

Subsidy Advice Unit Report on the proposed Welsh Freeports Subsidy Scheme

Referred by the Welsh Government and the
Ministry of Housing, Communities and Local
Government

01 November 2024

Subsidy Advice Unit

Part of the Competition and Markets Authority



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1. The Referral

- 1.1 On 17 September 2024, the Welsh Government (WG) and the Ministry for Housing, Communities and Local Government (MHCLG) requested a report from the Subsidy Advice Unit (the SAU)¹ in relation to its proposed Welsh Freeports Subsidy Scheme (the Scheme) under section 52 of the Subsidy Control Act 2022 (the Act).²
- 1.2 This report evaluates WG and MHCLG's assessment of compliance (the Assessment) of the Scheme with the requirements of Chapters 1 and 2 of Part 2 of the Act.³ It is based on the information and evidence included in the Assessment.
- 1.3 This report is provided as non-binding advice to WG and MHCLG. It does not consider whether the Scheme should be implemented, or directly assess whether it complies with the subsidy control requirements.

Summary

- 1.4 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](#)).
- 1.5 In our view, WG and MHCLG have considered in detail the compliance of the Scheme with the subsidy control and energy and environment principles. In particular, the Assessment:
- (a) 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 (Principle A).
 - (b) 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 (Principle E).
- 1.6 However, in our view, the Assessment should give further consideration to the broader potential competitive impact that the Scheme may have on other ports or

¹ The SAU is part of the Competition and Markets Authority.

² [Referral of the proposed Welsh Freeports Subsidy Scheme by the Welsh Government \(WG\) and the Ministry of Housing, Communities and Local Government \(MHCLG\) - GOV.UK \(www.gov.uk\)](#)

³ 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.

disadvantaged areas in the UK (Principle F); as well as potential negative effects on international trade or investment (Principle G).

- 1.7 We discuss these areas below, along with other issues, for consideration by WG and MHCLG in finalising its assessment.

The referred scheme

- 1.8 WG and MHCLG are proposing to create the Scheme to establish Freeports⁴ in places that are experiencing economic disadvantage but have unmet potential in Wales.
- 1.9 Following a competitive bidding exercise completed in 2023, two Welsh Freeports were selected; Anglesey Freeport (Anglesey) and Celtic Freeport (Pembrokeshire and Neath Port Talbot).
- 1.10 Under the Welsh Freeports Scheme, qualifying enterprises will be able to receive support through the following measures:
- (a) five tax reliefs (National Insurance Contributions, Enhanced Buildings Allowance, Enhanced Capital Allowance, Non-Domestic Rates and Land Transaction Tax) available on new investment on specific, underdeveloped sites - these are expected to be available from 2024 to 2034; and/or
 - (b) up to £25 million seed capital funding per Freeport, administered by Local Authorities and used for supporting projects which address local market failures and unlock sites for development, for example through transport infrastructure or site remediation works. Seed capital may or may not constitute a subsidy depending on how it is used by the Local Authority.
- 1.11 WG and MHCLG have stated that whilst it is not possible to establish a definitive 'budget' for the Scheme ahead of time, they estimate that it will be approximated as £185 million (£50 million in seed capital, £135 million in tax reliefs).
- 1.12 WG and MHCLG explained that the Scheme is a Subsidy Scheme of Particular Interest because it allows for the provision of one or more enterprises to be awarded over £10 million.⁵

⁴ A Freeport is a large, zoned area within a defined boundary which includes a rail, sea, or airport. Operators and businesses located specific sites within the zones can benefit from a package of tax and other incentives through a combination of devolved and reserved levers.

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.

2. The SAU's Evaluation

2.1 This section sets out our evaluation of Assessment, following the four-step structure used by WG and MHCLG.

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

2.2 Under Step 1, public authorities should consider compliance of a subsidy with:

- (a) Principle A: Subsidies should pursue a specific policy objective in order to remedy an identified market failure or 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.⁶

Policy objectives

2.3 The Assessment states that the policy objective of the Scheme is to promote regeneration and high-quality job creation in economically disadvantaged port geographies. It explains that Welsh Freeports will achieve this aim by realising two secondary objectives:

- (a) establishing national hubs for global trade and investment across the economy; and
- (b) fostering an innovative environment.

2.4 The Assessment explains that by encouraging private investment in parts of Wales that are less attractive to investors, but which have strong economic potential given existing port infrastructure, Welsh Freeports will drive regeneration and job-creation for these communities.

2.5 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, Welsh Freeports can maximise their regenerative impact.

⁶ See [Statutory Guidance](#), paragraphs 3.32-3.56 and the [SAU Guidance](#), paragraphs 4.7-4.11 for further detail.

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

Equity Objective

2.7 Equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.⁷

2.8 The Assessment states that the specific policy objective of the Welsh 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 Welsh Freeports programme is the equity rationale of addressing spatial inequalities, rather than addressing market failures.

2.9 The Assessment then sets out that there are specific economic disadvantages affecting coastal communities and areas around ports in Wales. 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.

2.10 It provides explanation and evidence⁸ 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.

2.11 The Assessment explains that Welsh Freeports are an important plank in the WG policy response to these spatial inequalities and in realising the economic potential of such geographies.

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

Appropriateness

2.13 Public authorities must determine whether a subsidy is the most appropriate instrument for achieving the policy objective. As part of this, they should consider other ways of addressing the market failure or equity issue.⁹

⁷ [Statutory Guidance](#), paragraphs 3.49-3.53.

⁸ [Levelling Up the United Kingdom White Paper, and Welsh Index of Multiple Deprivation \(WIMD\)](#)

⁹ [Statutory Guidance](#), paragraphs 3.54-3.56.

- 2.14 The Assessment sets out, supported with relevant evidence, why the Scheme is the most appropriate and least distortive available instrument, explaining that the Welsh 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.
- 2.15 It reasons, supported by logic models,¹⁰ 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.
- 2.16 WG and MHCLG 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.
- 2.17 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.
- 2.18 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.
- 2.19 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 out 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.
- 2.20 The Assessment also notes that Welsh Freeports are required to consider direct provision (eg local authorities delivering site remediation themselves) as part of

¹⁰ A logic model is a graphic which represents the theory of how an intervention produces its outcomes. It represents, in a simplified way, a hypothesis or ‘theory of change’ about how an intervention works. Process evaluations test and refine the hypothesis or ‘theory of change’ of the intervention represented in the logic model.

their business case and show why this is not possible wherever they propose to use the seed funding as a subsidy.

- 2.21 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.

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

- 2.22 Under Step 2, public authorities should consider compliance of a subsidy with:

- (a) Principle C: Subsidies should be designed to bring about a change of economic behaviour of the beneficiary. That change should be something that would not happen without the subsidy and be conducive to achieving its specific policy objective; and
- (b) Principle D: Subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy.¹¹

Counterfactual

- 2.23 In assessing the counterfactual, public authorities should consider what would likely happen in the future – over both the long and short term – if no subsidy were awarded (the ‘do nothing’ / ‘no subsidy’ scenario).¹²

- 2.24 The Assessment explains that the most likely counterfactual with no intervention, given the characteristics of the inequalities in the Welsh Freeport areas, is that the economic underperformance and comparatively low competitiveness in the Welsh Freeport areas will continue. This would mean the Welsh Freeports programme’s equity objective would not be realised.

- 2.25 In particular, the Assessment notes that without the Freeport subsidies, **Anglesey** would continue to face industrial and economic decline and continued outward migration of its younger population, tilting the demographic balance towards ageing communities and greater reliance on the seasonal visitor economy with opportunities for growth and regeneration reduced, delayed or lost. In particular, the Assessment states that:

- (a) The proposed package of seven projects, including infrastructure development, decarbonisation efforts, and green energy initiatives, would be

¹¹ See [Statutory Guidance](#), paragraphs 3.57-3.71 and the [SAU Guidance](#), paragraphs 4.12-4.14 for further detail.

¹² [Statutory Guidance](#), paragraphs 3.60-3.62.

delayed or abandoned without seed capital, making it harder to attract private sector investment to revitalise the area.

- (b) The absence of Freeport tax incentives could reduce Anglesey's appeal to businesses interested in investing in green industries such as hydrogen and renewable energy. It could affect Anglesey's ambition to contribute to achieving net zero by 2030, as green energy companies would likely seek alternative locations.

2.26 In relation to **Pembrokeshire and Neath Port Talbot**, the Assessment states that the absence of the subsidy would present a significant challenge for South Wales in establishing itself as a green energy hub and would stall projects. The Assessment states that seven schemes depend on the seed capital, including hydrogen and FLOW projects, and infrastructure and site works needed to leverage private sector investment.

2.27 In our view, the Assessment has given detailed and thorough consideration to the counterfactual scenario and supported its conclusions with appropriate reasoning and examples of the affected projects. However, the Assessment could better explain why and to what extent the economic decline is likely to continue absent the subsidy, for instance, by providing further economic evidence to demonstrate the nature and extent of the past decline over a longer time horizon.

Changes in economic behaviour of the beneficiary and additionality

2.28 Subsidies must bring about something that would not have occurred without the subsidy.¹³ They 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 ('additionality').¹⁴

2.29 The Assessment explains that the Scheme has been designed to influence a change in economic behaviour by influencing businesses to locate, invest and create jobs in the Welsh Freeport areas.

2.30 The Assessment further explains how the different components of the tax reliefs and seed capital, by their design, incentivise different types of investments and economic activity.

2.31 The Assessment explains that the tax reliefs are designed to spur new economic activity rather than supporting existing operations/business-as-usual costs. This would be achieved through incentivising (i) investments in land for development; (ii) investment in commercial buildings (eg through non-domestic rates relief); (iii)

¹³ [Statutory Guidance](#), paragraph 3.64.

¹⁴ [Statutory Guidance](#), paragraphs 3.63-3.67.

investment in plant and machinery; and (iv) new employment (eg through reduced National Insurance Contributions (NICs)).

- 2.32 In particular, reliefs such as the Land Transaction Tax, Enhanced Structures and Buildings Allowance, Enhanced Capital Allowances, and NICs reduce the set-up costs of investments and employment, which helps stimulate economic activity. The Assessment notes that while two of the tax reliefs (non-domestic rates and NICs) relate to operating costs, it clarifies that these are unlikely to be business-as-usual costs because they relate to new hereditaments (eg infrastructure and land) and new occupations/employees.
- 2.33 The Assessment explains that the seed capital has been designed to support costs that the private sector will not cover and enable economic activity that would not have occurred without the subsidy. Seed capital funding would be utilised for funding critical capital projects only (not business-as-usual costs), 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. Moreover, the UK and WG will carefully scrutinise seed capital proposals through a full business case assurance and approval process.
- 2.34 In our view, the Assessment describes why the subsidy is necessary to effect the change in economic behaviour needed to achieve the policy objectives in paragraph 2.3, including examples of potential projects resulting from the Scheme.
- 2.35 In particular, tax reliefs satisfy the additionality principle, including for schemes, in that they target new investments in underutilised and economically disadvantaged areas under government supervision, which would not have happened without the subsidies. We also note that the Assessment states that each proposal for seed capital will be analysed with the additionality principle in mind.
- 2.36 The Assessment provides the results of a job creation modelling exercise of both Freeports, with the WG further indicating each Freeport is expected to create 13,000 jobs in its wider region – a total of 26,000 jobs in Wales.
- 2.37 In our view, the Assessment clearly describes, with examples, the change in the behaviour of the beneficiaries and the additionality arising from the Scheme. It also sufficiently explains that the Scheme would not fund business-as-usual costs.

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

- 2.38 Under Step 3, public authorities should consider compliance of a subsidy with:

- (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.¹⁵

Proportionality

- 2.39 The Assessment submits that various Welsh Freeports design choices have been made with the intention of limiting the size of subsidy available. These include capping NICs relief on earnings up to £25,000 per annum and limiting tax reliefs to apply only to new investment on underdeveloped sites.
- 2.40 The Assessment states that the tax relief is proportionate as the amount of subsidy received depends on how much the beneficiary spends, with spending going towards achieving the policy objective. Therefore, Welsh Freeports tax reliefs will not result in high intervention rates, ie the proportion of subsidy compared to overall project cost is expected to be low.
- 2.41 Further, the Assessment also outlines how, through the Outline Business Case, Welsh 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.
- 2.42 The Assessment 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 the earlier UK Enterprise Zone experience, which consisted of a smaller package of measures, and which created only around a third of the additional jobs intended, according to estimates from a Centre for Cities report;¹⁶
 - (b) inequalities targeted by Welsh Freeports are deeply entrenched, requiring significant government intervention; and
 - (c) a smaller package being unlikely to meaningfully raise the relative competitiveness of Welsh Freeports given the magnitude of other internationally available subsidies.
- 2.43 Furthermore, the Assessment considers protections against cumulation of subsidies, both between tax reliefs as well as between tax reliefs and seed

¹⁵ See [Statutory Guidance](#) paragraphs 3.72-3.108 and the [SAU Guidance](#), paragraphs 4.15-4.19 for further detail.

¹⁶ In this instance, UK Enterprise Zones refer to a policy announced in 2011, rather than the English Investment Zones announced in 2022.

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.

- 2.44 The Assessment also outlines that public authorities must consider cumulation of subsidies when considering granting additional subsidies to businesses located on Welsh Freeport tax sites, and that the clear borders of the tax sites will aid them in doing so.
- 2.45 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.
- 2.46 However, while the Assessment describes the value-for-money benefits of seed funding in some detail, it could explain the seed funding allocation, management and monitoring processes more fully and how these processes will support MHCLG and WG in ensuring continued compliance with Principle B, given that decision-making over individual seed funding projects is devolved to relevant local authorities. Moreover, the Assessment could, as set out in the Statutory Guidance, consider further whether beneficiaries of the Scheme may receive other subsidies, including prospective future subsidies, for similar purposes.¹⁷

Design of subsidy to minimise negative effects on competition and investment

- 2.47 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 Welsh 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.
- 2.48 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 2.39 to 2.42.
- 2.49 The Assessment also notes that, to minimise distortive impacts, all components of the Scheme are either time-limited or one-off.
- 2.50 In relation to the nature of costs covered, the Assessment states that most of the subsidies under Welsh 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, although it explains that these measures only

¹⁷ See [Statutory Guidance](#) paragraphs 3.91 and 3.92.

apply to costs associated with new hereditaments and to new employees, which are viewed as unlikely to be business-as-usual costs.

- 2.51 The Assessment states that the UK government and WG will agree a Memorandum of Understanding with both Welsh 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.
- 2.52 More broadly, the Assessment outlines that the UK government and WG will undertake 'robust' monitoring and evaluation of the Welsh 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 Welsh Freeports accountable to the delivery of the agreed objectives.
- 2.53 The Assessment 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 Welsh 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.
- 2.54 Overall, in our view, the Assessment engages with most of the subsidy design aspects set out in the Statutory Guidance. When discussing the nature of the instrument, the Assessment could build on its identification of different subsidy and non-subsidy options from step 1 and compare how these options would differ in their impacts on competition and investment specifically.

Assessment of effects on competition or investment

- 2.55 The Assessment states that by increasing the quantity of commercially viable locations/sites, Welsh Freeports are likely to increase competition, over the medium term, in sectors that are already well established in the UK.
- 2.56 It submits that Welsh Freeports are aimed not at raising the commercial attractiveness of currently viable locations but at improving the commercial attractiveness of currently uncompetitive locations. The Assessment identifies that a key risk of Welsh Freeports is that they incentivise relocation of businesses from elsewhere in the UK. It cites a report from the Centre for Cities which estimated that 34% of jobs created from the UK Enterprise Zones programme were displaced from elsewhere in the UK. However, the Assessment points out several mitigating factors that are intended to minimise the negative impacts of displacement including:

- (a) Welsh 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 Welsh Freeports from more disadvantaged areas;
- (b) Welsh Freeports mainly support initial set-up costs rather than business-as-usual costs, which is unlikely to make commercial sense for established businesses as a reason to move;
- (c) Welsh Freeports must, as part of their Outline Business Case, model displacement and demonstrate net economic benefit to the UK economy; and
- (d) non-domestic rate relief is subject to a displacement test.

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

2.58 The Assessment sets out that, given the nature of the Scheme, in particular the wide range of sectors which may be able to benefit from Welsh 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 Welsh Freeports are less likely to be distorted. The Assessment also provides a detailed evaluation of the FLOW industry:

- (a) FLOW is a nascent market with limited firm concentration and substantial export potential. Moreover, there is an early-mover opportunity for Welsh 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. Inverness and Cromarty Firth Green Freeport and Forth Green Freeport in Scotland are identified as the main domestic competitor sites. However, the Assessment outlines that meeting the UK's 2030 FLOW target is recognised to be a multi-port strategy with between £3 billion and £4 billion in investment required; and
- (c) the Assessment's case study recognises that Welsh Freeports could have an impact on international trade and investment, but this is considered unlikely as Welsh 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 Welsh Freeports in terms of size.

- 2.59 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 Welsh Freeport through the selection process that gave 'rigorous consideration' to ensure the support of small and medium sized firms alongside larger beneficiaries.
- 2.60 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 describes several characteristics of the Welsh Freeport design and other factors (eg the nascency of target sectors) that reduce the risk of displacing economic activity.
- 2.61 However, in light of the evidence provided on displacement, the Assessment could further consider the Scheme's potential negative impacts on economic activity in other parts of the UK. Furthermore, while the case study covers potential impacts on international trade for the FLOW sector, the Assessment also suggests that the Scheme aims to support Holyhead Port to regain trade with other ports that it lost in recent years. The Assessment should therefore discuss more broadly the risks of potential distortions to competition or investment within the UK, and the impacts on international trade between Holyhead and other ports.¹⁸

Step 4: Carrying out the balancing exercise

- 2.62 Public authorities should establish that the benefits of the subsidy (in relation to the specific policy objective) outweigh its negative effects, in particular negative effects on competition or investment within the United Kingdom and on international trade or investment.
- 2.63 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 26,000 jobs in Wales;
 - (b) increasing investment, trade, and innovation whereby the Welsh Freeports combined are expected to catalyse £6.73 billion investment and unlock between £7 and £9 of private sector investment for every £1 of government investment;

¹⁸ See paragraph 3.75 of the [Statutory Guidance](#).

- (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 Welsh 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.

2.64 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 Welsh 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 Welsh 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 being most likely to benefit from the Scheme);
- (c) impact on employment rates whereby the Welsh 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 Welsh 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 Welsh Freeport

(although it is expected that the Welsh Freeports will generate benefits for surrounding regions).

- 2.65 WG and MHCLG 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 Welsh Freeport's business case demonstrate that in both cases the positive impacts of the Welsh Freeport subsidies outweigh the negative impacts.
- 2.66 In our view the Assessment demonstrates that WG and MHCLG have considered and balanced the Scheme's expected benefits and potential negative effects. However, it should explore further the potential likelihood and scale of displacement from other disadvantaged areas and the risk of potential distortions to competition in the UK (as set out in paragraph 2.61), as well as the potential negative effects on international trade or investment.

Energy and Environment Principles

- 2.67 This section sets out our evaluation of the Assessment against the energy and environment principles.¹⁹
- 2.68 The Assessment, citing the bidding prospectus,²⁰ sets out that 'the Freeport Programme will look to incentivise private businesses to invest in new opportunities in Wales, particularly in relation to climate resilience and making maximum progress towards decarbonisation.'
- 2.69 The Assessment also sets out that the delivery requirements for Freeports in Wales align with the Well-being of Future Generations (Wales) Act 2015, and include decarbonisation and environmental goals. Hence it is expected that the Freeports will improve the economic, social, cultural and environmental well-being of Wales, help drive the decarbonisation agenda, and embed environmental sustainability.
- 2.70 The Assessment sets out that, 'given this explicit focus on decarbonisation and a just transition to a net zero economy, the Energy & Environment Principles (Principle A and Principle B) apply.'
- 2.71 WG and MHCLG have therefore conducted an assessment of the Welsh Freeports Subsidy Scheme against Energy and Environment principles A and B.

¹⁹ See Schedule 2 to the Act, and [Statutory Guidance](#), Chapter 4.

²⁰ [Freeport Programme in Wales: bidding prospectus - GOV.UK \(www.gov.uk\)](#)

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

- 2.72 Subsidies in relation to energy or the environment should be aimed at (1) delivering a secure, affordable and sustainable energy system and a well-functioning and competitive energy market, or (2) 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 limbs.²¹
- 2.73 The Assessment sets out that both Welsh Freeports include a focus on sustainable sources of energy and developing nascent sectors that can contribute to long-term development of a competitive energy market, providing an opportunity to increase the competitiveness and sustainability of the energy system as a whole.
- 2.74 The Assessment sets out that without the Freeport programme and associated subsidies, the strategic focus that is being proposed for Welsh Freeports around renewable and alternative energy sources may not materialise in the same way or at the same pace, potentially leading to a less sustainable mix of investments (or none at all). The Assessment also sets out that the Freeports intervention sets high standards in relation to net zero goals and requires decarbonisation plans and subsequent monitoring and evaluation of progress, which are likely to deliver better environmental impacts than under the do-nothing scenario.
- 2.75 In our view, WG and MHCLG have outlined within the Assessment why they believe the Scheme complies with Principle A, and have explained that, through the focus on supporting renewable, sustainable and alternative forms of energy, the Scheme aims to help deliver a sustainable and competitive energy system, and increase the level of environmental protection compared to the level that would otherwise be achieved.²²

Principle B: Beneficiary's liabilities as a polluter

- 2.76 Subsidies in relation to energy or the environment should not relieve the beneficiary from liabilities arising from its responsibilities as a polluter under the law of England and Wales, Scotland, or Northern Ireland.²³
- 2.77 The Assessment sets out that the design and conditions of the seed capital and tax reliefs instruments, combined with wider government performance monitoring, assurance mechanisms and controls, will ensure that the Scheme 'will not relieve beneficiaries from any liabilities arising from their responsibilities as polluters.'

²¹ [Statutory Guidance](#), paragraphs 4.19-4.28.

²² [Statutory Guidance](#), paragraph 4.22.

²³ [Statutory Guidance](#), paragraphs 4.29-4.35.

2.78 In our view, the Assessment sufficiently explains how the Scheme is intended to comply with Principle B.

Other Requirements of the Act

2.79 WG and MHCLG confirmed that no other requirements or prohibitions set out in Chapter 2 of Part 2 of the Act applies to the scheme.

1 November 2024