



# Select Committee on the European Union

## Internal Market Sub-Committee

### Corrected oral evidence: The level playing field and state aid

Thursday 12 March 2020

9.35 am

Watch the meeting

Members present: Baroness Donaghy (The Chair); Lord Berkeley; Baroness Kramer; Lord Lansley; Lord Lilley; Baroness Prashar; Lord Robathan; Lord Russell of Liverpool; Lord Shipley.

Evidence Session No. 3

Heard in Public

Questions 20 - 26

### Witness

I: Dr Luca Rubini, University of Birmingham (via video link).

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## Examination of witness

Dr Luca Rubini (via video link).

Q20 **The Chair:** Professor Rubini, my name is Rita Donaghy, I am Chair of the Sub-Committee. We are very grateful to you for making this arrangement to submit evidence. I think you have been given advance notice of the questions. Is that right?

**Dr Luca Rubini:** Yes.

**The Chair:** We will all share out the questions, and there may be a follow-up. You will appreciate that this is a public session. There will be a transcript of your evidence that you will have the opportunity to scrutinise and correct, if necessary. I am going to open with the first question.

**Dr Luca Rubini:** Yes, that is fine. Thank you.

**The Chair:** The UK Government's recent statements about their intention for the UK-EU negotiations talk not about state aid but about "subsidy control". What do you think the significance of that change in language is? In principle, what might the differences and similarities be between a system of subsidy control and a system of state aid? If you want to make some opening remarks at this stage, that is fine.

**Dr Luca Rubini:** Thank you for the invitation; it is a huge honour.

We can see a noticeable shift in the narrative of the UK Government from state aid to subsidy language. That is not just terminology. There are important practical differences between a system of subsidy control and a system of state aid control. When the UK Government refer to subsidy control, it is clear from various documents and from the recently produced negotiating guidelines of the UK Government that they mostly refer to the WTO system—the World Trade Organization.

That system is different from the one we have in the EU—EU state aid control—because it is much looser. The disciplines in the WTO are looser and partial; for example, they apply only to goods and not to subsidisation in the services sector. The standards that you need to satisfy in order to use them to object to subsidies are very high and very demanding, with the result that some commentators, including me, have concluded that overall those disciplines are not very effective. To use an image, they do not really 'bite'. They do not constrain Governments. They are very permissive.

The only real remedy under WTO subsidy rules is the unilateral track, whereby a Government or a country that believes it has imports from other countries that are subsidised and harm its competing domestic industry can impose countervailing duties. Only in that scenario, where the country is importing, do you have a meaningful remedy, which is countervailing duties, for the simple reason that in political economy terms you play at home.

The other track under subsidy rules, whereby you can complain about subsidies of another country by filing a case in Geneva, is not very effective. As I said, the thresholds are very high, not because you see this in the legal text, which is very deceiving, but because of how they have been applied and interpreted in the 25 years of life of the World Trade Organization.

Other elements of deficiency are that the WTO subsidy control system does not have explicit, express exceptions or justifications for what we could call good subsidies or legitimate subsidies. Those are subsidies for regional development and research and development, or environmental or energy subsidies.<sup>1</sup> There is no rule in the WTO subsidies chapter that explicitly permits those types of subsidies under certain conditions. The degree of permissiveness in the WTO rules is based on the fact that the rules we have are very difficult to apply. It is a kind of default, negative-type approach—a *laissez-faire* type of approach.

Transparency and governance are very deficient. Notoriously, countries do not freely notify their subsidies, so there is huge delay. The notifications are partial. The governance does not really work. There is a committee on subsidies in Geneva that meets twice a year. That is the regular standard for such committees, but there are no meaningful discussions. Private parties have no role.

The final element of deficiency relates to remedies. In the WTO, and not only for subsidies, the remedies if you win a case are only for the future. You may adopt a subsidy and you know perfectly well that the subsidy is illegal; you are confident that it might be challenged in Geneva and that after one, two, three or four years, you may be required to withdraw the illegal measure, but you will only have to suspend it for the future. The effects of the subsidy in the meantime are perfectly safe. That may be enough to achieve your goal of, for example, protecting your domestic industry.

In the EU, the system is very different. First, it applies to both goods and services. Secondly, it is comprehensive as regards justifications. There is a huge body of law, legislation and soft law, whereby certain state aids are eventually permitted because they pursue good policy goals. The governance system is highly sophisticated. There is a strong enforcer in Brussels—the European Commission. National courts play a huge role in safeguarding the respect of the rules. Private actors can participate in the process, and remedies are retroactive, so if you cheat and break the law you may be required to recover the aid that you have paid, and pay interest on it.

The philosophy of the two systems is completely different. The system in the EU is very much a system of governance, whereas the WTO system is very basic and aims only to chastise or to prohibit certain types of

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<sup>1</sup> Note from the witness: This remark was intended to give a few examples of subsidies that may be considered legitimate. There may certainly be others.

subsidies. It relies heavily on the unilateral action of Governments in import scenarios, when there are subsidised imports.

There is literally no remedy if you want to tackle a problem that is not in your market.<sup>2</sup> Say that the United States gives a subsidy to its domestic industry and the UK wants a remedy and complains about that.<sup>3</sup> The rules are very difficult to action. The only real remedy the UK might have is that the imports from the United States to the UK are causing harm, because then it can apply countervailing duties.

**The Chair:** Thank you very much. We will pass straight on to the next question. If we have any follow-ups, we will see how the time goes.

Q21 **Lord Shipley:** On 3 February the Prime Minister made a Written Statement to the UK Parliament that indicated that on “competition policy, subsidies, environment and climate, labour, tax” the Government would not agree to “measures ... which go beyond those “typically included” in a comprehensive free trade agreement.

We can conclude that the UK Government have indicated that a future UK-EU trade agreement should not contain provisions on subsidy control that go beyond those “typically included” in comprehensive free trade agreements. Could you give the Committee an overview of the standard provisions, focusing on EU trade deals generally?

**Dr Luca Rubini:** The question about “typically included” subsidy provisions is a bit tricky. Something like 304 trade agreements have been notified to the World Trade Organization.<sup>4</sup> All those agreements include subsidy provisions. Most of the agreements are simply based on the WTO rules.

If you move to the agreements of the EU, which constitute a sizeable share of the 300 agreements—more than 50 preferential trade agreements—what you see there is slightly different. To oversimplify, there are two categories of preferential trade agreement concluded by the EU concerning subsidies. In one category, which is pretty limited, the EU demands only the application of the subsidy rules in the WTO. One example could be Canada. I mention the CETA agreement because it has been referred to extensively recently by the UK Government. The agreement replicates essentially what is in the WTO, but it is quite exceptional in the practice of the EU.

Normally, the EU requests that you abide by, to a greater or lesser extent, EU state aid law. Here, there are two groups of agreements. There are agreements concluded with countries such as Singapore,

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<sup>2</sup> Note from the witness: This statement was intended to mean that there is ‘practically’ no remedy if you want to tackle a subsidy problem which is not in your country.

<sup>3</sup> Note from the witness: This remark was intended to refer to a hypothetical post-Brexit scenario.

<sup>4</sup> Note from the witness: More precisely, I wanted to refer to the agreements that are included in the Regional Trade Agreements database of the WTO and are currently in force.

Vietnam, Japan and Mercosur. They are all recent agreements. They are based on the language of the WTO, but with significant inputs from EU state aid law.

I would include in that category the current negotiations with Australia. That is something to be highlighted because I often see statements referring to the Australian model. There is no formal Australian model yet because we do not have an agreement yet. We are still at the negotiation level. However, what we have is significant, because we have some guidelines for negotiations from the EU. I will take the liberty of reading from them. The EU says, in its negotiating guidelines with Australia, "The agreement should contain robust and binding provisions on subsidies in line with EU standards and principles of state aid". That is the Australian one.

If you look at the text that is currently being negotiated between the EU and Australia, you can see that there are some provisions that are heavily inspired by EU state aid law. So, even in agreements with Australia, Japan, Vietnam, Singapore and Mercosur, there are significant excerpts or borrowings from EU state aid law regarding what subsidies are permitted and what subsidies are not permitted.

There is a second category where the EU squarely and expressly requests the other country to subscribe to the EU state aid model. Mostly that refers to agreements with countries in the European continent—association agreements and stabilisation agreements. Nowadays, we have, for example, agreements with six countries or six economies in the west Balkans.

**The Chair:** You are starting to freeze up. Sorry, the video has frozen. Would you mind starting the last sentence again?

**Dr Luca Rubini:** The last category, roughly speaking, is agreements of the EU with other countries in the European continent, accession countries such as the western Balkan economies. It is a model whereby the EU demands two things. The first thing is that you need to subscribe to EU state aid law, to the rules on what is state aid, what is permissible and not permissible state aid. On the other hand, there are specific demands with respect to governance. The EU requests that a national authority is set up that has significant enforcement powers, and in many cases there are consultations with the European Commission and dispute settlement. In the previous category, which was the agreements with non-European countries, you may or may not have dispute settlement. For countries in the European continent, it is standard.

That is exactly what is in the negotiating guidelines of the EU. They are clearly inspired by the template for trade agreements with countries in the European continent. If I may add a gloss from the perspective of the EU, that makes sense because the factual economic and regulatory situation of the UK now, for geographical reasons and given the high economic and trade interdependence, makes the UK comparable to these countries.

There is a graph that I want to show you to highlight that. It is a graph that has been created by—<sup>5</sup>

**The Chair:** Yes, we have seen that. Thank you.

**Dr Luca Rubini:** That graph is useful because it shows the unique position of the UK vis-à-vis other countries that are not in the European continent.

**The Chair:** Thank you very much. I am sorry to rush you, but I am conscious that there are several more questions that we need to ask.

Q22 **Baroness Kramer:** Going back to the first question, the assumption here is that it is to the advantage of the UK to be in a subsidy regime rather than a state aid regime. But if I was sitting in the European Union and it became my goal to shift financial services out of the UK to continental Europe, a subsidy regime would allow me very freely to do it, would it not, and I would be very unlikely to get resistance, say from France attacking changes in Germany? I can see it as an almost ideal scenario to be able to intervene to create that shift in the services sector. Do you agree with that, or am I misunderstanding?

**Dr Luca Rubini:** I would generally take a different position. I think I would suggest that, in the Greenwich speech, the Prime Minister was right when he repeated the fact that the UK has always been first in the class; it has been the brightest pupil in the class with respect to state aid enforcement, with fewer cases, fewer investigations, fewer actions and fewer infringement proceedings, whereas, as you highlighted, it is in the European continent, with Germany, France and Italy, that you have the heavy subsidisers.

I would suggest that the strategic interest of the UK is not to subscribe to a very loose system of subsidy disciplines, but rather the contrary. The chances that you may have subsidies that harm the UK will come from Germany and from France.<sup>6</sup>

**Baroness Kramer:** That is exactly the point I was trying to explore, if that makes sense.

**Dr Luca Rubini:** This is my take on it. What would make sense is not only for the UK to subscribe to what the EU suggests in the negotiating guidelines, but even more proactively to have a high degree of participation in the EU state aid regime to have control against France, Germany and Italy granting subsidies that might distort the economy of the United Kingdom.<sup>7</sup>

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<sup>5</sup> Note from the witness: This was a reference to the graph included in the 'Trade Agreements Geography and trade intensity' document produced by the European Commission, Task Force for Relations with the UK, dated 19<sup>th</sup> February 2020.

<sup>6</sup> Note from the witness: This statement was intended to refer to the two biggest economies of the EU but it is equally valid for subsidies or state aid granted by other EU Members.

<sup>7</sup> Note from the witness: Idem.

**Q23 Lord Lansley:** I want to take us into the area of the environmental objectives of the EU and the UK respectively. The EU is developing its state aid regime, particularly for the purposes of the Green Deal. For example, there will be major exemptions in the state aid regime for low-carbon industry. The EU is setting out to change the shape of industry and will no doubt use state aids in part to achieve that.

When we look at the state aid regime in the EU and how it might change for those purposes, what do you think we should expect? To what extent do you think the United Kingdom would be seeking to align with that or depart from it?

**Dr Luca Rubini:** My take on the Green Deal is that every area, not only state aid law, would be informed by the goal of tackling climate change. This is the revolution. It is definitely going beyond the state aid area.

Over a few years, significant provisions have been introduced in state aid to allow, as you were suggesting, state aid that helps in achieving a low-carbon economy. Over there, I would expect to see simply some fine-tuning, depending on how the market and the technologies develop, with wind, solar and new technologies for storage. I would expect, as normally happens for new state aid policy, to have new rounds of modernisation, new public consultations and impact assessments. The rules will be adjusted to that.

On the second part of the question, I suppose it would be in the interests of the UK, as the UK has significantly contributed to shaping state aid policies, or, to put it another way, the good guidelines for what is good state aid in the EU have been significantly shaped by key principles that you have in Britain. You have the use of science and economics, with economic analyses, impact assessment and transparency. That is not extraneous to the EU.

Linked to that we are talking about a common challenge. It was particularly wise to see in the EU negotiating guidelines the expectation that the UK would link its cap-and-trade system, the ETS, to the EU ETS, which is the biggest experiment in the world in this respect. We expect roughly the same thing to happen in all the other major areas of green state aid policy.

**Q24 Lord Berkeley:** You will be aware that a Conservative Party paper in November last year suggested that the state aid regime should be based on the WTO commitments on restricting harmful subsidies. To some extent, you have answered part of the question. Has any progress been made with the WTO to define what the subsidies might be? Is it realistic to expect any change? You talked about the failure of remedies, and I am sure you are right there, but how would it be enforced? Could it be enforced?

**Dr Luca Rubini:** I am sorry, I missed the last bit of your question.

**Lord Berkeley:** You talked about the failure of many remedies in the WTO process. This is a major change, if it ever happens, for the WTO to

create rules with respect to harmful subsidies. Do you think that is likely to happen? How would it happen? Could it be enforced by the WTO?

**Dr Luca Rubini:** If I could make a brief preface, there is a shifting narrative in the UK, with a very pejorative assessment of EU state aid law, whereby EU state aid law is very unclear, ambiguous and pliable. Linked to that, there is a very confident assessment of WTO subsidy laws. Everything would be clear there. The notion of subsidy would be very clear. You would have these harms tests that would be very easy to satisfy. I do not buy that. I have been working in this area for many years and there are the same problems of definition in both legal systems. They are both ambiguous. They are both uncertain.

The biggest difference is in the remedy in the governance structure. In the WTO, as I mentioned, the only real practical, pragmatic remedy that you have is countervailing duties, but they apply only if you are receiving imports. It is only for that scenario. If you are complaining because you have difficulty in accessing a foreign market because of subsidies there, you are basically left without any type of legal remedy.

I would not be quick to suggest that WTO subsidy rules are perfect and can solve any problems. Even in the WTO, there is increasingly a perception that there are problems. You are probably aware of that. I might highlight that, a few years ago, three major countries—the US, the EU and Japan—started to discuss changing the rules in order to tackle Chinese capitalism. Clearly, that was based on the understanding that the rules we have now do not really bite.

Q25 **Baroness Prashar:** What objectives should the Government pursue in their negotiations with the EU on subsidy control? What landing zones, if any, do you see for the UK-EU negotiations on state aid control? In particular, what characteristics would the UK's future subsidy control system, announced by the Government, need to satisfy the EU of its efficacy?

**Dr Luca Rubini:** If you look at the proposals, with the EU on one side and the UK on the other, it is clear that they are at different ends of the spectrum. What the EU is demanding, as I mentioned, is the typical template for European countries—countries that are integrated or aim to be highly integrated with the EU internal market. The UK proposals are very minimal, very basic. They seem mostly to refer to what is in the Canada agreement, and maybe other agreements such as the one with Japan, with respect to the application for both goods and services.

As regards the flexibility of the EU, I am not sure how much ground the EU will concede, not particularly on the substantive rules but on the governance. To be more precise, I do not think that the EU would accept that there is no state aid authority or subsidy authority in the UK. I do not think that the EU would be ready to accept that there is no dispute settlement and no co-ordination with the European Commission.

The EU might concede some ground, which would mean that you might have something that lies between the most recent PTAs with countries such as Vietnam, Singapore and Japan, where there is some influence of EU state aid law on substantive law—what is permitted and what is not permitted. The other would be the typical EU model. I think the EU would definitely push for a relatively strong governance and enforcement system. It will definitely push, at the very least, for introducing rules specifically saying that certain negative types of subsidies are prohibited.

As I said, it is in the interests of the UK to have a U-turn and even push the EU beyond what they are proposing and say, “We don’t want only rules saying what we have to do, but we want a say in the EU governance system because it is in our interest to keep an eye on and control the subsidies granted by Germany, France and Italy”. I highlight them because they are three big countries that can harm the UK economy.

**Baroness Prashar:** Is the UK missing an opportunity by not making its own demands?

**The Chair:** Did you hear that, Dr Rubini? Is the UK missing an opportunity by not making its own demands?

**Dr Luca Rubini:** I would say so. It is 100% in the interests of the UK to do that.

Q26 **The Chair:** Thank you very much. We have skated over a huge area. I am sorry if you felt slightly rushed. Before we conclude the session, Dr Rubini, do you have any final remarks to leave us with, given the tenor of our questions?

**Dr Luca Rubini:** The only remark I would like to make is that the area of state aid is key. The area of the level playing field mechanism is important, but state or subsidy control is really the key—

**The Chair:** I am very sorry, but the screen is freezing again so we missed the last sentence of your remarks.

**Dr Luca Rubini:** I was repeating a point that went through the whole session. I really believe that state aid control and subsidy control is very important and prominent in the negotiating objectives of the European Union. The EU will very much stick to that end. I am not saying that it will consider it a red line, but maybe close to that.

**Lord Lilley:** Can I ask for factual clarification? You said that the WTO rules do not allow any good subsidies. My reading of the rules is that they allow subsidies for research and development, for regional aid and for adaptation to environmental policies. Is that not the case?

**Dr Luca Rubini:** You are right. Initially, in 1995, when the WTO was created, there were two provisions.

**Lord Lilley:** Up to 2000.

**Dr Luca Rubini:** They expired in the year 2000. Exactly. Those provisions permitted certain regional, environmental and research and development subsidies, largely modelled on state aid law, but they were so controversial that they were not confirmed in the year 2000. What we have now is a kind of negative permission. If you do not manage to prove adverse effects, you are fine and you can keep your subsidies.<sup>8</sup> We do not have positively or explicitly an express recognition that certain subsidies are particularly laudable and important and that they should be non-actionable. That has gone. That is probably one of the major differences in the substance of the law comparing EU state aid law and WTO subsidy laws. EU state aid law is characterised by a huge body of secondary legislation, soft and hard law, whereby many subsidies are considered positive.

If I may add a final statement, in the end both systems are permissive because the number of state aid and subsidy measures that are actually prohibited is very limited, but they do that in a different way. The subsidy regime is a laissez-faire approach. The state aid regime positively defines what subsidies are permitted and what characteristics the subsidies should have to be eventually permitted. It is much more a governance system as compared with the WTO system.

**The Chair:** I am most grateful to you for this session. You will be given a transcript of the session to have a look at. Thank you very much indeed, Dr Rubini, for being available today. We are very grateful to you. At the end of our inquiry it is our intention to write a pretty long letter to the UK Government giving the outline of the statements made by our witnesses, so that that might aid them in their negotiation. Thank you very much indeed.

**Baroness Kramer:** May I say thank you as a Committee member? I found it to be a useful session.

**Dr Luca Rubini:** Thank you.

**The Chair:** I declare the session closed.

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<sup>8</sup> Note from the witness: This remark was intended to highlight that if the claiming government A cannot prove that the defending government B has caused adverse effects to them through their subsidies, government B can keep their subsidies.