HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

Number SN06775, 16 September 2020

EU State Aid Rules and WTO Subsidies Agreement

By Ilze Jozepa

Contents:

Contents

Summary

As a member of the European Union, the United Kingdom was part of the EU regime on restricting trade-distorting subsidies ("state aid"). EU state aid rules continue to apply to the UK till the end of the transition period on 31 December 2020. After that, the Government has said it will put in place an independent UK subsidy regime. But both EU state aid rules and the WTO Agreement on subsidies and countervailing measures will remain relevant in the UK. The extent of this effect will depend upon the result of the UK-EU future relationship negotiations.

This briefing explains what EU state aid rules mean. It also sets out the recent changes brought about in response to the coronavirus outbreak. A further section looks at the state aid rules which apply during the transition period, and the settlement of 'ongoing' cases. Finally, the briefing sets out the main principles of the WTO Agreement on Subsidies and Countervailing measures.

For more information on state aid in the UK-EU negotiations see Commons Library briefing CBP 8852, [The UK-EU future relationship negotiations: Level playing field.]()

What is state aid?

EU Member States sometimes use public resources to intervene in their national economies by assisting companies or industries. This can range from a government tax relief scheme for investors, to a local authority giving a subsidy to a property developer.

State aid is when public organisations support certain enterprises or industries, financially or by other means.

This type of assistance is called 'state aid' and is normally prohibited if it threatens to distort trade and competition between firms, through for example, discouraging investment and increasing costs to consumers. EU state aid rules aim to create a level playing field so that, for example, French firms can compete fairly with German ones.

The EU and its Member States also use state aid as a policy tool. Exemptions to the EU state aid rules allow for certain beneficial interventions. For example, state aid might be necessary and justified to address a market failure, as when small and medium enterprises (SMEs) have difficulties finding investment capital. It may also be necessary to achieve policy goals such as regional economic development or environmental protection. Governments can, for instance, use state aid to stimulate businesses to invest in less developed areas or the development of advanced environmentally friendly technologies.

The European Commission (EC) has strong powers to assess cases of state aid, approve them and enforce stringent 'claw-back' mechanisms when state aid is deemed unlawful. The UK has never had specific legislation for state aid, as EU state aid rules apply directly.

What does the EU state aid framework look like?

As a general rule, an EU Member State cannot pay out state aid unless a scheme or an aid measure is approved by the European Commission. Policymakers have to make sure that support is legal through making it compliant with guidelines set out at EU level.

However, there are many exemptions, such as the *de minimis* rule for assistance worth less than €200,000 over three years and the General Block Exemption Regulation. These exemptions generally allow smaller schemes to be set up without a prior notification in Brussels. In addition, EU state aid rules do not restrict policies open to all businesses, such as a general reduction of corporation tax or changes in employment law.

In 2019, the Commission started an evaluation of the current rules. This is expected to result in amended rules in several areas, including energy and environmental aid. There will also be more flexibility towards transnational projects supporting strategically important technologies and value chains.

In response to the coronavirus outbreak, the EU has temporarily relaxed the usual state aid restrictions to give Member States more flexibility to support their economies.[1]

Has there been much state aid in the UK?

While an EU Member State, successive UK governments have supported rigorous state aid controls and have avoided subsidising particular industries or companies.

The UK public sector has spent less in business support than most other EU countries. In 2018, the UK spent 0.38% of GDP on state aid (excluding railways, and agriculture and fisheries), while France spent 0.79% and Germany 1.45%.

Transition period

During the transition period, the UK continues to apply EU state aid rules and regulations and the EC continues to assess and approve UK state aid measures. The Commission will be able to finish ongoing procedures and take follow-up action beyond the end of the transition. For up to four years after that date, the Commission will also have power to initiate new examinations of UK aid, which authorities may have paid to businesses before the end of transition. This for example allows the Commission to investigate allegations of unlawful UK aid paid out in the past.

The Protocol on Ireland and Northern Ireland foresees that EU State aid Law will apply in Northern Ireland regarding trade between Northern Ireland and the EU. This is limited to trade in goods and electricity. The European Commission will remain the enforcement authority.

World Trade Organisation Agreement on Subsidies and Countervailing Measures

In addition to EU state aid rules, the UK is party to the WTO Agreement on Subsidies and Countervailing Measures. The government has announced that its commitments under the WTO will play an important role in the future UK subsidy regime.

Under the Agreement, some subsidies are prohibited outright while the rest are 'actionable' – meaning that the subsidy is allowed, but other countries can take certain actions if the subsidy harms them. Countries can protect their industries by taxing imports of the subsidised good – this is known as imposing a 'countervailing duty'.

Although the definition of a 'subsidy' under the WTO regime is broadly similar to 'state aid' in EU law, the EU rules are a lot more stringent than the WTO rules on subsidies. The key differences are:

- The default position in WTO rules is that subsidies are generally allowed, while EU rules consider subsidies to be generally illegal.
- WTO rules apply to goods, but EU rules include services too.

---

1 European Commission, Temporary Framework for State Aid Measures to Support the Economy in the Current Covid-19 Outbreak (informal, consolidated version), accessed 15 September 2020. The State aid Temporary Framework, which was published on 18 March 2020, has been amended on 3 April 2020, 8 May 2020 and 29 June 2020.

- EU rules are applied prospectively (i.e. legality must be proved *before* awarding any support), while WTO rules are only reactive, and are only triggered if a member country lodges a complaint.
- WTO rules rely on state-to-state enforcement while under EU rules there are remedies available to businesses and individuals.
- Under EU rules, a business has to repay illegal state aid. There is no such mechanism to remove anti-competitive effects under the WTO rules.

In case the UK and the EU do not reach a free trade agreement by the end of the transition, the WTO rules on subsidies would still apply.

The EU state aid legislation currently in force can be found on this page of the European Commission's website.

The full text of the WTO's Agreement on Subsidies and Countervailing Measures can be found on this page of the WTO's website.

1. EU state aid rules

EU Member States sometimes intervene in their national economies by providing assistance to companies or industries using public resources. This can range from a government tax relief scheme for investors to a local authority giving a subsidy to a property developer.

State aid is when public organisations support certain enterprises or industries, financially or by other means.

This type of assistance is called 'state aid' and is normally prohibited by EU rules, unless it is covered by one or more of the exemptions outlined later.

State aid is generally prohibited in the EU because it can distort competition between firms, discourage investment and cost consumers. State aid rules aim to create a level playing field so that, for example, British firms can compete fairly with German ones. The arguments in favour of state aid rules also apply to domestic competition.

The UK government has historically supported strong state aid rules:

> The ineffective use of State aid in the long run can … lead to a persistence of inefficient and unproductive industries, preventing the emergence of new and more innovative, high growth firms … and so damaging the country's long term prosperity. And of course, if taxpayers' money is not being used to subsidise inefficient enterprises, taxes can be lower or public spending can be increased in other areas.[2]

But state aid can also be an important policy tool. Exemptions to the state aid rules allow for certain beneficial interventions. For example, state aid might be necessary and justified to address a market failure, as when SMEs have difficulties finding investment capital or companies are reluctant to invest in employee training. State aid may also be necessary to achieve policy goals such as regional economic development or environmental protection. Governments can, for instance, use state aid to stimulate businesses to invest in poorer regions or to purchase advanced environmentally friendly technologies.

1.1 Is it state aid?

There are four key questions to determine whether an aid measure involves state aid (i.e. whether state aid rules apply). Note however that **the presence of state aid does not automatically mean that a measure is prohibited**. Rather, the authorities need to ensure that the proposed measure is legal. This can be done, for example, by demonstrating that the aid measure is covered by an exemption to the rules, or by seeking the approval of the European Commission (EC).

State aid can be legal or illegal.

For any assistance provided by EU Member States, if the answer to all of the following questions is 'yes', then the measure involves state aid. Conversely, if 'no' is the answer to at least one of these questions, then

[2] Department for Business, Energy and Industrial Strategy, The state aid manual, July 2015, p6

the measure does not involve state aid (i.e. state aid rules do not apply).[3]

1. Does the aid **favour certain undertakings** (such as companies) or the production of certain goods?
2. Is aid **provided through state resources**?
3. Does the aid distort or threaten to **distort competition**?
4. Could the aid **affect trade between Member States**?

These four questions are explained in more detail below:

1 Does the aid give an **advantage to certain undertakings** (such as companies) or the production of certain goods?

The state aid rules apply if the aid provides financial assistance to an organisation or group of organisations. Normally the rules apply to assistance provided to companies, but assistance to third sector organisation (such as charities) can also be considered state aid.

Assistance to individuals is not considered state aid. Assistance such as tax measures which apply to all businesses equally, are not considered state aid. However, if the assistance applies to a specifically defined type of businesses (for example, businesses in a certain area, or businesses of a certain size) then it will count as state aid. Indirect financial assistance (such as exemption from a certain charge or fee) will also count as state aid.

There is no state aid advantage to a particular company if a public body behaves (purchases, sells, invests, lends etc.) like a private business would do, in similar circumstances (this is called the Market Economy Operator (MEO) principle).[4] For example, a local authority can inject capital in a business expecting the same returns as a commercial investor. It can also provide a loan to a company at an interest rate that would be acceptable to a commercial lender. If the local authority can demonstrate that the MEO is met, there is no state aid.

2 Is aid **provided through state resources**?

The rules apply if the assistance is provided by any organisation that is controlled by a Member State. This includes non-departmental public bodies, executive bodies, as well as government departments and local authorities.

The form of state support is not decisive. It can be a grant to a company, a loan or a guarantee below market rates, a tax relief scheme, sale of public property at a discounted rate or free consultancy advice and more.

3 Does the aid distort or threaten to **distort competition**?

---

3 Department for Business, Energy and Industrial Strategy, The state aid manual, July 2015, p6. Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) contains the definition on state aid.

4 European Commission, Commission Notice on the notion of State aid as referred to in Article 107(1) of the TFEU, 19 July 2016, OJ C 262, p17

If the assistance strengthens the position of a company within a particular market, relative to other companies operating in that market, then the assistance distorts or could distort competition in that market.

Since the EU operates a free trade area involving other Member States, assistance which strengthens the position of all companies in a particular sector within one country would be considered state aid since these companies may operate in a market involving companies in other Member States.

4 Could the aid **affect trade** between Members States?

This condition is interpreted broadly. If the good or service benefitting from the aid could possibly be traded between Member States, then the assistance is considered to affect trade.[5]

To reiterate, if the answer to all of the above questions is 'yes', then the assistance would be considered a state aid measure by the EC. For the aid measure to be legal, the EC's approval would have to be sought, unless it can be demonstrated that the policy is covered by at least one of the exemptions outlined below. If an exemption applies, then there is no need to seek the EC's approval.

1.2 Exemptions

There are three categories of exemptions to state aid rules. If any exemption applies to a state aid measure, then the assistance is normally permitted without the need to seek the EC's formal approval, although some requirements regarding transparency and reporting apply. These categories are the *de minimis* rule; individual aid under schemes that have already been approved by the EC; and the General Block Exemption Regulation.

State aid that is covered by one of these 'exemptions' is legal…

De minimis rule

According to the *de minimis* rule small amounts of assistance are exempt from state aid rules. Any aid that is worth less than €200,000 per business over three years is allowed by the EC.[6] The threshold is lower in two sectors: €100,000 in the road transport sector, and €15,000 for agriculture.

In order to be covered by the *de minimis* rule, the value of the aid must be "transparent" – that is, precisely calculable in advance. This means that aid which requires any form of risk assessment in order to determine its monetary value is not exempt under the *de minimis* rules, regardless of how small the amount of assistance is.[7]

5 Department for Business, Energy and Industrial Strategy, The state aid manual, July 2015, pp7-8
6 European Commission website, State aid procedures (accessed on 15 September 2020)
7 Department for Business, Energy and Industrial Strategy, The state aid manual, July 2015, p20

Aid under an approved scheme

The EC can approve state aid schemes by giving its consent to a policy framework, maximum amounts and conditions of aid, as well as types of beneficiaries of these schemes. When public organisations grant assistance to companies under such a pre-approved scheme they will normally be exempt from a prior notification.

Various UK state aid schemes fall into this category, for example the Enterprise Management Incentive scheme, which helps SMEs attract and retain skilled personnel, and the Enterprise Investment Scheme, whereby state aid is used to promote investment in smaller knowledge-intensive companies.[8]

General Block Exemption Regulation

State aid with the following aims is included in the General Block Exemption Regulation (GBER) and is exempt from prior notification. Block exemptions exist for aid that promotes:[9]

- **Small and medium sized enterprises (SMEs)**. Aid which overcomes market failures that prevent SMEs from starting and thriving is allowed. This aid often takes the form of assistance to invest, take on new workers or cover intellectual property costs.
- **Research, development and innovation.** Aid that allows the EU to move towards a 'knowledge-based economy' is allowed. This can include assistance with patent costs, technical feasibility studies or development projects.

  Beyond traditional research and development, aid is also exempt from state aid rules if it assists in the creation of innovative enterprises, advisory services or support services.
- **Employment and training, especially for disadvantaged residents and workers with disabilities.** Aid for training workers is generally allowed. Aid which helps disadvantaged workers into employment is also allowed. This aid often takes the form of assistance to employ people with disabilities, provide training or establishing family friendly leave/pay systems. Aid for the transport of workers who live in remote regions is also allowed.
- **Regional aid.** One of the key objectives of the EU is to raise the quality of life of citizens in disadvantaged regions of the Union. Aid is allowed if it "enhances economic cohesion" by helping the development of less developed areas (see box 1 on Regional state aid).
- **Infrastructure aid.** Aid for investment in local infrastructure and broadband, sport and multifunctional recreational infrastructure is allowed.
- **Environmental protection.** Aid which favours environmental protection or measures to tackle climate change is exempt from

8 Pre-approved UK state aid schemes are registered in the EC State aid database.
9 Council Regulation (EU) 2015/1588, OJ L 248, 13 July 2015, Article 1

state aid rules. In particular, investments in energy savings, investments in renewable energy and environmental tax reductions are allowed.

- **Aid for culture and heritage conservation**. It is for Member States to define what they consider cultural or natural heritage.
- **Aid to make good the damage caused by natural disasters.**

The detailed rules and limits on the aid that is allowed under each of the different block exemptions can be found in Commission Regulation (EU) No 651/2014 of 17 June 2014.

Box 1: Regional state aid

Authorities can give state aid to support investment and employment in less advanced regions of the EU, thereby contributing to more balanced economic development within and between EU Member States. Regional state aid is restricted to eligible geographical areas which Member States record in their regional aid maps. The most recent map for the UK is available on http://www.ukassistedareasmap.com/.

According to the EC's Regional Aid Guidelines Member States can grant state aid to companies in the designated areas to support investment in new production or modernisation of existing facilities. The guidelines limit how much state aid companies can receive as a percentage of their costs.

Schemes targeting sensitive sectors like steel are not eligible. For other sectoral schemes, Member States have to demonstrate how those would be more beneficial than horizontal policies available to all sectors. Smaller schemes under the GBER do not need prior approval of the EC.

Regional aid is not intended to encourage relocation of firms from one Member State to another.

Regional state aid may not be awarded to firms in difficulty, as state aid for rescuing and restructuring of businesses is strictly limited in the EU and specific guidelines apply.

The UK has received EC's approval for a wide range of aid schemes targeting assisted areas, for example the Regional Growth Fund in England and the Welsh Local Government Property Development Grant Scheme. Examples of local initiatives are SCR Jessica Urban Development Fund and Business Growth Programme in Yorkshire.

Export-related aid is not allowed

Aid for "export-related activities" is not allowed even if the assistance otherwise meets *de minimis* or GBER exemptions. Examples are aid directly linked to quantity of exported products or to setting up distribution networks. Support to attend trade fairs is allowed though.

Export-related aid is never allowed.

Further detail on GBER exemptions can be found in this EC publication, General Block Exemption Regulation (GBER) Frequently Asked Questions.

1.3 Special rules for public services

In the EU legal framework public services are referred to as Services of General Interest. These include non-commercial services provided by the government, such as defence and public education, but also services which governments contract out to businesses but financially support their provision. The latter are called Services of General Economic Interest (SGEIs).

EU law refers to public services as "Services of General (Economic) Interest".

Under the EU law, SGEIs are economic activities which deliver outcomes in the overall public good that, in absence of public intervention, would not be available at all or would not live up to the desired standard in terms of quality, safety, affordability, equal treatment or universal access. Such services for example can include public utilities such as gas and electricity supply, postal services, public service broadcasting, rural transport, provision of social housing and more.

Public authorities can choose to define what they consider a service of general, public interest. Thus, SGEIs may refer to different services across the EU, depending on the market situation and policy choices in that particular Member State. However, the Commission and the Union's courts can determine whether a Member State has made a "manifest error" in defining something as an SGEI and giving it financial support which distorts the level playing field for businesses. The Court and Commission have found manifest errors in several cases, including:

Member States are free to define what they consider a SGEI. The Commission guards against manifest errors.

- broadcasting organisations engaging in activities related to advertising and e-commerce;[10]
- broadband networks limited to business parks and not benefiting the population at large,[11] and
- port operations, i.e. the loading, unloading, transhipment, storage and movement which do not differ from other, commercial activities in ports.[12]

These activities, although earmarked as SGEI, were not found to be different from purely commercial services and did not warrant financial support.

State aid rules and compensation for SGEI

In general, **state aid principles apply** to the funding of SGEIs in the same way as they apply to any other economic activity: public authorities should not excessively subsidise such services. This is because an undertaking which provides the service might use an overly generous compensation to cross-subsidise its other, commercial activities to the detriment of fair competition.

However, **a separate set of state aid rules** exists for SGEIs.[13]

There is **no state aid if** the following conditions are met:

A separate set of state aid rules applies to SGEIs.

- Public service obligations are clearly defined and explicitly entrusted to an undertaking which will provide the service;
- The amount of compensation is calculated using objective and transparent methodology and does not exceed the costs incurred.

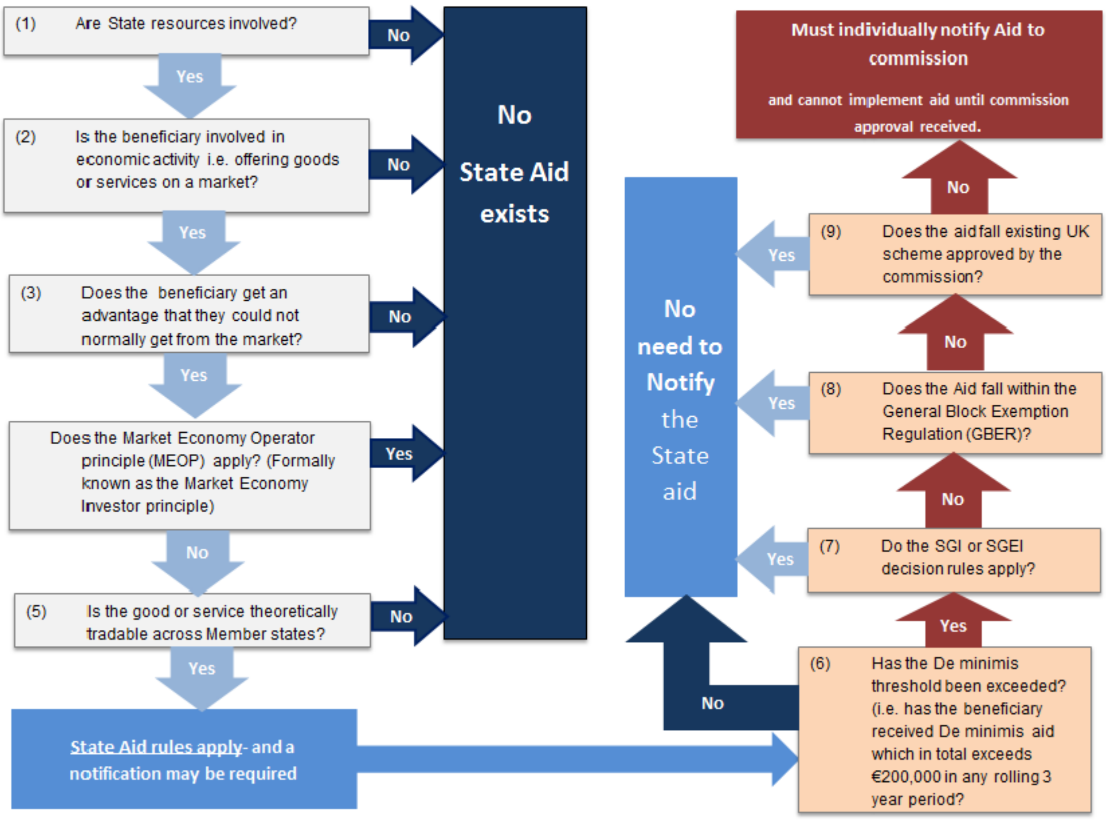
[10] C-195/06, Kommunikationsbehörde Austria (KommAustria)/Österreichischer Rundfunk (ORF), 18 oktober 2007
[11] Commission decisions on state aid N 890/2006, France, SICOVAL and N 284/2005, Ireland, Metropolitan Area Networks
[12] CJEU, 27/11/2003, C-34/01 to C-38/01, Enirisorse
[13] European Commission, Guide to the application of the European Union rules on state aid, public procurement and the internal market to services of general economic interest, and in particular to social services of general interest, 29 April 2013

- Finally, a provider is selected in a public tender. Alternatively, the level of compensation is determined based on a bench-mark analysis of the costs of a typical well-run business.[14]

If one of the three conditions above is not met, a compensation for an SGEI is considered state aid and has to comply to SGEI state aid regulations; the higher the amount of support the more thorough the scrutiny by the Commission. State aid rules for SGEI can be found on this website of the Commission. These rules are also explained in more detail in chapter 7 of the State Aid Manual of the Department for Business, Energy and Industrial Strategy (BEIS).

The flow chart below summarises all that has been laid out so far:[15]

Figure 2- State aid flow chart:



1.4 Notifying the European Commission

If an instance of assistance is found to involve state aid, and none of the exemptions applies, then the EC must be formally notified to seek its approval for the aid measure.

---

14 The European Court of Justice set out these conditions in its Altmark judgement - Case C-280/00, 24 July 2003

15 Department for Business, Energy and Industrial Strategy, State aid: the basics, July 2015

Generally, the EC grants its approval based on whether the aid is:[16]

- The minimum necessary to remedy the failure (proportionate)
- Really changing the behaviour of the organisation that receives it (incentive effect)
- The best way to address the failure (appropriate)
- Beneficial enough to outweigh any negative effects on competition (balancing test)

1.5 Fitness check of EU state aid rules

In January 2019, the Commission launched an evaluation of the current state aid rules which have been in force since 2014 – the so-called "fitness check". This may result in a possible update with new accents in the rules in 2022, especially regarding energy and environmental aid.

The Commission is also preparing to take a more flexible approach towards public support for transnational projects of strategic significance. In 2014 the Commission published a Communication on Important Projects of Common European Interest (IPCEIs) which allows exemptions from normal EU state aid rules for strategically important multinational projects where several Member States pool their resources.[17] Examples are pan-European research facilities or cross-border transport projects. Several projects have been approved under the guidelines so far, including an initiative by seven Member States to support innovation in the field of batteries with €3.2 billion, which was approved in December 2019. The guidelines are seen by many as too complex.[18] The Commission has said that revised rules will be put forward in 2021. This would be part of the new EU industrial strategy to support strategically important technologies and value chains.[19]

1.6 Coronavirus support

In response to the current Covid-19 outbreak, the European Commission relaxed the usual state aid restrictions. On 19 March 2020 it published a Temporary Framework for state aid measures, which gives EU Member States more flexibility to support their economies during and after the pandemic.[20]

[16] Department for Business, Energy and Industrial Strategy, State aid: the basics, July 2015, p8

[17] European Commission Communication. Criteria for the analysis of the compatibility with the internal market of State aid to promote the execution of important projects of common European interest, OJ C1 88, 20 April 2014, p2

[18] Euractive, Commission ponders state aid review to support 'Airbus of the future', 20 December 2012; Financial Times, Europe First: how Brussels is retooling industrial policy, 2 December 2019

[19] Financial Times, Europe First: how Brussels is retooling industrial policy, 2 December 2019; European Commission Communication A New Industrial Strategy for Europe, COM(2020) 102 final, 13 March 2020

[20] European Commission, Temporary Framework for State Aid Measures to Support the Economy in the Current Covid-19 Outbreak (informal, consolidated version), accessed 15 September 2020. The State aid Temporary Framework, which was published on 18 March 2020, has been amended on 3 April 2020, 8 May 2020 and 29 June 2020.

Commentators have compared the scale of these temporary measures to the Member States' action taken during the financial crisis in 2007-2008. Some note that this is a serious departure from normal state aid restrictions and offers major flexibility to support businesses.

The EU Temporary Framework aims first to ensure that companies have the liquidity to keep operating, or can temporarily freeze their activities, if need be, and second that support for businesses does not undermine the European single market.

Box 2: EU State Aid Temporary Framework in response to Covid-19 outbreak

The Temporary Framework enables Member States to provide the following types of support:

- direct grants (or tax advantages) of up to €800,000 to a company;
- state guarantees for loans taken by companies from banks;
- public loans with favourable (subsidised) interest rates to companies;
- safeguards for banks that channel support to businesses of all sizes. The framework gives guidance to ensure that the support is direct aid to the banks' customers, not to the banks themselves;
- additional short-term export credit insurance to be provided by the state.[21]

The initial Framework has been amended to allow

- additional support to research, testing and production of products relevant to tackle the pandemic;
- aid in form of tax deferral, suspension of social security contributions, and wage support to employees;
- recapitalisation of failing businesses directly by taking an equity share (which could amount to nationalisation in certain cases);
- support for micro and small businesses, even if they were already in financial difficulty on 31 December 2019;
- incentives for private investors to participate in coronavirus-related recapitalisation aid measures.

Member States' public authorities have to make state aid available by 31 December 2020.

The Temporary Framework complements other options already open to Member States under state aid rules. The Commission can approve national support measures

- to remedy a serious disturbance to the economy of a Member State in circumstances, such as those caused by the Covid-19 outbreak (Article107(3)(b)), and
- to compensate specific companies or specific sectors for the damages directly caused by the outbreak (Article 107(2)(b)).

Outside the Temporary Framework, Member States can take various other steps to support businesses affected by the Covid-19 outbreak. As set out in the Commission Communication of 13 March 2020, state aid rules permit measures such as:

- rescue aid to support acute liquidity needs of companies facing bankruptcy;
- compensations to companies for the damage suffered in exceptional circumstances. This may include supporting sectors that have been particularly hard hit (e.g. transport, tourism and hospitality) and measures to compensate losses suffered by organisers of cancelled events.[22]

21 European Commission, statement by Executive Vice-President Margrethe Vestager, 19 March 2020

22 EC Communication on a Coordinated economic response to the COVID-19 outbreak, 13 March 2020

Generic support schemes which are open to all companies fall outside the scope of state aid and do not require involvement of the Commission. These include wage subsidies and tax suspensions which are available to all businesses.

The government's coronavirus related business support schemes, as well as wider support measures, are subject to EU state aid rules. By 23 July 2020, the European Commission had approved six UK government Covid-19 related support schemes, including Coronavirus Business Interruption Loan Scheme (CBILS) and Coronavirus Large Business Loan Interruption Scheme (CLBILS).[23]

The European Scrutiny Committee has analysed the impacts of the EU state aid rules on the UK government's coronavirus support schemes and published its findings in consecutive reports. The Committee wrote in its Seventh report of 7 May 2020:

> There is no indication that the Government's preferred way of providing public support to businesses affected by the Covid-19 outbreak to date has been impeded by EU laws.[24]

1.7 How are state aid controls organised in the UK?

The Department for Business, Energy and Industrial Strategy (BEIS) has the overall policy responsibility for state aid in the UK. It can advise local and regional authorities, as well as devolved administrations on their state aid measures. BEIS State Aid Team coordinates notifications to the EC submitted by other government departments, agencies or authorities. The Department for Environment, Food and Rural Affairs (Defra) offers guidance on application of the rules to agriculture, fisheries and aquaculture. The Department for Transport (DfT) deals with matters related to state aid to transport.[25]

---

23 For an analysis of the Commission state aid approval decisions regarding UK schemes, see European Scrutiny Committee, Eleventh Report of Session 2019–21, 17 June 2020
The approved UK schemes are:
SA.56792 Loan guarantees under the Coronavirus Business Interruption Loan Scheme (CBILS), 25 March 2020
SA.56794 Interest subsidy under the Coronavirus Business Interruption Loan Scheme (CBILS), 25 March 2020
SA.56841 Umbrella scheme: Temporary State Aid Framework for the UK Government (covers also the Coronavirus Large Business Loan Interruption Scheme (CLBILS)), 6 April 2020
SA.57078 COVID-19 Temporary Framework for UK authorities (amendments to the Umbrella scheme), 23 April 2020;
SA.57152 COVID 19 - UK - Self-Employed (including members of partnerships) Income Support Scheme, 11 May 2020
SA.57617 COVID-19 Temporary Framework for Gibraltar Authorities, 6 July 2020

24 European Scrutiny Committee, Seventh Report of Session 2019–21, 7 May 2020, para 2.28; An update of the application of EU State aid Rules to UK business support schemes was included in the Eleventh Report of Session 2019–21, 17 June 2020, section 1.

25 Department for Business, Energy and Industrial Strategy, State Aid Team website (accessed on 15 September 2020)

Devolved administrations

Although state aid is not devolved, each of the devolved executives in Scotland, Wales and Northern Ireland have their own state aid units that offer advice and guidance to state aid grantors, liaise with BEIS and represent devolved perspectives in state aid cases in Brussels.[26]

The ultimate authority to decide whether an aid measure involves state aid and when it can be permitted, rests with the European Commission.

The current approach to state aid controls in the UK will change after the end of the transition period. See section 3.3 below.

1.8 Statistics

The European Commission collects statistics on approved state aid expenditure in an annual *State Aid Scoreboard*.[27] The 2019 Scoreboard shows that public organisations in the UK spend less on business support than in many other EU countries. According to Member State expenditure reports, in 2018 the UK spent 0.38% of GDP on state aid (excluding agriculture, fisheries, and railways), while France spent 0.79% and Germany 1.45%. In total, Member States' state aid was worth 0.76% of EU GDP in 2018.[28]

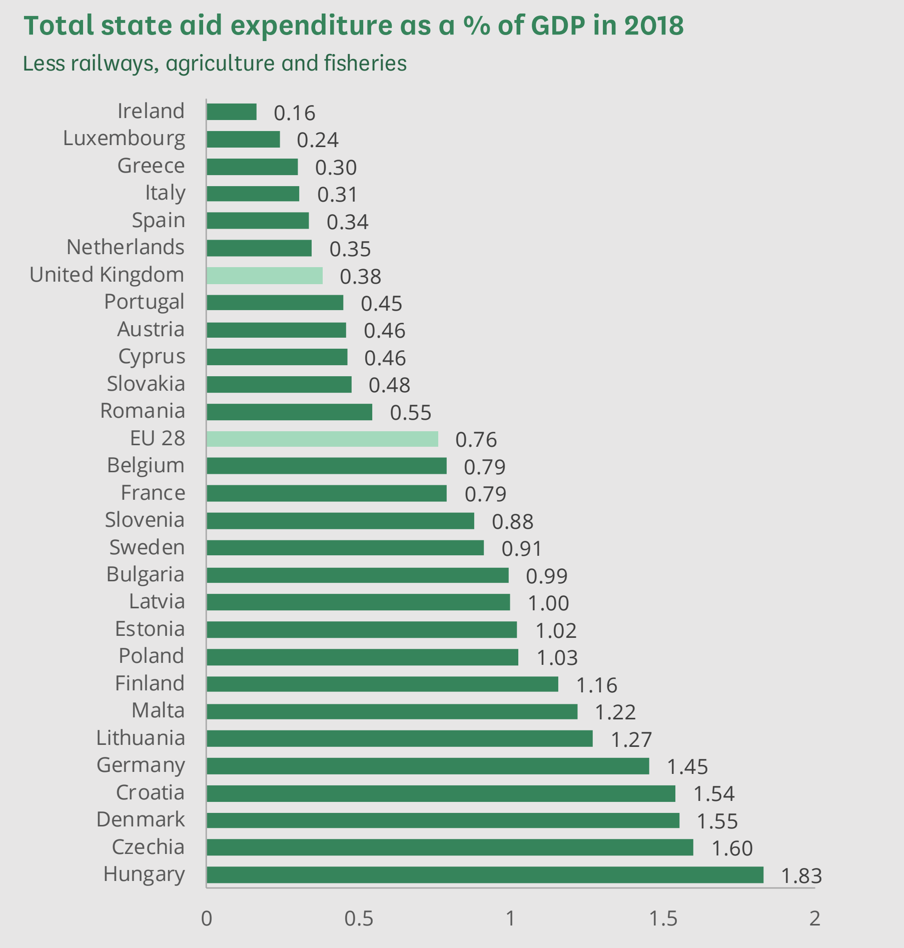
Data covers all existing state aid measures to industries, services, and transport for which the EC adopted a formal decision. It also includes state aid which falls within the scope of the General Block Exemption Regulation (GBER). *De minimis* aid, aid to railways, agriculture, and fisheries, measures in support of public services and crisis aid to the financial sector are not included.

---

26 Department for the Economy State Aid Unit Northern Ireland, Scottish Government State Aid Team, Welsh Government State Aid Unit (accessed on 15 September 2020)

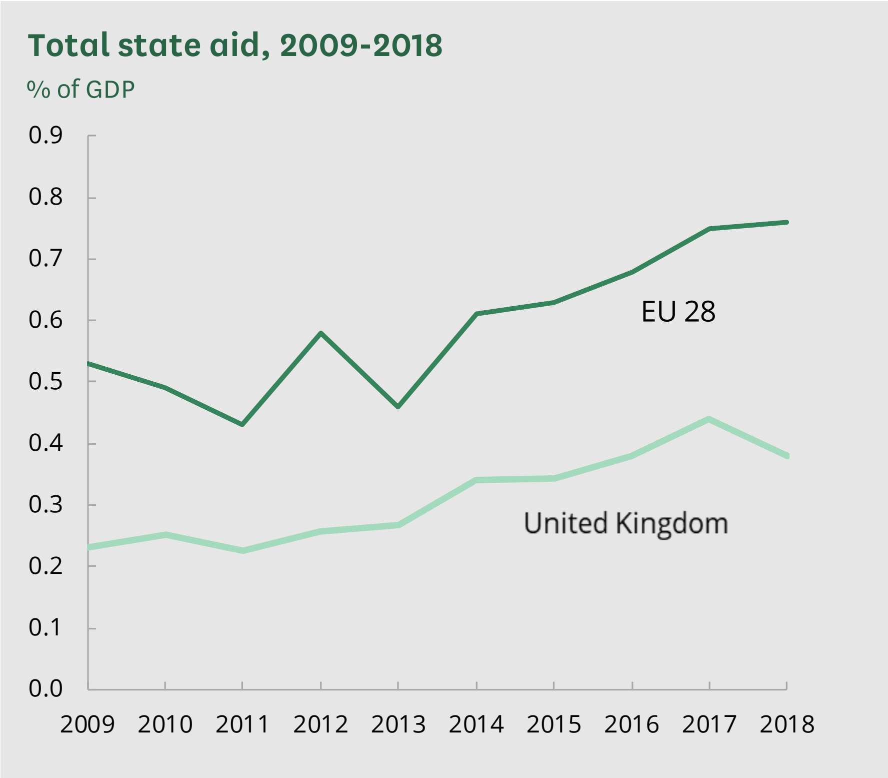
27 European Commission, State Aid Scoreboard 2019 website (accessed on 15 September 2020)

28 European Commission, State aid Scoreboard 2019; data from DG Competition, Aid by main objectives in current prices.



Source: European Commission, State Aid Scoreboard 2019, Aid by main objectives in current prices

In the past, successive UK governments have spent less on state aid than most other EU countries. Over the 2009-2018 period, UK state aid as a percentage of GDP remained well below the percentage of EU GDP as a whole.



Source: European Commission, State Aid Scoreboard 2019, Aid by main objectives in current prices

2. Transition period

Although the UK left the EU on 31 January 2020, under the terms of the Withdrawal Agreement (WA) and the European Union (Withdrawal) Act 2018 which gives effect to it, EU state aid law continues to apply to the UK until the end of the transition period on 31 December 2020.

Under the terms of the WA, state aid assessment remains unchanged in the UK during the transition period. The UK is being treated as if it were a Member State for state aid purposes.[29]

The Commission continues to be responsible for monitoring and enforcing **ongoing** state aid **procedures** which are initiated before the end of the transition period on 31 December 2020. Retaining the authority of the Commission during the transition was in line with the previous Government's position during the withdrawal negotiations with the EU.[30]

2.1 State aid in the Withdrawal Agreement

Part 3 Separation provisions of the Withdrawal Agreement is intended to take care of an orderly exit of the UK from the EU by allowing 'live' processes and arrangements to come to an end under current rules following the end of transition.

Articles 92, 93 and 95 prescribe the procedures and processes regarding ongoing state aid cases and aid paid out before 31 December 2020. Under provisions of **Article 92**, the Commission will continue to be responsible for monitoring and enforcement of **ongoing** state aid **procedures** initiated before the end of the transition period.[31]

The Commission will also be able to **initiate new procedures** regarding UK aid which was granted before the end of the transition period, and is alleged to be illegal state aid. The Commission will retain this power for a period of four years after the end of the transition period. The Commission will also retain its competence to follow up on those procedures after the end of the four-year period, i.e. after 31 December 2024 (**Article 93**).

Article 95 of the WA says that state aid decision of the Commission taken during the transition period or under Articles 92 and 93 of the WA, and addressed to the United Kingdom or to natural and legal persons residing or established in the UK, shall be binding on and in the UK. The legality of EU state aid decisions in both ongoing and new

29 V. Verouden, P. Ibáñez-Colomo, "Ensuring a level playing field post-Brexit: State aid control", 11 January 2019, p21

30 Department for Business, Energy & Industrial Strategy, Government response to the House of Lords EU Internal Market Sub-committee report on the impact of Brexit on UK competition and state aid, 29 March 2018, p2

31 *Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community*, 19 October 2019

cases covered by the separation provisions, will be reviewed exclusively by the CJEU.[32]

During the transition period and thereafter, UK lawyers will maintain their rights to represent clients in UK state aid cases before EU institutions (**Article 94 (2)**). Also, UK experts or other representatives will be able to attend Commission expert meetings relevant to UK cases, although they will not have voting rights (**Article 128(5)**).

What happens if the UK is found to breach the state aid provisions of the WA? The Commission's explanatory slides of 8 February 2019 summarise on page 39 the contents of **Part VI** (Governance Structure) of the WA, as follows:

> In the event of a dispute on the interpretation of the agreement, an initial political consultation would take place in a **Joint Committee.** If no solution can be found, either party can refer the dispute to binding arbitration. The decision of the **arbitration panel** will be binding on the EU and the UK. In case of non-compliance, the arbitration panel may impose a payment to be paid to the aggrieved party. However, if there is a question of Union law, the panel is obliged to refer it to the CJEU.
>
> If compliance is still not restored, the Agreement allows parties to **suspend proportionately** the application of the Withdrawal Agreement itself, except for citizens' rights, or parts of other agreements between the Union and the UK. Such suspension is subject to review by the arbitration panel.[33]

Commons Library briefing The UK's EU Withdrawal Agreement (section 4.11) has more detail on this issue (the text of the revised Withdrawal Agreement of October 2019 remained unchanged with regard to state aid).[34]

2.2 Protocol on Ireland and Northern Ireland

The Protocol on Ireland/ Northern Ireland accompanying the Withdrawal Agreement sets out the arrangements to maintain an open border on the island of Ireland after the end of the transition period. The Protocol will remain in force after the end of the transition, subject to the consent mechanism of NI institutions.

Under the Protocol, in order to prevent undue distortion of competition and trade between Northern Ireland and the EU, EU state aid law will continue to apply to Northern Ireland (**Article 10** of the Protocol). State aid controls will apply to business support measures which can potentially affect trade between Northern Ireland and the EU in the areas covered by the protocol. The Protocol covers trade in goods and wholesale electricity markets.[35]

32 Commons Briefing Paper The UK's EU Withdrawal Agreement, 4 December 2018, CBP 08453, Chapter 4.11
33 Commons Library Briefing CBP-8453, The UK's EU Withdrawal Agreement, 11 April 2019, section 7.1
34 Commons Briefing Paper The UK's EU Withdrawal Agreement, 4 December 2018, CBP 08453, Chapter 4.11
35 See HM Government Command Paper, The UK's approach to the Northern Ireland Protocol, May 2020, CP226, para 40

It is not immediately clear how broadly the Protocol provisions on state aid will work in practice, and how far measures that affect NI-EU trade may also include UK support to businesses in Great Britain that sell goods in Northern Ireland.[36] State aid experts and commentators have noted, that by signing the Withdrawal Agreement with the Protocol, the UK has agreed to a system which could in practice extend the reach of EU state aid enforcement beyond Northern Ireland.[37]

For further details on state aid provisions in the Protocol see Commons Library briefings
CBP 8713 The October 2019 EU UK Withdrawal Agreement, 18 October 2019, and
CBP 9003 United Kingdom Internal Market Bill 2019-21, section 6.5, Northern Ireland Protocol. State aid, 14 September 2020.

2.3 Future UK policy on subsidies

The UK government's position is that having left the EU, it would develop its own, independent state aid/ subsidy regime.[38] Prime Minister Johnson has announced that from 1 January 2021, the UK regime will not be based on EU rules, but on the World Trade Organisation commitments on restricting harmful subsidies. The Prime Minister's written statement of 3 February 2020 on UK-EU relations confirmed that the UK will in future develop separate and independent policies in various areas including subsidy policy.[39]

On 9 September 2020, a BEIS press release set out the Government's approach to future subsidy control in some more detail. It confirmed that the new regime will be based on WTO subsidy rules from 2021 and that the UK will adhere to its obligations on subsidies agreed under its future free trade agreements. The Government also confirmed that "it does not intend to return to the 1970s approach of trying to run the economy or bailing out unsustainable companies" and will ensure "a dynamic and competitive market economy" throughout the UK. The new regime will be set up to ensure that subsidies do not distort competition among the four nations and regions of the UK.[40]

The Government has said that before the end of 2020, it will publish a guidance explaining the WTO rules, and the UK's international commitments on subsidies. It will also consult in on whether the new

---

36 Matthew Holehouse, State aid, competition, environmental obligations feature in UK's revised exit package, MLex, 18 October 2019

37 MLex, Comment: Brexit deal's state aid rules might have long reach, 19 October 2019; MLex, EU powers to review UK state aid under Irish Border Protocol to be assessed 'case by case', 24 January 2020; G.Peretz QC in Boris Johnson's efforts to escape EU state aid rules 'mistaken' Financial Times, 9 February 2020

38 The current UK Government generally refers to a 'subsidy regime' or 'subsidy controls' rather than state aid when discussing its proposals for a future domestic regime.

39 UK / EU relations: Written statement, HCWS86, 3 February 2020

40 BEIS, Government sets out plans for new approach to subsidy control, 9 September 2020

subsidy regime should go further than the UK's international commitments and whether new legislation would be necessary.[41]

The scope of the UK subsidy regime is interconnected with the outcome of the UK-EU negotiations on future economic partnership. State aid/ subsidies has become one of the most contentious areas in the UK-EU negotiations as part of the so-called "level playing field" – agreed rules and principles that would guarantee open and fair competition and trade between both parties.

The UK is proposing to use the SCM agreement as a basis for provisions on subsidies/ state aid in the future UK-EU Free Trade Agreement, while the EU has proposing that the UK continues to follow the evolving EU state aid rules.[42] According to press reports, the EU has signalled a willingness to drop its demand that the UK accepts future EU state aid rules and CJEU oversight.[43] In exchange it wanted the UK to sign up to a "shared philosophy" on future subsidy policy, including precise commitments and an enforcement mechanism. However, the UK has not revealed what its future state aid/subsidies regime will look like. At the time of the publication of this briefing, the UK-EU negotiations are ongoing.

For further details on UK-EU negotiations and state aid/ subsidies see Commons Library briefings CBP 8852, The UK-EU future relationship negotiations: Level playing field, 19 June 2020;
CBP 8977, UK-EU future relationship negotiations update: is an agreement possible? 4 August 2020, and
Commons Library Insight UK-EU future relationship: Can a deal be reached in time? 1 September 2020

Further reading

The Institute for Government explores the future of subsidy control in the UK in its report Beyond state aid, 13 September 2020.

For a discussion of possible new approaches to the UK subsidy controls see:
J. Webber, All Change? UK State Aid after Brexit What Law? Whose Courts? Politeia, February 2020
J. Branton, A. Rose, The future of State aid law in the UK – should the UK adopt strong or weak rules?, 4 August 2020

41 BEIS, Government sets out plans for new approach to subsidy control, 9 September 2020
42 For more information see CBP-8852, The UK-EU future relationship negotiations Level playing field, section 2; See also HL EU Select Committee, Goods Sub-Committee, Uncorrected oral evidence: Level playing field and state aid follow-up, 29 June 2020, Qq 10-11
43 Financial Times, The hard Brexit choices that could yet deliver a deal, 27 July 2020

3. WTO Agreement on Subsidies and Countervailing Measures

The vast majority of countries in the world are members of the World Trade Organization (WTO). The WTO is a forum where member countries agree on trade rules and resolve their trade disputes.

WTO member map, 2020

Source: www.wto.org

One of the key WTO agreements is the Agreement on Subsidies and Countervailing Measures (SCM). This agreement lays out rules on the use of subsidies and on the actions countries can take to protect themselves from the effects of another country's subsidies. The SCM forms the basis of anti-subsidy provisions of many free trade agreements including CETA and the EU-Japan FTA.

For the purpose of the SCM, a subsidy is defined as consisting of three elements:

(i) A financial contribution (e.g., grants, loans, equity infusions, loan guarantees, fiscal incentives, the provision of goods or services, the purchase of goods, payments into funding mechanisms)

(ii) by a government or any public body within the territory of a Member

(iii) which confers a benefit.

To qualify, a subsidy must be 'specific', that is, it must be targeted at certain enterprises or industries.

All elements must apply for a subsidy to exist.

Under the Agreement, some subsidies are prohibited outright while the rest are 'actionable' – meaning that the subsidy is allowed, but other countries can take certain actions if the subsidy harms them. All subsidies fall into one or the other category.

Some subsidies are prohibited outright while the rest are 'actionable' – meaning that the subsidy is allowed, but other countries can take actions if the subsidy harms them.

- **Prohibited subsidies:** these are subsidies that require recipients to meet export targets, or to use domestic goods instead of imported goods. They are prohibited because they are specifically designed to distort international trade, and are therefore likely to hurt other countries' trade.

  The WTO prioritises complaints about prohibited subsidies by handling them more quickly than procedures regarding actionable subsidies. If the dispute settlement procedure confirms that the subsidy is prohibited, the offending country must withdraw it immediately or face 'countermeasures' – a form of retaliation authorised at the WTO level. If the offending country does not withdraw the subsidy, the complaining country can impose a special tax on imports of the subsidised good to counteract the effect of the subsidy. This is called a 'countervailing duty'.

- **Actionable subsidies:** any subsidy that is not prohibited outright is allowed but 'actionable'. Most subsidies, such as production subsidies, fall into this category. Actionable subsidies can be challenged by other WTO countries if they hurt their domestic producers. The complaining country has to show that this is the case, otherwise the subsidy is permitted.

  There are three types of harm that actionable subsidies can cause. First, one country's subsidies can hurt a domestic industry in an importing country. Second, they can hurt rival exporters from another country when the two compete in third markets. And third, domestic subsidies in one country can hurt exporters trying to compete in the subsidizing country's domestic market.

  If the WTO's Dispute Settlement Body rules that the subsidy does indeed have harmful effects, the subsidy must either be withdrawn or its harmful effect removed. Again, countermeasures against the subsidy can be taken at the WTO level, and the complaining country can impose countervailing duties if its domestic producers are hurt by imports of the subsidized products.[44]

Countervailing duties are a tax on the imports of subsidised goods which makes these goods more expensive to buy. The principle behind these duties is to bring the market price of subsidised goods back up to what it would have been without subsidies. Doing so restores a level playing field between domestic producers and the imports they compete with.

Countervailing duties are a tax on the imports of subsidised goods which makes these goods more expensive to buy.

To be allowed to impose countervailing duties, a country must carry out a detailed investigation to prove that certain imports are subsidised, and

[44] World Trade Organisation, Understanding the Agreements website and SCM Agreement website (accessed on 15 September 2020)

that these subsidies are hurting a domestic industry. Countervailing duties can usually be imposed for five years.[45]

There are **special rules for agricultural products**, which are more permissive of subsidies. The rules are set out in the Agreement on Agriculture. The broad objective of the agreement is to secure reductions to the levels of support and protection in the agricultural sector.[46]

3.1 Comparing EU state aid and WTO rules

EU state aid rules are more stringent than WTO subsidy rules.

WTO rules on subsidies and EU state aid rules are two different frameworks. The EU rules are more stringent than the WTO's. Although the definition of a 'subsidy' under the SCM is broadly similar to 'state aid' under the Treaty on the Functioning of the European Union (TFEU), the WTO rules are more limited in scope. The key differences are:

1 The default position in WTO rules is that subsidies not targeted at exports and/or import substitution are allowed, unless another country can demonstrate that these subsidies are hurting a domestic industry or trade in general; EU rules can apply domestically, as they consider state aid to be generally illegal, unless it falls within an exemption or has been approved.

2 The provisions of the SCM only apply to goods trade, while EU state aid rules apply to any economic activity, including services and capital movements.

3 EU rules are applied prospectively and do not need an official complaint from a Member State to be triggered. For instance, a public body planning to provide state aid must either satisfy itself that its scheme is exempted or seek the explicit approval of the European Commission *before* awarding any subsidy. WTO rules, on the other hand, are only reactive.

4 EU rules allow businesses and individuals to lodge a complaint to the Commission and to bring claims in national courts. The WTO rules rely on state-to-state enforcement. Private actors such as companies cannot complain to the WTO, so businesses who believe there has been a breach of the SCM have to persuade their own government to take action.

5 The EU state aid rules are set up to remove anti-competitive effects through recovery of illegal state aid. The WTO offers dispute settlement mechanisms to terminate the subsidies or to offset them by allowing the importing country to introduce countervailing duties on subsidised imports.

The report of the House of Lords EU Committee's Internal Market Sub-Committee Brexit: competition and State aid of 2 February 2018

[45] World Trade Organisation, SCM Agreement website, (accessed on 15 September 2020)
[46] World Trade Organisation, Legal texts: Agreement on Agriculture website, (accessed on 15 September 2020)

examines the differences between the WTO rules on subsidies and the EU state aid regime in greater detail.[47]

3.2 Critique of SCM and global trends

While the SCM forms the basis of anti-subsidy provisions of many free trade agreements including CETA and the EU-Japan FTA, the SCM has been described by many as ineffective and in need of enhancement. The SCM has fallen short of addressing market-distortions created by state-subsidised exports, and state-owned enterprises, especially from state-managed economies. It does not cover investment incentives or services activities.[48] "Chronic low compliance with the fundamental obligation to notify subsidies" under the SCM constitutes a serious problem in the functioning of the agreement. The SCM has also been described as lacking adequate and effective remedy mechanisms.[49]

"Non market-oriented policies and practices" of countries which subsidise their industries is a global concern.[50] For example, parties like the United States, Japan and the EU have come forward with initiatives for enhanced rules on industrial subsidies.[51]

In June 2020, the EU Commission published a White paper proposing new EU policies on foreign subsidies. The White paper paves way for legislative proposals later. The Commission is seeking to develop tools, besides the SCM, which would help address distorting effects of non-EU subsidised business activities in the Single Market. Such subsidies may, for example, have facilitated the acquisition of EU companies, distorted the investment decisions, market operations or pricing policies of their beneficiaries, or distorted biddings in public procurement, to the detriment of non-subsidised companies. The new EU policies would include remedies, such as EU powers to investigate and ask the subsidy to be repaid, investment to be withdrawn or a compensation to be paid to the EU or the affected Member State.[52]

The Government is considering its role in promoting new global anti-subsidy standards. The Minister for International Trade Liz Truss said at the WTO on 3 March: "We will make the case to update the WTO rulebook to tackle underlying trade tensions such as industrial subsidies…".

47 European Union Committee, Internal Market Sub-Committee, Brexit: competition and State aid, 2 February 2018, HL 67 2017-19, pp47-48; a comprehensive comparison is given in L. Rubini, The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective, Oxford University Press, 2009

48 Bernard Hoekman, Douglas Nelson, Rethinking International Subsidy Rules, Global Economic Dynamics, Bertelsmann Stiftung, Working paper, 28 February 2020.

49 Chad P. Brouwn, J. Hillman, WTO'ing a Resolution to the China Subsidy Problem, Peterson Institute for International Economics, October 2019, section 4

50 Jehan Sauvage, OECD, Why government subsidies are bad for global competition, 15 April 2019

51 Joint Statement of the Trilateral Meeting of the Trade Ministers of Japan, the United States and the European Union, 14 January 2020

52 European Commission, White Paper on levelling the playing field as regards foreign subsidies, COM(2020) 253 final, 17 June 2020 and EC Press release, 17 June 2020

For more information on the role of the SCM in the UK-EU negotiations see Commons Library briefing CBP 8852, The UK-EU future relationship negotiations: Level playing field.

3.3 Statistics

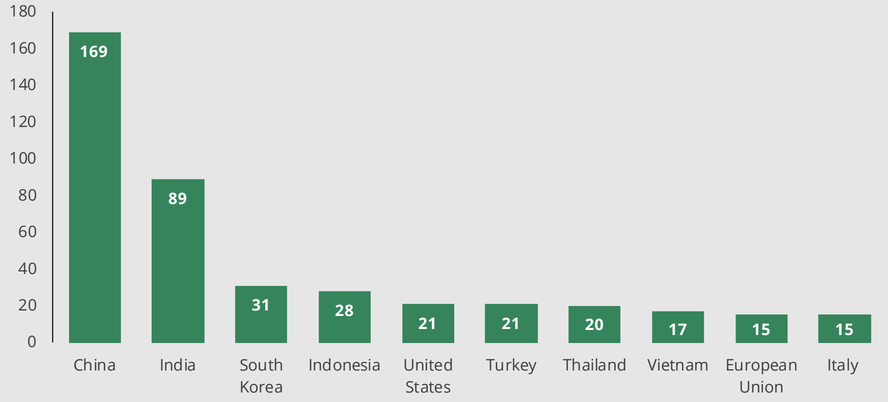
The WTO publishes data on the number of countervailing measures taken by countries (i.e. the imposition of countervailing duties on certain imports).

The data presented in the charts below cover the period from January 1995 to December 2019. The data comes from WTO members submitting reports for the relevant periods and may underrepresent the actual number of measures. Each measure reported covers one product imported from one country or customs territory.

Over the 1995-2019 period, the highest number of countervailing measures (169) was taken against China, which makes 29% of all measures taken during that period. The United States initiated nearly a half of all countervailing measures (266), followed by the EU with 86 measures.

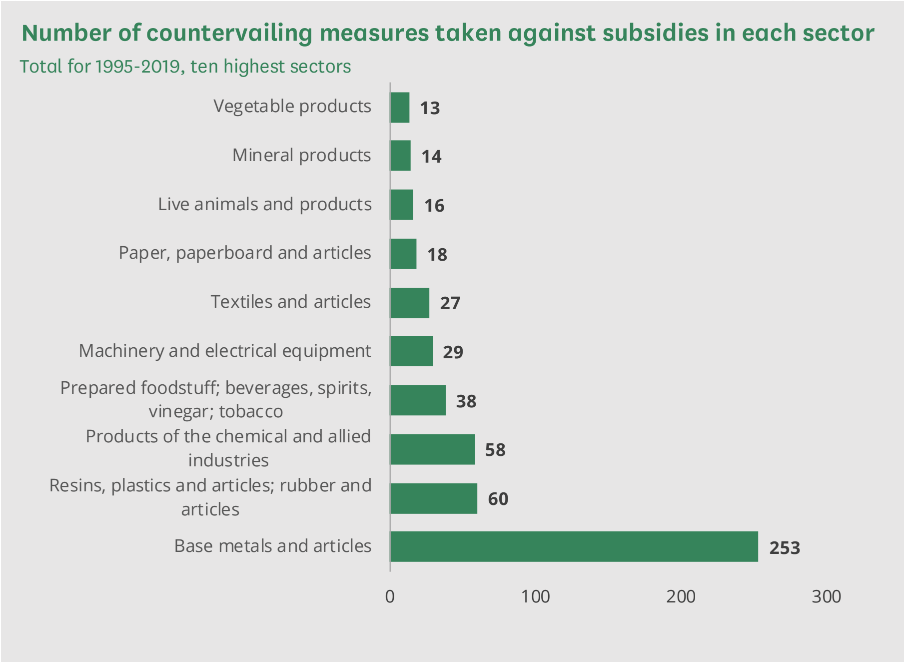
Number of countervailing measures taken against exporters, by country of exports

Total for 1995-2019, ten highest



Source: WTO SCM, Countervailing initiations: by exporter

The chart below shows countervailing measures by sector. Half of the total of 257 countervailing measures are taken against subsidies in the base metals and articles sector.



Source: WTO SCM, [Countervailing initiations: by sector]

BRIEFING PAPER
Number SN06775
16 September 2020