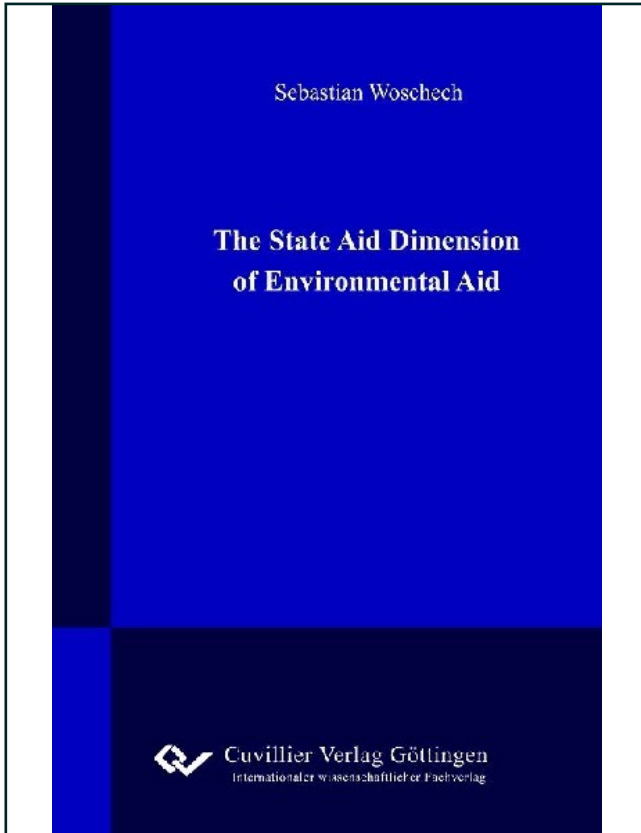




Sebastian Woschek (Autor)  
**The State Aid Dimension of Environmental Aid**



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Germany

Telefon: +49 (0)551 54724-0, E-Mail: [info@cuvillier.de](mailto:info@cuvillier.de), Website: <https://cuvillier.de>

## A. Introduction

Twenty years ago, in the summer of 1988, the issue of Climate Change first came to public attention after large parts of the Amazon Rain forest and the Yellowstone National Park were ablaze. Discovery magazine ran the headline “The greenhouse effect – this summer was merely a warm up”<sup>1</sup> and reported on the (now famous) testimony by James Hansen<sup>2</sup> before the US Senate in which he stated “with 99 percent confidence” that a recent rise in global temperature was occurring. "The greenhouse effect," he claimed, "has been detected and is changing our climate."<sup>3</sup>

Now, 20 years later, we know that the greenhouse effect has not only changed our climate but our whole society. At least since the Stern Review<sup>4</sup> revealed that climate change is a threat to the public purse it is on top of the political agenda. Environmental policy in general is now at the forefront of everyday's news. The issue makes Peace Nobel Prize laureates<sup>5</sup> and wins elections<sup>6</sup> but also creates droughts, famines and, more recently, the first environmental refugees.<sup>7</sup> The global scale of the problem calls for a global solution but in a multipolar world any such solution demands not only global cooperation but also local implementation.

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<sup>1</sup> October 1988 edition.

<sup>2</sup> Now head of the NASA Goddard Institute for Space Studies.

<sup>3</sup> The testimony on 23 June 2008 was based on: Hansen, et al., ‘Global Climate Changes as forecasted by Goddard Institute’ (1988) 93 Journal of Geophysical Research 9341.

<sup>4</sup> Stern, *The Economics of Climate Change: The Stern Review* (CUP, Cambridge, 2007).

<sup>5</sup> In 2007 awarded to the Intergovernmental Panel on Climate Change (IPCC) and Al Gore "for their efforts to build up and disseminate greater knowledge about man-made climate change, and to lay the foundations for the measures that are needed to counteract such change."

<sup>6</sup> See victory of the Australian Labor Party in November 2007 whose leader, Kevin Rudd, promised to sign the Kyoto Protocol as first political act after being sworn in.

<sup>7</sup> Gupta, ‘Pacific swallowing remote island chain’ online: <<http://edition.cnn.com/CNN/Programs/anderson.cooper.360/blog/2007/07/pacific-swallowing-remote-island-chain.html>> accessed: 01. January 2009.

Before conducting a legal analysis<sup>8</sup> of the measures with which the European Union tries to implement environmental policy “locally” this paper will briefly take a look at the international level and it is hoped that this will help to place the European measures into their international context.

## **B. European Environmental Policy placed into (the State Aid) context**

### **I. International Measures**

Whether as a consequence of Hansen’s testimony or not, 1988 was the year in which the International Panel on Climate Change (IPCC) was jointly founded by the United Nations Environmental Program and the World Meteorological Organization. The IPCC is a scientific body tasked to evaluate the risk of climate change caused by human activity. Its first Assessment report (1990) served as a basis for the United Nations Framework Convention on Climate Change (UNFCCC) which was drawn up during the Earth Summit<sup>9</sup> in June 1992 in Rio de Janeiro. Although not setting binding targets the UNFCCC acknowledged the need to stabilize greenhouse gas (GHG) concentrations in the atmosphere and provided for regular “updates” of which the Kyoto Protocol is certainly the most prominent. The latter, adopted in December 1997, entered into force in February 2005 and can be called the so far most successful environmental treaty. It contains binding targets to reduce GHG-emissions and has been ratified by 182 nations to date.<sup>10</sup> By ratifying the Kyoto Protocol in May 2002<sup>11</sup> the EU and its Member States (MS) committed themselves to

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<sup>8</sup> The analysis will concentrate on the State Aid dimension of these measures.

<sup>9</sup> Formally known as the United Nations Conference on Environment and Development (UNCED), June 1992.

<sup>10</sup> See: <[http://unfccc.int/files/kyoto\\_protocol/status\\_of\\_ratification/application/pdf/kp\\_ratification.pdf](http://unfccc.int/files/kyoto_protocol/status_of_ratification/application/pdf/kp_ratification.pdf)> accessed: 01 January 2009.

<sup>11</sup> Pursuant to Article 175(1) of the Treaty establishing the European Community.

reducing emissions of six key GHG<sup>12</sup> by 8% against 1990 levels over the five-year period 2008-2012.<sup>13</sup> The Kyoto Protocol allows for flexibility in the way that parties achieve their targets. Making use of this flexibility the EU Commission emphasized the need for a common and coordinated approach, including economic instruments<sup>14</sup> and a fair distribution of the reduction-burdens amongst the MSs<sup>15</sup>. However, the Commission also stressed that in the absence of Community provisions it is for each MS to formulate appropriate policies.<sup>16</sup>

This now leads us to the “local” European measures. A short look at their development will reveal that, in contrast to the international efforts that mainly focus on climate change, they address environmental degradation as a whole. A look at the development of European environmental legislation and regulation will clarify why the latest environmental policy measures deserve further attention from a competition and in particular state aid perspective.

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<sup>12</sup> Annex A of the Protocol.

<sup>13</sup> Article 3(1) in conjunction with Annex B of the Protocol.

<sup>14</sup> Commission (EC), ‘Preparing for Implementation of the Kyoto Protocol’ (Communication) COM (99) 230 final, 19 May 1999.

<sup>15</sup> Council Decision (EC) 2002/358/EC concerning the approval of the Kyoto Protocol [2002] OJ L130/1.

<sup>16</sup> Commission (EC), ‘Community Guidelines on State Aid for environmental protection’ [2001] OJ C37/3, para 70.

## II. European Measures

### 1. The Evolution of Environmental Legislation and Regulation

In the 1960s and 1970s market integration was at the forefront of public policy, and in the 1980s industrial policy was dominant on the EC agenda, but now the most controversial public policy issue is environmental policy.<sup>17</sup> This is reinforced when looking at (a) the history of Environmental provisions in the Treaty (legislation) and at (b) the changing approach to environmental regulation. These will now be dealt with in turn.

a) The EEC Treaty remained silent on environmental issues. Early cases of environmental legislation<sup>18</sup> were based on Article 100 EEC [now 94]<sup>19</sup> and could only go as far as was necessary for the functioning of the Common Market. Environmental policy (only) served the attainment of the Common market. This started to change when the Single European Act (1987) firstly introduced environmental policy in the Treaty<sup>20</sup> and change became evident when the Maastricht-Treaty (1993) introduced the environment as a Treaty-objective of its own.<sup>21</sup> The final “upgrade” of the environment to a general principle of EC Law was accomplished by the Treaty of Amsterdam (1997) according to which environmental protection requirements *must now be integrated* into the definition and implementation of other Community policies.<sup>22</sup> *Wasmeier* aptly calls the resulting “merger” of environmental and

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<sup>17</sup> Basaran, ‘How should Article 81 address agreements that yield environmental benefits’ (2006) 27 ECLR, page 479, Fn. 1.

<sup>18</sup> Eg. Council Directive (EEC) 75/716 on the sulphur content of certain liquid fuels [1975] OJ L 307/22.

<sup>19</sup> Art. 100 EEC was confirmed as legal basis by the Court in Case 92/79 Commission v Italy [1980] ECR 1115.

<sup>20</sup> Articles 130r, 130s, 130t, 100a(3)+(4) EEC [now 174, 175, 176, 95(3)+(4) EC].

<sup>21</sup> Articles 2 and 3(1)k EC [now 3(1)l].

<sup>22</sup> Article 6 EC.

economic objectives into one overall concept an “environmental common market”<sup>23</sup>. The growing legislative importance of the environment equally reflects itself in a changing regulatory approach.

**b)** A common characteristic of early European environmental regulation was a so called “command-and-control” approach. This is an approach that strictly regulates certain environmental aspects in often absolute terms. Certain levels of pollution are not allowed to be exceeded<sup>24</sup> or certain behaviour is forbidden<sup>25</sup>. This approach however has inherent disadvantages. One frequently raised objection is the fact that it does not provide any incentive to go beyond the level of protection prescribed by the regulations.<sup>26</sup> A further problem is that different economic actors have different avoidance costs so that an obligatory reduction can distort competition. One final point of critique addresses the underlying perception of the role of the state. The command-and-control approach implies that the state knows best how to efficiently and cost effectively provide environmental protection. However, this is often not true.

Consequently and in line with the integration principle in Article 6 EC the EU has left this approach behind and turned to the use of market-based regulatory instruments (MBIs).<sup>27</sup> These are based on the economic insight that most environmental problems have their origins in the misworkings of the economic system.<sup>28</sup> More specifically, environmental pollution comes with a cost for society and these external costs are not fully accounted for in the economic

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<sup>23</sup> Wasmeier, ‘The Integration of Environmental Protection as a General Rule for Interpreting Community Law’ (2001) 38 CMLRev. 160.

<sup>24</sup> E.g. Council Directive (EEC) 78/1015 on the permissible sound level of motorcycles [1978] OJ L349/21, see Annex I.

<sup>25</sup> E.g. Council Directive (EEC) 78/319 on toxic and dangerous waste [1978] OJ L84/43, see Article 3(2).

<sup>26</sup> Vedder, *Competition Law and Environmental Protection in Europe – Towards Sustainability?* (Europa Law Publishing, Groningen, 2003), page 47.

<sup>27</sup> The Sixth Environmental Action Programme (2001) suggests policies “encouraging the market to work for the environment”, COM (2001) 31 final, page 15.

<sup>28</sup> Pearce, *Blueprint for a Green Economy* (Earthscan Publications, London, 1995).

process. Addressing this market failure MBIs seek to internalize these costs by giving them a price. The main legal tool with which this can be achieved is the application of the “polluter pays principle”<sup>29</sup> according to which the polluter should bear the costs of his damage to the environment. A simple application of this principle would be to oblige the producer of a car to recycle it after its lifespan.<sup>30</sup> However, such measures always tend to (arbitrarily) hallmark an economic operator as *the polluter*.<sup>31</sup> Avoiding the difficulties involved in appointing the polluter can be achieved by imposing a (pigovian) tax on the use of the externality.<sup>32</sup> This can be done by taxing each unit of pollutant emitted.<sup>33</sup> However, setting the tax at the correct level can involve considerable costs.<sup>34</sup> Other measures avoid this by using the market forces of supply and demand to set the price at the correct level.<sup>35</sup> Such tradable permit schemes achieve reductions in pollution or resources<sup>36</sup> at the lowest overall costs to society<sup>37</sup> through the provision of market incentives to trade. All MBIs have in common that they make pollution a real economic cost and companies will tend to maximize their profits by reducing this cost component and therefore reducing at the same time pollution. Following a report by the European Environment Agency<sup>38</sup> the Commission plans to increasingly make use of MBIs<sup>39</sup> because

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<sup>29</sup> Already mentioned in the first environmental action programme (1973) OJ C 112/1, part I, title II, no. 5.

<sup>30</sup> So called “cradle to the grave” regulation.

<sup>31</sup> In this case the producer. But is not the consumer with his demand for the car the real polluter? Should he pay?.

<sup>32</sup> Proposed by Pigou in *Wealth and Welfare* (London, 1912).

<sup>33</sup> Council Directive (EC) 2003/96 restructuring the taxation of energy products and electricity (Energy Taxation Directive), OJ L283/51.

<sup>34</sup> Hussen, *Principles of Environmental Economics* (Routledge, Rev. Ed., London, 2008), p. 106.

<sup>35</sup> E.g. Council Directive (EC) 2003/87 establishing a scheme for greenhouse gas emission allowance trading [2003] OJ L275/32, p. 32.

<sup>36</sup> E.g. individual transferable quotas for fisheries in Iceland since 1984.

<sup>37</sup> Stavins, ‘Market-Based Environmental Policies: What can we learn from the U.S. Experience?’ Harvard University, Research Working Paper, Series 2, 2003.

<sup>38</sup> European Environmental Agency, *Market-based instruments for environmental policy in Europe* (Office for Official Publications of the EC, Copenhagen, August 2005).



they provide flexible and cost-effective means to correct certain market failures. However, if market based instruments are to bring about these corrections, it is essential that the markets in which they operate are not distorted.<sup>40</sup> This is where competition policy and State aid control play a significant role. Before turning to the main part of this paper that will analyse some of these measures from a State Aid perspective we will now have a short look at the specific measures with which European environmental policy tries to fulfil its international obligations outlined above. This will help to identify those measures that need special attention from a state Aid perspective.

## **2. Specific Environmental Legislation**

Concomitantly with the growing prominence of the environment in the Treaty the number of environmental issues addressed by the European Union rose dramatically. To date more than 620 Acts addressing all aspects of the environment are in force. The Sixth Environmental Action Programme identified four priority areas for environmental action: climate change, nature and biodiversity, environment and health and natural resources and wastes.<sup>41</sup> Of these “Climate Change” is in the light of the on-going international efforts and the scientifically proven urgency<sup>42</sup> certainly the most dynamic. Although the EU took its first climate-related initiatives in the early 90s, in the light of Kyoto the

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<sup>39</sup> Commission (EC), ‘Commission Staff Working Document Accompanying the Green Paper on market-based instruments for environment and related policy purposes’ (Working Paper) COM (2007) 140 final, 28 March 2007.

<sup>40</sup> Commission (EC), ‘State Aid Scoreboard – Spring 2008 Update’ (Report) COM (2008) 304 final, 21 May 2008, p. 10.

<sup>41</sup> Art. 1(4) of Council Decision (EC) 1600/2002 of the European Parliament and of the Council of 22 July 2002 laying down the Sixth Community Environment Action Programme [2002] OJ L242/1.

<sup>42</sup> IPCC, *Climate Change 2007 – Working Group I Contribution to the Fourth Assessment Report* (CUP, Cambridge, 2007); predicts a global temperature rise of up to 6.4°C and urges immediate action to avoid irreversible changes of the climate.



pace has picked up dramatically. In January 2007, as part of an integrated climate change and energy package<sup>43</sup>, the European Commission proposed options for an ambitious global agreement.<sup>44</sup> These were endorsed by the Council in March 2007 which committed the EU to reducing GHG by at least 20% by 2020. To underpin their commitment EU leaders set further targets, i.e. reductions of energy consumption by 20% and an increase of renewable energies' share to 20% by 2020.<sup>45</sup> Called upon by the Council the Commission presented a detailed Energy and Climate Change package<sup>46</sup> setting out the mechanisms with which to achieve the Council's political commitments. This package touches upon many issues which deserve special attention from a state aid point of view, namely the introduction of new guidelines on State aid<sup>47</sup>, the promotion of renewable energy and (amendments to) the EU Emission Trading System (EU ETS).

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<sup>43</sup> Commission (EC), 'An Energy Policy for Europe' (Communication) COM (2007) 1 final, 10 January 2007.

<sup>44</sup> Commission (EC), 'Limiting global climate change to 2 degrees Celsius - The way ahead for 2020 and beyond' (Communication) COM (2007) 2 final, 10 January 2007.

<sup>45</sup> Council (EC), 'Brussels European Council 8/9 March 2007' (Presidency Conclusions) 7224/1/07 Rev 1, 2 May 2007.

<sup>46</sup> Commission (EC), '20 20 by 2020 - Europe's climate change opportunity' (Communication) COM (2008) 30 final, 23 January 2008.

<sup>47</sup> Commission (EC), 'Community guidelines on State aid for environmental protection' [2008] OJ C 82/1, 1 April 2008.