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BUSINESSEUROPE VIEWS ON STATE AID IN THE CONTEXT OF THE EU EMISSIONS TRADING SCHEME (ETS)

1. GENERAL OBSERVATIONS

BUSINESSEUROPE is very supportive of the Commission initiative to put forward Guidelines on the application of state aid rules to possible measures by Member States to support sectors exposed to a risk of carbon leakage due to costs relating to greenhouse gas emissions passed on in electricity prices (indirect CO₂ costs) in the context of the EU Emission Trading System (ETS).

BUSINESSEUROPE stresses that any state aid measures in this context should respond to the need to counterbalance the lack of competitiveness induced by the increase in electricity prices in the EU that is directly linked to the ETS.

This is an exceptional case where the need for member state intervention is created by EU legislation on ETS and the lack of comparable climate action by Europe's trading partners, and not by a market failure of an economic nature. State aid for indirect emission costs should thus aim at mitigating both the above described potential perverse effects of the ETS system (namely carbon leakage) and the loss of competitiveness of EU companies indirectly affected by the ETS.

BUSINESSEUROPE believes a balanced approach is needed as these state aid measures might cause distortions of competition in the single market, with negative effects on those Member States whose economies are already less competitive.

However, the main justification for allowing state aid to compensate for indirect emissions costs is to prevent companies from leaving the single market, or losing out to foreign competitors. If a company exposed to carbon leakage closes down in one Member State, or loses market shares, its output is likely to migrate to non-EU countries with less or no CO₂ constraints.

The new state aid guidelines need as soon as possible to be adopted and applied to Member States wishing to compensate for these costs. Since the beginning of the ETS in 2005, electricity-intensive industries have been strongly affected by indirect cost effects through an increase in electricity prices induced by ETS.

While these guidelines only will address state aid issues arising from the ETS Directive, we underline that carbon leakage is caused also by direct costs from the ETS as well as by other energy policies of the EU. For example, many Member States' renewable electricity subsidy policies cause higher electricity prices, increasing the risk of carbon leakage. It is necessary to further assess how these costs can be compensated.



2. COMMENTS ON SECTION A: ELIGIBLE SECTORS

2.1 Section A1

Question 1: BUSINESSEUROPE cannot name specific sectors. However, we point out the following:

- Data collection at NACE 4 level provides insufficient disaggregation to identify all sub-sectors exposed to a significant risk of carbon leakage. The ETS Directive does not require that NACE codes should be used for this purpose, but that they should be used only “as a starting point” (recital 24). It must be possible to use more highly disaggregated data in cases where only certain subsectors (e.g. NACE 6 level) within a NACE 4 sector are exposed to a significant risk of carbon leakage.
- Any measure put in place by Member States measures should compensate for those costs in accordance with state aid rules. Financial support for indirect emissions may be distortive, unless:
 - aid is strictly targeted to sectors at risk of carbon leakage due to indirect emissions, and
 - aid is strictly limited to the additional indirect costs resulting from ETS.
- Financial support should be limited to those electricity intensive sectors which are unable to pass through the electricity cost increase stemming from CO₂ to their customers into product prices without significant loss of market share. These sectors risk to relocate outside the EU, suffer a loss of sales or go out of business due to unfavourable cost structures in the EU.

Question 2: addresses the delicate issue of the relationship between the subsidised and non-subsidised sectors:

- Compensation is designed to prevent carbon leakage from electro-intensive sectors. It is theoretically correct that if leakage occurs – i.e. that emissions within the EU fall as a result of products previously made in Europe being imported – then the achievement of the Europe’s 2020 emissions target and of the EU ETS emissions cap becomes easier, and the burden placed on other sectors would therefore lessen.
- This however is not a reason for not allowing or reducing compensation: it would damage the EU economy and could increase global emissions as production moves to countries with relatively more carbon in the electricity mix.

Question 3: looking at the international context, it is clear that the prospect of reaching a binding international agreement on emissions reduction in the medium term is unrealistic. BUSINESSEUROPE hence highlights again the need to provide guidance on Member States’ measures aimed at counterbalancing the lack of international competitiveness in this context.

There is no other emissions-trading scheme like the EU ETS in any other important economy. Specifically we note that:



- In the USA, the federal Government is very unlikely to approve such a scheme. At state level, the Californian scheme is under legal scrutiny, and several other states are considering withdrawal from the Regional Greenhouse Gas Initiative (RGGI).
- In Japan, progress towards implementing a scheme had stalled even before the recent emergency situation following the earthquake and tsunami. In the light of the latter, a Japanese scheme now looks a very distant prospect.
- India has recently announced an emissions trading scheme based on efficiency targets. This however appears more like a baseline and credit system than a cap and trade system.

Any policy measure that inflates the cost of electricity will have an impact on the production costs of electro-intensive sectors. This obviously includes the ETS, but also for example green certificates systems, feed-in tariffs, electricity consumption taxes and upstream carbon taxes. A complex mixture of such measures already exists at national and/or regional level within the EU. In making a comparison at international level between climate-change related costs in the EU compared with competing countries, it is essential to take into account the cumulative burden of such national measures in addition to the EU ETS.

2.2 Section A2

BUSINESSEUROPE is not in a position to answer the questions in section A2, related to the inability to pass-through increased indirect emission costs due to the ETS. We however submit the following observations:

- We question the consultation's approach in this regard insofar as the criteria are already set by the ETS directive.
- Carbon leakage is the result of the increase in the CO₂ component of electricity prices (indirect emission costs) which firms may not be able to pass on or to bear. It occurs when global greenhouse gas emissions increase¹ because companies that cannot pass on to their customers this increased electricity costs either lose sales to competitors in countries where no CO₂ constraints exist, and/or move their production outside the EU to such countries. In both cases the EU-based share in world production is reduced.
- BUSINESSEUROPE emphatically asserts, therefore, that relocation outside the EU is not the only way in which carbon leakage can occur. Indeed this is the least likely scenario. The assumption lying behind **question 4** that carbon leakage only occurs as a result of relocation of EU facilities into to other countries appears therefore to be incorrect.
- In particular in relation to **question 6**, we stress again that the bulk of carbon leakage in certain sectors will occur as a result of the slow but persistent loss of sales to third

¹ Carbon leakage causes an increase in global emissions in theory because it is assumed that, if emissions from certain ETS-regulated sectors fall as a result of carbon leakage, this will reduce the level of effort required from the other ETS sectors. In other words, the ETS cap sets both a maximum and minimum level for emissions.



country competitors who all operate in countries where there is no internalisation of carbon costs.

3. COMMENTS ON SECTION B: LEVEL OF SUPPORT

Question 31 aims at exploring stakeholders' views as to how financial support can maintain an incentive to reduce electricity consumption and stimulate a shift in demand from "grey" to "green" electricity:

- BUSINESSEUROPE believes that the high price of electricity in the EU already gives an incentive to electro-intensive sectors to reduce electricity consumption. Basing the level of compensation on an efficiency benchmark would provide an additional incentive.
- Carbon pricing according to the ETS Directive is designed inter alia to stimulate a shift in generation from "grey" to "green" electricity. BUSINESSEUROPE does not understand however how the ETS as such can stimulate a shift by consumers from "grey" to "green" electricity. Consumers generally have no influence over how the electricity they buy is generated. Thus, BUSINESSEUROPE considers this objective to be unachievable.

Question 32 asks which level of aid reduction would help preserving an adequate incentive to reduce electricity consumption:

- We believe the reduction in aid resulting from basing the compensation on an efficiency benchmark should be adequate incentive for electro-intensive companies to reduce electricity consumption. Even those electro-intensive companies that already achieve the benchmark values have an incentive to continue to improve their energy efficiency in order to retain their competitive advantage. The benchmarks should be reviewed periodically in order to maintain their incentive effect.
- Reducing the level of aid beyond this would increase the risk of carbon leakage, reduce the funds available for investment and therefore would be counter-productive.

As regards **question 33**, BUSINESSEUROPE does not consider that requiring an own contribution would give an extra incentive to electro-intensive sectors to become even more energy efficient. The response given to question 32 above applies equally here.

Question 34 seems to require clarification. If the hypothesis is that requiring an own contribution to electricity users would prompt power generators to invest in low carbon facilities to remain more competitive, BUSINESSEUROPE considers this hypothesis unrealistic.

On **question 35** relating to the need to avoid aid dependency, we note that support will only be needed for as long as the EU ETS internalises the cost of carbon for electricity generation and similar costs are not internalised by competing nations. Until the latter is achieved, phasing out support would merely mean phasing in carbon leakage. The temporary character of the support can be maintained by regular assessments of its necessity.

**4. COMMENTS ON SECTION C: BENCHMARKS**

BUSINESSEUROPE does not have any specific comments on the section on benchmarks. However, when setting benchmarks, already available data should be used as far as possible, in order to prevent additional administrative burdens for the companies involved as much as possible.

5. COMMENTS ON SECTION D: EMISSION FACTOR (METHODOLOGY)

As a general principle, BUSINESSEUROPE believes that compensation should reflect as closely as possible the actual indirect costs in each case, taking into account the particularities of the relevant electricity market.

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