depends principally on the powers and role of the regulator that will have some role in monitoring subsidies; the role of the courts; and the processes in place to make it easier to get approval for lower risk subsidies.

The role of the regulator

The TCA requires that the UK has an independent body, or regulator, with an "appropriate" role in overseeing subsidy control. But the UK's subsidy regulator need not have the same powers as the European Commission.

The BEIS consultation on subsidy control sets out five possible roles this regulator could play in the UK system:[3]

- **Information and enquiries.** The regulator could explain regulation and guidance to public bodies if requested and be responsible for keeping guidance up-to-date.
- **Review and evaluations.** The regulator could scrutinise the operation of the subsidy control system as a whole.
- **Subsidy development advice.** The regulator could offer advice to public bodies considering offering a subsidy, for example on the design of the scheme or the possible impact of the subsidy.
- **Post-award review.** The regulator could review specific subsidies and advise the government about any emerging systemic issues.
- **Enforcement powers.** The regulator could have certain powers to take action against unlawful subsidies.

At its most limited, the subsidy regulator could play a minor and advisory role in the new system. This would be a considerable departure from the EU system, where the commission is the sole arbiter of state aid.

The UK does not need a subsidy regulator with the commission's 'gatekeeper' role

In the EU system the commission plays the pivotal role as the gatekeeper in the system (see Box 1). Any subsidy is presumed to be unlawful unless and until the commission has approved it and the commission writes the regulations and guidance that it uses as the basis for approval decisions.

The UK government's consultation makes it clear that it does not want an independent body with the commission's remit,[4] and the TCA does not require this of the UK. And given the UK's constitutional structure, it would not be appropriate in any case: a regulator would not be able to overrule acts of parliament, and would be subject to the oversight of Westminster (and possibly devolved institutions too). The commission also defines the rules of the state aid system as a whole, whereas in the UK at least some of these decisions should fall to the governments because they are political in nature.

There are other reasons why what is appropriate for the EU system is not appropriate for the UK. The EU system must regulate 27 countries with very different reputations for public spending control, and one UK state aid lawyer told us that the system has to draw a lot of "bright lines", however arbitrary, to give the impression of fairness to

all members. The standstill obligation – with automatic recovery of any subsidy that is granted without being notified or falling under the block exemptions – means that the commission retains tighter control of subsidies that are granted, rather than needing to seek out subsidies it has not been informed about in advance.

These concerns do not apply in the same way in the UK, which generally has good institutions in place to manage public spending. The National Audit Office (NAO) imposes a check on whether money is spent well, and specific decisions made by public bodies can be challenged in strong and respected national courts.[5] The risk that subsidies would be approved 'under the radar' in the absence of the standstill obligation is therefore a lesser concern.

Isabel Taylor, a state aid lawyer, has said that losing the standstill obligation is "a real game-changer",[6] given the additional speed and flexibility it could allow in the UK system. The UK State Aid Law Association (UKSALA) – an expert forum of lawyers, economists, academics and representatives from the public and private sector – has written that:

> **"The fact that notifying and getting approval for a State aid from the Commission is a lengthy process and may take 6 months or more even for fairly straightforward cases (and considerably longer for more complex cases) is a serious obstacle in the way of projects that involve (or may well involve) State aid."**[7]

The slowness of the advance notification route was a disincentive for public bodies to experiment with subsidy designs. In the new UK system, without the standstill obligation or advance notification requirements, public bodies could have more room for manoeuvre.

But the interim regime cautions against giving the subsidy regulator a minor role

The interim regime that currently applies – in which there is no regulator playing any role – provides a cautionary tale about how a system without a prominent regulator playing a role in the process will fail to provide certainty.

In the interim regime, the legality of a subsidy can be tested only through the courts after they are awarded. Many interviewees said that this has created a high degree of uncertainty; without the ability to get prior approval for a subsidy, public bodies and businesses are more exposed to the risk of a legal challenge and a court ordering that the subsidy be repaid. This risk is not only one that grantors will wish to avoid. Many projects will rely on co-funding from the private sector, and potential private sector funders are much less likely to provide the investment if there is a risk that the co-finance from the public sector will have to be withdrawn.

Interviewees noted that this uncertainty is likely to have had a "chilling effect" on public bodies' willingness to grant subsidies and on banks and businesses' willingness to co-invest. Most lawyers we spoke to expected that, in practice, very few subsidies would be overturned by court challenge. But the inability to formally check compliance

in advance – compounded by the fact that the system is new and it is hard to predict how the courts will approach their role – means that grantors have been deterred.

However, the absence of a regulator in the interim regime also means that there is no guarantee that harmful subsidies will be prevented. If a regulator plays no role in assessing the compliance of subsidies, it is left to the courts. But under normal grounds of judicial review, the courts can assess only whether a public body applied the principles in a reasonable way. The most common ground for challenge would likely be the standard of irrationality – that a public body had acted so irrationally in granting the subsidy that no other actor could have reasonably reached the same conclusion. But this is a high bar to meet.[8]

Clear guidance and regulation over how to demonstrate compliance (recommended in Chapter 3) would make judicial review more effective by reducing the latitude afforded to grantors. But some latitude (for example, to weigh up costs and benefits) would remain and would not guarantee that damaging subsidies would be prevented. Furthermore, for some harmful subsidies there might be no competitor or other party willing to intervene in court to challenge the subsidy. In the absence of a regulator that had standing to do this, harmful subsidies could face no court challenge.

Overall, the interim regime shows how a regulator with too small a role could leave public bodies uncertain of their compliance with the new rules, and at the same time mean a 'leaky' system that would not prevent some damaging subsidies.

Public bodies need some way to check their compliance – but this does not need to be compulsory advance notification

The interim subsidy control regime shows – by its absence – the importance of a regulator that can offer some form of advice to public bodies wanting to grant a subsidy. Interviewees felt this would considerably reduce the current legal uncertainty.

A greater role for the subsidy regulator in advising on compliance would also reduce the role for the courts. The regulator could ensure a more consistent evaluation of subsidies. It would also be able to go further than the courts and look at the merits of a subsidy as well as the reasonableness of a public body's judgment.

This can and should be a voluntary process for most subsidies. The regulator would not formally approve subsidies, but rather offer advice and recommend changes. However, for subsidies that pose the greatest risk to competition – such as those that might threaten the internal market, distort trade with the EU or subsidies for rescue and restructuring – the process of seeking an evaluation from the regulator should be compulsory. These subsidies are likely to be the most politically contentious and carry the greatest risks, so they are the ones where the greater rigour of merits-based review by the regulator would be most useful.

The decision of the regulator would not be legally binding, so a granting government or public body could still proceed with a subsidy the regulator did not like and a subsidy given the green light by the regulator could still be challenged in court. However, most

lawyers we interviewed felt that the regulator's advice would be given considerable weight in court. So a judge would be likely to find a subsidy unlawful if the regulator said this in its advice, and a positive assessment from the regulator would have more weight than if the granting body had 'marked its own homework'. In other areas of regulation, the courts tend to defer to the judgments of independent regulators; for example, the Competition Appeals Tribunal (CAT) rarely overturns decisions on mergers from the Competition and Markets Authority (CMA).[*,9] This precedent suggests that public bodies could proceed in subsidy awards with much greater certainty if they had sought prior advice from the independent body.

The subsidy regulator should have an enforcement role

The subsidy regulator also needs to have the power to challenge in the courts subsidies that it considers to be harmful because, as outlined above, there will not always be a private party willing to challenge a subsidy.

There may also be a case for the regulator to take on a more formal enforcement role. In its submission to the BEIS consultation, the Joint Working Party of the Bars and Law Societies of the UK on Competition Law (JWP) proposes that the regulator be able to review subsidy schemes either in response to a complaint or of its own volition. If it finds in such a review that a subsidy is unlawful, the JWP argues it should be able to order changes to a subsidy scheme or individual award, or – in the most serious cases – recovery.[10]

It would be unusual for a regulator to have such enforcement powers with regards to government bodies, and interviewees' opinions were mixed as to whether this was appropriate. The advantage would be that these alternative enforcement mechanisms could go further than judicial review, which is limited in the grounds it can consider. The regulator could review subsidies on the merits and make decisions accordingly. Given the lack of precedent for such a role, the government could reserve the right to give the regulator this role should it prove difficult to overturn questionable subsidies in court.

A big role for the subsidy regulator in drafting regulations will help build trust in the new regime

The controversial UK Internal Market Act 2020 makes subsidy control a reserved policy area, meaning that the Westminster parliament legislates for the whole UK. While the UK government maintains that subsidy control was already reserved, and the Act merely puts this beyond legal doubt, the Scottish and Welsh governments argued that it was not.[11] Having BEIS as the only actor involved in drafting subsidy control regulations is therefore likely to inflame tensions further and reinforce the impression that these rules are written for the UK government's interests only. The risk is that the UK's new subsidy control regime will start off on the wrong foot and will increase the potential for clashes in the courts if the devolved administrations try to test rules they feel they have no say over.

[*] Since 2010, the CMA and its predecessor, the Office of Fair Trading, has won almost two-thirds of appeals in the CAT.

One way to de-escalate the tensions brought out by the Act would be to give the regulator a role in designing and updating the rules. The devolved administrations are not opposed to a UK-wide regime in principle: in November 2020, the Welsh government wrote to the UK government that "the Welsh Government has been clear that it would wish there to be a single state aid/subsidy control regime for the whole of the United Kingdom... provided it is co-designed by all governments which have to implement it".[12] Below, we explore how best to make the regulator a genuinely four-nation body; its involvement in drafting the rules will help to signal that these rules are not just Westminster imposing its will on the devolved administrations.

The regulator will also be better placed than BEIS to update guidance, as it will be closer to the day-to-day operation of the system. It could apply lessons it learns conducting reviews of awards to identify emerging systemic issues. The European Commission performs a similar function in the state aid system and these reviews can help identify where the rules and guidance need to change.[13]

The CMA has the right expertise and reputation for independence to take responsibility for subsidy control

Many of our interviewees agreed that the Competition and Markets Authority (CMA) was the most suitable body to take responsibility for subsidy control. This view was not unanimous. One suggested instead that the Trade Remedies Investigations Directorate (TRID), which already investigates foreign subsidies, should take on subsidy control regulation. On balance, however, we recommend that the CMA is best placed to take on the role.

The subsidy regulator must have sufficient expertise. As well as legal expertise to understand compliance with all relevant legislation, it will need economic expertise to engage with the principles and tests underpinning subsidies such as proportionality and incentive effects. Though subsidy control includes additional judgments not required in competition policy, many of the economic skills and judgments read across well from the CMA's competition work.

Any new organisation would struggle to assert its independence given it has no track record. For example, TRID is part of the Department for International Trade (though it will soon become an arm's length body) so it risks being seen as a 'creature of Westminster'. The CMA, on the other hand, has a long track record of independent decision making. In the words of one interviewee: "The CMA has a good reputation and hasn't proved to be partial." Decisions on subsidies will at times be contentious, and local authorities and the devolved administrations may be barred from pursuing what they believe are important policy objectives when the system constrains their actions, so the regulator needs to be trusted.

The CMA's reputation for credibility and expertise is international too. Interviewees told us that the EU Commission had a positive view of the CMA; one interviewee said that this advantage "should not be underestimated", given co-operation with the commission may help to defuse conflicts over subsidies between the EU and the UK.

This is not the first time that the CMA has been proposed to take on subsidy control regulation in the UK. Throughout 2018 and 2019, the CMA was lined up to be the body that would take on the commission's role in a system based on EU rules. Indeed, it even got as far as hiring many of the staff required to take on this role.[14]

The CMA would also be able to deploy staff more flexibly than any new body. In its consultation response, the JWP notes that it will be important to be able to move staff in and out of subsidy control, as it is highly uncertain how busy the new UK regulator will be.[15] In the EU, state aid is the single biggest area of activity in the Directorate General for Competition,[16] so any UK body would need adequate resourcing. But exactly how much resource is hard to predict. Rather than having people sitting idle, it is better for the CMA to be able to respond flexibly to resourcing needs as they arise.

But subsidy control is more political than the CMA's competition functions

Although the CMA is best placed to take responsibility for subsidy control, this area is different from its existing responsibilities in competition regulation. The CMA has historically had the power to regulate companies but not had any oversight of public bodies, which would be a new, more political function. The assessment of subsidies requires balancing harm to domestic competition against the benefits in terms of contributing towards policy objectives; the former is within the CMA's current remit, but the latter is not.

However, the CMA already has a role overseeing the actions of public bodies – and in a particularly contentious political area – under the UK Internal Market Act. The Act gives the CMA statutory powers to investigate the internal market,[17] though these will be exercised through the new Office for the Internal Market (OIM), which will sit within the CMA.[18] The OIM consists of a chair and panel members appointed by UK government ministers, who must seek consent over appointments from the devolved administrations. The chair of the OIM will also sit on the board of the CMA. The OIM does not have its own budget, but will have an estimated staff of 30 from within the CMA.[19]

Subsidy control functions could be set up within the CMA in a similar way to the OIM, or even be given to the OIM itself. The advantage of this approach would be that the CMA could keep the more 'political' parts of its functions separate from its competition role. This could help the CMA protect its reputation for impartiality. On the other hand, the OIM model is untested – it remains to be seen how effective it will be, and how flexible its staffing will be in practice.

However, ultimately this choice is administrative rather than legislative. It is the CMA that ultimately gains the new statutory powers granted to the OIM in the UK Internal Market Act,[20] and so it would be the governance of the CMA that would need to change to reflect the new powers it would gain as the new subsidy regulator.

The CMA's governance needs to change to make it a four-nation body

As noted above, the devolved administrations accept the need for "a single state aid/subsidy control regime for the whole of the United Kingdom",[21] but argue that any system should have their input. To regain the trust of the devolved administrations lost during the controversial passing of the UK Internal Market Act, and to ensure the effective working of the new system, the regime should be a four-nation one. In evidence to the Scottish government's Finance and Constitution Committee, subsidy control lawyer George Peretz QC noted that, with the CMA taking on the OIM, if it were to also take on responsibility for subsidy control "the case becomes unanswerable for the CMA, instead of being a creature of Westminster, to become a creature of all four governments".[22]

At minimum, this would involve the devolved administrations having a say in the approval of board members for the CMA. However, one public appointments expert cautioned that these sorts of requirements to seek consent tend to become an afterthought. For example, if the devolved administrations do not consent to an appointment to the OIM panel within a month, the UK government may make an appointment without consent.[23]

For subsidy control, there should be a stronger statutory requirement for devolved administration involvement in appointments for the CMA, even if there is a separate subsidy control panel, because the CMA is where the ultimate statutory powers will lie. Ministers in Edinburgh, Cardiff and Belfast should each be able to appoint a board member of the CMA. Ofcom has recently moved to this model, with dedicated members for Scotland and Wales and a pending appointment for a Northern Ireland member.[24]

Four-nation involvement in the governance of the CMA can also go beyond board appointments. As the Institute for Government's *Devolution after Brexit* report recommended, co-ownership between the four nations can also be fostered by:[25]

- **Offices in all four nations.** The CMA already has staff in London, Edinburgh, Cardiff and Belfast,[26] but making sure offices are adequately resourced will be important to signal a commitment to four-nation working.

- **Reporting to committees in all four legislatures**, to improve accountability across the UK. This model has a precedent with the OIM – now that the CMA has taken on supervision of the internal market through the OIM, the CMA must lay its annual and five-yearly reports before all four legislatures.[27]

The CMA should also explore ways to develop expertise on the economies of Wales, Scotland and Northern Ireland. In its initial assessment of the UK Internal Market Act, the Scottish government wrote that "there is no reason for the UK Government to have exclusive competence over subsidy control, especially as decisions on subsidies are very particular to local circumstances and industrial concerns".[28] To address these concerns, the CMA should set up advisory sub-committees that focus on each of the four nations and their economic contexts. This is a model followed by the Food Standards Agency (FSA), which covers England, Wales and Northern Ireland,[29] and could also be employed more broadly to incorporate the interests and views of local government.[30]

These governance changes within the CMA would go a long way towards reducing political tensions over subsidy control. Preventing battles between the UK government and the devolved administrations is important if the new subsidy control system is to function smoothly and effectively. Otherwise, rather than a Brexit 'dividend', the UK government may find that the new regime is seen in Scotland, Wales and Northern Ireland as a way of tying the hands of the devolved governments. At a time when support for the union, especially in Scotland, is precarious, the government should avoid designing the regime in a way that looks like it is imposing the will of England on the rest of the UK.

The role of the courts

The other key institution in the subsidy control system will be the courts. Article 3.10 of the TCA gives the courts a role in reviewing subsidy awards.[31] In the EU, this role is fulfilled by the general court and ECJ and in the UK, for the time being, this role has gone in England and Wales to the Administrative Court – which routinely hears judicial review cases where the decisions of public bodies can be scrutinised. In Scotland, subsidy cases will be heard by the Court of Session, and in Northern Ireland by the High Court.

The operation of the European courts to which appeals of commission decisions are made has been one of the major complaints from UK stakeholders about the EU regime. Contested cases can take years for appeals at different levels to be heard. For example, it was only in September 2020 that the ECJ upheld the commission's 2015 approval of aid by the UK government to Hinkley Point C nuclear power station.[32,33] UK lawyers that we interviewed felt that UK courts would be able to hear appeals more quickly.

The Competition Appeal Tribunal has the expertise to hear subsidy challenges and the capacity to do so quickly

The Competition Appeal Tribunal (CAT) is a specialist tribunal that reviews decisions by the CMA. The overwhelming view of our interviewees – echoed in the JWP consultation response – is that the CAT should take over from the Administrative Court (and Court of Session and High Court) in hearing subsidy cases.[34]

There are three advantages to the CAT hearing subsidy cases. The first is that it has substantial economic expertise, due to its role in scrutinising CMA merger decisions. This will make for more rigorous scrutiny of any subsidy control decisions, where the court will need to understand complex economic analyses underpinning, for example, the incentive effects of a subsidy or whether an award is proportionate.

The second advantage is that, unlike the Administrative Court, the CAT is a UK-wide court with jurisdiction to hear cases from Scotland and Northern Ireland. Having a single court ruling on subsidy cases is preferable to ensure a consistent approach.

The third advantage is speed. Because the CAT does not have the same pressures in terms of caseload as the Administrative Court, it is able to decide cases more quickly.[35] Being able to process subsidy challenges and appeals quickly would be a significant improvement over the EU state aid system.

The treatment of lower risk subsidies

While the UK's new regime is an opportunity to give greater flexibility for big, important subsidies that might otherwise have had to be notified to the European Commission, many subsidies would never have had to be notified because of the EU's block exemptions. One state aid lawyer, referring to the interim regime that currently applies, told us that "the 'prize' of the new system is that a handful of difficult cases don't have to go to Brussels any more. But this is at the cost of 98% of awards that have become more difficult." As things currently stand, with a system based on a self-assessment of compliance with the TCA principles, public bodies that might otherwise have been covered by block exemptions now have less certainty – and possibly more work – if they want to grant subsidies.

If the government wants to deliver a less administratively costly system than state aid, it must address these smaller subsidies that pose a lower risk to distorting competition, but which still fall within the reach of the new regime.

A two-track approach is the right one

There is a strong rationale for taking a different, less intrusive, approach for smaller subsidies. For big measures – such as co-funding for major infrastructure that contributes towards net zero – the potential benefits of a well-designed subsidy are greater, but there is also a greater chance that it will distort competition. It is therefore sensible to require some additional process to ensure that the subsidy is designed well. For smaller subsidies – such as local support to build a leisure centre

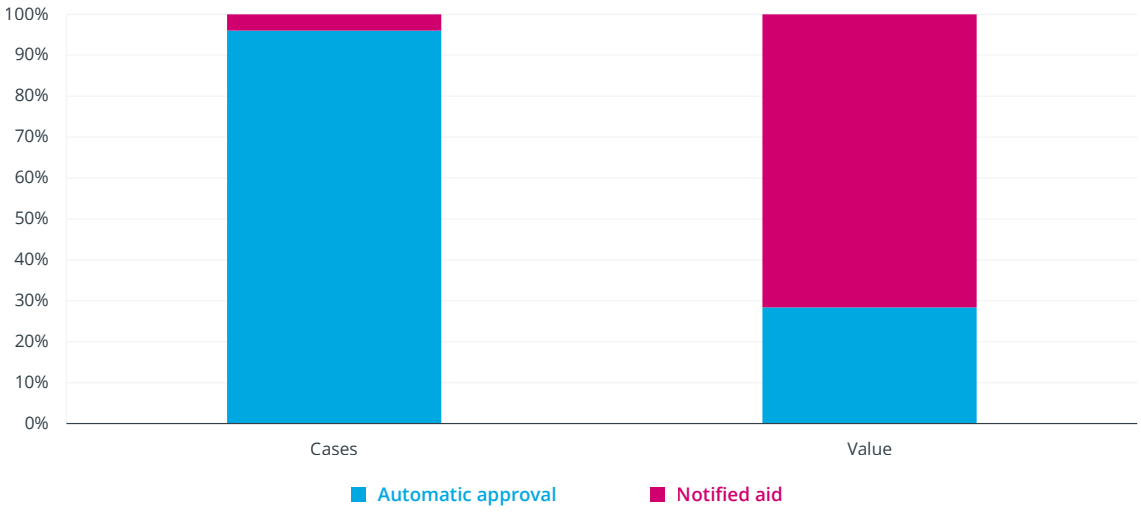
or to contribute towards staff training – the stakes are lower. Subsidies are less likely to distort competition and a big administrative burden or legal uncertainty is more likely to deter a grantor from offering the subsidy.

Smaller bodies are likely to be deterred from offering subsidies in a system that requires extensive analysis to demonstrate the compliance of a measure with the principles. In a survey of representatives of public bodies that grant subsidies (mostly local authorities), 58% said the biggest problem they faced with the interim regime was the lack of safe harbours and legal certainty.[36] Smaller granting bodies are unlikely to have in-house expertise and will then be deterred from engaging with the system. Other interviewees expressed doubts that local authorities would have the analytical capacity to carry out an economic analysis demonstrating compliance with the principles.

The EU system adopts a two-track approach through its block exemption regulations. Grantors can choose to notify their subsidy to the commission and await approval – the more intrusive approach – or can design a subsidy to comply with detailed conditions and regulations to acquire automatic approval. This latter 'safe harbours' route is quicker, provides greater legal certainty and requires less analytical justification.

Demand for the safe harbours route in the EU is high, with 95% of subsidies approved via the block exemptions rather than notification. But those subsidies account for less than 30% of the total value of subsidies awarded. The EU system has therefore been able to separate out those (mostly small) subsidies that pose little risk by requiring that they abide by various regulations, while focusing its attention on the minority of subsidies that account for most of the spending and which are most likely to cause distortions. It would be sensible for the UK regime to adopt a similar approach.

Figure 2 **Share of UK state aid measures and state aid spending approved through notification and GBER (2018)**



Source: Institute for Government analysis of European Commission, 'State Aid Scoreboard 2019', https://ec.europa.eu/competition-policy/state-aid/scoreboard_en and European Commission, 'State aid modernisation fitness check", 30 October 2020, retrieved 19 May 2021, https://ec.europa.eu/competition-policy/state-aid/legislation/modernisation/fitness-check_en

The TCA makes it difficult to define a 'low risk' subsidy

Broadly, there are two options for the definition of 'low risk' subsidies. Either the regime sets out some criteria for what constitutes a low risk subsidy – such as the size of the measure – or it sets out safe harbours that allow grantors to self-select into a low risk route. However, the first option is unlikely to be effective in the new UK regime.

It is hard to design 'cut-off' points below which subsidies do not need to be scrutinised. While the size of aid can be a relevant factor in whether that aid distorts competition, by itself size is not a sufficient measure.[37] The design of a scheme can make similar sizes of aid more or less distortive. This means that any simple minimum threshold or similar cut-off would need to be relatively low, to catch all possible high risk, distortive subsidies that might otherwise slip through the net.

The UK's obligations under the TCA also make it difficult to provide 'light touch' scrutiny for measures that exceed the *de minimis* threshold of £335,000 for a business over three years. The UK system must ensure that any measure above that threshold satisfies the principles. In evidence to the House of Lords Sub-Committee on EU Goods, Jo Lappin, CEO of the Cumbria Local Enterprise Partnership (LEP), said that in her view, a minimum threshold of around £500,000 would be preferred by local authorities and LEPs.[38] But in practice, that is not an option available for the UK regime.

A safe harbour approach allows public bodies to self-select into a low risk regime

The alternative is to allow public bodies to self-select into a less burdensome regime by designing their subsidy according to regulations. These regulations would set out safe harbours, where subsidies designed in a particular way would be assumed to be compliant with the principles of the new regime and therefore lawful. This approach would necessarily mean being more restrictive about what lower risk subsidies can be awarded by limiting their design, but would provide greater certainty for funders and recipients that a subsidy was compliant. By setting safe harbours in legislation, any subsidy meeting those requirements could guarantee legal certainty with no risk of a subsequent challenge.

The advantage for the government is that it can be confident that any subsidy compliant with safe harbours will be well designed, avoid bad distortions and be directed towards a stated objective which has been approved as a national priority. The advantage for the subsidy regulator is that it does not need to spend as much time monitoring low risk subsidies.

One interviewee did express concern that adopting safe harbours would present a missed opportunity for the UK system to make public bodies exercise discretion and think more rigorously about the principles underpinning their awards. However, there is relatively little in-house expertise at local authorities. The safe harbours provide a guide as to what constitutes a well-designed subsidy and so can help ensure subsidies

are effective rather than wasteful. Furthermore, the existence of safe harbours does not prevent a public body from offering subsidies outside of those guidelines, and demonstrating compliance with the principles, if it prefers.

A system that does not have safe harbours would likely develop one over time anyway. This was the case in the EU, where all subsidies had to be notified until 1998. The sheer number of notifications that the commission needed to manage, combined with a consistent approval approach over time, made the block exemptions a natural development. In the UK system, too, over time the practice of the regulator and the courts will develop a de facto set of safe harbours. Getting on the front foot and introducing safe harbours at the start of the regime, when uncertainty about the legal approach is highest, would add clarity.

Safe harbours can improve on the restrictive EU system

One reason why the government might be reluctant to adopt a safe harbours approach is that the EU's version – the General Block Exemption Regulations (GBER) – have a bad reputation. They are perceived as overly complex and difficult to comply with. One lawyer expressed frustration that "the vast majority of work that goes on in the state aid regime is wasted" because the effort is focused on demonstrating compliance with GBER rather than asking whether a subsidy is actually well designed for its intended purpose. One local government representative said that "the complexity of GBER meant local authorities didn't really understand what they could and couldn't do, so they tended to err on the side of caution and do nothing".

The GBER rules covering regional aid demonstrate the complexity.[39] Aid can only be provided in regions designated based on their GDP per head or population density. Beyond constraining which areas can get aid, the rules also prescribe what kinds of aid can be offered. Regional investment subsidies would have to meet several conditions. For example, if the subsidy is going to a large business, it can only cover new economic activity in an area, rather than expanding existing activity. Whatever investment the subsidy supports must be maintained in the local area for at least five years (three for SMEs). The subsidy can cover investment costs in tangible and intangible assets, or the estimated wage costs due to job creation, but in either case there is a string of further conditions about purchasing assets or how quickly new posts must be filled. In each case, assessing and proving compliance with each requirement is a difficult and time-consuming task that reduces the 'simplicity' benefits that safe harbours should confer.

Interviewees have pointed to reasons why GBER is designed in this way. GBER applies to all 27 member states with different attitudes to spending control. A more flexible set of safe harbours might be subject to abuse and may mean the commission is perceived as treating subsidies differently in different countries. The UK system would not face these same constraints and so a better set of safe harbours could be designed. However, this will not be a quick or easy task. The government should set up a working group to develop an effective set of safe harbours, which can be adapted over time.

Recommendations

- **The independent regulator does not need the exact same powers as the European Commission, but it should have an important role.** The current model of subsidy control – with no regulator – is flawed. A regulator needs to be able to offer voluntary advice in advance to reduce legal uncertainty. It should also be able to investigate subsidies after they have been awarded and order changes to a scheme or recovery of the subsidy. The regulator should also take the lead in drafting regulations and guidance.

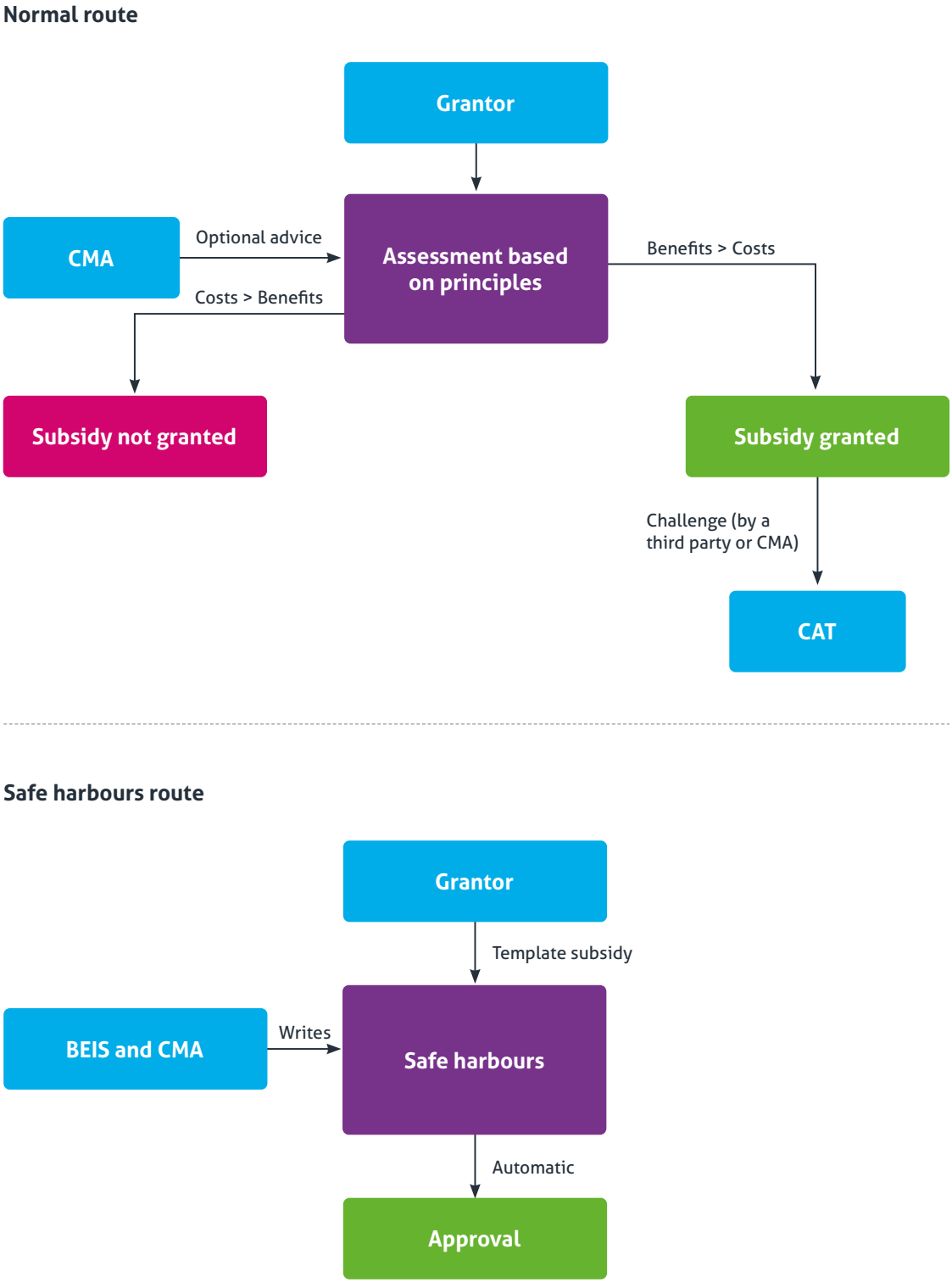
- **The CMA is the natural body to take on the role of regulator.** Only the CMA has the expertise and credibility necessary to take on this role. It has expertise in legal and economic reasoning in competition policy and a strong reputation for impartiality, both domestically and with the EU.

- **The CMA's governance should be reformed to give a clear role to the devolved administrations.** The role of the system in protecting the UK internal market and the importance of cross-UK buy-in means the regulator should be a four-nation body. The devolved administrations should have a formal role in the governance of the CMA – including board members appointed by the Wales, Scotland and Northern Ireland governments – as well as a presence in all four nations and advisory sub-committees.

- **The Competition Appeal Tribunal (CAT) should take on the judicial review role.** The CAT has the right specialist expertise to take on judicial review of subsidies due to its scrutiny of CMA merger decisions. It also has the advantage of being able to deal with cases quickly.

- **A safe harbours approach is the best way to deal with low risk subsidies.** It makes sense to impose greater administrative burdens on higher risk subsidies due to their possible distortive effects on competition. However, for most subsidies that are lower risk, a safe harbours approach is less burdensome. It also allows public bodies to self-select into the low risk regime, rather than trying to set arbitrary thresholds for what constitutes a low risk subsidy. The government should set up a working group to design these regulations.

Figure 3 **Recommended model for the UK's new subsidy control regime**



Source: Institute for Government analysis.

5. Interaction with the Northern Ireland protocol

The new domestic subsidy control regime will not be the only system of its kind in operation in the UK. Article 10 of the Northern Ireland protocol,[1] agreed as part of the Withdrawal Agreement signed in early 2020,[2] means that EU state aid rules will continue to apply to some UK subsidies.

This poses a dilemma for the new regime. Some UK subsidies will require approval from the European Commission – those which "affect trade subject to the protocol" (effectively trade in goods between Northern Ireland and the EU).[3] If the UK regime applies to all UK-granted subsidies, this will mean grantors have to jump through two sets of hoops, but by not imposing UK rules on those subsidies the UK would be granting the EU sole jurisdiction. This problem is complicated by ambiguity and disagreement over the scope of Article 10.

The scope of the Northern Ireland protocol is contested

The UK and EU do not agree on the scope of Article 10 – that is, what constitutes a subsidy that "affects trade subject to the protocol". In EU state aid, the test for whether a subsidy "affects trade" is notoriously low. A material effect does not need to be proven. In principle, applying such a low test would mean that subsidies offered in Great Britain could nonetheless be subject to EU state aid rules. For example, a subsidy to a manufacturer in England that also has a subsidiary in – or even just sells into – Northern Ireland could be judged to affect trade.

In December, before the TCA was signed and at a point when the UK government was threatening to legislate to allow UK ministers to unilaterally interpret Article 10, a declaration by the EU side of the Joint Committee on the application of the protocol appeared to rule out such a broad interpretation.[4] It stated that "an effect on trade between Northern Ireland and the Union which is subject to this Protocol cannot be merely hypothetical, presumed, or without a genuine and direct link to Northern Ireland".

The UK government took this declaration as confirmation of their narrow interpretation. In its subsidy control guidance published in January, BEIS wrote that "in practical terms, this declaration means that subsidies granted in Great Britain are only in scope of Article 10 where there is a clear benefit from and a genuine, direct link between the subsidy and companies in Northern Ireland".[5]

Even at the time experts were sceptical that this declaration had the meaning and legal force that the UK side was keen to emphasise. George Peretz QC pointed out that "one way of testing whether a pronouncement such as that tells you anything interesting or significant is to ask yourself whether anyone would ever have claimed the opposite".[6] While the test for what constitutes an "effect on trade" is low, the European Commission would never accept that a link could be "merely hypothetical".

A commission "notice to stakeholders" in January 2021 suggested that the December declaration did not have the effect the UK government has claimed.[7] It said that the statement "is fully in line with the case law of the Union courts" and further that "the case law thus creates a presumption that an effect on trade exists as soon as a financial support from State resources strengthens the position of an undertaking compared with other undertakings in a market subject to trade".

Therefore the UK government and the commission still disagree on the scope of the protocol. And the difference is potentially very large. Only 6% of subsidies offered in the UK were to businesses in Northern Ireland in 2019,* but a much greater proportion will have been made to businesses with a sales presence there – for example, Nissan cars manufactured in Sunderland will be sold into Northern Ireland. The BEIS guidance states that any measure can only be notified to the commission if the relevant government department (BEIS or Defra) agrees that the measure is subject to the protocol. But if the commission disagrees, or if the subsidy is challenged by a third party in the UK courts, a measure could be subject to the 'standstill obligation' and will have to be repaid.

What this means for a UK regime

The problems outlined above are twofold. First, that some subsidies will still need commission approval. And second, that the scope is contested. The government can and should address each problem separately.

Subsidies subject to the protocol should not require approval under both regimes

Some subsidies are subject to state aid rules through Article 10 of the protocol, for example subsidies to manufacturers in Northern Ireland. If the UK designs a more flexible regime that works better for public bodies and businesses, those captured by Article 10 will already be at a disadvantage. Their subsidies will need to comply with EU rules, which might be more bureaucratic and rigid.

Requiring these subsidies also comply with the UK regime would provide a further disadvantage and disincentive to offer subsidies. The EU rules also comply with the TCA, and the UK's more flexible rules should mean that any measure that is compliant with state aid could also demonstrate compliance with the UK regime. A requirement to also comply with the UK regime would just be additional red tape.

* Source for this calculation is Institute for Government calculations using European Commission, 'EU State Aid Transparency Database', retrieved 19 May 2021, https://webgate.ec.europa.eu/competition/transparency/public?lang=en . Calculation covers all subsidies recorded between 1 July 2016 and 1 July 2019.

Importantly, as BEIS and Defra must approve any notification of a subsidy to the commission, this would not lead the government to lose control of the system or mean that many GB subsidies were notified to the commission instead of complying with the UK regime. We understand that this is the approach the government intends to take.

The risk of legal uncertainty is high while the scope of Article 10 is unclear

A two-system approach, as we propose, is not ideal but it would be workable and the best solution in the circumstances if the scope of Article 10 were not contested. Eventually, the case law will develop such that it is clear which subsidies require commission approval. However, in the interim the competing systems could breed uncertainty and have a significant chilling effect on subsidies.

Public bodies offering subsidies must abide by the BEIS guidance in interpreting Article 10. If a measure is not notified to the commission and subsequent legal challenge finds that it should have been, it will need to be recovered. Public bodies will be reluctant to offer subsidies, and businesses unwilling to accept them, with that threat hanging over the measure.

The potential solutions to the Article 10 problem are the same in 2021 as they have been since this version of the protocol was agreed in late 2019. The UK and EU could clarify a joint and agreed position on the scope of the protocol. However, this has not proved possible so far – the apparent accord in December's Joint Committee statement has proved to be far short of an agreement that would provide certainty. And given the current positions of each side it seems unlikely that an agreement that would lead to legal certainty is politically feasible at this time.

The other solution would be for the UK to renegotiate the scope of the protocol by making commitments about UK-wide subsidy control. The EU negotiators included Article 10 as a safeguard against excessive UK subsidies on a member state's doorstep on the island of Ireland, but an effective and robust UK regime would mean it is not necessary. *Beyond State Aid* recommended that the UK should try to limit the scope of Article 10, or remove it entirely, by signing up to subsidy control provisions in a UK–EU agreement.[8] But the EU was unwilling to make this change, or the UK was unwilling to make sufficient commitments on subsidy control to secure it.

While these solutions are off the table in the short term, the best approach for the UK government is to design an effective domestic subsidy control regime. By demonstrating a commitment to preventing harmful subsidies and developing an effective dialogue between the commission and the new UK subsidy regulator, it should allow for future renegotiations that will limit the scope of Article 10 or remove it entirely. However, any such renegotiation is likely to happen in years rather than months, and so Article 10 will remain a problem for the UK regime in the short term.

Recommendations

- **Northern Ireland subsidies should be able to receive commission approval and for that to be sufficient for approval under the UK system.** It would be too burdensome for any subsidies caught by the Northern Ireland protocol to have to comply with two subsidy control regimes. It makes sense for any subsidy approved under state aid to be treated as sufficient for compliance with the UK system.

- **The UK government should design an effective regime to demonstrate that Article 10 of the protocol is unnecessary.** As it stands, uncertainty over the scope of Article 10 is problematic and could have a chilling effect on subsidies to Great Britain-based businesses with a Northern Ireland presence. By delivering an effective subsidy control regime, the UK government can demonstrate that the Article 10 'backstop' is not necessary to prevent UK subsidies from affecting the EU. Over time, the UK government should try to negotiate a limit to the scope of Article 10 or removal entirely.

Conclusion

The government's objectives for the new UK subsidy control regime are reasonable and ambitious. It is in the UK's interest to prevent harmful subsidies and, as part of broader industrial policy, to funnel resources towards priority objectives including net zero and levelling up.

The TCA allows the UK to design a regime that is distinct from EU state aid rules and can be tailored to the UK's domestic needs. The government must use that freedom wisely and seize the opportunities available to create a better targeted, more flexible and less bureaucratic regime. But this must not come at the cost of increased legal uncertainty and inconsistent application of the rules across the country that would discourage some authorities from offering subsidies while permitting others to offer damaging ones.

The proposals in the government's consultation document correctly identify many of the big opportunities for a UK regime. A domestic regime need not be as restrictive as state aid, which needs to monitor subsidies across 27 countries with different approaches to public spending. This means the UK can do away with the restrictive 'standstill obligation' and make the system faster. The government also recognises the role the regime will play to prevent subsidy races between the countries of the UK.

However, as they stand, the government's proposals risk creating an ineffective regime. The regulator in a UK system should not have all of the powers of the European Commission, but can play an important role advising public bodies on whether their subsidies comply with the rules, and can ensure those rules are enforced. Without a regulator doing this, harmful subsidies might be approved, either because judicial review gives deference to grantors or because no party challenges a subsidy in court.

The CMA has the expertise and reputation to take on the role as a strong regulator with powers to approve subsidies before they are granted, as well as review awards after they have been given. Its governance should be reformed to make it a genuinely four-nation body. The government should also adopt a safe harbours approach for low risk subsidies which are more flexible than the much-maligned EU block exemptions.

Article 10 of the Northern Ireland protocol is the elephant in the room that risks undermining the effective operation of the new UK regime. Attempts to resolve the dispute with the EU over its scope have so far been unsuccessful. The best outcome is if the government can show the EU that the safeguard of Article 10 is not needed. The way for the government to do that is to design a robust and effective UK regime along the lines proposed in this report. That means a detailed set of guidance and regulation clarifying what it means to comply with the principles, a role for the CMA to provide advice on subsidies and to enforce breaches, and a set of sensible safe harbours that will minimise legal uncertainty while guaranteeing that subsidies are well designed and harmful subsidies are prevented.

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