Subsidy Advice Unit Report on the proposed subsidy to Cardiff International Airport Limited

Referred by the Welsh Government

02 October 2024

Subsidy Advice Unit

Part of the Competition and Markets Authority

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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 Welsh Government's assessment of compliance of the proposed subsidy to Cardiff International Airport Limited (the Airport) 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 the Welsh Government in its Assessment and evidence submitted relevant to that Assessment. The SAU has also received and considered six third party submissions.

1.4 This report is provided as non-binding advice to the Welsh Government. 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. The Welsh Government 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 The Welsh Government is proposing to award a subsidy to the Airport in the form of an investment package of up to around £205 million over a ten-year period. The Airport is owned by the Welsh Government at arm's length via a holding company, WGC Holdco Ltd (WGC Holdco).

1.7 The investment package will consist of:

(a) Capital investment to support new non-passenger business development at the Airport, including two maintenance, repair and overhaul (MRO) facilities,[2] general aviation,[3] fixed based operations (FBO) development and

[1] Chapter 1 of Part 2 of the Act requires a public authority to consider the subsidy control principles and energy and environment principles before deciding to give a subsidy. The public authority must not award the subsidy unless it is of the view that it is consistent with those principles. Chapter 2 of Part 2 of the Act prohibits the giving of certain kinds of subsidies and, in relation to certain other categories of subsidy creates a number of requirements with which public authorities must comply.
[2] Aircraft maintenance, repair and overhaul (MRO) covers both scheduled maintenance to keep aircraft airworthy on an ongoing basis as well as unscheduled or unplanned maintenance due to damage, component and engine failures, mandatory modifications, and upgrades to the cabin interior, systems and other components (see UK aerospace maintenance, repair, overhaul & logistics industry analysis (publishing.service.gov.uk))
[3] The Assessment sets out that general aviation at the Airport spans a range of activities, from leisure flying by light aircraft through to private clients using business jets.

improvement,[4] a fire training facility and infrastructure upgrades, a hangar village, cargo services and lower carbon aviation technologies. The Assessment provides a breakdown of the forecasted costs under each category.

(b) Financial packages to support air route development in the form of incentive payments to existing and new airlines to expand their operations. The Welsh Government explained that the actual cost will be established through negotiation and can include airline revenue guarantees, cash payments, marketing support and airport fee waivers as appropriate. The Assessment provides a breakdown of the proposed payments according to the geographic areas related to the airline routes that the payments aim to incentivise, and also sets out that part of the funding will aim to support 'low cost carriers / other airlines including at least one aircraft base'.

(c) The Subsidy will also cover associated capital works to allow for an increase in passenger throughput and reduce associated energy consumption, such as terminal building upgrades, lower energy airfield lighting, landside traffic management and fuel farm relocation. The Assessment provides a breakdown of the proposed funding for each category.

1.8 The Subsidy is given against a backdrop of other sources of financial support that the Welsh Government has provided to the Airport over time. The Welsh Government submitted that it has invested £179.6 million in the Airport since purchasing it in 2013 in acquisition costs, equity investment, loans and grants. Funding in recent years notably includes the following:

(a) In 2020, it provided the Airport with a COVID-19 emergency loan of £4.8 million. It explained that this loan was made on commercial terms under the Commercial Market Operator (CMO) principles[5] under State Aid rules.

(b) In March 2021, it provided the Airport with a rescue and restructuring grant of £42.6 million, which it explained will be fully drawn down by the end of December 2024. It explained that this grant was designed to cover for the fall in passenger numbers following the Covid pandemic.

(c) At the same time, it wrote off £42.6 million of the Airport's total commercial loan debt. The Welsh Government explained that the write-off was made on commercial terms under the CMO principle.

[4] The Assessment sets out that an FBO is a commercial operation that provides aviation services to both major airports as well as smaller airports and hangars. These include services for both pilots and travellers, from fuel supplies to maintenance and repair, parking and flight instruction. The Assessment sets out that three FBO companies already operate at the Airport.

[5] Under this principle, the beneficiary of a State Aid derives no economic benefit from the financial assistance as it is held to be equivalent to a commercial transaction.

1.9 The Welsh Government explained that the totality of financial arrangements in place means that the business can continue to operate for the short to medium term.

SAU referral process

1.10 On 15 August 2024 the Welsh Government requested a report from the SAU in relation to the proposed subsidy to the Airport.

1.11 The Welsh Government explained[6] the subsidy is a Subsidy of Particular Interest because its value exceeds £10 million.

1.12 The SAU notified the Welsh Government on 21 August 2024 that it would prepare and publish a report within 30 working days (ie on or before 2 October 2024).[7] The SAU published details of the referral on 22 August 2024.[8]

[6] In the information provided under section 52(2) of the Act
[7] Sections 53(1) and 53(2) of the Act.
[8] https://www.gov.uk/cma-cases/referral-of-the-proposed-subsidy-to-cardiff-international-airport-limited-by-the-welsh-government

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 In our view, the Welsh Government has considered the compliance of the Subsidy with the subsidy control principles at a high level. The Assessment sets out a clear policy objective that is narrowly focused on the development of the Airport and explains how the policy objective addresses an equity rationale.

2.3 As a general observation, the Assessment should ensure that all statements that underpin the Assessment are supported by objective and verifiable evidence and that all supporting evidence is correctly referenced.

2.4 In relation to the subsidy control principles, the Assessment should:

(a) Be clear on what is the most likely counterfactual and provide appropriate evidence to support this, such as financial projections and internal documentation from the beneficiary of the Subsidy - ie the Airport (Principle C).

(b) Provide more evidence to support the conclusion that all costs covered by the Subsidy are additional and would not have been funded otherwise (Principle D).

(c) Provide additional explanation and supporting evidence to show that the Subsidy is proportionate to its policy objective (Principle B). Specifically, the Assessment should:

(i) consider the size of the Subsidy relative to the size and costs of the beneficiary, and/or the value of the relevant markets; and

(ii) explain in more detail what checks and processes, such as clawback mechanisms and key performance indicators, are in place to ensure that the individual funding disbursements will be kept to the minimum necessary to achieve the stated policy objective.

(d) More systematically set out and evidence potential competition and investment impacts, drawing on the relevant parts of the Statutory Guidance (Principle F). In particular, the Assessment should:

(i) identify the product and geographical markets most likely to be affected by the Subsidy (including input and related markets) as well as the most important competitors for each of the beneficiary's affected products

and services and provide more detail and supporting evidence on the potential distortive impacts on competition;

(ii) consider how the Subsidy could impact competition - directly or indirectly - across the different supply chains of the proposed investments, including exploring how the incentive payments may distort competition between airlines; and

(iii) consider whether the Subsidy could result in displacement of private investment and draw on relevant parts of the Statutory Guidance to demonstrate how the proposed subsidy design minimises those negative impacts.

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 the Welsh Government.

3. The SAU's Evaluation

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

Step 1: Identifying the policy objective, ensuring it addresses a market failure or equity concern, and determining whether a subsidy is the right tool to use

3.2 The first step involves an evaluation of the Assessment against:

(a) Principle A: Subsidies should pursue a specific policy objective in order to (a) remedy an identified market failure or (b) address an equity rationale (such as local or regional disadvantage, social difficulties or distributional concerns); and

(b) Principle E: Subsidies should be an appropriate policy instrument for achieving their specific policy objective and that objective cannot be achieved through other, less distortive, means.[9]

Policy objectives

3.3 The Assessment sets out that the specific policy objective is to grow the regional economic activity associated with the Airport and maximise the potential agglomeration benefits linked with to the wider aviation and aerospace sectors in the region. The Assessment sets out that the policy objective is intended to address equity issues that have been identified by the Welsh Government.

3.4 The Assessment explains that the investment in the Airport will contribute to three well-being objectives of the Welsh Government's 'Programme for Government June 2021'[10] (building an economy based on the principles of fair work, sustainability and the industries and services of the future; enabling tourism, sports and arts industries to thrive; giving Wales the strongest possible presence on the world stage).

3.5 It explains that the policy objective and investment plan are also aligned with the Wales Transport Strategy 2021[11] and Welsh Government's National Transport Delivery Plan 2022 to 2027,[12] which set out a commitment to maintaining an aviation capacity in Wales because of the benefits that it brings to the Welsh economy as a whole. It also refers to the Cardiff Capital Region – Strategic

[9] Further information about the Principles A and E can be found in the Statutory Guidance (paragraphs 3.32 to 3.56) and the SAU Guidance (paragraphs 4.7 to 4.11).
[10] Welsh Government Programme for government: update | GOV.WALES
[11] Llwybr Newydd A New Wales Transport Strategy 2021: full strategy (gov.wales)
[12] National Transport Delivery Plan 2022 to 2027 (gov.wales)

Business Plan 2021 – 2026,[13] which sets out that new 'trade bridges' through Cardiff Airport, will support new trade relations and potentially, new international research partnerships.

3.6 It explains that the benefits of the investments in passenger and non-passenger business are expected to include new jobs, inbound tourism, increased Foreign Direct Investment and cargo (belly hold) exports, increased income from foreign students, an improved offer for organisers of major (eg sporting) events, and new commercial opportunities (eg hotel demand) associated with a greater level of general aviation at the Airport.

3.7 The Assessment notes that, since the Welsh Government purchased the Airport in 2013, the passenger numbers gradually increased from about 1 million in 2012 to 1.65 million in 2019. The number of passengers dropped during Covid and has since recovered to 0.84 million in 2023. The Welsh Government anticipates that the Subsidy will help the airport grow to a volume of 2.3 million passengers within 10 years.

3.8 In our view, the Assessment sets out in clear terms a policy objective that is narrowly focused on the development of the Airport and explains how this aligns with wider Welsh Government policies.

Market failure and equity objective

3.9 The Statutory Guidance sets out that:

(a) Market failure occurs where market forces alone do not produce an efficient outcome.[14]

(b) Equity objectives seek to reduce unequal or unfair outcomes between different groups in society or geographic areas.[15]

3.10 The Assessment explains that the equity rationale that the Subsidy seeks to address is helping to reduce social and economic disadvantage in Wales and in particular the South Wales region relative to the UK. It states that the Subsidy is not intended to remedy a market failure.

3.11 The Assessment cites evidence for high levels of deprivation in South Wales, and for primary income per head, employment rate, full-time weekly earnings and Gross Disposable Household Income per head being generally low in Wales compared to Scotland, Northern Ireland and England.[16,17] The Assessment also

[13] DRAFT CCR STRATEGIC BUSINESS PLAN 2021-2026 (cardiffcapitalregion.wales)
[14] Statutory Guidance, paragraphs 3.35 to 3.48.
[15] Statutory Guidance, paragraphs 3.49 to 3.53.
[16] Welsh Index of Multiple Deprivation (WIMD) 2019: Results report (gov.wales)
[17] Welsh economy in numbers | GOV.WALES

cites Office of National Statistics 2021 data to show higher levels of economic inactivity in Wales compared with England.

3.12 The Assessment explains that the Subsidy will address the equity rationale through growing the regional economic activity associated with the Airport and maximising the potential agglomeration benefits linked to the wider aviation and aerospace sectors in the region.

3.13 In support of this, the Assessment cites analysis commissioned by the Welsh Government[18] and a report by the Public Policy Institute for Wales[19] and sets out that the Subsidy is expected to lead to sustainable employment growth in the region and an incremental gross value added (GVA) impact across the 10-year period.

3.14 In our view the Assessment sets out a clear equity rationale and provides appropriate supporting evidence. The Assessment also explains how the policy objective will help to address the equity rationale.

Consideration of alternative policy options and why the proposed subsidy to the Airport is the most appropriate and least distortive instrument

3.15 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.[20]

3.16 The Assessment considers the following non-subsidy options to deliver the policy objective:

(a) Direct provision by the Welsh Government. the Assessment states that WGC Holdco's control mechanisms would make it challenging as they were designed to maintain independence from the Welsh Government. For the Welsh Government to directly provide airport services, this ownership structure would need to be undone. Although the Welsh Government consider this is technically possible, this would be complex, timely and costly.

(b) Further equity investment on commercial terms. The Assessment sets out that such investment would not be CMO compliant, as no reasonable private investor would dilute the value of their existing shareholding to that extent, considering the valuation of the business and the timescale for repayment of equity.

[18] Cardiff International Airport Limited Economic Impact Study, Grant Thornton, July 2024 (unpublished).
[19] PPIW-Report-Maximising-the-Economic-Benefits-of-Airports.pdf (wcpp.org.uk)
[20] Statutory Guidance, paragraphs 3.54 to 3.56.

(c) Further loans on commercial terms: the Assessment sets out that such loans would not be CMO compliant given the interest rates that would be attached to such loans. In any event, a commercial lender would 'almost certainly seek some form of guarantee from the Airport's shareholders, ie the Welsh Government' and such guarantee could potentially be interpreted as a subsidy.

3.17 The Welsh Government also considered the following alternative forms of subsidies:

(a) Extending the existing rescue and restructuring subsidy plan. It discounted this option as it considered the Airport to be a going concern that is not ailing or insolvent and the Act does not permit successive restructuring packages to be put in place, unless exceptional circumstances apply.

(b) Granting loans on subsidised terms (interest free). This option was also discounted given the Airport's financial projections and existing level of debts.

3.18 Therefore, the Assessment concludes that the most appropriate option for delivering the policy objective is to grant the Subsidy.

3.19 In our view, the Assessment explains why a subsidy is necessary to achieve the policy objective (defined as growing the regional economic activity associated with the Airport) and appropriately sets out a number of alternatives considered, providing reasoning for discounting them.

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

3.20 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.[21]

Counterfactual assessment

3.21 In assessing the counterfactual, the Statutory Guidance explains that public authorities should assess any change against a baseline of what would happen in

[21] 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).

the absence of the subsidy (the 'do nothing' scenario').[22] 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.

3.22 The Assessment explains that, absent the Subsidy, the Airport would be significantly constrained in its ability to grow the business, as it would not have the cash needed to provide commercial incentive payments to airlines, nor for stimulating the creation and growth of non-passenger businesses.

3.23 The Assessment adds that a lack of passenger revenue growth would compound the problem, as it would deprive the Airport of the ability to start generating its own funds for investment. The Assessment outlines that any new business the Airport could secure on its own would more likely be transient and/or opportunistic in nature, making it harder for the Airport to plan ahead and riskier for it to pursue new business opportunities.

3.24 The Assessment also states that, in the counterfactual, the aviation industry would notice a lack of investment by the Airport, especially in the context of investments happening at many other airports across the UK and worldwide, and may decide to relocate or close their operations at the Airport, potentially precipitating a collapse of the Airport.

3.25 However, the Assessment also states that, absent the Subsidy, the Airport would still try and offer some form of package to airlines to incentivise route development opportunities, although they would in most cases be too small to attract significant new business, resulting in stunted or even no growth.

3.26 In our view, the Assessment does not present a clear counterfactual. The Assessment sets out that the Airport will face challenges in the future; however the extent of these challenges, and the scope for the Airport to undertake any of the activities which will be funded through the Subsidy, are unclear. The Assessment should be clear on what is the most likely counterfactual and provide appropriate evidence to support this, such as financial projections and internal documentation from the beneficiary. It should then explain whether, in the counterfactual (absent the Subsidy), the Airport would have undertaken any of the activities that would have been funded through the Subsidy, or contributed to regional economic activity.

3.27 The counterfactual should then be used as the baseline against which changes in economic behaviour, additionality, and competitive distortions resulting from the Subsidy are assessed.

[22] Statutory Guidance, paragraphs 3.60 to 3.62.

Changes in economic behaviour of the beneficiary

3.28 The Statutory Guidance sets out that subsidies must bring about something that would not have occurred without the subsidy.[23] In demonstrating this, public authorities should consider the likely change or additional net benefit.

3.29 The Assessment explains that the Subsidy will provide the necessary sustained, large-scale investment that will enable the Airport to change its strategic focus away from survival and recovery to growth for the benefit of the regional economy.

3.30 The Assessment goes on to describe the change in economic behaviour relating to non-passenger business and air route development.

(a) Non-passenger business: the Assessment explains that developing non-passenger activities will enable the Airport to secure long-duration deals with aviation and aerospace sector firms that will offer impactful numbers of well-paid jobs and career pathways for newer job market entrants.

(b) Air route development: the Assessment explains that the funding package for air route development will enable the Airport to establish, and lock in for the longer term, regular scheduled services to global hubs and economic centres.

3.31 In our view, the Assessment explains how the Subsidy will bring about a change in economic behaviour, specifically an increase in non-passenger activity and new air routes. However, the Assessment provides limited evidence to support its assertion that the Subsidy will change the Airport's strategic focus 'from survival and recovery to growth'.

Additionality assessment

3.32 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.[24]

3.33 The Assessment explains that the Subsidy has been designed to focus only on activities to enable growth in a more sustainable manner and to avoid funding activities considered to be solely business as usual, eg spend on regulatory compliance and general operational and maintenance costs. It further explains that whilst the Airport would offer some form of package to airlines absent the Subsidy, they would be too small to attract significant new business.

[23] Statutory Guidance, paragraph 3.64.
[24] Statutory Guidance, paragraphs 3.63 to 3.67.

3.34 However, the Assessment also explains that, absent the Subsidy, the Airport would try and offer some form of support to airlines to incentivise new route development opportunities.

3.35 Third party representations have challenged whether the costs funded under the Subsidy would meet the additionality principle or whether these would be funded by the Airport absent the Subsidy.

3.36 In our view, in the absence of a clear counterfactual and not knowing what costs the Airport would fund absent the Subsidy, the Assessment does not clearly demonstrate whether or not any of the planned projects would go ahead absent the Subsidy. The Assessment should provide more evidence to support the conclusion that all costs covered by the Subsidy are additional and would not have been funded otherwise.[25] For example, such evidence could take the form of financial projections, with or without the Subsidy.

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

3.37 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.[26]

Proportionality

3.38 The Assessment states that the grants will be the minimum necessary and that WGC Holdco and the Welsh Government will conduct robust assessments of funding requests. The Assessment states that the maximum proposed investment over the 10-year period is based on data provided by the Airport, recent and live negotiations, extensive aviation market experience and capital project costings. The Assessment sets out that the Welsh Government 'considers the individual costings to be sensible' and has seen the commercially sensitive information supporting these figures.

3.39 The Assessment notes that the Welsh Government is incentivised to spend no more than is necessary to achieve the policy objective because of its own budget.

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[25] For instance, this evidence could show that incentive payments supported by the Subsidy would not have been funded anyway.
[26] 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).

Additionally, the Assessment states that monitoring and evaluation will be undertaken, including by an independent monitor, of the Airport's financial performance on a quarterly basis, along with a review mechanism stipulated in the contract with the Airport whereby outperformance of financial forecasts could reduce the annual investment and/or investment period itself. WGC Holdco will also provide challenge as part of the monitoring function. The Assessment also describes the Airport's policy for procurement which aims to ensure market prices are paid for any services used by the Airport, and notes that any major capital projects will require scrutiny and consent from the WGC Holdco.

3.40 The Assessment argues that the grant is proportionate by comparing the size of the investment at the Airport to commercially funded investment projects at other UK airports and to a US and an Irish subsidy.

3.41 The Assessment also briefly considers certain characteristics of the Subsidy which are relevant to proportionality, including a high-level consideration of performance criteria, ringfencing, and the use of the Airport's standard process for procurement. Specifically, the Assessment states that performance criteria will focus on the impact of the investment on employment and GVA, and that ringfencing (of expenditure within certain categories) will not be used because it will negatively impact on the Airport's ability to negotiate deals. The annual grant amount will be decided each year such that there is flexibility allowing for the best opportunities to be selected when they arise that meet the Welsh Government's economic objectives, and there will be disbursements based against a series of successive business cases as opportunities arise and develop.

3.42 Two third parties argued that the value of the subsidy was high relative to key financial parameters of the Airport and relative to the size of the markets which may be affected. For instance, one third party submission noted that the proposed subsidy would exceed the Airport's current annual turnover, in each year of the 10-year duration. Another third party stated that the size of the subsidy is unprecedented in the UK airport sector.

3.43 In our view, the Assessment should provide additional explanation and supporting evidence to show that the Subsidy is proportionate to its policy objective. Specifically, the Assessment should:

(a) Explain how the overall subsidy maximum was determined and provide evidence demonstrating that the Subsidy was set to keep it to the minimum amount necessary.[27]

[27] For example, the Assessment asserts that the Welsh Government considers the maximum proposed investment presented to it by the Airport as appropriate and that it has been privy to the evidence supporting the maximum grant figure (as explained in paragraph 3.38). However, the Assessment should have explained what the evidence is, how the Welsh Government scrutinised the evidence, and how it demonstrates that the grant is the minimum necessary.

(b) Consider the size of the Subsidy relative to the size and the costs of the beneficiary, and/or the value of the relevant markets.[28] Whilst the Assessment provides some evidence of private investment in other UK airports and two examples of subsidies for airports in other countries, it does not explain how or why this evidence is relevant to the proportionality of this subsidy and the objectives it seeks to achieve, which makes the comparisons less meaningful. The Assessment should clearly set out and consider the proportion of the projected investments that the Subsidy will cover, whether such proportion is proportionate to the policy objective, and whether a lower intensity would have minimised distortions.

(c) Explain in more detail the checks and processes WGC Holdco and the Welsh Government will use to ensure that the individual funding disbursements will be kept to the minimum necessary to achieve the stated policy objective, particularly in the absence of any ringfencing mechanism constraining expenditure to specific purposes. For example, the Assessment should consider any clawback mechanisms, key performance indicators and the thresholds which would trigger those mechanisms in case of financial outperformance or non-delivery.[29] Additionally, the Assessment could refer to the terms of a draft contract to demonstrate how such terms would minimise the size of the grant.

Design of subsidy to minimise negative effects on competition and investment

3.44 The Assessment briefly discusses design characteristics for the Subsidy, in particular how the Airport's focus on business-to-business aviation and different routes differentiates it from its closest competitor. The Welsh Government argues that this design reduces the risk of distortive impacts.

3.45 The Assessment provides little explanation or evidence as to how the proposed subsidy design will help minimise distortions. To address this limitation, it should systematically assess the design features listed in the Statutory Guidance and consider the extent to which the subsidy's implementation in relation to those design features contributes to minimising negative effects on competition and investment.[30] This should include a consideration of how the design features discussed in paragraph 3.43 minimise distortions. The Assessment should also consider whether the Subsidy could be granted over a shorter period while still meeting the policy objective. Alternatively, the Assessment should be clearer why the ten-year horizon is needed to implement the investment program effectively.

[28] Statutory Guidance paragraph 3.88.
[29] Key performance indicators could monitor expenditure of funding and the outcomes they realise, eg what infrastructure was completed, business opportunities attracted and retained.
[30] Statutory Guidance, paragraphs 3.76 to 3.108 and Annex 3.

Assessment of effects on competition or investment

3.46 The Assessment acknowledges the potential for distortive effects on competition or investment in the air passenger market and states that distortive effects for the MRO, GA and air cargo markets are unlikely. In support, it notes the following:

(a) The Assessment considers Bristol Airport as the market operator most likely to be affected by the Subsidy, with any adverse effects most likely to be experienced in the passenger business. It states that the competitor's larger size and different growth strategy, seen as focusing on high-volume tourist and low-cost carriers, reduce the risk of effects on competition or investment. In contrast, the Airport's growth plan is targeted on a small number of routes, some long haul, to important economic centres and global air hubs, served by major carriers.

(b) The Assessment discusses the potential displacement impacts (in terms of passenger demand and investment) on the UK and international airports. It states that any displacement of Welsh passengers from London airports and other large international airports would be a tiny fraction of the respective annual volumes. It also states that Birmingham airport is unlikely to be affected to any significant degree by an increase in passenger traffic at the Airport given the limited scope for overlaps in passenger demand between the two airports.

(c) The Assessment expects demand for MRO and general aviation services to outstrip supply in the near- to medium-term and so considers such a growing market to be less at risk of distortions from the subsidy. It describes the current state and revenue projections for the MRO market at a global and European level and lists some investments made by other UK airports in the market recently, to make the economic case for investment in MRO capacity. The Assessment argues that the subsidy would have minimal distortive effects on the air cargo market because of the small size of the proposed Subsidy for that activity and the low current levels of freight activity at Cardiff and Bristol airports. The Assessment does not discuss FBO to any significant extent.

3.47 In third party submissions, several UK airports expressed concerns about distortions to competition and investment. Bristol Airport showed a large overlap of catchment areas between itself and Cardiff Airport. Regional & City Airports (RCA) stated that it operates in each of the markets mentioned in the case summary.[31] RCA and Birmingham Airport argued that some of these markets operate UK-wide and potentially EU-wide, and both anticipated a risk of substantial distortion to

[31] Referral of the proposed subsidy to Cardiff International Airport Limited by the Welsh Government - GOV.UK (www.gov.uk)

competition and investment from the subsidy. In contrast, Gloucestershire Airport did not see any negative effects for its business given the scope of the proposal, geography and its current operating model.

3.48 Overall, our view is that the Assessment should more systematically set out and evidence potential competition and investment impacts, drawing on the relevant parts of the Statutory Guidance.[32] Specifically, the Assessment should:

(a) Identify the product and geographical markets most affected by the subsidy (including input and related markets) as well as the most important competitors for each of the beneficiary's affected products and services. While the Assessment identifies some potentially-affected competitors in the air passenger market, including Bristol Airport as the most affected competitor, third party submissions from additional competitors show that this analysis could be more comprehensive in considering competitors and markets. The Assessment should extend such analysis to non-passenger markets (MRO, general aviation, FBO, and air cargo services) to identify which airports may plausibly compete for the provision of these services, and assess how the proposed subsidy impacts those competitors.

(b) Provide more detail and supporting evidence on the potential distortive impacts on competition, considering also the different perspectives and concerns raised by several competitors in third party submissions. In particular, the analysis of the impact on Bristol Airport makes some unevidenced assumptions about how Bristol Airport factored in Cardiff Airport's potential growth into its strategy and why those strategic considerations should mitigate competition distortions. The Assessment should also use more evidence to support its analysis of the non-passenger markets, eg the size of the relevant funding in relation to the sales volume or the value of services provided for each of the markets affected by the Subsidy. Further, the Assessment should consider the impact on competition in a forward-looking assessment, for instance whether other airports are likely to compete for similar activities in the future.

(c) Consider how the Subsidy could impact competition – directly or indirectly - across the different supply chains of the proposed investments. In particular, whilst the Assessment sets out that the air route incentive payments are common practice across the industry, which aim to mitigate the financial risks airlines face when starting services in new markets, it should explore whether these payments may distort competition between airlines.

(d) Explain how allocating part of the Subsidy towards creating new passenger routes and attracting low-cost carriers implements and is consistent with the

[32] Paragraphs 3.76 to 3.108 and Annex 3 of the Statutory Guidance.

stated strategy to not compete on passenger volumes in general, and for low-cost carriers specifically. In this context, the Assessment could also describe the checks and balances that would limit the amount of subsidies going to these activities.

(e) Consider whether the Subsidy could result in displacement of private investment and draw on relevant parts of the Statutory Guidance to demonstrate how the proposed subsidy design minimises those negative impacts.[33] We note that in third party submissions, several parties raised concerns that a subsidy of the proposed scale, duration and design could disincentivise investments into the UK airport sector and wider infrastructure.

Step 4: Carrying out the balancing exercise

3.49 The fourth step involves an evaluation of the Assessment against subsidy control Principle G: subsidies' beneficial effects (in terms of achieving their specific policy objective) should outweigh any negative effects, including in particular negative effects on: (a) competition or investment within the United Kingdom; (b) international trade or investment.[34]

3.50 The Assessment explained that the Subsidy is capable of having an effect on competition, although it states that the Airport's growth plan is designed to minimise adverse competition effects as far as possible. It adds that the Subsidy is explicitly designed to affect investment in the UK, as it actively aims to help South Wales attract inward investment.

3.51 It sets out that, in addition to wider benefits to the whole of Wales, the expected positive effects of the investment amount to over £1 billion in additional GVA for South Wales, with significant long-tail benefits occurring beyond that period, and the creation of nearly 2,000 additional jobs. It shows a positive cost benefit ratio and sets out an aim to reduce reliance on Welsh Government investment and generate sustained financial returns for the Airport in the longer term.

3.52 The Assessment sets out that, without the proposed investment in the Airport, there would be a lower level of economic growth in the South Wales economy in the near term, and the opportunity to reduce economic inequity within the South Wales region and between South Wales and the rest of the UK would be lost. A lack of investment is also expected to have negative effects on market confidence resulting in uncertainty for the longer-term prospects of the Airport and the businesses that depend on it.

[33] Statutory Guidance, paragraphs 3.76 to 3.108 and Annex 3.
[34] See Statutory Guidance (paragraphs 3.109 to 3.117) and SAU Guidance (paragraphs 4.20 to 4.22) for further detail.

3.53 The Assessment concludes that having considered the potential benefits likely to accrue from the investment package, and the risks of not investing, that the economic equity benefits of the investments in the Airport will significantly outweigh any potential negative effects in the passenger and non-passenger markets.

3.54 In our view, the Assessment considers at a high level the positive and negative effects of the Subsidy. However, the balancing exercise should be revisited after the Welsh Government have considered our advice on Step 3, taking into account any negative effects that the Subsidy is likely to have, in particular on competition and investment within the UK.

Other Requirements of the Act

3.55 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.[35]

3.56 The Welsh Government confirmed that no other requirements or prohibitions set out in Chapter 2 of Part 2 of the Act apply to the Subsidy.

3.57 Several third parties, having referred to the Airport's historical performance accessed from publicly available sources, submitted that the Subsidy appears to be for the purpose of rescuing or restructuring an ailing or insolvent enterprise.

3.58 The Welsh Government noted that the Act does not permit successive restructuring packages to be put in place, unless exceptional circumstances apply.[36] It explained that the Subsidy is not a rescue and restructuring subsidy because the Airport is not 'ailing or insolvent'. In support, the Welsh Government provided a note summarising the Welsh Government accounting expert's analysis of the Airport's financial position.

3.59 In our view, the Welsh Government has clearly explained its assessment of why the Subsidy does not engage Section 20 of the Act. In light of third parties' submissions and the previous rescue and restructuring package provided to the Airport in March 2021, the Assessment could usefully be improved by referring to the underlying financial evidence and data that led to the conclusion that the Airport is not 'ailing or insolvent'.

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[35] Statutory Guidance, chapter 5.
[36] Section 20 of the Act.