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Business, Energy
& Industrial Strategy

Baroness Donaghy
EU Internal Market Sub-Committee
House of Lords
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15 May 2020

Dear Lady Donaghy,

Re: House of Lords EU Internal Market Sub-Committee – ‘Inquiry into UK–EU negotiations on the level playing field and state aid’

Thank you for your letter of 3 April, setting out the conclusions of the Committee’s inquiry into UK–EU negotiations on open and fair competition – the so-called ‘level playing field’ – and subsidy control/state aid. Your letter raised a number of points about the Government’s approach to the UK–EU FTA negotiations and the UK’s subsidy control regime after the transition period.

I have replied to these in order so far as possible, although some answers have been grouped to avoid repetition. The Government is developing its future subsidy control regime and is, of course, in the middle of negotiations with the EU on the FTA.

Union rules and legal autonomy

The Committee has asked the Government to clarify whether it intends to incorporate Union rules in the FTA as a benchmark for assessing whether the UK will maintain high standards over time, and about the EU’s wish to protect the autonomy of its legal order. (Paragraph 21 of the Committee’s letter.)

The Government is committed to maintaining high standards in open and fair competition areas. As the Prime Minister indicated in his 3 February 2020 speech at Greenwich, the UK will continue to be ambitious in tackling climate change and standards of environmental and labour protections. The UK’s present high standards are not dependent on EU membership and, in many areas, the UK has adopted regulation before the EU, or has chosen to raise its standards above EU (minimum) requirements.

As set out in the Government’s publication of 27 February 2020, *‘The Future Relationship with the EU’*, any agreement must respect the sovereignty of both parties and the autonomy of our legal orders. The Government is clear, therefore, that there should be no role for the Court of Justice of the European Union (CJEU) in the UK’s future relationship with the EU, including the dispute resolution mechanism of that relationship. This is consistent with previous free trade agreements concluded by the EU.

Consequently, where the UK approach includes commitments that the Parties will not weaken or reduce levels of protection in order to unfairly distort trade (such as in the labour and environment chapters), the point of reference should be the level of protection provided

by each Party's own laws as they stand at the end of the Transition Period (ie, 31 December 2020).

Typical agreements and EU precedent

The Committee has asked what the Government has in mind as typical FTA provisions for ensuring open and fair competition (paragraph 41).

FTAs usually include commitments to uphold certain standards on subsidy control and labour and environmental protections to ensure that neither Party can reverse the benefits of the agreement by introducing protectionist measures or by pursuing a deregulatory agenda with the intention of securing an unfair trade advantage. The commitments may be by reference to standards that already exist in multilateral agreements, such as the WTO Agreement on Subsidies and Countervailing Measures. It may also be by reference to standards – often exceeding international ones – that are written into the FTA itself. Crucially, it is not typical that these should be by reference to the laws of one Party.

In typical EU FTAs, dispute resolution mechanisms for subsidy control, environment, labour, trade and sustainable development and climate change usually provide for a consultation mechanism only.

Looking to existing EU agreements, some with the EU's near neighbours such as Ukraine and Switzerland do contain extensive provisions on what the EU would term the 'level playing field'. However, this is because these agreements give the third country a far greater level of access to the Single Market than the UK is seeking. As set out in the Prime Minister's written statement to Parliament of 3 February 2020, among others, the Government is seeking a progressive and comprehensive FTA like the EU has struck with other countries such as Canada and Japan, not membership of the Single Market or Customs Union. The Political Declaration that accompanies the Withdrawal Agreement notes that the commitments to prevent distortion of trade and unfair competitive advantages in the UK–EU FTA must be 'commensurate with the scope and depth of the future relationship'.

Non-regression and enforcement for labour and environmental protections

The Committee has asked what laws and standards the Government proposes to take as a reference point to measure regression from existing levels of labour and environmental protection, and what measures the UK has in mind to protect against breaches of labour provisions in the agreement (paragraph 42).

The Committee has also asked a similar question in relation to breaches of the environment provisions (paragraph 23). (Disputes about subsidies are addressed in 'Subsidies in a trade agreement with the EU', below.)

The UK's proposal, as set out in the '*Future Relationship with the EU*' command paper, is based on precedents from existing modern FTAs and in line with the Political Declaration. It commits both Parties not to reduce their standards to gain an unfair trade advantage. Neither party will regress from the levels of environmental and labour protection that are in each Party's respective laws from the end of the Transition Period.

For the UK then, these are the standards that are in UK law at the end of that period. For the EU, this is EU law at the end of that period.

In his written statement to Parliament of 3 February 2020, the Prime Minister indicated that the UK is seeking to apply mechanisms for dispute resolution that are appropriate to a relationship between sovereign equals. The Government considers that the model offered by modern FTAs is the most effective way of ensuring compliance provisions of the agreement, including those on labour and environmental protections. In particular, agreements such as the EU–Canada Comprehensive Economic and Trade Agreement (CETA) include a process of dialogue and consultation, as well as review by an expert panel. The outcome of that process is implemented by the Parties if required.

Emissions trading and the UK’s global leadership on environmental protection and climate change

The Committee has asked whether the Government has considered the possibility of *de facto* dynamic alignment if a new UK Emissions Trading System (ETS) were to link to the existing EU ETS (paragraph 42).

In ‘*The Future Relationship with the EU*’, the Government stated that the UK is open to considering a link between any future UK ETS and the EU ETS – as Switzerland has done with its ETS – if it suits both sides’ interests. Linking carbon markets does not necessitate dynamic alignment between systems and any such agreement would need to recognise both parties as sovereign equals with their own domestic laws.

The Committee has also asked about the possibility of fixing non-regression to levels of environmental and climate-change ambition, rather than regulatory protection (paragraph 43).

As the Prime Minister made clear in his 3 February 2020 speech in Greenwich, the UK is seeking a comprehensive free trade agreement with the EU, similar to the ones the EU has already struck with countries like Canada. Such agreements include commitments not to regress from existing laws and standards, rather than ambitions. However, these commitments would not prevent the UK from developing more ambitious climate change and environmental policies in the future.

Turning to the global dimension, the UK is committed to tackling climate change and we are proud of the leading role we have played globally. We have decarbonised more quickly than any G20 since 2000 and were the first G20 country to legislate for Net Zero.

The Political Declaration makes clear that the UK and EU will look to cooperate in international fora on environmental (and other) matters.

The UK’s approach to subsidy control

As the Prime Minister set out in his speech on 3 February, we will develop our own separate and independent policy on subsidies. In doing so, one of our key objectives will be to have a modern system for supporting British business in a way that fulfils our interests.

The UK’s subsidy control regime will not involve any alignment with EU rules.

The UK must retain its sovereign right when deciding how and when to spend taxpayers' money to intervene in markets to support business, workers and consumers, while also protecting UK business from unfair competition from the EU market.

The Government agrees with the Committee's conclusion that there are several complexities to developing a new domestic subsidy control regime (paragraph 96), particularly as we are continuing to develop our domestic policy in tandem with the EU negotiations on open and fair competition. We are working at pace to develop this policy and will share more detail on domestic subsidy control with key stakeholders in due course.

With this important context in mind, I will address below the Committee's questions on subsidy control as far as possible, arranged by topic.

Subsidies in a trade agreement with the EU

The Committee notes that its recent evidence has suggested scope to develop a set of common rules on subsidy control, "without tying the UK to the EU state aid regime" (paragraph 44).

In '*The Future Relationship with the EU*', and as noted above, the Government is clear that we are seeking a precedented trade deal, similar to those that the EU has previously agreed with countries like Canada. This would include commitments on subsidies in line with Free Trade Agreement (FTA) precedent and build upon existing rules in the WTO Agreement on Subsidies and Countervailing Measures, which are the internationally recognised common standards for subsidy control.

The EU has a range of subsidy control arrangements in its various FTAs. However, standard FTAs, such as those the EU has with Canada and Japan (i.e. not association agreements or customs union agreements) do not require countries to adopt the EU State aid rules. Instead, those FTAs are based on transparency, demonstrating the effects of harmful subsidies when these might occur, and forums to discuss concerns.

'*The Future Relationship with the EU*', set out the UK's position on subsidies for negotiations with the EU. The UK will have its own regime of subsidy control. The Agreement with the EU should include reciprocal commitments to transparency about the award of subsidies which go beyond the notification requirements set out in the WTO Agreement on Subsidies and Countervailing Measures. This should include an obligation on both parties to notify the other every two years on any subsidy granted within its territory, applying to goods or services, in line with EU-Japan Economic Partnership Agreement (EPA).

The Committee has asked how the Government intends for any possible complaints about subsidies within the EU to be made (paragraph 48).

The UK has proposed that the Agreement should also include the right to request consultations on any subsidy that might be considered to harm the interests of the parties.

In line with precedent such as CETA and the EU–Japan EPA, the consultation commitment should not be subject to the Agreement's dispute resolution mechanism.

Engaging the Devolved Administrations

The Committee has requested an update on how the Government proposes to engage with the Devolved Administrations (DAs) and, specifically, how we are working to resolve the issue of whether State aid is a reserved matter (paragraphs 49 and 87).

UK Government officials have discussed with officials from the DAs possible objectives for a domestic subsidy control regime and have committed to further discussions as the policy develops. It is in all our interests to ensure that the regime works for the whole of the UK and enables the UK's internal market to function properly. UK Government and DA officials will continue to discuss wider open and fair competition issues within the EU negotiations.

In the Government's view, the regulation of State aid is a reserved matter. The DAs, however, are responsible for their own spending decisions on subsidies (how much, to whom and for what) within any State aid or subsidy control framework. We note the Scottish and Welsh government's views on competency, and we will continue to work closely with the DAs to seek to agree the shape of a UK-wide domestic subsidy control regime.

More broadly, the Cabinet Office is leading work across Whitehall to ensure the DAs are engaged in key stages of the EU negotiations and also have the opportunity to scrutinise the process. The Chancellor for the Duchy of Lancaster has written to his counterparts in each of the DAs to set out how this will work.

State aid in the Northern Ireland Protocol

The Committee has asked how the Government is working to ensure that the UK-wide implications of the Northern Ireland Protocol in a State aid context are fully understood (paragraph 56).

The Northern Ireland Protocol is a practical solution to prevent a hard border on the island of Ireland, and makes clear that Northern Ireland is and will remain part of the customs territory of the UK. The arrangements we will introduce will reflect this. Our top priorities are to protect the Good Friday Agreement and gains from the peace process, and to preserve Northern Ireland's place in the UK.

The first meeting of the Ireland/Northern Ireland Specialised Committee was held on 30 April via video conference, co-chaired by officials from the UK Government and European Commission. This Committee was tasked by the first meeting of the Withdrawal Agreement Joint Committee held on 30 March, to start work on implementing the Northern Ireland Protocol.

The UK and the EU exchanged updates on the implementation of the Protocol and discussed the preparatory work for future decisions to be taken by the Joint Committee.

We will take into account the unique circumstances that have been agreed for the island of Ireland as we develop and implement our domestic policy on subsidy control and intend to provide further information on this prior to the end of the Transition Period.

The UK Shared Prosperity Fund

The Committee has noted the role of a new UK subsidy control policy in reaffirming the Government's commitment to support vital regional projects and commented on plans to establish a UK Shared Prosperity Fund (paragraphs 80 and 83).

The Government remains committed to the objectives of the UK Shared Prosperity Fund, which binds together the whole of the United Kingdom, tackling inequality and deprivation in each of our four nations.

This country is in the midst of dealing with the Covid-19 pandemic which the Government is responding to with an unprecedented package of financial support. The scale of what we are now facing as a result of Covid-19 will have serious implications for our economy going forwards.

We will continue working closely as one United Kingdom to understand the changing needs of local and regional economies and our response to that, including the role that the UK Shared Prosperity Fund can play.

The future development of EU State aid rules

The Committee has suggested that the EU will likely amend the State aid rules in future and considers that this would have implications for British businesses (paragraphs 61 and 62).

The Government shares the Committee's expectation that the EU State aid rules may evolve in future. The European Commission has expressed its desire to bring in revised State aid rules in some specific areas, such as energy and environmental aid, by 2021. It is worth noting, however, that the European Commission announced in January 2019 that much of the legislation, including the General Block Exemption Regulation (GBER), and several key State aid guidelines, will not change before 2022 at the earliest. The Commission usually consults on and communicates any changes to the rules clearly and accessibly for businesses and the public on their website, and we envisage this continuing in future.

Negotiating any formal influence for the UK over the future development of EU State aid rules, as the Committee has proposed, would be very challenging though we will always strive to protect the interests of British businesses abroad. State aid is a sole Commission competence so even EU Member States cannot block a proposal or demand changes. It would be unprecedented for the Commission to allow a third country which does not align with EU rules to have any say over EU State aid policy. Equally, the Government would not accept that the EU should have any influence over the development of the UK's future subsidy control policy.

Net zero goals

The Committee has commented on the link between State aid and the UK's ambitious net-zero goals and suggested that a long-term and consistent plan for providing state support for critical net-zero projects is essential to allow businesses and individuals to plan for and deliver change (paragraphs 72 and 73).

The Clean Growth Strategy (published October 2017) sets out an ambitious blueprint for accelerating clean growth across the UK through to 2032, building on the great strides we have made in decarbonising the power sector. The Strategy contains 50 key policies and proposals to drive progress across all areas of our economy and society – including housing, business, transport, the natural environment and green finance.

The Government has continued to bring forward new policy and deliver on the Strategy. Our response to the Climate Change Committee’s annual progress report – ‘*Leading on Clean Growth*’ (October 2019) – sets out the progress we have made against the Clean Growth Strategy and the further action we are taking across all sectors of the economy to bring down emissions, meet our carbon budgets and deliver net zero.

We have set out bold commitments in our manifesto and budget – from investing £9.2 billion in the energy efficiency of our buildings, to £800 million to deploy the first carbon capture and storage cluster in the UK, to planting an additional 75,000 acres of trees a year by the end of the parliament. The Prime Minister chairs a new Cabinet Committee on Climate Change to oversee this effort and drive forward action across the whole of government.

HM Treasury will take forward a review on how to achieve this transition in a way that works for households, businesses and public finances, as well as ensuring that this is compatible with our plans for a thriving and competitive economy.

The Competition and Markets Authority

The Committee has asked for clarification regarding the role of the Competition and Markets Authority (CMA) (paragraph 91) in a domestic subsidy control regime.

The UK’s position on subsidies for the trade agreement negotiations with the EU, as described above, does not necessarily require a domestic regulator (as demonstrated by other countries, like Canada, that do not maintain a domestic subsidy control regulator to fulfil their trade agreement obligations with the EU).

As previously indicated, we will share more detail on domestic subsidy control with key stakeholders in due course. (This will also include the Government’s thinking on block exemptions, which we note the Committee’s interest in (paragraph 75)).

The policy of the previous Government, if the UK had left the EU without a Withdrawal Agreement, was that the State aid rules would be transposed into UK law and made operable in a domestic context, with the CMA as regulator. The Government prepared draft secondary legislation under the European Union (Withdrawal) Act 2018 (as amended) to this effect and provided additional funding to the CMA to ensure it was ready to take on the role of domestic subsidy control regulator, if required.

Following ratification of the Withdrawal Agreement with the EU, the draft State Aid (EU Exit) Regulations 2019, which had not yet completed all stages of Parliamentary procedure, were no longer deemed necessary. The Government therefore withdrew them from Parliament in February 2020.

Notifications to the European Commission

The Committee has requested an update on the number of UK notifications to the Commission since the 2016 referendum and questioned whether these figures suggest that notifications are being delayed until details of the domestic regime are known (paragraph 92).

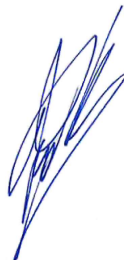
In the period following the referendum, from 1 January 2017 to 31 December 2019, the Commission approved 37 UK aid measures. While these figures are just under half the number of individual notifications approved in the preceding three years, it is worth noting that the number of notifications under the General Block Exemption Regulation (GBER) also fell, albeit at a lower rate of decline. This would suggest that fewer aid measures were implemented primarily because of policy or spending decisions, not because of State aid considerations. There is no other obvious explanation for why UK public authorities would refrain from using GBER, under which aid can be granted immediately, even with a view to the domestic subsidy control policy landscape.

Although the UK has left the EU, under the terms of the Withdrawal Agreement and of the European Union (Withdrawal) Act 2018 (as amended) which gives effect to it, EU state aid law continues to apply to the UK until the end of the transition period on 31 December 2020. This means that subsidies that meet the definition of EU State aid and granted in the UK before the end of the transition period must still be notified to the Commission. It is unlikely, therefore, that future domestic subsidy control policy, and the Government's indication that this will not align with EU rules, is yet significantly reducing the number of UK notifications (with the possible exception being for any potential cases for which there are early plans to give subsidies after the end of the transition period). The Government has recently quickly secured approval, for example, for several schemes to help mitigate the impacts of Covid-19.

I hope the Committee finds this response useful and of course I remain at your disposal should you have any further questions.

I am copying this letter to Darren Jones MP and Lord True.

Yours sincerely,



PAUL SCULLY MP
Minister for Small Business, Consumers & Labour Markets
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