About the Illustrative Guidance

The Subsidy Control Bill was introduced to Parliament on 30 June 2021. The legislation will, subject to Parliamentary approval, introduce new requirements on public authorities relating to the giving of subsidies.

The following document is designed to give a sense of what the final guidance on the practical application of the subsidy control principles will look like. Clause 79 of the Bill provides the Secretary of State with the power to issue guidance on the practical application of certain elements of the regime. It will also place a legal obligation on public authorities to have regard to any guidance issued under this clause.

This document is aimed at Parliamentarians, businesses, subsidy granters, and other stakeholders with an interest in subsidy control. It is hoped that it will enlighten stakeholders as to the proposed structure and content of future guidance and act as an aid for future discussion and engagement.

The illustrative guidance has been published for information purposes only. This guidance will continue to be developed and refined as the Bill progresses through Parliament and following further targeted internal and external input and engagement with key stakeholders. As such, the contents of this document are subject to change.

The government will publish the final guidance sufficiently in advance of the new regime's commencement to allow public authorities and other interested parties time to familiarise themselves with its content. This guidance will, among other things, provide support for public authorities in determining whether an intervention is or is not a subsidy, the practical application of the energy and environment principles, complying with their transparency obligations, and understanding the prohibitions.

Illustrative Guidance on Subsidy Control

Summary

This document contains guidance for public authorities to help them interpret the subsidy control principles and other requirements in the Subsidy Control [*Bill/Act 2022*]. All public authorities should read this guidance and assure themselves that they understand the requirements in relation to the award of subsidies.

This guidance explains the legal obligations on public authorities under the domestic subsidy control regime. It provides a framework for designing and awarding subsidies in a way which is consistent with the Subsidy Control [*Bill/Act 2022*]. The guidance is designed to help public authorities award subsidies in a way which minimises any negative impacts to competition and investment, as well as promoting the effective and efficient use of public money.

There is separate guidance *[link to be inserted*] for public authorities to help them understand the limited circumstances where subsidies will fall within scope of the Northern Ireland Protocol.

Public authorities are expected to consult and refer to this guidance as part of their decision-making on the granting of subsidies. Nevertheless, this guidance is not intended to be exhaustive. They should also seek their own expert legal advice if, and where, they are unsure of their legal obligations or the lawfulness of a proposed subsidy.

Contacts for further advice:

- [*to be inserted*]

Subsidy Design and Assessment

Introduction

Subsidies can be important and useful tools to help deliver policy objectives, but they need to be designed carefully so that their benefits outweigh any negative effects.

Well-designed subsidies can bring about different benefits for society by correcting market failures or addressing social equity issues. They can, for instance, spur businesses to undertake activity which would not happen otherwise and would increase economic productivity and wider non-economic prosperity, such as research and development or increasing the uptake of low carbon technology. However, subsidies can also give rise to adverse effects on competition and investment which may prevent markets from delivering efficient outcomes which ultimately benefit society.

The Subsidy Control [*Bill/Act*] sets out seven principles that public authorities will need to consider when giving subsidies. These principles are:

A. Subsidies should pursue a specific policy objective in order to remedy an identified market failure, or address an equity rationale (such as social difficulties or distributional concerns).

B. Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it.

C. Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. That change, in relation to a subsidy, should be conducive to achieving its specific policy objective, and something that would not happen without the subsidy.

D. Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.

E. Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means.

F. Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the United Kingdom.

G. Subsidies' beneficial effects (in terms of achieving their specific policy objective) should outweigh any negative effects, including in particular negative effects on competition or investment within the United Kingdom, international trade or investment.

The subsidy control principles help to ensure that public authorities design subsidies in such a way that they deliver strong benefits and good value for money for taxpayers, minimise any negative effects on competition and investment in the UK, and help the UK meet its international obligations.

The subsidy control principles should be carefully considered as part of the subsidy design process. Given the interlinked and overlapping nature of the principles, a four-part framework is provided to help public authorities ensure that a subsidy is consistent with these principles. These steps are:

1. *Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use*
2. *Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change*
3. *Considering the distortive impacts that the subsidy may have and keeping them as low as possible*
4. *Carrying out a final assessment against the subsidy control principles and making any changes necessary to achieve compliance with these.*

The depth of analysis conducted needs to be proportionate to the size and potential distortive impact of the subsidy or scheme in question. In most cases, assessing compliance with the subsidy control framework should be done alongside the business case for the subsidy, using similar evidence sources and analysis. The analysis can be less detailed where the subsidy is relatively lower in value or has very few potentially distortive design features (see section 3 below) and/or where there is established evidence that similar subsidies have resulted in few adverse impacts. Conversely, the analysis should be more extensive for novel and contentious subsidies and for those with more distortive design features – particularly if the subsidy meets the criteria for a 'Subsidy or Scheme of Interest' (SSoI) or 'Subsidy or Scheme of Particular Interest' (SSoPI).[1]

If the subsidy meets the criteria for SSoI or SSoPI, the public authority will have to carry out more extensive analysis as set out in Annex [x].[2]

[1] [to insert – further information on the criteria for SSOPI and SSOI]

[2] The Subsidy Advice Unit is an independent body established within the Competition and Markets Authority. All SSoPIs must be referred to the Subsidy Advice Unit, and SSoIs may be referred to the Subsidy Advice Unit. The Subsidy Advice Unit will evaluate the public authority's assessment and may advise on how it could be improved or how the design of the subsidy might be modified.

1. Identifying the policy objective and determining whether a subsidy is the right tool to use

To ensure there is a benefit to wider society, public authorities may only give subsidies to pursue a policy objective[3] which:

a) remedies a market failure; and/or

b) addresses an equity concern.

In doing so, the subsidy can improve societal welfare or distribute it more fairly. The identified policy objectives may straddle both efficiency and equity issues, and address more than one market failure or social equity concern.

Market failure

What is market failure?

Market failure occurs where market forces alone do not produce an efficient outcome.[4] Where this arises, businesses may make privately, but not socially, desirable investments or under- or over-supply some services or goods from a societal perspective. In such cases, the granting of subsidies may improve overall efficiency by adjusting firms' incentives. The most common cases of market failure which are relevant for subsidy control relate to the existence of externalities, public goods, and information asymmetries.

- *Externalities* are the side effects of a business's activities that no one pays for. Externalities affect third parties that are not involved in the activities of the business and can be positive or negative.

  A negative externality occurs when a business does not bear all the costs stemming from its activities. This causes a business to have a level of output that is too high from a societal perspective. An example is greenhouse gas emissions, the full cost of which is not directly factored into the costs of a firm and therefore the decisions of the businesses involved in producing them. This causes harm to people and society even if they did not purchase or directly benefit from the good or service produced.

  A positive externality occurs when a business does not receive all the benefits stemming from its activities. This leads to a level of activity that is too low. For instance, research and development (R&D) brings about positive externalities as, by increasing the level of knowledge in society and contributing to

[3] Where a subsidy or scheme has multiple policy objectives, the primary objective must be directed at either remedying a market failure or addressing a social equity concern.

[4] An efficient outcome can be defined as a situation where the allocation of resources is such that no one can be made better off without making the situation worse for someone else. In effect the outcomes for a group or society at large are maximised.

innovation, it provides benefits beyond just the firm that undertakes R&D. Therefore, from a societal point of view, firms should undertake more R&D.

- *Public goods* are products or services which are, by their very nature, non-rival (their consumption by one person does not reduce the amount available for others) and non-excludable (it is prohibitively costly or sometimes impossible to limit the good or service to only those who pay). Due to these characteristics, firms cannot extract sufficient economic benefits. Without intervention in the market public goods are often undersupplied, have lower rates of retention as many people will benefit (despite only a few paying for them), or are not supplied at all. The preservation of heritage buildings or cultural sites can have public good dimensions as it is difficult to prevent the public from appreciating their presence and one person's enjoyment, up to a point, does not detract from another's. The owner, however, may privately profit from putting the heritage building to another use which does not benefit society in the same way.

- *Asymmetric or imperfect information* is where one party involved in a transaction has markedly better information (or businesses are not acting with full information), and so beneficial deals do not go ahead, or do so, but not on terms that would be optimal for wider society. For instance, banks may focus on the financial statements and collateral of a business to assess their credit worthiness, rather than carrying out a more thorough but costly assessment of the firm's viability. This can present challenges for new, yet economically viable and potentially fast growing, businesses in obtaining finance from traditional lenders to grow their business.

Assessing market failure

Public authorities should establish the existence of a market failure, assess its significance, and demonstrate how the subsidy will address the issue so as to provide a more efficient outcome. Evidence that a project or activity would not go ahead in the absence of subsidies is not necessarily a sign of market failure – in fact, it may show that a market is working well. Public authorities need to also identify why the subsidy leads to more socially optimum outcome. Furthermore, the identification of a market failure does not in itself justify using a subsidy – there may be other, more suitable ways of addressing that market failure.

The following questions should be considered in establishing whether there is a market failure that needs to be remedied:

- *Will the market deliver an efficient outcome in the absence of intervention?*
- *If not, why? What reason causes the market to fail?*
- *Can a subsidy address this market failure?*

Equity objectives

What is an equity objective?

While market forces tend to bring about efficient outcomes, they can exacerbate and even entrench inequality. Equity objectives seek to reduce these disparities between different groups in society or geographic areas. Examples include subsidies targeted at:

- Levelling up a deprived or disadvantaged area.
- Employment of disadvantaged or disabled workers.
- Extending access to cultural or educational amenities.
- Rescue and restructuring subsidies to prevent serious social difficulties arising from the closure of a large employer. Please note that rescue and restructuring subsidies are subject to more detailed requirements [*to be inserted – link to future section on additional requirements on rescue and restructuring subsidies*].

Assessing equity objectives

Public authorities must use supporting evidence which demonstrates the need for a social equity intervention. This should include measures or statistical indicators set against appropriate comparators (such as regional or national averages).

The following questions should be considered as part of establishing whether there is a social equity issue that needs to be addressed:

- *Will the policy objective be achieved in the absence of intervention?*
- *How significant is the issue?*
- *Could a subsidy address the equity issue?*

Is a subsidy the most appropriate policy instrument?

Once the policy objective has been identified, public authorities must determine whether a subsidy is the best means for achieving the chosen policy objective. As part of this, there should be consideration of other ways of addressing the issue. There may be more appropriate tools available to the public authority, such as regulation, direct provision of the good or service by the state and/or loans on commercial terms. Use of alternative levers may have a lower cost impact on the public authority, bring about less distortion, or more effectively achieve the stated policy objective.

In order to comply with Principle E, public authorities should address the following questions:

- *Why is the subsidy route the most appropriate instrument for addressing the identified policy objective? What other means have been considered and why are they not appropriate for supporting the identified policy objective?*

2. Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change

Subsidy Control Principle C states that subsidies should be designed in a way that leads to a change in the economic behaviour of the beneficiary and, when considered alongside Principle D, also requires that subsidies bring about a change over and above what would occur anyway. Subsidies which fail to meet either of these principles are unlikely to represent value for money to the taxpayer.

The baseline for assessing change

Typically, firms will continue making investments in improvements, innovations, or new products. However, there will be cases where, without intervention, negative impacts are likely to occur in the future and subsidies may be needed simply to maintain the status quo. Therefore, public authorities should look to consider what would happen in the absence of the subsidy, the 'do nothing' scenario. The baseline for this comparison would not necessarily be the current 'as is' situation, but what would likely happen in the future if no subsidy were awarded now. In determining the 'do nothing' position, public authorities may find it helpful to refer to detailed guidance on the use of 'counterfactual' analysis.[5]

Almost all subsidies will bring about a change in the decisions of the beneficiary. However, the intended change in behaviour must support the policy objective being pursued. To demonstrate how the subsidy will influence the economic behaviour of the beneficiary, public authorities should address the following questions:

- *How will the subsidy influence the beneficiary to take one course of action over another?*
- *How will the subsidy contribute to the achievement of the policy objective?*

Subsidies should also bring about something that would not have occurred without the subsidy. In demonstrating this, public authorities should consider the likely change or additional net benefit stemming from the subsidy.

Examples of when changes or additional benefits might arise include:

- A project or activity being carried out, which would have otherwise not gone ahead (or at least not in in a way that benefited a group of people or a specific geographical area);
- A measurable improvement in the quality of the output or outcomes;
- An increase in the scale or scope of a project or activity, for instance in order to extend the geographic area or number of groups benefiting from it; or
- A project or activity occurring at a significantly earlier point than it would have otherwise. A public authority must be satisfied that there are justifiable public

[5] https://www.gov.uk/government/publications/rpc-case-histories-counterfactuals-september-2020--2.

policy benefits to using a subsidy to bring forward a project that would have happened without a subsidy.

As a result of this 'additionality' requirement, subsidies should not be used to finance a project or activity that the beneficiary would have undertaken in a similar form, manner, and rate of speed without the subsidy. Similarly, subsidies should not normally compensate for 'business as usual' costs – in other words, those costs that the beneficiary would have incurred and had to fund itself in the absence of any subsidy. In practice, this means that public authorities should avoid using subsidies to cover the ongoing costs related to the normal day-to-day of running of the business, facility or project. There may be circumstances where the funding of day-to-day expenditure can be justified where that expenditure is directly linked to the subsidy's policy objective. For instance, a subsidy used to increase the wages of disadvantaged workers or to offset the costs stemming from a severe public health outbreak or natural disaster.

The following questions should be considered as part of this:

- *What are the types of costs the subsidy is to be used to support?*
- *Why is the targeted project or activity and the associated costs not considered as 'business as usual'?*
- *Would the investment be needed by the beneficiary to maintain their market share or meet a legal or contractual obligation now or in the future? If the answer is 'yes', it is likely that the project or activity would be undertaken regardless of the subsidy.*
- *What would the likely outcomes be 'with' and 'without' the subsidy over the short- and long-term?*

3. Considering the distortive impacts that the subsidy may have and keeping them as low as possible

The subsidy control principles require consideration of the distortive and potentially harmful impacts of a subsidy. Principle B sets out that subsidies must be proportionate and limited to what is necessary. Principle F requires the public authority to minimise any negative effects on competition and investment within the UK domestic market insofar as they do not limit the specified policy objective being achieved. In other words, the public authority should be satisfied and show that any negative effects on competition or investment within the UK – and which are identifiable at the point of assessment - cannot be further reduced without harming the ability to meet the stated policy objective.

When considering impacts on competition and investment, public authorities should examine:

- *The characteristics of the subsidy and whether these can be redesigned to further reduce the impacts of the subsidy on the affected market(s). This requirement is expanded on in section 3.1.*

- *The geographical and distributional impacts of the subsidy. In other words, will there be any particular adverse effects for a particular group or geographical area? This requirement is further explored in section 3.2.*

The following subsections explore each of these in turn. Public authorities are advised to consider, in a proportionate way, whether the subsidy could be deployed in less distortive ways and still achieve the policy objective. There should be more thorough consideration of other options if the subsidy is more likely to lead to substantial distortion, such as those meeting the criteria for SSoI or SSoPI.

3.1 The characteristics of the subsidy

Certain features and characteristics can make a subsidy more likely to have distortive impacts on competition and investment within the UK, and on international trade and investment. It is important to identify where these features are present and consider whether it would be possible to alter or offset them to reduce the levels of distortion they might cause.

The public authority should systematically review each of the relevant characteristics of the proposed subsidy which could increase the probability of the subsidy being more distortive. In doing so, it is worth noting that, in some cases, it may not be possible to design a subsidy without some distortive characteristics. The features set out below should therefore be considered in the round. However, the public authority should evidence a consideration of the factors covered below (when relevant) and whether the subsidy could be re-designed to minimise the impact of distortive characteristics and thus the extent of distortion to competition and investment whilst still meeting the policy objective.

The nature of the instrument

Subsidies can be provided in many different forms, including grants, soft-loans[6], loan guarantees, and tax breaks. Other forms, such as taking an equity stake in firms, the provision of goods or services at below-market prices, or the procurement of goods and services at above-market prices by public authorities, may also constitute subsidies [*to be inserted – link to future section on determining whether an intervention is a subsidy*]. Some forms are less likely to distort domestic competition, investment, and trade than others. For instance, a loan typically leads to less distortion than a grant as it will ultimately need to be paid back by the beneficiary. Furthermore, a loan provided at close to commercial interest rates is less distortive than a loan at a lower, preferential interest rate.

As a general rule, where a public authority is acting in a way more comparable to that of a rational private investor, the beneficiary is likely to derive a smaller economic advantage, and the subsidy is likely to be less distortive.[7] However, the

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[6] Loans with no interest or below-market rates of interest.

[7] [*Clause/section*] 3(2) confirms that financial assistance, such as a state loan or investment, given on terms that might reasonably have been expected to have been available on the market to the enterprise does not meet the definition of a subsidy.

choice of a subsidy instrument may in some cases be limited by the policy objective being pursued or the intended recipients (see sections below).

Question: can a less distortive form of instrument be deployed which still meets the identified policy objective?

How the subsidy targets the policy objective

Subsidies should be designed carefully to target the specific policy objective and do so as effectively and efficiently as possible. This is closely tied to other key design features, including (choice of) selected recipients, the nature of the costs being covered, the performance criteria, and monitoring and evaluation. A poorly targeted subsidy may, for instance, place too few restrictions on how the beneficiary may use the subsidy so that it best achieves the policy objective in question. As such, poorly targeted subsidies are likely to lead to greater distortion for the given outcome achieved.

Some policy objectives may only be achievable by subsidies that could lead to (significant) distortive impacts. For example, the most distortive subsidies tend to be those where financial assistance is provided to a failing or unsustainable enterprise to ensure it stays in the market. This is why rescue and restructuring subsidies to ailing or insolvent enterprises are generally prohibited unless specific conditions are met. However, the high risk of distortion from such subsidies may be justified, in very specific cases, to prevent social hardship or severe market disruption. Further information on this can be found in [*to be inserted – link to future section on prohibitions*].

Question: could the subsidy better target the specified policy objective?

The selection process

Subsidies that are available to a broad set of recipients are less likely to distort competition and investment than subsidies that are only made available to a single firm. Subsidies should not intentionally or unintentionally favour one firm to the detriment of, for instance, its competitors unless this would be contrary to the stated policy objective. Public authorities should consider whether a subsidy could be opened up to other market participants.

There may also be instances where it is appropriate for the awarding process for a subsidy to involve an element of competition between potential recipients. For instance, the public authority could select recipients on the basis of which firm(s) can demonstrate that they would best meet the policy objective. The best placed firms can be identified by asking recipients to bid to win the subsidy and select the recipient(s) that require the smallest subsidy to achieve the policy objective. A competitive allocation process for a subsidy thereby also helps public authorities to meet Principle B.

Questions: could the subsidy be made available to any competitors? Could firms compete to win the award of the subsidy?

The size of the subsidy

Smaller subsidies are less likely to distort competition and investment. Public authorities should consider the size of a subsidy in absolute terms as well as relative to the size of the recipient, the costs on the beneficiary, or the value of the market(s) of the affected products or services. For example, while a £1m grant may have a significant bearing on the decisions of a small or medium-sized enterprise[8], it is likely to have a smaller influence on the behaviour of a multinational enterprise.

In line with Principle B, public authorities should design subsidies to be proportionate to their specific policy objective and limited to what is necessary to achieve it. Further detailed guidance on identifying the size of the subsidy needed to bridge the 'funding gap' is provided in *[link to future annex to be inserted].*

Question: could the value of the subsidy be lowered?

The timespan over which a subsidy is provided

Time-limited and one-off subsidies are less likely to distort domestic competition, investment and trade. The timespan of the subsidy and investment can provide an indication of the longevity of any effect on the market. Where appropriate, public authorities should design subsidies that are time-limited and payment schedules should be linked to performance criteria such as the achievement of specific milestones of a project (see the performance criteria subsection below). Public authorities should consider this feature in combination with the cost being covered by the subsidy (see the nature of the costs subsection below) as funding of different costs may have different effects on the timespan of funding.

Providing recurring subsidies over a period of time compared to a single, limited award is likely to have a greater impact on competition and investment, including on firms' entry and exit decisions. First, recurring and open-ended subsidies increase the risk of projects or activities continuing even after they have become uneconomic or obsolete (see the nature of the costs subsection below) and incentivise recipients to request further funding to continue a project or desired activity. Second, potential entrants could be deterred from entering the market if they have to compete with incumbents that are expected to receive further subsidies. Recurring subsidies could also prevent efficient rationalisation - a firm may remain in a market when this is no longer the best option for it either because it is committed to as part of a subsidy programme or because it has reason to expect future subsidies.

Question: Is the subsidy a one-off contribution or time-limited?

The nature of the costs being covered

Consideration should be given to how the subsidy will affect the beneficiary's costs. One-off subsidies which support the funding of an initial investment or the set-up costs of a project tend to be less distortive. As discussed in step 2, ongoing

[8] The Companies Act 2006 SME definition requires that two out of three characteristics are met – turnover (less than £25m), employees (less than 250), and gross assets (less than £12.5m).

subsidies which cover a beneficiary's 'day-to-day' costs, in particular those which vary with output, are more likely to impact competition, investment, and trade. Funding only initial investments or set-up costs also reduces the risk that a project or activity continues to be funded even if it has become obsolete or ineffective during the project's lifetime. Further detailed guidance on identifying the cost impact of the subsidy (which will mostly be relevant for SSoIs and SSoPIs) is provided in *[link to future annex to be inserted].*

Question: Could the subsidy offset the initial investment (e.g., the set-up costs) of a project or activity as opposed to supporting the ongoing operating costs?

Performance criteria

While the award of public funding will typically include consideration of performance management, the design of a subsidy may be improved by the inclusion of clear performance indicators in the agreement. These will help to ensure that the assistance is being best used to achieve the specified policy objective. Careful consideration will need to be given to the outcomes the beneficiary will be assessed against. Among other things, the subsidy agreement should clearly set out:

- the performance criteria;
- how the necessary information will be obtained;
- who will conduct the performance evaluation and at which points;
- dispute mechanisms, including any appropriate clawback provisions;
- the consequences for the beneficiary where it does not meet or falls short of the performance criteria. This could include conditions where later tranches of funding are only released if and when certain standards or outcomes have been exceeded, and/or recovery of tranches of funding where these have not been met.

Question: can performance criteria and a payment schedule linked to achievement of specific milestones be incorporated into the subsidy agreement?

Ringfencing

In their considerations on how to best target a subsidy (see section above), public authorities should also consider whether conditions could be imposed on beneficiaries that limit which activities or projects the subsidy can be used for. Among other things, this can help prevent funds being used to cross-subsidise other areas of the beneficiary's business.

Question: can the subsidy be ringfenced to ensure that funds are only spent on activities which contribute to the policy objective?

Monitoring and evaluation

Public authorities should consider building in periodic reviews of any ongoing subsidies where it is proportionate and appropriate to do so. This will assist with evaluating whether the subsidy is meeting the policy objective as well as identifying any distortions to competition and investment. Depending on the nature of the subsidy, these reviews could include an evaluation of:

- progress against the stated policy objective and whether interim objectives have been met;
- whether any new and overlapping subsidies have since been introduced which address the same policy objective;
- whether the market failure or equity issue still exists (or is sufficiently significant) and planned future subsidies are still required;
- any negative outcomes stemming from the subsidy, including on competition and investment;
- whether the subsidy should be altered going forward, phased out, or halted.

UK Government Departments should consult the Magenta and Green Books which provide detailed guidance on evaluation methods.[9]

Question: can monitoring and evaluation be embedded into the subsidy?

3.2 Geographical and distributional impacts

Subsidies often have geographical and distributional impacts. Distributional impacts can occur as a direct consequence of pursuing the policy objective, leading to one group being advantaged over another. For example, a scheme to subsidise youth employment could make it less likely that new jobs will be offered to older unemployed workers. Subsidies also often have geographical impacts. A subsidy designed to encourage growth or attract new investment into a disadvantaged area may impact the likelihood of investment in other disadvantaged areas. Public authorities should take these kinds of impacts into account before proceeding and consider whether there are ways to counteract the specific negative effect in the design of the subsidy.

Subsidies are commonly targeted at particular geographic areas, or sectors within particular areas, to improve regional economic development. While these subsidies may have a clear public policy objective and identified market failure, they can carry the risk of distorting competitive conditions between parts of the UK. Public authorities should consider the geographic spread or concentration of the industry within the UK even where this is outside their own geographic area of responsibility. Particular attention should be paid to subsidies directed at an industry made up of firms in different parts of the UK and directly competing for the same customers.

Relocation subsidies are prohibited where, first, the subsidy contains a condition requiring relocation and second, the relocation would not occur without the subsidy [*to insert – link to future section on prohibitions*]. Relocation for this purpose means where an enterprise carries on activities in one area of the UK and then, after receiving a subsidy, ceases to carry on those activities in that area and moves to a new area. Public authorities may still require the business to, for example, create new jobs within a certain area – but the awarding of a subsidy cannot require relocation from within the UK. Subsidies which are liable to incentivise the recipient

[9] www.gov.uk/government/publications/the-magenta-book
www.gov.uk/government/publications/the-green-book-appraisal-and-evaluation-in-central-governent

to relocate existing activities or divert the originally planned location of new investment (without requirement or conditionality) are not prohibited.

When considering the geographic and distributional impacts, public authorities should address the following questions:

- *Is the subsidy likely to advantage or disadvantage a particular group?*
- *Is the subsidy likely to lead to adverse effects on other geographical areas*?
- *Can the subsidy be redesigned in such a way as to minimise these impacts while still meeting the stated policy objective*?

Subsidy races

In addition to the above, public authorities should give regard to the risk of 'subsidy races' or bidding wars where two or more public authorities are vying for new investments. Public authorities should be cautious about subsidy races occurring as these may lead to a displacement of investment away from locations where the public benefits are the greatest and it may incentivise firms to use their leverage to secure larger subsidies than would have been possible had public authorities not been bidding against each other to secure the investment. This would also risk the subsidy not complying with Principle B, which states that a subsidy must be proportionate and limited to what is necessary. Where there is a greater risk of a subsidy race occurring, public authorities should:

- *Carry out more extensive analysis of both the positive and negative impacts of the subsidy (looking at the counterfactual of where the investment would be located in the absence of the subsidy).*
- *Consider whether competing offers from different parts of the UK have increased the size of the subsidy on offer from what it originally would have been, and whether the subsidy can still be justified as being proportionate.*
- *Consider the relative levels of disadvantage of the areas in question. Subsidies which may result in a shift in economic activity from a less disadvantaged area to a more disadvantaged one, and which could lead to an increase in economic output for the UK as a whole, will be easier to justify against Principle G (the 'balancing test').*

4. Carrying out a final assessment of compliance against the principles

[*This section will set out how to assess the remaining distortions to competition, investment, and trade in order to conduct the balancing test. It will include guidance on how to assess the relevant characteristics of the market(s) that are affected by the subsidy and whether these might counterbalance or exacerbate the distortive characteristics a subsidy may have. This will include a template for public authorities to demonstrate compliance against the principles once they have completed step.*]