POSITION PAPER

30 May 2008

BUSINESSEUROPE position on revision of the Energy Tax Directive

Executive Summary

The Energy Tax Directive (2003/96/EC), adopted on 27 October 2003, imposes EU-wide minimum rates of taxation for electricity and energy products. In the forthcoming review of this Directive, the Commission suggests splitting the minimum tax levels into an energy portion and a CO_2 portion to more effectively complement other economic instruments such as the EU emission trading scheme (ETS).[1]

BUSINESSEUROPE sees risks of additional cost pressure from separating the carbon and energy content of energy taxes and imposing minimum CO_2 tax rates at EU-level. The European Commission would have to demonstrate that this is the most cost-efficient instrument to abate emissions.

While BUSINESSEUROPE is in principle not in favour of the introduction of minimum CO_2 tax levels, this position paper presents key demands from business if the proposal should nevertheless go ahead in order to ensure a level playing field and maintain competitiveness in a global context.

A crucial starting assumption for this position is that companies covered by the ETS will under no circumstances be taxed on their CO_2 emissions. BUSINESSEUROPE would like to emphasise that, as a result of the ETS, all companies already pay for the carbon costs either because their direct emissions are covered by the scheme and/or through higher electricity prices. Any form of double burden would be extremely detrimental to the competitiveness of EU business and inefficient with regard to the environmental outcome.[2]

[1] Terms of Reference for a Study on the Review of the Energy Tax Directive (TAXUD/2007/AO-011)
[2] ZEW Discussion Paper No. 06-018 (April 2006) "Efficiency Losses from Overlapping Economic Instruments in European Carbon Emissions Regulation"

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1. General Comments

Companies need a stable policy environment to be able to make long-term investment decisions. This is particularly relevant in the development of and investment in a low-carbon economy. Both the European Commission and the Member States need to commit to a long-term policy framework to provide this stable environment. This requires, amongst other things, realistic objectives, simple and clear rules and a detailed implementation timeline without retroactive effects.

The long-term, global competitiveness of European business should be a key determinant in designing the policies to implement the EU's emission reduction strategy. Any review of the Energy Tax Directive must take account of the following context:

- current and forecast energy prices are much higher than when the Directive was introduced in 2003;
- EU electricity prices now include their carbon cost through EU ETS, whose cost will increase further with the revision of the EU ETS directive;
- energy prices will remain under upward pressures, not least through the cost of delivering on the Renewables Directive.

The competitive consequences of minimum tax levels on energy products and electricity for business use should be reviewed carefully and the minima in no case increased. The combined impact of high energy prices and carbon pricing will create incentives to use energy sources with low carbon content which tend to be more secure than fossil fuels and further encourage energy saving and energy efficiency.

2. Review of the Energy Tax Directive

2.1 Specific remarks

A number of specific provisions in the Energy Tax Directive are of high relevance for companies and need to be considered in the review process:

- <u>Exemptions</u>: The exemptions under article 2(4)(b) for energy tax must be retained. They are justified by the fact that exempt industries cannot avoid high energy consumption due to the high energy requirements of their processes. Full taxation would strongly affect their international competitiveness and entice them to relocate outside the EU. In addition, sectors that are covered by an EU-wide or local emission trading scheme (ETS) should be exempted from the CO_2 tax and the energy tax to avoid double burden.

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- Tax reductions: According to article 17(1), Member States may apply tax reductions, provided the minimum levels of taxation prescribed in Directive 2003/96/EC are, on average, respected for each business.
  - Energy-intensive business: The definition in article 17(1)(a) of energy-intensive business should be widened to include all energy products and electricity. In addition, both the 3% and the 0.5% rule for defining an energy-intensive business should be retained.
  - Avoiding the double burden: In addition, the tax reduction for agreements, tradable permit schemes or equivalent arrangements leading to the achievement of environmental protection objectives or to improvements in energy efficiency as defined in article 17(1)(b) must be retained to avoid a double burden.
- Electricity: Moreover, the minimum tax on electricity should not be raised and there should be no CO_2 tax on electricity as the power sector will be fully covered by ETS.

To ensure legal certainty for companies, BUSINESSEUROPE considers that State aid rules should not overrule exemptions and tax reductions specified in the Energy Tax Directive:

- Under the present State Aid Guidelines, Member States are allowed to have a lower tax rate for some businesses as long as the reduced rate is not below the harmonised minimum rates.
- As long as minimum rates are respected, tax reductions regimes for business should be granted for an unlimited period. Moreover, in some instances, it is possible to go below the minima under the Energy Tax Directive. This is allowed for state aid purposes as long as it remains within the nature and logic of the national energy tax system.
- To ensure legal certainty for companies, the Council protocol to the revised Energy Tax Directive should state that it must not be possible to challenge reductions and exemptions in a future revised Energy Tax Directive from a state aid perspective.

2.2 What is the objective of a *minimum CO_2 tax at EU level?*

A minimum CO_2 tax level can only be justified if it reduces distortions of competition within the Internal Market and is an efficient and effective measure for reducing CO_2 emissions. To that end, it has to be fully consistent with other emission-reducing policy instruments. Based on the principle of subsidiarity, it should be up to Member States to decide on the best policy mix to reach national emission reduction targets by 2020. It will be difficult to design a “one-size fits all” policy and a flexible approach is preferable as it would allow a more efficient outcome.

An additional CO_2 tax would increase costs and compliance burden for business. In most EU countries, energy taxes are well above the minimum levels set out in the Energy Tax Directive. The split of minimum levels into a minimum tax on energy and a minimum tax on CO_2 would therefore not change the incentives structure for companies. New minimum levels for a CO_2 tax would most likely be added to the energy tax in those countries.

The CO_2 tax should be designed with a view to reducing CO_2 emissions without generating carbon leakage associated with unilateral implementation of costly environmental regulation. Revenue generation should not be the objective and should not drive the process.

In this context, BUSINESSEUROPE believes that the so-called 'double dividend' – achieved by earmarking tax revenue from CO_2 emissions for a reduction of labour taxes - is difficult to implement in practice. In particular, experience in various Member States shows that earmarking is not politically sustainable. By way of example, the reduction of social security contributions to compensate for the introduction of the Climate Change Levy in the UK was abolished after one year. In addition, if efficiently implemented, the tax would not yield sufficiently stable revenue to finance a reduction in labour taxation to increase employment significantly.

In particular, CO_2 taxes should obey to the following principles:

- **Neutrality**: When measuring the tax burden on energy consumption, all costs have to be taken into account (energy tax, CO_2 tax, emission trading and related charges). Firstly, neutrality means no increase in total tax revenue - any tax increase has to be compensated by lowering other business-relevant taxes. Secondly, tax-neutral solutions for energy-intensive business need to be provided through specific, tailor-made refund or reduction regimes.
- **Efficiency/Effectiveness**: Tax proposals have to be evaluated based on their efficiency and effectiveness to abate emissions compared to other instruments.
- **Simplicity**: The administrative burden and resulting compliance costs should be kept to a minimum.
- **Legal certainty**: When setting the rate, Member States must legally define the time period and future rises for a period of 10-15 years.

2.3 Would a CO_2 tax be efficient in achieving its aim?

BUSINESSEUROPE would like to emphasise that there is no evidence that imposing a CO_2 tax on non-ETS businesses is the most efficient instrument to abate emissions. It could lead to investment distortions and carries the risk of overlapping regulation.

If the objective is to achieve the same marginal CO_2 emission costs for companies outside ETS as for companies covered by it, there is a risk of volatility arising from the two systems. The carbon price is usually adjusted following the publication of CO_2 emission data and has shown high volatility in the first trading period (2005-2008), ranging between 10 eurocents per tonne of CO_2 in March 2007, and its peak of 30 euros per tonne of CO_2 in April 2006. This makes it difficult to predetermine the CO_2 price in advance.

BUSINESSEUROPE would like to re-emphasise that in no case should sectors covered by ETS be subject to an energy or CO_2 tax. The cost implications of overlapping regulation can be substantial. A study undertaken by the German Centre for European Economic Research (ZEW) shows that "unilateral emission taxes within the EU ETS are ecologically ineffective and subsidise net permit buyers".[3] For firms covered by ETS, an energy or carbon tax has no additional ecological effect.

[3] See footnote 2.

3. Conclusion

The current revision of the Energy Tax Directive should not lead to higher taxation and avoid all cases of double burden for companies. If a CO_2 tax should be introduced, a consistent approach is necessary to ensure the well-functioning of the Internal Market. While it should be up to Member States to decide on the specific policy mix to reduce greenhouse gas emissions, there should be some uniform application (e.g. common standards for calculating CO_2 emissions). However, tax rates should be determined by Member States subject to minimum levels.

When tax instruments are being designed, the key elements for business are the creation of a level playing field, a long-term and stable regime, and simplicity to reduce compliance costs. Above all, the global competitiveness of European business must be maintained in achieving these policy aims. The best measure is the one that delivers the highest emission abatement at the lowest cost.