

Reforming EU Environmental State Aid Policy: Who will Gain and Who will Lose?

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1. Introduction and research questions

How much can an EU Member State subsidize its wind power production? How big a tax exemption can it give to its hydroelectric power producers? Can it provide full public financing to Carbon Capture and Storage (CCS) projects in the petroleum sector? The answers to these questions are to a large degree dependent on the EU Guidelines on State Aid.¹ These guidelines sketch out the political and judicial specifics on how much a Member State² can give in terms of state aid, and to what projects and on what conditions this aid can be provided.

These days, EU state aid guidelines are changing. In June 2005 the European Commission launched a comprehensive reform of its state aid rules, under the banner of “less and better targeted aid” (European Commission 2005). In this context, also the specific *Environmental State Aid Guidelines* have been put under review, a document listing the rules and specifications on such issues as aid for energy saving, aid for renewable energy, and aid for improving on environmental standards. The consultation process on reforming the environmental guidelines is still on-going, and new rules are expected to be adopted early in 2008.

The environmental state aid reform has potentially significant implications for actors dealing with climate- or energy related issues in Europe. Throughout the process, stakeholders have no doubt been promoting different sets of technological and environmental solutions – each probably claiming to be more eligible for state aid and special treatment than the other. For instance, industry is likely to have pushed for higher aid levels for energy saving, whereas renewable energy actors are likely to have pushed for higher aid levels to renewable energy production. The petroleum sector, on its side, is likely to have worked for favourable rules relating to CCS. In other words, the reformed guidelines, once concluded, might leave both winners and losers, both in terms of which actors, which technologies and which energy sources it prioritizes.

The object of this study is to investigate the outcome of the reform, with an eye to revealing which actors and which interests have been politically prioritized. The study will pose the following main research questions:

- How do the new Environmental State Aid Guidelines differentiate between different actors, different technologies, and different sources of energy?
- How can this differentiation be explained?

¹ The EU Guidelines on State Aid consist of a number of issue-specific documents, such as the Environmental State Aid Guidelines, the Regional Aid Guidelines, the Risk Capital Guidelines, and the Research, Development and Innovation Guidelines (confer European Commission 2007c).

² EU state aid regulations also set the standard for the EFTA countries, due to the EEA agreement.

2. Preliminary empirical picture

As the process of reforming the environmental state aid regulations is still on-going, it is of course too early to give an exact record of what the reform has in hold for relevant stakeholders. However, some preliminary indications can be drawn from the policy drafts and the consultation process thus far (European Commission 2007a, 2007b). Among other things, it seems that the new environmental state aid regulations might entail

- *More state aid:* Both energy saving, renewable energy sources, cogeneration, district heating, and waste management is eligible for more state aid in the second draft of the environmental guidelines than in the current ones. However, the maximum levels of aid will vary between different energy sources and different technologies, between 10-30 percentage points as compared to the current levels (confer European Commission 2001, 2007b: 20-21).
- *New issues:* The new guidelines have, among other things, proposed to include District Heating (DH) as a technology/energy carrier warranting state aid – a new feature as compared to earlier state aid guidelines. Likewise, aid through tradable permit schemes is specifically addressed – another new feature in the environmental guidelines. In this context, the proposed guidelines clearly state that “no over-allocation of allowances can be justified”, and that the allocation cannot “favour certain undertakings or certain sectors, unless this is justified by the environmental logic of the system itself” (European Commission 2007b: 16, 35). In addition, CCS is likely to get special treatment, in line with what the Norwegian government is hoping for. This issue is still being negotiated within the EU and the Member States, and the specifics are still unclear. However, according to the second draft of the guidelines, state aid for CCS might be accepted, provided that the project is “of common European interest”, and that the project is of “great importance with regard to its volume” (Ibid.: 37-38). However, as opposed to what the Norwegian government is hoping for, the last draft clearly states that the Commission will consider projects more favourably if they are not fully financed by the state, and likewise if the project involves undertakings from several Member States (Ibid.).
- *More to SME's:* The new rules seem likely to entail a stronger favouring of small- and medium sized enterprises (SMEs). SMEs are given bonuses also in the current guidelines, but the differentiation between large and small enterprises seems likely to be further strengthened by the current reform.

A more comprehensive and detailed picture of what the reform has in hold will of course be presented once the policy-making process is concluded. Once the complete picture is gathered, though, how will it be dealt with analytically?

3. Theory and explanatory hypotheses

The study will take on a multi-level analysis approach, building on such contributions as Weale et al. (2000), Hooghe and Marks (2001), and Skjærseth and Wettstad (forthcoming 2008). This means that we will scrutinize possible determinants on EU environmental state aid policy both on a sub-national level, a national level, EU level, and also on a EU-external, or global level.

The first explanatory approach is based on the assumption that the final environmental state aid framework will reflect the interests of pivotal actors at the sub-national level, in this

context meaning dominant domestic industry- and energy actors.³ These key sub-national actors are expected to have lobbied actively up against the EU system to promote their interests in the making and shaping of the new state aid rules. It follows from this assumption that domestic actors of a certain size and “weight” will be more likely to succeed in pushing through their interests than smaller actors. Similarly, domestic actors with a high degree of internal unity and cohesion will be more successful than actors struggling with internal conflicts. Moreover, the degree of “Europeanization” of the domestic actor, that is, the strength of its respective euro-federations or cross-country partners (if it has any), will certainly be of relevance: the stronger and more resourceful the domestic actors’ euro-organization is, the stronger an influence it will have on EU policy-making. On the basis of these assumptions, we can formulate a first explanatory hypothesis with regards to the EU environmental state aid framework: *The environmental state aid framework will reflect the direct influence of the strongest and the most internally and cross-country-united industries and energy actors in the EU.*

As a second explanatory approach, we will assume that the environmental state aid framework is not influenced directly by sub-national industry and energy actors, as the first approach foresees, but rather that it is influenced primarily by the will of the Member States’ governments. This is an approach building, above all, on the work of Andrew Moravcsik (1991; 1998; 1999). According to Moravcsik, the key explanatory factor in EU policy-making is the Member States’ preferences. These preferences will indirectly reflect sub-national pressures, including the objectives of domestic industries. However, instead of these forces influencing directly on EU policy, this explanatory perspective assumes that sub-national forces will be channelled through the government, which acts as a “gate-keeper” between the national and the international realm. In practice, this implies that the Council of Ministers will be the most powerful player in the policy-making process, and that we should focus on the aims and priorities of the political executives in key Member States. This suggests the following explanatory hypothesis: *The environmental state aid framework will reflect the preferences of the most powerful Member State coalition in the Council of Ministers.*

A third explanatory perspective turns to the EU level, and focuses on the key political institutions of the “Brussels game”, in this context meaning the European Parliament and the Commission. Hooghe and Marks (2001) have been among the many scholars highlighting the influence of these institutions. The Parliament is increasingly functioning as a real and legitimate co-decider equal to the Council. Not least on green issues has the Parliament been said to take an active stance (Sbragia 2000; Weale et al. 2000). As for the Commission, this institution has a unique position, both in that it has monopoly on initiating new policies (such as the state aid guidelines) and in that it provides expertise and input throughout the whole decision-making process. Hence, the role of both the Commission and the Parliament should be closely investigated when it comes to the reform process of the state aid framework. As an explanatory hypothesis, we can postulate that *the environmental state aid framework will reflect the input and decisions made by the European Parliament and the Commission.*

Whereas the three explanatory perspectives presented so far have all focused on factors pertaining to the national or the EU context, a final explanatory approach zooms out and tries to capture some of the international circumstances which might be relevant for the development of EU state aid regulation. Analysts such as Skjærseth and Wettstad (2002) and Oberthur and Gehring (2006) have pointed to the fact that EU policy-making is increasingly being influenced by factors and institutions outside of the EU itself. In the context of EU state aid policy making, it seems reasonable to view both the international climate regime

³ One could of course argue that also environmental organizations are concerned with, and thus might have had an influence on, environmental state aid policy. However, for the purpose of this study, and for the overall purpose of the Canes project, we will primarily focus on the interests of energy- and industrial actors.

(UNFCCC and the Kyoto Protocol), with its environmental- and climate objectives; and the World Trade Organization (WTO), with both its environmental- and its competition objectives; as potentially relevant international factors. Could it be that the norms, regulations and objectives of the UNFCCC or the WTO have had an influence on how EU state aid regulations should be designed? The scenario is embedded in the final explanatory hypothesis of the study: *the environmental state aid framework will reflect the aims and objectives of relevant international regimes, more specifically the UNFCCC and the WTO.*

4. Disposition and time schedule for the study

We propose the following disposition of a first, broad study on the recent environmental state aid developments:

- 1) Introduction: mapping out the background of the study and presenting the research questions
- 2) Analytical framework: specifying the dependent variable as well as the theoretical and methodological framework
- 3) Empirical record: partly mapping out the EU environmental state aid developments in a historical perspective, but first and foremost mapping out the recent developments and current regulations after the 2005 reform
- 4) Analysis: assessing the different hypotheses up against the recent empirical record
- 5) Conclusions and recommendations for Nordic stakeholders

The first article will be finished sometime during the spring/summer 2008. Interviews will be starting up in January/February 2008.

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