

Greening the Internal Market in a Difficult Economic Climate

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Introduction

2008 was a year of turmoil in the financial markets, rapid economic slow-down and the start of recession in several European economies, bank bail-outs and growing calls for protectionism (see Quaglia *et al.*, in this volume). We might expect the principal casualties of these developments to have been European market integration and liberalization measures, the rigorous application of EU Competition Policy rules and the adoption and application of environmental and other measures that impose costs upon European industry. EU fiscal policy rules have effectively been suspended and several bank bail-outs by national governments have verged on breaking EU competition policy rules. However, it is difficult to demonstrate that the internal market and environmental legislative and policy agenda of 2008 was altered significantly by reactions to the crisis.

As bankruptcies and unemployment rise in 2009, no doubt the negative impact of the recession on market integration and liberalization will be further felt. In 2008, one of the most significant policy developments concerning the internal market was the stalled liberalization of the energy sector. However, this was in no way linked to the economic slow-down: French and German governments have long dragged their heels on liberalization in these sectors and long opposed the unbundling of gas and electricity production and supply. More surprising was the success in adopting ambitious targets to cut EU carbon emissions over the next decade. Despite the inevitable watering

down of the European Council's initial goals and the Commission's legislative proposals and the frequent disappointment of environmentalist groups, this represents a considerable achievement – if not the greatest legislative accomplishment for the EU in 2008. Following a brief analysis of the agreement on energy markets, the bulk of this article is centred upon the climate change package.

I. The Fudged Liberalization of Energy Markets

In 1996 and 1998, the EU adopted directives to liberalize, respectively, the electricity and gas sectors (96/92/EC and 98/30/EC, revised in 2003). Several Member States supported the Commission's push for liberalization and moved quickly to open their markets or, as in the case of the UK, had already largely done so. Other Member States, notably France and Germany, were sceptical if not hostile to full liberalization and the unbundling of production and supply (Andersen, 2001). German and French governments stuck to the minimum requirements of the 1996 and 1998 directives. The Commission took legal action against no fewer than 17 Member States (by 2006), including the UK, to force through some developments. The principal problems encountered were: price discrimination to the benefit of historical customers; lack of legal unbundling and insufficient managerial separation between electricity and gas transmission and distribution system operators to ensure that they were independent of each other; preferential access to networks for historical customers and insufficiently transparent tariffs; lack of free choice of supplier; and insufficient independence or competence granted to national regulators, in particular to set tariffs for accessing the networks. In addition to ideological opposition to liberalization there was persistent domestic political opposition, with strong trade union, party political and public hostility – stoked by the fear that gas and electricity prices would rise after liberalization. One of the most contentious issues, third-party access to transmission networks for electricity and gas, was blocked by several Member States through the discretion allowed in the 1996 and 1998 directives (Andersen and Sitter, 2006). The directive allowed Member States to choose between regulated and negotiated third-party access and to develop or maintain their national regulatory models. Germany opted not to establish a new regulatory authority for gas. A third 'single buyer' model was incorporated into the directive to allow France to maintain elements of its national electricity monopoly, although this option (in effect an opt-out) was never used. In several Member States, public take-up of alternative energy providers has been minimal and market access restricted. Homogeneous integration in the energy sector worked only

with respect to a limited range of policy initiatives including price transparency for electricity and gas contracts.

The Commission continued to push for a complete unbundling of production and supply which would force energy producers to sell off transmission networks. It sought to break up large energy companies into production and supply entities, arguing that only this would effectively allow new entrants greater access to the market. The Commission argued that insufficient competition inside Member States hindered investment in infrastructure and kept prices artificially high. Giving competing energy companies access to Europe's pipeline and transmission networks would, it was claimed, reduce the scope for market abuse by integrated suppliers. Independent transmission businesses would have an incentive to install new pipes and wires to meet demand, rather than restrict capacity to protect parent companies.

The March 2006 European Council agreed a new 'Energy Policy for Europe' which set market liberalization among its top objectives, while the March 2007 European Council renewed its commitment to proceed with the liberalization of European energy markets, establishing a list of criteria with which to proceed. In response, the EU energy commissioner, Andris Piebalgs, renewed the Commission's efforts to push ahead with unbundling. However, eight Member States remained firmly opposed to forcing energy producers to sell off transmission networks – the Group of Eight: France, Germany, Austria, Bulgaria, Greece, Latvia, Luxembourg and Slovakia. Given this refusal but also the perceived need for a clearer EU legal framework, the Commission decided to change tack.

In January 2008, the Commission proposed a new directive on unbundling energy production. This directive would effectively allow Member States that had not decoupled to avoid doing so. Energy companies would not be required to sell grids and pipelines. However, they would face tougher regulation and a requirement for more independent management. The Commission proposed the establishment of an independent system operator (ISO). Big energy companies would retain ownership of the transmission lines, but hand managing control over networks to an entirely separate operator which would be required to have a different group of shareholders from the parent company.

Yet this compromise gesture was still rejected by the Group of Eight which argued that energy producers should be allowed to retain ownership of transmission and called for a less radical energy liberalization scheme. Opponents of unbundling argued that strong national champions were needed to square up to Gazprom, the Russian gas giant that supplied much of Europe. When one supplier was so dominant, they argued, the debate about asset ownership was an irrelevance. In an open letter to the Commission, the Group of Eight

also argued amongst other points that unbundling violated private property rights, was incompatible with the free movement of capital and increased the risk of EU companies falling under the control of non-European firms (notably Gazprom).¹

The Group of Eight presented their own proposal for a new EU directive which called for a third option involving the creation of a so-called transmission system operator (TSO). Energy companies would be allowed to retain their hold over both production plants and supply grids but the management would be kept separate as a way to satisfy the Commission's demand for the separation of energy companies' production and supply operations. While independent from one another they would be connected only by a common set of shareholders. Transmission system operators would be organized in the legal form of a joint-stock company, would have their own corporate identity, with separate branding, communication and premises. A strict regulatory regime would be established in order to guarantee the separation. The Commission challenged both the content and legal aspects of the Group of Eight's initiative. It argued that the proposal did not meet the criteria outlined by the EU leaders in March 2007 for liberalization of the energy sector and that it was illegal for Member States to initiate what was, in effect, a proposal for an EU directive.² The Commission insisted that only the two options outlined in the January version of the directive – full ownership unbundling and an independent system operator (ISO) – could be considered by the European Parliament.

In early May, members of the European Parliament's Industry Committee backed the Commission's two-choice solution and explicitly rejected the Group of Eight's third option. Yet the vote was close and MEPs split along national, rather than party, lines. Some 26 committee members voted against the third option, 22 MEPs were in favour, while three abstained, which suggested that a vote in plenary could see a different outcome. The German centre-right MEP Angelika Niebler, who chaired the Industry Committee, asserted that 'there will be a compromise, including the third way, or there will be nothing'.³ Then, in a second vote on 19 May, the Industry Committee made a U-turn, calling for the Commission to take on board the objections of the Group of Eight.

In June 2008, Member State governments reached a compromise, agreeing to embed into EU law the right for individual governments to choose one of three different models of unbundling: full ownership unbundling, when a

¹ *EUObserver*, 31 January 2008.

² *EUObserver*, 20 February 2008.

³ *EUObserver*, 7 May 2008.

parent company sells its transmission networks to a different firm; the independent system operator (ISO) option proposed by the Commission in January that allows big energy companies to retain ownership of the transmission lines, but requires them to transfer managing control over networks to an entirely separate operator (which would not share any shareholders with the parent company); and a third option – very close to the one preferred by the Group of Eight – the creation of a so-called independent transmission operator (ITO) which permits a parent company to retain ownership of transmission networks which would be heavily supervised by a national regulator. Under this new third option, the new directive imposes additional requirements upon the parent company and ITO to reinforce the independence of the latter, including a mechanism preventing top management from moving freely between a company's production and transmission wings. Management involved in transmission operations is not to be permitted to work three years before and four years after in the parent company. Furthermore, the national regulator is to examine the transmission operator's development and investment plans and could demand changes. While the new directive will bring about a change in national practice in the eight Member States which have to date opposed unbundling, the new directive in effect formally reinforces differentiation in the organization of national energy markets. Opponents to the directive have argued that it effectively endorses the anti-competition practices in certain Member States and undermines full market liberalization and European market integration.⁴ In a 9 July vote in the Parliament, 579 MEPs voted in favour, while only 80 were against and 52 abstained.

II. Greening the Internal Market

Amongst the most significant EU legislative developments in 2008 was the adoption of the climate change package. Four directives were adopted, establishing targets that, if met, should result in a significant reduction of CO₂ emissions by the year 2020. Throughout the year, there were intense debates on the precise provisions to be adopted – within and between Member States governments, EU institutions, industrial interests and environmentalist groups. The EU needed new targets on climate change to cover the period following the Kyoto Protocol's 2008–12 target dates and to cover the newest 12 Member States. The Commission and Member States also sought to establish EU policies prior to international negotiations on Kyoto II to take place in Copenhagen in December 2009. The Commission argued that European economies should adopt higher targets and direct increased funding to

⁴ *EUObserver*, 10 July 2008.

green technologies as a double incentive to establish first-mover advantage. The March 2007 European Council committed the EU to cutting carbon emissions by at least 20 per cent on 2005 levels by 2020 and to increasing energy security and requested the Commission to draw up necessary draft legislation and policy proposals.

The EU-15 were on track to meet their collective target of 8 per cent under the 1997 Kyoto Protocol of cutting greenhouse gas emissions by 8 per cent for the period 2008–12 from 1990 levels, the Kyoto agreement's baseline year (EEA, 2008). While Denmark, Italy and Spain were behind in reducing emissions, the performance of the other EU-15 nations was enough to compensate. As of 2006, four Member States – France, Greece, Sweden and the UK – had already apparently reached an emissions level below their Kyoto target and the eight other states were on track to meet their targets. Further reductions were to be achieved by a combination of domestic policies and measures, reforestation and buying 'carbon offsets' – permitted under the Kyoto Protocol – through which countries pay for other states to make the carbon reductions on their behalf. However, it was likely that several Member States would have to purchase more carbon offset credits than previously planned in order to achieve their target. At the start of 2008, renewable energy in the EU stood at 8.5 per cent of total production.

On 23 January 2008, the Commission presented an impressive climate change package, consisting of three directives to be adopted by the Member States. The package included three targets, known rather catchily as 20-20-20: a 20 per cent overall reduction in CO₂ emissions from a 2005 baseline, a 20 per cent increase in the share of renewable energies in energy consumption and a 20 per cent increase in energy efficiency, all to be achieved by 2020. The reduction in emissions would have to increase to 30 per cent by 2020 if an international agreement was reached committing other major economies to this higher target. The targets, for the period 2013–20 cover those industries not included within the existing carbon emissions trading scheme (ETS) – the EU's key method for reducing greenhouse gases under the Kyoto Protocol – notably agriculture, buildings and transport. The Commission also proposed fines to be imposed upon Member States which did not meet targets: an 'excess emissions penalty' – equivalent to those imposed under the ETS of around €100 per extra tonne of CO₂ emitted. If a Member State did not pay the penalty, the extra CO₂ emitted would then be deducted from the ETS allowances allotted to the Member State and sold instead by the European Commission. Member States that 'overachieved' by cutting greenhouse gases to below their targets would be able to sell that part of their emissions allocation to another Member State. But any money from the sale would have to be spent on 'green' investments such as renewable energy development or

Table 1: Member State CO₂ and Renewable Energy Targets (for 2020)

<i>Member State</i>	<i>CO₂ targets (percentage change from 1990 base)</i>	<i>Renewable energy targets (percentage of total energy consumed)</i>
Austria	-16	34
Belgium	-15	13
Bulgaria	+20	16
Czech Republic	+9	13
Cyprus	-5	13
Denmark	-20	30
Estonia	+11	25
Finland	-16	38
France	-14	23
Germany	-14	18
Greece	-4	18
Hungary	+10	13
Ireland	-20	16
Italy	-13	17
Latvia	+15	42
Lithuania	+15	23
Luxembourg	-20	11
Malta	+5	10
Netherlands	-16	14
Poland	+14	15
Portugal	+1	31
Romania	+19	24
Slovakia	+13	14
Slovenia	+4	25
Spain	-10	20
Sweden	-17	49
United Kingdom	-16	15

Source: Commission (2008).

energy efficiency. The package also detailed how each Member State would contribute to meeting the targets by 2020 (see Table 1).

The package included a proposal to reinforce the ETS – in which high-polluting companies buy CO₂ emission credits from lower-polluting firms in order to meet national carbon output quotas. The existing ETS covered 11,186 energy-intensive installations throughout the EU – including power plants, oil refineries, steel mills and cement factories – which produced almost half of the EU's CO₂ emissions. Under the existing ETS, 90 per cent of credits were given out free. The Commission argued that the existing ETS was faulty because it was based on national emissions caps and did not provide enough

guarantees to achieve the 2020 goal. In the new proposed ETS, Member States would no longer devise their own national allocation plans and grant pollution permits to companies. These plans would be replaced from 2013 by auctioning or free allocation through single EU-wide rules. The auctioning revenues would be delivered to Member State governments. Apart from the power sector which would be subject to full auctioning from the start of the new regime in 2013, industrial sectors and aviation would increase auctioning gradually, with the sale of one-fifth of pollution permits in 2013 rising by 10 per cent annually to 2020. In energy-intensive industrial sectors where the competitiveness of companies would be strongly undermined by the ETS, the free provision of ETS allowances could continue.

The Commission also proposed a directive on carbon capture and storage – a carbon emissions reduction method that involved storing underground carbon instead of releasing it into the atmosphere. The Commission announced an overhaul of the rules on granting state aid for environmental projects to permit an increased government subsidy of measures such as carbon capture and storage (CCS), public transport projects and emissions trading. Governments would be able to contribute up to 60 per cent of the cost of environmental projects co-ordinated by large enterprises – up from 40 per cent – and up to 70 per cent and 80 per cent for medium-sized and small businesses, respectively, and up to 100 per cent for projects awarded by competitive tender.

In a speech to the European Parliament on 15 January 2008, President Barroso promised not to bow to Member State and industry pressure to water down the Commission package. The Commission repeatedly argued that the EU, by acting quickly, would have a first-mover advantage in the green market. Furthermore, the EU's international reputation for being a flag-bearer for environmentally friendly proposals was at stake. In the months following the 23 January launch of the legislative package, the Commission had to resist intense Member State pressure to modify its directives and change its calculations on how much each Member State should contribute to CO₂ emissions reduction and renewable energy. Rich Member States criticized the methodology used to set national targets (GDP per capita and relative national wealth) but several poorer Member States also expressed their opposition to their targets.⁵ BusinessEurope, Europe's main employers' association, and the European Round Table of Industrialists warned of the huge economic implications of the revised ETS, and the disadvantage for European firms if they had to comply with stricter environment rules than their American and

⁵ *EUObserver*, 13 March 2008.

Chinese competitors.⁶ Industry also feared that the new ETS would begin operation even if the 2009 international negotiations on a new climate change deal failed to reach an agreement. To address this concern, the March European Council agreed that ‘appropriate measures’ would be taken if international negotiations failed: energy-intensive industries could get free pollution permits – instead of having to buy them by auction – linked to technological benchmarks, while the EU could also seek to make foreign companies take part in the ETS.

By mid-2008, it became apparent that nine Member States would be obstructive on the climate change package: eight central and eastern European countries (CEECs) (Poland, Hungary, the three Baltic states, Romania, Bulgaria and Slovakia) and Italy, with the Poles and Italians posing the greatest potential threat to an agreement. In late May, seven CEECs (all the above with the exception of Poland) proposed a different distribution of carbon dioxide emission targets to those tabled by the Commission in January, arguing that the new regime should take into account previous national efforts in curbing climate change and future growth prospects.⁷ This new proposal assigned the newest EU Member States lower targets on the grounds that they expected to see a more rapid rise in industrial output in the coming years. The seven CEECs also sought more generous emission quotas in the sectors not included in the existing ETS, beyond those already provided by the Commission in its January proposal which applied a solidarity principle (according to GDP per capita) in allocations of quotas in areas such as transport, waste, construction and farming, with richer countries receiving stricter targets than poorer ones. The seven CEECs argued that the Commission’s proposal, which set 2005 as the new baseline year for setting new emissions targets, did not fully take into consideration the efforts made by EU countries in the fight against climate change from the early 1990s. The Commission challenged these claims, arguing that the new Member States underwent economic restructuring during the 1990s rather than real efforts to cut emissions, and that relative wealth levels were already taken into consideration in its proposal. The eastern Europeans claimed that there were serious investments made at the time in more modern, cleaner technologies, pointing to how emissions did not noticeably increase after their economies improved. Italy and Poland threatened to veto the EU’s package to tackle climate change, saying their economies could not bear the added burden that emissions reductions would impose. They led efforts to block the launch of ‘full

⁶ See, for example, *Financial Times*, 21 January 2008.

⁷ *EUObserver*, 28 May 2008.

auctioning' of CO₂ credits in heavy industry from 2013, pushing this back to 2020. With high-polluting coal plants producing 96 per cent of the country's energy, the Polish government feared that the introduction of the auction system from 2013 would see its energy firms outbid by richer western rivals, resulting in increased energy costs, hampered investment in new technologies and lower economic growth.

The French Council Presidency of the second half of 2008 placed an agreement on the climate change package at the top of its priorities and a key criterion by which the success of the Presidency should be determined (Dehousse and Menon, this volume). Italian and eastern European opposition prevented an agreement on a common text at the October European Council. In early December, President Nicolas Sarkozy met with eastern European leaders in Gdańsk to reach a compromise deal. Sarkozy offered the group of nine countries (the eight mentioned above and the Czech Republic) to phase in the CO₂ permits payments for existing power facilities, with the nine countries to receive 70 per cent of permits for free in 2013 dropping to zero by 2020. Sarkozy also offered to lift the threat of legal penalties for countries which did not meet their national CO₂ reduction targets by 2020. He proposed the organization of a 2016 climate change summit to introduce corrections to any package agreed at the December European Council, if the impact upon post-communist economies was too great. Sarkozy also promised to help the CEECs construct nuclear power plants in the coming years, while President Barroso offered the Polish government an extra €2 billion in energy infrastructure grants up to 2013. The nine eastern European countries continued to demand a CO₂ 'compensation mechanism', which would assign them an additional 10 per cent carbon emissions allowances compared to wealthier EU states, allowing them to sell the credits to finance new power plants. In the lead-up to the December European Council there were further concerns about the impact of the financial crisis upon financing the climate change package.

The MEPs on the European Parliament's Environment Committee voted to reinforce the European Commission's legislative package on 7 October. The day was dubbed 'Green Super Tuesday' by environmental groups because of the committee's marathon session which involved voting on all three major laws in the Commission's climate package because the French Council Presidency sought to fast-track their adoption by Member States. Committee MEPs voted to support the Commission's national CO₂ emissions reductions but also voted to cut emissions still further in the future – by 50 per cent as of 2035 and between 60 and 80 per cent by 2050. The MEPs accepted the Commission's proposed ETS reform, its fines on Member States that did not meet their emissions targets and rules on selling excess emissions cut to

another Member State. However, the committee also voted to ensure that power companies, which had benefited from profits as a result of earlier free allocation of permits, would be forced to pay for all their emissions permits from 2013. The committee ring-fenced 100 per cent of auction revenues from the ETS, a sum that could be worth as much as €50 billion a year by 2020, strictly for climate-related purposes. More controversially, the committee moved to decrease the Commission's original proposals for the amount of 'carbon offsets' that European Member States could use towards their carbon reduction targets. The December European Council reached an agreement on the energy and climate package which effectively eliminated all the reinforced measures sought by the Parliament's Environment Committee. The final package was nonetheless approved by the Parliament on 17 December.

The Inclusion of Aviation in the ETS

There was a running battle throughout the year on whether the aviation industry should be included in the ETS and, if so, from when. Although the aviation sector was responsible for just 2 per cent of global carbon dioxide (CO₂) emissions in 2008, its contribution to climate change was, according to some experts, growing faster than any other source, with greenhouse gas emissions from aviation in the EU increasing by 87 per cent between 1990 and 2006, according to the Commission.⁸ In its January legislative package, the Commission proposed for the aviation industry to take part in the ETS from 2012. On 27 May, the European Parliament's Environment Committee voted for the aviation industry to be in the ETS from 2011, with the sector having to pay for 25 per cent of its permits to produce carbon dioxide in the first year and from 2013 falling into line with other sectors. The Environment Committee agreed to include business jets in the scope of the scheme but not small aircraft. Member States argued that only 10 per cent of pollution permits should be auctioned. In June, negotiators from the Parliament and the Council agreed that aviation should be included from 2012, with 15 per cent of pollution permits to be auctioned and 85 allocated for free. The measure would apply to all aircraft taking off or landing in the EU, including those of non-EU companies. In July, the Parliament voted overwhelmingly (640 to 30) for this and on 19 November, the Parliament and Council adopted the directive to include aviation activities in the ETS. The International Air Transport Association (IATA) was incensed, arguing that many airlines would collapse

⁸ *EU Observer*, 6 February 2008.

especially in a context of skyrocketing fuel prices. For their part, environmental groups claimed that the measures approved would actually lead to increased emissions on the grounds that the extra warming impact of aviation emissions over ground-based CO₂ emissions was unaccounted for in the agreed scheme.⁹

The EU has encouraged the construction of less-polluting airplanes through the Clean Sky initiative, a joint public–private partnership to develop ‘green’ aviation technologies, confirmed by an EU regulation in December 2007. With €1.6 billion in funding, the initiative was to be one of the biggest EU research funding programmes in history. Aeronautics manufacturers Airbus, Dassault, Saab and Rolls Royce signed up to the initiative. Half the money is to come from the EU’s R&D funding programme with the other half from industry. The aim of the initiative is to halve emissions of carbon dioxide by 2020, cut nitrogen oxide by 80 per cent, halve noise pollution and set up an eco-friendly life cycle for products – across design, manufacture, maintenance and scrapping or recycling. The Clean Sky project involves 86 organizations from 16 countries: 54 private companies, 15 research centres and 17 universities.

The Carbon Capture Debate

In its January legislative package, the Commission called for the promotion of a controversial carbon emissions mitigation technology known as ‘carbon capture and storage’ (CCS). CCS ‘captures’ carbon dioxide from power plants and stores it in underground geological formations or in deep oceans instead of releasing it into the atmosphere. The CCS was presented as one mechanism to help achieve the long-term goal of halving greenhouse gas emissions by 2050. The January package included a series of revised guidelines on state aid for environmental protection that would enable Member State governments to support CCS pilot project plants, because the current cost of the technology was much higher than the price of carbon. Carbon dioxide captured and stored would not be considered as emitted under the ETS. There were many critics of the scheme. The iron and steel industry was very sceptical of the EU’s schedule for the development of CCS prior to 2020. Environmental groups also expressed concern as to the viability of CCS because it would undermine efforts to cut back on fossil fuels usage. These groups argued that the CCS process itself was very energy intensive and required the extra extraction of fossil fuels and they noted the potential for leakage of CO₂ from underground sites.

⁹ *EUObserver*, 18 July 2008.

The Automobile Industry and CO₂ Reductions

Late in 2007, the Commission had proposed another EU directive (not part of its climate change package) that from 2012, the average carbon dioxide emissions of new cars would have to be reduced to 130 grammes per kilometre – a reduction of about 24 per cent on the average 158 grammes of CO₂ per kilometre cars emitted in 2008. Companies that did not meet the 130g target would be fined €20 per gramme per kilometre over the limit in 2012, an amount that would increase to €95 by 2015. In 2007, automobiles accounted for about 14 per cent of the EU's CO₂ emissions.¹⁰ Environmentalists wanted to see a target of 120g/km by 2012, in line with an official EU target first proposed in 1994 by the then German environment minister, Angela Merkel. The 14-year-old target was supposed to have been achieved by 2005 but was postponed three times – in 1996, 1997 and 2007. The European Automobile Manufacturers' Association (ACEA) – which represents 15 major producers – also opposed the emission cap of 130 grammes per kilometre and insisted that any target should be based on an impact assessment,¹¹ estimating the new CO₂ legislation would cost the industry €25 billion while consumers would have to pay an extra €1,500 per car. The ACEA lobbied for amendments to the legislation to introduce a three-step phase-in of the emissions reduction targets, with 70 per cent of a company's car fleet having to meet the target in 2012, 80 per cent in 2014 and the full fleet only having to meet the target in 2015. The industry also proposed a considerable reduction in the fine imposed on car firms from €95 per gramme per kilometre to €50. Member States were divided on the new directive with some preferring to avoid making reference to any specific figure. Other points of disagreement included the calendar and penalties and as to whether revenues collected via penalties would be reverted to the EU's budget or be transferred to national coffers. It was also necessary to define how to share the burden between different car manufacturers. While Germany was the chief producer of large, heavy vehicles such as BMW, Daimler and Porsche, French and Italian carmakers produced lighter, more energy-efficient automobiles, such as Peugeot, Renault and Fiat.

There were significant divisions in the Commission on car emissions that surfaced repeatedly throughout the year, with the German Industry Commissioner, Günter Verheugen, adopting the more sceptical German position on the directive that was championed by the Environment Commissioner Stavros Dimas and formally approved by the College of Commissioners. In a 14 January speech to the European Parliament, for

¹⁰ *Financial Times*, 25 September 2008.

¹¹ *EUObserver*, 5 June 2008.

example, Verheugen argued that the Commission's directive should be structured in a way that did not harm the competitive position of European carmakers on the world stage.¹² On 9 June, French President Sarkozy and German Chancellor Merkel agreed to support the Commission's proposal to limit average CO₂ emissions of new cars. Yet the two countries also called for a period of several years to introduce the cap and for a softer line on penalties imposed if industry failed. France further proposed that instead of all cars sold in 2012 being restricted to emitting a maximum of 130 grammes of CO₂ per kilometre, only 60 per cent of all new cars would have to meet the standard, with new cars having to meet the target by 2015. The proposal would effectively give car manufacturers an additional three years to implement CO₂ emissions reductions across the entirety of their fleets. The French proposal recommended giving car companies credit for 'eco-innovations' that produce cleaner vehicles or lower-emission cars. The French government also sought exemptions for manufacturers that did not sell many vehicles and credit offered to those that sold electric cars.

In a surprise vote, on 25 September, the European Parliament's Environment Committee endorsed the Commission's proposed directive on car emissions, rejecting the amendments agreed by Member States on a phase-in and industry pressure to extend the deadline to 2015. The committee also proposed a second, deeper target of 95 grammes of CO₂ per kilometre on average by 2020, subject to a review in 2014. The 46 MEPs voting in favour (versus 19) included Socialists, Liberals and Greens. The Commission's proposals had still however to win approval of the full sitting of the Parliament, where German MEPs across party lines would vote against it. On 6 October, the ACEA asked the EU for a €40 billion loan to maintain a 'level playing field' with the US car industry which the Bush administration had just provided a \$25 billion support package.¹³ On 15 December, an inter-institutional agreement was reached on car CO₂ emissions which accommodated Member State concerns. There would be a phasing-in of car volumes that needed to comply with the target, starting with 65 per cent in 2012 – only slightly more than the 60 per cent agreed by the Member States – rising to 100 per cent in 2015. The phasing-in of penalties would also be delayed with the €95 fine applying only from 2019. The second deeper target of 95 grammes of CO₂/km by 2020 would be non-binding and car manufacturers would be allowed to earn eco-innovation credits which could contribute up to seven grammes to their target until 2014.

¹² *EUObserver*, 15 January 2008.

¹³ *Financial Times*, 6 October 2008.

The Directive on Renewables

The third element of the Commission's climate change package and third major directive to be adopted concerned the development of renewable energy sources with the target of 20 per cent renewables by 2020, with binding national targets for each Member State (see Table 1). The adoption of this directive was subject to comparatively little Member State discord, although the Italians temporarily delayed the final agreement by demanding that the 2020 target be subject to a review in 2014. Having been disappointed by the legislation adopted in the other areas, environmental groups were very supportive of the directive on renewable energy agreed by the Parliament, Commission and Council on 9 December, calling it 'historic' and 'the world's most important energy law'.¹⁴ By June 2010, Member States will have to draw up national action plans describing how they will meet their 2020 targets, which the Commission will then assess. Member States will also have to report biennially on their progress. Central to the agreement are largely intact proposals from the Parliament's Industry Committee on greater co-operation between Member States to achieve the target, including joint projects on green electricity production, heating or cooling. Member States will also be able to transfer renewable energy 'statistically' between themselves. The new directive also permits the counting of green electricity consumed in a Member State but produced via newly constructed joint projects with countries beyond the EU.

The Biofuels Debate

The encouragement of biofuels as a source of renewable energy proved one of the most controversial elements of the Commission's climate change package. At the March 2007 European Council, Member States agreed that the EU should increase the use of biofuels in transport fuel to 10 per cent by 2020, up from the 5.75 per cent target to be achieved by 2010. However, expert attitudes were already shifting dramatically on biofuels. In September 2007, the Organization for Economic Co-operation and Development (OECD) pointed out the environmental and social risks created by biofuels. The World Bank and the United Nations World Food Programme produced similarly critical positions. In January 2008, the Commission's own scientific institute, the Joint Research Centre (JRC), leaked an unpublished internal report criticizing the sustainability and social costs of biofuels.¹⁵ On 11 January, a group of 17 NGOs – including Oxfam and Friends of the Earth –

¹⁴ *EUObserver*, 10 December 2008.

¹⁵ *Financial Times*, 18 January 2008.

sent a letter to the EU Energy Commissioner, Andris Piebalgs, asking him to introduce much tougher standards on biofuel production or give up mandatory transport biofuel targets altogether.¹⁶ Several international organizations and environmentalist groups saw increased production of biofuels as a major contributing source of the dramatic rise in world food prices in 2008.

As opposition to biofuels grew, the EU came under increasing pressure to develop a set of sustainability rules governing the fuel source. EU Member States disagreed on what constituted 'sustainable'. In April, President Barroso requested a study on whether there was any relationship between the recent jump in global food prices and biofuels. The move came amid speculation that there was a growing division within the Commission over the question. In mid-April, the Commissioner responsible for development, Louis Michel, said that biofuels were a 'catastrophe'.¹⁷

Most EU Member States also switched their position on biofuels. At the end of June, the French government came out against the EU's 10 per cent biofuels target and indeed any target, arguing that the EU had proposed things the wrong way round by setting targets prior to environmental and social criteria for the production of biofuels.¹⁸ In early July, European energy ministers backed away from the EU's biofuels for transport target, admitting a gross confusion on their part in which they said they had been misreading policy documents since the target was initially proposed a year and a half earlier.¹⁹ The ministers said that upon closer inspection, EU proposals that aimed for a target of 10 per cent of fuels for cars and lorries to come from biofuels by 2020 in fact only required 10 per cent of fuels to come from renewable sources which may or may not be biofuels. These sources could also include hydrogen fuel cells or electric cars using electricity from alternative sources.

In early July, the Parliament's Environment Committee voted to cut the EU's biofuels target in a unanimous 36-0 vote, with eight abstentions. The MEPs recommended that the EU should aim to make between 8 and 10 per cent of energy for transport come from renewable sources by 2020, with an interim target of 4 per cent by 2015. Of this latter target, at least 20 per cent would have to come from electric cars or the use of hydrogen fuel, or alternately biogas or second-generation biofuels made from algae or agricultural waste. The Commission responded with concern, while environmental campaigners welcomed the higher target, but repeated their insistence that biofuels should be excluded altogether. On 11 September, members of the

¹⁶ *EUObserver*, 14 January 2008.

¹⁷ *EUObserver*, 24 April 2008.

¹⁸ *EUObserver*, 30 June 2008.

¹⁹ *EUObserver*, 7 July 2008.

European Parliament's Industry Committee voted overwhelmingly to re-establish the original target of using renewable sources for transport fuel for 10 per cent of vehicles by 2020, but confirmed that these sources were not necessarily traditional biofuels, recommending that two-fifths of the 10 per cent target would have to come via cars that run on hydrogen or that use electricity from renewable sources such as solar and wind power, or from so-called second-generation biofuels. MEPs also voted for a major review in 2014 of biofuel impact on the environment and on food prices before Member States could continue with the 2020 goal.

The 9 December inter-institutional agreement supported the Commission's original target figure but also provided some non-binding encouragement to Member States to increase their use of renewable sources other than first-generation biofuels. According to the agreement, second-generation biofuels will be able to be counted twice towards the 10 per cent target and electric cars could be counted at two and a half times their real contribution towards the target. Binding sub-targets for forms of renewable transport such as electric cars or clean-energy trains which had been introduced by the Parliament were abandoned, leaving Member States free to choose whether to count these toward the 10 per cent target. In the inter-institutional agreement, biofuels will have to achieve a 50 per cent saving in greenhouse gas emissions by 2017 in order to be accepted under the 10 per cent target. This figure represented a compromise splitting the difference between the Commission's 35 per cent and the Parliament's Industry Committee's 60 per cent saving by 2015. The move to 50 per cent would be subject to a review. Yet the Commission's controversial and unverified new rules for calculating the greenhouse gas impact of different biofuels will apply – thus allowing European sugar beet to continue to be used in the production of biofuels. The Parliament gave in on most of its previous demands. Environmentalist groups were exasperated with the agreement which they said represented a major defeat on biofuels.²⁰

Conclusion

There has been considerable criticism by many MEPs, environmentalist groups and others of the climate change package adopted in December 2008. Some have called the 20 per cent cuts by 2020 a 'mirage' given the extent to which Member States will be able to engage in carbon offsetting.²¹ Even the

²⁰ *Financial Times*, 10 December 2008.

²¹ *EUObserver*, 12 December 2008.

Financial Times bemoaned the concessions made to heavy industry,²² which is to be shielded from much of the cost of buying tradeable permits in the ETS – the major concession made to principally Poland and Germany. The concessions fundamentally undermine efforts to make polluters pay for emissions, seen as an essential step in fighting climate change. However, that a deal was achieved on the verge of the worst recession faced by Europe since the 1930s should be celebrated as an accomplishment. The EU's climate change package agreed on 17 December is the world's most stringent and sets the benchmark for the international negotiations that are set to take place in 2009.

Key Readings

Knill and Liefferink's (2007) *Environmental Politics in the European Union* textbook provides an excellent introduction to the making, development and implementation of EU environmental policy.

Pedersen *et al.*'s (2008) *Energy Policy for Europe: Identifying the European Added-Value* is a CEPS Task Force Report prepared by a group consisting of industry, NGOs and EU officials and other experts examining the main direction, principles and added-value of EU energy policy and the key measures that will be crucial for a successful policy. The report focuses upon energy market and security issues as well as climate change.

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²² *Financial Times*, 14 December 2008.