Competere

Response to BEIS Consultation on Subsidy Control Regime

Submitted on behalf of Competere Advisory Council

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Opening Statement

Submitted on Behalf of Competere Advisory Council

This statement summarises our views on the potential for a new UK Subsidy Control Regime ("SCR").

In addition to answering the questions below, we have also made some introductory remarks stressing the need for the UK to take actions to reduce anti-competitive market distortions ("ACMDs") at home and abroad through its trade policy. These are linked, and the UK's domestic settings very much determine its ability to project a liberalising trade policy.

We have chosen to limit our remarks to the manner in which the UK can deal with Anti-Competitive Market Distortions, as we feel that the literature on traditional trade remedies such as anti-dumping and countervailing duties is well developed. Subject to the concern that even traditional trade remedies should reflect artificial changes to firms' costs as opposed to purely price differences, we feel our highest value is in drilling down on how a mechanism to control anti-competitive market distortions at home and in foreign markets should be applied. In addition, the mechanism proposed here will pick up any issues that would ordinarily be picked up in an anti-dumping or countervailing duty context, if they are genuine cost-based distortions of trade.

It is crucial that the UK's SCR is based on robust economic doctrine and is not distorted by short term political concerns. We note the many countries that have moved to eliminate their own trade distortive and market distorting practices and the progress they have made. There are many examples of countries whose economies have improved dramatically as a result of the elimination of harmful subsidies (New Zealand for example).

Anti-Competitive Market Distortions, or ACMDs, refer to government-imposed restrictions on competition

Singham has written extensively about market distortions for over twenty years.[1] Singham also dealt with the issue extensively in his 2007 book, A General Theory of Trade and Competition: Trade Liberalisation and Competitive Markets (CMP (2007). Formally, Abbott and Singham[2] have defined ACMDs as those that "involve government actions that empower certain private interests to obtain or retain artificial competitive advantages over their rivals be they foreign or domestic."

Singham also discussed market distortions in a working paper for the Council on Foreign Relations, Freeing the Global Market by Curbing Regulatory Distortions (October 2012, Council on Foreign Relations). This paper included an inventory of distortions and explained why they have a pernicious impact on international trade.

[1] See for example Market Access and Market Contestability: Is the Difference purely semantics? 25 Brook. J. Int'l L. 337 (1999); Singham, Advancing the competition and trade policy agenda: Public Sector Restraints on Trade in the Free Trade Area of the Americas**,** International Antitrust Bulletin, Summer 2001
Singham and Sokol, Public Sector Restraints; Behind the Border Trade Barriers, Texas International Law Journal, Vol. 39, 625 (2004)

[2] Abbott, Alden F. and Singham, Shanker. Enhancing welfare by attacking anticompetitive market distortions. November 2011, Revue Concurrences No. 4-2011, Art. No. 39547.

Having identified that ACMDs present a pernicious problem in international trade, the lack of a quantum of the impact of these distortions made it very difficult to evaluate the scale of the problem. It was therefore necessary to research different ways of evaluating the harm posed by ACMDs. Singham and Rangan embarked on this exercise with a series of papers from 2014.[3] Singham and Rangan also published two papers introducing the economic analysis of ACMDs in 2016 for the Legatum Institute.[4] That work is ongoing.

It is only by fully understanding the metrics of anti-competitive market distortions that we can really evaluate their impact. ACMDs can damage international trade flows as well as distorting markets in ways that reduce competition and destroy wealth out of the economy. Hence ACMDs are just as relevant to the international trade agenda as they are to the domestic regulatory agenda. Policymakers would greatly benefit from understanding the cost of ACMDs and how they relate to domestic regulatory promulgation. The OECD in its regulatory toolkit and competition assessment has advised policymakers to promulgate regulation in ways that are the least anti-competitive possible consistent with a publicly stated, legitimate regulatory goal. Many countries include this sort of competition assessment in the ways they promulgate regulations, including taking into account the views of competition agencies. However absent a robust metric to measure distortion, it is difficult for governments to properly evaluate the harm caused by certain types of regulation, and it is also impossible for publics to fully understand what the impact of regulation so that they can properly weigh the costs and benefits of regulation and determine if the harm is justified by the importance of the regulatory objectives.

ACMDs can be particularly harmful (as distinct from private anti-competitive behaviour) as they are imposed by the government. Therefore, they enjoy state-backed power, and the force of law. Consequently, they may be impervious to attenuation by ordinary market processes. One example of an ACMD is as follows:

Consider a market, where firms generate a certain level of pollution. Now suppose that the government orders all firms to cut down on pollution by the same amount. However, suppose there is no cap-and-trade system in place, whereby firms with high costs of reducing pollution can buy permits from other firms at a price lower than its cost of reducing pollution. In such a case, the firm with high costs may be forced to exit the market due to lack of profitability, and consequently, with fewer competitors, the remaining firms may have the opportunity to collude and set high prices for the consumer. In this less competitive market, the welfare benefit from reduced pollution could be offset by the welfare cost of reduced competition. This distortion can be termed an ACMD.

Economists have long recognised the prevalence and pernicious consequences of ACMDs. The complexity and breadth of this issue, however, have made it an especially difficult one for policymakers to tackle.

If we are able to develop metrics to measure ACMDs, there are a number of policy consequences that are of great value. These include allowing governments to tariffficate market distortions in the markets of trading partners which allows a nuanced approach to issues like the US China trade dispute (as opposed to the imposition of a tariff regardless of evidence of ACMDs in China). Such a policy would have the advantage of actually incentivising the party which has the ACMDs to actually lower them (and thereby benefit from the lower tariff), as well as enabling countries to signal to their trading partners that they are open to imports which are efficiently produced because of the consumer welfare gains for their economies.

Policymakers can also improve the quality of their own regulatory promulgation processes. Under the OECD Regulatory Toolkit and Competition Assessment, governments should regulate in ways that are the least

[3] See Singham and Rangan, The effect of anticompetitive market distortions (ACMDs) on Global Markets Concurrences Dec 2014

[4] See Anti-Competitive Market Distortions and their Impact; A case study of India, Singham, Rangan, Bradley and Kiniry (see here); See also An Introduction to Anti-Competitive Market Distortions, Legatum Institute, September, 2016, available here.

damaging to competition consistent with a publicly stated, legitimate regulatory goal. If policymakers had a sense of the effect of ACMDs in their own markets on their own economic output, this would be tremendously valuable in coming to better regulatory decisions. It would also be invaluable in ensuring that legislators can properly evaluate the regulatory goal and the cost of the ACMD and make informed decisions.

Such a metric would also inform the public debate and ensure that this is actually being carried out in a manner that balances the regulatory objectives that need to properly and clearly stated, and the cost of the ACMDs to the economy. Too often in public debate, a knee jerk response to a perceived market failure occurs without any attempt to present, much less understand the economic evidence.

A metric will also tell us something about the scale of the economic impact of ACMDs. It has been assumed that reduction of trade barriers is where the largest economic gains are to be found, and reduction of distortions is important but not of the same order of magnitude. A metric will enable us to evaluate this impact. A sense of the scale of this impact was developed in preliminary fashion by Cebr in 2019.[5] According to the Cebr report, imposing a distortion inside the border as opposed to at the border in an agency-based model led to a 37% reduction in output, versus an 11% reduction of output for an equivalent border measure. This suggests that the impact of ACMDs might be much higher than previously supposed.

ACMDs can be dealt with in the context of the UK's subsidy control regime by imposing an internal discipline on sectoral regulators and government departments to limit ACMDs, but also by setting up a mechanism to tarifficate as a trade remedy ACMDs in foreign markets which have an impact on conditions of competition in the UK. This remedy was referred to in the report of the Trade and Agriculture Commission to the UK Secretary of State (released on 2 March 2021 and linked here).

We include thoughts on how both of these objectives can be achieved.

Reducing Domestic Distortions

The OECD's Competition Toolkit (2019) is the most comprehensive guide for competition assessment available today. It is a global "gold standard" that can readily be employed by the UK in administering its SCR.

As the OECD explains:

"[The] Toolkit provides a general methodology for identifying unnecessary regulatory restraints and developing alternative, less restrictive policies that still achieve government objectives. Governments can use the Toolkit to:

- Evaluate draft new laws and regulations (for example through regulatory impact assessment programmes).
- Evaluate existing laws and regulations (either in the economy as a whole, or specific sectors)
- Evaluate the competitive impacts of regulations (either by the government bodies that develop and review policies – or the competition authority)

The Toolkit can be used by officials without specialized economic or competition policy training. Potential users include ministries, legislators, government leaders' offices, sub-national governments and external policy evaluators."

More specifically, the Toolkit includes three volumes that build on each other, (1) the Toolkit Principles, (2) the Technical Guidance, and (3) the Operational Manual. Of particular note, the Toolkit Principles contain a

[5] See An Agent Based model of Trade; Market Distortions and Output, Cebr, Feb, 2019 available at https://img1.wsimg.com/blobby/go/bf4d316c-4c0b-4e87-8edb-350f819ee031/downloads/Cebr%20Market%20Distortions%20Trade%20Report.pdf?ver=1603533215968

"competition checklist," a set of threshold questions that indicate when a proposed law or regulation may have significant potential to harm competition.

The SCR should put these principles into practice and provide strong disciplines on subsidies that constitute ACMDs.

Any exemptions or justifications for subsidies should be narrowly drawn and relate only to subsidies for pure research or for economically disadvantaged regions. Even if subsidies are justified, the government should consider automatically sunsetting all of them, so they would be limited to a specific period of time at the moment that they are introduced. Subsidies once enshrined into law are notoriously difficult to remove. By announcing that they are time limited from their introduction, this allows businesses to plan as if a normal competitive market applied.

The purpose of the SCR should be to limit the pernicious effect of ACMDs in the UK market. The mechanism itself should be administered by a newly created division of the Competition and Markets Authority so a competition focus is brought to bear on the impact of subsidies, or by an independent regulator such as the Trade Remedies Body with substantial input from the Competition and Markets Authority. If the SCR is focused on ensuring the limitation on the sorts of subsidies that have competition effects in the market or give certain privileged producers an artificial edge outside of what is typically permissible for services in the general economic interests, then all negative subsidies will be picked up. If further, and in compliance with the WTO Agreement on Subsidies and Countervailing Measures, the subsidy has a damaging effect on trade it should also be disciplined by the SCR independent body in order to ensure UK compliance with WTO rules. But it is important to point out that the primary reason to discipline subsidies is not just to comply with trade agreements but to ensure that anti-competitive harms are not visited on the UK economy.

We discuss below a mechanism which would assist the UK in ensuring that anti-competitive distortions in other markets are controlled by a tariffication mechanism. This would include foreign subsidies that have trade and competition distorting effects. Such a mechanism was proposed unanimously by the UK's Trade and Agriculture Commission (see Trade and Agriculture Commission - Final Report March 2021 (publishing.service.gov.uk).

Tariffication of ACMDs in Foreign Markets

Tariffication of the distortion is a mechanism which could be used in trade policy to deal with situations where countries agree to lower their tariffs but protect their markets and give their producers an artificial edge by distorting their markets. The result of the mechanism is a tariff based on the scale of the distortion which operates like a trade remedy. The mechanism can also be used offensively where a country is preventing market access by the UK by the market distortion, or defensively where a distortion in a foreign market leads to excess exports from that market. The below mechanism shows how this can be applied defensively. Offensively, we envisage provisions on distortions in trade agreements that discipline their use and allow dispute resolution when they are applied in violation of the agreement.

Defensive Mechanism

An aggrieved country would have to show:

1. A market distortion (i.e. an artificial reduction of cost by government support that has impacts on conditions of competition in the UK).
2. Impact on competition
3. Excess exports as a result of the distortion
4. Damage to its producers.

The questions to be resolved would be as follows:

1. Is there a law, government regulation or practice that lowers the cost of producers in the exporting market?
2. Does that law, regulation or practice significantly lessen competition in the UK?
3. Are there excess exports from the exporting country as a result?
4. Are the UK's producers adversely affected and can you prove both damage and causation?
5. If yes to all, then the tariffication mechanism can be applied.

Standing

All effected traders (at all levels of the supply chain) would have standing to bring (and in some cases defend) cases. The standing could also be extended to trade associations whose members are affected but who do not necessarily have the resources individually to bring cases.

We now turn to the specific questions raised in the consultation.

Consultation questions

132. We invite respondents' thoughts, where possible with appropriate evidence, on the designof the UK's future subsidy control regime. We specifically invite responses to the following questions:

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

This question calls for three steps: (1) what is a subsidy? (2) when does a need for a subsidy arise? and (3) when are subsidies beneficial to the UK economy? The response below covers these three questions.

A subsidy is usually a benefit in cash or tax reduction given by the government to a firm or individual in order to incentivise the firm or individual to behave in a way that is socially beneficial. For example, a government may subsidise rail travel so that individuals will drive less and thus contribute less to pollution and road congestion. Another example is when government subsidises production of a good by firm(s) if those goods would otherwise have not been produced.

The examples given above indicate when a need for subsidies arises. In the first example, when rail travel is subsidised, it causes what economists call positive externalities which in this case is less pollution. In the second example, a subsidy to a firm helps produce a good or service that otherwise would not have been produced since the market left to itself may not produce them. This is a case of what economists would term as correcting a market failure. Market failures can occur in such areas as research and development when R&D projects with long time horizons may not be funded by private firms or capital markets. A special case of market failure argument is that of infant or nascent industries. These are industries which a country may be in a position to develop and gain competitive advantage but due to market failures (often but not exclusively capital market failures) the industry may not develop in that country. In such circumstances, many economists argue for subsidies to jump start such an industry and allow it time to gain competitive advantages such as economies of scale. Since developed economies tend to have well developed market including capital markets, infant industry arguments arise more often in developing countries.

The responses above suggest the circumstances under which subsidies can be beneficial to an economy such as the UK's. Subsidies are beneficial to the UK economy only when such subsidies could be clearly justified on the basis of either positive externalities or market failures.

It is our view that subsidies in general are not beneficial, because they distort the allocation of resources based on limited information currently held by government officials. Even with what may appear to be the best of intentions (e.g. promoting a "green technology" to lower emissions or promoting a "critical infrastructure"), subsidies typically will interfere with the efficient allocation of capital lead to waste of taxpayer funds (see e.g. Solyndra "green" subsidy in the USA), and prompt efficiency reducing trade retaliation by other nations. Also, the mere availability of subsidies prompts special interest rent seeking by private actors who prefer to advance their enterprises by government fiat rather than by their own innovation and unique enterprise. This is wasteful. Finally, there is an economic "public goods" justification for subsidising certain forms of basic R&D, which might be undersupplied by private actors, but the government must act carefully in not expanding basic R&D subsidies beyond their appropriate boundaries.

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

Any subsidy that cannot be clearly justified on the basis of either positive externalities (or reduction of negative externalities) or market failure arguments are harmful to the economy and distortive of market allocation of resources guided by price signals. Such subsidies are not only wasteful of government funds they also deprive resources to otherwise worthwhile projects. In other words, poorly designed subsidy regimes can waste resources and also neglect funding critical needs of the country.
Those that protect inefficient firms and those that protect an incumbent monopolist from entry are particularly pernicious.

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

A subsidy control regime that builds on the principles enunciated above is an important policy approach and we would support it. It is important that the regime is least wasteful of scarce public resources and directs them to the most socially beneficial activities. An excellent subsidy control regime would avoid regulatory capture (i.e. potential beneficiaries dictating who should get subsidies), political favouritism (i.e. politicians rewarding their cronies with subsidies), and failure of review mechanisms (i.e. lack of regular and systematic review of subsidies and their results).

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

- Additional datasets (other than the European Commission's Transparency AwardModule) on local or regional subsidy awards (e.g. by value, sector or category)
- Research and evaluation projects that have been conducted on the impacts of differenttypes of subsidy awards on domestic competition and trade (e.g. by value, sector or category)
  We have done extensive work in this area which is referred to in our opening statement above. This work relates to the impact on conditions of competition of anti-competitive market distortions.

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

Any subsidy regime should be based, as far as possible, on neutral principles. That is, it should neither favour nor discriminate on the basis of characteristics mentioned above. Such a neutral approach has the merit of directing subsidies or state support to those who need them most. For example, if the UK government wants to promote some kind of vocational training in a new technology in order to help its industries, it may decide to subsidise such training by offering scholarships to those who want to undergo such training. Here, it is best to make those scholarships (in effect subsidies) contingent only on their academic accomplishments, their prior experience in related technologies, and income level rather than on other characteristics. This has the effect of getting the most benefit for the country for the amount of subsidy incurred. If an argument is made that people of a race or gender are not getting such scholarships, it suggests that those people do not have the characteristics (academic training, prior experience, etc.) that would justify subsidies for them. In

other words, their failure to qualify for subsidies is due to externalities or market failures elsewhere in the socio-economic system. If so, it is best to intervene with subsidies in those areas rather than here in vocational training.

Ideally subsidy controls should not take into account non-economic characteristics of the type described above. Effects on different population groups are very difficult to measure, may change over time (as group composition and demographics change), and may also generate special pleading that fosters, rather than eliminates, invidious forms of discrimination. Instead, we believe the best way of helping groups in these classes is to ensure that the overall economy is not unduly distorted by subsidies so that there is increasing economic opportunity for all.

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

We set out the conditions for a subsidy to exist in our answer to question 1. We believe the UK should follow the WTO Agreement on Subsidies and Countervailing Measures and prevailing practice in international law. This is consistent with its Global Britain ambitions as set out in the Prime Minister's Greenwich speech (Johnson Speech, 3 Feb 2020).

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

Subsidies tend to be ubiquitous in modern societies and it is likely UK is no exception. Moreover, many subsidies are not recognised as such and, what is worse, they continue long after many of the recipients had ceased to need it. To make any Subsidy Control Regime to work effectively, it is important that every subsidy to every sector is recognised and made public as such. Such recognition will also note the amount, duration, and the recipients of subsidies in a public document so that any citizen using the Freedom of Information Act can access that list and raise questions if need be. It is important that any subsidy regime be transparent and easily accessed. Since subsidies involve public funds such transparency is critical for a Subsidy Control Regime.

If a particular sector is subsidised by the government, it is always open to the government to provide that and justify it. The Subsidy Regime should contain defences and justifications, which could operate in areas like healthcare, and in particular to subsidies granted to under-privileged areas.

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

As a general principle, agriculture should also be subject to the same subsidy control regime as other sectors in the economy. Agricultural subsidies have been justified on a number of shifting grounds ranging from protection of farmers' income, land use, and food security with the result such subsidies have been difficult to dismantle in many countries. Moreover, agriculture subsidies tend to have a number of pernicious effects such as: non-conservation of water which is a scarce resource in many countries, wasteful and inefficient farming practices, poor land management, pollution of air and water tables, perpetuating the use of labour in low productivity sectors, distortion of international trade in agricultural products, and so on.

That said, and this should be provided for in the Subsidy Regime, the AoA allows green box subsidies for direct farm payments in certain cases, and the UK's regime should mirror those green box allowances. However, the precise definition of direct production supports which may be amber or red box in some cases may change over time and negotiation, and it is important UK domestic subsidy policy keeps pace with this.

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

Subsidies to audio-visual services (AVS) have been the bone of contention between the EU and its trading partners since the early 1990s when they clashed in the WTO negotiations. With UK out of the EU now, this issue is likely to crop up between UK and EU now.

At its core, subsidies to AVS revolve around preservation of cultural/linguistic diversity and small domestic/global markets for some language groups. A couple of things need to be recognised here. UK products in this sector such as English movies, books, and theatre productions tend to have large and growing global markets as the importance of English as a global language continues to rise. It is therefore very important for UK producers to overcome subsidies and distortions in other markets based on the WTO AVS exemption. Hence the UK has strong offensive interests in a free and competitive market in this sector without distortions in other countries and limited defensive interests (unlike, say France). As such, it is important for the UK's AV sector to secure less distortions and less subsidies around the world and it will only be credible in seeking that outcome if it outlaws domestic subsidies at home. It has far less to lose in this regard than almost any AV sector in the world.

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

Yes. We completely support this view. Subsidies have the immediate effect of distorting competition in the domestic arena as well before having an impact on international trade. In other words, anti-competitive market distortions (ACMDs) are pernicious domestically as well as cross-border. It makes perfect sense to incorporate the notion of minimising ACMDs within the UK internal market as a vital principle that competition authorities can lean on in their efforts to promote and protect competitive markets in various sectors within the United Kingdom.

Subsidies inherently distort competition by reducing the cost base of the subsidy recipient and thereby implicitly raising the costs of its rivals (as compared to those of the subsidy recipient). While they tend to favour large incumbents, who can use their lobbying power with government to push for supports through special pleading. This can have the effect of knocking out smaller, new entrants or preventing market entry by firms. This can have a devastating impact on innovation in precisely the sectors the UK has targeted for growth and providing opportunity (especially with respect to the Levelling Up agenda).

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

Since, at its core, a subsidy control regime is for the purpose of minimising the impact of subsidies on competition, any additional principle should relate to the key goal of preserving vigorous competition in the marketplace. Based on that idea, two principles are worth considering: one, the Subsidy Control Regime (SCR) should work closely with the Competition and Markets Authority; two, an SCR should not only address

trade and competition distorting subsidies brought to its attention by others but also undertake *sua sponte* examination of subsidies in various sectors on a regular basis so that it can have a continuous subsidy monitoring role. This should be coordinated by the Subsidy Control body in partnership with the CMA. The UK government would have to consider what would be the appropriate competition test for the subsidy and recognise that government distortions and private sector distortions operate in different ways economically (because the government is at best a revenue maximiser, whereas private firms are profit maximisers). The appropriate test might be to require significant lessening of competition as opposed to any impact whatsoever. Some of the articles referred to in our opening statement address this issue, as well as A General Theory of Trade and Competition: Trade Liberalisation and Competitive Markets (Shanker Singham, 2007 (CMP Publishing).

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

Our preliminary statement addresses this question. As with other domestic regulatory promulgation, the UK should aim to distort its internal market from a competition perspective as little as possible consistent with legitimate public stated (i.e. transparent) regulatory goals. The test of whether there is a significant lessening of competition should be decided by the CMA after a product and geographic market analysis. The precise competition test (significant lessening of competition, impact on consumer welfare, impact on total social welfare etc) needs to be carefully considered. The test should also consider that some government distortions need to be actionable because they can by definition last much longer than private sector distortions (in the latter case, the firm engaged in private anti-competitive activity might simply go out of business if it was cross-subsidising to knock out competition before it was able to monopolise, whereas this would never happen where the government was providing a subsidy to the firm). Again, these issues are dealt with in the papers referenced in our opening statement, and in A General Theory of Trade and Competition which we refer to in our answer to question 12.

Question 13: Should the threshold for the exemption for small amounts of financial assistance to a single recipient replicate the threshold in the UK-EU Trade and Cooperation Agreement at 325,000 Special Drawing Rights over a three-year period? Ifnot, what lower threshold would you suggest and why?

An exemption is only one way of looking at the issue. In practice, a competition test would not capture these very small subsidies because they would not impact the market. If they did, then the product market definition means that the subsidy should not be applied in that market.

In theory, no amount is small when it comes to subsidies. In practice, though, it is important to ensure that the Subsidy Control Regime (SCR) is nor overwhelmed with having to deal with a number of small subsidies. It may have the perverse effect of delaying action on large subsidies that are more distortionary. So, it seems reasonable to adhere to the suggestion that the threshold be kept at the level (SDR 325K over three years) mentioned in the UK-EU Trade and Cooperation Agreement. In effect, this means a subsidy of a little over SDR 100,000 (about US$110,000) per year. It is unlikely to be greatly distortionary in any market. One possible rider is to ensure that the same recipient is not getting the same subsidy repeatedly in order to fly under the radar of the SCR.

However too many resources being deployed to investigate these cases, a de minimis amount should be used, but that de minimis amount should be as low as possible.

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

In order to ensure compliance with international rules and consistency, we advocate using SDRs. The exchange rate for SDRs is fixed by the IMF and is well known. Of course, for local discussion purposes, it may be worthwhile to convert the amount into pound sterling (GBP) as is commonly done with EU state aids rules for example.

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

Yes, as argued above, the small amounts of financial assistance could be exempted from all obligations under domestic regime as well. The caveat about the same recipient getting such assistance repeatedly still applies. Clearly the UK must comply with its WTO obligations.

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

Only if those occurrences (true events that were totally unpredictable e.g. analogous to a force majeure event) are carefully defined and limited in scope, so as not to turn into special aid regimes for special pleaders. (By analogy, firms should never be granted exemptions from neutral regimes such as competition law based on "special circumstances," like a major recession. For many years, e.g., the Japanese Government exempted industries hit hard by a recession from cartel prohibitions ("recession cartels'), but those exemptions were never lifted, and the cartels lived on. Eventually, in light of the economic harm they caused, the Japanese Government eliminated all special exemptions for recession cartels.)

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

No. See answer to question 16 re completely unforeseen events.

Question 18: Should the threshold for the exemptions for Services of Public Economic Interest replicate the relevant thresholds in the UK-EU Trade and Cooperation Agreement at 750,000 Special Drawing Rights over a three-year period, and for transparency obligations at 15 million Special Drawing Rights per task? If not, what lower threshold would you suggest and why?

While in principles we do not see why there should be exemptions, we recognise the Services in the General Economic Interest could be subject to an exception. But these must be truly public service obligations, which must be clearly stated and justified, and there must be provisions for the obligation to be truly limited to Public Service Obligations. For example, the Subsidy Control measures should ensure that there is discipline for parties who benefit from a Universal Service Fund obligation but who use that USO funding to anti-competitively cross-subsidies into other sectors. The UK can look to the EU's state aids jurisprudence in this area, such as the Altmark case (Case C-280/00 Altmark Trans GmbH and Regierungspräsidium Magdeburg v

Nahverkehrsgesellschaft Altmark GmbH, judgment of 24 July 2003). The four Altmark conditions for allowable aid under SGEI are:

1. The recipient undertaking must actually have public service obligations to discharge and those obligations must be clearly defined.
2. The parameters on the basis of which the compensation is calculated must be established both in advance and in an objective and transparent manner.
3. The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of the public service obligations, taking into account the relevant receipts and a reasonable profit.
4. Where the undertaking is not chosen in a public procurement procedure, the level of compensation must be determined by a comparison with an analysis of the costs that a typical transport undertaking would incur (taking into account the receipts and a reasonable profit from discharging the obligations).

The Altmark conditions are broadly sensible for SGEI, but the UK should not feel bound to merely replicate them but should instead consider what would be best for the UK itself**.** The UK test should be heavily economics based and focus on the impact of the subsidy on competition outside of the PSO/USO area which should be legitimately and clearly drawn.

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

See response to Question 18.

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

UK rules should follow the ASCM in terms of prohibited subsidies such as export subsidies. However, applying a competition test will pick up these subsidies and is an economically better approach than creating categories which are prone to confusion and abuse. What matters is what is the impact of the subsidy on conditions of competition and internal and external trade in and with the UK market. If there is no effect on competition or trade, then the subsidy should be allowed. If that is the test, there no need for an exemption except on SGEI or de minims grounds.

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

Those details are not needed if a much simpler approach is employed. See response to Question 20**.** The UK government should resist putting together a subsidy code that is riddled with exemptions and categories that are prone to abuse and can be easily gamed by companies. Such an approach creates perverse incentives which can be economically damaging.

In general, the fewer the exemptions from a subsidy control regime (SCR), the simpler and easier to administer the SCR. That said, governments are often under pressure to ensure that short-term economic dislocations do not become too large. As long as the long-term need to implement an SCR that adheres to

the principle of minimising if not eliminating anti-competitive market distortions (ACMDs), SGEI and de minimis exceptions are acceptable. However, this does not apply to failing firms, where a rigid and legalistic definition may cause more economic damage than resolve. If a definition is needed, then it should be very tightly drawn, and we propose that the antitrust failing firm defence should be used in merger analysis for example. In the failing firm defence, because of the firm's likelihood of market exit, its market share need not be included in the analysis of what the proposed merged firm's market share would be (for the purposes of a Herfindahl-Hirschmann Index calculation for example). However, even without such a definition such dynamic factors would be taken into account in any competition analysis, so we would think even in this case a definition is otiose.

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

Promotion of vigorous competition in the marketplace is a sine qua non for both short term economic growth and long-term prosperity. This principle should be the lodestar for policymakers dealing with the UK internal market. Elimination of any kind of anticompetitive market distortions (ACMDs) should therefore be a part of the government agenda. Whenever a subsidy control regime (SCR) seeks to deal with a particular situation, it would do well to pay attention to this principle and assay its proposed actions against it.

Furthermore, it is axiomatic to say that subsidies should not be the means for protection of the internal market. Rather, competition should be maximised at all times. A carefully calibrated ex post tariff calibrated to the cost effects of foreign anticompetitive market distortions (ACMDs) such as discussed in our opening statement could be allowed. At the same time, the UK should endeavour to eliminate, to the greatest extent feasible, all of its ACMDs. We cover these specifically in our opening statement.

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

The response given above for Question 22 is also applicable here. The key criterion is whether the subsidy is likely to be an ACMD whether the subsidy is of domestic origin or of foreign origin (i.e. give to a firm operating abroad but which may be operating in UK or exporting to UK). Such a clearly enunciated and understood principle is more useful than any amount of ad hoc reasoning.

Foreign subsidies should be dealt with through carefully calibrated cost-based measures aimed at eliminating the effect of the foreign ACMD (see response to Question 22) and our opening statement.

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

As a matter of principle, transparency in policy making and policy dispensations is vital for a functioning democracy. So, it is critical that all competition impact reviews under the Subsidy Control Regime (SCR) or the CMA be made public. Making public the reviews has a number of benefits. One, it allows the public to see the reasoning behind SCR's decisions. Two, the likelihood that any subsidy request will eventually be seen by the public may make firms hesitate to ask for egregious subsidies that are ACMDs lest they be seen as taking advantage of public largesse. The costs on overall social and consumer welfare can be readily seen and policymakers can make more informed decision. Three, the obligation to make public the reviews,

forces the SCR to be scrupulous and rigorous in their analytical reasoning for or against a subsidy request. Four, it makes SCR to be especially careful about helping politically salient but economically dubious requests for subsidies since any positive decision in such instances will become precedents that will come back to haunt the SCR later.

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

In a democracy, the public authorities, i.e., duly elected governments, have the right to override statutory bodies such as SCR or Competition Commission and certainly can do so in the case of emergencies. It is best, however, if the laws require that any such overruling be explained in detail and subsidies are shown to be limited in scope, duration, and cost. Ideally, such overriding must also be seen as rare and exceptional done only under emergencies. The UK has succeeded in moving private anti-competitive conduct analysis to be a technical and not political analysis. It should not make the SCR subject to political forces except in exceptional cases. There should be very strict limitations on when this can occur (such as truly force majeure events and Acts of God.

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

In general, a fully functioning SCR with strong roots in restricting ACMDs should be sufficient to ensure that migration of jobs and factories follow economic logic. So, additional measures may not be necessary provided such ACMDs apply across all parts of UK uniformly. Where one devolved nation seeks to use a subsidy to drive investment decisions away from other devolved nations, that should be actionable, and there should be disciplines subject to exceptions such as local empowerment zones, freeports and so forth. However, the UK government should guard against these measures being used to driven upwardly harmonised tax policy.

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

It is not clear what would fall under the category "low risk" subsidies, and what the risk is. It is possible that the subsidies referred to under Questions 13 and 18 above dealing with small subsidies under the UK-EU agreement could be defined as low risk. If so, the SCR could make them proceed with legal certainty and minimum bureaucracy except for periodic review to ensure that such subsidies are misused or used as backdoor mechanisms to avoid scrutiny by the SCR. Again, if an ACMD competition-based test is used, there is no need for further complex rule-making that further distorts the market and creates perverse incentives.

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

As indicated in the response to Question 27 above, the category of low-risk subsidies is best used sparingly and only for those mentioned in the UK-EU agreement.

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

As of now, most energy and environment subsidies are justified on the basis of market failure arguments mentioned in the response to Question 1 above. Both green energy projects (such as wind or solar energy production) and environment projects (such as carbon capture initiatives) may come under this head. If subsidies for such projects are in the trade agreements, it is necessary to ensure that they are phased out over time through trade renegotiations as it makes no economic sense to subsidise something indefinitely. It goes without saying that such a discipline should also apply to the domestic regime both to minimise ACMDs and to comply with trade agreements.

The UK government should set out a clear path in its future trade negotiations to eliminate or at least phase out energy and environment subsidies, with an ACMD discipline applied to subsidies that are not eliminated.

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

It is important to recognise that a subsidy control regime (SCR) will work best if it is based on clearly enunciated economic principles that apply almost uniformly to all sectors, activities, and geographic areas. The elimination or reduction of ACMDs is one such clear and neutral principle. Other principles relate to market failures and externalities as indicated in the response to Question 1. If any deviation is desired from these neutral economic principles, the burden is on the entity requesting such special subsidy consideration to argue the case for such a deviation. Otherwise, the SCR will be riddled with ad hoc exceptions and reasoning leading to uncontrollable use of subsidies indiscriminately. **The thrust of the SCR should be the elimination of harmful, competition and trade distorting subsidies not as intimated by this question a set of rules to allow subsidies to exist indefinitely**.

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

As mentioned in the response to Question 24, transparency in a democracy is vital. So, any set of rules that promote transparency is welcome and desirable.

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

As indicated in the response to Question 13, if the small amounts of subsidies mentioned in the UK-EU trade agreement is maintained, it makes sense to adhere to similar information disclosure thresholds.

It should also be pointed out that phasing out financial assistance will phase out the need for such public information submissions.

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

As indicated in the response to Question 13, if the small amounts of subsidies mentioned in the UK-EU trade agreement is maintained, it makes sense to adhere to similar information disclosure thresholds. Subsidy obligations that are inextricably tied to existing FTAs should be notified publicly, but future and amended FTAs should seek to eliminate all such subsidies and provide for the application of an anti-ACMD remedy regime, as described in responses to previous questions.

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

No.

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

Yes, it makes sense to make it obligatory to upload information on subsidies within a reasonable time after the commitment to award the subsidy was made. It seems that it is not necessary for the period to be six months. It is best to shorten the time to three months or less to ensure speedy disclosure of making subsidy decisions public.

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

- information and enquiries.
- review and evaluations.
- subsidy development advice.
- post-award review; and/or,
- enforcement.

The independent body in charge of subsidy control regime (SCR) should cover all these functions. In addition, it should be responsible for posting all the subsidy grants and their justifications on a common database easily accessible by the public. The independent body must work closely with the CMA, and logically should be appended to the CMA. It should also be explicitly aimed at reducing ACMDs and harmful subsidies not overseeing their increase.

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

As indicated in the response to Question 30 above, it is important to recognise that a subsidy control regime (SCR) will work best if it is based on few clearly enunciated economic principles that apply almost uniformly to all. The elimination or reduction of ACMDs is one such clear and neutral principle. Other principles relate

to market failures and externalities as indicated in the response to Question 1. If any deviation is desired from these neutral economic principles, the burden is on the entity requesting such special subsidy consideration to argue the case for such a deviation.
In other words, the SCR should not be in the business of coming up new and most likely ad hoc principles and trying to justify them through analysis of interactions among them. Certainly, the governing principle should be the reduction of anti-competitive and trade distortive subsidies.

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

The independent body entrusted with promoting the subsidy control regime (SCR) should serve as a guardian of the economic principles that promote marketplace competition. It should serve as a reviewer of all requests for subsidies and the publisher of such reviews. Moreover, it should proffer its considered advice on the request for subsidy to the public authorities and also publish such advice. Such an approach will help the body to be a watchdog of the public purse as well as the country's market economy.

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

Yes, the independent body should be responsible for post-award review and also the receiver of complaints from anyone who feels that the subsidy is either unjustified or affects another entity or distorts market competition. It may even make sense to make it obligatory on the part of the body to hold public hearings on such complaints to ensure wider public debate and education. The body should also be specifically charged with advocacy in favour of market competition principles. To that end it should work closely with the CMA or even better be part of the CMA.

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

The enforcement powers of the independent body should be akin to a Competition Commission with powers to enforce its decisions. Its principal charter is to restrict, if not eliminate, anti-competitive market distortions (ACMDs). Just as a CMA decision could be appealed to the judiciary under certain circumstances, the decisions of the independent body should also be appealable to the judiciary.

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

THE UK government should consider whether the Independent Body should in fact be part of the CMA or whether it should act in close collaboration with it. Such close collaboration should be spelled out legislatively. The greatest danger of this body is that it will become captured by vested interests who are special pleaders for subsidies, and it will end up arguing for greater subsidy levels rather than against them. This is the global experience for other trade remedy bodies. The independent body should have an odd number of members to ensure decisive rulings. Ideally, its members should be economists and trade/competition lawyers but who have had some business experience as managers or consultants. They should have fixed terms of five years or more during which they cannot be fired. They should not be eligible

for reappointment. They should have a staff of mainly economists and some lawyers to assist them in analysis of subsidy requests and grants. The body should be obligated to make an annual report on the state of the subsidy control regime in the country.

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

In general, the power of such a body should be similar to those with similar powers that could be enforced through governmental machinery.

The body should have the power to order disgorgements of illegal subsidies from the receiving businesses to the government as is the case for EU state aids law.

Question 43: Should a specialist judicial forum such as the Competition Appeals Tribunal hear challenges to subsidy schemes and awards? If not, why?

Yes, it makes sense to have such a tribunal. Indeed, the CAT might well be the appropriate body as this will ensure a competition focused approach to resolution of disputes. The CMA should also be able to make representations in this review process.

Shanker Singham, Former advisor to UK secretary of state for international trade, and former cleared advisor to US Trade Representative and Department of Commerce (Chairman)

Alden Abbott, Former General Counsel of the US Federal Trade Commission

Grant Aldonas, Former Under Secretary of International Trade, US Department of Commerce, Bush Administration

Peter F. Allgeier, former acting USTR and former US Ambassador to the WTO

Meredith Broadbent, Former Chairman of the US International Trade Commission

Lars Karlsson, Former head of the Swedish Customs agency and former Director of World Customs Organisation

Alan Oxley, Former GATT Council Chairman, Former Australian Ambassador to the WTO, Founder of the Cairns Group of Agricultural Exporting countries

Eduardo Perez-Motta, Former Chairman of the Mexican Competition Commission, and Former Mexican Ambassador to the WTO, Former Chairman of the International Competition Network

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John Weekes, Former WTO General Council Chairman, Former Canadian chief trade negotiator and Canadian Ambassador to the WTO