To the attention of:
Mr Johan Van Overtveldt, Rapporteur
Members of the ECON Committee

Subject: Limiting ineffective energy tax reductions for energy-intensive industries under the Energy Taxation Directive (Art 18)

Brussels, 11 July 2022

ECOS, Carbon Market Watch and Réseau Action Climat France would like to draw your attention to the fact that the Energy Taxation Directive should limit energy tax reductions for energy-intensive businesses. Such tax reductions are ineffective in driving energy efficiency, unfair, and go against the EU Green Deal objectives. Instead, EU Member States should use the energy taxation income to support businesses that take climate action seriously.

The report on the proposal for a Council Directive restructuring the Union framework for the taxation of energy products and electricity – also known as the Energy Taxation Directive – will be discussed at the ECON Committee in the upcoming weeks.

We would like to take this opportunity to invite you to amend Article 18 on energy tax reduction for energy-intensive businesses. This article allows the EU Member States to apply tax reductions in favour of energy-intensive companies if they have concluded agreements with the public authorities to improve their energy efficiency or help achieve environmental protection.

Such energy tax reductions are ineffective, unfair, contradictory to the objectives of the EU Green Deal, and unsupportive of companies that commit to climate action:

- **Energy tax reductions are ineffective and inefficient in stimulating investments in energy efficiency.** As the text stands, to be eligible for energy tax reductions, companies only need to participate in agreements with national authorities, committing to enhanced energy efficiency or environmental protection actions. However, these agreements do not require savings from energy tax reductions to be used for the relevant objectives. Companies often direct those tax reductions into increasing profits instead of investing in energy-saving measures or improving their environmental performance.

- **Reducing the cost of fossil fuels contradicts the EU Green Deal objectives.** The proposed recast of the Energy Taxation Directive does not set a limit to energy tax reductions on fossil fuels. Similarly, there is no significant difference between the minimum energy tax levels allowed for fossil fuels and those applied to renewable fuels. Yet, moving away from fossil fuels is necessary to achieve climate neutrality by 2050.

- **Improving efficiency only is no longer enough - we need full decarbonisation.** We must expand the scope of tax-reduction agreements from the current commitments to improve energy efficiency toward the signature of binding pledges to full decarbonisation. Regrettably, the Energy Taxation Directive does not reflect this urgent need. It is a missed opportunity, given that many companies are already committing to full decarbonisation.
• **Energy tax reductions are unfair.** Energy efficiency programmes usually address both energy-intensive and less energy-intensive companies. The less energy-intensive ones benefit most from such programmes as they face more difficulties in tapping into the energy efficiency potential. Yet, the Energy Taxation Directive only allows energy-intensive businesses to benefit from energy tax reductions.

We firmly believe that EU law should grant direct support to investments in energy efficiency rather than to reducing the companies' energy costs. Such approach would be more effective in achieving energy savings and allow all companies, both energy-intensive and less energy-intensive, to act for energy efficiency effectively.

> We, therefore, urge to **gradually increase the minimum levels of taxation applicable to heating fuels, motor fuels and electricity** (see Tables B, C and D of Annex I of the proposed recast of the ETD).

> **EU Member States can use this extra tax income to feed subsidy schemes for the industry.**

EU law should give companies clear signals in line with the overarching EU climate objectives. Fossil fuel consumption should be disincentivised, while climate action should be stimulated.

> **We, therefore, urge to increase the difference between minimum tax levels applied to fossil and renewable fuels.** We **must phase out energy tax reductions for fossil fuels well before 2030.**

> **We also urge to expand the scope of the agreements, in which the businesses must participate to be eligible for energy tax reductions.** Rather than only focusing on improving energy efficiency and environmental performance, these agreements should prepare companies for full decarbonisation.

In the attached Policy Brief, you will find more details on why the currently proposed energy tax reductions are an issue that should be urgently tackled. You will also find enclosed a case study to illustrate the issues at stake, highlighting the amendments that Members of the European Parliament can pass to provide solutions.

Yours sincerely,

Justin Wilkes ECOS Executive Director
Policy Brief

Why the Energy Taxation Directive is ineffective, unfair, and against EU Green Deal objectives

Article 18 of the proposed recast of the Energy Taxation Directive (ETD) (Article 17 in the current ETD) allows the EU Member States to ‘apply tax reductions [...] on the consumption of energy products used for heating purposes; motor fuel for stationary motors and plant and machinery used in construction, civil engineering and public works; and on electricity:
(a) in favour of energy-intensive business [...] (b) where agreements are concluded with business entities as [...] associations of such business entities, or where tradable permit schemes or equivalent measures are implemented, as far as they lead to the achievement of environmental protection objectives or to improvements in energy efficiency.’

Why is this an issue?

Energy tax reductions are too indirect to be effective and efficient in stimulating energy efficiency investments

Offering companies investment or operational support is the most effective way to offer financial incentives to invest in energy efficiency. However, this is not what energy tax reductions do. To be eligible, companies only need to participate in such agreements regardless of their real actions. As a result, companies may benefit from tax reductions irrespective of their final investments or improvements in energy efficiency.

The money does not land in the companies that it should. Energy tax reductions are cashed in by financial departments, where they are used to maximise profits instead of directing the public money to operational departments. Operational managers, usually unaware of granted energy tax reductions, continue to experience difficulties persuading financial managers that they should allocate funds to the smart energy-saving projects they have in mind.

We, therefore, urge you to gradually increase the minimum levels of taxation applicable to heating fuels, motor fuels and electricity (see Tables B, C and D of Annex I of the proposed recast of the ETD). EU Member States should then use these extra tax incomes to feed subsidy schemes for the industry. Granting investment support instead of energy cost reduction would reward companies that take their investments in energy efficiency seriously.

In line with this, we urge you to support:

- Amendment 349, proposed by Mr Gruffat: ‘[...] Member States may apply tax reductions , [...] for a maximum period of ten years after the entry into force of this Directive, [...]’
- Amendment 360 c), proposed by Mr Gruffat: ‘Invest at least 80% of the tax reduction amount in projects that lead to substantial reductions of the installation’s greenhouse gas emissions; where
applicable, the investment should lead to reductions to a level well below the relevant benchmark used for free allocation in the Union ETS.

In addition, for these agreements to be effective, we also ask to support:

- **Amendment 358, proposed by Mr Gruffat**: 'The Member State verifies the necessity of a tax reduction to indirectly contribute to a higher level of environmental protection by means of an ex ante open public consultation where the sectors eligible for the reductions are properly described and a list of the largest beneficiaries for each sector is provided.'

- **Amendment 359, proposed by Mr Gruffat**: 'The agreements referred to in Paragraph 1 letter a) and b) must fulfil the following cumulative conditions:
  (i) the substance of the agreements is negotiated by the Member State, specifies the targets and fixes a time schedule for reaching the targets;
  (ii) the Member State ensures independent and regular monitoring of the commitments in the agreements;
  (iii) the agreements are revised periodically in the light of technological and other developments and provide for effective penalties in the event that the commitments are not met.'

- **Amendment 360, proposed by Mr Gruffat**: 'The Member State must also commit to monitoring that beneficiaries defined in letter a) and b) do one or more of the following:
  (a) when beneficiaries are required to conduct and energy audit under Article 8(4) of Directive 2012/27/EU, implement recommendations of the audit report, to the extent that the pay-back time for the relevant investments does not exceed 3 years and that the costs of their investments is proportionate;
  (b) reduce the GHG footprint of their electricity consumption, so as to cover as much energy consumption as possible, and at least 50 % from additional renewable energy sources;
  (c) invest at least 80% of the tax reduction amount in projects that lead to substantial reductions of the installation's greenhouse gas emissions; where applicable, the investment should lead to reductions to a level well below the relevant benchmark used for free allocation in the Union ETS'

**Reducing the cost of fossil fuels contradicts the EU Green Deal objectives**

To achieve climate neutrality by 2050, we must move away from fossil fuels – the sooner the better. This does not only matter for the climate but also for the energy dependency of the European Union. The energy crisis, resulting from the Russian invasion of Ukraine, has made very clear how dependent the EU Member States are on fossil fuel imports and how vulnerable our economies are.

Yet, the proposed recast of the Energy Taxation Directive does not set a limit to energy tax reductions on fossil fuels. Nor is there a significant difference between the minimum energy tax levels for fossil and renewable fuels. The proposed energy tax reductions on fossil fuels give companies a signal that goes in the opposite direction to the one they should take. Tax reductions hamper the industry’s decarbonisation and directly contribute the EU Green Deal objectives.

**We, therefore, urge you to increase the difference in minimum tax level between fossil fuels and renewable fuels and to phase out energy tax reductions for fossil fuels well before 2030.**
Improving efficiency only is no longer enough – we need full decarbonisation

Energy tax reductions can be granted if companies participate in programmes to improve their energy efficiency. This was relevant twenty years ago, when this article was first added to the Energy Taxation Directive. There were hardly any energy efficiency programmes in place, and a large energy efficiency potential was untapped.

While improving energy efficiency remains relevant, the challenge companies now face has expanded to achieving full decarbonisation by 2050. In addition to the improvement of existing processes, companies also need to develop new, less-carbon intense products, less carbon-intensive processes, and source carbon-free energy.

Many European companies are already taking the lead in this challenge, voluntarily committing to ambitious decarbonisation objectives, such as the Science Based Targets initiative. The European Commission fosters this development with the launch of the EU Corporate Covenant, a pilot that supports European companies in adopting deep decarbonisation targets.

Regrettably, nor the urgent need to expand the scope of the agreements from improving the energy efficiency only to achieving full decarbonisation, neither the current trend of companies already committing to full decarbonisation, is reflected in the proposed recast of the Energy Taxation Directive.

We, therefore, urge for the agreements that are one of the conditions to benefit from energy tax reductions to include objectives on preparing companies for full decarbonisation.

In line with this, we urge you to support:

- Amendment 351, proposed by Mr Gruffat: 'in favour of energy-intensive business conditional on the conclusion of agreements between them (beneficiaries), or associations of beneficiaries, and the Member State whereby the beneficiaries or associations of beneficiaries commit themselves to achieve highly energy efficient, circular, zero-pollution and renewable based business operation through actions which may relate, among other things, to a reduction in energy consumption, the uptake of sustainable renewable energy sources a reduction in emissions and other pollutants, or any other environmental protection measure.' (See also amendment 357)

- Amendment 356, proposed by Ms de Lange: 'In the context of government support to the companies with the highest national CO₂ emissions, individual agreements can be made between a company and its respective Member State with regard to a tax reduction on the consumption of energy products. This support is allowed provided that it is linked to ambitious CO₂ reduction plans that contribute to meeting the Union’s 2030 and 2050 climate objectives.'

Energy tax reductions are unfair; companies with the least energy efficiency potential receive the highest tax reductions

Only energy-intensive companies can benefit from energy tax reductions. However, energy efficiency programmes usually address less energy-intensive companies as well.

These less energy-intensive companies have a higher energy efficiency potential, as they face more difficulties than energy-intensive ones when trying to tap into their potential for energy savings. Less
energy-intensive companies hence benefit more from energy efficiency programmes and realise more energy efficiency improvements in these programmes than energy-intensive ones.

Yet, they cannot benefit from these energy tax reductions. That reduces the cost-efficiency of these energy efficiency programmes considerably.

**EU law should grant direct support for investments in energy efficiency rather than lowering the companies' energy costs. This would eliminate the discrimination against companies that are less energy-intensive. We, therefore, urge you to gradually increase the minimum levels of taxation applicable to heating fuels, motor fuels and electricity (see Tables B, C and D of Annex I of the proposed recast of the ETD). EU Member States can use this extra tax income to feed subsidy schemes for the industry.**

**Why does it matter?**

Energy Efficiency programmes targeting the industry are widely implemented across the European Union and hence cover a large share of the industry in Europe, see Figure 1.

![Figure 1: Voluntary energy efficiency programmes targeting the industry (Source: Odyssee-Mure)](image_url)

They are also known as voluntary agreements or long-term agreements. Most of these are negotiated, meaning that the agreements’ terms result from a negotiation process between the authorities and the industry. Examples are the Dutch Long Term Agreements or the Danish Climate Agreement for energy
and industry. The Netherlands was the first country to conclude such agreements with the industry. Their first agreements started in 1991 already.

However, the adoption of the Energy Taxation Directive in 2003, allowing the EU Member States to grant energy tax reduction to industrial companies on the condition that they participate in an energy efficiency programme, has spurred the rollout of these agreements in Europe. Examples of countries that started implementing such programmes in the first half of 2000 are the United Kingdom, Belgium and Sweden. In the 2010s, eastern EU Member States followed, such as Latvia and Slovakia.

Most of the current voluntary agreements will expire soon and will be renewed in the coming years. The Flemish and Luxembourgish voluntary agreements, for instance, end in 2022, while the Walloon one does so in 2023. All are considering the expansion of the scope from improving energy efficiency only to decarbonising more in general.

It is hence of utmost importance that the European legislative framework supports this trend. That is why energy tax reduction should only be granted to companies that commit to contributing to full decarbonisation.

**Case study – Flanders, Belgium**

*Energy Policy Agreements – a flagship measure of Flemish industrial efficiency policy*

Flanders, the northern region of Belgium, is one of the jurisdictions in the European Union that has opted for voluntary agreements to spur energy efficiency in the industry. They target the largest companies. About 350 companies participate, representing more than 80% of the industrial energy consumption.

The first generation of voluntary agreements – called covenants – started in 2002 (for companies with obligations under the Emission Trading Scheme) and in 2005 (for companies without such obligations). In 2014, they were succeeded by the second generation of voluntary agreements – the Energy Policy Agreements (EPA). They expire at the end of 2022, and negotiations for the third generation of agreements is ongoing.

**Many financial benefits for little energy efficiency improvements**

The participating companies must carry out an energy audit every four years and implement all economically viable energy-saving measures within four years following the energy audit. They receive some financial benefits in return:

- Making use of Art 17 of the Energy Taxation Directive: a number of energy tax reduction, amounting in total to about 130 million € annually
- Making use of the Emission Trading Directive: compensation for indirect emissions (for electro-intensive companies only): 140 million € annually

However, none of these benefits relates to the amount of energy they save.

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1 See: Commissie Energiebeleidsovereenkomst | EBO Vlaanderen (ebo-vlaanderen.be) [In Dutch]
Companies avoid about 300 million tons of CO₂ because of the energy savings measures they implement in the framework of these agreements. Linking these emission reductions to the total amount of financial support they receive – about 270 million € annually – results in a specific abatement cost that amounts to 900 €/ton CO₂, much higher than the current cost of an emission allowance. The Flemish Energy Policy Agreements are hence very cost-inefficient.

Moreover, the energy efficiency improvements are declining, as shown in Figure 2. The metric is the Energy Performance Index and indicates how much energy is needed to produce a certain quantity of products; thus, the lower, the better.

The Energy Performance Indices of the Energy Policy Agreements improve at a lower rate than the indices of the previous covenants. Yet, about the same companies are covered by both generations of agreements. They continued to benefit from the same energy and emission cost reductions when moving from the covenants to the Energy Policy Agreements. This demonstrates that granting tax reductions are not effective in driving energy efficiency improvements.

The companies that save the least benefit the most

The Energy Performance Index of the largest companies – those also covered by the ETS – has increased since 2017 instead of declining. In 2020, they needed as much energy per unit product as in 2014. Participating in the Energy Policy Agreements did not result in energy efficiency improvements for the largest companies. The less energy-intensive ones, in contrast, continued to improve their energy efficiency.

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2 Energy policy agreements - annual report 2020 (in Dutch)
This observation contrasts considerably with the energy tax reductions granted to the different categories of companies, see Figure 3. The higher the energy consumption, the less are companies taxed. More specifically, the higher their energy consumption, the less they contribute to the development of renewable energy. In addition, the ETS-companies are the only ones that can benefit from compensation for indirect emission costs. This illustrates that granting energy tax reductions is unfair. Companies that benefit the most from the scheme save the least energy.

![Figure 3: Energy taxes of non-domestic consumers in Belgium - 2021 (Source: Eurostat)](image)

**Conclusion**

Through this case study, it is our aim to demonstrate that the Energy Taxation Directive does not lead to a fair and cost-efficient realisation of energy efficiency improvements in the industry.

We believe that EU law should stop reducing energy costs (and carbon costs) based on the annual energy consumption of companies. Large companies should contribute to tax revenues to the same extent as smaller companies. Then, EU Member States can use the additional income from energy taxes and ETS allowances to support companies that take climate action seriously.