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UNICE OPINION ON COMMISSION GREEN PAPER

"TOWARDS A EUROPEAN STRATEGY FOR THE SECURITY OF ENERGY SUPPLY"
[COM (2000) 769]

I. General comments

1. Taking as its starting point a relatively circumscribed issue – security of energy supply – the green paper has opened a very wide debate including:

   - the question of action on energy demand, regarded as an important means of rebalancing supply policy with a view to greater security of energy supply;

   - the energy/environment question. The Commission believes that a proactive policy in favour of sustainable development would simultaneously reinforce security of supply and action to tackle climate change.

2. UNICE believes that a debate on security of EU energy supply comes at an opportune moment. However, this debate must be engaged in the knowledge that a large energy import dependency in Europe is not new. This dependency is a fact of life which Europe can seek to attenuate to a certain extent but without any expectation that it can be changed radically. In this context, one fundamental question that requires attention is: how can Europe be made more competitive in order to enable it to have the best possible access to the energy resources on offer on the world market?

3. That said, UNICE would have liked the debate on security of energy supply and connected themes to have been organised around a series of much more open questions than those submitted by the Commission (see below). UNICE believes that a fair number of these questions tend to confine the discussion in a simplistic analytical framework and a limited range of strategic options corresponding to what the Commission itself regards as plausible and appropriate.

4. Regarding the type of action to be taken by the EU for energy, UNICE continues to think – in line with the 1995 Commission white paper – that the aim should be coordination of national energy policy measures rather than a Community energy

   UNICE also continues to support the white paper's view that Community action must focus on those areas where real added value can be achieved.

5. Against this background, UNICE considers that the goal of Community action in the area of *energy supply* should be to create an environment which allows for and ensures secure, diverse and sustainable supplies of energy at competitive prices by:

- developing a legislative/fiscal regime that allows maximum economic supply from indigenous resources;
- removing barriers or disincentives to investment in new or enhanced supplies;
- recognising the long-term and, often, high-risk nature of the investments required in order to achieve sustainable supplies;
- ensuring the good functioning of the markets for all energy providers, which will stimulate a widening of supply at competitive prices;
- securing a stable and effective legal framework combined with fiscal stability, allowing companies to deploy operations efficiently;
- promoting development of interconnection structures;
- assisting potential energy supply countries to create the political, economic, business and legal climate where energy investment by private companies can flourish;
- refraining from direct intervention in balancing supply and demand as well as from commercial arrangements (e.g. long-term contracts) and price-setting.

6. The Community actions that ought to be taken in connection with *energy demand* are addressed in questions 9 and 12 below.

7. For its actions on energy questions, the EU must be guided by the concept of sustainable development, which involves the quest for a balance between economic, social and environmental progress with a view to maximising overall progress in the long term. In its recent manifesto "European industry's views on EU environmental policy-making for sustainable development", UNICE highlighted the means on offer to define and implement environmental objectives which are coherent with the economic and social objectives pursued by society.

II. Responses to the questions in the green paper

Q1. Can the European Union accept an increase in its dependence on external energy sources without compromising its security of supply and European competitiveness? For which sources of energy would it be appropriate, if this were the case, to foresee a framework policy for imports? In this context, is it appropriate to favour an economic approach: energy cost; or geographical approach; risk of disruption?

A1. As indicated in point I.5, UNICE is very attached to market-driven energy policy which gives consumers a free choice. In principle, no energy provider should be excluded out of political considerations. The basic objective should be to have a well functioning market for all energy providers. More generally, UNICE does not approve any excessively political approach.

UNICE has the feeling that question 1 reveals just such an excessively political approach. UNICE does not have a positive attitude regarding the idea of introducing a framework policy for imports. The objective of improving the security of imports should not lead to a policy of managed imports or to direct involvement of public authorities in energy supply investments.

By contrast, UNICE believes it desirable for the European Union to encourage launch of a new dialogue between oil-producing countries and consumer countries whose aim would be to moderate the scale of fluctuations in oil prices.

Q2. Does not Europe's increasingly integrated internal market, where decisions taken in one country have an impact on the others, call for a consistent and coordinated policy at Community level? What should such a policy consist of and where should competition rules fit in?

A2. The internal energy market should function in accordance with general single market rules, including competition rules and without sector-specific provisions or exceptions.

The principle of subsidiarity should also be respected.

Q3. Are tax and state aid policies in the energy sector an obstacle to competitiveness in the European Union or not? Given the failure of attempts to harmonise indirect taxation, should not the whole issue of energy taxation be re-examined taking account of energy and environmental objectives?

A3. Advantages could accrue from better harmonisation of energy taxation in Europe, but UNICE believes that improving the business climate in Europe, and in particular competitiveness, is an infinitely more important objective than harmonisation of taxation on energy products.

UNICE notes that the Commission's recent initiatives in the area of energy taxation (Community framework proposal COM 97-30) are characterised by poor environmental effectiveness and create serious threats for the competitiveness of the European manufacturing sector. UNICE sets out the reasons for its opposition to this proposal in the attached opinion dated 17 May 1999. For the same reasons, UNICE also opposes a strengthening of this proposal under the approach described in the communication "A European Union strategy for sustainable development" (COM 2001-264).

UNICE underlines that the Community guidelines for state aid for environmental protection (OJ 37 of 3 February 2001) is likely to complicate protection of the international competitiveness of European companies insofar as it defines highly restrictive conditions for companies to gain exemption from national and Community energy taxes.

UNICE is also extremely reserved about the very central position that the green paper attributes to energy and environmental taxation for the pursuit of environmental objectives in the energy sector. In UNICE's view, the focus of this instrument is not a move in the direction of the innovative approaches that support sustainable development as recommended in part I above.

Q4. In the framework of an ongoing dialogue with producer countries, what should supply and investment promotion agreements contain? Given the importance of a partnership with Russia in particular, how can stable quantities, prices and investments be guaranteed?

A4. The security of Europe's energy supply could be improved through greater participation of operators based in Europe:

a) in ownership of energy reserves situated outside EFTA;
b) in controlling exploitation of these resources;
c) in possession and operation of the related logistics;
d) in the sharing of profits of joint ventures.

The revival – recommended in point A1 – of dialogue with all producing countries should seek to improve the rules regarding points a) to d) above. Generally speaking, there needs to be greater certainty and transparency surrounding these rules.

In this context, it is necessary to speed up ratification of the European Energy Charter.

On the other hand, setting parameters for quantities/prices is inappropriate for our economic system and also a pure illusion.

Q5. Should more reserves be stockpiled – as already done for oil – and should other energy sources be included, such as gas or coal? Should the Community take on a greater role in stock management and, if so, what should the objectives and modalities be? Does the risk of physical disruption to energy supplies justify more onerous measures for access to resources?

A5. Given the resources and production situation in Europe, creation of expensive coal stocks for energy purposes is superfluous. Oil stocks function in the framework of the EU and IEA crisis mechanism.

Regarding gas, UNICE recommends that the EU develops initiatives to encourage development of storage capacities, notably with a view to being able to respond more flexibly to seasonal demand patterns (storage in clay soils, etc.).

In the same way, Community initiatives would be welcome to encourage development or maintenance of adequate reserve capacities for electricity production. The power industry has developed its own standards for reserve capacity. Liberalisation of energy market may prompt a re-examination of these standards. Adequate interconnections with neighbouring countries and effective agreements between transmission systems operators should be part of a policy for reserve capacity. Thought should also be given to initiatives targeting storage of biomass.

These initiatives in relation to gas and electricity should be deployed in line with the principle of subsidiarity.

Q6. How can we ensure the development and better operation of energy transport networks in the European Union and neighbouring countries that enable the internal market to function properly and guarantee security of supply?

A6. Establishment, extension and utilisation of energy transport networks is primarily a matter for the businesses active on energy markets. Their capacity for investment should not be disrupted by state aid and obstacles.

Liberalisation must go hand in hand with an economic policy that creates conducive framework conditions for the investment needed for developing infrastructure, including cross-border links.

As in the past, EIB can provide credits in special cases.

Q7. The development of some renewable energy sources calls for major efforts in terms of research and technological development, investment and operational aid. Should co-financing of this aid include a contribution from sectors which received substantial initial development aid and which are now highly profitable (gas, oil, nuclear energy)?

A7. Oil and gas have not received any subsidies. Nuclear energy long since returned subsidies received to consumers in the form of low electricity prices. Traditional energy providers already help directly and indirectly to finance renewables, through high energy taxation. Regarding renewables close to commercial viability, we regard temporary and decreasing market introduction aid as sensible.

Q8. Seeing that nuclear energy is one of the elements in the debate on tackling climate change and energy autonomy, how can the Community find a solution to the problem of nuclear waste, reinforcing nuclear safety and developing research into reactors of the future, in particular fusion technology?

A8. The first priority should be to make it clear to the public at large that nuclear energy is an option that is indispensable for tackling the climate change problem. This emerges from numerous studies, including scenarios developed by the Commission itself for the horizon of 2020.

Use of nuclear energy is not a technical problem, as the question suggests, but rather a political problem. The public ought to be informed that the risks linked to global warming are infinitely greater than those linked to nuclear energy as it is exploited in the EU. EU initiatives for improving nuclear safety outside the EU would be useful to improve public acceptance of nuclear energy.

UNICE therefore advocates further development of nuclear energy in the framework of an energy diversification policy which should also encompass renewables. When this diversification policy is deployed, it is important to bear in mind that the quantities that can be provided by nuclear and renewables are not of the same order of magnitude.

The need to encourage nuclear energy is also a function of its very positive role for the security of energy supply.

Q9. Which policies should permit the European Union to fulfil its obligations within the Kyoto protocol? What measures could be taken in order to exploit fully potential energy savings which would help to reduce both our external dependence and CO_2 emissions?

A9. Any EU strategy designed to control greenhouse gas emissions must start from the consideration that control of climate change calls for carefully coordinated progress at the societal, environmental and economic levels.

Economic policy must in particular support companies' own initiatives (innovations, investments, etc.) which have been a decisive source for making progress in climate change control.

The European commission estimates that spontaneous initiatives by companies will reduce greenhouse gas emissions by 9.4% in absolute terms between 1990 and 2010, against the background of increasing industrial production. Some sectors will achieve (or are prepared to achieve) significantly higher reductions (as much as 30%) on the basis of effective agreements between industry and public authorities. Furthermore, thanks to technological innovation, actual or projected energy efficiency gains and carbon savings are very significant at the level of products[1].

So, for industry, initiatives and agreements are the first choice of instruments to respond to climate change. As indicated in UNICE's contribution for COP-4, the Kyoto mechanisms can help meet targets agreed in this way.

The Kyoto mechanisms can help EU Member States and companies to meet their commitments in the most efficient and cost-effective way, so helping to ensure the environmental effectiveness of the protocol whilst protecting the competitiveness of European business and industry.

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[1] See in particular "Climate change: how governments and industry can work together", European Round Table (ERT) report

Both the environmental effectiveness and the economic efficiency of the Kyoto mechanisms will depend upon establishing open and transparent global markets, with equivalent emission reduction units being fully tradable between all three of the mechanisms, and without artificial or arbitrary constraints being placed on trading.

Emissions trading by companies should be encouraged on a voluntary basis, since the lowest cost to reduce emissions will come from encouraging trading on the widest possible basis, which will also ensure greater liquidity and price transparency.

The financial resources needed for investments should not be extracted from companies, e.g. through energy taxes: investment is the most important condition for the introduction of energy-saving technical progress.

As indicated in the response to question 8, greater use of nuclear energy is necessary if Europe wants to achieve the targets it set for itself in Kyoto.

Q10. Can an ambitious programme to promote biofuels and other substitute fuels, including hydrogen, geared to 20% of total fuel consumption by 2020, continue to be implemented via national initiatives, or are coordinated decisions required on taxation, distribution and prospects for agricultural production?

A10. Some coordinating efforts at EU level in the framework of EU promotion programmes can be helpful. Such efforts should not be supported by additional taxation. There are serious doubts about the technical feasibility of a 20% market share; rather, this figure should be regarded as an indicative objective.

Q11. Should energy saving in buildings (40% of energy consumption), whether public or private, new or under renovation, be promoted through incentives such as tax breaks, or are regulatory measures required along the lines of those adopted for major industrial installations?

A11. Energy-saving measures in buildings are marked by highly divergent national particularities. We do not believe that EU-wide and uniform provisions for buildings are the right route.

Q12. Energy saving in the transport sector (32% of energy consumption) depends on redressing the growing imbalance between road haulage and rail. Is this imbalance inevitable, or could corrective action be taken, however unpopular, notably to encourage lower use of cars in urban areas? How can the aims of opening up the sector to competition, investment in infrastructure to remove bottlenecks and intermodality be reconciled?

A12. <u>General</u>

The question of energy-saving in the transport sector requires initiatives which are balanced and well coordinated from the economic, environmental and societal angles, notably because of:

- the important role played by transport and logistics in maintenance of European companies' international competitiveness. Europe suffers from a serious handicap as compared with the USA in terms of total logistics costs which represent 12% of GDP in Europe against 10% in the USA;
- the significant impact of transport on the environment;
- the key role that some policies for societal development (territorial development, urban planning schemes, etc.) exert on flows of persons and goods.

Broadly speaking, the line of thought in the green paper and other Commission documents is that:

- market prices for products, resources and services are often largely responsible for the unsustainable trends observed;
- public action aimed at "getting the prices right" constitutes a powerful remedy for correcting these unsustainable trends.

The possibilities envisaged by the Commission for influencing prices in the transport sector are of two types:

a) transport infrastructure charging;
b) charging for external costs (linked to the environment).

Regarding the coverage of infrastructure costs, UNICE considers[2] that application of principles such as those advocated in the High Level Group Report on infrastructure charging is theoretically appropriate, but that any concrete measure must be adapted not only to the theoretical framework but also to cut-throat global competition and industrial structural change.

The concept of "getting the prices right" through internalisation of external costs can be defended on a purely theoretical level, but there are very serious concerns about:

- its practical implementation (particularly because of uncertainty about the real level of external costs and concerns in the light of a competitive international environment);
- its efficiency. The academic approach aimed at reflecting external costs in transport prices via taxation scores very poorly in terms of environmental effectiveness and economic efficiency. It is much more effective to develop more targeted measures, for instance:

- drafting more stringent emission standards, in liaison with industry, and encouraging industry's efforts to innovate and invest to meet these standards;
- encouraging technological progress in other relevant areas (telematics, materials technologies, etc.);
- reactivating investment in infrastructures;
- promoting interoperability of networks;
- injecting greater managerial and commercial dynamism into rail by further opening this sector to competition[3].

Practical comments on use of the price mechanism (goods transport)

UNICE has very serious reservations about the view that the current pricing structures are causing the "imbalance between road haulage and rail" and that more active intervention on transport prices (cf. quoted green paper COM 95-691 "Towards fair and efficient pricing in transport") could easily bring about major progress in the goods sector, especially if making road transport more expensive were to be considered.

Price is far from being the only factor that transport users take into consideration when they choose a mode of transport. The aspects of punctuality and quality of service also play an extremely important role in these choices and therefore in the use made of the various infrastructures available.

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2 UNICE positions on the High Level Group Report on transport infrastructure charging (17 June 1998)

3 See in particular "UNICE opinion on the green paper in preparation at the Commission on internalisation of the external costs of transport" (15 November 1995) and UNICE Manifesto "Breakthrough in goods transport by rail in Europe is imperative" (July 2000)

The fact that the utilisation rate of some infrastructures (rail, for instance) is not optimal may also result from insufficiently sophisticated management of these infrastructures. Work involving rail operators and users in the Netherlands has shown that a more creative dialogue between the two parties, together with the use of innovative scheduling models, could increase utilisation of the rail infrastructure by 30 to 40% (with the current state of the art).

If the introduction of additional taxes or differentiated rates (as proposed in green paper COM 95-691) results in an overall increase in the cost of road transport, there is every reason to fear a general increase in the prices of non-road transport, bearing in mind the monopolistic or oligopolistic structures of the sectors concerned.

Q13. How can we develop more collaborative visions and integrate the long-term dimension into deliberations and actions undertaken by public authorities and other involved parties in order to evolve a sustainable system of energy supply? How are we to prepare the energy options for the future?

A13. A clear, well structured dialogue without pre-ordained conclusions needs to be set up to look at the future role of existing fuels and the future role that technology can play in developing a competitive renewable energy sector. It should be noted that government plays a less dominant role in a liberalised energy market. An ever-growing number of stakeholders in the market will shape the future energy supply, with the help of adequate regulation and a proper market structure. Government, and less so the EU, should not try to "pick winners".

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ANNEX

15/3 **17.5.1999**

PROPOSAL TO RESTRUCTURE THE FRAMEWORK FOR THE TAXATION OF ENERGY PRODUCTS (COM 97-30)

UNICE REITERATES:

- **THE REASONS FOR ITS PROFOUND OPPOSITION TO THE DRAFT**
- **ITS COUNTER-PROPOSALS FOR TAX HARMONISATION, EMPLOYMENT AND ENVIRONMENT**

A. INTRODUCTION

Discussions on the above-mentioned proposal for a directive have resumed in the ECOFIN Council and in the public debate from three angles:

a) from the angle of tax harmonisation, which has been the essential justification given by the Commission for its proposal;

b) to a lesser extent, from the angle of employment policy, since the theme of job creation via:

   - an increase in energy taxation,
   - a simultaneous reduction in indirect labour taxation

   continues to be discussed despite many years of inconclusive debates on this subject;

c) lastly, from the angle of environment. Although the Commission proposal has not been fundamentally inspired by environmental considerations, this proposal is regarded in various quarters as a necessary instrument for meeting the EU's Kyoto commitments.

Given that this proposal could have a major impact on industry, UNICE believes it its duty to reiterate its position on this dossier[4].

B. EVALUATION OF THE PROPOSAL FROM THE ECONOMIC ANGLE

a) Impact on the competitiveness of European companies

The proposal for a directive would lead to:

- *in the short to medium term, additional taxes on several categories of energy product in several countries;*
- in the longer term, a large and general increase in energy taxes in all Member States. This conclusion is inescapable given that the proposal has been clearly thought out around this objective[5].

[4] UNICE published its preliminary comments on the proposal for a directive in an opinion dated 6 May 1997.

[5] This is witnessed, inter alia, by the plans to increase taxation over the period 1998-2002 included in the preliminary draft directive.

Such an increase in taxation would result in:

i) an increase in the production costs of energy-intensive sectors (direct energy costs);
ii) an increase in the price of energy-intensive intermediary consumption (indirect energy costs). Industries making wide use of subcontracting or whose spatial organisation is already adapted to the single market would be particularly hard hit.

These price increases would clearly be in total contradiction to the policy to liberalise energy markets followed hitherto.

The seriousness of the negative impact on energy-intensive industries in a scenario of unilateral and significant increases in energy taxation has been commented on in sufficient detail in the European Commission's own publications, and there is no need to repeat the arguments here[6].

As protection against this negative impact, the proposal for a directive makes provision for a system of partial and temporary tax exemptions for a limited segment of industry. These measures would engender extremely complex problems of legal uncertainty and competition[7].

In short, the proposed mechanism is completely unsuited to correcting the problems of international competitiveness that can be foreseen in the short to medium term.

At its meeting on 1 December 1998, the ECOFIN Council decided to study "special provisions for energy-intensive industries and firms which meet the targets set for energy efficiency". UNICE welcomes this recognition of the problems that higher energy taxes would pose in the manufacturing sector, but considers that this very recognition emphasises the flaws inherent in the Commission proposal.

b) Tax harmonisation

The proposal for a directive makes no real contribution to tax harmonisation since it leaves Member States free to exceed the minima it sets.

UNICE believes that any progress in the area of tax harmonisation needs to be made by reducing energy taxes in those countries where they are highest. In any event, improving the business climate in Europe, and in particular competitiveness, is an infinitely more important objective than harmonisation of taxation on energy products.

c) Impact on employment

For reasons linked to national tax sovereignty, no guarantee can be given that Member States will in fact adopt the approach of neutrality advocated by the Commission, i.e.:

- higher energy taxation,
- parallel reduction in indirect taxation of labour.

Experience shows that, with the exception of a few particular cases, the introduction of new energy taxes has not been offset by equivalent tax cuts elsewhere in national taxation systems.

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6 For instance, see chapter 2.1 "A European energy tax: economic and environmental consequences " of the article entitled "An economic evaluation of alternative approaches for limiting the costs of unilateral regional action to slow down global climate change – Simulations with WorldScan" (Economie européenne no. 1, 1998).

7 More detailed comments on these measures are given in the UNICE opinion dated 6 May 1997.

The current low level in the oil price has deprived states of a source of income which means that priority will be given to classical budget expenditures when revenues from new taxes are being allocated.

The many debates in recent years about the idea of a double dividend, in both the Commission and Member States, have shown that the net result, in terms of jobs, of an increase in environmental taxation offset by lower social charges concentrated on the lowest paid is uncertain and, in any event, modest when positive. The uncertainties which prevail in this area need to be set against the certain risk of a loss of competitiveness by European companies and of the attractiveness of the European Union which would result from the envisaged measures.

C. EVALUATION OF THE COMMISSION PROPOSAL FROM THE ANGLE OF ENVIRONMENTAL PROTECTION

1. UNICE's general views on development of economic and fiscal instruments for environmental protection

UNICE has on several occasions in the past said that it is willing to discuss well thought-out plans for economic instruments (tradable permits, fiscal incentives, differentiated taxation, charges, etc.) capable of offering companies greater flexibility and reducing the cost of environmental protection measures[8]. Among other things, such instruments must meet the following criteria:

a) Existence of transparent objectives: economic instruments should target clear environmental objectives and give clear market signals. Ecological taxes should not degenerate into simply a way of collecting additional budget resources without any marked benefit to the environment.
b) Environmental effectiveness: the possibility of moving closer to the environmental objective in view, using the chosen instrument, must be plausible.
c) Economic efficiency: an economic instrument should be chosen as the most cost-effective to achieve the specific objective compared with other options (regulatory instruments, non-fiscal economic instruments, long-term agreements, etc.).It is essential to preserve the competitiveness of European industry and not to reason in a closed framework which ignores the economic contexts of competitors.

2. Environmental ineffectiveness of the proposal

This proposal clearly fails the test of each of these criteria, which is hardly surprising given the stated objectives.

Two elements at least prevent the proposal from making an effective contribution to post-Kyoto EU strategy:

- first of all, the proposal contains no clear and coherent objectives for control of greenhouse gas emissions. Hence, it proposes to tax nuclear power, which generates no greenhouse gases;

- second, the loss of international competitiveness brought about by higher taxes will also have very serious consequences for the environment.

In the first place, this loss of competitiveness would reduce the financial resources available to manufacturing industry to intensify its contribution to combating the greenhouse effect.

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[8] See UNICE discussion paper dated 12 December 1990 on the use of economic and fiscal instruments in EC environment policy.

In addition, it would have an indirect negative impact on the capacity of:

1. the transport sector
2. households
3. the electricity sector
4. public undertakings

to make the very large investments needed to modernise their equipment in such a way as to become more energy-efficient and reduce the carbon content of fuels.

The health and competitiveness of the manufacturing sector largely determine the abundance of resources:

- private:

  - wages in the private sector
  - wages in the public sector
  - capital budgets in non-industrial firms

- and public:

  - capital budgets of national/regional/local public authorities

which can finance investments in new energy technologies.

UNICE believes it essential for the public authorities to develop a context favourable to voluntary initiatives by companies and to the agreements between industry and the public authorities which have played a preponderant role in the good performance of industrial companies hitherto in the area of improved energy efficiency.

3. <u>UNICE is willing to discuss strategies which would reduce the greenhouse gas emissions of European society as a whole while preserving the competitiveness of companies</u>

UNICE is very willing to intensify its existing dialogue with the EU institutions and the other stakeholders with a view to reflecting on an EU strategy for climate change which is firmly harnessed to the concept of sustainable development. UNICE has already tabled proposals on this subject[9].

The need for the EU to develop innovative solutions (instead of merely imposing penalties on European industry) is evident when the context in which American companies operate is taken into account:

a) lower energy prices than in Europe;

b) establishment of a system with clear and attractive incentives for voluntary efforts by industry to improve control of greenhouse gas emissions (early credit system);

c) coupled with b), launch of pilot schemes for emission trading.

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[9] See UNICE position "EU strategy responding to climate change – UNICE input to COP-4, Buenos Aires, November 1998" (October 1998).