



Contribution to the public consultation on Guidelines on certain State aid measures in the context of the system for greenhouse gas emission allowance trading post 2021

Key messages

- There are several elements in the draft text that undermine the effectiveness of the provisions to prevent the risk of carbon leakage. For example, limiting the state aid intensity to 75%, exclusion of sectors in the steel value chain such as industrial gases, mining of iron ores and tubes result in a low level of compensation, up to less than 50% of the actual indirect costs.
- The default aid intensity should be increased to 100% of the benchmark OR there should be a possibility for member states to grant compensation beyond 75% as an important step to reduce indirect costs to eligible sectors.
- The additional compensation should be set so that indirect costs are capped at 0.5% of the GVA and it should be open to all eligible sectors and not restricted only to some of them. It should also be accessible to both the electric arc furnace (EAF), using large amount of electricity to melt and recycle scrap, and the integrated route, which consumes electricity produced from the combustion of recovered waste gases generated unavoidably by the steel making process.
- Compensation does not distort incentives for energy efficiency investments and thus it should not be made conditional. Compensation is based on very strict benchmarks. Making state aid conditional to additional measures to be taken by the company, de facto it is not anymore a (partial) reimbursement of incurred costs as it requires additional costs to the company.
- The fall-back benchmark (80% of reference electricity consumption) should not be reduced further, since it entails already a major reduction of aid.
- The steel industry (NACE code 2410) is recognized as eligible for indirect costs compensation in the draft Guidelines. However, the consultants' study classifies the sector only at medium risk. There is clear evidence indicating that steel is at very high risk of carbon leakage.

Introduction

The EU ETS Guidelines are an essential element of the legal framework that aims at preventing the risk of carbon leakage. In line with the EU ETS Directive, the objective of both free allocation and indirect costs compensation is to avoid undue costs at the level of best 10% performers in the EU. The Guidelines should be developed and implemented in all Member States in view of reaching that objective. This is even more urgent now due to the higher CO₂ price compared to phase 3. Electrification is one the key elements to reduce the CO₂ emissions of the industry which means that the electricity consumption in the steel sector will increase further. Also, proposals in the European Green Deal are expected to rise the price of CO₂.

Indicative impact assessment of the draft Guidelines on the steel sector

The steel industry (NACE code 2410) is recognized at risk of carbon leakage in the draft Guidelines and hence is eligible for compensation of indirect costs. Still, several elements of the draft text undermine significantly the effectiveness of the provisions to prevent the risk of carbon leakage because they result in a very low level of compensation when compared with the actual indirect costs of a steel site. Due to several restrictions mentioned in the Guideline, the compensation could cover even less than 50% of the actual indirect costs to a steel producer. Thus, these elements of the draft Guidelines need to be improved to

provide effective prevention of the carbon leakage risk.

Default aid intensity and possibility for additional aid

The steel sector is highly exposed to carbon leakage risk linked to indirect costs. The steel sector is unable to pass through unilateral regulatory costs without genuine risk of losing market shares. This risk is even more relevant as the CO₂ price has risen, compared to the situation until 2017. The decisions based on the proposals in the European Green Deal is expected to further rise the price of CO₂.

Affordable and competitive electricity prices are essential to facilitate the transition to breakthrough technologies which require even larger amounts of electricity. Therefore, it is important to set the aid intensity at 100% of the benchmark; any reduction of the aid intensity below the benchmarks undermine the effectiveness of the carbon leakage provisions as long as there is no comparable climate legislation in competing countries. Especially the energy intensive industry needs strong incentives to electrify its processes.

Even 100% aid intensity would not mean full compensation of indirect costs, as it would still be capped by the very strict benchmarks. For instance, in fall-back benchmarks, it would still be reduced by 20% compared to the baseline electricity consumption; i.e. with the current 75% aid intensity level fixed in 2020, the installations in fall-back may receive compensation only for 60% of the indirect costs (75% of 80%). This is far below the maximum aid intensity level according to EU state aid rules.

If the default aid intensity is not increased to 100% of the benchmark, introducing the possibility for member states to grant additional compensation beyond the default value is an important step to reduce indirect costs to eligible sectors. **The additional compensation should be set so that indirect costs are capped at 0.5% of the GVA.** This possibility should be open to **all eligible sectors** and not restricted only to some of them.

Furthermore, it should be accessible to both the electric arc furnace (EAF), which has very high electro-intensity because it uses large amount of electricity to melt and recycle scrap, and the integrated route, which consumes electricity produced from the combustion of recovered waste gases generated unavoidably by the steel making process. Financial compensation for this case is explicitly mentioned in recital 13 of the post 2020 EU ETS Directive in order to preserve the incentive to recover waste gases, since free allocation is granted only partially for waste gases' emissions. Therefore, if the option of granting additional aid beyond 75% is retained, it should consider not only the electro-intensity, but also the actual carbon leakage risk and the environmental purpose of the state aid (i.e. promoting the recovery of waste gases).

Finally, it should be noted that undertaking specific assessment need to take into account the actual specificities of the sites. The GVA of companies is highly dependent on their structure, including the configuration of the production steps where the higher share of value added is generated. Hence, a site assessment would also be necessary where appropriate. Furthermore, company-specific assessment on electricity consumption should not lead to unintended results in case energy efficiency measures that have been already implemented.

Conditionality

Compensation should not be made conditional on additional requirements. Compensation is a measure aiming to reimburse partially the energy consuming sectors for the indirect costs passed on in the energy bill. If state aid would be made conditional to additional measures (i.e. investments in energy



efficiency or emission reductions and carbon free power purchase agreement,) de facto it is not anymore a (partial) reimbursement of incurred costs since it requires additional expenditure to the company. As the eligible sectors are acknowledged as being at risk of carbon leakage (on the basis of market characteristics, profit margins and abatement potential), the missed reimbursement would create the conditions for the materialization of such risk, leading to an increase in global emissions.

To remain competitive, energy efficiency improvements are a continuous on-going process for energy intensive industry. There is always an incentive for energy efficiency investments as compensation of indirect costs is based on very strict benchmarks reflecting the best performance in the sector. Also, the state aid intensity covers only 75% of the full benchmark. Furthermore, the benchmarks will be updated during the phase 4, so companies will have further interest in improving performance, where technically possible.

It is worth noticing that the proposed conditionality requirements are actually linked to other legislation, i.e. the Energy Efficiency Directive and the Renewable Energy Directive). However, Member States retain the possibility of adopting different instruments to promote energy efficiency and renewables to achieve the targets set in such legislation. Thus, the conditionality requirements would overlap and possibly collide with different national measures.

The three proposed conditionality requirements present several specific limitations that do not reflect with current reality:

- The energy efficiency investments with a payback period of 5 years do not reflect the reality of business decisions in the steel sector, which are bound to significantly shorter periods. Also, the Guidelines should take into account early actions such as recent energy efficiency investments.
- The requirement to install an on-site renewable energy generation facility covering at least 50% of the electricity needs does not currently match at all with the very large energy consumption of industrial sites and the physical limits of such on-site generation.
- The requirement to invest at least 80% of the received state aid into investments to reduce direct emissions of the installation is not consistent with the scope of the Guidelines which are targeting indirect costs and preventing carbon leakage.

Update of the fall-back benchmark

The draft guidelines do not indicate the default value of the fall-back benchmark. In phase 3, this was 80% of the reference electricity consumption. Since this represents a major reduction of aid, it should not be reduced further, otherwise the state aid would be insufficient to achieve its objective of avoiding the risk of carbon leakage. It should also be noted that the reference fall-back benchmark in the free allocation rules for direct emissions is the process emissions benchmark, which is much higher than the electricity fall back benchmark (97% of historical process emissions) and most importantly has not been further reduced between phase 3 and phase 4.

Outokumpu Oyj, EU Transparency Register ID: 085686030231-69
Salmisaarenranta 11, 00180, Helsinki, Finland

More information: Mia Nores, Head of Low Carbon and Energy Efficiency
mia.nores@outokumpu.com, +358 44 330 0928