Subsidy Advice Unit Report on the proposed Green Freeports in Scotland Subsidy Scheme

Referred by Scottish Government and Department for Levelling Up, Housing and Communities

24 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 Scottish Government (SG) and Department for Levelling Up, Housing and Communities (DLUHC)'s assessment of compliance of the proposed Green Freeports in Scotland Scheme (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 SG and DLUHC in their Assessment and evidence submitted relevant to that Assessment.

1.4 This report is provided as non-binding advice to SG and 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. SG and DLUHC are ultimately responsible for making the scheme, based on their 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 SG and DLUHC are proposing to create the Scheme to help achieve the strategic ambitions for Green Freeports in Scotland. These are discussed further under our evaluation of Step 1 of the Assessment.

1.7 In 2021, the UK government established the UK Freeports Programme, as part of its Levelling Up agenda. Eight Freeports were initially selected in England and, in 2022, the Scottish and UK governments agreed to jointly deliver two additional Green Freeports in Scotland.

1.8 The Assessment defines a Green Freeport as 'a large, zoned area within a defined boundary which includes a rail, sea or airport. Operators and businesses locating on specific sites within the zone can benefit from a package of tax and other incentives through a combination of devolved and reserved levers'.[3] They are delivered by a local coalition including local authorities, ports, businesses and academic institutions. Green Freeports are designed to boost innovation and

[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 Green Freeports in Scotland Subsidy Scheme by Scottish Government and Department for Levelling Up, Housing and Communities - GOV.UK (www.gov.uk)
[3] For more information on Freeports please see guidance published by DLUHC.

inclusive growth within communities, creating new green jobs, upholding the highest environmental protections, and supporting economic transformation.

1.9 Following a competitive bidding exercise, Forth Green Freeport (FGF) and Inverness and Cromarty Firth Green Freeport (ICFGF) were selected in January 2023 as the two Scottish sites for the UK Freeport Programme.

1.10 SG and DLUHC told us that under the proposed Scheme qualifying enterprises will be able to receive support through the following measures:

(a) Land and Buildings Transaction Tax relief for land and buildings in Green Freeport tax sites bought for commercial use or development for commercial purposes;

(b) non-domestic rates relief; for 5 years on newly occupied business premises, and certain existing businesses where they expand in Green Freeport tax sites;

(c) first year capital allowance on plant and machinery;

(d) zero rate of secondary National Insurance contributions for employees;

(e) enhanced structures and buildings allowances; and

(f) seed capital funding totalling £50 million across both sites which will be targeted at enabling infrastructure and site remediation.

1.11 All the subsidies are limited in duration - seed capital may be claimed between 2024-27 and tax measures may be claimed for qualifying activity from 2024-34, with specific terms and conditions set out in the relevant guidance. Prior to designation as tax sites, the Green Freeports were subject to assessment and analysis of their Outline Business Cases, and specific analysis of the proposed sites.

1.12 A lead local authority within each Green Freeport will be allocated around £25 million seed capital funding, primarily to use on supporting projects which address local market failures and unlock sites for development. Prior to seed capital being awarded, the Full Business Cases must be provided and demonstrate how seed capital projects will achieve the equity rationale of the policy, why public intervention is required, and why subsidy (rather than direct provision) is appropriate, as applicable.

1.13 The Scheme is designed to achieve transformational change in Green Freeport locations. The proposed benefits include projected growth in economic activity through new business formation and the expansion of existing businesses, which will create an increased number of jobs and raise average private sector wages.

1.14 SG and DLUHC have stated that, whilst it is not possible to establish a definitive 'budget' for the Scheme ahead of time, based on Office for Budget Responsibility costings the value of the Scheme is approximately £118 million (£50 million in seed capital, £68 million in tax reliefs).

SAU referral process

1.15 On 5 March 2024, SG and DLUHC requested a report from the SAU in relation to the proposed Scheme.

1.16 SG and DLUHC explained[4] that the Scheme is a Subsidy Scheme of Particular Interest because it allows for the provision of one or more Subsidies of Particular Interest to be given.[5] They explained that this is because one or more beneficiaries may receive a subsidy of over £10 million.

1.17 The SAU notified SG and DLUHC on 11 March 2024 that it would prepare and publish a report within 30 working days (ie on or before 24 April 2024).[6] The SAU published details of the referral on 12 March 2024.[7]

[4] In the information provided under section 52(2) of the Act.
[5] Within the meaning of regulation 3 of The Subsidy Control (Subsidies and Schemes of Interest or Particular Interest) Regulations 2022 which sets out the conditions under which a subsidy or scheme is considered to be of particular interest.
[6] Sections 53(1) and 53(2) of the Act.
[7] Referral of the proposed Green Freeports in Scotland Subsidy Scheme by Scottish Government and 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 SG and DLUHC have carefully considered the Scheme's compliance with the subsidy control principles and would highlight the following positive features:

(a) In relation to Principle A, the Assessment clearly describes both the policy objective and in particular, the equity objective, explaining the inequalities the Scheme seeks to address, that they are longstanding and self-reinforcing and supports this with appropriate reasoning and evidence.

(b) In relation to Principle E, the Assessment demonstrates that several policy options for achieving the policy objective were considered and clearly sets out the arguments in favour of the chosen model, which are well-reasoned and supported with relevant evidence.

(c) In relation to Principle C, the Assessment gives detailed and thorough consideration to the counterfactual scenario and supports its conclusions with appropriate reasoning and evidence.

2.3 However, we consider that the Assessment could be improved by:

(a) In relation to Principle B, explaining more fully how the seed funding allocation, management and monitoring processes set out in the supporting evidence will support SG and DLUHC in ensuring continued compliance with the Principles when devolving decision-making over seed funding projects to relevant local authorities.

(b) In relation to Principle F, giving further consideration as to the broader potential competitive impact of freeports, for example by considering the actual impact of other freeports, or similar investment zones in the past and assessing the likelihood of those applying to Green Freeports; as well as potential negative impacts that the Scheme may have on other ports.

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 SG and 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.[8]

[8] 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 framework structure used by SG and 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.[9]

Policy objective

3.3 The Assessment states that the specific public policy objective of the Scheme is to promote regeneration and high-quality job creation in economically disadvantaged port geographies. It goes on to describe that Green Freeports will achieve this by realising three intermediary objectives. These are:

(a) promoting decarbonisation and a just transition to a net zero economy;

(b) establishing hubs for global trade and investment; and

(c) fostering an innovative environment.

3.4 The Assessment explains that by encouraging private investment in parts of Scotland that have historically seen less of it, but that have strong economic potential given existing port infrastructure, Green Freeports will drive regeneration and job-creation for these communities.

3.5 Further, it states that by focusing on innovative businesses, those engaged in international trade, and low carbon sectors, which are associated with higher levels of productivity and economic impact, Green Freeports can maximise their regenerative effects.

[9] 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).

3.6 In our view, the Assessment clearly describes the policy objective, which it supports with appropriate reasoning and evidence.

Equity objective

3.7 The Statutory Guidance sets out that equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.[10]

3.8 The Assessment sets out that the specific policy objective of the Green Freeports programme is to address an equity objective of reducing spatial economic inequalities across the UK. It explains that whilst spatial inequalities are both a cause and consequence of market failures, the core aim of the Green Freeports programme is the equity rationale of addressing spatial inequalities, rather than addressing market failures.

3.9 The Assessment then sets out that there are specific economic disadvantages affecting coastal communities and areas around ports. It provides reasoning and evidence demonstrating that these communities typically display lower levels of economic performance, higher levels of unemployment, as well as labour markets more populated with lower-skilled jobs than average for their regions.

3.10 It provides explanation and evidence[11] as to the existence of these inequalities, that they are longstanding and self-reinforcing, explaining how, for example, lower connectivity and population densities in port areas results in less agglomeration and lower productivity which in turn causes both firms and high skill workers to locate elsewhere. These effects result in a 'vicious cycle' which prevents market forces from delivering significantly improved outcomes in these communities.

3.11 The Assessment explains that Green Freeports are an important plank in the government's policy response to these spatial inequalities and in realising the economic potential of such geographies.

3.12 In our view, the equity objective that the Scheme seeks to address is well explained with appropriate reasoning and substantial evidence.

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

3.13 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

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[10] Statutory Guidance, paragraphs 3.49 to 3.53.
[11] Levelling Up the United Kingdom White Paper,

identified policy objective, and why other means are not appropriate for achieving the identified policy objective.[12]

3.14 The Assessment sets out, supported with relevant evidence, why the Scheme is the most appropriate and least distortive available instrument, explaining that the Green Freeports policy model has been developed to increase the attractiveness of these locations to businesses thus overcoming the spatial inequalities and economic disadvantages described in Step 1.

3.15 It reasons, supported by logic models, that the tax reliefs directly decrease the cost of investing in Freeport areas, helping unlock investment. It further explains the role of seed capital in 'pump priming' this investment by for example, helping remediate or prepare sites which have remained underdeveloped.

3.16 SG and DLUHC also explain how the Scheme has been carefully designed to ensure that interventions are targeted only at locations that exhibit the kind of economic disadvantage the policy aims to address.

3.17 The Assessment then goes on to set out several alternative policy interventions that were considered to address the policy and equity objectives. These include:

(a) regulatory/planning tools: reducing the regulatory burden for businesses, and/or streamlining planning processes to increase the attractiveness of these locations to businesses;

(b) loans/equity investment on commercial terms;

(c) marketing/promotion support; and

(d) direct provision.

3.18 The Assessment explains that whilst (a) to (c) each have the potential to assist the achievement of the policy objective, and to a certain extent are already being utilised, these are insufficient to change the investment decisions of firms to the extent necessary.

3.19 Similarly, it concludes that whilst limited direct provision may in some cases be possible, for example upgrading physical capital (eg infrastructure works) or human capital (eg upskilling programmes) public authorities may lack the capability or powers to do so. The Assessment also sets outs that, in any event, these interventions are unlikely to be sufficient to change firms' investment decisions to the extent necessary and present higher risk to public authorities.

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[12] Statutory Guidance, paragraphs 3.54 to 3.56.

3.20 The Assessment also notes however that Green Freeports are required to consider direct provision (eg local authorities delivering site remediation themselves) as part of their business case and show why this is not possible wherever they propose to use the seed funding as a subsidy.

3.21 In our view, the Assessment demonstrates that several policy options for achieving the policy objective were considered and the arguments in favour of the chosen model were well-reasoned. DLUHC and SG provided relevant evidence in support of their conclusions.

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

3.22 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.[13]

Counterfactual assessment

3.23 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').[14] 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.

3.24 The Assessment explains that the most likely counterfactual with no intervention, given the characteristics of the inequalities in the Green Freeports area, is that the economic underperformance and low competitiveness in the Green Freeports area will continue as they have for decades. This would mean that the Green Freeports programme's equity objective would not be realised.

3.25 The Assessment explains that ICFGF was previously a prosperous centre of oil and gas manufacturing, with the expansion of heavy industry driving investment and positive economic outcomes. However, a decline in oil and gas activity and other ancillary services has meant that the area has seen an increase in other

[13] 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).
[14] Statutory Guidance, paragraphs 3.60 to 3.62.

sectors such as retail and tourism, with lower productivity per hour and lower job benefits. This has resulted in a persistent downward economic trend leading to reduced opportunity, increased outward migration of the working age population and unsustainable levels of pressure from an ageing population.

3.26 The Assessment explains that without intervention in the ICFGF area the following would happen:

(a) some opportunities for advancing offshore wind would be lost;

(b) tax sites aimed at unlocking land within Inverness would no longer be viable with various projects not proceeding;

(c) existing land scarcity would be exacerbated and impede Inverness' plans to diversify growth away from tourism and retail;

(d) the fall in the working age population would continue as well as the attendant negative effects.

3.27 The Assessment explains that the FGF area has a rich manufacturing and engineering past, which has resulted in economic success and prosperity in Edinburgh and parts of wider Lothian. However, the economic success has not been uniform as there are pockets of inequality, low pay, insecurity, and poverty.

3.28 The Assessment explains that without intervention the area would likely face:

(a) the risk of the continued decline of the existing fossil fuel-based industries, the loss of inward investment in new long-term industries and the associated jobs within the Forth Estuary;

(b) limited site preparation, with undeveloped sites remaining uncommercial for new activities and job creation without site preparation.

3.29 It also explains that there would be an increase in the risk of missing key targets for both the UK government and SG such as the SG's aspirations for net zero by 2045.

3.30 The Assessment provides examples of seed capital projects which would not proceed within the required timeframe or be commercially viable without intervention, ie an integrated energy system project at the Rosyth Waterfront; and the potential development of a blue hydrogen plant at Grangemouth.

3.31 In our view the Assessment has given detailed and thorough consideration to the counterfactual scenario and supported its conclusions with appropriate reasoning and evidence.

Changes in economic behaviour of the beneficiary

3.32 The Statutory Guidance sets out that subsidies must bring about something that would not have occurred without the subsidy.[15] In demonstrating this, public authorities should consider the likely change or additional net benefit.

3.33 The Assessment explains that the Scheme has been designed to influence a change in economic behaviour through influencing businesses to locate, invest and create jobs in the Green Freeports areas.

3.34 The Assessment goes further to explain how the different components of the tax reliefs and seed capital by their design incentivise different types of investments and economic activity.

3.35 The Assessment explains that the tax reliefs would encourage the following: (i) investment in land for development; (ii) investment in commercial buildings; (iii) investment in plant and machinery; (iv) support for new employment; and (v) businesses to operate in a tax site due to the non-domestic rates relief.

3.36 In relation to seed capital, the Assessment explains that the seed capital has been designed to support costs that the private sector will not cover and therefore to enable economic activity that would not have occurred in the absence of subsidy, see paragraph 1.10(f).

3.37 The Assessment notes that seed capital funding would only be utilised for key enabling capital works, including providing infrastructure or covering abnormal costs in the site development process (eg site investigations, measures to mitigate wildlife disturbance, demolition, and clearance of existing structures) which may have influenced commercial choices in the past and deterred investment to other locations.

3.38 In our view, the Assessment describes why the subsidy is necessary to effect the required change in economic behaviour needed to achieve the policy objectives in paragraphs 3.3 to 3.5, including examples of potential projects as a result of the Scheme.

Additionality assessment

3.39 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.[16] For schemes, public authorities should also, where possible and reasonable, ensure

[15] Statutory Guidance, paragraph 3.64.
[16] Statutory Guidance, paragraphs 3.63 to 3.67.

the scheme's design can identify in advance and exclude those beneficiaries for which it can be reasonably determined would likely proceed without subsidy.[17]

3.40 The Assessment provides details of modelling exercises which we calculate indicate that the subsidy would add around 19,400 jobs to the Green Freeport Areas. It also describes the positive developments and significant commercial interest in the area further to the selection and announcement of the Green Freeports locations.

3.41 The Assessment further explains that the Scheme will not result in the funding of projects and activities that beneficiaries would likely have undertaken anyway, nor of business-as-usual costs.

3.42 It notes that (i) the Green Freeport subsidies are focused on supporting capital investment and not business-as-usual costs, for example, the five tax reliefs are only available on sites that have been verified as undeveloped (ie not in economic use); (ii) the seed capital funding can only be used for capital projects and three of the five tax reliefs relate to capital costs; and (iii) the other two tax reliefs that relate to operating costs are for hereditaments (eg infrastructure and land) and employees (which are unlikely to be business as usual costs).

3.43 In our view, the Assessment clearly describes the additionality arising from the Scheme.

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

3.44 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.[18]

Proportionality

3.45 The Assessment submits that various Green Freeports design choices have been made with the intention of limiting the size of subsidy available. These include capping National Insurance Contribution relief on earnings up to £25,000 per

[17] Statutory Guidance, paragraph 3.69 to 3.70
[18] 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).

annum and limiting tax reliefs to only apply to new investment as well as underdeveloped sites.

3.46 It states that the tax relief is proportionate as the amount of subsidy received is dependent on how much the beneficiary spends, with spending going towards achieving the policy objective. Therefore, Green Freeports tax reliefs will not result in high intervention rates, ie the proportion of subsidy compared to overall project cost.

3.47 The Assessment also outlines how, through the Outline Business Case, Green Freeports had to consider a smaller seed funding scenario (ie below £25 million). This includes demonstrating that the requested level of funding cannot be reduced without limiting the achievement of the policy objective.

3.48 It explains that further reductions in the subsidy size were also considered, but it describes how this may impede realisation of the policy objective. It points to:

(a) learning from UK Enterprise Zone experience, which consisted of a smaller package of measures, and which were insufficient to achieve the scale of impact sought;

(b) inequalities targeted by Green Freeports are deeply entrenched, requiring significant government intervention;

(c) a smaller package being unlikely to meaningfully raise the relative competitiveness of Green Freeports given the magnitude of other internationally available subsidies.

3.49 Furthermore, the Assessment considers protections against cumulation of subsidies, both between tax reliefs as well as between tax reliefs and seed funding. For instance, the Assessment points to cumulation protections that do not allow capital allowances on expenditure met by a contribution (eg government grant). It stipulates that where cumulation between seed funding and tax sites may happen, this must be justified in terms of additionality and proportionality.

3.50 It also outlines that public authorities must consider cumulation of subsidies when considering granting additional subsidies to businesses located on Green Freeport tax sites, and that the clear borders of the tax sites will aid them in doing so.

3.51 Overall, the Assessment appropriately covers considerations raised by Principle B of the Statutory Guidance to demonstrate that the subsidy offered is being limited to what is necessary. However, for transparency and understanding, the Assessment could be improved by explaining more fully how the seed funding allocation, management and monitoring processes set out in the supporting evidence will support DLUHC and SG in ensuring continued compliance with

Principle B when devolving decision-making over seed funding projects to relevant local authorities.

3.52 The Assessment could have also been strengthened, as set out in the Statutory Guidance, by considering whether beneficiaries of the Scheme may receive other subsidies for similar purposes.[19]

Design of subsidy to minimise negative effects on competition and investment

3.53 The Assessment outlines that the breadth of potential beneficiaries has been maximised through the selection process, including by running a competitive allocation process when choosing Green Freeport locations, and by the tax advantages of these sites being open to any business that wishes to locate there where it aligns with the agreed use and objectives.

3.54 The size of the subsidy, including ensuring it is the minimum necessary and proportionate to the policy objective, are discussed in detail within the Assessment as set out in paragraphs 3.45 to 3.48.

3.55 The Assessment also notes that, to minimise distortive impacts, all components of the Scheme are either time-limited or one-off.

3.56 In relation to the nature of costs covered, the Assessment states that most of the subsidies under Green Freeports cover capital costs, not operating costs, and as a result are less likely to be distortive. It acknowledges that two of the tax relief measures relate to operating costs, however, it explains that these measures only apply to costs associated with new hereditaments (eg infrastructure and land) and to new employees, which are viewed as unlikely to be business as usual costs.

3.57 The Assessment states that the UK government and SG will agree a Memorandum of Understanding with both Green Freeports and their respective partners regarding the performance criteria built into the Scheme. This includes clear delivery expectations as part of a wider performance management framework and sanctions for unsatisfactory performance.

3.58 More broadly, the Assessment outlines that the UK government and SG will undertake 'robust' monitoring and evaluation of the Green Freeport programme, both at the programme-level and the individual freeport level. The aim is to help inform future policy development while the gathering of near-real-time data is also expected to help the governments hold Green Freeports accountable to the delivery of the agreed objectives.

[19] See Statutory Guidance paragraphs 3.91 and 3.92. See also the SAU report on the proposed subsidy to Sumitomo [Referral of the proposed subsidy to Sumitomo Electric Industries Ltd by Highlands and Islands Enterprise - GOV.UK (www.gov.uk)](www.gov.uk).

3.59 It states that the relevant local authorities must put in place grant funding agreements with beneficiaries, ensuring funds are ring-fenced for their intended purposes and providing for clawback provisions as required. Moreover, the Assessment outlines that Green Freeports subject prospective tax site investments to a 'gateway test'. This aims to ensure that inbound investments are aligned with the agreed use of the tax site and tax subsidies are correctly applied.

3.60 Overall, the Assessment engages with the majority of the subsidy design aspects set out in the Statutory Guidance. When discussing the nature of the instrument, the Assessment focusses on alternative non-subsidy options that were considered at the onset of the Scheme.

3.61 However, as envisaged by the Statutory Guidance, this section of an assessment should cover alternative types of subsidies (eg equity investment, preferential loans, loan guarantees) that may have been considered at the design stage of the subsidy.[20] Consequently, the Assessment could be improved by more closely following the Statutory Guidance in this respect.

Assessment of effects on competition or investment

3.62 The Assessment states that by increasing the quantity of commercially viable locations/sites, Green Freeports are likely to increase competition, over the medium term, in sectors that are already well established in the UK.

3.63 It submits that Green Freeports are not aimed at raising the commercial attractiveness of currently viable locations but improving the commercial attractiveness of currently uncompetitive locations. The Assessment identifies that a key risk of Green Freeports is that they incentivise relocation of businesses from elsewhere in the UK. However, the Assessment covers several mitigating factors that aim at minimising the negative impacts of displacement including:

(a) Green Freeports locations are selected based on evidence that they are affected by acute economic disadvantage, reducing the probability that relocated economic activity is moving to Green Freeports from more disadvantaged areas;

(b) Green Freeports mainly support initial setup costs rather than business-as-usual costs, which is unlikely to make commercial sense for established businesses as a reason to move;

(c) Green Freeports must, as part of their Outline Business Case, model displacement and demonstrate net economic benefit to the UK economy; and

[20] Statutory Guidance, paragraphs 3.80 to 3.82.

(d) non-domestic rate relief is subject to a displacement test.

3.64 The Assessment also explains that many target sectors are nascent and are not established in the UK, reducing the likelihood of displacement.

3.65 The Assessment sets out that given the nature of the Scheme, in particular the wide range of sectors which may be potentially able to benefit from Green Freeports, it would be impractical to provide a detailed evaluation of competition and investment impacts on every target sector. Consequently, the Assessment identifies what it believes is a sector potentially susceptible to distortion, Floating Offshore Wind (FLOW), and explains why other sectors likely impacted by Green Freeports are less likely to be distorted. The Assessment also provides a detailed evaluation of the FLOW industry:

(a) FLOW is a nascent market exhibiting substantial export potential. Moreover, there is a first-mover opportunity for Green Freeports to set up serial manufacturing for both the UK and European markets, with the current constraint being a lack of port facilities in the UK;

(b) in the UK, FLOW manufacturing is concentrated in a small number of clusters made up of several ports, with each cluster receiving significant private investment and government policy support. Celtic Freeport, particularly Port Talbot, is identified as the main domestic competitor. However, the Assessment outlines that meeting the UK's 2030 FLOW target is recognised to be a multi-port strategy with £3.25 billion in investment required.

(c) the Assessment recognises that Green Freeports could have an impact on international trade and investment, but this is considered unlikely as Green Freeports subsidies are not seen as significant enough to incentivise large multinationals to relocate. It further outlines the main international competitors globally and discusses at length international subsidies in the space of renewable energy (eg in the US and the EU), which it argues are more distortive and outweigh Green Freeports in terms of size.

3.66 The Assessment outlines that evidence from similar special economic zones in the United States shows that larger firms benefit more from such policies than smaller firms. However, the Assessment outlines that this risk has been managed in Green Freeport through the selection process that gave 'rigorous consideration' to ensure the support of small and medium sized firms alongside larger beneficiaries.

3.67 Overall, the Assessment identifies several aspects relevant to evaluating impacts on competition and investment. Particularly, the use of a case study is a helpful way of evaluating impacts of a scheme in more detail than otherwise possible. Moreover, the Assessment covers in some depth why displacement of economic activity is minimised through Green Freeport design and other factors (eg the nascency of target sectors).

3.68 However, the Assessment could be improved by looking at publicly available evidence of broader competitive impacts of other freeports, for example freeports in England, or similar investment zones in the past and assessing whether the creation of Green Freeports may result in similar impacts. Moreover, whilst the Assessment mentions positive outcomes for other ports due to the Scheme, it could be improved by considering potential negative impacts that the Scheme may also have.

Step 4: Carrying out the balancing exercise

3.69 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.[21]

3.70 In the balancing exercise, the Assessment identifies and describes the following as being among the benefits of the Scheme:

(a) regeneration, agglomeration, and high-quality job creation, as a result of firms and people being in close proximity (reducing transportation costs for goods, people and ideas) leading to the creation of an estimated combined total of 29,210 gross direct jobs on tax sites over 25 years;

(b) increasing investment, trade, and innovation whereby the Green Freeports combined are expected to catalyse £10 billion investment and unlock between £7 and £9 of private sector investment for every £1 of government investment;

(c) less state dependence in the future whereby following the award of subsidies the regions are likely to require less taxpayer support and generate additional tax receipts;

(d) social impact arising from empowering communities and strengthening local economies, leading to better outcomes for those based in Green Freeport regions;

(e) decarbonisation as a result of new investment in clean energy, new green industrial clusters, and acceleration of the UK's clean energy output, enabling cheaper, greener and more secure energy for the long term.

[21] See Statutory Guidance (paragraphs 3.109 to 3.117) and SAU Guidance (paragraphs 4.20 to 4.22) for further detail.

3.71 The Assessment then identifies and describes the following as being among the potential negative impacts of the Scheme:

(a) geographical and distributional impacts and displacement of activity from other (disadvantaged) areas. It is expected that these effects will be mitigated by locating the Green Freeports in areas with acute economic disadvantage (reducing the likelihood of displacement of economic activity from more disadvantaged to less disadvantaged areas) and targeting nascent sectors not already established in other parts of the UK. The Assessment also sets out that individual Green Freeport business cases are required to demonstrate the net benefits of the subsidies, taking into account displacement;

(b) market distortion, although this is expected to be low, based on the market analysis of the potential to distort international and domestic trade and investment in the FLOW sector (the sector identified as highest risk);

(c) impact on employment rates whereby the Green Freeport zones may result in decreased employment rates in other areas;

(d) potential benefits to larger firms over smaller firms whereby evidence from other countries suggests that larger firms may be able to take advantage of enterprise zones at the expense of smaller ones. The Assessment sets out that this has been considered in the selection process to ensure that plans support small and medium sized activity, as well as that of larger firms;

(e) negative impacts of agglomeration on pollution, traffic congestion and house prices. The Assessment sets out that Green Freeports are required to consider the environmental impact of their proposals and ensure that interventions uphold the highest environmental standards;

(f) the Assessment acknowledges that not everywhere can benefit, and not all places in need of a boost to regeneration can benefit from a Green Freeport (although it is expected that the Green Freeports will generate benefits for surrounding regions).

3.72 SG and DLUHC conclude that the benefits of achieving the policy objective (addressing economic inequality) justify the awarding of the subsidies, and that the design of the scheme reduces the possible harms. The Assessment sets out that cost-benefit analyses conducted as part of each Green Freeport’s business case demonstrate that in both cases the positive impacts of the Green Freeport subsidies outweigh the negative impacts.

3.73 In our view the Assessment demonstrates that SG and DLUHC have considered the expected benefits of the Scheme and its potential negative effects in line with the Statutory Guidance.

Energy and Environment Principles

3.74 This step involves an evaluation of the Assessment with regard to compliance with the energy and environment principles, where these are applicable to the scheme.[22]

3.75 The Statutory Guidance summarises the scope of the different energy and environment principles that apply to different types of subsidies.[23] SG and DLUHC have conducted an assessment of the Scheme against Principles A and B. They have not considered it necessary to assess the other Principles.

Principle A: Aim of subsidies in relation to energy and environment

3.76 The assessment against Principle A should show how the subsidy is consistent with delivering a secure, affordable and sustainable energy system and a well-functioning and competitive energy market, or increasing the level of environmental protection compared to the level that would be achieved in the absence of the subsidy. If a subsidy is in relation to both energy and environment, it should meet both of these limbs.[24]

3.77 The Assessment sets out that the secondary policy objective of promoting decarbonisation and a just transition to a net zero economy are aligned with the aims of delivering a secure, affordable and sustainable energy system and a well-functioning and competitive energy market.

3.78 It further states the Scheme's potential to contribute to the wider net zero agenda through a range of measures such as attracting new investment and building green industrial clusters and promoting decarbonisation in port operations.

3.79 It notes that both Green Freeports are required to set out the intended outputs and outcomes in relation to decarbonisation within their business cases. Green Freeports are also 'required to provide detailed decarbonisation plans, demonstrating how the Green Freeport intends to contribute to a just transition to net zero emissions by 2045'.

3.80 The Assessment also states that in terms of increasing the level of environmental protection compared to the level that would be achieved in the absence of the subsidy, Green Freeports are required to 'outline how proposals will ensure

[22] See Schedule 2 to the Act.

[23] Statutory Guidance, Chapter 4, paragraph 4.9. Principles A and B apply to all subsidies in relation to energy and environment. Principle C applies for subsidies for electricity generation adequacy, renewable energy or cogeneration. Principle D applies to subsidies for electricity generation only. Principle E applies to subsidies for renewable energy or cogeneration. Principle F applies to subsidies in the form of partial exemptions from energy related taxes and levies. Principle G applies to subsidies that compensate electricity intensive users for increases in electricity costs, Principle H relates to subsidies for decarbonisation of industrial emissions. Principle I relates to subsidies for improving energy efficiency of industrial activities.

[24] Statutory Guidance, paragraphs 4.19 to 4.28.

compliance with all applicable environmental regulations and standards' and to 'carry out an Environmental Impact Assessment if required before planned development can proceed'.

3.81 In our view, SG and DLUHC have outlined within the Assessment why they believe the Scheme complies with Principle A, including through its goals of decarbonisation and a just transition to a net zero economy.

3.82 However, the Assessment could be improved by more fully explaining how the Scheme is aimed at incentivising beneficiaries in delivering a secure, affordable and sustainable energy system and a well-functioning and competitive energy market to the extent that is relevant.

3.83 In addition whilst the Assessment explains how negative environmental impacts created by the Scheme will be mitigated, it could be improved by more clearly explaining how the stated measures increase the level of environmental protection compared to what would have happened otherwise.[25]

Principle B: Subsidies not to relieve beneficiaries from liabilities as a polluter

3.84 The assessment against Principle B should explain clearly how the proposed subsidy or scheme does not relieve a polluter from having to bear the full costs of the pollution caused.[26]

3.85 SG and DLUHC consider that the Scheme 'does not relieve beneficiaries from any liabilities arising from its responsibilities as a polluter'. The Assessment states that through a number of performance monitoring, assurance mechanisms, and robust controls they will be able to ensure that beneficiaries could not divert the use of resources to alleviating responsibilities as a polluter, and that if this was found to be the case, government can remove any incentives.

3.86 The Assessment clearly explains that it does not relieve beneficiaries from liabilities as a polluter. In our view, it sufficiently explains how the Scheme complies with Principle B.

Other Requirements of the Act

3.87 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. SG and DLUHC stated that none of the prohibitions or other requirements in relation to the giving of subsidies apply.

24 April 2024

[25] Statutory Guidance, paragraph 4.22.
[26] Statutory Guidance, paragraphs 4.29 to 4.35.