

Scottish Enterprise ('SE')**Proposed Capital Investment Scheme****Executive Summary**

Following receipt of the Report of the Subsidy Advice Unit dated 20 December 2024, SE has reviewed its Assessment of its proposed Capital Investment Scheme. For the reasons detailed below, it is considered that the proposed Scheme is compatible with the Subsidy Control Act 2022, satisfying the subsidy control principles; and as such it is appropriate for SE to introduce the Scheme and award grants under it, subject to compliance with relevant transparency requirements and expiration of the relevant challenge period.

1. Introduction

- 1.1 This document refers to SE's detailed assessment of its proposed Capital Investment Scheme (the 'Scheme') against the subsidy control principles of the Subsidy Control Act 2022, which was submitted to the Competition and Markets Authority ('CMA') on 4 November 2024 (the 'Assessment'). The CMA issued its report (the 'CMA Report') on 20 December 2024 (available at [Referral of the proposed Capital Investment Scheme by Scottish Enterprise - GOV.UK](#)). The CMA Report was required under the Subsidy Control Act 2022 as the Scheme envisages subsidies exceeding £10 million, includes the ability to support in sensitive sectors and allows for support for relocation subsidies, making it a Scheme of Particular Interest and therefore subject to mandatory referral to the SAU.
- 1.2 The CMA Report comments that the Assessment considered the compliance of the Scheme with the subsidy control principles, including: identifying the policy objective of the Scheme and considering how it relates to the objectives of SE and Scottish Government; presenting evidence indicating lower levels of business investment and productivity in Scotland relative to the UK average and OECD countries; identifying alternative policy options; explaining how the Scheme seeks to change the beneficiaries' economic behaviour and could bring about changes that would not have occurred in a longer timeframe without the Scheme; providing some useful detail on a number of design features that are relevant to proportionality and to the minimum necessary; and identifying several design features of the Scheme that will contribute to minimising negative effects on competition and investment.
- 1.3 However, as to be expected, particularly in light of the broad nature of the Scheme and the wide range of potential beneficiaries, there were some suggestions for improvement and areas for the SE to consider further. The suggestions and SE's response are summarised in Section 2. Sections 3 - 7 focuses on SE's response to the key points for improvement and consideration raised in the Report, working through them as they appear within the CMA Report. The CMA Report has been considered in full before reaching the conclusion in Section 8.

2. Summary of CMA Report recommendations and SE response

- 2.1 The CMA Report recommended that SE consider the following improvements to the Assessment:
- (a) Better explain and evidence the equity objective and market failure that the Scheme seeks to address and consider how this impacts the identified policy objective. (Principle A).
 - (b) Finalise and more fully describe the criteria and processes that will be used to assess subsidy applications under the Scheme and consider how these contribute to ensuring additionality, proportionality and minimising negative effects on competition and investment. (Principles B, D and F).
 - (c) More clearly establish that the policy objective could not be achieved in the counterfactual by more fully testing the robustness of the counterfactual model's conclusions. (Principle C).
 - (d) Examine the potential distortive effects of the Scheme in the UK in line with the Statutory Guidance and conduct a more thorough analysis of the potential for subsidy races resulting from the Scheme. (Principle F).
 - (e) Explain the conclusion that the benefits of the Scheme outweigh any negative effects as part of the balancing exercise. (Principle G).
 - (f) Fully explain what measures or indicators which will be used to assess the effect of subsidies that will involve relocation on social or economic disadvantage to satisfy the conditions in sections 18(5) to 18(7) of the Act. Update the design of the Scheme, so that the measures or indicators, as well as the processes, that will be used to assess the compliance of relocation subsidies with the conditions of the Act are incorporated within the Scheme, or reconsider whether it is appropriate to provide for relocation subsidies under the Scheme. (Other Requirements of the Act).
- 2.2 SE has considered the recommendations in detail and updated its Assessment taking them into account. This has resulted in updates throughout the Assessment to include more evidence, more explanation and to provide more detail on Scheme criteria and processes. SE reconsidered, as suggested, whether it is appropriate to provide for relocation subsidies under the Scheme and concluded that it is, but that relocation subsidies will only be considered where they are within Scotland. Relocations to Scotland from other parts of the UK will not be supported under the Scheme. SE has explained the indicators it will use to assess the effect of those intra-Scotland relocation subsidies in the updated Assessment and has also added details of indicators into the Scheme.

SE's response to the recommendations

3. 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

- 3.1 The CMA Report made some suggestions to help inform SE's further consideration of the equity objective and description of market failure. SE has reviewed and updated the Assessment to take account of the suggestions and does not consider the policy objective changes as a result; it remains as productivity growth in Scotland through increased capital investment by businesses in Scotland. The aim is to reduce the gap between Scotland and the UK, and Scotland and other OECD countries, in business investment levels. The Scheme also aims to address the market failure of low levels of

capital investment to date and, therefore, to help address the equity concern of the impact of low levels of productivity on wider society in Scotland.

Equity Objective

- 3.2 The CMA recommended that the Assessment more clearly justify why Scotland is the target area. Additional evidence has been presented to demonstrate the gap in business investment and productivity levels between Scotland and other relevant comparator countries (specifically OECD countries). The Assessment also now explains that one of the impacts of lower productivity and productivity stagnation is the low growth of earnings from employment and low pay.
- 3.3 It was suggested that SE use supporting evidence to demonstrate unequal opportunities or outcomes between Scotland and appropriate UK national or regional comparators on the identified economic and social wellbeing indicators that the Scheme seeks to improve. In response, the Assessment now more clearly demonstrates Scotland's weak position in relation to other UK regions in relation to economic and social wellbeing including the higher economic inactivity rate in Scotland (22%) compared to England (20.9%), the higher proportion of long-term sick and economically inactive residents in Scotland (33.7%) compared to England (27%) and Wales (33.4%), and the higher proportion of 16 to 17 years old proxied unemployed claimants compared to any other area in the UK. Sectorial pay data also highlights how 54% of Scottish employees are in sectors where median pay is lower than the rest of the UK.
- 3.4 The CMA Report also suggested the Assessment should critically assess whether the Scheme could have any negative effects on inequalities within Scotland and consider how these effects could impact the equity objective. It is considered that negative effects on inequalities within Scotland will be minimal for two reasons. Firstly, the Scheme is open across all areas of Scotland. Secondly, the appraisal will take into account the [wider economic] impacts of proposed projects. While the Scheme is not targeted to specific locations within Scotland, the impact on inequalities overall is assessed as positive.

Market Failure

- 3.5 The CMA Report recommended that the Assessment provide a more detailed explanation, supported by evidence, of how externalities have hindered investments in the breadth of sectors and activities targeted by the Scheme and how this has led to an inefficient outcome. This could explain why this market failure is more prevalent in Scotland than in the rest of the UK, and other comparator OECD countries cited in the Assessment.
- 3.6 In response, more detail has been added on how the Scheme responds to the Scottish Government's National Strategy for Economic Transformation ambition to transform Scotland's economic model and addresses some of the main issues that are impacting Scotland as a consequence of the low levels of capital investment. More detail has also been provided around the benefits of higher investment levels on workers' wages and product quality and the limits of the price mechanism in capturing all the potential socioeconomic spillover effects of better capital investment performance.

Appropriateness

- 3.7 The CMA Report suggested that the Assessment should consider more fully the range of policy instruments that public authorities use to increase capital investment and productivity and set out in more detail the advantages and disadvantages of each option, including why (supported by evidence) these alternatives would not be appropriate to achieve the policy objective in this instance.
- 3.8 In response, SE added further details to the Assessment to clearly set out SE's role and policy instruments that are within our statutory powers to use for the purposes of supporting economic development. An evaluation of the strengths and weaknesses of policy instruments available to SE has been carried out and added, including provision of information advice and guidance; loans; soft loans; loan guarantees; and provision of subsidy through grants.
- 3.9 The evaluation concluded that provision of grant support is the best economic instrument available to SE to address Scotland's business investment and productivity growth gap with the UK and other OECD countries. The provision of grant support under the Scheme has the scope to solve the underlying market failure and compensate economic actors to promote the highest level of capital investment by supported companies. Details have been added around the rationale behind the choice for grants over loans, the conditions for grant funding and the cases where grant repayment might be required.
- 4. STEP 2: Ensuring that the subsidy is designed to create the right incentives for the beneficiary and bring about a change**

Counterfactual

- 4.1 The CMA recommended that the Assessment should: (a) Clearly describe the counterfactual model's core assumptions and methodology, with sensitivity analysis to validate the robustness of the conclusions or, in its absence, explain the model's limitations. It was suggested that SE should explain why investment was been modelled up to 2030 rather than for the lifetime of the Scheme (i.e., up to 2034); (b) Clarify what legacy subsidy schemes are included in the counterfactual, the predicted developments for these schemes and how these schemes interact with the proposed Scheme.
- 4.2 In response, SE has updated the counterfactual investment modelling and extended to 2035 to cover the lifetime of the Scheme. Detail has been added on the key elements of the counterfactual, i.e. which legacy schemes are included, as well as on the structure of the model itself.
- 4.3 Annualised modelling of the average size of projects needed for Scotland to close the business investment gap has been added alongside the historical levels of capital investment from projects supported by SE through current and legacy schemes. This illustrates that continuing with a business-as-usual approach will leave Scotland some way short of closing the gap.

- 4.4 Four case studies included within the Assessment, from a bank of over 40 projects, have been updated to provide examples of projects which have either been lost, supported through alternative mechanisms or placed on hold due to lack of available capital investment support. These highlight the limitations with the current schemes and the scale of the missed opportunities for Scotland.

Changes in economic behaviour of the beneficiary and additionality

- 4.5 The CMA Report also advised that the Assessment could not definitively comply with Principle D (that subsidies should not normally compensate for the costs the beneficiary would have funded in the absence of any subsidy) until the eligibility and appraisal criteria had been finalised.
- 4.6 SE has updated the Assessment to include further details on the appraisal criteria against which grants under the Scheme will be appraised and has developed a grant product user guide and guidance for appraisers which provides more detailed guidance to SE staff on how to develop and appraise projects under the scheme.
- 4.7 SE appraises and awards a large number of grants each year. Our project lifecycle and approval governance process is modelled on the HM Treasury Green Book Principles therefore individual applications will be appraised on a case-by-case basis against the requirements of the Green Book (specifically the five-case model), the Scheme, the Subsidy Control Act and UK subsidy statutory guidance. The Scheme is focused on supporting projects with strong additionality and that represent value for money.

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

Proportionality

- 5.1 In order for SE to help demonstrate compliance with Principle B (that subsidies should be proportionate to their specific policy objective and limited to what is necessary to achieve it), the CMA recommended that SE describe in more detail the processes that will be used to appraise individual subsidies under the Scheme to ensure proportionality. The CMA recommended that the Assessment should specify the criteria that SE will apply to ensure that projects do not receive more than the minimum necessary intervention, how it will consider other subsidies given to the same recipients for similar purposes, and what circumstances would warrant advance payments. SE was also guided to explain and evidence in more detail how it arrived at the size of the intervention rates and maximum grant amount and how these contribute to proportionality.
- 5.2 In response, SE has added details of our appraisal criteria to the Assessment and set out the approach taken to ensure the grant amount is the minimum required to enable the project to proceed. Grants are paid quarterly in arrears unless exceptional circumstances warrant advanced payments and such cases are subject to additional appraisal rules.
- 5.3 Two case studies have been added to the Assessment, based on real projects, to show how the appraisal criteria would be applied to each case and the information that SE requires from the applicant for each project. This demonstrates how factors such as

relocation, competition and potential for market distortion are identified and assessed at an early stage in the process – prior to a full application being received.

- 5.4 The case studies and appraisal criteria set out in detail how the rate of subsidy required has been calculated with respect to the example projects. This illustrates the process the appraisal officer goes through to factor in a wide range of criteria including a detailed review of eligible costs, the economic impact assessment, financial due diligence and evaluation of the estimated economic outputs from the project such as cost per job, job quality, benefits to the Scottish supply chain and wider Scottish economy.

Design of subsidy to minimise negative effects on competition and investment

- 5.5 In relation to showing compliance with 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), the CMA recommended that SE describe how the eligibility and appraisal criteria and processes contribute to minimising negative effects on competition and investment.
- 5.6 A detailed description on the approach SE will take to appraising applications and minimising negative effects has been added to the Principles Assessment. This includes details on how SE will evaluate the need for support, the nature of the subsidy required, size of the funding gap, appraisal criteria including economic impact, the nature of eligible costs being covered, grant performance criteria and approach to monitoring and evaluating the outputs and outcomes.

Assessment of effects on competition and investment

- 5.7 The CMA Report also suggested that SE include a more detailed analysis of how the Scheme could influence businesses' incentives to invest in Scotland as opposed to other parts of the UK, or use case studies to assess the potential impacts of subsidies that could reasonably be given under the Scheme that have the highest risk of being excessively distortive. It was recommended that the Assessment conduct a more thorough analysis of the potential for subsidy races resulting from the Scheme, with explicit consideration of paragraphs 3.107 and 3.108 of the Statutory Guidance. For example, the Assessment could consider how the Scheme could influence the decisions of other UK public authorities awarding subsidies or whether any characteristics of the Scheme design limit the potential for subsidy races.
- 5.8 The commentary in the Assessment on potential subsidy races within the UK has been expanded with an analysis of individual subsidy awards made by other public bodies in the UK without using subsidy schemes.
- 5.9 A new section has been added to the Assessment on European competitors, their offering in the capital investment subsidy space, including maximum grant amounts and intervention rates, as well as performance on capital investment metrics, to show how the proposed subsidy is coherent with other public funding offering provided by countries that consistently perform better than Scotland on the key metrics discussed in the Assessment.

- 5.10 Further details have also been added to the Assessment to confirm the principles in place between the UK Government and the devolved administrations of Northern Ireland, Scotland and Wales to minimise any negative effects on competition across the UK.
- 5.11 SE will not seek to support relocation projects from other parts of the UK (England, Wales and Northern Ireland) using the Scheme.

6. Step 4: Carrying out the balancing exercise

- 6.1 The CMA suggested that the balancing exercise could not be completed until the Assessment considered in more detail any potential negative effects of the Scheme on international trade or investment and outlined in more detail how SE concluded that the benefits outweigh the negatives.
- 6.2 As explained under Step 3 above, more details have been added to the Assessment in relation to Scheme appraisal criteria, analysis on comparable schemes within the UK and Europe and steps taken to minimise competition.
- 6.3 The Assessment summarises the predicted positive and negative effects of the Scheme. SE has concluded through the evidence and analysis provided that the Scheme respects Principle G, on the basis that the positive direct and indirect effects on the Scottish economy and society of solving the existing market failure and reducing the existing equity gap with regards to other OECD countries' business investment and productivity growth levels, significantly outweighs the potential distortions introduced by having a subsidy scheme in place to support capital investment in Scotland.

7. Other Requirements of the Act

Relocation of Activities

- 7.1 The CMA Report recommended that the Assessment should fully explain what measures or indicators will be used to assess the effect of subsidies involving relocation on social or economic disadvantage for the purposes of satisfying the conditions in sections 18(5) to 18(7) of the Act. It also suggested that the Assessment should consider how the equity objective of the Scheme relates to the assessment of the effect of these subsidies on social or economic disadvantage for the purposes of satisfying the conditions.
- 7.2 The CMA Report also said SE should reconsider whether it is appropriate to provide for relocation subsidies under the Scheme, taking into account paragraph 2.24 of the Statutory Guidance, which states 'a public authority should consider whether a scheme is an appropriate way of approaching the assessment, as subsidies engaging the qualified prohibitions may often require a case-by-case consideration.'
- 7.3 Firstly, SE considers that it is appropriate to provide for relocation subsidies under the Scheme. Due to the nature of the Scheme design, all subsidies awarded under the Scheme will be appraised on a case-by-case basis in any event and the application of relocation conditions will be carried out as part of that. Appraisal criteria will establish at an early stage whether a project may involve a relocation. Where a relocation is involved, additional work will be carried out to work through the conditions in sections 18(5) to 18(7) to determine if a project can be supported under the Scheme or not.

- 7.4 Secondly, in SE's deliberations on this point following the CMA Report, SE has decided only to support intra-Scotland relocations under the Scheme. SE will therefore not seek to support relocation projects from other parts of the UK (England, Wales and Northern Ireland) using the Scheme. This is considered as lowering the potential for competition and investment with other UK nations.
- 7.5 Finally, the Assessment now explains the measures and indicators that will be used to assess social or economic disadvantage when considering if the conditions in section 18(5) to section 18(7) are met. The conditions are also now reflected in the Scheme. SE has taken into account the Statutory Guidance on this point and the primary focus will be on unemployment in origin and destination areas, based on Travel to Work area and/or Scottish local authority. Labour market indicators may also be considered, including employment rate, economic activity rate, qualification levels and gross weekly pay. This will be in addition to a wider economic impact assessment which will also have an eye to the equity objective of the Scheme, which is considered compatible with the inclusion of relocation subsidies.

8. Conclusion

Having considered the CMA Report in its entirety and strengthened the Assessment in response to the recommendations, SE is satisfied that the Scheme is consistent with the Subsidy Control Principles within the Subsidy Control Act 2022. SE considers that the Scheme will deliver positive direct and indirect impacts on the Scottish economy and society, through contributing towards solving the existing market failure related to Capital Investment by businesses and through reducing the existing equity gap with regards to other OECD countries.