

Brexit and the Cross-Border Spillover of the EU's State Aid Rules

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Executive Summary

- > After its withdrawal from the European Union, the United Kingdom is likely to maintain a state aid regime that is similar to that of the EU.
- > This is because the EU will require the UK to prevent distortions to bilateral trade caused by state aid and to preserve frictionless movement of goods and services between Ireland and Northern Ireland.
- > It will also be in the interest of the UK to maintain rules on state aid so as to avoid countervailing duties imposed by the EU in the World Trade Organization framework.
- > Moreover, as the devolved administrations within the EU acquire more autonomy in economic policy-making, it is likely that the UK will find it necessary to rely on state aid rules to prevent distortions to competition within the UK. Since public authorities in the UK already comply with EU state aid rules, the retention of these rules will not be difficult.

The European Union (EU) prohibits, in principle, state aid that affects cross-border transactions. In order for this prohibition to be effective it must be enforced on both sides of the border. This is one of the reasons why the EU systematically inserts provisions on state aid in the trade agreements it signs with third countries.

Through those agreements EU rules spread beyond the Union's borders. But EU rules also tend to spread simply because the EU is a "regulatory activist" and the single European market is very large. Bradford (2012) argued in a seminal article entitled the "Brussels Effect" that the EU exercises an unseen but keenly felt power to regulate global markets (see also Damro 2012 for a similar argument focusing on the internal market). By setting

the rules that govern products sold in the world's richest single market, it also forces producers in third countries to manufacture and supply goods ranging from food to chemicals according to its regulations. It thus effectively determines international regulatory standards.

The Brussels effect is not limited to goods. It extends to other policy areas such as the rules on data protection or on competition. For example, Articles 61-63 of the European Economic Area (EEA) Agreement contain provisions on state aid that mirror those of the EU's. And so do association agreements such as that with Ukraine (see Article 262).

A question that has arisen since the United Kingdom (UK) referendum of 23 June 2016 triggering the Brexit is whether the UK will retain the current state aid regime after it leaves the EU. In the short term and at least until 31 December 2020, the answer is in the affirmative. In the longer term and regardless of whether formal state aid rules will be explicitly included in a future agreement of cooperation between the EU and the UK, the UK is likely to maintain in some form the EU's state aid regime. This prediction is based on two reasons: the first is the likely spillover of the EU's rules into UK policies; the second is that it will be mostly in the UK's interests to keep a similar if not the same set of rules as those of the EU. After all, the EU will continue to be its main trade partner and prevention of trade-distorting state aid will help the UK to avoid countervailing tariffs by the EU.

This policy brief first discusses short-term legacy effects of EU state aid rules on the UK before considering the longer term spillovers of the EU's single market and competition rules to the UK. It concludes that because of the needs to prevent a 'hard' border between Ireland and Northern Ireland and avoid distortions to competition between its devolved administrations, state aid rules are likely to be retained in the UK.

Transition period and legacy issues

There is recognition both in the EU and in the UK that businesses need time to adjust to Brexit and also that the EU and the UK need time to negotiate the terms of their future relationship. The extra time is provided by a “transition” period. The draft Withdrawal Agreement (WA) of 28 February 2018 between the EU and the UK provides in Article 122 that EU law will be applicable on and in the UK until the end of the transition period and that it shall produce the same legal effects in the UK as in the EU (European Commission 2018).

The transition period starts from the expected exit of the UK on 30 March 2019 and ends on 31 December 2020. Therefore, at least until 31 December 2020, the substantive state aid rules will remain the same. But will state aid *procedures* remain the same?

With respect to proceedings initiated before EU courts, Article 82 WA refers to pending cases and clarifies that the Court of Justice of the European Union (CJEU) shall continue to have jurisdiction on such cases brought before it until the end of the transition period, including requests from UK courts for preliminary rulings. Moreover, Article 85 WA provides that judgments will have a binding force also after the transition period. Presumably, this means that if a case is lodged before the end of the transition period, but the judgment is rendered after the transition period, the decision of the CJEU will be enforceable in the UK, too.

With respect to administrative procedures, the picture is not so clear. Article 88 WA refers to ongoing administrative procedures. It provides that EU institutions shall continue to be competent for administrative procedures initiated before the end of the transition period, whereas Article 91 WA – entitled “binding force and enforceability of administrative decisions” – stipulates that decisions adopted before the end of the transition period shall be binding on and in the UK. It is thus clear that procedural rules will continue to apply to the UK until 31 December 2020 and that the European Commission will be empowered to monitor state aid, assess its compatibility and order recovery of incompatible aid.

However, what is not clear is what will happen when a procedure is initiated before the end of the transition period but concluded after that period is terminated. In this respect Article 89 WA provides that EU institutions remain competent to initiate new administrative procedures where the facts forming the subject matter of the administrative procedure occurred before the end of the transition period. With respect to state aid, the

provisions of Article 89 raise two questions. First, will decisions of the Commission, say, concluding a formal investigation procedure, be enforceable in the UK? If the UK does not comply, the Commission will normally have to initiate an infringement procedure. Yet, as this will occur after the end of the transition period, Article 82 WA will not apply and the CJEU will not have jurisdiction. Any dispute will have to be resolved by future dispute-settlement arrangements which are not yet known.

A second significant question is: will a complaint concerning pre-2020 illegal aid that is lodged with the Commission after 2020 also be considered as falling within the scope of Article 89 WA? It probably will because the “facts forming the subject matter” of the administrative procedure will have occurred before the end of the transition period. This implies that the Commission will be able to issue, for instance, a decision instructing recovery of aid. But, again, the enforceability of such a decision will depend on future dispute-settlement arrangements.

Given these considerations it is thus likely that EU state aid rules will continue to have an impact on the UK economy after 2020.

Spillover effects

While legacy issues will affect the UK for some time after its exit from the EU and also after the end of the transition period, the most significant channel through which EU state aid rules are likely to spill over into the UK are via a formal agreement between the EU and the UK and through Northern Ireland.

Formal agreement

At a recent event on the impact of Brexit on rules of competition, the Global Competition Law Centre (GCLC 2018) of the College of Europe discussed *inter alia* state aid matters. Speaking on the subject, Margaritis Schinas, the chief spokesperson of the European Commission, pointed to paragraph 12 of the negotiating guidelines given to the Commission by the European Council on 23 March 2018 (European Council 2018). This paragraph states:

“Given the UK’s geographic proximity and economic interdependence with the EU27, the future relationship will only deliver in a mutually satisfactory way if it includes robust guarantees which ensure a level playing field. The aim should be to prevent unfair competitive advantage that the UK could enjoy through undercutting of levels of protection with respect to, *inter alia*, competition and state aid, tax, social, environment and regulatory measures and practices. This will require a combination of

substantive rules aligned with EU and international standards, adequate mechanisms to ensure effective implementation domestically, enforcement and dispute settlement mechanisms in the agreement as well as Union autonomous remedies, that are all commensurate with the depth and breadth of the EU-UK economic connectedness” (emphasis added).

The EU thus clearly wants the UK to retain a state aid regime that mirrors or bears close resemblance to its own. The panel on state aid at the GCLC event discussed how effective enforcement could be achieved in the UK after it leaves the EU. The prevailing view was that a supranational mechanism was necessary, even if the UK would be likely to entrust the Competition and Markets Authority (CMA) with responsibility on state aid. At present, CMA decisions can be appealed to the Competition Appeals Tribunal (CAT), which is an independent court. In turn, the decisions of the CAT can be appealed to the various appeals courts of the UK, depending on where the cases arise. The issue that UK courts will be inevitably confronted to is whether and how their rulings ought to be aligned to those of EU courts to ensure consistent and uniform interpretation.

The Northern Ireland channel

The draft Withdrawal Agreement also contains a Protocol on Ireland/Northern Ireland. Avoidance of a visible border between the Republic of Ireland and Northern Ireland is politically very significant. It is acknowledged by both sides that the exit of the UK from the EU should not create a legal lacuna in Northern Ireland. For this reason, Article 168 WA stipulates that the Protocol on Ireland/Northern Ireland shall apply as from the end of the transition period. Article 9 of the Protocol requires that “the provisions of Union law on aids granted by States listed in Annex 2.9 to this Protocol shall apply to the United Kingdom in respect of Northern Ireland. For the purposes of those provisions, “in respect of Northern Ireland’ means that only measures that affect trade between the territory of Northern Ireland and the Union shall be considered as aid within the meaning of Article 107(1) TFEU”.

Although Annex 2.9 is still empty, it is rather likely that the EU will demand that the same state aid rules apply to either side of the border. This immediately raises the important question whether the UK will or should seek to apply different rules concerning state aid in the rest of the UK without causing competition distortions in the trade between Northern Ireland and other regions of the UK. Since it is not obvious how different sets of rules can be applied in different regions of the same country without leading to distortions of competition, it can be tentatively

concluded that the EU’s state aid rules will, through Northern Ireland, spill over to the rest of the UK.

Article 9 of the Protocol does not touch on the enforcement of the aid and the rules that will be listed in Annex 2.9. However, it will be difficult for the same UK authority to apply two sets of rules if they are not consistent with each other.

Will it be in the UK’s interest to deviate from the EU’s regime?

At the recent GCLC event, there was also discussion on whether the UK would *want* to maintain the EU’s state aid regime. Several panellists observed that the UK has had a very good compliance record, and it would be in its own narrow interests to maintain the *status quo*. In the absence of agreed rules on state aid, UK companies receiving state aid in the future would be exposed to the risk of countervailing measures by the EU within the World Trade Organization framework on subsidies.

However, it was also pointed out that if the UK chooses to maintain a state aid regime in the future, this does not imply that the rules will be identical to those of the EU. Among others, the UK could deviate with respect to the definition of assisted areas, the weight it will attach to market distortions caused by state aid, the assessment of the ‘common interest’ and the thresholds for individual notification laid down in the General Block Exemption Regulation (Regulation 651/2014). The UK’s rekindled interest in industrial policy was also highlighted as well as recent proposals for tax incentives, some of which could be linked to setting up operations in enterprise zones.

The panel did not examine the important issue of how different future UK rules can be from EU rules without becoming liable to countervailing measures and how to ensure equivalence between the two sets of rules also within the EU legal order. At this stage it is impossible to know how far the UK may want to deviate from EU rules.

In addition, a question that did not receive the attention it deserved was how much competition between its devolved administrations the UK would be prepared to tolerate in the absence of a state aid regime like that of the EU. At present, the UK does not need to establish national rules on subsidies granted by England, Scotland, Wales or Northern Ireland. However, if it leaves the EU without any formal agreement in place, then the issue that the UK will be confronted to is whether it should tolerate a subsidy competition such as that which takes place between the individual states of the United States. There is ample evidence that the US regime results in significant waste of public resources (see, e.g., Myers & Kent 2001).

Ultimately, these are not difficult policy issues. It will not hurt the UK to maintain the *status quo* which, after all, seeks to ensure that competition is fair and unfettered. But what appears now not to be difficult from the perspective of pursuing efficient policies may prove to be politically too costly in the future. Much will depend on the provisions of the agreement between the EU and the UK on their future relationship.

Conclusion

The 30th of March 2019 will be a sad day for the EU. However, regardless of sentiment, the exit of the UK is not likely to signify a similar exit from the EU's state aid regime. At least until the end of the transition period on 31 December 2020, both sides agree in principle that EU law, including competition rules, will apply to the UK.

After the end of the transition period, state aid rules will continue to be enforced in Northern Ireland to ensure frictionless trade across the Irish border. This will make it difficult for the UK not to adopt similar rules in the rest of the UK. The EU wants state aid rules to be included in the agreement on its future relationship with the UK so as to maintain a level playing field for companies on both sides of the English channel. But even if the EU does not demand state aid rules to be included in this agreement, it will be in the UK's own interests to retain the present state aid regime to prevent distortions to competition caused by

subsidies granted by its devolved administrations. A state aid regime will also act as an insurance policy to protect the UK from countervailing action by the EU.

What of course is unknown at this stage is whether the UK will apply precisely the same rules as those of the EU, as is currently the practice in the EEA, or if it will enforce different but equivalent rules. A significant deviation is unlikely. But it cannot be excluded that UK authorities may have to adjust aspects of the rules such as the eligibility criteria for granting aid.

What is also unknown at this stage is the institutional structure for resolving disputes between the EU and the UK. There is hardly any doubt that some form of dispute resolution will be necessary. The unknown factor is how much each side will try to avoid or insist on, respectively, involvement of the CJEU.

With respect to domestic enforcement of state aid discipline, it is likely that the UK's competition and markets authority will be given the task of monitoring and authorising compatible aid. Although the credentials of the CMA as a competition enforcer are beyond doubt, it will have to develop in-house expertise to deal with state aid. Because of its track record and independence, it is the best-placed authority in the UK to ensure that subsidies do not distort transactions and investment decisions within the UK and between the UK and the EU.

Further Reading

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