Subsidy Advice Unit Report on the proposed subsidy to the National Theatre

Referred by the Department for Culture, Media and Sport

9 August 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 Culture, Media and Sport's (DCMS) assessment of compliance of the proposed subsidy to National Theatre (the Subsidy) 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 DCMS in its Assessment and evidence submitted relevant to that Assessment.

1.4 This report is provided as non-binding advice to DCMS. The purpose of the SAU's report is not to make a recommendation on whether the Subsidy should be given, or directly assess whether it complies with the subsidy control requirements. DCMS is ultimately responsible for granting the Subsidy, 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 subsidy

1.6 DCMS intends to award the National Theatre with a grant of £26,159,635 in a two-year programme of infrastructure works to carry out a series of repairs on its London South Bank estate.

1.7 The National Theatre moved into the purpose-built London South Bank site in 1976, which is home to three auditoria (seating around 3,000 people each night), rehearsal rooms, digital and new work studios, and on-site workshops where sets and props are created. The site has three theatres: Olivier, Dorfman, and Lyttelton.

1.8 However, due to the age of the building and its facilities, the National Theatre requires investment to replace end-of-life theatre systems, to support repairs which are necessary for the operation of the venue, and to refurbish the Olivier Theatre's unique stage drum revolve system.

1.9 DCMS states in the Assessment that the funding will enable the National Theatre to continue to operate as 'a world-class cultural institution', to prevent instances of

[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.

disrupted or cancelled performances from increasing, and to prevent the overall quality of creative programming being diminished.

1.10 The grant will be administered and monitored by Arts Council England (ACE).

SAU referral process

1.11 On 21 June 2024, DCMS requested a report from the SAU in relation to the proposed Subsidy to the National Theatre.

1.12 DCMS explained[2] the Subsidy is a Subsidy of Particular Interest because its value exceeds £10 million.

1.13 The SAU notified DCMS on 27 June 2024 that it would prepare and publish a report within 30 working days (ie on or before 9 August 2024).[3] The SAU published details of the referral on 27 June 2024.[4]

[2] In the information provided under section 52(2) of the Act.
[3] Sections 53(1) and 53(2) of the Act.
[4] Referral of the proposed subsidy to the National Theatre by the Department for Culture, Media and Sport - 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 recognise that, as outlined in the Assessment, support for the performing arts from public authorities means that organisations such as the National Theatre do not operate on a fully commercial basis. They may aim for objectives such as offering high quality and innovative productions with affordable tickets at price levels that are sometimes less than would be charged by a commercial operator. In addition, they may sometimes be a complement to rivals (eg in incubating new artistic content and talent). This dynamic complicates the Assessment at various stages of the subsidy control principles.

2.3 It is clear from the Assessment that the package of works to be carried out using the Subsidy has been clearly defined and that DCMS and the National Theatre have taken, and will take with ACE, measures to ensure that the cost of the works is limited to that which is necessary.

2.4 However, we consider that there are a number of areas in which the Assessment should be improved:

(a) Although the Assessment sets out a clear market failure rationale, it should more clearly link the maintenance works, which the Subsidy will facilitate, with the delivery of the stated equity objective. For example, it could set out in more detail the National Theatre's programmes which address the equity rationale and explain how they are effective in addressing inequities, and explain how such programmes would be impacted under the counterfactual.

(b) The Assessment should more clearly explain:

(i) what the 'no subsidy' scenario is against which the Subsidy should be assessed;

(ii) how the National Theatre might prioritise its existing cash reserves in the absence of the Subsidy to ensure the ongoing viability of the National Theatre building;

(iii) why it was not possible for the National Theatre to seek further fundraising (eg philanthropy) for at least some of the Subsidy works given that it is partially funding other capital works in this way; and

(iv) the implications of the 'no subsidy' scenario for delivery of its policy objectives.

(c) Whilst the Assessment does discuss the potential for competitive impacts that could arise as a result of the Subsidy, it should ensure that a consistent position is taken on this issue across the Assessment. At present, the competitive position of the National Theatre is portrayed differently in Step 3 and Step 4, leading to some contradictions on whether or not there is a competitive impact on other theatres.

2.5 Our report is advisory only and does not directly assess whether the Subsidy complies with the subsidy control requirements. The report does not constitute a recommendation on whether the Subsidy should be implemented by DCMS.

3. The SAU's Evaluation

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

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.[5]

Policy objectives

3.3 The Assessment sets out that the public policy objective of the Subsidy is to avoid, mitigate and remediate high priority material failures of the National Theatre building, while also limiting the longer-term degradation of the building, lowering the risk of catastrophic events (eg fire, flood and structural failure).

3.4 It sets out additional objectives, including, by March 2027, to:

(a) decrease the frequency of abandoned or cancelled performances from equipment or infrastructure failures;

(b) improve value for money by decreasing the financial impact of these abandoned or cancelled performances; and

(c) grow global audiences by safeguarding the National Theatre's reputation for creative excellence through renewing and upgrading essential infrastructure for theatre productions.

3.5 It sets out that in doing so, the National Theatre can continue to produce and deliver theatre programming for the general public, and that the grant ensures continued access to the cultural amenities provided by the National Theatre and its

[5] 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).

building, as well as the continuation of community partnership work and offerings for children and young people.

3.6 When discussing the equity objective, the Assessment sets out an aim to ensure the continued provision of high-quality theatre to the public at affordable prices, reducing the barriers to accessing the arts for marginalised groups.

3.7 The Assessment states that the Subsidy is being given to ensure the sustainability of the National Theatre building and to safeguard it for the future. Without it, in due course performances will suffer. It explains that performance cancellations and having to pause or withdraw creative programming would undermine the National Theatre's ability to deliver public goods, and that the priority objective of this project is to address the risk of cancellations and catastrophic events.

3.8 The Assessment explains that the National Theatre carries out work to engage people from lower socio-economic backgrounds via reduced ticket prices and community outreach work, and engaging those who are less likely to get into the arts, noting the historic nature of theatre attendance being dominated by older age groups from higher socio-economic groups. It states that this work can only continue if the project is carried out.

3.9 It explains that the National Theatre funds its activities from four sources: ticket sales and income from its productions nationally and internationally; catering and front of house trading; philanthropic support; and an annual grant from ACE.

3.10 The Assessment states that ticket sales alone cannot cover the National Theatre's operations or fund the capital expenditure now needed to upgrade and refurbish the theatre's infrastructure. It explains that if the National Theatre could only rely on ticket sales, it would need to operate as commercial theatres do, by making shows anticipated to have maximum popular appeal, minimum commercial risk, and maximum ticket price and income potential. It explains that this would remove all of the benefits of its wider programming. It also states that ticket sales alone cannot fund the exceptional capital expenditure now needed and the National Theatre is not able to invest in essential maintenance in the way that an operator in another market might do.

3.11 The Assessment states that the grant ensures continued access to the cultural amenities provided by the National Theatre and its building, as well as the continuation of community partnership work and offerings for children and young people.

3.12 In our view, the Assessment could ensure that the policy objective considers the wider activities of the National Theatre. The policy objective as described in the Assessment is drawn narrowly to describe the specific aims of the Subsidy but the broader purpose, for example 'continued provision of high-quality theatre to the public at affordable prices, reducing the barriers to accessing the arts for marginalised groups' in relation to the equity rationale, helps explain the overall purpose of the Subsidy in supporting the National Theatre's activities.

Market failure

3.13 The Statutory Guidance sets out that market failure occurs where market forces alone do not produce an efficient outcome.[6]

3.14 The Assessment identifies several market failures:

(a) Positive externalities of production relating to the local economic benefits of investing in cultural assets like theatres: it sets out that investment in culture, heritage, and visitor economy initiatives can benefit local economies in places across the country. It explains that there are agglomeration benefits and spillover effects to other sectors, where the development of local cultural and creative clusters which host firms in proximity can enable local knowledge and skills exchange, competition, economies of scale, and innovation, in the local area and wider creative industries. It sets out that the National Theatre is a skills incubator for the creative industries and plays a key role in London and South East's creative and cultural cluster.

(b) Positive externalities of consumption relating to the societal benefits of consumption of arts and culture through improvements to health and wellbeing: the Assessment sets out that there is evidence that engagement in community cultural assets is associated with better wellbeing and that engagement in the arts can help reduce inequalities in health outcomes for children experiencing adverse circumstances. It explains that studies have identified that cultural participation can contribute to social relationships and community cohesion.

(c) Provision of a public good in the form of non-use value: the Assessment explains that there is value which people get from the existence of a cultural good, and from others being able to benefit from a good or service, in the present or for future generations. It sets out that non-use value can be considered a public good as the benefits are non-rivalrous and non-excludable.

3.15 The Assessment explains that the activities of the National Theatre have a diffuse economic benefit that is not reflected in the ticket prices that the National Theatre is able to charge, and that in many cases the market will underfund UK theatre as it cannot internalise these wider cultural benefits.

[6] Statutory Guidance, paragraphs 3.35-3.48.

3.16 In our view, the Assessment has set out a clear market failure rationale. However, the Assessment could provide more evidence to demonstrate these market failures and should clearly reference the evidence it mentions.

Equity objective

3.17 The Statutory Guidance sets out that equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.[7]

3.18 The Assessment sets out that the equity objective of the Subsidy is to ensure the continued provision of high-quality theatre to the public at affordable prices, reducing the barriers to accessing the arts for marginalised groups. DCMS wishes to avoid a situation where fewer members of the community can experience, engage with, or have access to the benefits of theatre.

3.19 The Assessment states that it is in the fundamental public interest to enable the provision of world class theatre at accessible prices for the good of the population as a whole; therefore, there is an equity rationale of provision of arts and culture to the general public that is facilitated by the Subsidy. It notes that the Statutory Guidance uses subsidies targeted at extending access to cultural or educational amenities as an example of an equity objective measure.[8]

3.20 It adds a further equity rationale of ensuring opportunity for all children and young people who may not otherwise have the opportunity to partake in programmes focused on learning about making theatre and inspiring future theatre makers.

3.21 The Assessment sets out evidence of a gap in engagement between adults living in areas within the most deprived and the least deprived deciles. It asserts but does not evidence that: there is an engagement gap for different age groups; that engagement in the arts can help reduce inequalities in health outcomes for children experiencing adverse circumstances; and that several studies demonstrate a strong link between arts and culture and wellbeing in young people.

3.22 It sets out that National Theatre has a number of separate initiatives that improve engagement across deprived audiences by increasing accessibility. It gives examples of free or discounted tickets that the National Theatre makes available, including to young people, and educational programmes that it runs. It also sets out accessibility measures the National Theatre has implemented.

3.23 The Assessment states that public subsidy permits many arts and cultural institutions to offer educational programs and other types of non-income deriving work without fear of failure or risk of trading at a loss. Without this investment, the

[7] Statutory Guidance, paragraphs 3.49 to 3.53.
[8] Statutory Guidance, paragraph 3.49.

Assessment states that such public-good work may be dramatically reduced or cease to exist.

3.24 The Assessment sets out that the Subsidy would prevent the mothballing or closure of either the entire or part of the National Theatre South Bank estate. It states that by preventing its closure, the public retain access to it and the work that National Theatre offers, thereby satisfying the equity rationale.

3.25 The Assessment asserts that addressing the equity objective is desirable because the support aligns with DCMS' commitment to maintain the UK's reputation for world class creativity. To support this, it lists the achievements of the National Theatre, and demonstrates its national reach and global reputation.

3.26 Given the market failure rationales, we consider that it is not necessary to rely on the equity rationale. In our view the Assessment sets out a clear equity objective. However, it is not as clear on explaining how the Subsidy delivers outcomes to achieve this objective. In our view, the Assessment should more clearly link the maintenance works, which the Subsidy will facilitate, with the delivery of the equity objective, for example by:

(a) setting out in more detail the National Theatre's programmes which address the equity rationale, explaining how they reduce the inequity and how they are targeted at specific groups to facilitate this (eg how reduced ticket prices are targeted to people within the most deprived areas), and evidencing of the gap in engagement between age groups given that some of its measures target younger people; and/or

(b) explaining how the subsidy enables National Theatre to expand, or maintain, access to theatre for people within areas in the most deprived deciles, for example by explaining how the deterioration or closure of the National Theatre building, or alternate funding arrangements for the maintenance works, would impact on the National Theatre's works targeting the equity objective.

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

3.27 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.[9]

[9] Statutory Guidance, paragraphs 3.54-3.56.

3.28 The Assessment sets out in detail the National Theatre's financial situation, showing how its operations have been impacted by cost inflation on materials, supplies, energy and workforce. The Assessment explains that the National Theatre's financial sustainability in the coming years relies on its theatres being open – which will not be possible if there are disrupted and refunded performances. The Assessment explains that the National Theatre would not be able to fund the works from its own cash funds given the need to maintain general reserves in line with Charities Commission guidance.

3.29 Using the structure of the Statutory Guidance, the Assessment works through alternative ways of achieving the policy objective, explaining why regulation, direct provision and equity investment were not considered practicable, given the existence of a funding gap resulting in a lack of finance and the nature of the capital works required (in relation to which DCMS does not have the same level of procurement as National Theatre). The Assessment sets out DCMS' view that the Theatre Tax Relief Scheme was not designed for the purpose of meeting the viability gap in this situation. It also explains that funding in the form of a loan or repayable grant would require National Theatre to reduce or restrict its cultural programming in order to meet repayments.

3.30 We consider that the Assessment considers alternatives to the proposed grant in line with the Statutory Guidance. However, the Assessment could more clearly explain why the Theatre Tax Relief scheme 'would not feasibly facilitate the viability gap identified for this subsidy award', and the evidence supporting this assertion.

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

3.31 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.[10]

[10] 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).

Counterfactual assessment

3.32 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').[11] 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.

3.33 In our view, there is a lack of clarity in the Assessment with regard to the counterfactual scenario. We have interpreted the baseline 'do nothing' scenario set out within the Assessment as being best described as a 'business as usual' counterfactual, in which the infrastructure of the National Theatre building would continue to deteriorate, putting at risk future productions. The Assessment explains that the National Theatre would prioritise the most urgent projects requiring capital investment and would fund these via fundraising efforts. It notes that the National Theatre would do this in the knowledge that either: (i) performance disruptions would continue and the National Theatre would increase its annual deficit position to compensate for the ongoing business continuity losses; or (ii) one or more of the highlighted areas for works would further deteriorate, resulting in a complete closure of one or more of its theatres for a prolonged period, with associated reputational and financial impact.

3.34 The Assessment refers to the Business Case, noting that the effects of the counterfactual can be summarised as:

(a) frequent and impactful cancelled performances (leading to loss of audiences);

(b) ongoing material failure and degradation of the building;

(c) a loss of income from ancillary income due to lower audience numbers; and

(d) continued maintenance costs due to continued patch and repair. The National Theatre will have to spend money on maintenance and repair absent the Subsidy, but these repairs will not prevent costly disruptions and cancellations. Additionally, even with National Theatre money being spent on maintenance, the permanent shutdown of the Olivier theatre and the potential shutdown of other parts of the theatre will not be avoided.

3.35 The Assessment explains that in the longer-term counterfactual, the National Theatre may be forced to leave the building. It notes that it is unlikely that a replacement occupant could be found, so the building may remain empty and go into disrepair. It notes that it is unlikely that philanthropy alone would be sufficient

[11] Statutory Guidance, paragraphs 3.60-3.62.

in covering the investment gap due to the type of work (capital repairs and maintenance) that is being undertaken would not attract private philanthropists.

3.36 In our view, the Assessment should more clearly explain what the baseline ‘do nothing’ scenario is – ie business as usual in which the National Theatre continues to hold back on investing in capital infrastructure. At present, it focuses largely on the impact of a lack of investment into the National Theatre, and suggests, but does not clearly set out, the counterfactual scenario. The Assessment could clearly reference relevant discussion of the counterfactual in the Business Case.

3.37 Further, there is some uncertainty throughout the Assessment as to what works would (or could) be undertaken absent the Subsidy. In the case of no subsidy, it seems that some essential works would be required, but, as a result, wider objectives may be prejudiced as the National Theatre’s time and resources would be redirected away from activities which meet the wider benefits from delivering high quality, innovative theatre at accessible pricing. The National Theatre has allocated its existing funding into different funding ‘pots’ within its business.[12] These are ‘unrestricted funds’, meaning that the National Theatre is free to utilise this funding as it prefers.[13] The Assessment should be clearer in explaining how it might prioritise its existing funding in the absence of the Subsidy to ensure the ongoing viability of the building (particularly as it notes that some essential repairs and maintenance would be required regardless of the Subsidy). In doing so, it could more clearly explain that – in diverting other funds to pay for these works – the ability to continue delivering high quality theatre at accessible prices would be at risk (thereby highlighting the importance of the Subsidy).

3.38 The Assessment should provide evidence to support its assertion that, in the counterfactual, philanthropy or funds from other sources would not be sufficient to cover the investment gap, and why it is not appropriate to fund at least part of the work using fundraising, given that the National Theatre does appear to be able to raise funds for the purpose of carrying out other capital works relating to the building.

Changes in economic behaviour of the beneficiary

3.39 The Statutory Guidance sets out that subsidies must bring about something that would not have occurred without the subsidy.[14] In demonstrating this, public authorities should consider the likely change or additional net benefit.

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[12] These include the: (i) Building and equipment fund; (ii) Risk fund and programme fund; and (iii) Unrestricted operations fund.

[13] This differs from restricted funds – restricted funds are those which are raised for a particular purpose and may only be used for that specific purpose.

[14] Statutory Guidance, paragraph 3.64.

3.40 The Assessment explains that the change in economic behaviour generated by the Subsidy is the upgrading of the National Theatre's capital infrastructure. It notes that National Theatre will be able to complete necessary repairs and replacement work, and therefore continue to deliver cultural programming with minimal disruption to business as usual. These projects include the delivery of major rewiring, roof repairs, replacement of end-of-life lighting systems, stage lifts and other essential stage equipment.

3.41 The change in economic behaviour assessment is generally consistent with the counterfactual scenario identified within the Assessment – ie as a result of the Subsidy, the National Theatre will be able to complete required capital works without putting at risk its wider objectives.

Additionality assessment

3.42 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.[15]

3.43 The Assessment identifies 14 projects that will be undertaken as a result of the Subsidy. It notes that, absent the Subsidy, these works 'would likely not be undertaken until a successful fundraising campaign had generated sufficient income, and there is no reasonable expectation that this could be achieved absent subsidy.' On this basis, it concludes that the Subsidy does not compensate for the costs the beneficiary would fund anyway in the absence of the Subsidy, on the basis that it would not be able to afford to proceed without support. Further, the Assessment highlights that the works relate to a 'one-off capital programme'.

3.44 The Assessment of additionality is largely consistent with the assumed baseline 'do nothing' scenario, in which the National Theatre would not have sufficient financing to fund the required capital repair works. It benefits from clear identification of the 14 projects that will be undertaken as a result of the Subsidy. However, consistent with our position on the counterfactual, the Assessment should include further analysis and evidence to support the position that the National Theatre could not raise financing via other means to support these works. Further, a clearer description within the counterfactual as to how the National Theatre would prioritise its spending in the absence of the subsidy may support the additionality assessment in respect of identifying costs that would have been funded even absent the subsidy.

[15] Statutory Guidance, paragraphs 3.63-3.67.

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

3.45 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.[16]

Proportionality

3.46 The Assessment provides a high-level breakdown of the Subsidy award of £26.2 million over the financial years 2024/25 and 2025/26. It further outlines the proportion of the Subsidy that is intended for the National Theatre’s capital works and the proportion that is required to cover the independent evaluation expenses that will accrue as these capital works are carried out.

3.47 The Assessment submits that the draft unaudited 2023/24 National Theatre’s statutory accounts show a deficit of £2.7 million on unrestricted funds, with the National Theatre's operating budget deficit standing at £4 million. The Assessment states that its financial situation leaves the National Theatre short of a break-even position required to maintain long term financial sustainability. The National Theatre’s Five Year 2023-2027 Strategic Plan includes a number of initiatives to grow income and reduce costs to achieve an operating break-even position by 2026-27, which is necessary to ensure long term financial sustainability. This plan includes allocating an additional £3.5 million to capital expenditure needs and giving a total annual allocation from its operating budget to capital expenditure needs of £7 million. With this annual allocation of £7 million, plus the government grant of £26.2 million, the National Theatre still falls short of funds needed to support its capital needs for the next 5 years.

3.48 Whilst not referenced under Principle B, a Budget Summary Annex submitted alongside the Assessment breaks down the requested subsidy amount into more granular detail, listing what the £26.2 million in government funds are intended to cover. It also outlines the National Theatre’s contribution of £1.1 million to the overall project costs of £27.5 million. According to the Business Case, the National Theatre’s contribution is intended to cover the ‘design fees’ of the planned capital

[16] 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).

works, ie scoping of the required work and providing cost certainty for the Business Case.

3.49 The Assessment states that DCMS is content that the Subsidy is limited to what is necessary to deliver the stated policy objective and submits that ACE will ensure that any spending undertaken by the National Theatre will be eligible as outlined by the grant agreement (see additional detail on monitoring and evaluation provisions and ringfencing of funds in paragraph).

3.50 Whilst not referenced in the Assessment, the Business Case outlines the individual procurement processes for the proposed works, which include open tenders as well as more targeted specialist contractor appointments following negotiated design and costing processes. The Business Case further states that ACE will continue to work with the National Theatre to identify any potential cost savings.

3.51 Regarding proportionality with respect to the policy objective, the Business Case outlines net present value and benefit cost ratio figures of the proposed works which are not mentioned in the Assessment.

3.52 Overall, the Assessment breaks down the drivers behind the Subsidy amount and states that National Theatre cannot contribute more to the works due to its wider financial position, but we consider that the Assessment could more comprehensively reference relevant sections of the Business Case.

3.53 As noted in paragraph 3.38, the Assessment should explain why external funds, such as donations, could not be sought to cover part of the proposed works, particularly as such donations are already expected to contribute to other capital expenditure the National Theatre is planning.

Design of subsidy to minimise negative effects on competition and investment

3.54 The Assessment discusses several subsidy design aspects raised by the Statutory Guidance.[17] This includes:

(a) The limited timespan over which the Subsidy is given.

(b) The nature of the costs covered by outlining that the Subsidy is intended to cover one-off capital works rather than day-to-day running costs.

(c) Performance criteria which outline what appears to be a robust subsidy framework including progress reports and the payment of subsidy amounts upon evidenced achievement of milestones.

[17] Statutory Guidance (paragraphs 3.72 to 3.108).

(d) Ringfencing requirements, in relation to which the Assessment states that funding administered by ACE is always provided in the form of a ringfenced grant and will only cover activities that go towards achieving the policy objective, with National Theatre having to agree to standard Terms and Conditions.

(e) Monitoring and evaluation provisions mentioned under Principle B of the Assessment where DCMS outlines the applicable review framework and how the required information will be obtained.

3.55 The Assessment outlines alternative types of subsidy (eg guarantees and subsidised loans) and states that these would not be appropriate (see paragraph 3.29). However, the Assessment could better explain why these alternative subsidy options were discounted.

Assessment of effects on competition or investment

3.56 Under Step 3, the Assessment submits that the impact on competition in the market is considered to be limited as the Subsidy is supporting the continuation of services already being delivered to the market, rather than the creation of new ones. The Assessment states that, should some of the National Theatre's service provisions end in the absence of the Subsidy, other organisations would not be in a position to fill the gap that the National Theatre's exit would leave behind. The Assessment further states that the Subsidy will not allow the National Theatre to produce more content and services or provide a wider variety of content and services compared to the existing provision, given that the policy objective of the Subsidy is to repair and renew existing facilities and thereby prevent performance disruptions. The Assessment also states that ACE considers updates to National Theatre's London site are unlikely to distort international trade or investment.

3.57 However, in contrast to the statement in Step 3 of the Assessment that National Theatre is a 'unique provider', under Step 4 it states that DCMS acknowledges that the Subsidy confers an advantage on the National Theatre over other 'comparable enterprises' as it will receive funds to carry out infrastructure works, noting that this level of publicly-funded capital investment in a specific arts organisation has not been typical.

3.58 DCMS' view is that theatre organisations are not necessarily competing for resources, but instead operate in an ecosystem of working collectively to constitute a world-class sector to deliver social and economic benefits. As such, citing its unique role, the National Theatre considers itself in more of a leadership role than a competitive one. However, the Assessment acknowledges that other theatres comparable in size and audience reach are expected to cover costs of maintenance themselves, or else face cancellations and eventual mothballing.

3.59 The Assessment goes on to submit that the proposed award would also allow the National Theatre to maintain its current price points, whilst simultaneously improving customer satisfaction. Overall, this could lead to consumers preferring the National Theatre over competitors going forward.

3.60 In Step 4, the Assessment also outlines potential competitors to the National Theatre:

(a) other publicly subsidised theatres;

(b) commercial theatre venues and producers (eg London's West End); and

(c) other publicly subsidised cultural venues.

3.61 The Assessment also names some other publicly subsidised and commercial theatres with 'the greatest comparability to the National Theatre in terms of the audience experience'.

3.62 In line with the Statutory Guidance,[18] the Assessment compares the size of the Subsidy (£26.2 million) with the turnover of the theatre sector (£4.4 billion). The Assessment states that, in the context of this wider turnover, the Subsidy could be considered as small. However, the Assessment provides another comparison of the Subsidy's size, this time with the average cost of a West End production (£3.5 million), reaching the conclusion that, based on this comparison, the Subsidy could be seen as 'quite significant'.

3.63 Overall, the Assessment discusses various competitive impacts that may arise as a result of the provision of the Subsidy to the National Theatre and why DCMS views them as unlikely to be significant. However, the Assessment should re-consider and reconcile a number of contradictory statements it makes in Steps 3 and 4 on the competitive position of the National Theatre relative to other venues. Clarity on this point is important in terms of the Assessment's coherence in assessing the Subsidy's potential impact on competition. This is particularly important given that the National Theatre is likely to compete with a number of other theatres in London and that the Subsidy confers an advantage to the National Theatre over other 'comparable enterprises'.[19]

Step 4: Carrying out the balancing exercise

3.64 The fourth step involves an evaluation of the assessment against subsidy control Principle G: subsidies' beneficial effects (in terms of achieving their specific policy

[18] Statutory Guidance, paragraphs 17.8 to 17.12.
[19] This advantage is conferred to the National Theatre relative to the counterfactual of the National Theatre's operations being impacted absent the subsidy, rather than the existing situation with the National Theatre's current levels of operations.

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.[20]

3.65 The Assessment acknowledges in Step 4 that the National Theatre is receiving an advantage over other comparable enterprises in receiving a subsidy to undertake the infrastructure works and acknowledges that other theatres comparable in size and audience reach are expected to cover costs of maintenance themselves, or else face cancellations and eventual mothballing.

3.66 The Assessment explains that compared to no remedial works over a 30-year period, DCMS estimate the impact of undertaking these works would reduce the frequency of cancelled shows and avert the loss of [0-5] million[21] audience members, resulting in savings of £[200-300] million. It also estimates increased audience confidence and enhanced reputation could prevent a decline of [10-20] million audience members and so avert a loss of £[10-20] million, and reduce expenditure on urgent repairs (£[5-10] million).

3.67 The Assessment also considers benefits from the Subsidy on the broader impact of the South Bank site, noting that significant numbers of people use the site for reasons other than attending a performance. It also states there are also a number of agglomeration benefits and interactions with supply chains that would be impacted without the investments supported by the Subsidy.

3.68 Noting the National Theatre's wider contribution to culture in the UK, and in particular its ambitions in accessibility and representation in theatre, DCMS consider that the Subsidy's benefits outweigh any potential harm or disadvantage to the National Theatre's competitors.

3.69 In our view, the Assessment has appropriately identified potential negative effects of the Subsidy on competition and investment within the United Kingdom, and explained that the benefits outweigh them. However, DCMS should consider our comments in paragraph 3.26 on demonstrating the benefits which will be realised in relation to the equity objective, and in paragraph 3.63 on competition, and consider how these points may impact the balancing exercise.

[20] See Statutory Guidance (paragraphs 3.109 to 3.117) and SAU Guidance (paragraphs 4.20 to 4.22) for further detail.
[21] The SAU has excluded from the published version of the report information which it considers should be excluded having regard to the three considerations set out in section 244 of the Enterprise Act 2002 (specified information: considerations relevant to disclosure). It has instead represented these numbers as a broad range within square brackets. The values lie within this range, but the range does not in any way constitute a maximum or minimum of the values.

Other Requirements of the Act

3.70 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.[22] DCMS confirmed that no other requirements or prohibitions set out in Chapter 2 of Part 2 of the Act apply to the Subsidy.

9 August 2024

[22] Statutory Guidance, chapter 5.