How EU State Aid Rules Affect the Design of Environmental Taxes

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Outline of My Presentation

- Why are environmental taxes important?
- State aid and environmental taxes – in general and in a Swedish context
- Why is state aid so difficult?
- Interaction with the EU Commission (DK, FIN, SE) and EFTA Surveillance Authority (IS, NO)
- EU State Aid Modernisation Process – what will life look like post 2022?

Note. My presentation relates to a Swedish perspective vs the EU Commission; to a large extent similar provisions apply from the EFTA countries perspectives vs EFTA Surveillance Authority (ESA).

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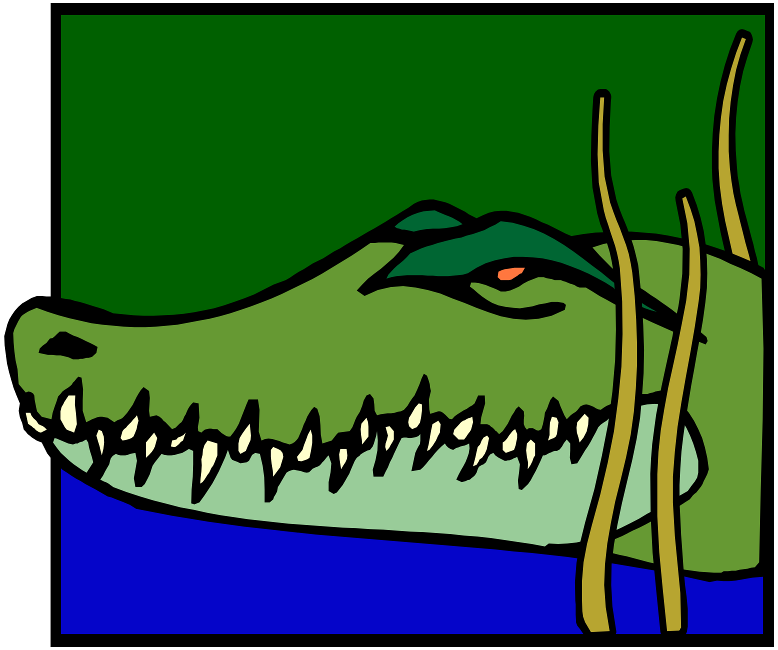
Why are
Environmental Taxes Important?

How to reach Climate, Environment and Energy Policy Goals?

Using environmental taxes in a cost-effective way

- … is Sweden's primary instrument to reach set goals
- … is easy to administer and gives results
- … may need to include state aid elements to ensure best environmental results at an aggregated level



Overview of Swedish Environmentally Related Taxes

	Revenues Billion € ($)[1] 2018	Introduced in
A. Energy tax	**4.82 (5.59)**	
- electricity	2.41 (2.80)	1951
- petrol	1.13 (1.31)	1924
- other fossil fuels than petrol	1.28 (1.49)	From 1937
B. Carbon tax	2.31 (2.68)	
- petrol	0.74 (0.86)	1991
- other fossil fuels than petrol	1.57 (1.82)	1991
C. Other environmentally related taxes	**0.15 (0.17)**	
- tax on sulphur	0.00 (0.00)	1992
- tax on pesticides	0.01 (0.01)	1984
- landfill tax	0.02 (0.02)	2000
- tax on natural gravel	0.02 (0.02)	1997
- tax on air travel	0.10 (0.12)	2018
D. Vehicle related taxes	**1.65 (1.92)**	
- tax on motor vehicles	1.28 (1.49)	1922
- road user charges	0.10 (0.12)	1998
- tax on congestion	0.27 (0.31)	2006
Total (A+B+C+D)	**8.93 (10.36)**	

[1] Prognosis.

Exchange rates used throughout this presentation 1 € = 10.33 SEK; 1 $= 8.90 SEK

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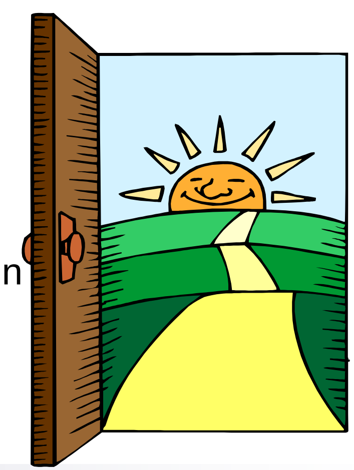
The Swedish Context

Increased Focus on Environmental Taxes

- **Until 1980's**: Primarily fiscal purposes for taxes
  - Generally low tax levels on energy sources
- **1990's and onwards**: Environmental issues given high priority by Government and citizens
  - Increased focus on environmental taxes to incentivize a changed behavior
  - Carbon tax along with energy tax on energy sources
  - Other areas than energy (e.g. waste, pesticides, air travel)
  - Increased tax levels, step-by-step
- **Now**:
  - New taxes are looked into (e.g. single use plastics, chemicals in clothes and shoes)
  - Planned green tax shift 15 billion SEK (~ 1.5 billion €) during the next 3 years



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State Aid and Environmental Taxes –
in general and in a Swedish context

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Basic Points ….

- The EU State Aid Rules are fundamental for the well-functioning of the Internal Market
  - "A small country's best friend"
  - Ensures efficient use of Government resources
  - Avoids "state aid race" between Member States and ensures a fair competition
- However, environmental tax aid merit special considerations – why?
- The very purpose of an environmental tax is to make firms change their behaviour = distorts competition!

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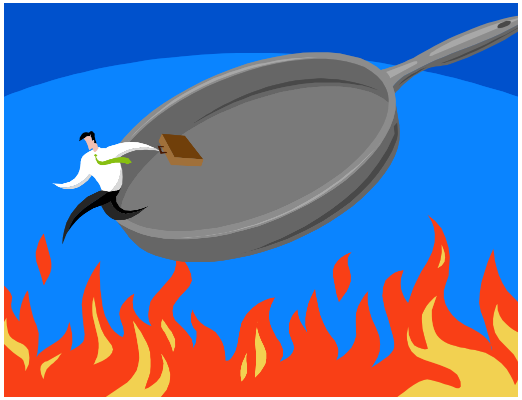

If State Aid Rules are not Observed ….

- Complaints to the Commission
- Unlawful aid should be recovered from the aid beneficiaries – *maintain a level playing field in the internal market*
  - “Ignorance of EU law excuses no one.”
  - No excuse to act in line with national law
  - Aid recovered retroactively for 10 years including interest
- Infringement procedures if a Member State does not recover unlawful aid
  - Example. ECJ imposed a 2 million € fine on the Greek Government for failing to recover 25 million € in state aid illegally granted to Olympic Airways. The fine increased by 16,000 € a day until the aid was repaid. (C 369/07, 7 July 2009)

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Recovery decisions by the EU COM ….

… to re-establish the situation that existed on the market prior to the granting of the unlawful aid

Recovery decisions since 1 January 1999

No. of recovery decisions adopted

Year	EU	AT	BE	BG	CY	CZ	DE	DK	EE	EL	ES	FI	FR	HR	HU	IE	IT	LT	LU	LV	MT	NL	PL	PT	RO	SE	SI	SK	UK
1999	24						10			2	4		2				5					1							
2000	16		3				8						2				2					1							
2001	20						6				10		1				1					2							
2002	25		2				14			1	3		2				1					1		1					
2003	10						5				2		2				1												
2004	24		1				8	1		1	3		4				5									1			
2005	11						2			1		1				1	4					1	1						
2006	7						1			1			1									2		1				1	
2007	11						1			1	1		1			1	4						2						
2008	15	1					1			2			1		1		5						2		1	1			
2009	8							1		1	2						3												1
2010	8						2						2		2		1							1					
2011	12			1			1			3	1	1	1				2							2					
2012	12		1				2			1	1	1	1		1	1	1									1	1		
2013	9		1				1				2		2				1					1						1	
2014	18		3	1			4			1	2		3				2						1					1	
2015	16				1				1	1			2				4		1			1	1	1	2				1
2016	11	1	2								4				1	1	2												
2017	6									1	1						1		1		1		1						
2018	7						1				1		1						1						2				1
Total	270	2	13	2	1		67	2	1	17	37	3	28		5	4	45		3		1	10	8	6	5	3	1	3	3

Swedish Example

State Aid Case Energy tax on electricity for manufacturing industry

- Swedish iron ore mines extracts > 90 % of all iron ore in the EU – most major competitors outside the EU do not pay any tax on electricity
- A Swedish manufacturing industry pays energy tax of 0.5 €/MWh for electricity
- The tax rate for manufacturing industry is deemed to be selective in comparison to other business (see e.g. ECJ C-143/99 Adria Wien)
- A Swedish grocery store pays 34 €/ MWh for electricity
- Electricity tax rate for industry is one of the largest monetary state aid schemes in the EU
- Is it fair to say that an iron ore company receives aid?
- It would never be politically feasible to apply 34 €/MWh for industry ….

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Some Swedish Statistics ….

- Total state aid (excl. agriculture) 4.3 billion €
- State aid for environmental protection incl. energy savings: 3.1 billion €
  - Close to 90 per cent environmental tax state aid
  - 19 different aid schemes energy and carbon taxation
    - 16 aid schemes under General Block Exemption Regulations (GBER, FIBER), 3 COM decisions based on Environmental and Energy Guidelines (EEAG)
  - Largest scheme lower energy tax on electricity for industry: ~ 1.3 billion €
- So … what's so special about environmental taxes??

[1] EU Commission State Aid Score Board 2018 (figures for 2017)
http://ec.europa.eu/competition/state_aid/scoreboard/state_aid_scoreboard_2018.pdf

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Incentive Effect …

…. in relation to environmental taxes

- Incentive effect is one criteria for compatible aid
- Aid in the form of a tax exemption to certain firms
  - …. gives them a direct incentive to change <u>their</u> behavior, e.g. reduce emissions, or
  - …. enables a higher tax level for <u>other firms</u>, thus indirectly contributing to an overall higher level of environmental benefits to society ("indirect incentive effect").

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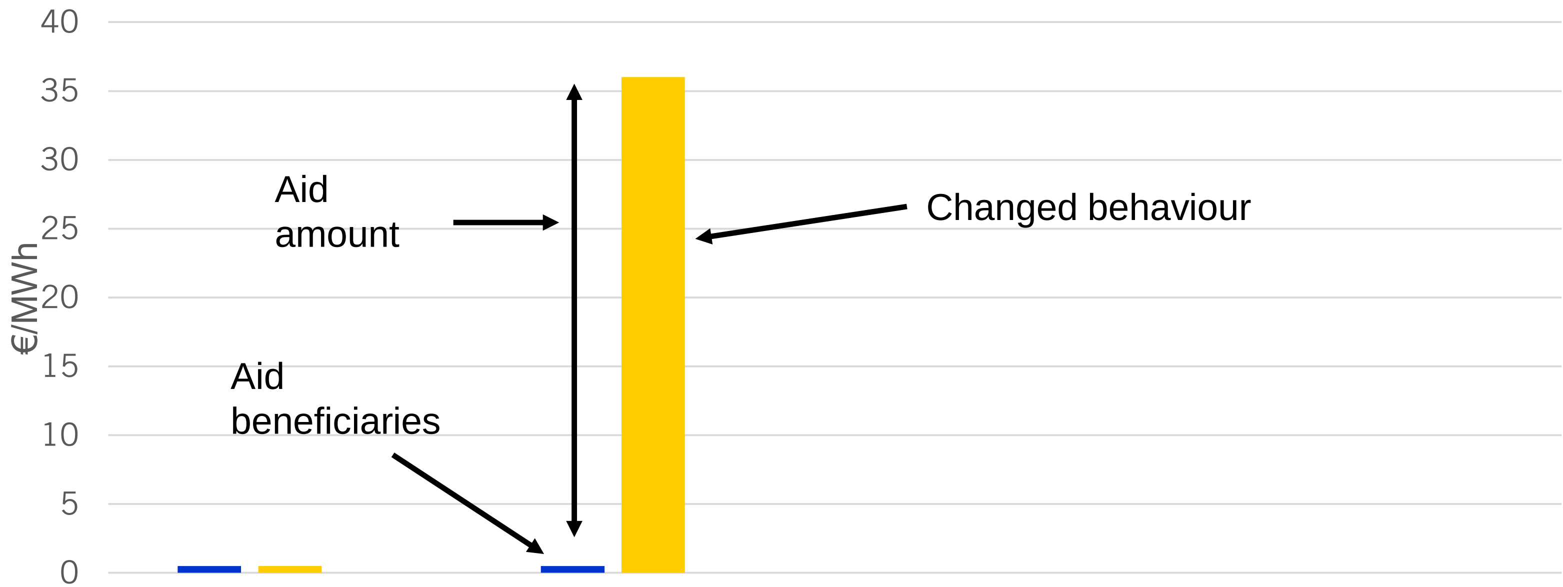
Indirect Incentive Effect

P. 168 of 2014 Environmental and Energy Aid Guidelines (EEAG)

"Indeed, granting a more favourable tax treatment to some undertakings may facilitate a higher general level of environmental taxes. Accordingly, reductions in or exemptions from environmental taxes, including tax refunds, can at least indirectly contribute to a higher level of environmental protection. However, the overall objective of the environmental tax to discourage environmentally harmful behavior should not be undermined. ….".

Example Sweden

Indirect incentive effect energy tax rates on electricity to different business sectors



Blue = industry; yellow = service sector. Left staples EU minimum (Directive 2003/96/EC); right staples Sweden

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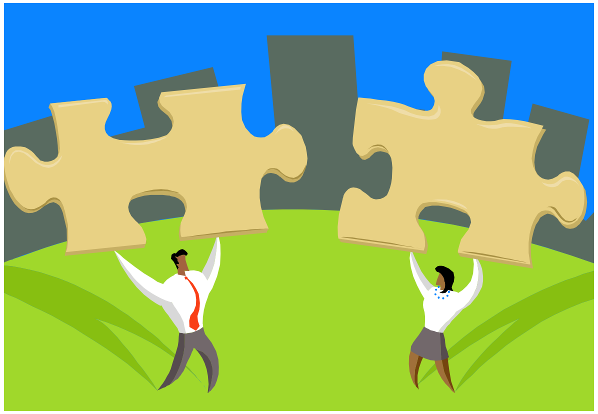
Why is State Aid So Difficult?



Why is it Hard …

… to advise policy makers on state aid assessment? (I)

- Hard to predict …
  - ECJ Court rulings, EU COM notices and guidelines, EU COM cases
  - Especially difficult when exploring a new area of policy design
- Even if a tax differentiation is allowed under an EU Directive, it is not necessarily OK in a state aid perspective
  - The Ecofin Council decides on Tax Directives, but the ECJ and the EU COM uphold the main competence on state aid
- If aid is found to be unlawful, the beneficiaries take the blame …
- Takes time …
  - If a General Block Exemption Regulation is not used, minimum 6 months to handle from date of formal notification to DG Competition to decision
  - COM guidelines, regulations and state aid decisions are time limited

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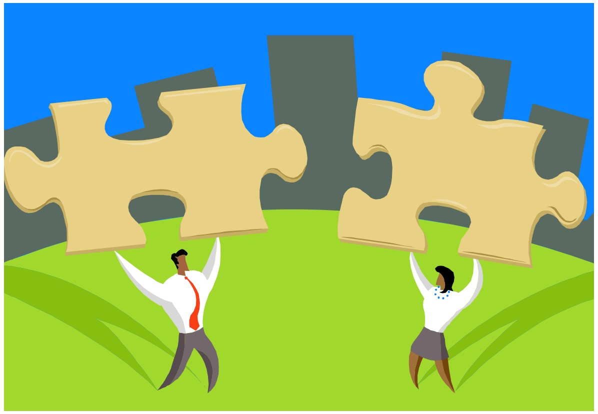

Why is it Hard ….

…. to advise policy makers on state aid assessment? (II)

EU State Aid provisions may seem logical for individual grants, but not as logical and more difficult to apply to environmental tax schemes – *why?*

- Tax measures are generally open to a large number of economic operators, based on tax law decided by national parliaments
  - Ensures a cost-effective incentive to reach set environmental targets
  - No room for any discretionary measures, all operators are to be treated equally
  - If risks of overcompensation occurs, it is not likely that those risks can be remedied on an individual firm by firm basis
- Administrative complexity, no long-term predictability
  - State aid cannot be given to firms in difficulty – difficult to administer in a tax scheme
  - EU Transparency Data Base – listing individual aid beneficiaries and amount of aid, tax confidentiality concerns …. https://webgate.ec.europa.eu/competition/transparency/public?lang=en

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Interaction with
EU COM (DK, FIN, SE) and ESA (IS, NO)

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Contacts Sweden ./. DG COMP - *from designing of aid and notification to ex post monitoring*

- Bilateral contacts relating to the environmental tax area
  - Pre-notification stage
  - Notification process or General Block Exemption Regulation (GBER)
    - GBER makes life easier for MS and DG COMP (96 % of all new aid cases in the EU)
  - Annual reporting to scoreboard http://ec.europa.eu/competition/state_aid/scoreboard/index_en.html
  - If applicable, overcompensation reports and discussions on how to eliminate future risks of overcompensation
  - Publication of individual aid on State Aid Transparency Website https://webgate.ec.europa.eu/competition/transparency/public/search/home/
  - DG COMP ex post monitoring of certain aid schemes
  - Recovery of aid (to be avoided!! An administrative as well as a political nightmare. 2004 Swedish recovery of energy tax on electricity for industry.)
- Lobbying when EU legal acts are revised, such as GBER and EEAG

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Lessons Learned I

- Never too early to start discussions with DG COMP …
  - Alternative ways of tax design and what arguments need to be brought forward
  - DG COMP officials want to help you!
- Explore options available within EU law, mainly
  - No state aid
  - State Aid Assessment by COM (Legal certainty non-aid?; Compatible aid – GBER?; guidelines; Treaty?; Case-law?; Harmonised tax legislation?)
  - Ensure non-discriminatory and non-protective treatment of imported good in the same situation
- Understand the logic behind the state aid rules
  - Express your national reasoning for aid in state aid terms
  - Ensure that the logic is clearly expressed in your national legislation

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Lessons Learned II

- A notification process takes time … in political life timing is crucial
  - Notify as early as possible in your legislative process.
  - Compatibility with state aid rules needs to be part of national political discussions.
  - Do not put a state aid notification as the last point on your “to do list” – your legislation cannot come info force until aid elements are approved by the COM or can be introduced under GBER.
  - Amendments of your notified scheme may prove necessary. Having to go back to your Parliament before agreeing to even minor changes is time-consuming.
- Prepare early for re-notifications of prolongations
- Remember that ….
  - Even if a tax differentiation is OK according to an EU tax directive, your national implementation may still involve state aid => state aid assessment is necessary.
  - Recovery of unlawful aid has to be carried out even if the beneficiaries have acted in line with national legislation.

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EU State Aid Modernisation Process –

what will life look like post 2022?

EU State Aid Modernisation (I)
– help or hindrance to reach climate and environmental goals?

- Many EU Guidelines and Block Exemption Regulations expire 31.12.2020; The EU COM has proposed prolongation until 31.12.2022 to allow further consultations.
- The design of especially the EEAG and the GBER are crucial enabling Member States to implement cost-effective environmental taxes.
- P. 34 b of the Swedish Government January 2019 agreement with the Center Party and the Liberals: *"EU state aid rules and other aid schemes shall be reformed in order to contribute to and not counteract a fossil free society and the implementation of the Paris Agreement."*

EU State Aid Modernisation (II)

Provisions important to maintain post 2022

- Simplified procedures for aid within EU harmonised taxation <u>above</u> minimum tax levels
- GBER for bulk part of aid schemes
- Acceptance of Indirect Incentive Effect
- Special considerations for tax aid when publishing individual aid data on public website
- Acknowledge that all sustainable biofuels is part of the solution and not a problem for a fossil free society

EU State Aid Modernisation (III)

Challenges for design of EU state aid provisions post 2022

- Design of guidelines and GBER are crucial as it is hard to get COM state aid approvals based directly on the EC Treaty
- Balancing test: *"Balancing the negative effects of an aid measure on trade and competition in the common market with its positive effects in terms of a contribution to the achievement of well-defined objectives of common interest."*
- So, how to design the guidelines and the GBER …
  - … strict enough to ensure a level playing field within the EU?
  - … not severely restricting innovative new environmental tax designs?
  - … keeping the administrative burden on authorities and firms at a reasonable level?
- If state aid rules in fact prevents Member States from applying properly designed environmental taxes => more costly for society to reach goals

EU State Aid Modernisation (IV)

Roles of the EU COM, governments and stake holders

- The EU COM decides its guidelines, based on approved state aid cases
  - Open public consultations
  - Internal impact assessment
  - Drafts of guidelines and GBER are published
  - Multilateral meetings with Member States
- What can Member States and stake holders do?
  - Start early, bring important points to the attention of the COM in different fora
  - DG COMP main counterpart, but don't forget other relevant DG's
  - Respond to public consultations and drafts
  - Be active in multilateral meetings
  - Form groups of Like Minded Member States and EFTA countries
  - Bilateral meetings with
    - DG COMP
    - Other relevant DG's, e.g. Climate, Environment, Energy, Taxation
    - Cabinets of Commissioners, Commissioners ./. Ministers

We Need All the Tools in the Tool Box to Fight Climate Change

A key element is properly designed state aid rules!

Questions?

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