HOUSE OF LORDS

Paul Scully MP
Minister for Small Business, Consumers and Labour Markets
Department for Business, Energy and Industrial Strategy
1 Victoria Street
London
SW1H 0ET

3 April 2020

Dear Paul,

House of Lords EU Internal Market Sub-Committee – inquiry into UK-EU negotiations on the level playing field and state aid

In July 2019, we wrote to the former Minister for Small Business, Kelly Tolhurst MP, regarding post-Brexit state aid and associated matters, asking for a response by 25 July 2019.[1] Having received none, we sent a follow-up letter on 31 October 2019. Although we received a formal response to the latter in November,[2] a substantive response to the detailed inquiries in our initial letter remains pending some nine months after the questions were first posed.

In that time, state aid has continued to be a key issue for the UK-EU negotiations, as it forms a critical part of the so-called level playing field. We have therefore carried out a short inquiry with a view to updating our understanding of the issue. Given the breadth of areas encompassed by the level playing field and the compressed timeframe for this inquiry, we focused our consideration on how labour and environmental protections and state aid matters are usually handled in trade agreements and how they might be handled in UK-EU negotiations. We have not focused in detail on the economic issues around state aid or regulatory compliance, but note their importance for any decision-making in this area.

The global public health crisis that has emerged as a result of the coronavirus will have significant implications on how state aid is used in the short and medium term, and it is not possible for us to incorporate all of those possible issues here. This letter summarises our further reflections and questions, informed by our new work and our previous scrutiny, about how state aid is ordinarily used and governed.

We would be grateful for a detailed response to this letter's conclusions and requests for clarification, set out in bold, by no later than **15 May 2020**.

[1] The full text of that letter is available on our website: https://www.parliament.uk/documents/lords-committees/eu-internal-market-subcommittee/brexit-competition/010719-Letter-from-Lord-Whitty-to-Kelly-Tolhurst.pdf
[2] The full text of that letter is available on our website: https://committees.parliament.uk/committee/340/eu-internal-market-subcommittee/publications/3/correspondence/.

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

1. Background

1. Those who have closely followed negotiations on UK withdrawal will be well acquainted with the EU's position that any long-term agreement with the UK should ensure a 'level playing field' between the Parties. The EU has consistently argued, in successive Council guidelines as well as the Political Declaration, that the "geographical proximity" and "economic interconnectedness" between the UK and EU require more robust level playing field safeguards than in the EU's other trade agreements. In addition, the EU sees a direct correlation between the strength of the level playing commitments agreed as part of the future UK-EU relationship and the depth of access to the Single Market that the UK will be able to enjoy.

2. This position is further developed in the Council negotiating directives on post-Brexit negotiations with the UK, agreed on 25 February 2020.[3] These contain detailed requests for each of the level playing field areas identified in the Political Declaration: competition and state aid; taxation; labour and social protection; environment and health; and the fight against climate change. While in some areas, for example labour and environmental protection, the EU is broadly seeking commitments not to regress from existing (and future) levels of regulation, on state aid the EU asks that the UK continues to align with the EU *acquis* in perpetuity.[4]

3. On the other hand, the UK Government has indicated that it does not intend to accept any level playing field commitments that would limit its ability to reshape the UK regulatory framework after Brexit. As David Frost, the UK's Chief Negotiator, put it: "To think that we might accept EU supervision on so-called level playing field issues simply fails to see the point of what we are doing."[5]

4. Given this disparity between the two parties' negotiating positions, the nature of the level playing field and the two parties' aims in negotiating on this issue seemed to merit closer examination, which we have done through a short period of evidence gathering.[6]

1.1 What is the level playing field?

5. Despite its prominence in UK-EU negotiations, the definition of a 'level playing field' is an elusive one. Our witnesses broadly concurred that level playing field

[3] The negotiating directives are available as an Addendum to the Council Decision to begin negotiations (5870/20): https://www.consilium.europa.eu/media/42736/st05870-ad01re03-en20.pdf.
[4] Dr Lorand Bartels provided us an analysis of these apparent 'ratchet' provisions (Q 3).
[5] 17 February 2020 speech by David Frost (https://www.spectator.co.uk/article/full-text-top-uk-brexit-negotiator-david-frost-on-his-plans-for-an-eu-trade-deal)
[6] Full transcripts of all the oral evidence we heard, as well as all the written evidence we received, are available on our website: https://committees.parliament.uk/work/55/level-playing-field-and-state-aid/publications/.

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

commitments exist, in different shapes and forms, in any trading relationship.[7] In fact, the definition can be cast so widely as to include international standards such as the International Labour Organization (ILO) core conventions.[8]

6. Broadly speaking, level playing field commitments and standards in negotiated trade agreements between international partners are intended to protect against the risk that, in trading with a partner where the cost of doing business is lower due to lower levels of regulation, a country might put its own economy and firms at a disadvantage. We did not explore in detail with our witnesses the economics of whether level playing field commitments and standards are actually effective at achieving this goal; rather, we considered with our witnesses how such commitments appear on the face of international trade agreements. The economics underpinning the notion of regulatory competition would merit its own, in-depth analysis, which was outside the scope of this short inquiry, although we note some of the research by Dr Damian Raess et al that suggests that labour clauses do not fulfil "protectionist" goals.[9]

7. Our witnesses were clear that there are no set boundaries to the scope of the commitments that can be negotiated and agreed with the intention of preserving a level playing field between the parties. Professor Andrea Biondi told us: "I do not think anybody knows exactly what [the term 'level playing field'] means", and he noted that the UK and EU negotiating positions reflected "two radical[ly different] visions of a level playing field".[10] While the EU has chosen to focus its demands for negotiations with the UK on areas such as state aid and social, employment and environmental standards, the UK could, in principle, set out other demands in other sectors.

8. Underpinning the use of level playing field provisions is the idea that regulatory competition is unfair, and so should be pre-empted. In Dr Lorand Bartels' words, level playing field commitments are usually entered into with the goal of "ensuring that the other side raises costs to your levels".[11] This is not unique to the EU. Dr Holger Hestermeyer cited the example of the US, noting that some of its recent trade policy decisions—such as the request to attach labour conditions to the rules of origin under the US-Mexico-Canada Agreement—are driven by concerns that US companies are "mistreated" by trading partners.[12] Dr Luca Rubini pointed us to the

[7] See, for example, Q 2 [Dr Holger Hestermeyer]
[8] Q 1 [Dr Damian Raess]
[9] Céline Carrère, Marcelo Olarreaga, and Damian Raess, "Labour Clauses in Trade Agreements: worker protection or protectionism?"
[10] Q 10 [Professor Andrea Biondi]; see also Q 1 [Dr Holger Hestermeyer] regarding the absence of a legal definition of 'level playing field'
[11] Q 1 [Dr Lorand Bartels]
[12] Q 4 [Dr Holger Hestermeyer]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

proposed reforms of the WTO rules, led by the US, the EU and Japan, "to tackle Chinese capitalism" because "the rules we have now do not really bite".[13]

9. Although we did not hear detailed evidence on how regulatory commitments and "rais[ing] costs" affected individual countries or firms' economic performance, Dr Damian Raess told us that his research on labour standards commitments suggested that "reducing or eliminating labour standards altogether" was unlikely to boost UK exports in the way that is feared, because of the shift to knowledge-based economies and the increased productivity and competitiveness resulting from "firms' compliance with social standards",[14] and he shared with us some of his research that showed including labour clauses in trade agreements had "no statistically significant impact on bilateral trade flows".[15]

10. To find a common understanding of what will be deemed to amount to fair regulatory treatment, trading partners typically agree on a reference point. Dr Bartels explained that this usually takes the form of internationally agreed standards, for example, in the area of labour protection, the ILO framework.[16]

11. It is notable, however, that the EU considers level playing field provisions as an instrument to protect not only its economic interests but also its values—and in fact to disseminate them beyond its borders. According to Dr Bartels, this more "missionary" approach rests on the idea that other countries should be encouraged to apply high standards "for their own good".[17]

12. **The concept of 'level playing field' is extremely broad and seems impossible to define from a legal perspective. It seems to be used variously to cover any provision, in bilateral or multilateral agreements, that serves to limit regulatory competition between trading partners in areas such as labour and environmental protection. Whether there is indeed a compelling economic rationale for using such provisions in trade agreements is a different but crucial question, which we could not pursue as part of this short inquiry.**

13. **So-called level playing field commitments, such as labour law commitments, exist in most modern trade agreements. Broadly speaking, they require the parties to maintain a minimum level of regulation, usually defined by reference to existing international standards, in a specific area. The inclusion of some form of level playing field provision in a future UK-EU trade deal is therefore not controversial in itself.**

[13] Q 24 [Dr Luca Rubini]
[14] Q 9 [Dr Damian Raess]
[15] Carrère, Olarreaga and Raess, "Labour Clauses"
[16] Q 1 [Dr Lorand Bartels]
[17] Q 1 [Dr Lorand Bartels]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

1.2 Key areas of tension around the level playing field

14. The choice of reference point is one of the key differences between typical level playing field provisions in trade agreements and the EU's demands from the UK. Paragraph 94 of the Council negotiating directives sets out that, as part of its future agreement with the EU, the UK should commit to continue upholding "high standards over time with Union standards as a reference point". This phrasing could suggest, on the face of it, an aspiration to dynamic regulatory alignment—which would prove controversial given the Government's current position. Dr Bartels felt, however, that it is sufficiently ambiguous to cover a range of negotiating outcomes, including softer commitments around striving for equal levels of ambition.[18]

15. We note, nonetheless, that there is no ambiguity in paragraph 96 of the Council negotiating directives, which clearly sets out a request for the UK to continue to follow EU state aid rules. According to Professor Veerle Heyvaert, that paragraph is the "most forceful expression we find in the whole document of aspired closeness".[19]

16. Related to the potential use of EU rules as a reference point is the question of the extent of the role of the Court of Justice of the EU (CJEU, but commonly still referred to as the ECJ or European Court of Justice) in interpreting the legality of the subsequent UK-EU agreement, interpreting EU law as applied to the Parties by that agreement, or resolving any disputes that may arise under it.[20]

17. Leaving aside Northern Ireland, the command paper setting out the UK Government's approach to UK-EU negotiations seeks to rule out any form of CJEU involvement, saying that the CJEU cannot have "any jurisdiction in the UK" and should have "no role" in any dispute resolution mechanism. The Government says that "this is consistent with previous Free Trade Agreements concluded by the EU", and that these principles are in line with the Government's desire to negotiate an agreement between "sovereign equals, with both parties respecting one another's legal autonomy".[21]

18. The Council's negotiating directives envisage a similar arbitration style dispute mechanism, proposing that the body responsible for overseeing the operation of an UK-EU agreement will "agree to refer the dispute to an independent arbitration panel at any time" and any decisions "should be binding on the Parties".[22] But, in line

[18] Q 3 [Dr Lorand Bartels]
[19] Q 10 [Professor Veerle Heyvaert]
[20] We note that the EU Select Committee published a detailed report about dispute resolution and enforcement post-Brexit in May 2018: https://publications.parliament.uk/pa/ld201719/ldselect/ldeucom/130/130.pdf
[21] Paras. 5 and 83
[22] Para. 159

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

with well-established principles of EU law concerning the autonomy of the EU's legal order,[23] the negotiating directives also say that, should any "dispute raise a question of interpretation of EU law … the arbitration panel should refer the question to the CJEU as the sole arbiter" of EU law.[24] Dr Bartels and Dr Rubini told us that this approach is common in EU association agreements, such as the one with Ukraine, which are often agreed with countries that aspire to join the EU over time.[25]

19. Dr Hestermeyer told us that it is an established principle that the CJEU has exclusive competence for "interpretation of EU law that is binding on the EU". He noted however that, in the case of an international agreement, this principle is only an issue if the agreement expressly makes EU law applicable between the parties.[26] Witnesses were clear that, legally, the CJEU's involvement in interpreting an international agreement (not the legality of the agreement itself) is only necessary insofar as the agreement expressly references EU law, and so makes it applicable. The solution, as Dr Bartels succinctly explained, could be to "not incorporate EU law by reference into your treaty".[27]

20. James Webber also urged against using EU legal terminology such as "state aid", noting that this would give the CJEU an indirect role "in that everyone ends up looking at" its case law and historical practice on the issue. He also noted that the question of the CJEU's jurisdiction might pose itself again if the UK were to re-join the EU's Emission Trading Scheme (ETS) as a third country after the end of the transition period.[28]

21. **A likely sticking point in the UK-EU negotiations on the level playing field will be EU proposals that Union rules should serve as a benchmark for assessing whether the UK will maintain high standards over time, and that, in line with the CJEU's role as the final arbiter of EU law, any questions governing the interpretation of these rules should be referred to the Court. Many of our witnesses concurred that neither is a necessity. However, outside of interpreting the legality of the agreement itself, the CJEU's involvement could potentially be avoided by making sure the future UK-EU agreement does not incorporate provisions of EU law by reference. Could the Government clarify whether this is the approach it intends to propose and how it plans to address the EU's wish to protect the autonomy of its own legal order?**

[23] The Court has issued numerous Opinions on this issue, including Opinion 1/03 of February 2006 and Opinion 1/09 of March 2011.
[24] Para. 160
[25] Q 3 [Dr Lorand Bartels]; Q 4 [Dr Holger Hestermeyer]
[26] Q 3 [Dr Holger Hestermeyer]
[27] Q 2 [Dr Lorand Bartels]
[28] Q 35 [James Webber]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

22. Further, outside of Northern Ireland, it does not appear clear what dispute resolution arrangements, if any, the Government is seeking to police the application of the standards applied to the parties across the level playing field in areas such as subsidy control, labour and environmental standards and taxation. The Government's command paper on the UK-EU negotiations simply states that the proposed mechanism for consultation on subsidies, as well as labour and environmental provisions "should not be subject to the Agreement's dispute resolution mechanism outlined in Chapter 32 of the document".[29]

23. **Leaving aside Northern Ireland, could the Government clarify what mechanisms, if any, it envisages for the resolution of disputes in relation to subsidies, labour and environment as part of a future UK-EU agreement?**

1.3 The rationale for the EU's approach to the level playing field

24. As part of our inquiry, we sought to understand the reasons for the EU's emphasis on the level playing field throughout negotiations on UK withdrawal. One explanation, according to Professor Heyvaert, is that the level playing field has formed part of the EU's "ethos" for generations.[30] More pragmatically, Dr Ulrich Soltész highlighted concern among EU businesses that UK competitors might undercut them in the absence of strong safeguards, and felt that the sense of "Brexit fatigue" in the EU contributed to a hardening of this position.[31] More broadly, however, witnesses noted that the EU anxiety about the level playing field was partly down to lack of trust in the Government. Nicola Smith of the Trades Union Congress said, in our discussion on the labour and social protections element of the level playing field, that "the evidence is when Governments [in the UK] have the opportunity they want to cut labour standards".[32]

25. In relation to state aid, Professor Biondi highlighted the immediate, tangible advantages that the Government could confer on UK businesses if subsidy levels were to increase due to laxer control rules.[33] George Peretz QC added that it would be extremely difficult for Member States to secure buy-in for a UK-EU agreement that did not contain any safeguards on subsidy control.[34]

26. **The EU's negotiating position places strong emphasis on obtaining a robust level playing field commitments as part of any UK-EU future relationship agreement. There are various reasons for this, including**

[29] Para. 65
[30] Q 10 [Professor Veerle Heyvaert]
[31] Q 11 [Dr Ulrich Soltész]
[32] Q 2 [Nicola Smith]
[33] Q 10 [Professor Andrea Biondi]
[34] Q 10 [George Peretz QC]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

uncertainty around the Government's long-term intentions regarding, for example, labour protection and subsidy control.

2. The UK's commitment to 'typical' provisions on the level playing field

27. In a 3 February 2020 written statement, the Prime Minister informed Parliament that the Government will be seeking an agreement with the EU that "respect[s] the sovereignty of both parties and the autonomy of [their] legal orders", and consequently on "Competition Policy, Subsidies, Environment and Climate, Labour, Tax"—in essence, the areas where the EU has made level playing field demands—will not agree commitments beyond those "typically included in a comprehensive free trade agreement".[35] The Government's 27 February command paper contains multiple references to existing EU trade agreements, in particular the EU-Canada Comprehensive Economic and Trade Agreement (CETA), as models for the future UK-EU partnership.

28. To better understand what the Government's position could mean in practice, we asked our witnesses what 'typical' EU trade-deal provisions might comprise across various elements of the level playing field.

2.1 Labour standards

29. Dr Damian Raess explained that there were four key features that could be consistently identified in labour provisions in EU trade agreements:

    a. "A range of substantive commitments" to complying with international labour standards and not derogating from the levels of labour protection afforded by domestic laws, including a guarantee that such laws can be enforced domestically (Dr Bartels emphasised that these commitments to do not amount to a prohibition to change domestic rules[36]);
    b. A mechanism to "institutionalis[e] co-operation" between the parties on labour matters;
    c. A "compulsory" review mechanism; and
    d. Dispute settlement arrangements, although the remedies for non-compliance exclude the withdrawal of trade concessions and fines.[37]

30. Dr Raess noted that CETA's labour standards are "more ambitious" than the above provisions, and span most of the areas which the EU is proposing to address in a

[35] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-02-03/HCWS86/
[36] Q 4 [Dr Lorand Bartels]
[37] Q 4 [Dr Damian Raess]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

future UK-EU trade agreement, such as fundamental rights at work and occupational health and safety. An exception is social dialogue, which is not covered by CETA.[38]

31. We note that the "Trade and Labour" section of the Government's command paper proposes commitments to "cooperation provisions between the parties" and non-regression from "the level of protection afforded by labour laws and standards"—which are however not listed in greater detail.[39] No reference is made to a review mechanism or, as pointed out above, specific dispute resolution provisions.

32. A frequent aspect of labour provisions in trade agreements is that their enforcement is weak. Ms Smith told us that, at best, "a strongly worded letter" is sent "to whichever side of the trade agreement has violated the labour standards".[40] Dr Bartels explained that the EU was "coming under a lot of pressure internally" to allow the use of "fines and trade sanctions" against breaches of labour provisions in its trade agreements—as is already done by the US and Canada.[41]

33. Dr Bartels drew attention to the fact that EU trade agreements generally contain a provision, known as an "essential elements clause", enabling the imposition of trade sanctions against violations of human rights, including workers' rights. He explained that the Council negotiating directives contain such a clause, and in fact seek to expand it to include compliance with the Paris Climate Agreement.[42]

2.2 Environmental protections

34. Professor Heyvaert explained that there are two main ways of devising environmental non-regression clauses in trade agreements depending on whether the parties decide to take either existing laws and standards, or levels of ambition, as their reference point. The Government's command paper seems to favour the former approach, proposing commitments "not to weaken or reduce the level of protection afforded by environmental laws".[43] However, Professor Heyvaert argued that the latter, "purposive" approach to non-regression would actually be "more productive", as it would provide sufficient flexibility to move away from a piece of legislation as it became outdated.[44]

35. Professor Heyvaert told us that the enforcement of such non-regression commitments could take various forms, from a generic provision that each party may question the compliance of new legislation to a requirement to produce impact

[38] Q 4 [Dr Damian Raess]
[39] Para. 74
[40] Q 3 [Nicola Smith]
[41] Q 4 [Dr Lorand Bartels]
[42] Q 4 [Dr Lorand Bartels]
[43] Para. 77
[44] Q 15 [Professor Veerle Heyvaert]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

assessment for each new proposal brought forward.[45] However, some of our witnesses expressed scepticism about the enforcement of environmental protections in EU trade agreements, noting that they were often subject to the same defects as labour and social protections enforcement processes.[46]

36. Dr Bartels noted that it was harder to agree objectively on what "high standards and low standards" might be regarding environmental protection than, for example, in respect of labour and social protection.[47]

2.3 Subsidy control/state aid

37. The "Subsidies" section of the Government's command paper reiterates the Government's desire to operate an independent "regime of subsidy control" after the end of the transition period. As for the future UK-EU trade agreement, the Government is proposing that the UK and EU should notify each other of any subsidies granted every two years—as in the EU-Japan Economic Partnership Agreement—and be able to hold consultations on potentially harmful subsidies.[48]

38. Identifying a single template for subsidy control provisions in EU trade agreements proved less straightforward. Broadly speaking, EU trade agreement provisions fall into three categories. The first, more common in association agreements with European countries, requires full compliance with the EU state aid *acquis*. At the other end of the spectrum are provisions that replicate WTO subsidy rules, as in CETA. Dr Rubini told us, however, that these are used in a "pretty limited" number of cases and were "quite exceptional in the practice of the EU". In between is a category of more hybrid provisions whereby, as Dr Rubini explained, the "language of the WTO" is adapted "with significant inputs from EU state aid law". This is the case, for example, in the EU agreements with Singapore, Vietnam and Japan. Dr Rubini felt that the future EU-Australia agreement could also fall into this category.[49]

39. This hybrid approach was indicated by most of our witnesses as a possible mutually agreeable compromise for the UK and the EU negotiations on subsidy control.[50] It could give the EU the reassurance it is seeking without negating the Government's objective of establishing an independent subsidy control policy. Several witnesses also argued that it would be in the UK's own strategic interest to have stronger subsidy control safeguards in its agreement with the EU, given that some Member States—for example France, Germany and Italy—have much greater propensity than the UK to subsidise their domestic industries.[51] As Mr Webber told us, such

[45] Q 15 [Professor Veerle Heyvaert]
[46] Q 3 [Nicola Smith], Q 4 and Q 7 [Dr Lorand Bartels]
[47] Q 6 [Dr Lorand Bartels]
[48] Paras. 64-65
[49] Q 21 [Dr Luca Rubini]
[50] Se for example Q 18 [George Peretz QC and Dr Ulrich Soltész]
[51] See for example Q 22 [Dr Luca Rubini]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

provisions between trading partners "only really need to catch subsidies that distort trade", with national policies that do not have distorting effects "really not the business of a trade agreement".[52] We note that any subsidies that might have the effect of creating so-called 'global champions', which could secure a dominant position internationally because of national state support, would most probably be distorting trade and so should be subject to subsidy control arrangements at international level.

40. Adopting this approach would enable the Government to bring its own demands to the negotiating table with the EU. One such demand could be, according to Mr Peretz, to institutionalise some form of UK input to inform the EU's decision-making on changes to its state aid policy where it may have consequences for the UK itself.[53] More broadly, Dr Hestermeyer urged the Government to consider what the UK wants from a level playing field" and how UK interests could be protected in such provisions.[54] The National Assembly for Wales highlighted that the benefits of divergence on level playing field provisions, in particular state aid, "must be weighed against the cost in economic terms of this occasioning a more distant trading relationship with the EU".[55]

41. **Our witnesses have provided us with helpful analyses of what is "typical" in EU trade agreements, including regarding the low level of enforcement on some types of level playing field provisions, such as those relating to labour, social and environmental protections. What provisions does the Government have in mind as 'typical' of existing agreements? And how far do our witnesses' assessments in various areas of the level playing field reflect the Government's current negotiating aims?**

42. **In particular, we would be interested to know what laws and standards the Government proposes to take as a reference point as part of a future UK-EU agreement, to measure regression from existing levels of labour and environmental protection. Is the Government considering the inclusion of fines and trade sanctions for breaches of labour provisions? And, in developing a new domestic Emissions Trading System that might in the future link to the existing EU ETS, or to a future, revised EU ETS, what consideration has the Government given to where that would amount to *de facto* dynamic alignment between the UK and EU on environmental issues?**

43. **Given the UK's aspiration to provide global leadership in the area of environmental protection and tackling climate change, what**

[52] Q 36 [James Webber]
[53] Q 13 [George Peretz QC]
[54] Q 8 [Dr Holger Hestermeyer]
[55] Written evidence from the National Assembly for Wales (LPF0011)

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

consideration has the Government given to the case for a more purposive style of non-regression from levels of environmental ambition, rather than regulatory protection, as suggested by one of our witnesses?

44. **We recall the findings in our 2018 report that the EU has consistently insisted that trade agreements with third countries include some form of state aid or subsidy controls, though, as our witnesses explained, these may be essentially the WTO rules on subsidy control, as in CETA. Our recent evidence shows that, within the range of options offered by existing EU agreements, there is scope to develop a set of common rules on subsidy control that could give the UK and EU reassurance about each other's use of subsidies, without tying the UK to the EU state aid regime. We endorse the statement by James Webber that "subsidy control between trading partners only really needs to catch subsidies that distort that trade, and anything that happens beneath it is really not the business of a trade agreement".**

3. The UK's approach to subsidy control

45. We asked our witnesses to reflect on the UK Government's change in language from "state aid" to "subsidy control". Most of our witnesses said this reflected a shift in focus towards WTO commitments, with Mr Webber noting that "state aid" was "a creature of EU law",[56] though Alexander Rose told us there was an opportunity to reclaim the term "state aid" through developing a strong "UK state aid law".[57] **The linguistic distinction between 'state aid' and 'subsidy control' is less important than the opportunities that developing a new domestic approach can bring to the UK. We urge the Government to focus on these opportunities.**

46. There are a number of substantial differences between WTO subsidy control rules and the EU's state aid regime, which we analysed in our 2018 report.[58] For example, the WTO system enables governments but not individuals or companies to challenge a subsidy, which Mr Rose described as a "fundamental deficiency" in the WTO regime,[59] and WTO remedies cannot be applied retrospectively, as Dr Rubini pointed out.[60]

47. **If the Government were to go ahead with plans to develop a subsidy control system based on the WTO framework, what consideration has it given to how it might, or whether it should, act to address gaps in this**

[56] Q 27 [James Webber]
[57] Q 27 [Alexander Rose]
[58] European Union Committee, *Brexit: competition and State aid* (12th Report, Session 2017-19, HL Paper 67)
[59] Q 28 [Alexander Rose]
[60] Q 20 [Dr Luca Rubini]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

framework, such as the lack of recourse for individuals and businesses? Is it the Government's intention that, under a new domestic policy, individual companies will be allowed to complain against potentially unlawful subsidies?

48. **We would be particularly interested to know how the Government intends any possible complaints about subsidies within the EU to be made. Do you envisage that complaints could be made directly, through the Government, or via the new Trade Remedies Authority and on WTO terms? Can you also clarify whether the Government intends to establish a market test similar to that used by the EU to determine if a measure is captured by UK rules on subsidy control? And if so, how will 'market' be defined? For example, will the relevant test that the CMA will have to apply be whether the aid has a distorting effect on trade within the UK, within the EU and the UK, or according to some other geographic definition?**

49. **What consideration has the Government given to the possibility of bringing forward primary legislation that would establish the new criteria to be applied to potential subsidies, which could help provide certainty, and would have the advantage of engaging all nations and regions of the UK in co-creating this new domestic framework?**

50. As part of our evidence taking, we asked witnesses about the barriers that might stand in the way of the UK seizing this opportunity, and in particular we identified two key factors that could have implications for a new domestic policy: the provisions relating to state aid contained in the Protocol on Ireland/Northern Ireland, and the continuing reforms of EU state aid law.

3.1 Consequences of the Protocol

51. Article 10 of the Protocol on Ireland/Northern Ireland states that EU state aid rules, as listed in Annex 5 to the Protocol, will "continue to apply to the United Kingdom … in respect of measures which affect that trade between Northern Ireland and the Union which is subject" to the Protocol—in essence, trade in goods.[61] Our witnesses were clear that the implications of these provisions are wide-ranging, for two sets of reasons.

52. First, Article 10 covers not just aid granted to Northern Irish beneficiaries or by Northern Ireland authorities; it can capture any UK measure. As Dr Colin Murray told us in written evidence: "Any … support for a widget-making business based in Sheffield but which has aspects of its production, subsidiaries or sales activity in

[61] The revised text of the Protocol and a Government 'explainer' are available online: https://www.gov.uk/government/publications/new-protocol-on-irelandnorthern-ireland-and-political-declaration

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

Northern Ireland would thus, prima facie, be subject to [the Protocol's] rules."[62] It follows that, if the Government were to introduce its own system of state aid or subsidy control, the lawfulness of aid measures would need to be checked against both the UK and EU rulebooks. Mr Peretz also told us that there was a challenge in interpreting the application of state aid rules solely to trade in goods as "EU state aid law does not distinguish goods and services".[63]

53. Second, the bar for triggering Article 10—an effect on trade between Northern Ireland and the EU—is a low one. Mr Webber explained that the Treaty on the Functioning of the European Union (TFEU) contains a very similar test for determining if a measure qualifies as state aid—that is, an effect on trade between Member States.[64] Mr Peretz noted that "analysis of [this] effect on trade" takes place "at an astonishingly superficial level". On this basis, he felt, aid to service providers could also end up being captured by the Protocol, for example if the providers in question had a large number of manufacturing clients.[65]

54. None of these matters are discussed in the Government's explainer on the Protocol.

55. The Northern Ireland Assembly highlighted their concern that Northern Ireland will "bear the brunt of any outstanding issues between the UK and the EU regarding state aid and subsidies", leaving businesses unable to sell goods in either the GB or EU markets and consumers' choice being limited.[66] In addition, the Scottish Government told us that an announced "work stream" on the Protocol's functioning, which should bring together the UK Government and devolved administrations, had yet to be set up, hampering all the devolved administrations' ability to gain "full sight" of the issues the Protocol may engender.[67] We note that it is also unclear whether the Protocol's state aid provisions will be discussed by the Specialised Committee responsible for matters related to implementation of the Protocol. These issues seem to be exacerbated by the lack of progress on negotiating a common framework on state aid, which we cover in greater detail in section 0 below.

56. **It is troubling that no one we heard from thought that the UK Government had a clear understanding of what state aid provisions it had signed up to in the Protocol, and that the regions and devolved nations we heard from were not clear on how the Protocol might affect them. How is the UK Government working now to ensure that the UK-wide implications of the Protocol in a state aid context are fully understood?**

[62] Written evidence from Dr Colin Murray (LPF0004)
[63] Q 17 [George Peretz QC]
[64] Q 30 [James Webber]
[65] Q 17 [George Peretz QC]
[66] Written evidence from the Northern Ireland Assembly (LPF0002)
[67] Written evidence from the Scottish Government (LPF0003)

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

57. Given the very real challenges of interpreting the Protocol and understanding its practical implications for the whole of the UK, most of our witnesses recommended renegotiating the Protocol's state aid provisions.[68] According to Alexander Rose, this could be done using the provisions that exist in Article 13.8 of the Protocol, whereby the Protocol can be superseded, wholly or in part, by a new negotiated agreement.[69] **We agree that it should be a key UK priority to renegotiate provisions on state aid in the Protocol as part of the future relationship agreement with the EU, or negotiate alternative arrangements for Northern Ireland-Republic of Ireland trade, as envisaged in the previous Withdrawal Agreement, which would replace the Protocol entirely.**

3.2 Addressing EU reforms

58. The EU state aid regime is not static, but evolves with the EU's broader political, economic and industrial policies. Further evolutions can be expected to arise from the EU's ongoing "fitness check" of its state aid rules, including the General Block Exemption Regulation (GBER) and the Commission's guidelines on state aid for environmental protection and energy. In particular, the Commission's December 2019 European Green Deal indicated that one of the goals of this fitness check will be to gear state aid rules towards the policy objectives of the Green Deal.[70]

59. According to Professor Heyvaert, the Green Deal could mark a more "purposive" use of public funding to support decarbonisation, including a "rather permissive approach to subsidies and state aids" in the environmental sphere. She also drew attention to proposals to "phase out grants to end state aid to fossil fuel sectors".[71] Dr Rubini, on the other hand, only expected the EU's review of its state aid regime in this area to lead to "some fine-tuning … with wind, solar and new technologies for storage".[72]

60. We note that the EU's industrial strategy, published on 10 March 2020, also announced a review of rules on state aid to Important Projects of Common European Interest (IPCEIs), aimed to clarify the system and facilitate the participation of SMEs in IPCEIs.[73] There was not time to discuss this document in detail with our witnesses but it will be subject to scrutiny by the EU Committee in due course.

[68] Q 18 [Professor Andrea Biondi], Q 29 [Alexander Rose] and Q 30 [James Webber]
[69] Q 29 [Alexander Rose]
[70] Communication from the Commission: The European Green Deal, COM(2019)640, https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1576150542719&uri=COM%3A2019%3A640%3AFIN
[71] Q 14 [Professor Veerle Heyvaert]
[72] Q 23 [Dr Luca Rubini]
[73] Communication from the Commission: A New Industrial Strategy for Europe, COM(2020)102, https://ec.europa.eu/info/sites/info/files/communication-eu-industrial-strategy-march-2020_en.pdf

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

61. **EU state aid rules play a role in steering public funding towards specific sectors, activities and categories of recipients, based on the EU's broader economic and industrial policies. It appears increasingly likely that the EU will make targeted adjustments to these rules in the near future, and possibly relax state aid controls on Member States' support to the green transition.**

62. **Any such move will have knock-on implications for UK businesses. It is therefore vital that the Government fully communicates to affected UK businesses both the rationale behind and consequences of changes in the EU's approach to state aid. We also urge the Government to consider negotiating a mechanism enabling the UK to retain some influence over the formation of EU state aid rules that could affect the UK, as suggested by some of our witnesses. We are also interested to understand what arrangements, if any, the Government is seeking to agree with the EU on cooperation on competition policies more broadly, in particular with regard to the digital economy.**

4. The substance of a new UK domestic control framework

63. We recognise that, while an EU Member State, the UK has used state aid in a comparatively modest way and has "always been first in the class" on state aid enforcement.[74] However, we heard from the Northern Ireland Assembly that they had struggled to obtain clearance from the European Commission for certain projects, and so felt they had "suffered" because of a lack of understanding of their "unique challenges".[75] **The UK clearly has a strong reputation for its subsidy control, but also has an opportunity to find a new way to ensure that subsidies or state aid can support the whole of the UK.**

64. The economic impacts of state aid are not always easy to measure, not least because, as we heard, subsidies are not always fully notified under existing subsidy control systems worldwide. Nevertheless, we asked our witnesses for their views about the return on investment that EU Member States that have used more state aid than the UK have received.

65. Dr Soltész noted that the UK's "system of renewable and green energy, which works with a relatively low level of subsidies" was more "cost effective" than the German approach to equivalent subsidies,[76] and he was critical of the German approach of using Landesbanken, public banks, to support private banks after the banking crisis.[77] However, Mr Webber highlighted that state aid "has played an

[74] Q 22 [Dr Luca Rubini]
[75] Written evidence from the Northern Ireland Assembly (LPF0002)
[76] Q 16 [Dr Ulrich Soltész]
[77] Q 10 [Dr Ulrich Soltész]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

enormous part in building competitiveness" in some areas, such as for Boeing and Airbus in the aviation sector.[78] **Overall, it was clear that our witnesses thought that the UK's approach to granting state aid while an EU Member State had struck broadly the right balance.**

66. We heard a range of views about how the UK should design a future subsidy control regime, with some witnesses suggesting that continuing to align as closely as possible with EU state aid rules after the transition period would be in the best interests of UK businesses,[79] while Mr Webber noted that having no state aid system at all post-transition could result in the fewest difficulties if there was no trade agreement between the UK and EU.[80]

67. On balance, however, witnesses felt that some form of subsidy control will be required. The two most compelling reasons put to us for that were the need to ensure transparency over the use of public money and to avoid a race to the bottom among devolved and regional authorities, with witnesses pointing to the example of Amazon in the US, which "held an auction" among cities to find "who could give the greatest incentive" to the firm.[81]

68. **We reiterate our previous conclusion that exiting the EU presents the UK Government with an opportunity to reshape the domestic state aid framework around its economic and industrial policies, as done by the EU in designing its own regime. We are concerned that the Government has not acted swiftly enough to seize the opportunities in these areas.**

69. In respect of the design of that domestic state aid policy, our witnesses seemed to agree that more flexibility and a less complex system would be beneficial to aid grantors and aid recipients alike.[82]

4.1 Using a domestic state aid system as a lever to achieve other goals

70. Our evidence-taking also focused on how state aid could be used by the Government as a lever to achieve other goals, especially regarding the UK's net-zero climate goals and the Government's "levelling up" agenda, which represent two areas in which the UK might use subsidies to address "market failure" without causing market distortion.[83] We address these in turn below.

[78] Q 33 [James Webber]
[79] Written evidence from Dr Ulrich Soltész (LPF0010)
[80] Q 36 [James Webber]
[81] Q 31 [Alexander Rose], also pointed out to us by Mr Peretz (Q 18)
[82] See, for example, written evidence from the LEP Network (LPF0008)
[83] Q 30 [Professor Karen Turner]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

4.1.1 Achieving the UK's net-zero climate goals

71. Globally, countries are increasingly willing to subsidise environmental projects, in particular in the area of renewable energy and decarbonisation, and the UK has been no exception, using state aid "an awful lot" for this purpose.[84] Professor Karen Turner provided us with detailed written evidence about the economic impacts of subsidies to support decarbonisation and energy efficiency. In her oral evidence, she highlighted that to meet the UK's net-zero goal, both the energy supply sector and emission-intensive industries would need support "to avoid them losing competitiveness" and allow the UK to continue to lead globally in this area. On the other hand, she also noted that to secure a high-performing economy, the UK will also "have to identify areas of competitive advantage".[85]

72. **State aid can be an invaluable lever for meeting the UK's ambitious net-zero goals, allowing the Government to incentivise vital sectors of the economy, such as emissions-intensive manufacturing, to make necessary changes in support of our collective goals. The UK Government will need to collaborate with businesses about how best to achieve this without crossing the dividing line between correcting market failure and creating market distortions.**

73. With regard to major infrastructure projects to support the net-zero transition, Professor Turner noted the need for "public intervention not just because of affordability but to secure confidence in those assets".[86] **A long-term and consistent plan for providing state support for critical net-zero projects is therefore essential to allow businesses and individuals to plan for and deliver change.**

74. Mr Webber and Mr Rose suggested a carve-out from subsidy control rules for infrastructure projects, possibly through a block-exemption on the model of those granted by the Commission through the GBER. However, Mr Webber explained that "infrastructure that can be exploited economically" was brought in scope of the EU state aid regime by a 2012 CJEU judgement, and that this has attached a "big cost" to delivering such projects.[87] The Greater Lincolnshire LEP also told us that a "prolonged tie in to GBER, de-minimis and regional state aid" rules from the EU "will continue to act as a detractor to business investment" at a local level and potentially limit "inward investment opportunities from outside the EU".[88]

[84] Q 30 [Professor Karen Turner]
[85] Q 30 [Professor Karen Turner]
[86] Q 31 [Professor Karen Turner]
[87] Q 31 [Alexander Rose and James Webber]
[88] Written evidence from the Greater Lincolnshire Local Enterprise Partnership (LPF0009)

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

75. **In our July 2019 letter, we sought clarity about the Government's plans for creating and amending block exemptions in the context of a UK state aid regime. We agree with our witnesses that there is a place for block exemptions, such as for infrastructure, in a new domestic state aid system, in the interests of providing certainty and simplicity for both aid grantors and aid recipients.**

76. **We remain interested in the Government's plans for incorporating block exemptions into a new domestic policy and whether and how these might align with the EU's approach following its policy review.**

4.1.2. Achieving the "levelling up" agenda

77. Our witnesses made several suggestions on how the UK's future subsidy control framework could best support the Government's objective of levelling up competitiveness across the UK's nations and regions. Professor Turner noted that there was a synergy between the UK's net-zero ambitions and its levelling up agenda because necessary infrastructure that can play a key role in the net-zero transition is often situated "at key regional locations"[89] and that, as with decarbonisation, addressing regional disparities was a matter of remedying "market failure" rather than creating market distortions.[90]

78. The Greater Lincolnshire LEP highlighted that a new domestic state aid policy could help by "addressing viability issues and site value differentials across the UK through creating a more level playing field for investment" in the UK's own internal market.[91] The LEP Network noted that the maximum level of aid intensities currently available were insufficient to "make any different to many business decisions" and urged the Government to consider "a simpler system aligned by geography to the new UK Shared Prosperity Fund" that would "re-enforce the focus of levelling up".[92]

79. A new domestic framework would also need to provide a replacement for EU rules on regional aid. The Welsh Government pointed to the assisted areas map—which determines the aid intensities allowed in different EU regions—as a model worthwhile retaining to avoid a situation where "wealthier parts of the UK" are "in a stronger position to 'spend their way out of a Brexit dip'".[93] The Local Government Association (LGA) noted that there should be "no downgrading of the ability to provide state aid to businesses in current Assisted Areas". It further suggested that any new regional aid regime should enable aid to "companies of all sizes" and enable

[89] Q 31 [Professor Karen Turner]
[90] Q 30 [Professor Karen Turner]
[91] Written evidence from the Greater Lincolnshire Local Enterprise Partnership (LPF0009)
[92] Written evidence from the LEP Network (LPF0008)
[93] Written evidence from the Welsh Government (LPF0006)

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

councils to support "non-profit-making activities" and "local social enterprises", which are not recognised under the EU system.[94]

80. **We welcome the Government's commitment to ensuring that all regions and nations of the UK can grow and thrive. The UK's departure from the EU has created significant uncertainty for more deprived regions about the level of support they will continue to be able to receive. A new UK state aid policy could help provide this certainty by reaffirming the Government's commitment to support vital regional projects.**

81. We heard frustration from our witnesses regarding the lack of progress in setting up a UK Shared Prosperity Fund (SPF), including the absence of a consultation, with Mr Rose noting "it is a real shame, as a northern regeneration lawyer, that it has not been taken forward in any meaningful sense at this point".[95] He highlighted the opportunities associated with designing the Fund at the same time as the UK's future subsidy control policy, noting in particular the efficiency gains (for example, fewer audits) of having to engage with a domestic state aid regulator rather than the Commission.

82. The Scottish and Welsh Governments and the LGA emphasised the importance of giving devolved and regional authorities a role in the Fund's design and administration,[96] with the Welsh Government also noting the Government's reassurance that the Fund will "at a minimum match the size of the [EU] funds in each nation".[97] In their written evidence, the LEP Network provided a detailed list of thoughtful points about how a new SPF ought to be designed.[98]

83. **The continued lack of progress in developing the proposed UK Shared Prosperity Fund (SPF) is regrettable. It is clear from the evidence we have taken that the UK Government has available a wealth of knowledge and insight from across the UK's regions and nations, of which it must take full advantage if the SPF is to deliver the maximum benefits for the country as a whole. That said, there is inevitably an important role for the Government to help address structural imbalances in the economy and in promoting support for new, developing sectors vital to the UK economy. The Government will need to beware vested interests keen to obtain subsidies for uneconomic projects. It should remember Dieter Helm's dictum that 'Governments are bad at picking winners; but losers are good at picking governments'.**

[94] Written evidence from the Local Government Association (LPF0001)
[95] Q 32 [Alexander Rose]
[96] See written evidence from the Welsh Government (LPF0006), written evidence from the Local Government Association (LPF0001), and written evidence from the Scottish Government (LPF0003)
[97] Written evidence from the Welsh Government (LPF0006)
[98] Written evidence from the LEP Network (LPF0008)

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

4.2. Consultation and subsidiarity in developing a new domestic regime

84. We noted in our July 2019 letter that the question of whether state aid was a reserved or devolved matter was a point of contention between the May Government and the devolved administrations. The Northern Ireland Assembly's submission to this inquiry suggests that little progress has been made in resolving this disagreement, given that "state aid remains as one of the issues still under discussion in the development of [the] Common Frameworks" that should set out a common approach to policy areas 'repatriated' to the devolved administrations after the end of the transition period.[99] The LEP Network highlighted that much of the day-to-day work of state aid was currently dealt with at a local level by the LEPs and local authorities.[100]

85. We were deeply concerned by the strong representations made to us by the Scottish and Welsh Governments about the UK Government's lack of engagement on the UK's negotiating position or the development of a new subsidy control policy. Both witnesses highlighted that, despite pledges to the contrary by the previous Government, there has been no meaningful engagement through the Joint Ministerial Committee on European Negotiations.[101]

86. **We strongly reiterate the recommendation in our 2018 report that the Government should involve and secure the support of the devolved administrations in devising the future UK state aid or subsidy control framework. It is disappointing that, almost two years later, the Government has not been able to build a consensus with the devolved nations about how to approach this issue.**

87. **We would welcome an update on how the Government proposes to engage with the devolved administrations and, specifically, how you are working to resolve the issue of whether state aid is a reserved matter.[102]**

[99] Written evidence from the Northern Ireland Assembly (LPF0002)
[100] Written evidence from the LEP Network (LPF0008)
[101] Written evidence from the Welsh Government (LPF0006), and written evidence from the Scottish Government (LPF0003)
[102] This was highlighted in previous correspondence from the National Assembly for Wales and the Scottish Parliament (Letter from Mick Antoniw, Chair of the Constitutional and Legislative Affairs Committee of the National Assembly for Wales, to Sir Bernard Jenkin, Chair of the House of Commons Public Administration and Constitutional Affairs Committee (6 February 2019): https://www.parliament.uk/documents/commons-committees/PACAC/Correspondence/Letter%20from%20National%20Assembly%20for%20Wales%20to%20Chair%20on%206.2.19%20regarding%20The%20State%20Aid%20(EU%20Exit)%20Regulations%202019.pdf [accessed 26 June 2019], and Letter from Ivan McKee MSP, Minister for Trade, Investment and Innovation of the Scottish Government, to Gordon Lindhurst MSP, Convener of the Economy, Energy and Fair Work Committee of the Scottish Parliament (28 January 2019): https://www.parliament.scot/S5_EconomyJobsFairWork/Inquiries/20190128-Minister-Trade_Investment_Innovation-State_Aid_Regulations.pdf [accessed 26 June 2019]).

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

88. **What immediate steps does the Government plan to take to develop an appropriate mechanism for designing a UK state aid policy collaboratively with the appropriate representatives from the devolved nations and the regions?**

4.3. The need for and role of a new domestic state aid authority

89. Finally, we turn to the governance of any new UK state aid regime. **Our overarching recommendation here is that clarity on the UK's intentions is vital for businesses, investors, the devolveds, and regional bodies.**

90. The Government announced its intention to designate the Competition and Markets Authority (CMA) as the UK's domestic state aid authority in a letter to us dated 28 March 2018. This was to be given legal effect by the State Aid (EU Exit) Regulations 2019, laid in draft before Parliament on 21 January 2019, but this SI was never approved in the House of Commons.[103] The LEP Network highlighted the continued "urgent need for clarity" about the CMA's possible future role.[104]

91. On 9 April 2019, we wrote to Lord Tyrie, Chair of the CMA, to request an update on the CMA's preparations for its new responsibilities. Lord Tyrie provided a helpful response on 9 May 2019, including estimates of the CMA's casework increase, progress in recruiting additional staff and stakeholder engagement.[105] We have no reason to conclude that any of the information set out in Lord Tyrie's previous correspondence with us has changed substantively. **We note with some frustration that it remains unclear what the Government's intentions are with regards to the CMA's role, or if the Government has considered the pros and cons of different roles the CMA might be given. For example, should the CMA have an advisory role, or should it be directly responsible for approving state aid or subsidies? We are concerned that lack of consideration of different options and the Government's reticence to develop and communicate its own subsidy control policy have put the CMA in a challenging position.**

92. In our previous correspondence, we asked about the risk that some state aid notifications were being deferred until the UK's domestic framework is clearer. **Can the Government provide an update on the number of UK notifications to the Commission since the 2016 referendum? Do these figures provide any**

[103] Draft SI: Draft State Aid (EU Exit) Regulations 2019
[104] Written evidence from the LEP Network (LPF0008)
[105] Letter from Lord Tyrie, Chair of the Competition and Markets Authority, to Lord Whitty, Chair of the House of Lords EU Internal Market Sub-Committee (9 May 2019): https://www.parliament.uk/documents/lords-committees/eu-internal-market-subcommittee/brexit-competition/090519-Letter-from-Andrew-to-Lord-Whitty-re-Brexit-competition-and-state%20aid.pdf [27 June 2019]

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

evidence that notifications are indeed being delayed, and so suggest that the CMA may see a large spike of work after the transition period? How is the Government supporting the CMA to prepare for such a challenge?

93. We have heard from Mr Webber about the possible risk that aid needed urgently after the transition period may not be approved as swiftly as needed because the CMA will be performing a new function. **We urge the Government not to underestimate the challenge facing the CMA in starting from scratch as a domestic subsidy regulator. Giving the CMA adequate time to prepare how it will approach this new function, including having important bilateral discussions with the Commission about how they will work together, is essential. At the moment, the Government's approach seems to be preventing this preparatory work from taking place.**

94. **Finally, and again returning to points raised in our July 2019 letter, we note that preparations for the domestic Trade Remedies Authority (TRA), which will form the key second pillar of the UK's new institutional architecture on subsidy control, and a new trade defence framework are proceeding much more rapidly, with the institution established in shadow form and the Trade Bill reintroduced earlier this month to set that body on a statutory footing. The progress made in this respect makes the lack of clarity about the CMA's role as a potential state aid authority particularly stark.**

5. Conclusion

95. We recommended in our 2018 report that the Government should clarify its position on the shape of the future UK State aid framework as soon as possible. The publication of the State aid Statutory Instrument setting out a continuity framework, and the announcement that the CMA will be the UK's domestic State aid authority went some way to achieving this, as we noted in July 2019, but this position now seems to be in doubt once again. UK stakeholders – both aid grantors and potential aid recipients – still face considerable uncertainty over the final shape of the post-Brexit regime.

96. **We are concerned about the continued lack of clarity around the Government's plans for a domestic subsidy control or state aid system. We note that whether to use state aid is an economic and political question, but there are several legal complexities to developing a new domestic regime, which our evidence sessions have explored.**

We look forward to your response to the conclusions and requests for clarification set out in this letter by no later than **15 May 2020**. We are copying this letter to Rachel Reeves MP, Chair of the House of Commons Business, Energy and Industrial Strategy (BEIS)

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

Committee, to Lord True as Minister of State (Cabinet Office), and to our witnesses, who are listed in the attached Appendix.

We will also be sending a copy of this letter to Lord Tyrie, Chair of the Competition and Markets Authority, inviting his comments on those conclusions and recommendations that touch on the CMA's potential role as a domestic state aid regulatory.

Yours sincerely,

Baroness Donaghy, Chair of the EU Internal Market Sub-Committee

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

Appendix: Witnesses to the Sub-Committee's inquiry into the level playing field and state aid

Oral Evidence

OE00000083	Dr Holger Hestermeyer (Shell Reader in International Dispute Resolution at Kings College London); Dr Lorand Bartels (Senior Counsel at Linklaters LLP); Dr Damian Raess (Assistant Professor in Political Science at University of Bern); Ms Nicola Smith (Joint Head of Equality and Strategy Department at Trades Union Congress)
OE00000125	Professor Andrea Biondi (Professor at Kings College London); Dr Ulrich Soltész (Patner at Gleiss Lutz); Professor Veerle Heyvaert (Professor at London School of Economics); George Peretz (QC at Monckton Chambers)
OE00000186	Dr Luca Rubini (Reader (Associate Professor) and Deputy-Director of the Institute of European Law at University of Birmingham)
OE00000188	Mr James Webber (Partner in the Antitrust practice at Shearman and Sterling); Mr Alexander Rose (Director at DWF); Professor Karen Turner (Professor at University of Strathclyde)

Written Evidence

LPF0001	Local Government Association
LPF0002	Northern Ireland Assembly
LPF0003	Scottish Government
LPF0004	Colin Murray (Reader in Public Law at Newcastle University)
LPF0005	Professor Karen Turner (Centre Director The Centre for Energy Policy at University of Strathclyde)
LPF0006	Welsh Government

This document is circulated in confidence for Committee use only and should not be disclosed. Any misdirected copies should be returned to Glenn Chapman, House of Lords, London SW1A 0PW.

LPF0007	Professor Andrea Biondi (Professor of European Union Law at Kings College London)
LPF0008	LEP Network
LPF0009	Greater Lincolnshire Local Enterprise Partnership
LPF0010	Dr Ulrich Soltész
LPF0011	National Assembly for Wales