



## **COMMUNITY POLICY AND NEW GUIDELINES ON STATE AID FOR THE ENVIRONMENT.**

### **Introduction**

Environmental protection is seen as an increasingly important objective of the European Union. One of the main tools which member states can utilise to address environmental concerns is the correct application of the polluter pays principle. This aims to ensure that the cost of environmental protection is internalised by companies and reflected in the final price of their products. It is widely accepted however, that environmental costs have for too long been hidden costs, which means that in many cases economic activities do not fully account for their impact on the environment<sup>1</sup>. To address this, governments may use regulation to ensure companies meet certain environmental standards or market based instruments (eg taxes, charges, emission trading systems etc.) to ensure companies pay for their pollution. If pollution becomes a real economic cost, companies will tend to maximise their profits by reducing this cost component and therefore pollution. In addition, if polluting goods are more expensive, demand will adjust towards less polluting sectors offering cheaper and more environmentally friendly goods and services. This in turn can help to stimulate economic growth and jobs in the eco-industry sector<sup>2</sup>.

Another option open to member states is the possibility of state aid. This may be justified to give companies an incentive to increase investment in environmental protection. State aid can also be directed to relieve firms from the financial burden of enforcing a stricter overall environmental policy.

### **State Aid Policy**

State aid policy in the European Union is outlined in the State Aid Action Plan (SAAP)<sup>3</sup>. The Commission noted that state aid measures can sometimes be effective tools for achieving objectives of common interest. Under some conditions, state aid can correct market failures, thereby improving the functioning of markets and enhancing competitiveness. It can also help to promote sustainable development, irrespective of the correction of market failures<sup>4</sup>. The SAAP also notes that environmental protection can provide opportunities for innovation, create new markets and increase competitiveness through resource efficiency and new investment opportunities.

The SAAP is based on the following elements:

June 2008

Environment and Green Technologies Dept.  
Mark Sweeney



- less distortive and better targeted aid, so that public money is used effectively to improve economic efficiency, social and regional cohesion, sustainable development and cultural diversity.
- a more refined economic approach so that less distortive aid can be approved more easily and quickly leaving the Commission to concentrate it's resources on the cases liable to create more serious distortions of competition and trade.
- more streamlined and efficient procedures – the Commission proposes to exempt more measures from the notification obligations previously required.
- a shared responsibility between the commission and Member States.

State aid aimed at environmental improvement has increased significantly in the E.U. over the last seven years<sup>5</sup>. The increase, which amounted to a doubling of green state aid from €7bn to €14bn between 2001 and 2006, arose in part from an increase in reductions or exemptions from environmental taxes. There are large disparities between member states however when it comes to their spending on green state aid. The largest grantors of state aid from 2004 – 2006 were Sweden (0.77% of GDP), Denmark (0.35%) and Germany (0.32%). The E.U. average spend was 0.12% of GDP. Spending on environmental state aid in Ireland was less than 0.01% GDP during this time period. The Commission noted that these disparities reflect different approaches by individual member states to the use of state aid as a tool for environmental protection but do not indicate any difference in attitudes to environmental protection as a priority per se.

State aid must fulfil certain criteria and be authorised by the European Commission. The Commission issues guidelines to help member states by announcing in advance which measures it considers compatible with the common market. Guidelines on state aid were last published in 2001. In 2008 the commission has decided to revise these guidelines in order to meet the objectives set out in the SAAP, in particular to ensure better targeted aid, more economic reasoning and more effective, transparent procedures. The new guidelines<sup>6</sup> also act as a safeguard to prevent badly targeted or excessive state aid that could distort competition.

The new state aid guidelines are also an important part of the new EU Energy and Climate Change Package<sup>7</sup>. This package puts forward ambitious policy measures with regard to, among others, renewable energy and emissions trading. To reach these targets the package is introducing mechanisms which should support the polluter pays principle and ensure more environmentally friendly technologies are encouraged. Firstly, by preserving effective competition, the guidelines support the market based instruments introduced

June 2008

Environment and Green Technologies Dept.  
Mark Sweeney



in the package and secondly they provide a series of measures that complement and support the achievement of greater environmental protection.

### **Specific Measures covered by the new Environmental Aid Guidelines**

The commission has identified a series of measures for which state aid may, under specific conditions, be compatible with Article 87 of the EC Treaty<sup>8</sup>. A number of new provisions are included in the new guidelines.

(\* implies new measure)

- Aid for undertakings which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards -this type of aid provides individual incentives to companies to achieve higher environmental protection
- Aid for the acquisition of new transport vehicles which go beyond Community standards or which increase the level of environmental protection in the absence of Community standards
- Aid for early adaptation to future Community standards
- Aid for Environmental studies \* – this aid is directed at companies for studies on investments aimed at going beyond Community Standards in the area of environmental protection, as well as studies on energy saving and production of renewable Energy. Often companies underestimate the possibilities and benefits related to energy saving and renewable energy which leads to under-investment
- Aid for energy saving – this type of aid creates individual incentives to attain environmental targets for energy saving and for the reduction of greenhouse gas emissions. State aid may be appropriate where the investments resulting in energy savings are not compulsory in relation to community standards and where they are not profitable, that is to say where the cost of energy saving is higher than the related private economic benefit. In the case of SMEs, more favourable support may be needed to take into account the fact that SMEs often under-estimate the benefits related to energy savings over long periods, which leads to under-investment in energy-saving measures by SMEs.
- Aid for renewable energy sources – increased use of renewable energy sources is an environmental priority for the EU. State aid may be justified if the cost of production of renewable energy is higher than

June 2008

Environment and Green Technologies Dept.  
Mark Sweeney

the cost of production based on less environmentally friendly sources. These high production costs can act as a barrier to market entry. Biofuels must fulfil the sustainability criteria set out in Article 14 of the proposed Directive on the promotion of the use of energy from renewable resources<sup>9</sup> before state aid can be considered.

- Aid for cogeneration and aid for district heating \* - cogeneration of heat and electricity (CHP) is the most efficient way of producing electricity and heat simultaneously as less energy is wasted in production. The community strategy outlined in the Commission's cogeneration strategy of 1997<sup>10</sup> sets an overall indicative target of doubling the share of electricity production from CHP to 18% by 2010. The Commission Action Plan for Energy Efficiency<sup>11</sup> promotes CHP and also points to the potential of waste heat, for example from industries or utilities in district heating. State aid can be granted with a view to giving incentives to attain environmental targets.
- Aid for waste management \* – The Sixth Community Environment Action Programme identifies waste prevention and management as one of the four top priorities. It's primary objective is to separate waste generation from economic activity, so that EU growth will not lead to increased volumes of waste. In this context, state aid may be granted to the producer of the waste as well as to companies managing or recycling waste. However the positive effects on the environment must be ensured, the polluter pays principle must not be circumvented and the normal functioning of secondary markets should not be distorted.
- Aid for the remediation of contaminated sites - where it is not possible to identify the polluter and ensure payment from them for repairing environmental damage, state aid may be justified if the cost of remediation is higher than the resulting increase in the value of the site.
- Aid for the relocation of undertakings – this kind of investment aid aims to reduce negative externalities by relocating companies that create significant pollution to areas where such pollution will have a less damaging effect.
- Aid involved in tradable permit schemes \* - these schemes may involve state aid in various ways eg. when member states grant permits and allowances below their market value.

- Aid in the form of reductions of, or exemptions from environmental taxes - these reductions/exemptions from environmental taxes usually involve certain sectors or categories of companies and may make it feasible to adopt higher taxes for other companies, ultimately leading to increased environmental protection.

**Note:** For the production of renewable energy and cogeneration operating aid may be granted in addition to investment aid to cover the difference between the cost of producing the energy and the market price for the energy concerned.

**Table 1** below illustrates the aid intensities for investment aid as part of eligible costs  
(Source: Community Guidelines on State Aid for Environmental Protection)

	<b>Small enterprise</b>	<b>Medium-sized enterprise</b>	<b>Large enterprise</b>
<i>Aid for undertakings going beyond Community standards or increasing the level of environmental protection in the absence of Community standards</i>	70% 80% if eco-innovation* 100% if Bidding process**	60% 70% if eco-innovation 100% if Bidding process	50% 60% if eco-innovation 100% if bidding process
<i>Aid for environmental studies</i>	70%	60%	50%
<i>Aid for early adaptation to future Community standards</i>			
- more than 3 years	25%	20%	15%
- between 1 and 3 years before the entry into force	20%	15%	10%
<i>Aid for waste management</i>	70%	60%	50%
<i>Aid for renewable energies</i>	80% 100% if bidding process	70% 100% if bidding process	60% 100% if bidding process

<i>Aid for energy saving</i>	80%	70%	60%
<i>Aid for cogeneration installations</i>	100% if bidding process	100% if bidding process	100% if bidding process
<i>Aid for district heating using conventional energy</i>	70% 100% if bidding process	60% 100% if bidding process	50% 100% if bidding process
<i>Aid for remediation of contaminated sites</i>	100%	100%	100%
<i>Aid for relocation of undertakings</i>	70%	60%	50%

\* Where the investment concerns the acquisition of an eco-innovation asset or the launching of an eco-innovation project, the aid intensity may be increased by 10 percentage points.

\*\* Where the investment aid is granted in a competitive bidding process – ensuring that the aid is limited to the minimum necessary for achieving the environmental gain, the aid intensity may amount up to 100% of the eligible investment costs.

### **Calculation of Eligible Costs**

Eligible costs must be limited to the extra investment costs necessary to achieve a higher level of environmental protection than required by the community standard. If this was not the case, any investment that increases the level of environmental protection would be eligible for environmental aid. Only state aid which has an additional effect on the environment should be authorised. Costs are calculated based on a reference investment – the investment which would have been made without state aid. It is a technically comparable investment that provides a lower degree of environmental protection and would credibly be realised without the aid. A detailed methodology for the calculation of eligible costs as well as compatibility guidelines for each aid category is discussed in chapter 3 of the Community Guidelines on State Aid for Environmental Protection.

## Assessment of State Aid

In assessing whether an aid measure can be deemed compatible with the common market, the Commission balances the positive impact of the aid measure in reaching an objective of common interest against its potentially negative side effects, such as distortion of trade and competition. The SAAP has formalised this balancing exercise in what has been termed a “balancing test” <sup>12</sup>. The balancing test is structured as follows:

- (1) Is the aid measure aimed at a well defined objective of common interest? – in the context of the new guidelines, the relevant common interest is the protection of the environment.
- (2) Is the aid well designed to deliver the objective of common interest?
  - (a) Is state aid an appropriate policy instrument?
  - (b) Is there an incentive effect - does the aid change the behaviour of companies?
  - (c) Is the aid measure proportional – could the same change in behaviour be obtained with less aid.
- (3) Are the distortions of competition and effect on trade limited, so that the overall balance is positive ?

This balancing test is applicable to the design of state aid rules as well as to the assessment of cases.

## Detailed Assessment

The new guidelines specify a number of conditions whereby a more detailed assessment of state aid is deemed necessary. The following aid awards must be notified individually to the commission:

1. investment aid: where the aid amount exceeds €7.5 million for one undertaking (even if part of an approved aid scheme);
2. operating aid for energy saving: where the aid amount exceeds €5 million per undertaking for five years;
3. operating aid for the production of renewable electricity and/or combined production of renewable heat: when the aid is granted to renewable electricity installations in sites where the resulting renewable electricity generation capacity exceeds 125 MW;



4. operating aid for the production of biofuel : when the aid is granted to a biofuel production installation on sites where the resulting production exceeds 150,000 t per year ;
5. operating aid for cogeneration: where aid is granted to a cogeneration installation with the resulting cogeneration electricity capacity exceeding 200 MW. Aid for the production of heat from cogeneration will be assessed in the context of notification based on electricity capacity.

The detailed assessment does not mean of course, that the envisaged State aid will be prohibited. It only means that the Commission will carefully check whether the aid is necessary and actually contribute to environmental protection without creating undue distortions of competition.

### **Block Exemption Regulations**

A significant new development is the proposal by the Commission to include environmental aid in the proposed General Block Exemption Regulation (GBER) which is due to be adopted before the 2008 summer break. Environmental aid is set to be exempted under the GBER. Member states would therefore be relieved from the notification obligation for certain types of environmental aid under a prescribed amount and would be able to use a simplified method to calculate the aid involved. The result would be a considerable reduction of the administrative burden and allow the Commission to focus more on the most distortive types of aid.

### **References:**

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2. Strategic report on the renewed Lisbon strategy for growth and jobs: launching the new cycle (2008-2010) - Keeping up the pace of change, COM(2007) 803 final.
3. State Aid Action Plan - Less and better targeted state aid: a roadmap for state aid reform 2005–2009 COM(2005) 107 final.
4. State Aid Action Plan, paragraph 10.
5. European Commission State Aid Scoreboard COM (2008) 304 final.
6. Community Guidelines on State Aid for Environmental Protection (2008/C 82/01).

June 2008

Environment and Green Technologies Dept.  
Mark Sweeney



7. Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions - 20 20 by 2020 Europe's climate change opportunity COM(2008) 30 final.
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9. Proposed Directive on the Promotion of the Use of Energy from Renewable Resources. COM (2008) 30 final.
10. A Community Strategy to Promote Combined Heat and Power (CHP) and to Dismantle Barriers to its Development COM/97/0514 final.
11. Action Plan for Energy Efficiency: Realising the Potential COM(2006)545 final.
12. State Aid Action Plan, paragraphs 11 and 20.

June 2008

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