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EU Commission waters down carbon market state aid rules to please large polluters

The final EU carbon market state aid rules will ensure massive handouts of taxpayer money to large polluting industries such as oil refineries and plastic producers over the next decade.

The EU ETS state aid guidelines for 2021-2030 set the framework for EU countries to compensate their electricity-intensive industries deemed at risk of 'carbon leakage' for potentially increased electricity prices due to power companies needing to buy emission allowances. These are called "indirect costs".

Carbon leakage refers to a hypothetical situation where production is moved to other parts of the world with laxer environmental regulation. However, as a study released by the European Commission highlights, there is actually no evidence of carbon leakage due to indirect costs[1].

This overly generous scheme exists since 2013 and has allowed public payouts of nearly 1.2 billion Euros[2] to the industry just in 2017 and 2018.

The draft guidelines issued for public consultation in February 2020 proposed limited climate action conditions on industry if they wanted to receive state aid - ensuring the subsidy scheme had at least some climate benefits. In addition, the list of eligible sectors had been shortened, with a clear methodology used to decide why sectors were included on the list.

However, the final guidelines (due to enter into law on January 1st of 2021) are a leap backwards. Even the explicit goal of reducing greenhouse gases (GHGs) has been deleted from

[1] https://ec.europa.eu/competition/consultations/2020_ets_stateaid_guidelines/consultance_report.pdf

[2] European Commission Report on the functioning of the European carbon market (2018 and 2019 iterations)

the final version.

6. The primary objective of State aid control in the context of implementation of the EU ETS is to ensure that ~~State aid measures will result in a higher reduction of greenhouse gas emissions than would occur without the aid and to ensure that~~ the positive effects of the aid outweigh its negative effects in terms of distortions of competition in the internal market. State aid must be necessary to achieve the environmental objective of the EU ETS (necessity of the aid) and must be limited to the minimum needed to achieve the environmental protection sought (proportionality of the aid) without creating undue distortions of competition and trade in the internal market.

Three of the main failures are:

- Sectors[3] such as oil refineries and plastic producers are on the list of eligible sectors, and that list has been expanded using a completely opaque method
- Climate conditions have been dropped
- The formula used to determine the amount of state aid companies can receive has been weakened which leads to more generous handouts

Below we look more in detail at each of these shortcomings.

Sectors with no future in climate-neutral Europe on the subsidy list

The final list of eligible sectors has been expanded again, and possibly even worse, it has been expanded in an opaque way using a blackbox backdoor called the 'qualitative assessment' - of which we know nothing. No mention is made of how this method works and what it is based

[3] The list now covers:

- Through the quantitative assessment: refined petroleum products, pulp, paper and paperboard, basic iron and steel and ferro-alloys, aluminium, lead zinc and tin, leather clothes, and 'other inorganic basic chemicals' (mostly manufacture of chemical elements and inorganic acids, bases and compounds),
- Through the qualitative assessment: polyethylene (the main throw-away plastic, used for example to produce plastic bags), hydrogen, copper, casting of iron, glass fibre mats and voiles, inorganic oxygen compounds of non-metals and 'other non-ferrous metals' (includes nickel, chrome and manganese)

on. Some sectors were added this way against the recommendations in a report prepared for the Commission by external consultants[4].

The guidelines do not explain what the qualitative 'assessment' is based on. This means that billions of euros are to be handed out to companies without the rest of society knowing why those companies deserve it. Petroleum refineries and virgin plastic producing companies are in line to receive taxpayer subsidies, even if these sectors have no future in a climate-neutral and green Europe.

Taxpayer money is being handed out without any climate conditions

The addition of climate conditions to this state aid scheme was a saving grace of the draft guidelines. However, in the final version, they are so weak that they might as well have been left out altogether. Large polluting industries will now receive billions of euros and are in no way forced to use this money to support their climate transition.

Companies only have to fulfil one out of three conditions (which have all been weakened with regards to the draft guidelines). The first condition is extremely easy to meet, making the other two conditions meaningless: companies will need to invest in actions recommended by an energy audit if those investments would pay themselves back within 3 years. If there are no recommendations with such a short payback time even that condition can be ignored. The conditions (follow through on energy audit recommendations, buy carbon-free electricity or invest in emissions reductions) should have been far more stringent: all state aid should be used for these purposes, and only additional investments should have been considered eligible (i.e. not investments the company would have made anyway in the absence of state aid).

Critical variables to determine how much aid companies can receive have been weakened

Unlike previous ETS state aid guidelines, the new rules don't foresee any reduction in state aid over time, which is a basic requirement for all state aid to prevent aid dependency. Companies will instead be able to rely on handouts until 2030 that are likely to increase each year, in step with the EU's carbon price.

The guidelines also absurdly assume that fossil fuel-based electricity generation is the only driver of electricity prices throughout the EU and that renewable energy and storage will not play a major role in the market by 2030. These assumptions could lead to massive windfall profits for industry and disregard the ongoing decarbonization of the EU power grid, as well as the EU long term climate strategy. To put it simply, if there was only one coal plant in all of Germany, and all other electricity came from renewable sources, this formula would allow

[4] https://ec.europa.eu/competition/consultations/2020_ets_stateaid_guidelines/consultance_report.pdf

paying eligible industry in Germany, Austria and Luxembourg as if they all paid the full carbon price of this one coal plant.

The final guidelines do include an alternative method to determine the emission factors - based on the real carbon intensity of the marginal powerplant (i.e. the one setting the price of electricity). However, member states can choose whether to use the old or the new method. Seeing that the guidelines are creating a race-to-the-bottom among EU countries to compensate (industry in a country that does not grant compensation is competitively disadvantaged compared to the industry in a country that does) we can predict that most countries will just choose the methodology that allows for the most compensation.

Another missed opportunity is the lack of regular annual updates to crucial variables to keep the guidelines in line with the real world and the decarbonization of the EU and its power sector. By choosing to set these variables in stone until 2025 or 2030 the Commission is ensuring that the handouts will be increasingly generous over time, while it should have aimed at exactly the opposite.

Conclusion

The above three issues together will lead to industry pocketing billions of euros (some of it EU carbon market revenues) without having to commit to climate action. It is a lost opportunity to trigger investments into a clean industrial transition, a waste of taxpayer money and blow to the credibility of the EU Green Deal.

The new guidelines are much worse than the draft that was published earlier this year. The dirty fingerprints of vested industry interests are all over them and the policymakers which allowed this are accountable.

The entire ETS indirect cost state aid scheme should be phased out rapidly and member states should refrain from using it altogether. It protects the industry against a risk that doesn't exist, has no societal benefits, forces member states into a race-to-the-bottom to spend taxpayer money on propping up the competitiveness of their polluting industry, and delays the inevitable transition which will only become more difficult and more costly the longer we wait. The funds that member states will hand out through this scheme the coming decade would be better used to invest in climate solutions and help the industry transition, rather than reward the highly polluting status quo.