EEB's reply to public consultation on EU ETS State aid Guidelines

The EEB welcomes the opportunity to comment on the European Commission's proposal for revised **Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post-2021 (ETS Guidelines)**.

The use of public resources, both at EU and national level, **must enable the transformative change in our economy necessary to achieve climate-neutrality before 2050 and be aligned with green financing principles.** It must also be consistent with the commitment to **greening the European Semester**, aiming to ensure that macro-economic policies are environmentally sustainable.

Economic instruments such as taxation, and financial instruments such as State aid must factor in the cost of negative externalities from industrial activities, while revenues should be reinvested for a socially fair redistribution of the costs of decarbonisation and to promote further industrial efficiency through innovation, so to achieve the broader objectives of a decarbonised, zero pollution circular economy.

Climate neutrality and the transition to a zero pollution industry are both instrumental for reaching the European Green Deal and Paris goals, and any form of aid rules can play a key role in driving the decarbonisation of industrial sectors under the Emissions Trading Scheme, or, adversely, work against these objectives. Public aid rules, which included the "State aid" Guidelines scheme, must provide an effective framework to incentivise further decarbonisation, increased resource efficiency of industrial processes and thrive to deliver on the wider zero pollution objectives, and **not keep subsidising environmentally harmful sectors and activities such as rewarding fossil-fuel based industries, including coal and gas**. This implies that the **eligibility criteria towards the meaning of "common interests" and "best value for money"** must integrate both decarbonisation aspects and assess and take on board the synergies with wider environmental protection acquis objectives.

Failure to achieve these major policy objectives would seriously undermine the overall consistency of the European Green Deal. It would also be a missed opportunity to deliver on the Paris Agreement goal of keeping the global average temperature rise below 1.5 °C on pre-industrial levels.

Our key messages

- **State aid rules under the EU ETS are inconsistent with the EU's Environmental Protection *Acquis* objectives and the key principles of environmental policy**. The implementation of EU ETS State aid through national compensation schemes is *de facto* contrary to the "polluter prevention and pays" principle, which is the foundation of European environmental legislation

- **State aid rules under the EU ETS have missed on the two objectives of strengthening industrial competitiveness and accelerating decarbonisation and de-pollution of European energy-intensive and manufacturing industries.** Indirect carbon costs are not a determining factor for business investment decisions and global competitiveness in today's world is closely dependent on technology innovation.

- **European energy-intensive and manufacturing industry is old and not at pace with global competitors' technology innovation.** Protection to industry (both from direct and indirect carbon costs), has been an obstacle so far towards incentivising the switch to fossil-free energy supply and to less environmental polluting industrial practices.

- The compensation of indirect costs under the EU ETS **must incentivise the acceleration of the transformation of European industry into innovative climate-neutral and zero pollution compatible techniques allowing energy independence, energy and resource efficiency, clean production, which will play a key role in strengthening industrial competitiveness.**

- **Conditionality should be strengthened and based on the principle of rewarding those industrial installations which have invested in decarbonisation techniques and have committed to achieving climate-neutrality within the next decade.** This should include the wider zero pollution ambition, to take account of lessons learned such as from bad bioenergy policies.

- **Conditionality should also include the principle that no-added harm to the environment is done when applying climate-related refurbishment and a further "additionality" principle** to reward industrial installations **which have invested in wider environmental co-benefits for air, water, soil and biodiversity (in line with the zero pollution goal).**

- Eligibility of sectors should not only be based on economic/market criteria. **A decision tree should be established to ensure that the key eligibility criteria of "serving a common interest" and "best value for money" are indeed met** when assessing the legitimacy and proportionality of the proposed support scheme, which should NOT be limited to aid or compensation schemes.

- Other instruments, such as **a well-designed Carbon Border Adjustment, could be considered to address the global level playing field of most traded commodities**, **but only if it can effectively eliminate support to European industry under all other forms** - including EU ETS direct and indirect costs - and NOT in parallel with it.

The implementation of the State aid Guidelines during Phase III of the EU ETS (2012-2020) has prompted three legitimate observations, further elaborated below: **whether State aid is fit for purpose, whether we are assessing competitiveness in the right way, whether State aid rules are aligned with climate neutrality.**

Our main arguments

1.1 Is the EU ETS State aid really fit for purpose?

The main purpose of the State aid Guidelines in Phase III of the EU ETS (2013-2020) was that of protecting the global competitiveness of energy-intensive industries at risk of carbon leakage due to indirect CO2 emissions costs (higher electricity costs passed on to customers due to the EU ETS) with regard to their global competitors. The Guidelines have established technical criteria – based on emissions intensity and trade intensity - for the eligibility of certain industrial sectors, as well as thresholds for intensity of aid allowed, based on the principle that such aid would be gradually reduced during the period covered by the Guidelines.

The uneven use of State aid by the Member States between 2013 and 2020 (only 11 MS have granted aid), however, has evidenced that **there is no fact-based conclusion on the effectiveness or even the need of such instrument to pursue the specific policy objective of protecting** global competitiveness of energy-intensive industries.

The report commissioned by the European Commission[1] has highlighted that **it is not possible to establish a clear correlation between market drivers and the aid schemes introduced in some Member States analysed**. According to the report, beside financial restrictions and policy choices, Member States' voluntary decision not to grant aid was driven mainly by two main reasons: ***1) lack of empirical evidence on the efficiency of such measures on carbon leakage and 2) inconsistency of the compensation mechanism with the decarbonisation objectives of the EU ETS.***

Furthermore, evidence shows that the instrument has created an unwanted consequence, i.e. **significant distortions in the internal market**, both across the same sectors in different Member States and across industrial sectors in the value chain. If the competitiveness risk were a widely recognised threat, the most adequate policy instrument to address it should be at European rather than national level.

According to the Commission's latest Carbon Market Report (2019), **the combined indirect cost compensation paid out by the 11 Member States in 2018 amounted to about EUR 462 million.** However, the oldest aid schemes (DE, BL, NL, ES, FI, SK, LT) have been in place since 2013-14, therefore the total amount over the period 2013-2020 is significantly high. The largest recipients of compensation were, respectively, **the (petro-)chemical sector, the non-ferrous metals sector, and the iron and steel sectors, i.e. still today among the most carbon-intensive manufacturing sectors in Europe.**

All these elements call for a careful rethinking of the actual purpose of aid under the ETS, the main question being whether the instrument is specifically designed for safeguarding the competitiveness of European industry vis-a'-vis global players or, instead, intrinsically supports other national purposes (for example, subsidising unsustainable industrial activities which in a Paris-compatible scenario will soon become uncompetitive, not only in the global but also in the internal market, due to their high carbon-intensity).

[1] *Combined retrospective evaluation and prospective impact assessment support study on ETS State Aid Guidelines, prepared by ADE and Compass Lexcon*

1.2 Is the EU ETS a cause of lack of global competitiveness and "carbon leakage"?

While many energy-intensive industries argue that indirect emissions costs play upon long-term business investment decisions in Europe, evidence shows that **it is difficult to identify indirect carbon costs as a determining factor for business investment decisions, as these are based on a number of other elements** such as demand growth in Europe and globally, and other general drivers of competitiveness (labour, raw materials supply, technologies, infrastructure, taxation etc.), which are far more complex to evaluate and quantify than the price of carbon.

Furthermore, according to assessments carried out by the European Commission[2], changes in electricity prices for industry in Europe are mostly dominated by network tariffs, taxes and levies rather than by the carbon price. As electricity price convergence for the next phase of the EU ETS will depend on several factors (cross-border capacity additions, availability of capacity for day-ahead market coupling, electricity mixes and internal bottlenecks), carbon costs and indirect carbon costs will affect industrial activities in an uneven way and much will depend on the relative national energy mixes and infrastructure.

Innovative climate-neutral and zero pollution compatible techniques allowing energy independence, energy and resource savings, and transition towards clean(er) production will play a key role in strengthening industrial competitiveness.

The current EU State aid rules are based on the assumption that there is a risk of carbon leakage "*either because production is transferred from the Union to other countries with lower ambition for emission reduction, or because Union products are replaced by more carbon intensive imports*". The Commission assumes that as a consequence "*there will be no reduction in global emissions*". This assertion is to be handled with caution and needs to be fact checked:

- **the energy-intensive and other manufacturing industry infrastructure of the EU is very old.** A lesson learned from the EU environmental performance standards review process (EU BREFs) shows that environmental performance standards vary a lot in ambition for "new" installations compared to upgrading existing infrastructure. Boiler efficiency is directly related to age and bigger steps improvements in overall pollution intensities are higher for greenfield plants compared to retrofit of old installations. In most cases, pollution reduction potential is highest for new production facilities;
- **decision makers often assume that the EU is a frontrunner in environmental performance on industrial activities but this is generally no longer valid**, e.g. other countries like China have much more recent industrial infrastructure and copy "new plant" standards of the EU, which are not yet complied with in the EU. This applies in particular to other air pollutants or water emissions but also energy efficiency benchmarks, the latter is left entirely optional in the EU due to limitations by the EU-ETS (see Article 26 of the EU-ETS and Article 9 of the IED, regulating the large scale industry);
- **EU's competitors at global level – China, the US and Japan - will be the top countries by far in terms of the sums invested in renewables capacity during the current decade**. They committed respectively $758 billion between 2010 and the first half of 2019, with the U.S. second on $356 billion and Japan third on $202 billion[3].

[2] *Energy Prices and Costs in Europe, 2017, 2018*
[3] *Global Trends in Renewable Energy Investments 2019, UNEP*

1.3 Is EU ETS State Aid consistent with climate-neutrality and the wider environmental protection *acquis* objectives?

A) Decarbonisation objective

There is an urgent need to accelerate the decarbonisation of energy-intensive industries, which are covered under the EU ETS Directive and receive free allocations based upon performance benchmarks to cover most of their emissions. In most cases, these industries also receive subsidies under other forms, notably tax exemptions/reductions related to the payment of the surcharge to support renewable energy[4]. Finally, they also benefit from certain fuel exemptions or advantages under the current Energy Taxation Directive.

According to data gathered by the European Commission's studies, **manufacturing industry (mainly energy intensive industries) received €18bn in energy related subsidies in 2016.**

Analyses[5] show **that despite efficiency improvements, from 2012 to 2018 overall industry emissions of the sectors covered by the EU ETS declined by 13% emissions**, while emissions in industry sectors like steel, cement and chemicals have remained stagnant.

Moreover, from 2010-2015, energy costs fell substantially among a number of energy intensive industries, including in Manufacture of cement and lime and plaster, Manufacture of basic iron and steel and of ferro-alloys and Manufacture of man-made fibres, where energy costs fell by over 25% between 2010-2015. The largest percentage point decline in cost share can be observed in the cement, lime and plaster with a decline in cost share from around 23% to 16% observed (-7%)[6].

B) Inconsistency with EU's Environmental Protection *Acquis* objectives and key principles of environmental policy

The implementation of EU ETS State aid through national compensation schemes is *de facto* contrary to the "polluter prevention and pays" principle, which is the foundation of European environmental legislation. State aid under the EU ETS has endorsed the principle according to which the most polluting industries – those which have a higher GHG emission intensity – are also those which receive more financial support. The restriction to only consider GHG emission and no other pollution impacts (e.g. air quality, resource consumption, wider sustainability aspects) points already to **an incomplete and short-sighted implementation of those principles.**

Furthermore, **State aid rules based on intensity of emissions make it attractive for energy-intensive industries not to reduce their emissions in order to maintain their "energy-intensive" status**. Aid granted to most emissions intensive sectors undermine one of the main objective of the EU ETS, which is that of incentivising decarbonisation through a market mechanism.

Further, the scope of the current draft State aid rules under consultation is limited to compensate increases in electricity prices (indirect emission costs) as well as for modernisation of the energy sector, which again is focused on "electricity generation". The CO2 emission factor proposed only relates to electricity produced

[4] *Guidelines on State Aid for environmental protection and energy 2014-2020, 2014/C 200/01, par. 3.7 "Aid in the form of reductions in or exemptions from environmental taxes and in the form of reductions in funding support for electricity from renewable sources"*
[5] *Sandbag, Carbon Market Watch*
[6] *AgoraEnergiewende and ClientEarth,,Making State Aid work for Industry Decarbonisation, 2019*

from fossil fuels and the aid intensity is based on default consumption efficiency benchmarks. This approach raises additional limitations:

- First, any other negative externalities, such as health damage costs due to other air pollution or environmental externalities are not discounted from the "compensation" schemes. The European Commission should subtract in all cases the externalised damage costs incurred by applying by default the value of statistical life (VSL) damage costs for air pollution, adapted to current price level and aligned to the OECD recommendations. Those external costs are often passed on to public budgets or citizens, which is contrary to the polluter pays principle. Further, not considering those externalities would provide a wrong assessment of the common assessment principle of "common interest" (para 15, 45) and eligibility criteria of "best value for money" (para 42);
- the guidelines assume no GHG emissions occur from renewable biomass combustion or do not factor in other fuel mix;
- energy conservation measures are not explicitly considered and put at higher ranking compared to energy supply options, which are worded in a way to allow any possible options ("environmental upgrading and retrofitting of the infrastructure, "modernisation of the energy production sector"- these can mean anything). The criteria should be explicit to assume a default compliance with the most ambitious "Union Standards" e.g. Eco-design, "new plants" BAT standards etc.

The EEB therefore proposes that a decision tree is established to ensure that the key eligibility criteria of "serving a common interest" and "best value for money" are indeed met when assessing the legitimacy and proportionality of the proposed support scheme, which should NOT be limited to aid or compensation schemes. Financial aid is one of the means to deliver a certain outcome, competent authorities should first be required to assess other policy options to achieve a certain change of behaviour of economic actors prior to considering "corrective" compensation aid schemes to certain economic actors, in most cases the high polluting ones [7].

1.4 Sectors, Compensation Level and Conditionality

Regarding the three specific issues raised by the European Commission in the present consultation, we believe that **conditionality** is by far and large the key aspect when setting out rules on public aid granting.

Conditionality as it is currently proposed in the draft Guidelines (i.e. conducting energy audits, implementing energy audit recommendations, facilitating an increase in sustainable and private investment, reducing the carbon footprint of their electricity consumption) is too weak, as **it basically means mere compliance with existing EU binding legislation (EED and RED).**

Conditionality should be strengthened and based on the principle of rewarding those industrial installations which have invested in decarbonisation techniques (fuel switch, electrification, circular economy measures, energy and material efficiency etc.) and have committed to achieving climate-neutrality within the next decade. This should include the wider zero pollution ambition, to take account of lessons learned such as from bad bioenergy policies.

[7] See some examples of possible alternative to "compensation" measures to be considered by decision making bodies, with the example of coal power plants https://beyond-coal.eu/solving-the-coal-puzzle/

Moreover, for the sake of harmonizing and improving policy coherence and synergy effects, **conditionality should also include the principle of no-added harm to the environment is done when applying climate-related refurbishment and a further "additionality" principle to reward industrial installations which have invested in wider environmental co-benefits for air, water, soil and biodiversity (in line with the zero pollution goal).** As a minimum, compliance with most ambitious "Union standards", as well as compatibility with relevant Environmental Quality Standards objectives, is to be expected for any eligible project.

Therefore, **we do not agree that the selection of sectors eligible for aid should be based exclusively on economic and market criteria** (significant international trade exposure, sectors significantly impacted by energy costs and with limited ability to pass on higher electricity costs, sectors with profit margins under pressure at international level, sectors with limited potential for improving their energy efficiency), as these would not be consistent with a strong conditionality principle and overall not coherent with the carbon neutrality goal nor the overriding common interest, which is about high level of environmental, including climate and human health protection. **Those common (public) interests should be the main if not only criteria and replace the current approach prioritising internal market, trade or competition considerations.**

Strong climate-neutrality and environmental criteria should be integrated in any public support granted to industrial activities to incentivise effective and more timely pollution prevention/reduction measures.

Finally, the **compensation** should be set at a level which maintains an incentive for industrial installations to achieve performance beyond state of the art standards, to further decarbonise their energy supply, improve their energy and resource efficiency, and aim at surpassing the highest environmental standards.

1.5 A Carbon Border Adjustment as a possible three-sided solution?

Based on our observations, we strongly call upon the European Commission to consider alternative measures to address industrial competitiveness concerns**. A Carbon (or wider pollution intensity) Border Adjustment (CBA) seems the most effective means to address both the direct and indirect carbon/wider pollution costs and ensure a level playing field with non-EU competitors in jurisdictions with less ambitious climate and environmental policies.**

A CBA would allow to address three main objectives at one time: ***1) eliminate the risk of carbon leakage 2) preserve the EU ETS objective of achieve cost-efficient decarbonisation and de-pollution 3) minimise competition distortions in the EU internal market.***

Moreover, by introducing a CBA the EU would lead by example in the international community and incentivise carbon pricing in non-EU countries as a measure to achieve the Paris Agreement goal.

Revenues generated by the tax would provide additional resources to governments to ensure a just transition and support innovative breakthrough technologies and infrastructure needed for achieving net-zero GHG-emissions (e.g. renewables, efficiency, hydrogen, CCS) and depolluting industrial activities.