INTRODUCTION

A delicate issue in the current EU-UK trade negotiations is the form of control the UK should exercise over State aid granted to firms and sectors. The EU is seeking dynamic alignment of any set of future UK State aid rules with the EU rules to maintain a ‘Level Playing Field’ (LPF) in areas relating to access to the Internal Market. This is a bold demand, especially since the responses to the COVID-19 pandemic will result in the EU State aid rules being in a state of flux for several years. However, for domestic purposes, the UK will need to replace the State aid rules currently based upon EU law once the transitional period has ended. Good governance requires openness, transparency and accountability in the use of public money. Thus the UK is at an important moment in defining the role of State intervention in the economy.
COMPETITION PROVISIONS IN INTERNATIONAL TRADE AGREEMENTS

The EU was an advocate of including competition provisions in international trade agreements but, to date, it has been difficult to find international consensus.\(^1\) Therefore the EU has moved forward by including competition clauses in some of its bilateral trade agreements since specific provisions appeared in the Europe Agreements of the 1990s. But there are varying degrees of regulation of competition in EU trade policy agreements, even amongst those with its neighbouring States.\(^2\)

State aid regulation is found in the competition chapter of the EU Treaty in Articles 107–109 TFEU. But there is an acknowledgement that the DNA of State aid owes more to the regulation of free movement goods and services than to competition.\(^3\) Thus, it is no surprise that because of the geographic proximity and the level of EU-UK trade, there should be a demand that the UK align its domestic State aid policy with EU policy.

THE EU NEGOTIATING POSITION

The EU mandate for the negotiations with the UK on the application of the State aid rules is consonant with the Association Agreements with the countries bordering the EU, especially the sophisticated EU-Ukraine AA. But the EU has set greater obligations for the UK.\(^4\)

The negotiation framework Council Directives\(^4\) state that ‘The envisaged partnership should ensure the application of Union State aid rules to and in the United Kingdom.’ [96]. Furthermore, they demand that the UK creates ‘…an independent, adequately resourced enforcement authority with effective powers to enforce the applicable rules which would work in close cooperation with the European Commission.’ [94]

Any disputes about the application of the State aid rules should be subject to dispute resolution.

The text also includes a provision to ensure that UK courts apply State aid rules and make preliminary references to the ECJ. This goes much further than the demands made of Ukraine which enjoys a degree of regulatory autonomy in implementing EU law into the domestic legal system. An independent regulator, the Anti-Monopoly Committee, enforces and monitors the domestic State aid rules, with a short Annual Report sent to the EU. The EU-Ukraine AA legal provisions do not have direct effect\(^5\) in Ukraine and, therefore, there is little opportunity for domestic courts to apply the State aid rules.\(^6\)

Currently, neither the EU nor Ukraine may resort to dispute settlement procedures in the field of competition.\(^7\)

THE UK NEGOTIATING POSITION

The UK takes the stance that it would introduce its own regime of subsidy control but does not want the involvement of the European Commission or the ECJ. The need to assert sovereignty and avoid delays to create a nimble industrial policy is one argument put forward by the UK for denying the European Commission a role in the new domestic State aid regime.

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\(^2\) The Agreement on the European Economic Area, OJ L1 3/1/1994, Articles 61-64, contains comprehensive State aid provisions; The Euro-Mediterranean Agreement with Israel, OJ L147 21/6/2000, Articles 36(1)(iii) and (3) States that public aid that may affect trade between the EU and Israel is incompatible with the agreement and seeks to provide transparency in public funding; Decision no 1/95 of the EC-Turkey Association Council of 22 December 1995 on implementing the final phase of the Customs Union, OJ L 353 13/2/1996, Article 33(3) contains a reference to State aid; State aid provisions are found in the agreement between the EEC and the Swiss Confederation, OJ L300 (31/12/1972) and the Agreement between the EC and the Swiss Confederation on Air Transport, OJ L114 (30/4/2002).


\(^4\) https://www.consilium.europa.eu/media/42736/st05870-ad01re03-en20.pdf

\(^5\) Direct Effect of EU law allows provisions which are legally perfect to be relied upon in national courts of the Member States. It will depend upon the wording of the trade agreement and the effect of national law as to whether a trade agreement may be relied upon in the national courts of a non-EU state.


\(^7\) Art. 261 EU-Ukraine AA. But Article 256 of the EU-Ukraine AA holds out a possibility that competition may be subject to dispute settlement procedures.
In terms of delay, on past experience, this is a disingenuous position to take. The EU State Aid Scoreboard 2019\(^8\) confirms that a very high percentage (94.7%) of national State aid is automatically legal under the General Block Exemption Regulation (GBER).\(^9\)

In addition, the EU has developed several Frameworks and Block Exemptions for specialised State aid.\(^10\) Thus, the schemes the Conservative Government has indicated it will introduce, for example, involving ‘green’ measures\(^11\) in the economic recovery would most likely be eligible for other EU green-light State aid schemes. Even with the new volume of measures triggered by the COVID-19 economic crisis the European Commission has shown that it can turn around applications and make Decisions in 24 hours and over weekends.

Indeed, the UK has rarely had any legal skirmishes with the European Commission, or the European Courts, in the area of illegal State aid. Even the extraordinary measures taken by the UK in response to the COVID-19 pandemic have been processed quickly by the European Commission and the UK has not fully utilised the Framework available. UK measures are limited, taken only where it was deemed absolutely necessary as a last resort.

In a speech in Greenwich on 3 February 2020 the PM was adamant:

‘There is no need for a free trade agreement to involve accepting EU rules on competition policy, subsidies, social protection, the environment, or anything similar any more than the EU should be obliged to accept UK rules.’\(^12\)

In its negotiating position of February 2020\(^13\) the UK states that any new EU-UK Trade Agreement should include reciprocal commitments for transparency on the award of subsidies which go beyond the requirements set out in the WTO-SCM Agreement. Both parties should notify each other every two years on subsidies granted to goods or services. This would be similar to the EU – Japan EPA and the CETA. In addition, the future Agreement should allow requests for consultations on any subsidy that might harm the interests of the other party. The consultation commitment should not be subject to the Agreement’s dispute mechanism.

NEW DIRECTIONS FOR THE USE OF STATE AID IN THE UK

Under the Theresa May government of 2016-2019, the UK stance on State aid was hazy. It was accepted that some form of State aid regulation was necessary, mainly to prevent cities and regions from offering incentives for investment that could create regional imbalances.\(^14\) Underpinning this approach was a desire to avoid the ‘beauty contests’ seen in the US where cities and regions offer incentives for large companies to invest.

Contingency plans were made to cover the situation if the UK had left the EU without a Withdrawal Agreement: the State aid rules would be transposed into UK law and made operable in a domestic context, with the Competition and Markets Authority as the regulator. The Government prepared draft secondary legislation under the European Union (Withdrawal) Act 2018 (as amended) and provided additional funding to the CMA. But these regulations were withdrawn in February 2020 after ratification of the Withdrawal Agreement with the EU.

\(^8\) https://ec.europa.eu/competition/state_aid/scoreboard/index_en.html
\(^12\) https://www.gov.uk/government/speeches/pm-speech-in-greenwich-3-february-2020
A change of perspective has occurred with the election of Boris Johnson as Prime Minister and the clear majority obtained by the Conservative Party in the General Election of December 2019. The constraints of the EU State aid rules were alluded to, for example, as to why the UK steel industry could not be propped up. But the political message was more than the removal of the EU yoke. Surprisingly the Conservative manifesto saw a greater role for the strategic use of public financing. The Election campaign was imbued with the advantages of supporting local industries through a ‘Buy British’ campaign without the constraints of the EU procurement and State aid rules. New promises were made of government spending on infrastructure, science and the levelling up of the regions in the UK. As part of a ‘One Nation’ promise, made before the vicious attack of the COVID-19 virus on the economy, the Prime Minister set a goal of raising the level of economic performance in all parts of the UK, with investment in infrastructure, transport and research and development. The government also pledged to replace the £2.1 billion funding received from the EU with a Shared Prosperity Fund to reduce inequalities between communities.

There was a vision, with a nod to the US, of ploughing public money into large-scale projects to create a role for the UK as a world leader, unfettered by EU rules. The PM Johnson set out the new plan in his Greenwich speech:

‘…. we will develop our own separate and independent policy on subsidies. In doing so, one of our key objectives will be to have a modern system for supporting British business in a way that fulfils our interests.’

The shift to embracing public funding was seen in newspaper reports in 2019 of a secret Project Birch, established to provide rescue subsidies to companies detrimentally affected by a No-Deal Brexit.

In May 2020 the Chancellor of the Exchequer, Rishi Sunak, authorised a bailout plan, Project Birch, to provide aid to companies affected by the COVID-19 pandemic. He indicated that the government is prepared to assist large companies ‘in exceptional circumstances’ and as a ‘last resort’ where an otherwise viable company has ‘exhausted all options’ and its failure would ‘disproportionately harm the UK economy’.

Also, in response to the economic shock of the COVID-19 lockdown, the Chancellor has drafted an economic stimulus package to come into operation in July 2020.

WHAT KIND OF STATE AID SCHEME WILL THE UK IMPLEMENT?

The UK must decide on how it will regulate State aid in the future. To maintain a close trade relationship with the EU it must manoeuvre into a position where it gives effect to a State aid regime equivalent to that maintained by the EU, with an effective and robust independent enforcement process.

In the EU-Ukraine AA a domestic regulator is used to regulate and monitor domestic State aid with an Annual Report exchanged by the EU and Ukraine.

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16 Chris Giles, Levelling up: how wide are the UK’s regional inequalities? FT, 2 March 2020: https://www.ft.com/content/c9db4bc6-6597-11ea-a528-d0df971e68bc.


18 Commentators locate the change in policy as being influenced by the PM Boris Johnson’s Special Advisor, Dominic Cummings: see Simon Nixon, Johnson’s obsession with state aid creates more problems than it solves, The Times, 4 June 2020: https://www.thetimes.co.uk/article/johnsons-obsession-with-state-aid-should-set-alarm-bells-ringing-bbctc2jig.

19 See fn 14.


24 Although the ideas have been discussed for some time, it is perhaps not a coincidence that on 17 June 2020 the European Commission unveiled proposals for tackling subsidies granted to foreign (non-EU) companies operating in the EU. The original target countries were the US and China, but of course, could include the UK in the future. The proposal covers procurement and subsidies: WHITE PAPER on levelling the playing field as regards foreign subsidies https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf.
STATE AID: NOT ONLY ABOUT TRADE

There are issues as to whether a new regulatory body should be established in the UK, perhaps with presence in the devolved administrations and even in large cities. The Competition and Markets Authority (CMA) did not want the role of a State aid regulator. In addition, to the extra work generated from leaving the EU, the CMA recognises that a different skills set is required to handle State aid cases. Sotto voce it would prefer to be outside of political decisions on granting State aid. 25

On 15 May 2020 the Department for Business, Energy and Industrial Strategy replied to the House of Lords Internal Market Sub-Committee Inquiry into UK–EU negotiations on the level playing field and State aid 26 stating that a future domestic State aid regime may not include a regulator. 27 While the document recognises many of the concerns raised to ensure an effective domestic State aid regime is in place it provides no concrete proposals. Without a regulator, there would be a lack of transparency and accountability of how public money is allocated. This would leave the courts as the forum for challenging policy decisions taken by central and local government. Across the EU there has been an increase in domestic litigation where aggrieved competitors have challenged domestic State aid policy. 28

Using the framework seen in other Association Agreements with the EU, bridges could be built between the EU and the UK by allowing a UK-EU Joint Committee to examine subsidies which raise LPF concerns, perhaps with recourse to independent arbitration. 29 But such a solution neutralises one of the main advantages of the EU State aid regime which, by specifying details rules, aims to rely on ex ante control to the maximum extent possible.

Arguably, a rational position for the UK should be to stake a role in the development of the European Commission’s future policy on State aid. According to the 2019 State Aid Scoreboard, 94.7% of new measures fell within the General Block Exemption Regulation. 30 The specific Block Exemptions are also under review during 2019-2022. 31 The willingness of the Member States to frame their aid packages within the EU framework shows that the European Commission must get the balance right in judging the acceptability of its rules by the Member States. The UK government, as well as stakeholders, 32 should want to be part of the consultations when State aid provisions are reviewed.

But the government has taken a different view:

‘Negotiating any formal influence for the UK over the future development of EU State aid rules, as the Committee has proposed, would be very challenging though we will always strive to protect the interests of British businesses abroad. State aid is a sole Commission competence so even EU Member States cannot block a proposal or demand changes. It would be unprecedented for the Commission to allow a third country which does not align with EU rules to have any say over EU State aid policy. Equally, the Government would not accept that the EU should have any influence over the development of the UK’s future subsidy control policy.’ 33

25 See the oral Evidence provided by the CMA, fn14
27 https://committees.parliament.uk/publications/1381/documents/12714/default/
32 This is an over-looked issue. The European Commission is adroit at weaving stakeholders into its web of consultation to reinforce policies which may not always secure the backing of national governments. For a discussion of the use of interest groups, ngos and other stakeholders in building credibility for the regulation of public services and State aid see Erika Szyszczak, “Soft Law and Safe Havens” in U. Neergaard, et al. (eds) Social Services of General Interest in the EU (2012, Springer). 317-345.
33 https://committees.parliament.uk/publications/1381/documents/12714/default/
There are concerns within the EU that the emergency State aid responses to the COVID-19 economic crisis may result in distortions within the Internal Market and that some Member States may take advantage of their relative prosperity to gain a competitive edge. In the past, the UK has not been interested in participating in a subsidy race, as a matter of principle, but also knowing it cannot win against Member States with stronger economies, especially Germany. There are stirrings within certain major Member States of the need for the EU to allow for a more aggressive industrial policy at the national level. The UK could find any weakening of EU State aid policy leaves the UK exposed to greater competition from its nearest neighbours. Thus, a rational response from the UK would be to insist upon having a say in maintaining a foot in the EU door to maintain strict observance of the State aid rules by the EU-27.

### THE NORTHERN IRELAND PROTOCOL

In fact, the UK has already tied its negotiating hand. George Peretz QC points out that the effect of Articles 10 and 12 of the Northern Ireland Protocol is to preserve the application of EU State aid rules in the UK. Peretz shows that the Articles apply to any UK measure that effects trade in goods between Northern Ireland and the EU27. He makes the point that the trigger of ‘effect on trade’ is a low and imprecise threshold. But arbiters of the test will be the UK regulator, the UK courts, the European Commission and ultimately the ECJ. Thus, ultimately, the UK Government has no control over the interpretation of the test.

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### A STATE AID PLAN FOR DOMESTIC POLICY

At home, the UK has to find domestic credibility. Currently, there is no official domestic plan for State aid. Peretz commented upon a Conservative Party proposal (that was not contained in the Manifesto but sent to journalists) at the time of the December 2019 General Election which would base a domestic State aid (or subsidy) scheme on the WTO rules. But the WTO rules are designed to handle trade disputes between nation states and are designed to address unfair trading conditions as a result of effects on exports. Few cases are brought under the rules since they rely upon proof of harm caused by a subsidy and cases take years to process.

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CONCLUSION

The reaction of the government to the COVID-19 crisis has revealed the need for transparency in the granting of subsidies as well as accountability in procurement, to put aside allegations of cronyism. The large public investment necessary for the post-COVID-19 economic recovery will require a greater role for the state in the years to come. Additionally, over 650 public bodies are in a position to grant aid often to local businesses. Devolved administrations also have powers to grant State aid. The different responses to the health issues in response to the COVID-19 pandemic suggest that these administrations may want to flex their independence in the future.

A lot of State aid activity is small-scale and under the radar, creating few legal problems or challenges. But in times of scarcity and greater public awareness of State aid and procurement issues, there may be the temptation to challenge State aid decisions, even at a local level.

The current situation offers anything but certainty.
ABOUT THE AUTHOR

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FURTHER INFORMATION

This document was written by Erika Szyszczak. The UK Trade Policy Observatory (UKTPO), a partnership between the University of Sussex and Chatham House, is an independent expert group that:

1) initiates, comments on and analyses trade policy proposals for the UK; and
2) trains British policy makers, negotiators and other interested parties through tailored training packages.

The UKTPO is committed to engaging with a wide variety of stakeholders to ensure that the UK’s international trading environment is reconstructed in a manner that benefits all in Britain and is fair to Britain, the EU and the world. The Observatory offers a wide range of expertise and services to help support government departments, international organisations and businesses to strategise and develop new trade policies in the post-Brexit era.

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