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State aid regulation post-Brexit

Why a state aid control mechanism is likely to be included in a future EU-UK trade agreement

*Laurence Bielen**

To what extent will the UK apply state aid control post-Brexit? This question is highly dependent upon the future UK trade relationship with the EU. The more market access granted beyond regular WTO commitments, the more state aid discipline beyond the World Trade Organization (WTO) anti-subsidy regulation will be required from the UK by the EU to ensure a level playing field

In December 2017, after six months of negotiations, the Council of the European Union decided to proceed to the second phase of Brexit negotiations, considering that sufficient progress was achieved on the issues in phase one. This second phase will focus on negotiations on the transition period and the future relationship. One of the most challenging issues of the second phase is the discussion around maintaining a level playing field post-Brexit.

Level playing field and state aid control

Ensuring a level playing field is one of the guiding principles on the EU side in the Brexit negotiations. Considering that the United Kingdom (UK) is pushing for regulatory autonomy post-Brexit, the fear exists that the UK might diverge from European Union (EU) standards and gain a competitive advantage compared to their EU counterparts. One aspect in which the UK might diverge is its state aid regime. By April 2018, discussions on the future trade relations are expected, so it is necessary for the EU to have a clear vision by then on state aid provisions.

Current state aid framework

The two most important frameworks that currently exist to regulate state aid internationally are the EU state aid framework and the anti-subsidy regulations by the WTO. The EU state aid regulation, under the auspices

* Laurence Bielen is an attaché EU Trade Policy and WTO within the Directorate General for EU Affairs at the Belgian Federal Public Service of Foreign Affairs, Foreign Trade and Development Cooperation. All the opinions expressed in this briefing are the sole view of the author, and do not represent the position of the Belgian Government nor of the Trans European Policy Studies Association (TEPSA).

of the European Commission, is only applicable to the EU member states. These rules are meant to monitor and control selective measures taken by governments that interfere with the competition laws in the EU internal market. As a member of the EU, the UK is currently bound by EU regulations with regard to state aid. More globally, the anti-subsidy regulations of the WTO apply to all 164 WTO-member states, including the EU and its member states. These regulations are anchored into the Subsidy and Countervailing Measures Agreement, also known as the SCM-agreement.

Compared to the EU state aid regulations, the SCM-agreement is more limited in scope. Only two categories of subsidies are specifically prohibited. Other subsidies are only 'actionable', or subject to challenge before the WTO, if a trading partner can prove that a certain subsidy directly affects its interests in a negative way, otherwise the subsidy cannot be fought. Additionally, in comparison to the EU regulation, there is no ex ante control, which means subsidies can only be contested after they have been granted. Lastly, the SCM-agreement does not cover services. Only the General Agreement on Trade in Services (GATS) provides a consultation mechanism when a WTO-member feels negatively impacted by a subsidy by another member. However, the subsidizing member only has to give the complaint "sympathetic consideration" (GATS, Art. XV).

State aid post-Brexit

Post-Brexit the UK will no longer be bound by the EU state aid regulations. However, whether this will allow the UK to subsidize its industries more freely depends largely on the kind of future trade relation it will have with the EU.

In case of a 'no deal'-scenario, the UK would fall back on the WTO SCM-agreement. Even though in principle this would allow the UK to grant subsidies to its companies more easily, within the limits of the SCM-agreement, than under EU state aid regulations, it would not be in the best interest of the UK. This is due to the fact that even post-Brexit the UK will be largely dependent upon trade with the EU market and it will therefore have to take into account the retaliatory measures the EU would impose in reaction to UK subsidies (Young & Vallat, 2017). For the EU this outcome is not preferable either, it would mean that UK companies could challenge subsidies granted to EU companies though the EU state aid regulation, while the opposite is no longer possible. Only EU anti-dumping measures might bring solace.

On the other hand, in case a trade agreement can be reached, UK freedom to subsidize will most likely be limited as well. The EU has traditionally required the inclusion of a mechanism of state aid control in its free trade agreements (FTAs) with third countries. These mechanisms, aimed at ensuring a level playing field with regard to state aid, can be categorized into two models: namely a 'parallel'-model similar to EU state aid regulation or a 'SCM+'-model, which adds elements to the provisions of the WTO SCM- agreement (Schonberg, 2017).

Parallel state aid system or WTO+?

First of all, a parallel state aid system was implemented in the European Economic Area and in countries with which the EU has concluded a Deep and Comprehensive Free Trade Agreement (DCFTA). It is considered parallel, because the state aid control mechanism is substantively, procedurally and institutionally similar to the EU state aid regulation (Schonberg, 2017). This is due to the nature of these kinds of trade agreements: gradual convergence towards the EU-acquis.

Another kind of state aid control mechanism included in FTAs is a 'SCM+'-model. In this case, the WTO SCM-agreement is used as a starting point, and depending on the trading partner, certain elements are added in terms of substance or procedure. The new generation FTAs the EU has been concluding generally fall under this category. In the EU- Singapore FTA for example, two categories of prohibited subsidies are added compared to the SCM-agreement and the scope is extended to include services as well as goods. The Comprehensive Economic and Trade Agreement (CETA), although less substantive than the EU-Singapore FTA, also adds provisions of procedural nature to the SCM- agreement (Schonberg, 2017).

Conclusion

The level of market access determines the level of protection in the form of state aid control mechanisms. Since it is in both the EU as the UK's interest to have an "ambitious free trade agreement", two models for state aid regulation can be discerned. Yet, considering that a parallel state aid system is based on the principle of regulatory convergence towards the EU-acquis, it is irreconcilable with the current UK red lines and can therefore be ruled out as a possible model. The 'SCM+'-model on the other hand, would provide a perfect framework for a UK state aid control mechanism. In return for improved market access in a future free trade agreement, the EU could ask the UK to abide by the general provisions of the SCM agreement, plus provisions tailored to specific EU-UK market access needs, for example in terms of services.

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Trans European Policy Studies Association
Rue d'Egmont 11, B-1000
Brussels, Belgium

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