Select Committee on the European Union

Internal Market Sub-Committee

Corrected oral evidence: The level playing field and state aid

Thursday 12 March 2020

10.15 am

Watch the meeting

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

Evidence Session No. 4 Heard in Public Questions 27 - 36

Witnesses

I: James Webber, Partner, Shearman and Sterling LLP; Alexander Rose, Partner, DWF LLP; Professor Karen Turner, University of Strathclyde.

Examination of witnesses

James Webber, Alexander Rose and Professor Karen Turner.

Q27 **The Chair:** Good morning, colleagues. I hope you found that remote session interesting. We now declare open the second session this morning. As you know, this will be screened; it is for public reception. A transcript of the session will be sent to you for scrutiny and correction, should you need to do so. You are very welcome, and we look forward to hearing what you have to say.

The UK Government's recent statements about their intentions for the UK-EU negotiations talk not about state aid but subsidy control. Could you tell us what you think is significant in that change and in principle what might the differences and similarities be between a system of subsidy control and a system of state aid?

Alexander Rose: Thank you very much for this opportunity. Ultimately, I disagree with Dr Rubini's view. I think it is just a change in the words; it

is as simple as that. On the substance that sits behind it, clearly there is a UK position that is currently different from the EU's, but I think the wording has been changed simply because state aid is seen to be synonymous with the EU. That said, that simply does not need to be the case. I do not think the UK needs to fear that. Indeed, it is noticeable that online references of the EU in recent days have changed. They now refer to "EU state aid", so essentially there is that space.

More broadly, three options are emerging. One is that we follow the current EU state aid rules; the second is that we have a bare-bones WTO system; and the third is to have a UK state aid law. If you listen to the speech on 3 February and read the text of the statements made by the Prime Minister during the election campaign, there are references to the WTO, but, if you look at the substance, it certainly points towards the third option of a UK state aid regime. From personal experience—I have worked in the Commission and helped draft rules, although it was not that big a role—I have seen there are areas to improve. My personal position on this is now the third option.

Professor Karen Turner: I am not a specialist in EU language or knowledge, but my feeling is that, if it is not just a change of language, it is perhaps, if anything, an opportunity as regards the focus the UK needs to have.

James Webber: It is an excellent question. My view is that the wording "state aid" is a creature of EU law; it has no independent meaning outside an EU treaty context. It is very different from competition, anti-trust, financial regulation or copyright; choose your area of EU competence. State aid is somewhat unique in being almost a pure EU idea.

The EU places a very high value on maintaining its legal autonomy. One of the ways it does that is ensuring that the ECJ has the last word on what EU legal concepts mean. If we want to use the term "state aid", we risk importing the ECJ into the UK system either directly, because that is what the treaty between us turns into having, or indirectly in that everyone ends up looking at the ECJ and historical practice, and HMG has a record of being extremely compliant with state aid rules.

There is an opportunity to break from state aid that creates a circuit break, as it were, in the dispute resolution mechanism. It also creates a significant opportunity for the UK to refocus on what subsidy control is ultimately about, which is trying to prevent trade-distorting subsidies. State aid has a much broader reach. The distinction is meaningful. The UK Government are right to focus on subsidy control, and we should avoid the term "state aid".

Q28 **Lord Lansley:** I am genuinely confused and I wonder whether you might help me. My understanding in the past has been that, if we are in a subsidy control regime based on the WTO, in so far as there is a challenge to somebody else's subsidies, that complaint must be actioned by Governments. If we are in a state aid regime, even one parallel to that of the European Union, the free trade agreement might, but not

necessarily, encompass individuals or companies making complaints directly to the EU state aid regime about its state aid activities without being required to go through the UK Government trade remedies operation. Is that not a substantial difference between the two operations?

James Webber: I was responding to the difference in terminology, which is at a higher level of abstraction than that question. You could have a subsidy regime that was more than a carbon copy of the WTO regime. You could have something called subsidy control that concerned itself with trade distortion but had an institutional and legal remedy framework substantially more advanced than the WTO's.

You could take a lot of the learning from the state aid rules and set up an institutional structure in the UK, run by the CMA, that looks at state aid; has ex ante notification, as under the state aid regime; and allows complainants to have direct access to the courts, or the authority, to complain about state aids or subsidies that adversely affect them. The principal useful thing that you are bringing across from the WTO regime is the intervention threshold. The intervention threshold under the WTO is high because it is trying to catch trade distortion. The intervention threshold on state aid is extremely low. That is the major difference.

Lord Lansley: Are there not two levels to the question? If we had a state aid regime of that kind and the CMA was running it, people could access that state aid regime and complain about what they regarded as distorting subsidies.

James Webber: Yes.

Lord Lansley: Could a French company complain to the British state aid system and could a British company complain to the French one?

James Webber: It could if you embedded it.

Lord Lansley: It has to go into the treaty.

James Webber: It has to be embedded in the treaty.

Alexander Rose: You make an excellent point. If you go purely with a bare-bones WTO position as a starting point, you end up with the fundamental deficiency in the system, which is that a business can be wronged but has no recourse. On your direct question about whether they could enforce, ultimately that comes into the EU angle. The EU position currently, according to its latest directive, is that it wants a UK system adequately resourced that uses European Union laws as a reference point. Obviously, a reference point is very different from the reference point, but it opens the door for a potential reciprocal arrangement.

Lord Lansley: But the institutional architecture that we need to talk to the Government about is not only potentially the CMA as a UK state aid regime but the Trade Remedies Authority as a mechanism for dealing

with trade-distorting subsidies in the European Union.

Alexander Rose: True, but more than that, and what is so interesting about the discussion today, is that much of the focus has been on avoiding distortion of trade, whereas the real impact at local government level and across regeneration is the ability of a state aid system to co-ordinate spending towards positive objectives.

Q29 **Baroness Kramer:** I am trying to understand this. If I sit in the position of a company that trades, there is a set of state aid rules of the European Union; there is a set of state aid rules in the UK; and there is some sort of third characterised system sitting in the middle. I realise I am talking to lawyers, but I have the sense that I am facing an absolute nightmare in trying to work out what I can and cannot do, where I contravene and whatever else. I am trying to get a sense of what burden lands on business as a consequence of what sounds like quite a fragmented set of arrangements.

James Webber: Some of that is just a function of leaving the European Union. We have left the European Union, and therefore the framework that existed previously has gone. The question is: what do we create? The EU state aid rules will continue to apply. By the way, the prohibition bites on Governments, not companies. If you are a recipient of aid, you might have to pay it back. Your primary concern is whether you have to pay it back. If you receive money from a European Government, you have to ask, "Do I have to pay it back under the EU rules?" If you receive money from the UK Government you have to ask, "Would I have to pay it back under the British rules?" That is not hard. Lord Lansley's question takes us to what remedy you have about someone else's aid.

Baroness Kramer: Which is what you are usually concerned about, particularly if you are a Brit.

James Webber: You are. Your remedy in the EU is to complain that the aid was not properly notified. You can complain about that. There is not much in the way of a good remedy framework, by the way, even in the EU system for companies affected in that way. If the UK had created the regime we are talking about, you would have a similar complaint in the UK, so I do not think there is a big gap. The extent of the gap could be overstated. I would not worry about it too much.

Alexander Rose: I think we are moving towards the Northern Ireland Protocol and situations where EU state aid law has an effect on trade between Northern Ireland and the EU. That will be very, very difficult administratively, because anyone reviewing a project to check its compliance has to work out whether there is an effect on trade between the EU and Northern Ireland. That is quite a light test and it is an EU law test. That issue will sit behind any future regime, unless the UK can find a way under Article 13.8 of the Northern Ireland Protocol, whereby future trade agreements can supersede the Northern Ireland Protocol.

The way that works, and this is ultimately what convinced me that there has to be a UK state aid regime, is that the Commission will only get to the point of having a sufficient level of assurance if the UK can put forward its own regime and say, "We are applying the same high standards; we have a proper system". The follow-up question is: what are those rules, and how far do we deviate?

If the UK takes exactly the same rulebook on the first day after the transition agreement ends, there are options. As you are well aware, the amount of aid the UK has given compared with other member states is much lower, but there is a chance to take that rulebook and apply the rules that the Commission has been reticent in applying.

For example, there is a very useful provision called the matching clause, which is paragraph 92 of the R&D&I framework. It allows the Commission to mirror aid to the same levels as given outside the EU for projects that do not affect trade within the EU. If you have a novel electric vehicle factory in a non-Member-State, you might want to use that.[1] The reality is that it has never been used by the European Commission, so the CMA, taking on that rulebook, could legitimately go ahead and apply the rulebook better and take forward those legal principles. Likewise, the second alternative is that we develop our own system that works for our objectives.

Q30 **Lord Russell of Liverpool:** That neatly segues into the next question. Up until the point you uttered the word "Ireland" it had not come in at all and it is the red hand rather than the elephant in the room. You elegantly stated how you think the Government could deal with what our Prime Minister agreed to last October. Could I hear from the other two witnesses how they feel the UK Government can work their way out of some of the problems that could be created by the Northern Ireland Protocol?

Professor Karen Turner: I am not a lawyer but an economist, so my understanding is more about what we want to do rather than what we actually can do. Not being a lawyer, I might be very naive, but, as I understand it, when we are talking about regional disparities and climate change problems we are talking about areas where markets are failing, so you are looking to correct a market rather than distort it. My understanding is that even under EU state aid we have been able to do an awful lot—for example, biomass conversions at Drax power station and suchlike. In principle, it should not be difficult if it is clear we are clearly trying to correct a market failure.

The evidence I submitted focused very much on our high-value manufacturing industries. That is where it will get complex. We are increasing attention from the energy supply sector and towards emission-intensive industries and looking to avoid them losing competitiveness. In principle, that[2] should be straightforward, but the problem is that as we

[1] Note from the witness: This is on the proviso that there is no existing EU market.
[2] Note from the witness: "That" refers here to "making the decarbonisation case".

move towards net zero carbon economies, which is a huge transformation, we have to identify areas of competitive advantage for the economy to be high performing going forward and for those sectors to be able to operate in that way.

On the one hand, you are saying that you are correcting market failures so that companies do not lose out by taking a lead. The UK is taking a lead in decarbonisation that other countries are not doing, so we do not want to disadvantage companies operating here. At the same time, what makes it complex is that the very nature of that[3] means we want to secure competitive advantage. That is where things could get somewhat woolly, but I defer to my colleagues on the Northern Ireland Protocol and its implications.

James Webber: The Northern Ireland Protocol is exceptionally problematic, and in my opinion it is important that it is replaced as soon as possible for an enormous number of reasons, of which state aid is a very good example. Without straying too much into hyperbole, it is extraordinary in two respects. The first is that it gives authority over fiscal decision-making in Northern Ireland to a wholly foreign institution in which the people of Northern Ireland have no representation. That is wrong in principle and unsustainable politically, although that is a political judgment. I am a lawyer so that is not for me to say, but it is my personal view. The first issue is at the level of principle.

A bigger issue, which affects Great Britain, is that the jurisdictional test Alex just referred to is deeply flawed. The Article 10 test applies EU state aid law to measures in Northern Ireland in so far as they "affect that trade subject to this Protocol". That phrase is the jurisdictional perimeter; a measure that affects trade "subject to this Protocol" is caught by the EU state aid rules under the Northern Ireland Protocol. A lot turns on what that means.

What is a measure that affects that trade subject to this Protocol? The first limitation is that "that trade" is only trade in goods. It is common ground that there is no EU state aid jurisdiction in respect of services in Northern Ireland or GB. Outside that, the common ground disappears very quickly. The words "affect that trade subject to this Protocol" are to be interpreted—they have not yet been—by the Court of Justice. How should the Court of Justice approach that? The European Commission's view in private conversations, and some officials are starting to say this in public as well, is that "affect that trade" in the Protocol context means exactly the same as the words "affect that trade between member states"; "affect that trade" appears in the Protocol and "affect that trade" appears in the treaty, and they should have the same meaning. They are the same words interpreted by the same court in the same state aid context, so they should have the same meaning.

As to "affect that trade between member states", in normal state aid the Court of Justice case law establishes a meaningless test. "Affect that

[3] Note from the witness: "That" refers here to "transitioning the economy".

trade" means that there is no effect on trade, or that at least as long as you can articulate something that is not wholly fanciful you can establish an effect on trade. Take TfL's regulation of London's bus lanes. Addison Lee, the minicab firm, challenged that on the basis that it represented a disguised subsidy to the London black cab trade, because minicabs are not allowed to use bus lanes.

One of the avenues of the defence offered by TfL was that it could not be state aid because the regulation of London's bus lanes could not plausibly affect trade between member states. That question was sent by the High Court in London to the ECJ. The ECJ said, "It could affect trade between member states. What if an Austrian wanted to set up a minicab firm in London? That rule would make it more difficult for them to operate in London, ergo it affects trade between member states". That is how low the test is for "affect that trade".

To go back to the Northern Ireland Protocol, if that is the meaning of "affect that trade subject to this Protocol", you can see immediately that it could apply to lots of measures in Great Britain, such as subsidisation to Nissan in Sunderland. It could be said plausibly that that would generate a car that is for sale in Northern Ireland and it is a sales opportunity lost to Renault. Therefore, it affects trade subject to the Protocol and the EU has jurisdiction over the aid. It is extremely problematic for that reason. There are a number of things we can do to try to remedy it, but that is the problem.

Lord Russell of Liverpool: Mr Rose suggested that to get out of jail we need to put a regime in place that is sufficiently robust and in some ways sufficiently similar to what there is at the moment, to make the EU feel comfortable enough that it is hard for it to make a big fuss over this and it will focus on other things instead. Do you agree?

James Webber: There is a lot of merit in that point. Ultimately, it is a negotiating leverage point. The closer you get to the EU's scheme, the easier it is to tell the EU that you are going to meet its legitimate concerns. The EU's negotiating mandate goes substantially beyond that. The EU's negotiating mandate says that Union state aid law should apply to and in the United Kingdom. That is a massive step beyond what Alex proposed. It is about EU law in its entirety—procedure, institutional framework, appeals and everything—applying in the United Kingdom.

That is not going to work, but a UK system that had no reference to the ECJ and used EU rules as a starting point—a bit like Australia used the English common law as a starting point when it became independent—would be an answer. There are big costs in doing that. But there is a definite advantage in doing it, in that it gives comfort to the EU and may allow us to escape the box of the Northern Ireland Protocol, but in my view there are large costs associated with doing that for UK policy.

Q31 **Lord Lansley:** Can I turn to the issue of the UK Government's desire to support regional development and the levelling-up agenda, in particular the question of infrastructure spending? If the UK Government were to

engage in large-scale infrastructure spending, for the sake of argument, big port infrastructure, which on the face of it would impact on trade, would it automatically follow that a state aid regime in the UK had to encompass such spending, or could we simply exempt it?

James Webber: It would depend on the regime we had. Under WTO rules, infrastructure is out and, until about 2012, under EU state aid rules it was also out. The Court of Justice changed the rules in a case called Leipzig-Halle. It changed them in respect of infrastructure that can be economically exploited. If you have infrastructure that has economic exploitation, say an airport or a port with access fees, a toll road, et cetera, state aid laws apply now, but historically they did not.

From the UK point of view, we are an island. There is an EU policy objective to capturing infrastructure over land borders, which is perhaps more obvious than it is for the UK, but I do not think a regime would need to catch infrastructure spending in the same way as European state aid rules do.

There is a big cost to having infrastructure caught by state aid. Even if it can be approved. I work in a lot of cases involving the financing of infrastructure projects. If you have a state aid component and you are trying to build a regional airport, a toll bridge or something of that order, which will require long-term government support, and someone seeks to challenge the public support component, that litigation can continue for decades, all of which undermines the legal certainty you have that the subsidy regime underpinning the financing of your projects is robust.

The financing structure for the famous Øresund bridge linking Malmö in Sweden to Copenhagen has been challenged under state aid rules. When it was originally built everyone accepted that it was outside the state aid rules. It was only after the rules changed that the state aid problem arose and the bridge was already up. There was a challenge to the fee structure, subsidies and traffic guarantees over the bridge. That is what supports the financing of the bridge. It was very long-lived project financing. The litigation has lasted ever since. There are real costs to applying state aid to infrastructure, particularly given the frailties of the European Court appeal process.

Professor Karen Turner: The nature of the transformation we will have to make could be crucially important for both levelling-up and climate change, whether we move towards a hydrogen system of supporting energy supply or carbon capture and storage as an industrial strategy, and whether that is recognised as a requirement to meet the kinds of ambitions we have. There are large-scale infrastructure projects needed for our net zero carbon ambitions, but a lot of them are at key regional locations. For example, in the north-east of Scotland there are concerns over the oil and gas industry; and there are concerns about how the south Wales cluster might access facilities on the east coast. There are huge infrastructure demands in addressing net zero that have implications for the types of regional capacity that we could exploit to help levelling up.

I echo the point that there will have to be public intervention not just because of affordability but to secure confidence in those assets. For example, carbon capture and storage would be problematic if there was uncertainty about firms capturing CO_2 emissions and taking them away, and concerns about emissions from transport and storage sites. There will be a need for regulated assets. If there is to be a complication in the form of challenges to how infrastructure is being run, that in itself could bring uncertainty in an area where we need to reduce it.

Alexander Rose: To address Lord Lansley's question straight on, can you? Yes, you can; you could set up a system where you could block-exempt lots of infrastructure. Should you? Sitting behind all this is the spectre of the trade agreement and whether it will give sufficient assurance to the European Commission, but, yes, I think you should. I note what James said about the potential for challenge, but simple, straightforward rules that cover simple, good governance are crucial and they need to cover two different points.

The first is a simple, straightforward transparency point. For example, if taxpayers are paying, why should they not know the amount of grant that has gone in? I am referring to things such as declaring the amount of grant and putting it in a single central location. The second point is a straightforward co-ordination element. What you are describing sounds very positive. If the Government want to go ahead with it, they can set up that structure. They would control UK state aid law to an extent and impose whatever conditions they want.

Those conditions are valuable because we have a proliferation of different organisations providing funding. For example, we have 38 local enterprise partnerships in England giving out funding. We also have 10 combined authorities, of which eight are mayoral combined authorities, and they do an enormous amount of good for the levelling-up agenda, but sometimes they compete against each other; sometimes there are inward investment projects. Do we simply want to say, "Go for it", or do we want to say, "Go for it but within this framework"?

That brings us back to the WTO point. In the USA, which has simpler WTO rules, there are subsidy races that are hugely damaging. I cannot verify the accuracy of it, but the *Atlantic* magazine reports that about $100 billion is spent on subsidy races to move headquarters from one place to another.[4] For example, Amazon held an auction that involved 238 different cities in the US squabbling, to all intents and purposes, over who could give the greatest incentive. There was the Foxconn case where the end intervention resulted in a subsidy equivalent to $230,000 per job. The rules protect the taxpayer.

The Chair: It sounds like Knock airport.

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[4] Note from the witness: See https://www.theatlantic.com/ideas/archive/2018/11/amazons-hq2-spectacle-should-be-illegal/575539/

Lord Berkeley: An example Professor Turner will know about is the subsidised ferry service from Rosyth to the continent, which was in direct competition with ferries across the North Sea from England. Probably part of that subsidy was some investment in the infrastructure of Rosyth to make it work. Surely, it is a good thing to have that infrastructure within this regime, because a lot of people—the ferry companies and some English local authorities—were complaining that it was an unfair subsidy by the Scottish Government. A question then arises about which political organisation or party was responsible for doing it. It is an interesting question. What do you think?

Professor Karen Turner: This devolved-national distinction is an interesting one. We talk a lot about geographical clusters and local areas. The actual supply chains they support are very complex and can spread throughout the whole of the UK, but there is a dual thing here. In an area such as Rosyth, that subsidy brought a lot of good in terms of levelling-up. The complexity of the question is about where the costs and the benefits fall. In particular, in the case of Rosyth there is a lot of interaction in a wider UK context where benefits are falling.

Q32 **Baroness Kramer:** I put a very brief question because so much of it has been covered. To stay with the levelling-up agenda, as you know, we expect a UK shared prosperity fund to replace European structural investment funds. There is a wide frustration because no one knows what it looks like and how much it will be. We have to start planning now. Is there anything you can say about it? It is trapped in the state aid or subsidy issue. Are there any guidelines you can give us for safe territory where this project could at least lay down some framework ahead of the completion of negotiations a year from now?

Alexander Rose: That is an excellent point. Although it is called the UK shared prosperity fund, when we are talking about EU funds disappearing, we are also talking about the overseas territories having their EU funds taken away, at the moment without any obvious replacement. They are essentially competing in many instances against other overseas territories that are receiving EU funds. That is currently a point that has not been covered, but in terms of the UK shared prosperity fund, absolutely, it is a real shame, as a Northern regeneration lawyer, that it has not been taken forward in any meaningful sense at this point. I know there are discussions behind closed doors, but there has not been a consultation even though it has been promised for two years.

To answer the question directly, we are currently talking about setting up a new system that will co-ordinate our public funding and, at the same time, will be the largest regeneration fund for the next decade. These two should absolutely go hand in hand. If we are talking purely in terms of comparison with EU funds, plenty of different lessons can be learned. The most striking one is that having a domestic regulator would be hugely helpful. When I was first involved in EU funds, the big point always made to me was that we cannot ask the European Commission because it might give the wrong answer. Indeed, the first thing I did was to make sure

that when I got to know people I asked the question, because if they are going to give you the wrong answer at least you have asked.

There is a lot to be learned in terms of having that direct contact with the regulator and, on state aid issues, if it is the CMA that takes over, having it on hand to provide that assurance at times. More widely, I think it is about removing a lot of the audits. For example, ERDF currently has four different levels of audit when it needs only one if you have a fully resourced and available regulator.

Enormous positives can be taken forward.[5] More broadly, in talking about the levelling-up agenda, state aid law is important, but hard cash is much more important. The UK shared prosperity fund needs to be accelerated in order for local enterprise partnerships, mayoral combined authorities and devolved Administrations to do all the great work they are doing currently.

Professor Karen Turner: In terms of how funds can be used, I think it is ironing out some of the complexities. As I understand it, regional cohesion funds did not allow spending in industries in the ETS Annex I. We do not know what is going to happen with the ETS and what funds for carbon pricing and things like that will be available going forward, but, crucially, in linking levelling-up at regional level and solving the decarbonisation problem, the key outcome is that the UK has the flexibility to maintain its economic performance. I think a lot of energy-intensive industry needs to be able to access funds in order to continue a stable environment. Again, that is not just about state aid; it is about being able to access hard cash. As we are designing something for the UK with its own shared prosperity fund, it is a matter of looking at what is and is not possible, and how things change and what we might want to make what we need possible.

James Webber: I take the view that, if government policy is as stated in the EU negotiating mandate, which is that we are going to have a Canada-style free trade agreement with a subsidy regime modelled on the free trade agreements that the EU has had with other western economies in the broad sense, you are able to design the shared prosperity fund as you wish. It is very unlikely that funds provided under that, unless it is of a very significant scale, will meet the threshold of a trade-distorting subsidy.

I would agree from a design point of view that, if the UK decides to have a more sophisticated domestic regime built on the WTO principles that I discussed at the beginning, or even a cut and paste of the state aid rules from the EU but with "EU" crossed out and "UK" written in, if that domestic decision is going to be taken, clearly those design questions need to come together, but at a global level the EU negotiations should not hold up things like the shared prosperity fund. If you take the

[5] Note from the witness: I was referring here to positives from better communication with the regulator.

Government's position as stated in their negotiating mandate, it gives you a lot of freedom.

The Chair: That is fascinating. Given my background as a negotiator, this is all lovely stuff.

Q33 **Lord Berkeley:** I want to turn to the terms of investment in state aid and throw in a question on mergers. For a start, if we take the Commission paper on which member states get most state aids, the UK and Germany we know about. I suspect that France gets just as much, but it is better at hiding it. I have been watching it for years. We saw the proposed merger last year between Siemens and Alstom that caused massive political fall-out. The argument was, "We need to merge in Europe to get a bigger, stronger company to compete worldwide". They lost in the end, which means I do not think the Commission will take any further complaint about France for the next year or two because of the political fall-out in that country.

If after Brexit the same happened in the UK, and there was a merger proposal between two companies to make a stronger one that might need some state aid in order to compete in other parts of the world but at the same time reduced the competition at home because those two companies did much the same thing, where would we go on that? Who would be able to complain, to whom and with what remedies? I am sorry; that is a bit of a complicated question.

James Webber: A few points jump to mind. First, you are exactly right. The Siemens-Alstom merger has been a neuralgic issue for the reason that you described. From our perspective as EU competition lawyers, the system held under the Siemens-Alstom example.

Lord Berkeley: Just.

James Webber: Just. It held partly because it was such an extreme case. There were literally no examples at all that the parties could point to where the Chinese had even participated in a tender for the high-end signalling and rolling stock they were merging, so it was quite an extreme example of it. Had there been a bit more evidence, or room for discretion as to how to weigh the evidence, one might have seen a slightly different result. We are going to see the Siemens-Alstom dynamic play out now at the policy and legislative level as the Commission comes under ever greater pressure to propose changes to the rules to prevent what many people in Europe think is the naive interpretation of the competition rules that disadvantage the EU. All of that is coming; that European "champion" thing is definitely on its way.

In a UK context, how would the system deal with it? At the moment, after the end of the transition period, a merger like that would be reviewed by the CMA, which is a rigorously independent and extremely aggressive anti-trust agency. I do not think that sort of transaction would have any real prospect of success at all, looking at the CMA's habit and working with it most days of the week. I think that sort of transaction in the UK would face very significant difficulties.

Lord Berkeley: On the second question about the return on investment if those companies were in receipt of state aid, or maybe asked for more, what is the view on the return on investment in state aid either in a merger or not?

James Webber: As an economist, Karen is probably better placed than I am to respond to the question of the return on investment in state aid. State aid has played an enormous part in building competitiveness. Look at Boeing and Airbus and the WTO saga. Those two companies and the position that they have in civil aviation is very largely as a result of state subsidisation. There are two different ways in which those funds are delivered, but the state has played a significant role.

Looking at the debate we are having today about Huawei's technological lead in 5G, arguably a lot of that will come from Chinese state aid. That has made it so difficult for Ericsson, Nokia and, before that, Alcatel-Lucent to compete against it. When you look at things over a long time horizon, where you have very heavy high-risk capital investments, you see the effect of state aid coming through quite brightly, but I defer to my colleague on the economic effects.

Professor Karen Turner: The reason you would use subsidies or state aid is that you know there is a danger of industry not being able to give a return to the shareholders to whom it has a fiduciary duty. We hear a lot in the decarbonisation debate about who is good, who is bad, who should do this and who should do that, but, at the end of the day, firms have a responsibility to make a return to their shareholders. When something happens that would affect that return, the public sector steps in on the basis that you get a return to the wider economy.

We gave an example in the evidence we submitted. If you require industry to pay all their own decarbonisation costs, it is not just the polluter pays. If they lose competitiveness and start to shed jobs, you start to lose earnings throughout the economy. Therefore, the return to providing state aid is being able to ensure that you can retain high-quality jobs. It is not just about people having jobs and earnings; if people do not have jobs and do not earn, they do not pay taxes and your tax base shrinks. If something is happening, it is all about whether, first, the return to shareholders is at risk, but, second, that is not the only return about which we should be concerned.

Alexander Rose: It is quite hard to discern purely on a state aid basis what that return on investment is, because, as you say, certain measures are outside the state aid regime. Likewise, if you look at Sweden's state aid spend, it is much higher than it needs to be because it has particular tax rebates that are not simple grants. If you look at the productivity figures that are regularly referred to by the Government, it appears that Germany has 20% better productivity and France has something similar. It feels like that might be the proper measure of greater investment in training, infrastructure and skills.

Q34 **Baroness Kramer:** The assumption of the language between the two

sides, if I understand it correctly, is basically that the UK is saying, "We have left the EU. Therefore, the EU should not have a say in whatever state aid or subsidy regime we have, except to the extent that it meets WTO standards of trade distortion".

If I was looking at this from a higher level perspective, the consequences are that the UK has no say in the way the EU applies state aid rules, except on very limited standards and very high thresholds under WTO rules. Our previous speaker was saying that that is like negotiating yourself into a position of disadvantage, because the UK, given its history, is very unlikely to exploit the capacity to use subsidy, and the EU is now being offered the opportunity to use state aid very extensively to exploit capacity.

I come from a financial services background. I can see the mechanisms you could quickly use within the EU to encourage, require or probe the move of services from the UK to the EU. You are all nodding to this. Is any of this being encompassed in the negotiation, and does that issue in any way change the way you approach what you would consider to be the ideal outcome?

James Webber: I would make two points. I agree with a lot of what you have said; I was nodding along. The first is that it is absolutely right that the EU, and Germany in particular, has far higher fiscal headroom than we do and a far greater propensity to subsidise than we do. Therefore, restraining that and the damage that that could do to our economy is a useful thing.

To give you an example of that point, I did a case a couple of years ago where Jaguar Land Rover was building a factory in Slovakia. The alternative to building a factory in Slovakia was building the same factory in Mexico. The EU approved the state aid that Slovakia wished to grant on the basis that, but for the aid, we would have built it in Mexico. The EU has a free trade agreement with Mexico, so the EU was explicitly authorising subsidisation to extract jobs and investments from someone with whom it had a free trade agreement. Your point is perspicacious and very true. For that reason, I think embedding some subsidy discipline in an agreement with the EU is in the UK's interests.

The second point on financial services brings in a very interesting dynamic, which is a big problem for the EU. Outside of that very particular circumstance I described—where essentially you have a counterfactual scenario where you could build a factory in the UK or whatever—if you were merely trying to use subsidisation to attract investments, say from London, of an investment bank or an exchange clearing house or some such, if Paris were to offer that, Paris has immediate problems under the state aid rules because it is not just Paris it could go to. It could go to Amsterdam or Dublin. It is not a bilateral competition. Because Paris is competing with Amsterdam and Dublin, essentially London gets a sort of umbrella protection effect because Paris cannot offer what it would like to in order to extract it from London. That

is a big constraint. It is an externality benefit that the UK has from the state aid rules.

So your point is right, but it is not as extreme as you might think because of that externality effect.

Alexander Rose: I agree with what James has just said. I would add that these are essentially UK championing rules. The UK has been stronger than any other member state in championing robust subsidy control rules within the EU. When we talk about Germany, it is not the high watermark here. On the 2017 statistics, Latvia gives 4.8 times as much state aid.

The only bit here that I do not think is necessarily logical is these references to the WTO as an alternative, not least because the UK's current position, as the Secretary of State Liz Truss said in her address to the WTO General Council a few days ago, was essentially saying that the rulebook is not working for us. As to whether the UK should have a say in the future, we have had a say in the past. I think that the best way to influence the future rules, given that we know they are about to change at the end of the year, is for the UK to publish its own regime and say, "We have been very good at state aid in the past. Here is what we are planning to do". It gives you assurance, but, also, frankly, we can put in place clearer rules.

If you go through Boris Johnson's speech on 3 February, where he complains about different points of the state aid regime, you can cover most of them off by having a properly resourced regulator. These are things like speed of decision-making, clarity of rules and procedures. These are all entirely within the control of a UK state aid regime. The only point that was slightly unusual was a reference to being able to address any permissive nature and bail-outs. That is a purely central government point of view, whereas state aid also needs to take in that local government point of view.

The Chair: Professor Turner, did you have anything to add to this?

Professor Karen Turner: On that point, in terms of setting things out this year, again in the context of decarbonisation it is important to set the context that the UK declared net zero. It was the first G7 nation to do so, and it is the only country in the EU bloc that has this ambition.[6]

This means that the UK has put itself in a position that it could disadvantage its own economy. Therefore, there is an argument that it has to have the flexibility to manage that. In taking this leadership role, and until such time as the other countries catch up so that there is a level playing field, the UK has to put forward that circumstance as being crucially important in what is initially set out.

Q35 **Lord Lansley:** Professor Turner, that gets us to the point I wanted to

[6] Note from the witness: This refers to the UK being the only country to make an explicit commitment to the ambition.

pursue a bit. In a way, people are often discussing alignment with the EU system, but the EU is going to change its state aid rules next year. One of the central ways in which it is going to change them is in order to accommodate the EU Green Deal.

I wondered what you might think in terms of the kind of exemptions or provisions that the EU may look to; how useful they are and how applicable they might be in our circumstances; and how far we would want to mirror those or deviate from them.

Professor Karen Turner: The problem here is that with net zero commitments we are talking about a systematic change that is going to affect the whole wider economy. The problem that we have had up until now is that attention has been very much on how you get your energy system to work—the trade and generation of electricity and things like that. When we are talking about net zero, we are talking about a fundamental change in how we produce goods and services, especially in the energy-intensive industries. But it is not just there. Up in Scotland, how do you produce whisky? That is still energy intensive, but it is not in one of these big geographical clusters.

It also comes down to how people are living their lives. We are going to have to have markets, industries and supply chains for making the building stock more energy efficient. We are quite unique. Every country is different in how it has historically chosen to heat homes and the types of building stock it has had.

That is my wariness about talking about matching up with things. This is a very large-scale challenge. The Treasury is conducting the net zero review. We need to look at what is going to be involved in this move to net zero for the UK and try to set up a framework that supports that rather than—

Lord Lansley: I am sorry to interrupt. It might be that Mr Rose and Mr Webber will want to come in as well, but it seems to me that, clearly, there will be block exemptions for things. The EU has already talked about some of them such as hydrogen and low-carbon industry and so on, but a great deal of weight will rest on its emissions trading scheme and carbon pricing.

Professor Karen Turner: Yes.

Lord Lansley: With regard to the UK's future relationship document, at the same time as it is moving away from our own regime, et cetera, when we get to carbon pricing, suddenly we are open to the possibility of doing things in the same way and having our emissions trading scheme allowances tradeable inside the EU system and vice versa. Presumably, thinking about our lawyers present, the EU is not going to let go of the ECJ jurisdiction in relation to the emissions trading scheme. It is going to be a very big thing.

Am I missing something or is this not potentially the biggest trojan horse in the whole system?

Professor Karen Turner: It could be. The benefit of the emissions trading scheme is that it is an alternative to having to use carbon taxes and things like that, which are more distortive because you are changing prices rather than controlling the level of emissions. You could argue backwards and forwards about how successful the EU ETS has been. There could be an argument that the carbon price has been too low; it has been so low that it has not allowed things to happen.

You need to find a price for carbon. Of all the different ways that you could be in something like the EU ETS, it is the most straightforward way to get to a price for carbon. You are right that that might be one of the biggest issues. The ETS does not just affect the supply of energy. All the emission-intensive industries that are regional clusters fall in there as well. I turn to the lawyers, but I think you may be right. I think what happens with the EU ETS and carbon pricing could be crucial, because if we stay in there then that is going to reduce the flexibility with how we set things up.

James Webber: You can see the merit of staying in the EU system, or at least having your carbon credits tradeable within the EU system for liquidity reasons and for competitiveness in maintaining an equivalent cost of carbon between our market and the EU. From a basic policy point of view it makes sense. If you are ideologically opposed to the role of the European Court of Justice, then that is a question.

My personal view is that I do think the role of the ECJ is objectionable in a state aid context because state aid essentially has two halves. It has, "What is state aid?", which is a definitional question as to what is caught by state aid. Then, "Is it allowed?", which is the Commission's discretion. The court only really plays in that first piece—what is or what is not state aid? One of my objections to the state aid regime is that that definition has shapeshifted and grown enormously. Whether it is a result or was a cause, it has expanded the Commission's jurisdiction and the EU's jurisdiction over member states' spending.

That expansionary effect of the definition of state aid makes the ECJ's role particularly problematic in state aid, whereas in perhaps other areas of ETS the trade-off benefit for our competitiveness of being able to share a liquid market with equivalent pricing would be too great for us to give up.

Alexander Rose: I agree with your take on it. I think it is correct. Just going back to what Karen was saying about the UK potentially taking a green leadership role, there is much that we could do to say, "Here are the new rules", because the current environmental rules that the Commission has on block exemptions are hugely unwieldly. They are very difficult to read, even for a lawyer who has worked in state aid for years. They need clarification, especially given it is such an important topic.

Again, this comes back to this point. If the UK was able to put its own system in place, particularly ahead of something like the 2020 United Nations Climate Change conference, this is bigger than the EU. Climate

change is a much bigger subject. It needs international co-ordination using public funds to essentially kick-start that revolution. It is bigger than the EU and it just needs some kind of co-ordination and boldness.

Lord Lilley: Pursuing Andrew's question, does co-ordination between our emissions trading scheme and the EU require the EU to oversee it? I was on the Energy and Climate Change Committee in the House of Commons and we went to China to discuss co-ordination between its emissions trading scheme and Europe. If we had suggested to China that it had to be subject to the European Court of Justice, it would have turned us out of the door. There must be other ways of doing it. Maybe there are no other ways of doing it and maybe we were on a fool's errand. Can you not envisage the co-ordination of two systems without one system dominating it all?

Alexander Rose: I think we can, and I think this goes back to that Northern Ireland Protocol 13.8 point. If we can give sufficient assurance to the EU that we have a system in place in the UK, then we can have that kind of discussion. My understanding is that the current system is that we are opting in. I have not seen anything that says otherwise.

Lord Lilley: A related question is that you, Mr Webber, reminded us that in the Malmö case the court ruled retrospectively. In my experience, the European Court, when asked what the law is, says, "This is what the law has meant since the law was first promulgated". So it has a retrospective effect, which is perfectly logical.

Do British courts do the same thing, or do they say what it is going to mean from now on?

James Webber: No; they tend to do the same thing. Courts are not legislators, so they have to apply or interpret the law as it always was. The practical impact of it in the European court system is often much more pronounced because the EU has such difficulty adopting new legislation, going the legislature route, as it were. Many policy decisions end up getting taken by the European courts. In the tax rules, for example, tax rulings were technically caught by state aid, but no one really perceived the level of supervision that the Commission has now asserted for itself over tax rulings in cases such as Starbucks, Fiat and Apple, and this big rush of cases that has come over the last five or six years. They have gone to the court and the court has redefined and moved the goalposts on what state aid is so as to allow the Commission to do that.

That expansionary decision has expanded the definition of state aid, but of course the court would always say that it has not done anything of the sort. It was just re-establishing orthodoxy and it just so happened that people had not brought these cases to its attention since the Treaty of Rome was first inked.

Alexander Rose: The only small point I would make is that with the Leipzig-Halle case that informs Øresund there is a fair case to say that, if

you look back in the law from 1984 in particular, you could see a consistent rationale. Therefore, I do not think it was a complete change, but I do not think the Commission had applied it in that way previously.

Q36 **Baroness Prashar:** We do not yet have a domestic state aid or subsidy control regime set up beyond 2020. What are the implications of the legal uncertainty both for grantors and recipients of aid?

Alexander Rose: That is an excellent question. Right now we currently have a transitional arrangement, so we are able to advise on the basis of that. As a Newcastle-based state aid lawyer, if someone comes to me and says at the end of the year, "We want to give this fantastic grant to assist this business and create jobs", we are going to have to say, "Well, there is a huge risk at the moment".[7] Unless there is a system in place, what can one do, other than to inform them that we do not know what the rules are going to be?

There are a few different points that need to be covered to deliver a level of certainty here. They are, first and foremost, that we need to appoint the regulator. Right now we have an assumption that it is the Competition and Markets Authority. We have the statutory instrument laid in January 2019. Obviously, a lot has changed in politics since then, but the basis of it seems sound. If it is the Competition and Markets Authority that is appointed, then it can start to go out and have discussions with the devolved Administrations. It can go out and consult and say, "These are the procedures we would like in place", and it can give that level of certainty.

My experience of talking to various levels of local government is that we need to move from that discussion of taking back control on these quite theoretical points to providing some certainty. At the moment we are at risk, at the end of the year, of stopping a lot of very good work happening.[8]

Professor Karen Turner: I am not an expert on the consideration of legal uncertainty, but basically any kind of uncertainty has negative impacts on decision-making. It can lead to inaction and wrong or ineffective decisions being made.

A good example was that we analysed, prior to its launch, the energy-efficient Scotland programme that came out in 2015. What we were trying to do was establish this public return to investment and to support it. We found that the best outcomes were where there was clear commitment by government to the programme up front. People were deciding to retrofit their houses or companies were getting involved in the process where they had more certainty, particularly over longer timeframes.

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[7] Note.from the witness: This refers to a scenario in which clear replacement rules have not been brought forward and the terms of the new system remain unknown or are otherwise not in place.

[8] Note from the witness: Idem.

If we look at some of the bigger things that we are going to have to do—the European Union is interested in hydrogen, carbon capture and storage and things like that—getting clarity over things like regulatory frameworks and who is going to manage what is all crucially important.

On the one hand, we are talking about a 30-year timeframe to a mid-century net zero. That is a long time. Can people feel confident over the 30-year timeframe that things are going to work? On the other hand, if you have investment cycles and things like that which run for 10 or 20 years, you need to act now. If you are going to stop exploration in the North Sea for oil and gas, you pretty much need to make that decision this year or next year.

My point would be that uncertainty is one of our biggest problems. We do know that in the UK environment in the past, when we have had things like the cancellation in 2015 of the last CCS competition, if things are not handled in the right way, it makes people a lot more afraid of uncertainty and less likely to take risks. It affects a wide range of perceptions. Alongside the leadership we have taken in declaring net zero, which is a key point, the other one is the need to be setting out as soon as possible a framework that is going to be able to survive the 30 years.

James Webber: From a state aid point of view, I think I would probably disagree with Alex. At the end of this year, if we do not have a state aid regime, then there will be no rules and there will be no risk associated with breaking them. I think the uncertainty associated with that could easily be overstated.

There is a significant advantage to not having a domestic regime, by the way, if we are in a no-deal scenario, if that is the right phrase, or we have a no-trade-agreement scenario. The Government will have the significant challenge of managing disruption in the economy and dealing with disruption to supply chains, and will need to move quite quickly. Probably the last thing the Government want, companies want or indeed the CMA itself wants, at exactly the same moment as there is a brand new regulator on the block, is to be dropped into the middle of that and face inherent conflict between the support that Government want to give business, the support that business says it needs and then a brand new regulator who has never done it before saying, "Well, hang on, I need to look at all of this and approve it". That seems to me to be worse than not having anything at all. I will stop there.

The Chair: You may just have explained—and we have been in the dark for some months—why a statutory instrument that went through the Lords, as you know, did go back to the Commons and then disappeared, and has now been formally withdrawn. You may well have just given the explanation as to why that has happened, but we shall see.

James Webber: Yes. I was suggesting that it should be withdrawn for that reason.

The Chair: I think we have reached the end of our questions. We are

very grateful to all of you for coming along. Do you have any final thoughts or words before I conclude the public session?

James Webber: I do, if you do not mind. I think that state aid has performed a very useful function. State aid control does many of the useful things we have talked about today. It has protected the UK from subsidy elsewhere in the EU, which is important, as Baroness Kramer highlighted. It stops wasteful subsidy races within the UK, as Alex highlighted about the US, so it does perform a very useful function. As a policy it is a good policy, but EU state aid rules have features that make it poorly suited to the UK's context after Brexit. It is much wider than it needs to be, as I have explained, largely because defining measures as state aid gives the EU competence. We do not need that in the UK environment.

It does not have sufficient regard to the effects of state aid, and it has significant procedural flaws. The UK can meet the policy objective in a better way, in my view, by focusing the regime on the harm it was originally intended to cure, which is trade distortion. I think that is the principal lesson we should draw from the WTO. We should not be distracted by all the accurate points people make about the frailties of the WTO procedures. You should leave all that at the door. The central observation is 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.

Getting rid of that regulation—getting rid of state aid's permeation through the rest of the economy—will release some innovation in scheme design. It will allow officials to focus on what the objectives of a scheme are—with things like the shared prosperity fund, what the policy is trying to do—rather than how to comply with the detail of the stuff.

If you have a good policy that is focused on trade distortion, you can and should, in my view, embed that in a treaty with the EU in order to gain the protection from it using subsidies in a trade-distorting fashion against you. That is how I see what the UK should be trying to do with this negotiation.

Professor Karen Turner: I would just emphasise a point that I made earlier. Certainly, we were talking about regional disparities and decarbonisation. We are looking to correct a market failure; we are not looking to distort a market. I think there is a need to look widely in setting out the position here. It is not just the energy system. High-value manufacturers are crucial here. We are not looking to give them an advantage. We are looking to stop them from losing competitiveness. We are doing so with the UK having legislated net zero and taken real leadership. I do not think we should be afraid to set that out. You could free up a lot of innovation, not just in high-value manufacturing but across the wider manufacturing sector in the UK, if companies feel confident that they can decarbonise in a way that is going to be supported and that they are not going to run into problems.

Alexander Rose: To my mind, once you take into account the Northern Ireland Protocol and the need for effective trade agreements, ultimately, we need some kind of system in place that provides assurance. I think a UK state aid regime can cherry-pick the very best bits. With a properly resourced regulator it will assist everyone. It will protect the taxpayer from paying more than is necessary. At the same time, it will also protect businesses from subsidies that undermine competition.

The Chair: Thank you very much indeed. We are grateful to you for coming. I think everybody would agree it has been a very enlightening session. The transcript will be sent to you for correction. All I can do is say thank you very much and declare the session closed.