

# European Fat Cats

EU Energy Intensive Industries:  
**paid to pollute**, not to decarbonise

## EXECUTIVE SUMMARY

Energy intensive industry sectors have been among the slowest in the European Union (EU) to reduce their greenhouse gas emissions and invest in solutions to decarbonise and maintain technological leadership. Instead, these sectors have been putting a break on more ambitious climate policy, benefitting from watered down regulation, soft tax deals and preferential pricing. Their efforts to preserve unrivalled privileges have pushed the cost of dealing with climate change onto the rest of society.

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## EU Energy Intensive Industries: **paid to pollute**, not to decarbonise

Instead of pursuing real decarbonisation plans, energy intensive industry in the EU has managed to turn pollution into profit:

- Rather than paying for its pollution under the **EU Emissions Trading System (ETS)**, energy intensive industry is able to make a cash-grab through a combination of exceptions under the scheme. A blatant example are the wind-fall profits from excess emission allowances that industry actors initially received for free amounting to over **€25 billion** during 2008-2015. At the same time, EU governments **missed out on €143 billion in revenue due to free allocation of pollution permits** during the same period of time. Even after a recent reform, the EU ETS will continue to issue free allowances to energy intensive industry sectors which means that **public revenues amounting to around €380 billion will be foregone by EU governments between 2008 and 2030**.
- Energy intensive industry receives **extremely generous tax breaks**. For example in Germany, households pay nearly **twice as much for their electricity** as energy intensive industry sectors with total financial gains from tax schemes amounting to over **€17 billion** in 2016, roughly the same as the 2017 German federal budget for research and education;
- European governments still provide nearly **€15 billion** of fiscal support that encourages **consumption of fossil fuels** in industry and business each year.

As a result of these subsidies to energy intensive industry and its delayed action on decarbonisation, citizens pick up the bill for climate change and air pollution. They are increasingly paying with their health and lives: each year 231,554 Europeans die prematurely due to air pollution, almost a quarter of which comes from energy intensive industry. In addition, average annual health costs associated with air pollution amount to at least €215 billion.

Subsidies such as tax breaks, hand-outs and insufficient emission reduction targets have given European energy intensive industry little incentive to innovate and decarbonise. It is falling behind competitors in other regions, like China, who are investing heavily in innovation and the upgrade of their industry and starting to compete in high value segments formerly led by European industry.

While industry has long used "carbon leakage" (business relocating to a country with less stringent climate policies) as an argument to keep the status quo of low ambition, studies have found no evidence of leakage (Ecorys, 2013). In fact, European energy intensive industry pays less for electricity than many competitors, for instance German energy intensive sectors pay roughly 25% less for electricity than the same sectors do in China (Fraunhofer ISI and Ecofys, 2015).

Rather than maintaining the current level of overprotection, the EU should be much more concerned about losing competitiveness in innovative low carbon break-through technologies.

EU energy intensive industry must face the inevitable need to decarbonise and stop undermining ambitious climate policy. Instead, the sectors can embrace the opportunities of innovation and the circular economy through forward-looking approaches.

At the same time, policy makers and regulators need to establish certainty about the necessary pathway for decarbonisation in the coming decades. The UNFCCC has launched a yearlong exchange on how countries can ratchet up their climate commitments, the so-called Talanoa Dialogue. This makes 2018 an important year for kick-starting the process and momentum to increase global climate ambition. It thus provides the impetus for the EU to reboot its policy approach to energy intensive industry; making it clear that it will contribute to, rather than detract from EU climate ambition. Governments need to substantially reshape their current approach of massive government subsidies for energy intensive industry to pollute, and rather make them pay for pollution. This would provide industry and EU governments an incentive to invest in and to commit to innovation.

In addition, under the Paris Agreement, member states and the EU need to communicate long-term greenhouse gas emission development strategies to the UN, outlining how they intend to mitigate emissions until mid-century. On 22 March this year, the European Council invited the European Commission to present a draft of such a long term strategy in early 2019 (European Council, 2018). It is crucial that these strategies set out pathways that ensure that every sector of the economy contributes substantially to the objective of the Paris Agreement, namely keeping global temperature rise well below 2 degrees and pursue efforts to limit temperature rise to 1.5 degrees.

## Policy Recommendations

In particular, the EU needs to rethink its current industrial approach and consider the following policy recommendations:

- Make clear that energy intensive industry sectors will be required to fully decarbonise before 2050, setting stretch goals for the various sectors as markers along the way. The European Commission **should develop its draft long term climate strategy as soon as possible**, sketching out the possible pathways to decarbonise the European economy before mid-century in ways **compatible with the 1.5 and 2 degrees Celcius target of the Paris Agreement**.
- Based on the draft Long Term Strategy, the European Commission should develop **pathways for the ambitious decarbonisation of energy intensive industries**. It should do so in consultation with existing expert groups such as the High level group on energy intensive industries or the High level industrial roundtable 'Industry 2030', bringing together stakeholders including governments, industry, trade unions, academics and civil society. This exercise could help sectors to update existing industry-specific roadmaps toward full decarbonisation or start drafting those embedded in a cross-sectoral roadmap that is aligned with the Paris Agreement.
- Both the sectoral as well as the horizontal roadmaps should pay particular attention to **address energy poverty and provide measures to support just transition plans** for affected communities and workers in industries that must, by necessity, phase down and be replaced with zero carbon alternatives.
- The rules of the **EU ETS need to be revised and tightened** in light of the long term targets of the Paris Agreement by strengthening the cap, cancelling surplus allowances and ensuring that the polluter-pays-principle is respected in all sectors covered by the scheme.
- The funds created under the EU ETS should not hamper the necessary decarbonisation of industry sectors. Rules should be toughened to ensure that the Innovation Fund is not simply used to pad industry profits, but supports low carbon technology for short term use, and zero carbon technologies to deliver the necessary decarbonisation and emission reduction pathway. As the prime beneficiary of these funds, industry needs to start paying for its emission allowances. The **free allocation of pollution permits under the ETS needs to be phased out**.
- It is clear that the ETS alone will not be enough. Complementary policies are necessary, both at EU and at national level. The first opportunity is the establishment of adequate and credible 2030 targets for the deployment of renewable energy and energy savings at EU level. The European Commission should encourage member states to **strengthen carbon pricing**, for example through a common carbon floor price and look into additional measures to complement the insufficient ETS framework at the EU level. Finally, the European Commission should consider the setting of Emission Performance Standards for the production of resource and energy intensive materials.
- Member states should **assess all national policies addressed at industry, including taxation policy**, and ensure that it supports, not undermines, a transition to a zero carbon industry. Progress towards policy change should be reported through existing frameworks such as the European Semester.

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