



31 January 2012

COMMENTS ON THE DRAFT STATE AID GUIDELINES IN THE ETS CONTEXT

KEY MESSAGES

- 1** Any state aid measures in the ETS context should respond to the need to counterbalance the decline of competitiveness of Europe's industry induced by the increase in electricity prices that is directly linked to the ETS.
- 2** In order to be effective and reduce the risk of carbon leakage, compensation should cover 100% of the eligible costs and should be kept constant over time. The incentive to reduce electricity consumption can be achieved by a reduction in aid resulting from basing the compensation on efficiency benchmarks.
- 3** A proportionate and 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.

WHAT DOES BUSINESSEUROPE AIM FOR?

- Achieving transparency and legal predictability by explaining the compatibility criteria that the Commission plans to apply to these state aid measures.
- Allowing Member States to lessen additional burdens posed on companies, ensuring that the aid is necessary, proportional and less distortive as possible.
- Ensuring that the CO2 factor used in the calculation reflects as much as possible the price increase that the electricity user is facing when buying electricity.
- Choosing carefully the electricity consumption benchmarks, which should allow for aid offering the sectors concerned a sufficient compensation, recognising the limited technical potential to improve further in a cost-effective way.

31 January 2012

COMMENTS ON THE DRAFT STATE AID GUIDELINES IN THE ETS CONTEXT

1. INTRODUCTION

BUSINESSEUROPE welcomes 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 Greenhouse Gas Emission Allowance Trading Scheme (ETS).

We are very supportive of the Guidelines' objective to ensure transparency and legal predictability by explaining the compatibility criteria that the Commission plans to apply to these state aid measures.

As regards the specific measures indicated by the draft guidelines, BUSINESSEUROPE will only comment on the state aid measures for indirect emissions.

2. GENERAL OBSERVATIONS

BUSINESSEUROPE stresses that any state aid measure in this context should respond to the need to counterbalance a competitiveness decline for Europe's industry induced by the increase in electricity prices in the EU that is directly linked to the ETS.

In addition, only truly efficient compensations schemes will be effective in contributing to achieving the EU's global climate objectives.

A proportionate and 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.

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. The Durban negotiations confirmed that there is no prospect of reaching a binding international agreement on emissions reduction before 2015, with no concrete application before 2020, which is the horizon of the draft guidelines.

BUSINESSEUROPE hence highlights again the need to provide guidance on Member States' measures aimed at counterbalancing the decline of international competitiveness within this period and thereafter, until a binding international climate agreement is in place which secures a level playing field for Europe's industry.

The new state aid guidelines need to be adopted and applied as soon as possible to member states wishing to lessen additional burdens posed on companies, ensuring that the aid is necessary, proportional and less distortive as possible.



3. SPECIFIC COMMENTS

Aid for indirect emissions

- 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 EU greenhouse gas emissions “migrate” to third countries because companies that cannot pass on to their customers these increased electricity costs either lose sales to competitors in countries where no CO₂ constraints exist, and/or leave the European single market and move their production to such countries. The main justification for allowing state aid to compensate for indirect emissions costs is to prevent this from happening.
- Therefore relocation outside the EU is not the only way in which carbon leakage can occur. As mentioned above, the bulk of carbon leakage in certain sectors will occur as a result of the persistent loss of sales to third country competitors who all operate in countries where there is no internalisation of carbon costs.
- In both cases the EU-based share in world production is reduced and global CO₂ emissions may increase. In addition, this situation may result in lack of investment in the sectors concerned in Europe, thus further undermining those sectors’ international competitiveness.
- 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 the risk of carbon leakage) and the loss of competitiveness of EU companies indirectly affected by the ETS.
- The current list in the guidelines does not adequately represent all the sectors and subsectors exposed to risk of carbon leakage. Financial support should be possible for the sectors, indicated in the ETS directive, 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.
- In particular, the use of NACE classification is not appropriate to correctly indicate the sectors. For example, some sub-sectors in a 6-digit NACE code which have a real risk of carbon leakage based on the proposed criteria, are not identified in Annex II for the simple reason that a broader 4-digit NACE code level is used. It would be more appropriate to indicate eligibility criteria tied to, for example, the electricity-intensity of the industry concerned. If the commission does not wish to allow the assessment of the eligibility criteria at a more detailed level, it could still ensure that individual installations or industries can put forward their case. Many industries are concerned that they would meet the criteria set out in annex II but do not appear in the list, presumably because the data is not robust enough or because they are being diluted by the broad range of industries that can exist within each NACE code.



- There is also a danger that limiting aid to the defined sectors may distort the supply chains of these sectors. An example of this would be in the steel industry where production of the constituent raw materials (such as industrial gases and lime) is also energy intensive. At present many steel works source these materials from other companies or outsource their onsite production to third-parties. Care must therefore be taken to ensure that support for certain sectors does not provide a distortive incentive for them to undertake additional practices on site to the detriment of existing providers. Although article 27a limits the chance of such a distortion by using specific benchmarks (at prodcom 8 level) article 27b uses base line electricity consumption which would allow for additional processes to be incorporated.

Reference to previous production period

- The draft guidelines propose that compensation be calculated ex ante based on production levels during an arbitrary reference period. BUSINESSEUROPE considers that compensation should in principle be related as closely as possible to the actual increase in costs incurred. An ex ante calculation will lead to either over-compensation (which will be trade distortive) or under-compensation (which could lead to carbon leakage).
- In principle therefore, compensation should be calculated ex-post based on actual "baseline production" or "baseline electricity consumption" during the year in question. This would be the best incentive and only way for optimised production and for energy efficient investments, as well as reducing the risks of both trade distortion and carbon leakage.
- If for any reason that would not be possible, an alternative option could be a more flexible ex-post correction method. The Commission currently proposes ex-post correction only if actual production or actual electricity consumption exceeds the baseline by 40%. This method could create large market distortions, where for example one company meets this threshold and benefits from a 40% uplift in compensation, while a competitor only increases output by 39% and receives no uplift. If this methodology is retained, a series of smaller thresholds should be applied. In any case, the period currently referred to by the definition of "baseline output" (art. 27 and Annex I), is inappropriate as this period includes the recession.

Aid intensity

- BUSINESSEUROPE recognises the search for an incentive effect, but does not consider that requiring an own contribution would give an extra incentive to electro-intensive sectors to become even more energy efficient. We believe no compensation cap is needed and Members States should be able to provide compensation covering 100% of eligible costs.
- In addition, an adequate incentive for electro-intensive companies to reduce electricity consumption can already be achieved by a reduction in aid resulting from basing the compensation on efficiency benchmarks. Even those electro-intensive companies that already achieve the benchmark values have an incentive to continue



improving their energy efficiency in order to retain their competitive advantage. By reviewing periodically the benchmarks, the incentive effect can be maintained over time. Reducing the level of aid beyond this would increase the risk of carbon leakage and reduce the funds available for investment, therefore being counter-productive.

- To be effective, the intensity of the aid for indirect emissions (art. 26) should not be degressive over time. The compensation should therefore be kept constant to 100% of the eligible costs until 2020. This would help maintain the effect of compensation on preventing carbon leakage, improving economic and environmental efficiency.
- While agreeing with 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.
- The CO₂ factor used in the calculation should reflect as much as possible the price increase that the electricity user is facing when buying electricity. It is possible that the methodology proposed in the guidelines is a reasonable proxy for this, but we stress the importance that the regions or markets defined reflect the actual market structures to get fair emission factors for all electricity users. We trust the Commission will consult extensively the sectors concerned when setting the benchmarks.
- Electricity consumption benchmarks should be chosen carefully: benchmarks established for the purpose of calculating allowances for direct emissions may not in all cases be the most appropriate benchmark for the purpose of calculating compensation for indirect emissions.
- In the fall-back situation, when a benchmark is not applicable, the guidelines suggest a figure based on the average of the other established benchmarks. In order to avoid carbon leakage, it is key that even the fallback benchmarks allow for aid levels offering the sectors concerned a sufficient compensation, recognise past efforts of the industry and the limited technical potential to improve further in a cost-effective way.
- Basing the “fallback” benchmark on the average of the other benchmarks might be an acceptable methodology, but until the results have been calculated it is impossible to assess if it will work in practice. The Commission should therefore consult further about the efficiency benchmarks to be used for this purpose.

Incentive effect

We stress that the criterion of the incentive effect can only be applied to those aid measures that presuppose an investment from the beneficiary. Therefore, this criterion can only be applied to two of the four specific measures covered by the guidelines – namely:



- Investment aid to highly efficient power plants (par. 1.2), and
- aid related to the modernisation of electricity generation (requiring a national investment plan of investments undertaken by operators – par. 1.3)

In addition, according to the ETS Directive, the aid for indirect costs should favour sectors exposed to a significant risk of carbon leakage in order to compensate for these costs. Therefore, the effectiveness of the aid cannot be measured by a change in behaviour, but only by a reduction of the risk of carbon leakage to which these sectors are exposed.

4. FINAL REMARKS

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. BUSINESSEUROPE observes that the Commission should commit itself to applying the same principles as set out in these guidelines when assessing national measures that have an equivalent effect on competitiveness.

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.

* * *