



SUBSIDY CONTROL – DESIGNING A NEW APPROACH FOR THE UK

Issued 31 March 2021

ICAEW welcomes the opportunity to comment on *Subsidy control – Designing a new approach for the UK* published by BEIS on 3 February 2021, a copy of which is available from this [link](#).

This response of 31 March 2021 has been prepared by the ICAEW Corporate Finance Faculty, with input from ICAEW's Tax Faculty and Public Sector experts and from ICAEW members from across the UK.

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Key points**The proposed regime**

1. With the EU State Aid regime no longer directly applicable, the UK needs a domestic regime for subsidies and subsidy controls. An effective regime should do more than evidence compliance with international commitments. It is an opportunity to use government support flexibly and wisely to promote business competitiveness, encourage innovation, and ensure the fair treatment of businesses operating across the nations and regions of the UK, in addition to the minimum objective of complying with the UK's international obligations including the Trade and Cooperation Agreement (TCA) with the EU.
2. It is disappointing that the consultation paper misses some of these opportunities. Much of the thinking appears rooted in the minimum standard necessary to evidence compliance with international commitments, rather than thinking more openly and freshly about the relationship between state and enterprise and the system that would best enable state support to foster innovation, growth and sustainable development. Perhaps these more domestic considerations can follow later, and we appreciate the urgency of establishing certainty that individual awards are consistent with the UK's TCA obligations. However, we hope a marker can be put down now for how the system of subsidy control can be made to work most effectively to achieve domestic policy objectives.
3. We welcome the clear statements in the consultation that subsidies should not be used to prop up failing businesses or to subsidise unfair competition. There is a role for targeted support that helps businesses to, for example, innovate, develop their workforces, become more sustainable, or expand into new markets. But importantly, this should not be at the expense of making it more difficult for other businesses to survive and thrive in competitive markets at home and abroad. Competition for support is important, to ensure that subsidies go to where they can have the biggest impact. For all of these reasons a practical, transparent, predictable and unambiguous regime for subsidy control is important. These are all domestic policy considerations that have little relation to compliance with international commitments.
4. We agree with many of the proposals set out in the consultation, for example where they attempt to strike a balance between compliance with international state aid rules and providing the flexibility all levels of government need to target support where it will do the most to deliver sustainable economic growth and increase prosperity. Our comments are included in our Answers to Specific Questions, below.

Definition of subsidy

5. The characteristics of a subsidy, set out on page 20 of the consultation paper, appear to be incomplete. Specifically, the form of financial contribution leaves out tax incentives and equity. There is also no recognition that the intended outcome of a subsidy could be an indirect or consequential benefit on the recipient. See our response to question 6.

Articulate the strategy

6. While the consultation focuses on implementation and control, it is less clear in linking the purpose and use of subsidies to the achievement of the government objectives (or strategic interests). One example is the ambition to 'level up' opportunities across the UK. To achieve this a clear economic development strategy is needed to guide decision-makers, so that the economic and social returns are commensurate with the amounts invested on behalf of taxpayers. It also demands fairness and transparency in allocating support and would benefit from competition, so that funding can go to entities best placed to deliver. A subsidy reporting and transparency regime could help to deliver on these objectives, yet the paper gives little

consideration as to how the regime can be used domestically. See also our response to question 3.

7. Empowerment, practicality and proportionality

8. There also needs to be a balance between providing the devolved administrations, regional combined authorities and local government with the powers they need to drive economic growth in their areas and the coherence of the UK internal market. In particular, there is a risk that businesses might be put at a competitive disadvantage simply because of their location and the subsidy regime needs to be carefully calibrated accordingly. Equally, there is a risk of competition between regions for relocating existing activity – a zero sum game. The regime needs to be able to ensure that subsidies only fund incremental, additive activity, even in instances where political pressure might distract from this objective. This is about more than simply complying with international commitments – it's about demonstrating value for money and how the subsidy control regime helps to do that and helping local strategy pathways to be aligned.
9. ICAEW members believe strongly that a practical approach is needed, and that lessons and pitfalls can be learned from EU State Aid as well as domestic schemes such as the Regional Growth Fund. A practical approach will set clear parameters with limited scope for interpretation and provide transparency so potential bidders for funding can see what is needed for success.
10. The approach to applying the regime must cater to the diversity of public authorities, their access to resources and knowledge of the regime, and the nature and size of the subsidies they award. Clear guidance should enable consistent but proportionate application by authorities. Equally guidance should be accessible to businesses of all sizes, with particular consideration to smaller ones.

Transparency and accountability

11. Transparency will be critical to ensure there is public, business and investor support for the subsidy regime that it is adopted. Yes, compliance requirements should not be excessively onerous for either businesses or public authorities and we agree that disclosure of individual subsidies should be limited to amounts above a reasonable threshold. Further research is needed on the optimum threshold and we believe this should be guided by domestic policy objectives rather than that required by international agreements (although of course it will need to meet or exceed them). In principle, we believe it is important there is aggregate information on the nature, number and level of subsidies being provided, adequate to enable businesses operating in local areas or in specific sectors of the economy to understand both the support that might be available and the level of subsidy that is being provided across an area or industry. Such information is likely to be particularly important to SMEs, who lack the resources to invest in their own research and may not be able to access support unless the terms and availability are very clearly communicated.
12. This is in addition to ensuring that taxpayers and their elected representatives can understand how public money is being used and can have confidence that subsidies are being provided in a fair and equitable way that delivers value for money. The consultation does not make clear how the outcomes of subsidy awards compare to the intended purpose. There must be a mechanism for reviewing the extent of achievement of goals so that lessons are learned, and subsequent decision-making is informed. The range of subsidies awarded should be in scope and the review should be conducted annually and published. See our response to question 31.

Transition

13. Over and above the compliance regime, the government must explain and communicate the replacement to EU State Aid in order to help the market transition to a UK domestic regime. The government should seek cooperation and support from sector representatives, business associations and professional bodies, and their communication channels, and also engage the Growth Hubs and Local Enterprise Partnership (LEP) network. For awarding authorities, the government should provide practical guidance for consistency in approach, including on impact assessments and for the evaluation of outcomes.
14. When developing guidance, the government should engage with local authorities and pre-empt and reduce the need for the latter to add their own interpretation. Such gold-plating can mean that authorities instruct delivery partners on their own auditable processes for ensuring a project stays within the subsidy control guidance. What starts as one set of rules can easily multiply.

ANSWERS TO SPECIFIC QUESTIONS

15. ICAEW has consulted widely to bring our members' relevant insights and expertise to the specific questions. Members consulted have experience of EU State Aid, of the application processes for financial support measures, and of challenges businesses can face in identifying measures for which they are eligible and administering ongoing scheme compliance. We have also heard from members that are close to LEPs, and/or advise businesses in regions including Humber, Merseyside, Midlands, North East, Cornwall and Devon.

Chapter 2

Question 1: What type of subsidies are beneficial to the UK economy?

16. Common features of subsidies that are beneficial include certainty as to duration, eligibility and straightforward ongoing compliance. However, even measures that are considered to be of great value to the recipients, can be wasteful if too lavish.
17. A balance of different types of subsidies will best achieve value for money and ICAEW members cite specific as well as more general examples of beneficial subsidies:
 - R&D tax credits
 - EU funding for research activities
 - Incentives for capital investment, decarbonisation and innovation
 - Support aimed at specific sectors - for example the Business Premises Renovation Allowance (BPRA), and support from Sport England for investment in health and related sectors
 - Subsidies aimed at geographical location, such as ones for infrastructure in rural areas, or for industries dependent on the local geography
 - Subsidies aimed at different stages of the business lifecycle
18. Beneficial subsidies may also include ones for which the non-economic rationale outweighs the economic one. Indeed, other objectives are alluded to in paragraph 31 of the consultation paper, however we observe that the commentary in paragraph 36 seems to be at odds with the levelling up agenda.

Question 2: What type of subsidies are potentially most harmful and distortive?

19. Broadly, these will include subsidies that:
 - crowd out existing private investors and funding; or
 - displace commercial spending; or

- favour one business in a sector over others of similar merit; or
 - are used to procure political advantage; or
 - prop up ailing businesses that would fail, no matter how much subsidy is provided; or
 - those where the cost to the Exchequer exceeds the potential benefits to the economy.
20. Subsidies of scale can generally help avoid a distortive effect compared to ones that target very narrow pockets.
21. Subsidies that require measurable outputs - rather than GVA targets - are generally more helpful for businesses to demonstrate the beneficial impact of subsidies.

Question 3: Do you agree with the government's objectives for a future subsidy control regime? Are there any other objectives that the government should consider?

22. Objectives are a useful tool to best target gaps in the supply of capital that may merit support through subsidy. The government's stated objectives, set out in the consultation paper (page 14), are:
- Facilitating interventions to deliver on the UK's strategic interests
 - Maintaining a competitive and dynamic market economy
 - Protecting the UK internal market
 - Acting as a responsible trade partner
23. We have reservations regarding the first of the objectives as it is not clear what the 'strategic interests' are. The commentary in Chapter 2 is not sufficiently precise - it refers to 'examples where subsidies can help markets deliver better economic outcomes' and cites the levelling up agenda and the shared prosperity fund, but it does not signpost to the source of strategic interests. We also comment on strategic interests in paragraph 6.
24. This lack of specificity leaves the definition of what is a strategic interest open to challenge; risks suboptimal distribution of subsidies; and does not facilitate decision-making or accountability.
25. Moreover, we question whether these are the right combination of objectives to achieve the maximum domestic effectiveness from the investment of government funds in subsidies. Although the second is clearly a benefit to the UK economy, the list seems incomplete. It makes no mention of levelling up, sustainable growth or other important objectives of a subsidy regime. We are concerned this is a missed opportunity and suggest this immediate exercise to comply with the TCA is followed with a more comprehensive assessment of the regime needed to ensure the most effective use of government funding to stimulate economic activity.

Question 4: We invite respondents' thoughts on further sources of evidence that would help to strengthen our analysis of policy impacts. In particular:

Additional datasets (other than the European Commission's transparency award module) on local or regional subsidy awards (e.g. By value, sector or category)

Research and evaluation projects that have been conducted on the impacts of different types of subsidy awards on domestic competition and trade (e.g. By value, sector or category)

26. Reference should be made to the annual monitoring reviews on the impact of the Regional Growth Fund, the last of which was in 2015.
27. NESTA highlights evaluations such as those conducted by the What Works Centre for Local Economic Growth, part of the What Works Network.
28. The Enterprise Research Centre has some research papers, for example, *The legacy of public subsidies for innovation: input, output and behavioural additionality effects. Research Paper No 21.*

Question 5: We invite respondents' views on whether our proposed subsidy control regime, including the way it functions, may have any potential impact on people who share a protected characteristic (age, disability, gender re-assignment, marriage and civil partnership, pregnancy and maternity, race, religion or belief, sex (gender) or sexual orientation), in different ways from people who don't share them. Please provide any evidence that may be useful to assist with our analysis of policy impacts.

We have no comment.

Chapter 3

Definition

Question 6: Do you agree with the four key characteristics used to describe a support measure that would be considered a subsidy? If not, why?

29. The characteristics of a subsidy, set out on page 20 of the consultation paper, appear incomplete. It is not clear why, in the 1st bullet point, 'financial contribution' leaves out tax incentives and equity. Moreover, in the 2nd bullet point, there is also no recognition that the intended outcome of a subsidy could be an indirect or consequential benefit on the recipient.
30. The consultation does not explicitly mention tax, but it is important to acknowledge that targeted tax incentives can be another form of subsidy and a comprehensive subsidy regime should encompass them too. Tax incentives can often involve greater transfers of value to recipients as direct cash transfers and so need to be considered carefully.
31. While grants, loans and guarantees are all included, there is no mention of equity. Such measures are often the only reason a business can secure equity finance. Measures may be of the direct funding type (eg, from funds run by LEPs and the now-ceased Regional Growth Fund), or of the type that enables a business to secure funding because the provider has been able to manage their risk, eg, with a tax incentive (eg SEIS, EIS and VCT).

Question 7: Should there be a designated list of bodies that are subject to the new subsidy control regime. If so, how could that list be constructed to ensure that it covers all financial assistance originating from public resources?

32. The question appears to suggest that certain bodies that have a role in distributing or awarding financial assistance from public resources might *not* be subject to the new subsidy control regime. Absent a clear rationale for such exemptions, all bodies that provide or award financial assistance from public resources should be subject to a proportionate regime.
33. Focus should be on making available real-time information on the ranges of subsidy measures, and the relevant awarding bodies. The current list, www.gov.uk/business-finance-support, could be developed to be searchable by subsidy measure, window of operation and application, as well as by awarding body.

Scope

Question 8: Do you think agricultural subsidies in scope of the AoA and fisheries subsidies should be subject to the proposed domestic arrangements? If so, what obligations should apply?

34. In principle, we think that subsidies that are subject to WTO rules should be subject to the domestic regime. However, for legacy EU CAP schemes with a short period remaining to run, there should be an analysis of the impact of including them that takes into account the fact that these subsidies are declining and considers if transitional arrangements are needed for replacement schemes to EU CAP.

Question 9: Do you think audio-visual subsidies should be subject to the domestic regime? Please provide a rationale for your answer.

35. We know of no reason why audio-visual subsidies should be excluded from the domestic regime.

Subsidy control principles

Question 10: Do you agree with the inclusion of an additional principle focused on protecting the UK internal market by minimising the distortive effects on competition?

36. We agree with an additional principle of minimising any harmful or distortive effects on competition within the UK internal market that might arise from a subsidy. However, there is a tension between this principle and the government's levelling up agenda. The government will need to be clear and set thresholds to determine when helping disadvantaged areas spills over into harming competition.
37. Our members have strong reservations about the requirement for the public authority to undertake such an assessment. There is a number of reasons for this concern, including a lack of expertise or knowledge as to whether a support measure is a subsidy. Moreover, authorities can also not be expected to have up-to-date knowledge of needs across the internal market.
38. If public authorities are to be responsible for considering the possible distortive impact on competition within the UK, the government will need to be clear and set thresholds to determine when helping disadvantaged areas spills over into harming competition. Authorities will need to be provided with detailed guidance and assistance for apply it in a consistent and informed manner and signposted to sources of information such as prescribed reference material or data sets.

Question 11: Do you think there should be any additional principles?

39. No, we don't.

Question 12: What level of guidance or information would be helpful for public authorities to assist with their compliance with the principles?

40. It is likely that practice notes, expanding the principles with examples would be helpful. A standard impact form would also be useful, together with illustrative examples.
41. See also our response to question 10.

Exemptions

Question 13: Should the threshold for the exemption for small amounts of financial assistance to a single recipient replicate the threshold in the UK-EU Trade and Cooperation Agreement at 325,000 special drawing rights over a three-year period? If not, what lower threshold would you suggest and why?

42. The TCA threshold should be kept. However, further analysis is needed to help assess where the threshold can best be set to achieve the government's domestic policy objectives.

Question 14: If you consider the small amounts of financial assistance threshold should replicate the UK-EU Trade and Cooperation Agreement, should it be fixed at an amount of pound sterling (GBP)?

43. Yes, it should be set in GBP.

Question 15: Do you agree that subsidies under the proposed small amounts of financial assistance threshold be exempt from all obligations under the domestic regime, except for the WTO prohibitions? If not, why?

44. This would seem to be a proportionate approach.

Question 16: Should relief for exceptional occurrences be exempted from obligations regarding principles, prohibitions and conditions in the subsidy control regime?

45. Yes, but there should be prescribed situations that count as 'exceptional occurrences' as well as a value cap.

Question 17: Should subsidies granted temporarily to address a national or global economic emergency be exempted from the rules on prohibited subsidies and any additional rules set out below?

46. This seems sensible.

Question 18: Should the threshold for the exemptions for services of public economic interest replicate the relevant thresholds in the UK-EU trade and cooperation agreement at 750,000 special drawing rights over a three-year period, and for transparency obligations at 15 million special drawing rights per task? If not, what lower threshold would you suggest and why?

47. The threshold should be kept the same as in the TCA.

Question 19: If you consider the SPEI thresholds should replicate the UK-EU trade and cooperation agreement, should they be fixed at an amount of pound sterling (GBP)?

48. Yes, it should be set in GBP.

Prohibitions and conditions

Question 20: Do you agree with the government's approach to prohibitions and conditions? Should any types of subsidy be added to either category? If so, why?

49. We have no other suggestions.

Question 21: Would more detailed definitions of any of the terms set out in this section, including the definition of "ailing or insolvent enterprises" be useful to ensure a consistent and proportionate approach to compliance? If so, what should these be?

50. A business is defined in the consultation to be 'ailing or insolvent' when it is 'highly likely to fail in the short to medium term in the absence of subsidy'. The characteristic 'ailing' together with the period 'short to medium term' are subject to interpretation and could hinder a consistent approach. Consideration could be given to using existing definitions of a business in financial trouble, eg, ones in tax acts. Guidance will be needed to help awarding bodies take a consistent and proportionate approach, and businesses to assess their eligibility.

Protecting the UK internal market

Question 22: Should the government consider any additional ways to protect the UK internal market, over and above the inclusion of a specific principle to minimise negative impacts? If so, what?

51. We have nothing to add.

Competition impact reviews

Question 23: Would an additional process for subsidies considered at high-risk of causing harmful distortion to the UK internal market add value to the proposed principles? If so, how should it be designed and what criteria should be used to determine if the subsidy is at high-risk of causing distortion?

52. We have no comment.

Question 24: Should public authorities be obliged to make competition impact reviews public? If not, why?

53. We believe that competition impact reviews should be made public.

Question 25: Should public authorities be permitted to override competition impact review e.g. In the case of emergencies? If so, why?

54. Override should generally not be permitted but there should be scope for clearly defining the emergencies that would merit an exemption subject to this being signed off at an appropriately high level.

Relocation of economic activity

Question 26: Should there be additional measures to prevent subsidies that encourage uneconomic migration of jobs between the four nations?

55. The need for additional measures will depend on government policy for employment. If measures are required there a de minimis threshold would be sensible.

Presumed compliance for lower risk subsidies

Question 27: Could additional measures help ensure that lower risk subsidies are able to proceed with maximum legal certainty and minimum bureaucracy? What should be included within the definition of ‘low-risk’ subsidies?

56. A definition for low-risk subsidies is likely to be open to abuse, so a fast-track process as above should be avoided.

Question 28: What guidance or information would be helpful for public authorities to assist on lower risk subsidies?

57. Not applicable, per our response to question 28.

Sector and category specific provisions

Question 29: Should the specific rules on energy and environment subsidies apply only in so far as they are necessary to comply with trade agreements? Or should they apply under the domestic regime more generally?

58. We have no specific comment.

Question 30: Which sectors or particular categories of subsidy (such as for disadvantaged areas, R&D, transport, skills etc) would benefit from tailored provisions or specific guidance on subsidy control? If so, why, and what should the nature, extent and form of the provisions be?

59. Guidance on subsidies will be useful where they are specifically linked to policy objectives and strategy. For example, guidance on subsidies for disadvantaged areas will help align these with the levelling up agenda. Guidance should be available on agricultures and fishing subsidies, including any replacements to legacy EU schemes, and on subsidies for sectors/industries dependent on the local geographical environment.
60. As well as guidance on design and outcomes, there needs to be guidance on assessing the impact on competition within the UK market as per our response to question 10.

Transparency

Question 31: Do you agree with the proposed rules on transparency? If not, why?

61. We agree that clear mechanisms for transparency are important. However, the system proposed appears to be driven by the need to comply with international obligations. A system of disclosure and reporting could in principle also be useful for domestic policy purposes, for example by enabling businesses to see what kinds of awards are being made and what the conditions were. That might help optimise competition and thereby help channel funds to where they can best be used, it might also help to reveal distortions such as unfair competition, should such situations arise. We note that the proposed rules do not refer to information on subsidy outcomes. There must be a mechanism for reviewing the extent of achievement of goals so that lessons are learned, and subsequent decision-making is informed. The range of subsidies awarded should be in scope and the review should be conducted annually and published.

Question 32: Do you agree that the thresholds for the obligation on public authorities to submit information on the transparency database should replicate the thresholds set for small amounts of financial assistance given to a single enterprise over a three-year period and for transparency for SPEI?

62. Yes, it should.

Question 33: If not, should the threshold be lowered to £175,000 over a three-year period to cover all reporting obligations for free trade agreements, enabling all of the UK's international subsidy transparency obligations to be met through one database?

63. Not applicable.

Question 34: Should there be a minimum threshold of £50,000 below which no subsidies have to be reported?

64. We agree that disclosure of individual subsidies should be limited to amounts above a reasonable threshold. However, we believe it is important there is aggregate information on the nature, number and level of subsidies being provided that enables businesses operating in local areas or in specific sectors of the economy to understand both the support that might be available and the level of subsidy that is being provided across an area or industry. This is in addition to ensuring that taxpayers and their elected representatives can understand how public money is being used and can have confidence that subsidies are being provided in a fair and equitable way that delivers value for money.

Question 35: Do you agree that the obligation should be to upload information within six months of the commitment to award a subsidy?

65. Six months seems an unreasonably long time and information will not be up to date. A significantly shorter period would be most useful.

Oversight and enforcement

Question 36: What should the functions of the independent body be? Should it be responsible for any of the following:

Information and enquiries;

Review and evaluations;

Subsidy development advice;

Post-award review; and/or

Enforcement.

66. An independent oversight body will play an important part in promoting consistency and transparency as well as a useful consultative role to public authorities (see question 38).

Question 37: Should any review of a subsidy by the independent body consider all the principles, and the interaction between them, or only some principles, and if so which ones?

67. A review should consider all the principles, and the interaction between them.

Question 38: What role, if any, should the independent body play in advising public authorities and reviewing subsidies before they have been awarded?

68. Public authorities should be able to consult the independent body before making an award. This will be useful in the early days of the new regime and will also help create a bank of expertise from which all authorities can benefit.

Question 39: If the independent body is responsible for post-award review, what types of complaints should it be able to receive and from whom?

69. The independent body should be able to receive and handle all complaints, as well as challenges to schemes and awards (see question 43).

Question 40: Which, if any, enforcement powers should the independent be given? In what circumstances could the body deploy them? What would be the routes of appeal and the interaction with judicial enforcement?

70. Powers would include halting of funding, issuing of penalties for non-compliance, and requiring relevant parties to respond to their questions. Compensation notices or fines might be considered in extreme cases. Appeals should be left to the Court system.

Question 41: How should the independent body be established in order to best guarantee its independence and impartiality when exercising its operational functions?

71. The appointment of key officers (the executive) should not be made by government departments or any awarding bodies. A board, appointed according to the normal public sector process, should oversee an executive. A CMA nominee would be sensible. The body should be funded from filing fees.

Judicial enforcement

Question 42: In addition to the application of time limits, are there any other considerations for implementation of the recovery power?

72. No comment.

Question 43: Should a specialist judicial forum such as the competition appeals tribunal hear challenges to subsidy schemes and awards? If not, why?

73. No, this can be carried out by the independent oversight body.