Subsidy Advice Unit Report on the proposed Investment Zones Scheme for England

Referred by the Department for Levelling Up, Housing and Communities

17 April 2024

Subsidy Advice Unit

Part of the Competition and Markets Authority

CONTENTS

1. Introduction

1.1 This report is an evaluation prepared by the Subsidy Advice Unit (SAU), part of the Competition and Markets Authority, under section 59 of the Subsidy Control Act 2022 (the Act).

1.2 The SAU has evaluated the Department for Levelling Up, Housing and Communities (DLUHC)'s assessment of compliance of the Investment Zones Scheme for England (the Scheme), with the requirements of Chapters 1 and 2 of Part 2 of the Act (the Assessment).[1]

1.3 This report is based on the information provided to the SAU by DLUHC in its Assessment and evidence submitted relevant to that Assessment.

1.4 This report is provided as non-binding advice to DLUHC. The purpose of the SAU's report is not to make a recommendation on whether the Scheme should be implemented or directly assess whether it complies with the subsidy control requirements. DLUHC is ultimately responsible for granting the Scheme, based on its own assessment, having the benefit of the SAU's evaluation.

1.5 A summary of our observations is set out at section 2 of this report.

The referred scheme[2]

1.6 The Assessment sets out that the Scheme is part of the Levelling Up agenda. It aims to boost productivity and growth in certain areas in need of levelling up by catalysing investment to support the development of economic clusters.

1.7 The Scheme will come into effect in Spring 2024 and will last for 10 years. Subject to meeting a set of published requirements,[3] each Investment Zone in England (Investment Zone) will have a funding envelope of £160 million over 10 years. This funding can be used flexibly between grants and tax reliefs, scalable based on the number of sites.[4]

1.8 Where a public authority establishes tax sites within an Investment Zone, businesses will be eligible to receive a subsidy in the form of tax reliefs if they undertake one or more of the following activities in the Investment Zone tax site:

[1] Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and energy and environment principles before deciding to give a subsidy. The public authority must not award the subsidy unless it is of the view that it is consistent with those principles. Chapter 2 of Part 2 of the Act prohibits the giving of certain kinds of subsidies and, in relation to certain other categories of subsidy creates a number of requirements with which public authorities must comply.
[2] Referral of the proposed English Investment Zones Scheme by the Department for Levelling Up, Housing and Communities
[3] Investment Zones: technical document - GOV.UK (www.gov.uk)
[4] Where tax sites are utilised in an Investment Zone, the budget for grant funding will be reduced by £75,000 per hectare of tax site.

(a) full Stamp Duty Land Tax relief for land and buildings bought for commercial use or development for commercial purposes;

(b) 100% relief from business rates on newly occupied business premises, and certain existing businesses where they expand in Investment Zone tax sites;

(c) 100% first year capital allowance for companies' qualifying expenditure on plant and machinery assets for use in tax sites;

(d) accelerated relief to allow businesses to reduce their taxable profits by 10% of the cost of qualifying non-residential investment per year, relieving 100% of their cost of structures and buildings over 10 years; and

(e) zero-rate Employer National Insurance Contributions (NICs) relief on salaries of any eligible new employee working in the tax site for at least 60% of their time, on earnings up to £25,000 per year, with Employer NICs being charged at the usual rate above this level. This relief can be applied for 36 months per employee.

1.9 Grants can be given to eligible businesses for activity in Investment Zone areas that is aligned with the Scheme's policy objectives under the themes of skills, research and innovation, local infrastructure, and business support. Under the Scheme, the maximum grant funding awardable to a single beneficiary for an activity over three years is capped for each theme.[5]

1.10 Subsidies given under the Scheme will be administered by either Mayoral Combined Authorities or constituent local authorities (referred to as accountable bodies under the Scheme).

1.11 The final plans for the first six Investment Zones were announced in March 2024.[6] The government is working with local partners to develop and agree two further Investment Zones.[7] All eight Investment Zones are expected to commence operation in the financial year 2024/2025.

SAU referral process

1.12 On 27 February 2024, DLUHC requested a report from the SAU in relation to the Scheme.

[5] The caps are: £20 million for skills, £45 million for local infrastructure, £35 million for research and innovation and £25 million for business support.

[6] The Greater Manchester Investment Zone, the Liverpool City Region Investment Zone, the North East of England Investment Zone, The South Yorkshire Investment Zone, the West Midlands Investment Zone, and the West Yorkshire Investment Zone.

[7] The East Midlands Investment Zone and the Tees Valley Investment Zone.

1.13 DLUHC explained[8] that the Scheme is a scheme of Particular Interest because it allows subsides to be granted over the value of £10 million.

1.14 The SAU notified DLUHC on 4 March 2024 that it would prepare and publish a report within 30 working days (ie on or before 17 April 2024).[9] The SAU published details of the referral on 5 March 2024.[10]

[8] In the information provided under section 52(2) of the Act.
[9] Sections 53(1) and 53(2) of the Act.
[10] Referral of the proposed English Investment Zones Scheme by the Department for Levelling Up, Housing and Communities - GOV.UK (www.gov.uk)

2. Summary of the SAU's observations

2.1 The Assessment uses the four-step structure described in the Statutory Guidance for the United Kingdom Subsidy Control Regime (the Statutory Guidance) and as reflected in the SAU's Guidance on the operation of the subsidy control functions of the Subsidy Advice Unit (the SAU Guidance).

2.2 We consider that DLUHC has carefully considered the Scheme's compliance with the subsidy control principles, and would highlight the following positive features:

(a) The equity objective under Step 1 is well set out, with evidence and statistics for different metrics indicating poor outcomes compared to the UK average provided for each of the Investment Zone areas.

(b) It uses case studies (based on existing similar schemes internationally and the individual Investment Zone proposals) to demonstrate that the Scheme is based on the minimum necessary and proportionate to achieve the policy objective. Using case studies is an effective way to assess such schemes where they involve a number of markets and as yet unknown beneficiaries.

(c) The counterfactual under Step 2 benefits from including a forward look at what might happen absent the subsidies over time.

2.3 We consider that DLUHC could strengthen parts of its Assessment, in particular:

(a) The Assessment sets out how DLUHC intends to monitor and evaluate the operation of the Scheme. However, this aspect could be improved with more detail on how DLUHC will manage the impact of devolving decision-making over certain aspects of scheme design (such as the selection criteria for beneficiaries) to the accountable bodies, in particular on what subsidies may be awarded under the Scheme and ensuring subsequent continued compliance with the principles.

(b) Step 3 of the Assessment could be improved with a fuller consideration of how elements of the Scheme's design could lead to distortions in competition and if any mitigations could be put in place to limit them.

2.4 Our report is advisory only and does not directly assess whether the Scheme complies with the subsidy control requirements. The report does not constitute a recommendation on whether the Scheme should be implemented by DLUHC. We have not considered it necessary to provide any advice about how the proposed scheme may be modified to ensure compliance with the subsidy control requirements.[11]

[11] Section 59(3)(b) of the Act.

3. The SAU's evaluation

3.1 This section sets out our evaluation of the Assessment, following the four-step structure used by DLUHC.

Step 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

3.2 The first step involves an evaluation of the Assessment against:

(a) Principle A: Subsidies should pursue a specific policy objective in order to (a) remedy an identified market failure or (b) address an equity rationale (such as local or regional disadvantage, social difficulties or distributional concerns); and

(b) Principle 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.[12]

Policy objectives

3.3 The Assessment describes the 'major' objective of the Investment Zones policy as addressing an inequity in economic and social outcomes in certain areas of the UK by boosting productivity in those areas. The Assessment states that 'the Investment Zone programme has been launched as a critical part of the levelling up agenda' and 'will catalyse a small number of high-potential clusters in areas in need of levelling up to boost productivity and growth'. The Assessment outlines further desired outcomes including increases in real earnings for high and low skilled workers in the areas concerned, increases in the international competitiveness of companies within the targeted clusters and the development of internationally demanded new technologies.

3.4 In our view, relevant policy objectives relating to the identified equity objective are set out throughout the Assessment. However, it would benefit from more explicitly identifying the specific policy objective of the Scheme upfront.

[12] Further information about the Principles A and E can be found in the Statutory Guidance (paragraphs 3.32 to 3.56) and the SAU Guidance (paragraphs 4.7 to 4.11).

Equity objective

3.5 The Statutory Guidance sets out that equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.[13]

3.6 The Assessment provides a range of statistics[14] demonstrating that each Investment Zone area has lower productivity than the UK national average, performs below other areas of England in terms of healthy life expectancy, contains some of England's most deprived neighbourhoods, and contains a disproportionate number of people who are not highly skilled compared to other areas, such as London.

3.7 The Assessment explains that the Scheme will address these inequalities by strengthening innovative economic clusters[15] in the Investment Zone areas.[16] These clusters will, through associated benefits such as enhanced supply chain linkages between firms and agglomeration externalities,[17] increase productivity and subsequently lead to economic growth, delivering improved social outcomes for the targeted areas.

3.8 In our view, the equity objective that the Scheme seeks to address is well explained, with appropriate statistics used to demonstrate the existence of inequalities between different areas within the UK.

Market Failure

3.9 The Statutory Guidance sets out that market failure occurs where market forces alone do not produce an efficient outcome.[18]

3.10 The Assessment describes the benefits of economic clusters and co-location, providing relevant supporting evidence such as academic research on agglomeration externalities and the impacts of clusters on productivity and growth. The Assessment then explains that these areas have failed to provide the relevant inputs[19] required in order to grow these clusters, as 'the market' (ie businesses acting in their private interests) is not incentivised to do so.

---

[13] Statutory Guidance, paragraphs 3.49 to 3.53.
[14] Sourced from ONS Subregional Productivity Data, ONS Health State Life Expectancy Data, English Indices of Deprivation 2019 and the Annual Population Survey.
[15] Clusters are concentrations of firms within the same or similar industries and other related institutions that benefit from co-location.
[16] The Assessment cites the Levelling Up White Paper (see Levelling Up the United Kingdom - GOV.UK (www.gov.uk) to support its conclusions regarding the economic benefits of clusters.
[17] Agglomeration externalities refer to the benefits that arise from the co-location of firms and industries in a specific geographical area.
[18] Statutory Guidance, paragraphs 3.35 to 3.48.
[19] Physical capital, human capital, intangible capital, financial capital, institutional capital, and social capital as identified in the Levelling Up White Paper (see Levelling Up the United Kingdom - GOV.UK (www.gov.uk)).

3.11 It further explains there exists a cycle where these areas lack the inputs needed to attract investment, and therefore lack the investment to generate those inputs, constituting a market failure and requiring government intervention to stimulate activity.

3.12 In our view, the Assessment's conclusions regarding the economic benefits of clusters are supported by reasonable evidence. However, the market failure described could have been improved by explaining how and why the areas chosen for Investment Zones lack the key inputs required to grow clusters, and how this constitutes a market failure in the specific areas chosen.

3.13 We note that, as set out in the Statutory Guidance,[20] it is for public authorities to decide whether to include an equity objective, market failure or both depending on what is most relevant to the subsidy.

Consideration of alternative policy options and why the Scheme is the most appropriate and least distortive instrument

3.14 In order to comply with Principle E, public authorities should consider why the decision to give a subsidy is the most appropriate instrument for addressing the identified policy objective, and why other means are not appropriate for achieving the identified policy objective.[21]

3.15 The Assessment sets out several options that were considered as alternative policy options to subsidy. These options were:

(a) encouraging greater networking between universities and businesses to catalyse private sector investments;

(b) providing loans instead of grants or tax relief;

(c) promoting exports and enhancing the UK's position as an attractive destination for foreign investment;

(d) advertising and marketing the UK as a location for investment and innovation; and

(e) the creation of more strategic plans such as Local Skills Improvement Plans and Local Industrial Strategies.

[20] Statutory Guidance, paragraphs 3.32 and 3.33.
[21] Statutory Guidance, paragraphs 3.54 to 3.56.

3.16 The Assessment concludes that these options do not provide the direct financial support needed to incentivise investment and development in the Investment Zone areas.[22]

3.17 In our view, the Assessment demonstrates that DLUHC considered several policy options for achieving the policy objective and explains why they were not considered appropriate. The Assessment would be strengthened by providing a more detailed explanation and supporting evidence on the variety of economic activities, sectors and beneficiaries the Scheme has been designed to support in order to demonstrate how DLUHC concluded that providing subsidies under the Scheme is the most appropriate instrument to achieve the policy objective.

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

3.18 The second step involves an evaluation of the assessment against:

(a) Principle C: First, subsidies should be designed to bring about a change of economic behaviour of the beneficiary. Second, 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; and

(b) Principle D: Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.[23]

Counterfactual assessment

3.19 In assessing the counterfactual, the Statutory Guidance explains that public authorities should assess any change against a baseline of what would happen in the absence of the subsidy (the 'do nothing' scenario').[24] This baseline would not necessarily be the current 'as is' situation (the 'status quo') but what would likely happen in the future – over both the long and short term – if no subsidy were awarded.

3.20 The Assessment explains that, in the absence of the provision of subsidies under the Scheme, regional productivity would not grow in the manner required to meet the equity objective. It states that economic disparities between regions would persist while economic growth would remain persistently low. The Assessment

[22] While loans do provide financial support, the Assessment explains that the associated repayment obligations and interest would increase the financial risk in investing in less developed areas (particularly for SMEs) and could exacerbate financial pressures on businesses. Additionally, as loans require an upfront indication that the project is feasible and worth pursuing, this would limit the policy to parts of England where land values are already highest, which is counterproductive to achieving the policy objective.

[23] Further information about the Principles C and D can be found in the Statutory Guidance (paragraphs 3.57 to 3.71) and the SAU Guidance (paragraphs 4.12 to 4.14).

[24] Statutory Guidance, paragraphs 3.60 to 3.62.

states that the clusters would, in the absence of the Scheme, lack both the financial incentives required to accelerate the delivery of the government's growth objectives and the necessary coordination to overcome the barriers to growth in each locality.

3.21 To illustrate the counterfactual at the regional level, the Assessment provides three case studies, covering the West Midlands, South Yorkshire and Greater Manchester, to 'typify the case for all Investment Zones'. These provide data showing trends in the evolution of the market failure or inequality by referring to growth rates and economic modelling undertaken by third parties.

3.22 In our view, the Assessment explains the counterfactual well. The case studies provide for a forward-looking assessment of what would happen in the chosen Investment Zone areas absent the subsidy. For example, rather than simply stating that there would be reduced investment in the counterfactual scenario, the Assessment sets out the anticipated level of future economic growth, thereby showing anticipated trends in the evolution of the market failure and inequality. The Assessment could be improved further by explaining how the chosen case studies are likely to be broadly representative of all the areas covered by the Scheme (eg by noting common features between the areas).

Changes in economic behaviour of the beneficiary

3.23 The Statutory Guidance sets out that subsidies must bring about something that would not have occurred without the subsidy.[25] In demonstrating this, public authorities should consider the likely change or additional net benefit.

3.24 The Assessment explains that the Scheme is designed to influence the beneficiaries to deliver outputs and outcomes in a specific area that would not otherwise have been delivered. The Assessment takes two approaches to evidencing the change in economic behaviour: (a) location-based examples (ie Investment Zone-based); and (b) examples for different types of subsidies.

3.25 For the location-based examples, the Assessment provides two case studies to demonstrate how subsidies will cause the intended behavioural change in beneficiaries: one in the North East (an R&D subsidy) and one in the East Midlands (a skills-based subsidy). The 'subsidy-type' based examples are in the form of 'illustrative' case studies which seek to identify how an R&D subsidy, a business support subsidy and a subsidy for local infrastructure could influence the behaviour of beneficiaries.

3.26 The Assessment further describes how tax subsidies have been designed to create behavioural change, and how decision making has been devolved to the

[25] Statutory Guidance, paragraph 3.64.

relevant accountable bodies to further ensure that the desired behavioural change in the beneficiary is achieved.

3.27 The Assessment explains that the change in behaviour which the subsidy is expected to bring about is an increase in economic activity that improves productivity in the eight Investment Zones.

3.28 We find that the case studies are again useful to demonstrate how the change in economic behaviour may evolve (although similarly to the advice set out in paragraph 3.22, it could be helpful to explain how the case studies selected demonstrate the expected change in economic behaviour across all Investment Zones and, in this case, all subsidy types). Finally, the inclusion of supporting evidence would also have improved the Assessment further.[26]

Additionality assessment

3.29 According to the Statutory Guidance, 'additionality' means that subsidies should not be used to finance a project or activity that the beneficiary would have undertaken in a similar form, manner, and timeframe without the subsidy.[27] For schemes, this means that public authorities should, where possible and reasonable, ensure the scheme's design can identify in advance and exclude those beneficiaries for which it can be reasonably determined would likely proceed without subsidy.[28]

3.30 The Assessment acknowledges that 'displacement and non-additionality is a risk with a place-based policy model', and that this is particularly the case where such policies designate specific tax-relief sites. It explains that the intention of this Scheme is not for businesses to relocate and deliver a benefit that would have just happened elsewhere. The Assessment explains that non-additionality has therefore been 'designed out' through:

(a) co-development of Investment Zone proposals by DLUHC and the relevant accountable bodies to ensure that subsidies are not funding costs that would have been funded in the absence of subsidies;[29]

(b) only half of the Investment Zones including tax sites;

(c) a trade-off between tax site size and flexible spending management arrangements; and

[26] Such as references to examples of similar types of subsidies (eg business-support subsidies) having changed behaviour in other cases.
[27] Statutory Guidance, paragraphs 3.63 to 3.67.
[28] Statutory Guidance, paragraph 3.66.
[29] The key criteria used to assess proposals include displacement, deadweight, leakage and substitution.

(d) strict tax site selection criteria.

3.31 The Assessment explains that Investment Zones were required to provide evidence of how subsidies will create social value that would not be created in the absence of direct funding interventions, and summarises the criteria used to assess proposals. The Assessment sets out four remaining subsidy types (not including tax sites) and summarises the kinds of costs that subsidies given under the Scheme could cover and why subsidies are necessary to cover those costs.

3.32 In our view, the Assessment's recognition of the risk of non-additionality is beneficial considering the broad nature of this Scheme. The discussion of how it 'designs out' non-additionality is positive, although in places relies on assertions that would benefit from additional explanation or evidence. Further, it is not clear that all factors set out in paragraph 3.30 arise by design – for example, it is a result of accountable bodies decision-making that only half of Investment Zones contain tax sites, and not due to the design of the scheme.

3.33 The Assessment clearly describes the types of subsidies that would be allowable under the Scheme, which is positive. The Assessment could benefit from discussing in more detail the eligibility requirements and the checks/processes that the accountable bodies should follow in granting subsidies to ensure that they remain in line with additionality guidelines at the time of being granted (ie not just at the design stage). This could include how DLUHC will monitor accountable bodies throughout the lifetime of the Scheme given the latter will have some discretion in how subsidies are granted, including over selection criteria for beneficiaries. This could take the form of explaining how monitoring and enforcement features discussed elsewhere in the Assessment help ensure this.[30]

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

3.34 The third step involves an evaluation of the assessment against:

(a) Principle B: Subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it; and

(b) Principle F: Subsidies should be designed to achieve their specific policy objective while minimising any negative effects on competition or investment within the United Kingdom.[31]

[30] The Statutory Guidance notes that it is not always possible in advance to ensure that every subsidy will lead beneficiaries to do things they would not otherwise have done and guides authorities to consider the use of eligibility restrictions to limit non-additionality. See Statutory Guidance, paragraph 16.39.

[31] Further information about the Principles B and F can be found in the Statutory Guidance (paragraphs 3.72 to 3.108) and the SAU Guidance (paragraphs 4.15 to 4.19).

Proportionality

3.35 The Assessment explains the methodology and process used to determine which areas would be included in the Scheme. This included identifying and scoring all Functional Economic Areas[32] to identify places with the potential to benefit from being an Investment Zone. It further explains how the methodology aims to ensure that subsidies will only be awarded in areas which suffer from the inequalities identified in Step 1, and with the right assets and capacity to achieve the policy objectives, thereby ensuring proportionality.

3.36 The Assessment explains that the size of the subsidy was set to ensure that multiple constraints facing a cluster could be addressed, with the aim to 'kick-start' private sector investment, incentivise match funding, and secure the long-term investment needed to achieve the policy objectives. The Assessment uses case studies (looking at similar schemes internationally) to illustrate the potential scale of different interventions and impacts that different levels of grant funding (ranging from £30 million to £3 billion) can achieve. The Assessment further explains why the chosen scheme budget for grants is proportionate to the policy objectives.

3.37 The Assessment also explains that the level and range of tax subsidies available under the Scheme were informed by outcomes from previous regional interventions such as Enterprise Zones and Freeports, as well as wider policy experience (leading to a wider suite of tax reliefs than previous interventions). Case studies are again used to demonstrate proportionality, in this instance illustrating the potential proportion of tax relief provided by the subsidy relative to a business's revenue.

3.38 The Assessment details how the scheme design is intended to ensure that the Scheme is proportionate to the policy objective of creating cluster growth, and limited to the minimum necessary, through elements including:

(a) funding being targeted at four specific themes only (see paragraph 1.9);

(b) caps for each theme of grant funding[33] and individual elements of the tax subsidies;

(c) providing a mix of tax reliefs and grant funding;

(d) the Scheme being open to a broad range of beneficiaries;

[32] As defined by DLUHC [Investment Zones place selection: methodology note - GOV.UK (www.gov.uk)]
Key economic markets broadly correspond to sub-regions or regional labour markets - known as functional economic areas (FEAs).
[33] Skills: £20 million; Local Infrastructure: £45 million; Research and Innovation: £35 million; and Business Support: £25 million.

(e) time limits (a timespan of 10 years for the Scheme overall, a time limit on grant funding of three years and time limits on tax reliefs); and

(f) criteria for the grant funding including clawbacks.

3.39 In our view, the Assessment demonstrates that the overall Scheme budget is proportionate to the policy objectives. The Assessment uses case studies to illustrate what can be achieved at different levels of funding, which is a good way to demonstrate proportionality.

3.40 While the supporting evidence provided includes more detail on the Investment Zones criteria and guidance on how a Public Authority should apply the policy, the Assessment could be improved by explaining further and more explicitly how DLUHC plans to oversee the granting of individual subsidies to ensure consistency with the subsidy control principles.

3.41 In particular, it would be improved by setting out how it plans to ensure proportionality at a more granular level (particularly where a single beneficiary could receive subsidies across multiple investment zones), as well as how the clawback mechanisms are intended to work in practice (as they will not be administered by DLUHC). As set out in paragraph 3.33 above, this could include detail on how DLUHC will ensure that subsidies awarded by accountable bodies under the Scheme remain consistent with the subsidy control principles given the discretion the latter will have over selection criteria.

Design of subsidy to minimise negative effects on competition and investment

3.42 The Assessment explains that although grant funding has the potential to be more distortive than other types of intervention, this risk is mitigated at a scheme level by the limits placed on the size of a potential subsidy (the theme caps, detailed in footnote 33), as well as other scheme design elements. These include:

(a) the Scheme being open to a broad set of recipients;

(b) a competitive process to award grant funding;

(c) a requirement for a contribution from the private sector, third sector or local government for the intervention (or a clear rationale where not) which should ensure failing companies are not propped up by the subsidy;

(d) the time limited nature of the Scheme;

(e) the design of tax reliefs to ensure subsidies for the same investment costs cannot cumulate with other subsides provided under the Scheme;

(f) clawback mechanisms; and

(g) ongoing performance and monitoring requirements of the Scheme.

3.43 The Assessment explains that the wide nature of the Scheme means that there will not be a concentration of resources and opportunities in specific locations which could potentially stifle competition and innovation elsewhere. It also explains that if the Scheme was not regionally spread then it could exacerbate regional disparities already in existence.

3.44 In our view, the Assessment could be improved further by explaining how certain elements of the Scheme design could lead to distortions in competition, and how these have been mitigated. In particular, while caps on grant funding are in place, a single beneficiary could receive a significant subsidy, both across multiple themes in a single Investment Zone (as grant caps apply to each theme, and do not apply to a beneficiary), as well as across multiple Investment Zones (as caps apply per zone, not across all zones). While DLUHC has explained that the Scheme is unlikely to lead to such an occurrence, due to Investment Zones focusing on different sectors and a limited number of businesses operating across multiple sectors, the Assessment could be improved by considering the significance of these potential distortions, and if any further mitigations could be put in place.

Assessment of effects on competition or investment

3.45 The Assessment provides a high-level analysis of the relevant sectors for which subsidies could be granted within the Investment Zones. These are creative industries, advanced manufacturing, digital and technology, life sciences, and green industries. The Assessment includes differing levels of information for each sector, including: the number and size of businesses (large vs SMEs), number of sites and employees, as well as the proportion employed in London/the South-East compared to the UK overall, and turnover data for the industry.

3.46 The Assessment recognises the potential for distortion in all sectors resulting from the Scheme. It details potential distortions to competition and uses case studies focusing on three of the relevant sectors (life sciences, nuclear energy, and advanced manufacturing) to illustrate how these could arise.

3.47 For each case study, the Assessment identifies potential competitors, and considers distortions that could happen if subsidies disproportionately favour certain regions or types of business (particularly in a specialist industry), the potential for subsidies to divert investments to areas where the Investment Zones are located (potential displacement), that businesses in receipt of a subsidy could potentially bring a product to market faster, and the potential for overlapping business specialisms meaning beneficiaries could be competing with businesses not eligible or receiving a subsidy.

3.48 The Assessment considers that subsidies granted to smaller businesses are likely to have a negligible impact on competition due to their size in the market, as well as considering that the impact would also be negligible for larger businesses due to the targeted nature of the Scheme (see for example paragraph 1.9). The Assessment also explains that where the overall size of the market is large, DLUHC do not expect subsidies to cause significant distortion to the market.

3.49 The Assessment also details potential positive effects on competition from subsidies granted under the Scheme. These include achieving the policy objectives (to stimulate economic growth and resolve the market failure/inequality identified in Step 1), improving overall resilience and sustainability of the sectors, potential for complementary industries to localise together creating an ecosystem that fosters innovation and productivity, the potential for targeted subsidies to have a big impact where significant costs are faced by the industry, and the potential for targeted subsidies to help create a diverse and competitive market without favouring certain players.

3.50 The Assessment considers at a high level the potential for subsidy races between Investment Zones but considers these to be unlikely given the different geographical location and sectoral focus for each zone.

3.51 In our view, the Assessment's use of case studies to illustrate potential distortions is a good approach. In particular, the case studies help to illustrate the relevant markets and competitors, and, at a high level, how competition could be distorted in the context of a scheme where the granular details of all subsidies to be granted and the beneficiaries are not yet known.

3.52 However, the Assessment could be strengthened by including more detailed explanations of the potential distortions to competition; although these are included, they are explained at a very high-level. It could also be improved by adding case studies and potential distortions for all relevant sectors (rather than just the three examples) or alternatively explaining why the case studies chosen are applicable to the entirety of the Scheme.

3.53 The Assessment could also consider more explicitly the types of costs being funded by the Scheme. For example, where tax subsidies are contributing to operating costs, the Assessment could consider more explicitly how significant these subsidies could be and the impact on competition, given that a subsidy funding this type of cost is more likely to be distortive to competition.

Step 4: Carrying out the balancing exercise

3.54 The fourth step involves an evaluation of the assessment against subsidy control Principle G: subsidies' beneficial effects (in terms of achieving their specific policy objective) should outweigh any negative effects, including in particular negative effects on: (a) competition or investment within the United Kingdom; (b) international trade or investment.[34]

3.55 The Assessment sets out the expected benefits of the Scheme resulting from increased economic activity, including increased employment, higher wage jobs and a higher level of skills in the Investment Zone areas.

3.56 The Assessment also considers the potential negative effects of the Scheme. These include geographic and distributional impacts on other disadvantaged areas, potential impacts on international trade or investment, displacement of economic activity and investment from other areas, impact on employment rates, larger firms possibly benefiting more than smaller firms and potential negative impacts on quality of life resulting from agglomeration. The Assessment considers how the Scheme design and other factors will mitigate these negative impacts.

3.57 The Assessment concludes that the expected benefits of the Scheme 'significantly outweigh' any potential negatives.

3.58 In our view the Assessment demonstrates that DLUHC has considered the expected benefits of the Scheme and its potential negative effects in line with the Statutory Guidance. The Assessment could however be improved with a clearer explanation of how it weighed the benefits and negatives against each other to arrive at its conclusion. This could include a quantification or estimation of the likely magnitude of the expected beneficial and negative effects (or an explanation of why doing so was not possible). We note that the Assessment refers to a benefit cost ratio analysis, but describes this only at high level. A more detailed explanation of this analysis could assist in supporting the conclusions of the balancing exercise.

Other requirements of the Act

3.59 This step in the evaluation relates to the requirements and prohibitions set out in Chapter 2 of Part 2 of the Act, where these are applicable.[35]

3.60 DLUHC has confirmed that none of the prohibitions or other requirements in relation to the giving of subsidies apply.

3.61 With regard to the rules on prohibiting subsidies for the relocation of activities where the subsidy is conditional on relocation and would not have occurred

[34] See Statutory Guidance (paragraphs 3.109 to 3.117) and SAU Guidance (paragraphs 4.20 to 4.22) for further detail.
[35] Statutory Guidance, chapter 5.

without the subsidy,[36] the Assessment notes paragraphs 5.22[37] and 5.32[38] of the Statutory Guidance and states that the intention of the Scheme is not to influence businesses to relocate and deliver a benefit that would have happened elsewhere.

3.62 We consider that the Assessment could be improved by explaining more fully and clearly why the relocation prohibition is not applicable to any category of potential beneficiary, including, if necessary, whether the exemption from the relocation prohibition is applicable.[39]

17 April 2024

---

[36] Section 18(1) of the Act.
[37] 'Relocation subsidies are generally prohibited where, first, the subsidy contains a condition requiring the relocation and second, the relocation would not occur without the subsidy. They may be permitted where the relocation subsidy is for the purposes of reducing economic or social disadvantage […]. Subsidies that require the enterprise to move within the same area are also not prohibited […].'
[38] 'Relocation subsidies will be treated as SSoI below a value of £1m, and SSoPI above that value.'
[39] Section 18(4) of the Act states that the prohibition on relocation does not apply if the public authority giving the subsidy is satisfied that: the effect of the subsidy is to reduce the social or economic disadvantages of the area that would benefit from the giving of the subsidy (section 18(5) of the Act), that the giving of the subsidy results in an overall reduction in the social or economic disadvantages within the UK generally (section 18(6) of the Act), and that the subsidy is designed to bring about a change in the size, scope or nature of the existing economic activities (section 18(7) of the Act).