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The Rt Hon Kwasi Kwarteng MP
Secretary of State for Business, Energy and Industrial Strategy
1 Victoria Street
London
SW1H 0ET

FSB Response the Consultation on Subsidy Control: Designing a new approach for the UK

FSB welcomes this opportunity to respond to the Government's consultation on the development of a domestic subsidy control regime.

The Federation of Small Businesses (FSB) is the UK's leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that is led by our members, for our members. Our mission is to help smaller businesses achieve their ambitions. As experts in business, we offer our members a wide range of vital business services, including legal advice, financial expertise, access to finance, support, and a powerful voice in government. FSB is the UK's leading business campaigner, focused on delivering change which supports smaller businesses to grow and succeed. Our lobbying arm starts with the work of our team in Westminster, which focuses on UK and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

Overview of FSB's position

FSB survey data found that half of small businesses welcomed the prospect of post-transition regulatory reform, where these were likely to have an impact on their business.¹ The development of a domestic subsidy control regime allows for such reform, hence FSB welcomes these proposals. Subsidies allow small businesses to pursue impactful projects, however it is important that awarding bodies are alive to the risk of market distortion, particularly where larger businesses are being awarded subsidies of significant sums. Accordingly, FSB endorses the Government's six guiding principles for awarding bodies. FSB also endorses the introduction of an additional principle regarding the material effects, of the award, on competition, international trade and investment.

¹ FSB, 'Regulation Returned: What Small Businesses Want From Brexit', (2017).

Government must ensure that the regime is suited to businesses of all sizes, including the smallest businesses, who make up a significant majority of the businesses in the UK. Further, the legislation by which the regime will be introduced should be clear and accessible for smaller businesses, many of which may not house the expertise which is often needed to discern the complex rules in this area. BEIS guidance on complying with the UK's International obligations on subsidy control goes some way towards achieving this, but must be developed upon.

FSB welcomes the creation of an independent oversight body through which these legislative changes will be enforced and monitored. However, the introduction of a new regime must not result in a greater regulatory burden upon small businesses, nor should it introduce a disproportionate number of regulatory requirements. FSB survey data shows that overly complex legislation and the cost of advice are significant barriers for smaller businesses; the foremost barrier being the overall quantity of regulatory requirements.² The legislative remit of the independent body must be determined according to domestic market need, rather than attempting to replicate the format of existing bodies in other parts of the world. Awarding bodies must accrue an understanding of the specific needs of smaller businesses across the whole UK Internal Market.

FSB has a significant national and regional presence and is attuned to the needs of the small business community in the devolved nations. Those needs can be nuanced and are often centred around precise market requirements, including the number of small businesses that operate within those markets. Moreover, the devolved governments are responsible for the delivery of a diverse range of policies across several portfolios, including, but not limited to, environment, agriculture and food, and economic development. Whatever the shape of the subsidy regime, it is important that it is flexible enough to be able to support policy at the devolved level in such areas, and that the risk of parallel funding administrations is minimised to ensure that smaller businesses do not fail to benefit from opportunities. Devolved authorities must be given the earliest opportunity to contribute meaningfully to the development of the regime.

Lastly, FSB supports the proposal of a light touch approach for low-risk subsidies, however the process by which support measures are assessed to be low-risk must be well considered, clear and transparent. Awarding bodies must adopt a broad approach to this assessment which should include locality, nicheness of the market and market power. For instance, in the case of the latter, where small amounts of financial assistance are concerned, the issuance of a relatively small subsidy to a significant market operator might still have a distortive effect.

² FSB, 'Regulation Returned: What Small Businesses Want From Brexit', (2017).

Definitions and Determinative Tests

FSB broadly endorses the definition of a subsidy which is outlined in the consultation. Retaining a definition which closely aligns with those followed by both the EU and the WTO allows for much needed legal certainty.

However, FSB calls for greater clarity regarding the meaning of ‘harmful or distortive effect on trade’, when determining whether a support measure constitutes a subsidy. Ordinarily, the actual or potential distortion of competition and the same on trade and investment are determined by way of economic tests and require an intricate knowledge of this area of the law. Government has helpfully narrowed the wording of the UK-EU Trade Cooperation Agreement (TCA) to include the terms ‘harmful’ and ‘distortive’. However, the remaining ambiguity can be allayed through further guidance as to the practical meaning of these terms. The aim of this exercise is not to reduce the number of subsidies which can be challenged, but rather to offer greater clarity to recipient businesses or those that are likely to be adversely affected.

FSB endorses the seven guiding principles that are proposed in the consultation, and emphasises its support for the introduction of a seventh principle on market distortion.

Low-Risk Subsidies

FSB agrees that the threshold for small amounts of financial assistance should be exempt from all obligations under the domestic regime, with the exception of WTO prohibitions. FSB also agrees that relief for exceptional occurrences should be exempted from obligations under the forthcoming subsidy control regime. As demonstrated during the Coronavirus pandemic, subsidies can be granted within a temporary framework that either exempts or eases rules on prohibited subsidies. FSB believes that a similar approach of adopting temporary frameworks in response to national or global economic emergencies can be adopted in the UK and would provide legal certainty and policy flexibility when such a situation arises.

Where subsidy thresholds are concerned, it is important that these are not lowered to such an extent as to have the effect of burdening the smallest businesses with disproportionate reporting requirements. For this reason and others, including the benefits of regulatory convergence between the UK and the EU, FSB agrees that the threshold for the exemption for small amounts of financial assistance to a single recipient remain at 325,000 Special Drawing Rights over a three-year period. Equally, exemptions for Services of Public Economic Interest should replicate the thresholds in the TCA. This currency and terminology should be retained for the purposes of legal certainty and should not be converted into GBP. Maintaining this reference to Special Drawing Rights will also allow for a greater degree of flexibility versus fixing the threshold to an amount in GBP, which may be affected by currency fluctuations.

Transparency Obligations and Subsidy Reporting

The consultation document proposes that awarding bodies are given a six-month window within which to publish subsidy awards, in line with the UK's obligations under the TCA. FSB supports the call for transparency which underscores this proposal, however Government must consider the unintended consequences of these reporting requirements upon small businesses. As identified in the consultation, it is important that awarding bodies do not incur an unnecessary administrative burden as a result of the process, which will likely filter down to businesses.

Subsidy Control Regime and the Implications of the Coronavirus Pandemic

A tailored domestic subsidy control regime can assist viable small businesses to access support to recover from the economic effects of the pandemic. Therefore, FSB is calling for tailored provisions to be introduced which consider the financial implications, upon small businesses, of the Coronavirus pandemic. The object of these provisions is not to promote a 'culture of subsidies', in which businesses or industries become reliant on government support, but to utilise the flexibility afforded by the forthcoming regime.

This may necessitate, for instance, the replication of temporary measures which were introduced as a result of the pandemic. Alternatively, or in addition to the above, the proposed legislation might also introduce temporary provisions for small businesses which mirror 'de minimis aid' or 'block exemption' rules. These temporary rules should remain in place for 2-3 years to take full account of the short to medium-term effect of the current circumstances. Where appropriate, these provisions should target industries that have been most affected by the pandemic, such as hospitality and retail. FSB would emphasise the broader supply chain implications for smaller ancillary businesses who are reliant upon the opening of businesses within the hospitality and retail industries, many of which do not have access to the same level of support.

WTO, UK-EU and UK-Wide Convergence

FSB would welcome clarity as to how various markets are to be defined under the proposed regime. This is particularly important within the context of trade within and between devolved nations. A number of special exemptions will likely be requested across several developed industries within devolved nations. Further, Government must also consider the impact of these provisions on the cost of exporting domestic produce.

Article 10 of the Northern Ireland Protocol outlines that EU State Aid rules will continue to apply to subsidies which affect trade in goods between Northern Ireland

and the EU, under which some Great Britain-Northern Ireland trade might inadvertently be caught. FSB calls for clarity as to how these rules might affect British and Northern Ireland small businesses who may be adversely affected by virtue of wider supply chain activity or other business transactions. On 17 December the UK-EU Joint Committee agreed that Article 10 would only apply to trade with a “direct and genuine link” to Northern Ireland. Small businesses would benefit from specific examples on this point. With two different subsidy control regimes operating within the United Kingdom, policy makers should be mindful of how future decisions might impact the viability of Northern Ireland businesses within the UK Internal Market.

More broadly, as earlier proposed, small businesses would benefit from further guidance as to what is meant by “affect trade”, here within the context of Great British-Northern Ireland trade.

Underscoring FSB’s position on the aforementioned points is the importance of minimising unintended consequences of inadvertent divergence. FSB welcomes the Government’s proactiveness in ensuring that the regime is reflective of international obligations. However, it is important that this process of legislative alignment continues beyond the formation of the regime, given the speed at which legislative provisions are revised in the UK and the EU.

More importantly, these must be communicated to UK small businesses across various nations, who will be variedly affected. A subsidy control regime that is tailored to the UK Internal Market allows all authorities to address regional imbalances. It will help to supplement innovations such as regional freeports. However, both central and local governments, as well as awarding bodies, must ensure that the proliferation of these regimes do not exacerbate existing inequalities by favouring certain regions over others. Correspondingly, the regimes should not foster new economic inequalities across regions. To oversee this, Government might consider centralising these matters to be dealt with by a single department or body going forward.

Role of the Independent Body

Pursuant to the provisions of the TCA, the UK Government has committed to establishing an independent body, although the role of the body is yet to be determined. FSB welcomes this innovation; however, it is important that the underpinning legislation clearly delineates the purpose of body. This includes setting out the extent of its legal power and the balance that is expected to be struck between its enforcement and oversight functions. Further, the provision must clearly outline any exemptions which might apply to particular subsidies, businesses groups and threshold limitations.

Much like the Commission, the body may be given powers of recovery along with domestic courts and tribunals, which have the effect of ordering the repayment of a subsidy where it is found to be unlawful. In such circumstances, although the award may have broader distortive implications for a given market, the independent body will be expected to adopt a balanced approach which also considers the financial implications, upon the domestic business, of repaying such an award. The European Courts have taken a strong position on this matter, to the extent that struggling and latterly insolvent firms are not exempt from this process.³ FSB is calling for a more liberal regime which takes into consideration the broader implications of enforcement decisions on the functioning of a small business.

The legislation should identify a government department that will oversee the decisions of the independent body. It should also explain if and how the independent body will interact with awarding bodies, given the elimination of the *ex ante* system. Under the EU regime, the State bears the greater burden of ensuring that awards are lawful. FSB expects that this duty of compliance will be transposed, pursuant to the forthcoming law, to fall upon awarding bodies. Hence, the framework which will govern the interaction between awarding bodies and the independent body must be made sufficiently clear. It is important that these matters are not spread too widely across a number of government departments, which would unnecessarily complicate the process for small businesses. For that reason, FSB suggests that the role of the independent body be added to the function of the Competition and Markets Authority.

The legislation should outline the process for dealing with challenges from competitor firms who disagree with the granting of a subsidy award. It must also clearly outline the criteria for determining if remedial action can be taken. The TCA allows for vertical challenges to be brought in domestic courts, and allows businesses to intervene where a challenge has been brought. Such complaints are common under the EU regime and are often brought against large firms operating within lucrative industries such as aviation.⁴ It is important that smaller businesses are granted the platform to bring these concerns before an independent body for review where they feel that they have suffered a disadvantage by the granting of an award to a larger firm. There are myriad benefits to allowing these matters to come before the independent body as a first port of call as part of a quasi-judicial process, including cost and comprehensibility. As is common to regulatory remedial regimes, further appeals can be referred to tribunals and higher courts.

³ Case C-42/93, *Spain v. Commission*; Case C-52/84, *Commission v. Belgium*.

⁴ Stefan Gössling, Frank Fichert and Peter Forsyth, 'Subsidies in Aviation', (2017).

Given the complex subject matter, FSB observes the value in creating a specialist tribunal to deal with disputes regarding subsidy awards and schemes. However, it is important that efforts are made to ensure that the process can be easily understood by small businesses, some of whom, for a number of reasons, might prefer to appear as litigants in person.

Thank you for considering our response to this consultation. If you would like to discuss any of the points further, please contact me via my colleague Damilola Ojuri, Senior Policy Advisor, on 0207 592 8127 or at Damilola.Ojuri@fsb.org.uk.

Yours sincerely,

Martin McTague



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