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Revision of the state aid guidelines in the context of the EU ETS: discussion on the draft guidelines

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Agenda

- Background and quick recap
- ERCST *(first) take on draft guidelines*
- Impressions from stakeholders
- Roundtable discussion

Legal Background

- Revision of the guidelines from 2012
  - Reviewed ETS Directive (2018/410/EU)
  - Art. 10a (6)
  - State aid measure under Article 107(3)(c) of the TFEU
- Targeted consultations
  1. 8 weeks
  2. Advisory Committee
  3. DG Competition
  4. Adoption foreseen for mid-Q3 2020
  5. Better Regulation – Have your say

ERCST *Main principles for indirect cost compensation*

- ***Effective*** carbon leakage protection for sectors that ***need*** it
- ***Transparent*** assessment of leakage risk
- ***Dynamic*** cost compensation
- Need for mid-Phase ***review***
- MS compensation ***as similar as possible*** (avoid market distortion)
- ***Symmetry*** with free allocation rules desirable

1. Eligibility criteria – Phase 3

Phase 3:

- Quantitative criteria for automatic addition to list
  - Intensity of trade with third countries is above 10%
  - Indirect costs would lead to a substantial increase in production costs (as a proportion of the gross value added) of at least 5%
    - Both need to be fulfilled
- Qualitative criteria for 'borderline sectors'
  - Sectors with missing or low quality data
  - Sectors 'considered to have been insufficiently represented by qualitative assessment'

Not stated in guidelines which sectors were included through quantitative/qualitative assessment

1. Eligibility criteria – ERCST

- **Desirable**: eligibility criteria should aim at making list as focused as possible *(soft cap of 25%)*
  - Principle: only sectors for whom indirect costs are 'a matter of survival'
    - How should 'matter of survival' be defined and operationalized?
  - Limited financial resources to be shared between fewer sectors
    - Less potential for *over*compensation and *under*compensation
    - Less potential for MS to further limit sectoral scope of national schemes and linked distortions to internal market
  - Could be done by using Prodcom for definition of sectors
    - NACE as fall back position

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1. Eligibility criteria – Draft guidelines Phase 4

Draft guidelines:

- Uses free allocation methodology, but only takes indirect emissions into account (trade intensity * indirect emission intensity ≥ 0.2)
  - Logical, in principle
- Additionally, a trade intensity (20%) AND indirect emissions emissions intensity (1 kg CO2/EUR) threshold need to reached
  - Results in a very focused list: 8 sectors
- Qualitative assessment still possible, but limited
  - Only 4 sectors seem eligible
  - Assessment at Prodcom level not possible (?)
- Assessment by consultants has been made public ✓

➔ Very strict criteria (⬄ Free allocation)

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1. Eligibility criteria - Draft guidelines Phase 4

Draft guidelines:

- Possibility for MS to *grant additional support* for some sectors with particularly high indirect costs (as ***tbd***% of GVA, after compensation has been given)
- Interesting addition, as it effectively introduces the possibility for a *tiered approach* to indirect costs compensation – precedent?
- Consultants' study shows that, depending on the GVA threshold, this could be applicable to a large number of sectors
- As this is an optional clause, there is a potential for increased market distortions between MS

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2. Setting of key variables

- Function for maximum aid has remained similar, yet some improvements have been made

$$\boldsymbol{Amax_t = Ai_t * C_t * P_{t-1} * E * BO}$$

$$\Downarrow$$

$$\boldsymbol{Amax_t = Ai * C_t * P_{t-1} * E * AO_t}$$

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2.1 Aid intensity and degressivity

- **Phase 3**: no full compensation + degressivity principle – aid intensity started at 85% and dropped to 75%

ERCST views:

  – Illogical that full compensation (at the benchmark) is used for Free Allocation but not for indirect costs compensation
  – A degressive aid intensity variable is not the right way to bring degressivity into the state aid guidelines

- **Degressivity should be brought in through other variables:**
  – Time-sensitive benchmarks (yearly, similar to free allocation rules)
  – Regularly revisit CO_2 intensity factors

2.1 Aid intensity and degressivity

- **Draft guidelines**: aid intensity will remain at 75% (degressivity principle removed)

- “the aid is proportionate and has sufficiently limited negative effect on competition and trade if it does not exceed 75% of the indirect emission costs incurred.“ – *as assessed by the consultants*
  - Acceptable method, but still no clear reason why free allocation is treated differently

2.2 CO_2 emissions factor

- **Phase 3:** static CO2 emissions factor, while it was implied to change over time in the formula (C_t)

- **Draft guidelines:**
  – Use of regional factors maintained where applicable
  – Mid-term review introduced
  – Calculation method will change to marginal plant approach based on fossil fuels for mid-term review

➔ Good changes

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2.3 EUA prices

- **Phase 3:** forward EUA price in the year t-1.
- Two options that could be considered more desirable :
  1. Use weighted 3-year average of forward prices
     - Could address partially the potential for under- and overcompensation of using one year forward prices
     - Fit more closely with hedging strategies and electricity price setting
  2. Use average EUA prices in the year for which compensation is granted
     - Decreases the difference between actual EUA prices and level of compensation
- **Draft guidelines:** remains the same as Phase 3

2.4 Product-specific electricity consumption efficiency benchmark

- **Phase 3:** static benchmark based on most electricity-efficient methods of production for the product
- **ERCST views**: dynamic benchmarks similar to free allocation rules
  - Average of 10% best producers
  - Ideally, **use annual reduction** rates for each benchmark
    - Implies annual change to the benchmarks
    - Mid-term review for assessing progress and methodologies
  - Incentives industry to reach (or best) the benchmark
  - Limit use of fall-back electricity consumption efficiency benchmark as much as possible

2.4 Product-specific electricity consumption efficiency benchmark

- **Draft guidelines** – 2 options included

1. Benchmark based on most electricity-efficient methods of production for the product - Update at the beginning of Phase 4 + reviewed mid-term

2. ”the Commission is considering aligning … with the methodology specified in Article 10a(2) of the EU ETS directive = extrapolate annual reduction rates for each benchmark based on past efficiency improvements
    - **Preference for this option.**

2.5 Output levels

- **Phase 3:** Baseline output levels used, static
- **ERCST view**: Activity levels should be made as dynamic as possible
- **Draft guidelines**: Actual output levels will be used in the calculation
  - Most dynamic method - can be encouraged
  - Inconsistency with EUA price formula
  - ⇔ Free Allocation *(HAL, 2year rolling average 15%, 5% thresholds)*

3. Conditionality (new provision)

- **Phase 3**: no conditionality
- **Draft guidelines:**
  - Energy audit mandatory
  - Three options:
    - Implement audit recommendations; OR
    - Reduce carbon footprint of electricity consumption (e.g. through on-site renewable energy generation covering 50% of electricity needs or a carbon-free PPA); OR
    - Invest > 80% of the aid amount in projects to reduce emissions

➔At this stage hard to judge this conditionality – Options applicable to whom? How would it be assessed? What would be the benchmarks? What if one of the options is already fulfilled?

⬄ Free allocation

4. Interactions with renewable energy

Phase 3 guidelines state that no state aid can be granted 'in case of electricity supply contracts that do not include any CO2 costs'

- If electricity prices are set through merit order, then 100% renewable contracts also pass through 'opportunity' CO2 costs
  - As do 99% renewable energy contracts
- Some anecdotal evidence that this has disincentivized industry to engage in 100% RE contracts as they miss out on state aid
  - Perverse incentive that needs to be addressed!

Draft guidelines: this clause is taken out

5. Evaluation and Transparency

Draft guidelines:

- Commission can require ex post evaluations of state aid schemes, which are to be made public
  - Common methodology to be developed by Commission
- More detailed information to be published by Member States

Increased transparency and assessment to be encouraged

Direct vs. indirect cost

- In theory: similar effects on competitiveness *(and electrification leads to increased indirect costs)* – but have always been dealt with differently
  - (EU + free allocation + full compensation ⇔ MS + cash + limited and digressive compensation)
- Draft guidelines: free allocation methodology is often used as a basis for the indirect costs calculations
- However, again, the draft guidelines for indirect costs compensation can be considered more stringent than the free allocation rules
  - More restrictive eligibility criteria
  - Aid intensity of 75%
  - Actual output levels used
  - Conditionality introduced

What is the rationale behind this different treatment?

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ERCST main principles for indirect cost compensation

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- ***Transparent*** assessment of leakage risk
- ***Dynamic*** cost compensation
- Need for mid-Phase ***review***
- MS compensation ***as similar as possible*** (avoid market distortion)
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Some final thoughts

- Different options available to MS to address limited resources - is there a need for guidelines?
  - Drop sectors?
  - Tiering?
  - Cross-sectoral correction factor?

Some final thoughts

- Treatment of accounting for indirect cost compensation towards Art.10 (3) of the EU ETS Directive?
  - 50% of revenues generated from the auctioning of allowances should be used for selected purposes (climate mitigation and energy efficiency among others)
- Need for state aid guidelines to compensate households?
  - California scheme: only 14% of compensation 2014-2016 went to industry

Thank you for your attention

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