EUROPEAN COMMISSION
IMPACT ASSESSMENT BOARD

Brussels, D(2011)

Opinion

Title **DG COMP - Impact Assessment on certain State aid measures in the context of the Greenhouse Gas Emission Allowance Trading Scheme**

(draft version of 14 October 2011)

(A) Context

The EU Emission Trading System (ETS) was established in 2005 to enable the EU to meet its 2020 climate change targets. The ETS is a key tool to reduce energy and industrial greenhouse gas emissions, based on a cap-and-trade model. However the system could have a potential negative externality in the form of "carbon leakage", which may occur when asymmetric costs impact on firms producing in the EU, possibly leading to loss of market share to competitors based outside the EU, or when investments are re-targeted towards countries which do not have equivalent CO2 constraints in place. Two mechanisms were incorporated into the 2009/29/EC Directive in order to protect EU (sub)sectors from carbon leakage: 1) compensation in the form of free EU allowances to emit CO2 when it impacts on their own production processes ("direct CO2 costs"); 2) the possibility for Member States to grant state aid for "indirect CO2 costs" (when these costs are passed on by electricity producers in their prices). This IA report accompanies the Guidelines on certain state aid measures in the context of the ETS. The report focuses solely on the second mechanism, i.e. tackling carbon leakage through state aid.

(B) Overall assessment

The report needs a considerable amount of further work to present the analysis in a more concise and accessible form, and to clarify a number of key issues. Firstly, the scope of the initiative should be better defined, and a clear baseline scenario should be presented that indicates how the situation with regard to carbon leakage and related impacts would evolve in the absence of new EU action to modify the State aid regime. Secondly, it should provide a more transparent presentation of the options in politically relevant packages. Thirdly, the report should strengthen the presentation of the costs and benefits of the different options, and should address the possible consequences of non-alignment of the treatment of direct and indirect costs. Finally, the report should compare the option packages in a more transparent way, and explicitly state the criteria which should guide the selection of the preferred option.

Given the nature of these recommendations, the IAB requests DG Competition to resubmit a revised version of the IA report on which it will issue a new opinion.

(C) Main recommendations for improvements

(1) Present a more robust baseline scenario. The report should provide greater clarity on the precise scope of the problem in view of political commitments made at the time of the adoption of the ETS Directive. It should summarise the available evidence on the incidence of carbon leakage problems, and on the drivers of this problem, in order to better indicate how the situation with regard to carbon leakage and related impacts (e.g. efficiency of the ETS/distortion of the internal market) is likely to evolve in the absence of new EU action to modify the State aid regime. It should clearly identify which sectors are most at risk of carbon leakage. On that basis the report should explicitly acknowledge the precautionary character of the proposed Guidelines, which are designed to address problems that are likely to arise, including when carbon prices would increase significantly above their current levels. In this context, the observation in the report about the relative importance of carbon leakage for the competitiveness of most sectors in comparison with exchange rates and labour, capital and other input costs (p.66) should be integrated in the problem definition. The baseline scenario should also clarify what the current State aid regime allows Member States to do with respect to the prevention of carbon leakage.

(2) Improve the presentation of the options. The report should provide a more transparent presentation of the options, by including politically relevant packages (with a clear identification of sectors covered) that would allow for a more concrete comparison of impacts. The various option packages should be clearly linked to the specific objectives to be achieved, such as preventing illegal operating aid, and avoiding distortions in the single market and between sectors. The report should consider introducing an additional option using a combined threshold for direct and indirect costs, rather than proposing a 5% threshold for indirect costs alone (as is done in option A2), or provide clear arguments why such an option has been discarded. The report should also better explain the selection of sectors that would undergo a qualitative assessment under option A3. A sensitivity analysis should be conducted for carbon prices, for instance with 10, 20 and 40€/t. It should be considered to differentiate options on the stringency of the state aid regime in function of the availability of concrete evidence of carbon leakage, or as an approximation for such evidence, of specific levels of carbon prices. On the issue of aid intensity, a combined option should be considered, which would begin at 100% and subsequently decline over time to provide a stronger incentive to reduce CO_2 emissions (option B1 coupled with B2b). With respect to the production level used to determine the eligibility of (sub-)sectors an additional option could be considered, using the historical output and monitoring its evolution. Where options have been discarded early on in the process, the report should clearly state why they were no longer considered relevant.

(3) Strengthen the presentation of costs and benefits. The report should complement its qualitative assessment of the most important option packages with the available quantitative evidence. The report should indicate which sectors would be most likely to be included in the application of the Guidelines under different option packages, and illustrate the broader impacts by providing an indication of the relative importance, geographical distribution, and number of people employed in these sectors. The report should explicitly address the possible creation of new market distortions within sectors as a consequence of non-alignment of the treatment of direct and indirect costs. It should also discuss the possible long-run consequences of a burden shift from energy intensive sectors (aid eligible), which are capital intensive, to more labour intensive sectors.

Against the background of the current economic difficulties, the report should, in summing up the expected impacts, clearly assess competitiveness issues, as well as the distribution of impacts across Member States.

(4) Compare option packages in a more transparent way. The report should better explain the reasoning behind the qualifications in the partial comparison tables, and provide a summary table that explicitly compares the most relevant option packages. On this basis it should indicate which option would perform best, subject to different assumptions about the value of key variables, such as prevailing carbon prices. The report should explicitly state the criteria by which this preferred option would be selected.

Some more technical comments have been transmitted directly to the author DG and are expected to be incorporated in the final version of the impact assessment report.

(D) Procedure and presentation

The report should be presented in a more concise and accessible form. It should be considerably shortened, by avoiding repetition of identical arguments under different sections, and by moving extensive quotations from legal documents to the annexes, retaining only the main arguments in the core text. Where the report refers to the "carbon leakage literature", it should provide explicit references and exact sources. The report should provide a table of contents with page numbers, as well as a glossary of technical terms and abbreviations.

(E) IAB scrutiny process	
Reference number	2011/COMP/11
External expertise used	No
Date of Board Meeting	9 November 2011.