

Europakommisjonen
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Public consultation on the guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post 2021 (HT.582) – Norway

Reference is made to the European Commission's consultation on the draft new State Aid Guidelines on ETS compensation of 14 January 2020 (hereinafter "the Draft Guidelines"). The Norwegian Government would like to thank the European Commission for the opportunity to comment.

The main points of the Government's comment are set out below. First, we would like to give some introductory remarks:

1. The Government fully supports the objectives of the ETS Guidelines to address the risk of carbon leakage due to indirect ETS costs while minimizing competition distortions and maintaining the incentives for a cost-effective decarbonisation of the economy.
2. Furthermore, the ETS Guidelines should safeguard the following principles:
 - Incentives for reduced energy consumption and reduced emissions should be maintained
 - Emphasizing equal treatment of undertakings facing the same risk of carbon leakage
 - Prioritizing undertakings that have the highest risk of carbon leakages
 - Avoiding aid dependency
3. Norway has welcomed the EU's efforts to reduce the large over-supply of allowances in the EU ETS, inter alia through the establishment of a market stability reserve. A higher price on EUA allowances encourages action and provides stronger incentives for investment in low-emissions solutions. However, increased ETS prices means that ensuring a compensation system targeted at those companies with an actual and high risk of carbon leakage is all the more important.
4. The ETS State Aid Guidelines are part of the Commission's European Green Deal initiative to achieve climate neutrality by 2050. It is, however, important that the

Guidelines effectively contribute to, and not in effect risk undermining, the achievement of the European Green Deal and the Paris Agreement climate targets. We would, in particular, stress the importance of equal treatment of *undertakings* with the same risk of carbon leakages. The industry has an essential role in developing sustainable products and solutions that are highly needed in the green transition. To achieve our ambitious climate goals, we cannot risk squeezing out undertakings that are in the front of developing eco-friendly products and solutions.

5. As regards the Norwegian processing industry, several undertakings operate with a high environmental standard. Several undertakings are considered as frontrunners with regard to eco-friendly technology and technology competence. The Norwegian processing industry consists of undertakings producing raw materials or intermediates that are exported to the EU or globally for further processing of goods. The industry operates in markets with strong competition and limited possibilities for individual undertakings to increase product prices without substantially reducing sales. The raw materials and intermediates from the industry are in many cases key components for other undertakings in the EU, producing eco-friendly products or solutions. Three examples:
 - Norwegian aluminium makes vehicles lighter and enables the production of hybrids and electric cars.
 - Norwegian nickel is an essential component in the production of batteries.
 - Advanced biochemicals from the Norwegian paper and pulp industry enables converting from traditional petrochemical products to a wide spectre of renewable-based products.
6. The power generation in Norway consist of about 98 per cent renewables (hydropower). This is unique both in a European and in a global context. The emission of climate gases from the Norwegian energy intensive industry comes almost entirely from the industrial process. Since 1990, the energy intensive/processing industry in Norway has reduced its process emissions by 40 per cent while output has increased. As power costs is their most important cost element, the undertakings are constantly working to increase energy efficiency. Over the last twenty years, the power consumption within the Norwegian processing industry, considered in relation to their value added, has reduced by 15 per cent.¹
7. Despite the Norwegian power generation being almost entirely renewable, the Norwegian consumers of power face power prices that are heavily influenced by European power prices, which are directly affected by CO₂-costs. This is due to the number of interconnectors and Norwegian hydropower producers with reservoir capacity. The ability to store power and assess the power price in the market before making a production decision implies that Nordic water values and prices are dependent on future electricity price expectations both in the Nordic region and on the

¹ Based on fixed 2015-prices, which corresponds to a 44 per cent reduction based on current prices.

Continent, and are strongly linked to the marginal cost of fossil fuels, including CO₂ costs.

8. In order to ensure equal treatment of undertakings facing the same risk of carbon leakage, the European Commission should ensure that Norwegian data have been taken into account.

The Government would stress the lack of transparency regarding the data and analysis underlying the Draft Guidelines. Access to this information is necessary for the States' proper assessment of the European Commission proposal, and in particular regarding eligible sectors and the carbon factor. Although the data applied by the European Commission's external consultant as such may be publicly available, it is in practice not feasible for national authorities to gather and properly analyse the relevant data within the short time frame of this consultation. In order to have an informed process and assessment of the European Commission proposal, the Government would ask that the European Commission give the States access to this information.

The Government notes that several issues are not resolved in the proposed Guidelines, including the regional carbon factors. The Government assumes that the Commission will involve the States in the further discussions on these issues.

Eligible undertakings

As expressed in the Draft Guidelines, an ambitious regional climate policy demands careful attention to the possible risk of carbon leakage. Otherwise, production capacity may be transferred from the EU ETS area to other countries with a less ambitious climate policy. This may happen either gradually due to less re-investments in European plants or more immediate due to shutdowns of European plants while new capacity is being established outside Europe. If this materialize, the reduction in global emissions will be limited. In addition, and of equal importance, industrial competence that form key building blocks of a decarbonized Europe may crumble.

The Draft Guidelines presents a list of eighth sectors deemed eligible for CO₂-compensation. In addition, the Draft Guidelines indicate a possibility of including additional sectors based on qualitative considerations.

The Government considers that an assessment of carbon leakage solely based on NACE levels, as applied in the Draft Guidelines, would result in unreasonable consequences for individual undertakings that would individually qualify for compensation based on the proposed criteria. In addition, the Government considers that such an approach would probably have adverse effects on achieving the ambitions of the European Green Deal.

The sector-based methodology proposed in the Draft Guidelines should therefore be supplemented by qualitative assessments making it possible to include *undertakings* that have high scores on the quantitative criteria and which are considered to be in line with the Guidelines' objective. In a Norwegian context, such a safety net mechanism would first and

foremost concern producers of nickel, fertilizers, petrochemicals and advanced biochemicals. A second-best solution would be a safety net mechanism allowing for a more detailed and thorough assessment of subsectors/prodcom level to ensure that the objective of equal treatment of companies facing the same risk of carbon leakage is maintained. If such a safety net mechanism cannot be implemented, the Government considers that the proposed threshold of eligibility needs to be lowered in order to ensure inclusion of all undertakings facing the same substantial risk of carbon leakages due to significant indirect emission costs passed on in the electricity prices.

Carbon pass-through factor

The Government would express two major concerns when it comes to power markets and carbon pass through factor. Firstly that, although mainly fossil-free, the price formation in the Norwegian and Nordic power market is strongly influenced by the ETS price. Secondly, we would like to underline that Norway is strongly connected with our Nordic neighbours, and that the Nordic countries form a synchronized common power market.

We would stress that the proposed method for calculating the actual pass through of carbon costs in the electricity prices is not a suitable method for Norway and the Nordic region due to specific features of the price setting mechanisms in our electricity market. These considerations have been fully taken on board by the European Commission under the current Guidelines.

Under the current Guidelines, a Nordic region is defined for the purpose of calculating and applying a common factor for the carbon impact on the electricity price (the carbon factor). The Nordic region comprises Norway, Sweden, Finland and Denmark. The European Commission argues in the Draft Guidelines, based on a narrow price convergence test, that there is no longer a Nordic region in this respect, and that Norway and Denmark now form separate geographic areas. Sweden and Finland remain one region. The European Commission has not given access to the data supporting this conclusion.

The Government would ask the European Commission to further explain the methodology and facts and substantiate in what way and to what extent facts underlying the identification of the relevant geographic area(s) in the Nordic power market factor have changed. The Government would furthermore reiterate its request that the European Commission give access to all relevant data concerning its assessment of the geographic carbon factor areas, for the States to be able to fully assess for themselves the identification of the relevant regions.

An external report on the carbon price transfer factor in Norwegian electricity prices recently carried out by Oslo Economics/SWECO for the Ministry of Petroleum and Energy² explains the Norwegian and Nordic power market. The report calculates both a Norwegian and

²Study of the carbon price transfer factor in Norwegian electricity prices, Oslo Economics/SWECO, 26 February 2020.

common Nordic carbon transfer factor. The two factors are identical. The report is attached. There are also other reports confirming these findings.³

The Government would furthermore argue that a narrow price convergence benchmark does not reflect real market conditions. A common and efficient market is not necessarily characterized by identical prices, but of a co-variance of prices (correlation). Different areas will not have identical prices until the transmission capacity between them is not a limitation factor and all bottlenecks are removed. This is not economically viable as it would require excessive investments in transmission capacity. Prices could also be kept equal by intervention in the power market, which is the case in some areas. However, such intervention does not create a well-functioning power market, but rather the opposite.

The Nordic power region, of which Norway is a part, is not merely interconnected. It is a fully synchronized power market, and one of the most liquid power markets in the world. There is a Nordic power exchange, NordPool. The Nordic power market also has a set of common market rules and institutions.

The Government would request that the European Commission reconsiders its methodology for defining relevant regions as well as its conclusions regarding the Nordic region. It is the Government's opinion that Norway should be part of the same region as Sweden and Finland.

Carbon factor

Notwithstanding the issue of regions, a decisive issue for the Government is to ensure that the methodology applied for calculating the carbon factor reflects the actual carbon pass through factor on electricity prices. Although to a very large extent hydro powered, there is a strong carbon impact from continental fossil fuels on Nordic and Norwegian electricity prices. This fact is fully recognised in the current Guidelines, where the carbon factor for the Nordic region, including Norway, is 0,67.

The Government would point out that the methodology for calculating the carbon factor in the proposed Draft Guidelines, which is identical to the methodology under the current Guidelines, is based on a Continental power situation and does not reflect the price formation in the Nordic/Norwegian, mainly non-fossil, power market. The Government would stress that, in order to achieve the objective of the Guidelines and not to put Nordic producers at a competitive disadvantage, the methodology for calculating the carbon factor for the Nordic region/Norway must fully take into account the specific features of the Nordic/Norwegian power market. The carbon factor must therefore be calculated applying power market models.

Norway would be available for further discussions on the methodology for calculating the carbon factor for the Nordic region.

³ NVE Langsiktig kraftmarkedsanalyse. Norskindustri_nordiccarbontransferfactor

Price formation and transfer factor of ETS in Norwegian power prices

Electricity prices (in a deregulated and efficient market) are determined by the cost of generating one additional unit of electricity, and the prices in interconnected markets influence each other through imports and exports. Norway is characterized by electricity generation with very low CO₂ emissions and a large hydro reservoir capacity. The hydro reservoirs work as a giant battery.

The combination of interconnection, the ability to shift production between periods (and scarcity of water) means that the Norwegian power prices are highly influenced by European power prices. The cost of CO₂ emissions is important for the power prices in European markets, and thereby for the power price in the Norwegian market. The CO₂ price influence on Norwegian power prices is not only a theoretical effect but can also be observed in historic price data, as confirmed by the 2020 external report.

Hydropower producers with reservoir capacity have the ability to store power. The producers will assess the power price in the market before making a production decision. This, and the interconnections with European markets which are still dominated by thermal power on the margin, result in the carbon price influencing the Norwegian power price.

Norway looks forward to further working with the Commission on the Guidelines.

Yours sincerely

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